LEARNING THE LAW:

TRUSTS IN BUSINESS AND COMMERCE[1]

1. Introduction

In the minds of most lawyers whose home is the common law world the trust is associated with the last will and testament of a testator. In other words, it is to be found in an instrument whereby an individual makes personal arrangements for the distribution of his assets among his desired beneficiaries on the occasion of his death. The husband may desire his widow to have the income of his assets during her lifetime, and that the capital of those assets be distributed among his children when she dies. Here successive interests are the testator's object. The parent or grandparent may wish to provide that funds be set aside for infants and young people under the age of majority, in which case he will employ a trust in order that those funds shall be protected while the young people are incapacitated by minority. The testator may also be concerned that among his adult children or grandchildren there are those who find it difficult to keep any money in their pockets, and to provide for this situation he may adopt a protective trust whereby a fund is held by a trustee for the spendthrift, and the interest of the spendthrift, usually a right to income for life, comes to a close in the event that that person attempts to alienate his interest or becomes bankrupt. A more familiar device nowadays, however, is the discretionary trust. This is used by the testator who wishes to distribute his assets among a class of persons, but prefers to leave it to his trustee to determine which of those persons shall benefit and the extent to which any so selected person shall benefit.

For centuries trusts have been employed by the private individual in providing for the family, and since the mid-nineteenth century the inter vivos trust has also been widely used. During that century

[1]This paper is based upon notes for a public lecture given by the author as the 1987 Robinson Cox Visiting Fellow. The lecture was delivered at the University of Malaya on 14 August, 1987.

and up until the First World War the marriage settlement in particular was very familiar; this 'living trust', as Americans would describe it, was normally drawn up on the occasion of the marriage of a son or daughter of the well-to-do family in order to launch the young couple into married life with a home and some assets. But since 1945 there has been a considerable growth in the drawing of inter vivos trusts for tax-saving purposes, and every jurisdiction is familiar with inter vivos family discretionary trusts and trusts of assets for younger members of the family, the idea being to alienate those assets during the lifetime of the donor in order that estate tax and succession duties shall be avoided or lessened on the occasion of the death of the donor.

The personal use of the trust by the testator and by the living donor has dominated the practice of trust law, and this is reflected not only in the profession's textbooks, but in our university classroom teaching of trusts. All the precedents in our casebooks reflect this centuries-old practice, and most students leave law school with the vision of a trust as concerned essentially with wills and the individual's tax planning. Many years later their perspective will not have changed, for little will have encouraged it to do so. In my own country 'Wills and Trusts' is the section of the national Bar association where you will expect to find the experts in trusts law; they are most unlikely to be found in the sections specializing in corporate law, commercial law, and securities law. However, the irony is that since the beginning of the Industrial Revolution in the eighteenth century the trust has had a wider employment. The South Sea Bubble was such a disaster in the eighteenth century because so many trustees not only of family funds, but of trading funds, were involved in the collapse. Funds of both origin were invested in speculative stock at a time when securities commissions were unknown, and such modes of investment were extremely hazardous. It is also ironic that during the first half of the nineteenth century it was the trust as a mode of conducting business, a trading trust, which inspired the structure of the joint stock banks, and ultimately led by the 1850s to the formation of the idea of a statutory company. Indeed, the statutory company of the 1980s is a direct descendent of the business trust (or trading trust) of the 1820s and 1830s. Today vast sums are held by way of trust in connection with the purposes of business and commerce, and, when compared with the drafting and administration of personal family trusts, this

business use of the trust often seems the more significant because of the considerable sums involved and the importance of the trust device as the central hinge in so many complex commercial and investment transactions.

In this lecture I propose to take the opportunity to examine the various ways in which the trust is employed for business purposes, and I suggest this should interest us not only because of the inherent importance of this modern mode of trust usage, but because in today's commercial conditions it is vital that young lawyers-to-be and those already in practice are aware of the means by which business is done. In contemporary commercial conditions it is paramount that the businessman and his legal advisor be as flexible as possible in the means which they employ in order to do business; technique should be the handmaiden of commerce, not its master, and in my opinion this means that an understanding of the trust is as crucial as an understanding of the corporate device, of general and limited partnership, agency, debt, mortgage, charge and lien. In a modern business dealing it is often the case that all or most of these particular legal concepts are employed in a multi-faceted transaction, and the trust documentation will look very different from that employed in a standard will or inter vivos personal trust provision.

This is not to say that the trust in business use is different from that employed for family provision. The nature of a trust is always one and the same, namely, that the legal title to property is in A and the equitable interest in B, or to put it another way, that the ownership rights of disposition and management of property are in the hands of A, and the right of enjoyment over the property is in the hands of B. Effectively A is always administering on behalf of B, because the right of enjoyment in the property is in B, but conceptually A and B are sharing the rights associated with ownership. It is this sharing of ownership rights that is singular to the common law concept of the trust. The trustee may be acting for the benefit of B, but he is independent of B in the discharge of the trustee duties and in the exercise of the trustee powers. These duties and powers are contained in the law and in the trust document, the trust terms, and it is to these terms that the trustee must adhere; provided he keeps to those terms there is no counter instruction which the beneficiary can give to the trustee during the lifetime of the trust. Business trust documentation differs because necessar-

ily the trustee powers and duties reflect the particular business purpose. But essentially it is these two universal ideas, namely, administration for the benefit of another, and independence of the trustee from the beneficiary's intervention, that make the trust concept as valuable in business as it is in personal family provision.

For business purposes the express trust is used in four major ways -- as an instrument for investment, to provide security for loans, as a "lending" instrument, and as a holding device. It is used additionally as a substitute for incorporation, but that is something different from the four modes of employment which I have just mentioned, and I will explain later what I mean.

Finally, at the close of this lecture I want to say just a word about the constructive trust, a device which is now proving of considerable significance as a remedy which puts the successful plaintiff, as a constructive trust beneficiary, ahead of all other claimants, often including secured creditors, in the constructive trustee's bankruptcy. In this way I am seeking to complete my picture of the adaptability of the trust concept, and the challenge it offers to us all -- courts, practitioners, and teachers.

2. The Express Trust

(1) (a) *Investment*

For a number of years now, tax-sheltered private saving schemes have been familiar in all the major common law jurisdictions. These schemes are operated by banks, credit unions, trust companies, and insurance houses. The idea is that the institution operates a fund into which the private individual may pay monies on a regular basis. Monies so assembled are invested for return, and the accumulated profits plus capital will be available to the investor on his retirement. Such arrangements are known in Canada as registered retirement savings plans. The state is interested in the individual providing for his or her retirement, and therefore offers the concession of no taxation on monies while they are in the plan, tax being payable only when the fund and its fruits are paid out after the retirement. The sheltering of the funds in question during the working lifetime of the individual is a direct encouragement to that individual to save for the period of his retirement and old age. It is usually provided that these funds can be withdrawn

at any time during the working lifetime, but the price of such an action is that tax is then payable in the year of withdrawal as income paid in that year. The trust is a common device utilized for these schemes. The state will require that such schemes be registered with the revenue authorities, and a ceiling is provided beyond which the individual in making payments to the trust does not secure a tax sheltering. In effect, the state allows so much -- the amount which it can afford -- to be taken out of taxable annual income, thereafter sheltered from tax, and utilized as a built-up trust fund for that period of retirement.

When individuals pay into a fund in which others are also participating, the trust deed will have been originated by the institution in question -- in this case we are assuming a trust (or trustee) company -- and this trust deed will set out both the duties and powers of the investing trustee, and the particular rights of the investing member as against the trustee for the proper discharge of the trustee's duties and powers. Many jurisdictions also permit the individual to pay into a trust-company-administered private plan, where the individual is the sole beneficiary and selects his own investments. Again a trust deed will be drawn up by the trust company and put before the investing member for his signature and approval; thereafter the only distinction from the general fund, with many investing beneficiaries, is that the individual investor can determine the nature of the investments in which his trustee may place the tax-sheltered funds.

The same thinking is also employed for the purpose of so-called unit trusts. These are investments trusts usually open to the public at large, and, though they may have no immediate tax sheltering advantage, they do offer a considerable advantage to the investor for participating in diversified investments. In the case of public investment trusts, these are customarily sponsored by a bank, a trust company, or an investment dealing company, and each trust will concentrate on different types of investments. The choice is made by the investing member of the public. That is to say, one fund operated by a bank, for example, will be invested solely in debt securities such as bonds and treasury bills, a second will be invested in blue chip equity investments on the stock exchange, and the third will be in a diversified portfolio of mixed debt securities and stock. The investing member of the public will select that fund with which he feels most comfortable; it all depends on the

degree of risk which he is prepared to undertake, and the object for which he is investing. Some members of the public invest for high income return because they are already living on such funds during the time of their retirement, others will invest in growth stock hoping to have sufficient capital, thus assembled for them, for a future retirement. When a trust is employed for this purpose, the trust company issues units to the investing public. The investor purchases units or certificates in the trust fund in proportion to the amount that he is investing, exactly in the way that one will buy shares in a company according to the amount one is investing in that company. Investment in the unit trust is particularly attractive to those members of the public who have some apprehension about the mysteries of dealing with stockbrokers and on the stock exchange. Trust units can be bought over the counter of trust companies and banks by a very simple procedure, and ease of purchase is lent by the fact that no stockbroker is involved in the transaction. In the United States and Canada real estate unit investment trusts have proved particularly attractive. These trusts will invest in anything from new residential properties or commercial premises through to the funding of developers of shopping malls and extensive downtown commercial buildings. Booklets setting out the terms of these various unit trusts, the sort of material one would expect to find in a trust indenture, are available at all major banks and financial institutions dealing in such trusts. Real estate investment trusts in North America constitute a dealing in securities, and therefore those sponsoring these trusts must also issue prospectuses. The prospectus will contain, once again, the terms and conditions of the trust in question.

In my view this is the sort of material that ought now to be available in our trust classes at universities and professional institutes so that students may study the structure, language, and the terms of investment trusts. The importance of such trusts was underlined on 12 August, 1987, when *The Asian Wall Street Journal* carried an item on the proposals now under consideration by Japan's Ministry of Finance to permit the issue, by consortiums of public and private companies, of revenue bonds, and the issue by banks of convertible bonds. The Ministry has in mind encouraging the private sector to invest in large development projects, like the construction of the Kansai International Airport, the bridge planned to cross Tokyo Bay, and the revitalization of Yokohama Harbour.

Japan as a state is carrying a large budget deficit, while the private sector in Japan has an abundance of capital available for investment. The proposals, still in the discussion stage, would facilitate the raising of considerable private sector funds to enable these large projects by way of loans to be carried out, the lenders being repaid capital and interest out of the revenue generated by the completed projects. The *Journal* notes that "land trusts" are one of the proposals under consideration. This is a reference to real estate investment trusts, where the investors by way of the trust purchase tracts of land, develop them and lease them back to users, or, alternatively, advance loans for the completion of projects against the repayment of capital and interest generated by the completed project. These ideas are all taken from the United States, and are an excellent example of the way in which the trust can be employed as an instrument for bringing together large amounts of capital for the purpose of carrying out large construction projects.

Unit trusts and real estate investment trusts present quite unique problems, of which lawyers have to be aware. For instance, in unit trusts what is the status of fund managers and investment consultants hired by the trustees? Do fund managers and investment consultants have their own fiduciary obligation to beneficiaries of the trust, that is to say, the investors, or do they merely have an agency relationship with the trustees of the fund? Another question the law student needs to consider is why unit or investment trusts are preferred as a medium for financing over investment corporations. The usual answer is that the state is giving a tax advantage to trusts, either by way of exempting from taxation the interest on bonds and project developments, or in allowing a direct passing through to the trust investors of all the tax deductions which would otherwise be available to the company or the trustees only.

A second type of unit trust is now familiar in several common law jurisdictions. This is the legislative authorization to trust companies to pool the funds of estates which they have under administration. We in Canada are very familiar with this phenomenon. Many an estate of the deceased person, or of an inter vivos settlement, is sufficiently small that the trust company as trustee of that estate or settlement is unable to diversify the portfolio of investments, simply because the size of the fund militates against it. In effect, the trustees are forced to invest in debt securities, that is, debt with fixed interest returns, because the risk would be too high if

the fund were to be invested even partly in equity stocks. The advantage of the pooled investment trust, which trust companies may now conduct, is that the funds of small estates and settlements can be amalgamated into one large fund, and the large fund can therefore be invested in equity stock as well as debt securities with commensurately less risk to each of those small investment funds. Once again the trust is conducted on a unit basis. The number of units in the large fund issued to each small estate or settlement depends on the size of that small estate which is invested in the larger fund.

Another type of unit trust, particularly familiar in Canada after the first oil discoveries in Alberta in 1947, is the oil and gas royalty trust. This is typical of the type of trust that can be found in common law jurisdictions where the mining of mineral wealth is taking place. The fee simple owner of land which includes all minerals, except gold and silver, enters into a lease where the leasing company will explore the site and, if minerals are found, mine them. In the Alberta case the leases were for the recovery of oil and gas. In each case the fee simple owner would require a covenant to be entered in the lease that, should oil and gas be discovered, 12.5% of the production would be payable to the owner of the land by way of royalty. In many of these situations after 1947 no oil or gas was found, but where it was located it was often found in sufficient abundance that the owner of the land had a very considerable income through the 12.5% royalty. This led to the desire of owners of royalties to market their royalty rights, and thus convert their income (or royalty) expectations into capital expectations. This procedure was carried out through the assignment by the landowner of his royalty rights to a trustee, who then would create units or certificates of ownership in the 12.5% proceeds of production, and market the certificates to interested persons. In this way a large number of persons, having purchased units in the trust, would become interested in the royalty. A gross royalty trust agreement entitles the trustee to receive a straight 12.5% of the proceeds of sale of oil and gas, following the deduction of debts, and a net royalty trust agreement entitles the trustee to 12.5% after the deduction both of taxes and of certain production costs. None of these 12.5% trusts are being newly created in western Canada, due to the limited number of persons who own both land and the mineral rights therein, and also to changes today in the

mode of financing of oil and gas mining. However, the fact remains that this type of unit trust can be very familiar in any type of royalty transaction. Once again, it is a means of converting an income right into a capital asset so far as the original owner of the royalty is concerned, and it is a way in which with ease would-be investors can acquire a regular income through an over-the-counter purchase of certificates.

In the recently reported case of *Guaranteed Trust Co. of Canada* v *Hetherington*,[2] a very typical example of such a trust instrument is to be found reproduced in the judgment of the trial judge. The case concerned whether the trust in question had been drawn as a trust of the proceeds of sale of oil and gas, or on the other hand was a trust of a royalty interest in the minerals themselves. In this case it turned out that the trust was merely an in personam relationship between the original landowner and the trustee. No rights in the minerals themselves had been created by the trust instrument, and therefore the purchasers of trust certificates found that on a sale of the land in question to bona fide third parties their interests had disappeared. Again we are reminded of the care that must be taken in the drafting of these trust instruments if this kind of potential disaster is not to occur.

A totally different form of investment is intended by the equipment trust. In this instance the investor is taking advantage, quite properly, of tax deductions that the jurisdiction permits him. A group of substantial investors will put together a fund, and the trustee will then borrow other funds from the bank against the security of equipment, typically railway or trucking equipment, which is to be ordered and paid for by the trustee and held as a trust asset. The completed equipment will be leased to a commercial user, and the loan acquired by the trustees will be repaid with the rentals received from the user by the trustee. Against these rentals, once the debt has been paid off, the investors can deduct the tax depreciation allowance for the articles originally produced, for example, railway cars and trucks. In this way the investor can both invest for return, and at the same time secure a capital asset and a tax advantage.

[2] [1987] 3 W.W.R. 316 (Alta.). See especially Appendix A.

A type of investment trust of particular significance today, however, is that which is concerned with the provision of employee benefits. I am here referring to 'trusteed' pension plans or superannuation schemes, so-called health and welfare trusts, vacation pay trusts and union dues trusts. The good employer today is concerned not only with the level of salary or wage which is paid to his employees, but with the provision of benefits that cater not only for the working life of the employee but for the period of his or her retirement. A health and welfare trust, as it is known in North America, is concerned to provide for the employee in the event of that employee's disability while engaged in his employer's business or the sickness of that employee and his temporary inability to carry out his employment duties. The employer will probably make a monetary contribution to a trustee, and the employee may be required to contribute also as a consequence of a labour agreement, and with these contributions the employer pays premiums on insurance policies against disability and sickness. In the case of a vacation pay trust it is agreed between the employer and employee that the employer may withhold from the individual's weekly or monthly wage or salary an agreed sum, and this sum, possibly together with a contribution by the employer, will be made available to the employee on the occasion of that employee's vacation occurring. Trusts of union dues will occur when the employer and the labour union agree that the employer will deduct from wages and salaries dues owed by employees to the union. The employer as trustee assembles these monies, and pays them directly to the union in question. Charitable donations by employees are often handled in the same way; deductions are made by the employer from the wage or salary, and the aggregate sum is paid over to the charity chosen by the employee. What is effectively happening in the case of vacation pay, union dues, and charitable donations is that the employer agrees to act as an initial collector of these funds, and in the case of the labour union and the charities he is ensuring on behalf of his employees that these funds are paid to the intended recipient without additional collection costs being sustained by the labour union or the charity.

However, pension plan (or superannuation scheme) trusts are the most important of these various employee benefit trusts. In North America, the United Kingdom, Australia and New Zealand probably the majority of employees are now covered by pensions

plans (as North Americans call them) of one type or another. Most are organized as trusts. Such a plan may be either contributory in the sense that both the employer and the employee make contributions to the plan or trust which is to provide the pension, or non-contributory in which case the employer alone makes payments. The object of the trust is to secure a fund out of which the pension to each employee will ultimately be paid. In the case of a so-called defined benefit plan, the employer agrees to pay a pension based in most instances (formulae differ) upon the final salary of the employee in his three to five last years prior to retirement and the number of years that he has been working for that employer. With this defined or predetermined quantum of pension, therefore, the obligation of the employer is to provide a pension at a certain level, regardless of the source from which the pension is paid; the function of the trust in this instance is to act as security to the employee that the pension will in fact be paid. It guarantees that the employer's obligation will be kept. Obviously the intervening insolvency or bankruptcy of the employer will otherwise seriously prejudice, if not destroy, the pension expectations of the employee. In the case of the defined contribution plan, however, the obligation of the contributor is merely to transfer an agreed sum at fixed periodic times throughout the employee's period of employment. Though the employer may alone be contributing, it is likely that both employer and employee are making payments to the plan, and the agreed amount of contribution from each party leads to the building up of an account for each employee. The account is made up of the combined contributions plus the investment returns on those contributions, and therefore ultimately the total combined account constitutes the capital sum which is available to the employee on his retirement. At this point with the accrued sum the plan itself provides a pension or the employee can purchase from a life insurance company an annuity or other regular income provision for the years of his retirement. In this case a fund is essential, because the combined contribution account of the employee is gradually being built up in the trust fund throughout the years of his employment.

Billions of dollars in North America are invested in this way by trustees of pension plans, and the same is true in England and Australia among the leading Commonwealth jurisdictions. It is probably not wide of the mark to say that one of the most important

applications of trust law today is taking place in the pension industry, for industry it is. Moreover, the relationship between the trust and other legal concepts is an issue in the pensions context; unique problems between trust law and contract law have yet to be solved in this area. For instance, if the employer guarantees a defined benefit pension, and surplus funds arise in the trust in the sense that those funds are not needed to provide the formula pension, can the employer draw on those excess or surplus funds in order to discharge his future contribution obligations, or on the other hand once monies are placed in the trust by the employer, do they become the property of the beneficiaries of the trust, that is to say, of the employees themselves? This is a serious issue which has caused considerable debate and litigation in Canada, and to a lesser extent in the United States. The answer cannot be found among the precedents on testamentary and inter vivos personal trusts, because pension plan trusts are essentially the emanation of both trust and contract principles.

The surplus problem is peculiar to pension trusts, but at the same time other problems experienced by pension plan trusts are similar to those which occur with other types of trusts. For instance, *The South China Morning Post* of 20 August, 1987, reported that the Hong Kong government is to carry out an examination of private pension plans within the territory, because there have been several company failures in the territory after which it was found that employee benefits had not been properly protected. It had become evident that some companies had not kept contributions of their own and the employees to pension plans separate from general corporate accounts, an outcome which means that no trust fund is traceable and that therefore the employees are placed in the position of general unsecured creditors in the event of the corporate employer's bankruptcy. In these circumstances the Hong Kong government may have to take a much stronger regulatory position vis-a-vis pension plans in the territory, and ensure both that there is adequate professional fiduciary management of such funds and regular auditing of accounts. Some in the territory are calling for the clear setting out by government of investment principles which must be followed by pension plan managements, and an accounting to pension members of the annual state of accounts. Then again *The Japan Times* reported on the 25 August, 1987, that a large pension plan in Japan had failed to obtain repayment

of a considerable sum that it had loaned by way of investment to a private finance company. The bad debt is alleged to be equivalent to 8% of the total funds in the plan, and this of course raises major questions as to the percentage amount of the assets of any one fund that can properly be invested in one security. This is an issue which also has been discussed both by the federal government and by the government of Ontario in Canada; it is a crucial matter as to whether pension trustees may adopt the old adage that one should place all one's eggs in a limited number of baskets and watch the baskets.

Investment in favour of employees is also behind two other types of trusts which are worthy of mention. First there is the so-called remuneration trust. A cyclical industry may suffer from the fact that during periods of poor markets and consequent low production salaries are either necessarily low in themselves or workers must be discharged. This result can at least be mitigated if a trust is maintained into which employees pay a percentage of their salary, when the industry in question is going through one of its high production periods at the top of the cycle. Such a trust fund then provides augmented income for employees when the low point of the cycle is being experienced. The second type of such benefits trusts is the profit sharing trust. Contributions to such a trust are made both by the employer and by the employee and the trustee will purchase a diversified portfolio, but including shares of the employer company. In this way, through dividends, the profits of the company are shared by those who are on the shop floor, and employee loyalty to the employer is potentially markedly enhanced.

(1) (b) *Security (Protecting the Lending Investor)*

The provision of security for the lender is one of the most important roles which a trust plays in business. Probably the best known of all the security provisions is the trust for debenture (or bond) holders. The company anxious to borrow monies will issue bonds and offer as security to the investors a floating charge over its corporate assets. A trustee will be appointed who will be the registered holder of the floating charge, and it is the business of the trustee to monitor the company's affairs. If the trustee judges the time has come for the bondholders to move to protect their interests

in the company, then it is the business of the trustee to commence appropriate proceedings for the crystallization of the charge and the recovery by the bondholders of their investment. The great advantage of this device, of course, is that it replaces a large body of investors, who can know little of the ongoing state of the company's business, with a single trustee, usually a trust company, which as a single institution can adequately protect the investors' general interest. A company may also wish to secure borrowed money with its corporate equipment. In these circumstances a trustee will be issued a certificate or indenture describing the trust assets and defining the duties of the trustee. That duty essentially is to protect the lenders to the company.

The mortgage trust is an obvious and common security device. A mortgage guarantees loan repayment by attaching property of the borrower as security, and that property may be land, chattels, securities or, indeed, any type of valuable asset. The investor lends on terms of repayment of the loan, and takes security to support the debt in the event that the borrower is unable or unwilling to repay the loan, an instalment of the loan, or interest, at the due time. There is no reason why a trust should be employed when one lender as a mortgagee is advancing money to one borrower as a mortgagor, and the lender receives security over the entire asset which constitutes the security. However, the trust is very often employed because the mortgagee wants to see the security in the hands of a disinterested third party, and the mortgagor would like the additional advantage of knowing that the mortgage will not be foreclosed upon without an independent party, the trustee, having decided that the circumstances have arisen justifying the frequent far-reaching consequences of mortgage foreclosure procedures. The lender for his part is primarily concerned to obtain regular interest payments on his investment loan, and it will often be to his advantage to have another, a fiduciary, 'police' the payments due and professionally judge if and when the occasion has come to realize the security. So a trustee will collect instalment payments of interest and capital from the borrower and then remit these monies to the lender.

When a trust is employed, it is described as a trust of a mortgage or a mortgage trust, because the trustee holds the security and enforces the terms which support the personal loan made by the lender to the borrower. Mortgage brokers principally deal in mort-

gages of land, and the broker or a lawyer instructed by the broker will hold the deed of mortgage or, in a registered land system, the registered charge, on trust for the investor, the lender. Brokers, however, are normally in touch with large-scale corporate borrowers who are engaged in the construction of an extensive development of residential houses or considerable commercial properties, and whose needed loans are therefore beyond the investment means of any one non-institutional lender. The broker will then approach a number of would-be lenders who are looking for mortgage investment, and assemble their aggregate monies as a single fund. These funds are then advanced against a single mortgage given by the development company. The trust will now be employed because there is a group of persons who are interested in the same single mortgage, and the trust is known as a syndicated mortgage lending trust. Each investor has an interest in the mortgage proportionate to his advancement of monies in relation to the total fund. Very often unit certificates are given to each of these investors, by means of which they can sell their mortgage investment to others by way of assignment if they wish so to do. So here we have another form of unit trust. The trust deed is held by the broker or lawyer, and in the event of foreclosure this deed determines the rights of each of the investors.

Difficult and peculiar problems of trust law can arise in those circumstances where, in the event of failure to repay instalments by the borrower, different investors have different opinions about whether the time has come to foreclose on the mortgage. The trustee must make this decision because he holds the title to the mortgage, and alone is empowered to implement the procedure; it follows therefore that no trust beneficiary can determine for himself when the single mortgage shall be foreclosed. Moreover, incidents have arisen where brokers have purported to give security to individual investors in the syndication by way of a 'percentage share' in a mortgage. Such an arrangement may purport to be an individual security for each investor, but clearly it can be no such thing because the legal title to the mortgage and the indivisible legal rights of the mortgagee are outstanding in the one person, the trustee. We have here a classic classroom problem as to what is the nature of the trust property so far as any particular single

investor is concerned. In one Canadian case[3] the broker was purporting to give security to each investor by way of a mortgage of a mortgage. I need not pursue here the problems which were created by this device, and the difficult litigation to which it gave rise when the insolvent broker was found to have given mortgages of a mortgage to an amount which was larger than the original size of the head mortgage. The questions concerned the type of security each investor had, and it was found necessary to go back to the original trust deed, from which might be determined the nature and terms of the trust of the mortgage.

The trust is also used for security purposes in dealings between wholesalers and retailers, and between financiers of retailers and retailers themselves. If a wholesaler supplies goods to a retailer and the retailer receives those goods on credit, it may be the wholesaler himself who finances the credit, or an intermediate finance company will pay the wholesaler, take title, and itself give credit to the retailer. In either case the credit arrangements are the same; for convenience of expression I will assume that the wholesaler is the one extending the credit. The normal arrangement is that the unpaid wholesaler will retain title in the goods in question until such time as they are sold by the retailer to the third party. The wholesaler obviously wants the retailer to be able to give title to his purchasing customer, or the customer's own intermediate financier. At the moment of sale to the third party therefore the wholesaler would lose his security interest, and to guard against this loss the supply agreement between the wholesaler and the retailer will provide that the wholesaler is to acquire the equitable interest in the proceeds of sale immediately upon the formation of the contract of sale between the retailer and the third party. This means that title in the goods remains in the wholesaler until the moment of sale to the third party, and thereafter the security continues in that the retailer will hold the proceeds of sale on trust for the wholesaler. This trust proceeds clause is an important element in modern commercial dealings of this kind; it allows the retailer without sufficient trading capital of his own to acquire goods and to vend them effectively while he still owes monies to

[3] *Re Winnipeg Mortgage Exchange Ltd. and Winnipeg Mortgage Holdings Ltd., sub. nom. Ranjoy Sales & Leasing Ltd.* v *Down*, [1982] 4 W.W.R. 16, reversed [1983] 1 W.W.R. 213 (Man. C.A.). See further (1983), 21 *Alberta Law Review* 395, 407 *et seq.*

the wholesaler for the supply. Trust proceeds clauses must be very carefully drawn, however; the clause must ensure that the equitable interest in the proceeds of sale does not initially vest in the retailer, even for a moment. When the chose in action for payment between retailer and third party customer arises, it must already be the equitable property of the wholesaler. The object is not that the retailer can effectively use the wholesaler (or the finance company) as a banker and deal with those proceeds of sale as he will prior to discharging his financial obligation to the wholesaler or finance company. If that were possible, the relations between the wholesaler or finance company on the one hand and the retailer on the other would be that of creditor and debtor, and this is the very thing the wholesaler or finance company does not want. The wholesaler like the finance company wants to be in the position that if insolvency or bankruptcy occurs to the retailer the wholesaler can recover the trust property, that is to say, the proceeds of sale to the third party, ahead of the retailer's creditors. This would not be possible if the retailer had been allowed to deal with those proceeds of sale as he would, so that the wholesaler was merely a creditor vis-a-vis the retailer. The purpose of the trust here is clearly and paramountly to put the wholesaler in what is tantamount to a secured position; the proceeds of sale, whatever happens to the retailer, are always the property in equity of the wholesaler. Not only does the wholesaler want protection from the retailer's unsecured creditors, he is also anxious that an existing floating charge of the retailer's bank or of bondholders cannot attach to those proceeds of sale.

Security is the object of other types of trusts of a similar nature. For instance, on the sale of a business inventory the purchaser who is purchasing on credit may take title at once, but hold all the inventory assets on trust in favour of the vendor, and that trust will endure until the purchase price has finally been paid off. Bills of lading, warehouse receipts, and documentation of this kind representing goods can also be used as a means of raising credit. The bill, receipt, or other title documentation, is handed to a trustee who holds the documentation as security for the repayment of the borrowed sums.

Statutory trusts will be familiar to all of us because we have in mind bankruptcy legislation and the trusteeship that exists over the property of the bankrupt and in favour of the creditors of

the bankrupt. Legislatures have also given trust security to certain labourers such as subcontractors who carry out work, introducing their own materials and supplying their own labour, on development sites of contractors who alone are in contractual relations with the owner of the land in question. As third party strangers to this head contract, these subcontractors would have no remedy other than that of a creditor/debtor relationship if the head contractor became bankrupt and had not paid his subcontractors. The function of this statutory trust, the builder's lien trust, to give it its statutory description, is to protect subcontractors by giving them an equitable trust interest in sums paid by the owner to the head contractor in discharge of the contractual obligation between the owner and the head contractor. In this way subcontractors are protected against the bankruptcy of the head contractor. The policy of the legislature is to protect the small subcontractor, and, though it is called a lien, a trust of monies is the chosen vehicle for this protection.

(1) (c) *"Lending" by way of a Trust*

It was held in *Barclays Bank Ltd.* v *Quistclose Investments Ltd.*,[4] that it is possible for a would-be lender to make monies available to the would-be debtor on the basis that the sums in question shall be applied only for an agreed purpose and, if that purpose fails to be carried out, the property revert by way of a trust to the advancer of the sums. This has become known as a primary trust for the benefit of the creditor of the would-be borrower, and a secondary trust for the would-be lender, if the payment to the creditor does not take place. Evidently in a situation like this an express trust should be very carefully drawn and the terms of the trust tailored to the particular circumstances in which the utilization of the money is to take place. In most cases the would-be borrower is anxious to use the funds in question, as I say, for the purposes of paying one of his own creditors. It is in the interest of the would-be lender that the money should be utilized for this purpose, probably to maintain the would-be borrower in active business, but the would-be lender does not wish to be caught in

[4][1970] A.C. 567 (H.L.). The terms of the loan imposed a trust.

the possible bankruptcy of the would-be borrower. This trust is yet another example of how the trust device can be used in order to prevent a person from falling into the relationship of creditor and debtor, it puts him into a preferred relationship which gives him priority over all the would-be debtors and secured creditors.

The idea was applied yet more extensively in *Carreras Rothmans Ltd.* v *Freeman Mathews Treasure Ltd.*,[5] another English case, where the trust came even closer to what would have seemed otherwise to be a creditor/debtor relationship. Freeman was engaged by Carreras as an agent to acquire media advertisements for Carreras' products. In order that Freeman should be in a position to pay the media outlets in which advertisements were being placed, Carreras made funds available on a regular basis to Freeman, and from this fund, paid by Carreras into a clearly required separate account, Freeman paid the media third parties. When Freeman went into bankruptcy the question arose as to whether monies held in the separate account by Freeman for these third parties but which had not yet been paid over to them, vested in the trustee in bankruptcy of Freeman for distribution among Freeman's creditors, or whether on the other hand it was held by Freeman on trust for Carreras. Peter Gibson J. held that the monies in the account were held on trust, the secondary trust, for Carreras. This case went further than *Quistclose* itself, because, whereas in *Quistclose* the bank was under no obligation to *Quistclose's* creditors, Carreras through its agency relationship with Freeman had an independent debt obligation to the media with whom Freeman had placed advertisements. There was therefore an antecedent debt connecting Carreras and Freeman's creditors. However, the court thought this was of no significance. There was a primary trust, a purpose trust, as Gibson J. described it, which the creditors in question of Freeman could enforce, and that enforcement having not taken place and the monies remaining in the separate account, Carreras could insist on the primary trust being carried out.

There has been debate[6] as to whether this analysis of the primary trust, that it is a purpose trust, is correct, the argument being that the primary trust is in favour of the original advancer of the funds

[5][1985] Ch. 207. A contract construed to impose a trust.

[6]P.J. Millett, Q.C. (now Mr. Justice Millett), 'The Quistclose Trust: Who Can Enforce It?' (1985), 101 L.Q.R. 269.

(that is, Barclays Banks and Carreras in the two cases under discussion) on a condition, rather than the creditor of the advancee, and there is no doubt that the exact nature of the primary trust has yet to be finally determined. There is a nice question as to whether indeed the would-be borrower's creditor can himself enforce the trust. That initiative may have to come from the would-be lender, who is the true trust beneficiary. But on this occasion I would merely like to stress one sentence taken from the judgment of Peter Gibson J. He said,[7] "In my judgment the principle in all these cases is that equity fastens on the conscience of the person who receives from another property transferred for a specific purpose only and not therefore for the recipient's own purposes, so that such person will not be permitted to treat the property as his own or to use it for other than the stated purpose." He continued,[8] "In my judgment therefore Carreras can be equated with the lender in the Quistclose case as having an enforceable right to compel the carrying out of the primary trust." The principle so recognized offers in my opinion a whole new spectrum of "lending" technique that has only just begun to be explored by business people. It gives considerable encouragement to finance companies and lenders in general to make sums available to persons or corporations engaged in speculative activity, or whose financial stability is in question, with the sure knowledge that, if the funds advanced are not applied to the earmarked purpose and remain in the separate account, they can be recovered by the person advancing the funds ahead of all the creditors of the advancee of the funds. Of course, once the monies are drawn upon by the would-be borrower and applied to the intended purpose, the primary trust comes to a close and the relationship of the would-be lender and borrower turns into that of true creditor and debtor. Now the lender is at risk, and in the ordinary course he needs other security, but at least until the moment of application of the funds he has a means of keeping a trader (for instance) in business who has no security to offer him. That can be a valuable instrument in today's climate of highly-levered corporate traders.

There is a note of caution here, however, for other true lenders. The person who enters into a genuine loan, a debenture secured

[7] *Supra*, footnote 5, at p. 222.
[8] *Ibid.*

by a floating charge, for instance, may find himself set back behind a trust over which he thought he had precedence. This recently occurred in Scotland in a decision of the Second Division, *Tay Valley Joinery Ltd.* v *C.F. Financial Services Ltd.*[9] On 13 January, 1984, Tay Valley (the trading company) granted a floating charge debenture in favour of a bank, and a few days later entered into an invoice discounting agreement with C.F. Financial Services Ltd. (the finance company). Such an agreement is a book debts factoring arrangement whereby, at a discount on the value of each debt, cash is made available to the trading company in advance of payment by the trading company's debtors. A trading company with little liquidity or trading capital may find this an invaluable way in which to acquire immediate cash. It also offers a means of avoiding the costs and hassles of debt collection. The agreement in question required Tay Valley to inform the finance company on a regular basis as book debts arose, and evidence revealed that the finance company had indeed regularly monitored this reporting duty. In the subsequent November the bank appointed a receiver of the property of Tay Valley further to its rights under the floating charge debenture, and the question was whether the receiver was entitled to those debts which were on the books of the company at the time in November when the floating charge crystallized. These debts (or receivables), further to the invoice discounting agreement, were alleged by the finance company to be its property, a position disputed by the bank which argued its charge had precedence over the later discounting agreement. The Second Division held that the assignment of its receivables, present and future, by Tay Valley in favour of the finance company, gave rise under Scots law to a declaration of trust by Tay Valley in favour of the company, and that, further to Scots law, the regular reporting of debts as they arose transferred all the beneficial interest in those debts from Tay Valley to the finance company, at least as of the date of the reporting. One member of the court of three judges considered the invoice discounting agreement was itself enough under Scots law to constitute a delivery and transfer of all future book debts. Consequently, when the floating charge crystallized later in the year the finance company already possessed the beneficial interest

[9] [1987] Scots Law Times 207.

in all the receivables and therefore that interest could not vest in the receiver. The bank was of course a creditor which was secured; nevertheless it could not attach assets in which the chargee had never had a beneficial interest.

Though the decision and its policy connotations have been criticized,[10] it seems clear that this is the analaysis which must flow from the utilization of the trust concept. The trust proceeds clause is effective to give priority for the same reasons that the declaration of trust succeeded in Tay Valley. In both instances the trust as a concept, whether utilized for the advancement of funds or for the acquisition of property rights, prevails over other debt arrangements, indeed security devices, because security cannot be given with assets that are never the beneficial property of the debtor. The creditor taking security by way of a floating charge must prohibit in the loan agreement any subsequent entry by the debtor into trusts of the debtor's future property. Given trust law theory, however, why is such a trust valid? This is a good question for the university classroom. It is both a contemporary issue, and of considerable significance for financing institutions.

(1) (d) *Holding (Disinterested Title Deposit)*

The hallmark of the trust is that one party, T, holds, and often administers, property for the benefit of another, B. It is a simple idea, as we have said, because it puts powers of disposition and of management in one person, and the right of enjoyment in another. Effectively, whatever the attitude of common law theory, T can only hold and administer on B's behalf. Unlike the corporation, the trust is also a very informal device; though the disposition of particular property may be subject to statute, the trust does not have to be registered with any state authority, and it is not subject to the details of statute as to its creation, its operation, or its termination. Simply as a holding device, therefore, it has come to play an important role in business and commerce. Two or more parties, with or without opposing interests, who have come to an agreement as to the provision and utilization of funds or assets which are to play a particular role as between them, may appoint a third party,

[10] *Ibid.*, at p. 113.

a trustee to hold title to those assets as a mode of insurance to all parties that the funds will be safely held by a disinterested third party until the use of those funds according to the terms of the agreement, comes into effect. Settlement-of-action trusts are a good example of the trust used as a holding device. For instance, it was reported on 13 August, 1987, in *The International Herald Tribune*, and on 24 August, 1987, in *The Wall Street Journal,* that A.H. Robins Co., the American pharmaceutical corporation, had announced a revised reorganization plan in its attempt to merge with another large American pharmaceutical company. The plan involved the setting up of a 1.77 billion dollar trust fund which it is proposed will provide compensation to persons who had previously used a Robins product and thereby allegedly suffered physical injury. The allegedly injured parties, a very large number of persons, have formed a committee to bring actions against Robins, and the trust is intended to provide settlement of all the claims, leaving it to the claimants to settle with the company the share which each allegedly injured person will receive. It was announced that two trusts would be set up. The first trust would meet all injured persons' claims, and the smaller second trust would meet indemnification claims by doctors, hospitals and company officials. It was announced also that the main trust would be funded by a downpayment of cash on hand, a sale of certain of Robins' assets, tax benefits received by the company from the sale of the allegedly injuring product, and future earnings from the proposed merged companies. Future payments would be guaranteed with bank letters of credit totalling 1.5 billion dollars and an undertaking that the assets of the merging company would stand behind the plan. The function of the trustees would be to hold the initial payments and all future payments, and from those sums to provide compensation for claimants in accordance with a company and claimant agreed settlement for each.

Holding trusts are also employed to hold insurance policies, when it is planned that the proceeds of such policies will go towards particular defined purposes. For instance, in the case of partnership buy-sell agreements each partner will insure the lives of his other partners, so that in the event of any partner's death the remaining partners can buy out the deceased's share and interest in the partnership. If instead of a partnership there is a company, the insurance policies on the lives of the 'key' persons as shareholders may be

taken out by the company itself. The insurance policies are then held by a third party trustee, normally a trust company, which will receive the proceeds on the death of any partner, and see that they are thereafter paid out to the persons entitled to the share of that deceased partner. In this way the partner is guaranteed that his property entitlement will be adequately recognized, and his heirs receive the value of that property, on his, the partner's, death. Insurance is also held by trustees in those circumstances where the employer and the employee, normally of a small company, enter into a stock purchase agreement. The employees are to purchase the shareholding of the sole shareholder and managing director, and do so over a period of time. However, should the sole shareholder die before all the shares available for purchase by the employees from that sole shareholder have been purchased, so that the employees now wish to complete the purchase from the estate, they will insure the life of the sole shareholder, paying the premiums themselves, so that in the event of that death the purchase price is automatically thereby paid off. The existence of the trust holding the insurance policy guarantees to each of the employees who is paying instalments that the end object of the scheme will indeed be carried out.

A third type of holding trust has become extremely important in relation to financial institutions and the professions. Should a financial institution fail, depositors with that institution may well suffer as a consequence. However, provision against such loss by the depositor can be put in place by institutions themselves, ahead of such hazards occurring. They do this either by insurance or by the creation of a trust fund. Where the device of a trust fund is employed, such as in the case of the credit unions (that is, savings and loan institutions) in Western Canada, or firms of stockbrokers and investment dealers throughout Canada, the institution or the firm makes a monthly or annual contribution to a standing fund. This fund is held distinct from all other assets of those institutions or firms by a trustee, and is available to meet client claims in the event of the insolvency of, or the defalcation of funds by, any company or firm in the subscribing group. Professional bodies also employ the trust device for the same purpose. Mutual fund dealers in Canada, for example, like real estate agents, pay into a trust fund on a regular basis, in order that should a member of the profession defraud a client of funds, the professional trust fund

is available to compensate that defrauded person. Here the trust is playing the role not only of protecting the public, but of ensuring that the public reputation of the profession as a profession is maintained.

Holding trusts are also invoked in the early stages of the formation of new trading, mining, or business companies. Promoters who acquire the first shares in the new company will put those shares into an escrow trust. That is to say, the shares can only be re-acquired by the assigning promoter from the trustees on the occurrence of a future situation, such as a level of prosperity of the new company being attained or the passage of a period of time having taken place. The intention of the promoter is to make it clear to his fellow promoters and also to the investing public that there is no opportunity for the promoter to realize his shares in the early stage and leave others thereafter with a possibly failing enterprise. Shares will often rise dramatically in value after the formation of such a promising new company, and after a few months settle back to a significantly lower level. In addition to stock escrow trusts, syndicates of business investors prior to the incorporation of a new enterprise may transfer to a trust the capital they intend to invest in the new enterprise. Such pre-incorporation syndicate trusts are intended to demonstrate, the one capital investor to another, that integrity will mark their steps in the pre-incorporation stage of the enterprise. If a trustee holds each syndicate member's capital on the terms that that capital is to be subsequently utilized for the purpose of the incorporation, then each investor will know that he can proceed with confidence in the new enterprise.

Protection of investment is also the object of the long established phenomenon of the stock voting trust. Stock voting trusts are commonly used in family businesses or among other private companies when there is an apprehension on the part of the stockholders that one or more of their number may intend to sell his shares to an outside party, possibly an undesired person or a corporation engaged in a takeover, and thereby shatter the original closely-knit stockholder membership of the company. Each stockholder advances his shares to a trustee, who will then traditionally cast the votes of those shares for existing management. Once again, though the task of the trustee in this case is not only to hold the shares but also vote them, the idea is that the shareholders as a whole can look forward to the expectation that present corporate policies

will continue in the future. There is nothing to prevent any person whose shares are in such a trust from transferring his beneficial interest in those shares to another, either by way of sale or gift, but the beneficial interest is represented by a 'voting trust certificate', and this certificate is the medium of the transfer. Such certificates are issued by the trustee to shareholders who have put their shares into the trust, and the certificates represent the right to the benefits to which the transferring shareholder would have been entitled. The benefits are dividends, whether of the originally transferred shares of any later voting stock issued to existing shareholders. The certificate means that the trust beneficiary is essentially a unit holder, and he assigns his unit, as it were, to his purchaser or intended donee. In this way the voting rights in the original and any newly issued shares remain with the trustee.

Finally, we cannot overlook the term, custodianship. Whether it constitutes title holding of the changing investment assets of a large pension plan, or the simple title deposit of a single asset,[11] custodian trusteeship is a sophisticated name for a holding arrangement. This is not to say that a custodian trust instrument does not require careful drafting; indeed, the trustee is almost always a financial institution, and will require detailed documentation. But essentially this trust provides safe lodging for valuable assets such as securities, though the trusteeship may also be providing disinterested title holding, as I have used that term.

In England, however, it is at the heart of the most usual form of timesharing ownership. Nowadays, when single-owner costs of real property and its management can be prohibitive for the owner who intends to occupy for only part of the year, timesharing of a vacation residence is increasingly popular. In this way the costs or hazards of renting for the remainder of the year are avoided, and also the holiday venue can be more easily changed when change is welcome. Under timesharing a number of persons will each be entitled to occupy the residence in question for a period of time during the calender year. As an unincorporated association of persons will have its club premises or society building vested in trustees, the vacation home timesharers will form an association, and the intended residence is conveyed to a custodian trustee, nor-

[11](1987), 131 *Solicitors' Journal* 1342.

mally a financial institution, which holds title to the property for those who from time to time are the members of the association. The purchaser receives a so-called 'holiday certificate' which describes the property, and identifies the period during which he may occupy the property. The terms of the association will regulate the rights and obligations of the purchasers between themselves, as the constitution or rules of a club lay down the rights and duties of the members of the club. And it is subject to these association terms that the owner of a 'holiday certificate' can assign the certificate and hence his timeshare 'interest'.

If you consider for a moment that the 'interest' in property which a timesharer obtains is difficult to express in the historically-rooted property law concepts of most legal systems, you will appreciate how simply and easily the association/trust structure accomplishes this purpose in common law jurisdictions. Like the trustee management of the common parts of a condominium or apartment building, an alternative to incorporated management which I shall next be discussing, the association/trust arrangement gives flexibility and affords lower costs to the participant in the timeshare. It is an arrangement which promises to become even more popular if affluence continues to be widespread in the post-industrial economies.[12]

(2) *As a Substitute for Incorporation*

We are familiar with the concept of a corporation and the manner in which the carrying on of a business is traditionally conducted through a limited liability company. A limited liability company is a statutory creation, and the concept was first originated in the middle of the nineteenth century. The company, as we know, is a distinct legal personality, its directors are agents of the company and the persons who own shares in the company are known as shareholders. Because the company is a distinct legal personality, it has become by far the most popular manner in both the common law and civil law worlds in which business is carried out. The

[12]Is this a common law bailment, or a trust? See further *Elgin Loan and Savings Co. v National Trust Co.* (1905), 10 O.L.R. 41 (C.A.).

company can sue and be sued, it can own assets and bear liabilities, and it can trade in its own right. For this reason the shareholders have a limited liability because they are not the corporation itself; they merely own interests in the company.

However, the trust can also be the instrument for the carrying on of a business, and in fact the precursor of the limited liability statutory company was the joint stock company of the 1840s, which itself grew out of the concept of trust management of assets. A group of persons gathered together to supply a service to customers or carry on a business of any sort may be associated through a general partnership. Alternatively, they may be organized as a limited partnership, where the general partner carries on the business and the limited partners are liable solely to the extent of the capital they have put into the enterprise. Partnership, where the investors are employed themselves in carrying out the business, is an idea which is best suited to small business enterprises, but normally a business as it grows will require capital infusion, and this is where other parties who are not to be working members of the enterprise are brought into the picture. These persons will invest capital in the business, and expect to have a return by way of dividends on their invested capital. These capital investors will delegate the administration of the business to a management committee, and it is that committee which will be concerned with the direct operation of the enterprise, accounting to the investors on a regular basis for the committee's conduct. The management committee will, of course, receive its instructions from that general body of investors, a body which might well include the managers themselves. So it was that ultimately this essential model of the joint stock company inspired the notion of the incorporation of the enterprise where the management committee members become the directors and the investors become shareholders in the company. The company itself will then own the assets required to carry on the enterprise, as I previously mentioned, and be liable for its own debts and wrongdoing.

When a trust is utilized the management will be vested in the trustees, and the investors will be the beneficiaries of the trust. The distinct character of a trust is seen in two things. First, the trustees themselves will be vested with title to all the enterprise assets, and they themselves will sue and be sued in the carrying out of the business. Secondly, and consequently, the beneficiaries

will not be liable for any contracts entered into or torts committed by the trustees, since the trustees are personally liable in their own names. A third distinction might be said to be that, whereas in the case of a company the shareholders vote in the directors and will vote also as to the policy to be pursued by the company, the directors being obligated to report to the shareholders, trust beneficiaries have no right to intervene in the discharge of the trust. In this case the carrying on of the business is the sole task of the trustees, and they cannot be questioned provided they are adhering to the terms of the trust instrument which is the source of their authority. However, whatever the distinctions, for all practical purposes the appearance of a trust carrying on a business is very similar to that of a company. The trustees carry on the business, a profit is made, and the profit will be distributed to the beneficiaries as the product of the trust.

The Achilles' heel of the trust, whatever the appearance, is nevertheless not difficult to locate. As a modus for the carrying on of business, the trust has undoubtedly been less popular than that of the company, simply because the trustees are personally liable on all the obligations they undertake and the obligations which are imposed upon them. If they are acting properly they are entitled to indemnify themselves out of the trust property, the enterprise assets, and in certain narrow circumstances they can look to the trust beneficiaries for reimbursement of expenses which cannot be met out of the trust property. But that is the extent of their protection. If the assets of the trust should prove to be inadequate, they must otherwise expect all the consequences of personal liability for their contracts entered into, and their civil wrongs occurring, in the course of their acting in discharge of their trust duties. Partly for this reason, and partly for the reason that taxing laws in so many jurisdictions enable the limited liability company more than the trust to be the desirable instrument for the carrying on of business, the so-called business trust or trader's trust, as it is known in Australia, is much less familiar outside the United States than might have been expected to be the case. In the Commonwealth common law countries the nearest approach to the business trust, so widely known in the United States, is the public investment trust, of which I spoke earlier. Here investors purchase units or unit certificates in the trust, and this governs the quantum of the

income or capital receipts which they can expect to receive from the investing trustees.

There are limited uses to which otherwise the business trust idea may be put, however. In England, and as an alternative to the management company, the trust has recently been suggested[13] as the on-going management vehicle for the common parts (e.g., the entrances to the building, the hallways and corridors, the laundry room, the main heating and electrical equipment) and the insurance needs of smaller blocks of flats (or apartments), each flat being owned by way of a long lease. The freehold title is vested in trustees upon trust for the lessees in whom from time to time the several flats are vested. The trust is less formal, there are no statutory requirements of annual returns and audited accounts for what is essentially a small- scale operation, and there is less expense involved as a consequence.

In the United States, however, if to a much lesser extent in Canada and Australia, the business or trader's trust is a recognized mode of carrying on an enterprise. Where the liability of the trustees is concerned, lawyers drafting the trust instrument will always provide that the trustees are heavily insured against liability to third parties over and above the quantum of the trust property, and in this way the drafting lawyers seek also to avoid the limited circumstances in which the beneficiaries can be liable for expenses properly incurred by the trustees. Moreover, the trust beneficiaries would accept the fact that in the trust deed the trustees are authorized to draw upon the trust property for the premiums that are to be paid on the insurance policies.

In the United States the origin of the business trust took place in Massachusetts, which accounts for the familiar term of the 'Massachusetts business trust'. Incorporation statutes were adopted in the American States between 1837 in Connecticut and the end of the century, but the Massachusetts trust long remained of significance in that state because limitations were placed upon the uses to which a corporation might be put. Today, throughout the United

[13](1987), 84 *The Law Society's Gazette* 1307-1309.

States, despite the fact that as elsewhere the corporate device remains the essential vehicle for the carrying on of business, there are many precedents for the trust deed that will be drawn for this mode of conducting a business. Though the business is to be conducted by the trustees, necessarily over a long period of time, and there are many powers that those administering a business need to have, the form of the business trust deed will look very familiar to any lawyer who is accustomed to a trust indenture.

The recitals will set out the reason for the drawing up of the trust and the terms of the trust will first vest the property in the trustees. The deed will then authorize the trustees to conduct business and to execute all instruments that are necessary for the performance of the trust and for the business. It will continue by setting out what the nature of the business shall be, and continue by describing how new trustees and substitute trustees are to be appointed. The trust instrument will usually continue by requiring the trustees to act as a whole instead of by way of majority, and it will set out the remuneration which they are to receive for their services. The instrument will then confer upon the trustees the powers which they must have in order to carry out the business, and these are powers which, strangely enough, are very familiar to those who are accustomed to trustees and executors acting in the administration of estates. The trustees are authorized to hold the legal title, to manage and control property as they think fit, to sell, exchange, mortgage, and otherwise dispose of any interest in property held in the trust, to purchase assets required for the business, to enter into contracts, to borrow money, to receive and collect debts due to themselves as trustees of the business, to invest surplus funds and to pay profits to the beneficiaries.

At this point the deed will set out what form the interest of the investors (or trust beneficiaries) shall take. The beneficial interest in the trust property will be divided into shares or units that are to be evidenced by certificates of equitable ownership, issued by the trustees in a form which is then described. The deed then describes the rights of the certificate holders, certificates which the investors have purchased in number according to the amount of the capital each has provided. The beneficiaries will be authorized to sell and transfer their certificates at any time, and required to surrender their certificates to the trustees on the occasion of any consequent disposition by gift or sale. The trustees, having register-

ed the transfer, are themselves required to issue new certificates to the new holders of those unit interests. The deed will conclude by providing for meetings of the unit or shareholders, and authorize the trustees to declare dividends and to distribute to shareholders other net income as they think fit. For perpetuity reasons the trust is normally to continue only for 21 years after the death of the last survivor of the subscribers whose names are originally entered on the first list of unit holders. And there you have it, a trust deed whereby a business can be carried on.

Whether we shall see business or trading trusts used extensively outside the United States at any time in the future is a question that must remain in doubt so long as tax laws in our various common law jurisdictions are not neutral as between the use of the corporation and the use of the trust as vehicles for the carrying on of business. Most commentators are of the view that, so long as the incorporation remains the understood and familiar mode of discharging business, there really is no need for revenue authorities to design ways in which the trust can be taxed other than as a conduit for the passage of income, capital and tax law deductions to the trust beneficiaries. Perhaps the main difficulty that we face, however, is the widespread unfamiliarity of so many in the profession and in business with the use that can be made of the trust as a business organization device. This in my opinion is where our law schools and bar training programmes come into operation, because it is surely curious that, while we give prime emphasis to courses on corporate law, commercial law and securities law, we provide little or, more usually, nothing on the trust as a device in business. No one doubts that, if the business trust became more familiar and more widely used, then revenue officials would quickly move to consider ways in which the tax laws of our various jurisdictions might take the same approach towards the trust as they do towards the company. Integrated taxation between company and shareholders, for example, long a familiar feature of the taxing systems of many jurisdictions, could become a feature also of our trust taxing systems.

To my mind in today's international trading scene, where the world in this sense is becoming a village, so rapid are communications and fleeting the immediate business opportunity, it is vital that the common law be as flexible as possible in its legal support devices for the carrying on of trade and business, and in that regard

the corporation, the joint venture, the general partnership, the limited partnership, and the trust ought to be alternatives which we can draw upon at any time according to the nature of the transaction that is under question. It is imperative that we be able to exploit the fact of the structural identicality between limited partnership and trust, and that we should appreciate that when it comes to doing business between different countries and different legal systems the more flexible and more informal device is often that which lends itself most easily to ease of trading.

Let me give you an example of the sort of situation which I have in mind. *The Wall Street Journal* reported on 24 August, 1987, that among the large number of American companies now withdrawing from South Africa a sale of the withdrawing company's South African subsidiary to a trust in favour of its South African employees is the most popular of the various possible withdrawal methods. The alternatives to the trust include assisting South African blacks to buy white-owned businesses, forming charitable trusts, moving the subsidiary to a neighbouring state, and selling to a central South African foundation that would administer the business and donate to South African charities.

The terms of the trust tend to differ from company to company according to the objectives the American directors in question consider most appropriate, but the basic format is the same. A trust with South African trustees is set up in a tax haven, such as Jersey or Guernsey in the Channel Isles, and the South African subsidiary is sold to the trust. The beneficiaries of the trust, as I say, are the South African employees, of all racial backgrounds, who will be unit holders. The American company finances the sale, and a first charge on the future profits of the business trust is the repayment of the American company. Dividends (or income) from a trust leave South Africa at the "commercial" rate of 50 cents per rand, while if they were leaving at the "financial" rate the South African government permits only 30 cents per rand. This means the first charge can be paid off that much faster. Subsequent trust terms differ. One model is to pay the first 3% of the profits to the employees if and when the trust achieves 80% of an American-set production goal, and 10% when the trust achieves 150% of that goal. Some companies are including a buy-back option for the company, and, though repayment over a preferred-creditor period of ten years is often provided, presumably the company as

the trustees' creditor for the sale price can also repossess if there is a default in the repayment of this loan. Some trust deeds also include product-supply links in favour of the selling company. Another model is not to pay profits directly to the employees, but to provide that, after retirement of the loan, income then arising shall be used to create additional employee benefits.

Whether these trusts will be successful or are an appropriate response to the particular nature of the South African problem is an issue that will be debated worldwide, but my point is merely to demonstrate two elements in the situation; first, the facility the business trust offers, even in a legal system where the trust must operate in a primary setting of Roman-Dutch doctrine, and, secondly, the igenuity of the American and South African lawyers who are seeking ways in which to maintain highly successful multinational businesses.

Undoubtedly with the business trust there are conceptual problems which have to be solved. For instance, in the United States, if the beneficiaries have a sufficient degree of control of the trustee's decisions, the courts may well hold that the trust in question is a partnership and not a trust. In other words, the so-called beneficiaries are in fact persons dealing through an agent with third parties. The better opinion is that that doctrine does not apply outside the United States, but here is an area where at least we should be aware of the discussion that is now in process and the significance of the so-called control test. This is a subject which goes to the liability of investors, the trust beneficiaries. So far as the liability of trustees is concerned, their personal liability, the question arises as to whether the trust deed can limit the trustees' liability by requiring the trustees to contract with third parties "as trustee". Would this limit their liability to the extent solely of the trust assets? So far as the duration of a trust is concerned, to which I spoke earlier, many business trust precedents suggesting it can only be the length of the perpetuity period, another question is as to whether the perpetuity rule applies to this type of business transaction at all. Some commentators are of the view that it clearly does not so apply. For my part I would like to see these issues discussed in our law courses, so that the operation of the concept of the trust in the business setting is fully understood by law graduates when they proceed to the practice of law, and here I think we in the universities have a very real role to play in the courses on

trusts that we design. We need textbooks on the subject, we need casebooks, and we need people whose expertise bridges estate law, corporate law and commercial law.

3. *The Remedial Trust and Insolvency*

When I began this lecture I said that I would look at two phenomena, the express trust in business and commerce, and the constructive trust. I would like now to turn from the express trust and make a few comments on what I see as the challenge for the future given to us by the constructive trust. This trust, of course, does not arise in any way from the intention of any settlor; it is a trust obligation, namely, that one party shall hold property for the benefit of another, imposed upon a defendant as a consequence of the defendant's conduct in certain circumstances, and the order of the court. It is entirely a machinery whereby property can be taken out of the hands of one person and put into the hands of another.

For generations discussion has taken place over the nature and the scope of the constructive trust. Only in recent years has the constructive trust been recognized as being a remedial device, but we still have no agreement within the Commonwealth as to whether there is a theme in the availability of the constructive trust as a remedy, or, as the English and Australasian courts argue, 'constructive trust' merely suggests a number of situations where fraud has been perpetrated and where as a consequence equity will order restitution. In the United States and in Canada the constructive trust is now recognized as a remedy for the rectification of unjust enrichment. That is to say, wherever the court is of the view that one party has been unjustly enriched to the detriment of another who has suffered a corresponding loss, and there is no legal explanation such as gift or contract for the enrichment, then the court will order the handing over of the property in question by the enriched party to the deprived party.

However, you will see that this characterization raises all sorts of open questions. In what circumstances will the courts discern that unjust enrichment has taken place? Undoubtedly the courts are applying criteria in order to determine whether such an event has occurred, and those criteria, namely, enrichment, corresponding deprivation, and no juristic justification, carry us a good deal down the path we have to tread in determining whether unjust enrichment

has taken place. But such criteria are necessarily vague, and there are numerous situations that occur in the competitive world of business and commerce where the line between legitimate competition and taking illegitimate advantage is singularly hard to draw.

Moreover, it will not have slipped your mind that the constructive trust is both a personal accounting remedy and a proprietary remedy. It is possible for the defendant to be personally liable for the enrichment which he has unjustly acquired, when he and he alone is responsible for making good the loss to the plaintiff. However, the constructive trust as a proprietary remedy means that the plaintiff is entitled to recover the property in the hands of third parties who have acquired the property in question from the unjustly enriched party, and who knew or ought to have known of the circumstances in which the transferor made the gain. In other words, the ramifications of a proprietary remedy are considerable, and here in this field of law we are just at the beginning of considering how we are going to determine when each of these remedies can appropriately be invoked. Certainly we in Canada are at the beginning, and in the other Commonwealth jurisdictions which still see the constructive trust as a remedy for unconscionable behaviour, I suggest that the scene is still more open for uncertainty as to how this remedy of the constructive trust will impact upon business and commerce. It is not my intention on this occasion to follow that matter through with detailed elaboration; my purpose rather is to leave you with the thought that the case precedents we have had to date give rise both to exhilaration and to some sense of concern when one sees the inroads that the constructive trust remedy can make upon occurrences in commercial life. In particular I would draw to your attention once again that the trust, whether express or constructive, permits the claimant who is successful to succeed over all the unsecured, and often the secured, creditors of insolvent or bankrupt defendants. If this is the priority (for it really can be seen as little else) that the trust can give to the plaintiff claimant, is there any necessity for us to be more precise as to those circumstances in which the personal liability constructive trust applies, and those where the proprietary constructive trust can be invoked? I suggest there is, and I will leave this final thought with you that sooner or later we are going to have to give a lot of consideration to what unconscionability and unjust enrichment are to mean, not only in litigation at large, but in particular to the world of trade and commerce.

4. Conclusion

The versatility of the trust has always been its strength. It is applicable to any situation involving, or so far as future property is concerned potentially involving, property holding or administration for the benefit of others. No specific language is necessary for the creation of a trust, and so far as personalty is concerned the language used can be oral. All that must be demonstrated is (1) the intention of the owner of a property interest to separate the rights of disposition and management in that interest from the right of enjoyment, and (2) the obligation of the holder of the former set of rights to act for the benefit of the holder of the latter right. Finally, for obvious reasons, the property interest in which those rights exist must be clearly discoverable. That is it. Even the quantum of enjoyment right the holder is to have need not be predetermined, provided the trustee or a third party is clearly empowered to determine that quantum during the lifetime of the trust. And the trustee, the holder of the rights of disposition and management, may be one of the trust beneficiaries, the holders of the right of enjoyment. The creator of the trust, if he thinks fit, can authorize the trustee, whether or not the trustee is also to be a trust beneficiary, to act in chosen and stated ways that will or may benefit that trustee personally (e.g., charging fees for his services, or taking trust property for himself), and the creator of the trust can and often does exculpate the trustee from liability for all but wilful breaches of trust. The creator of the trust may be the trustee, or one of them, and he may be one of two or more trust beneficiaries.

This is the concept of which we are speaking, and my submission is that, if as practitioners we overlook the possibilities stemming from this versatility, and think only of the trust as a possible medium for inter vivos or testamentary disposition within the family, we are not properly serving our clients. As teachers with that conception we are not opening our students' minds to the practical significance of the trust, or to the novel questions of law created by the business use of the trust. On the other hand, I have to concede that, so far as teachers are concerned, the omission is forgivable because all our instructional textbooks and case collections dwell exclusively on the family disposition role of the trust. The practitioner, too, can make the valid point that even as internationally

distinguished a work as *Scott on Trusts* expressly banishes the business use of the trust from its consideration. Moreover, he may add, statute and case law, at least in all Commonwealth jurisdictions, is essentially concerned with the individual's use of the trust within the family. Charitable trusts are an exception from that concern, but today that exception is very largely of particular interest to England and Wales, because the incorporated charity and the foundation have elsewhere come to dominate the charity scene. What is more, our practitioner will say, tax-planned gifting to these entities is a distinct and self-contained area of practice.

Nevertheless, the growth of new business applications of the trust concept, especially in the last two decades, is something we cannot ignore. There is not only scope for the wider utilization of these applications, but a need for awareness so that the new legal issues now arising can effectively be handled. For example, who would have thought even ten years ago that pension (or superannuation) trusts would become a field of specialization for lawyers, and the services of those lawyers be constantly called upon. And yet that is now becoming the case in all the post-industrial common law societies. Nor have I dealt with all the trust applications that are already in operation. For instance, I have said nothing of so-called 'blind' trusts and 'in-substance defeasance' trusts. The former trust arises when the law or accepted practice requires a minister of the state while in office to have all his personal portfolio assets handled independently of himself, and he be ignorant of (or 'blind' to) the investment decisions being made on his behalf. The trust ensures there can be no opportunity for, or allegation of, conflict of interest and duty in the minister's discharge of his official duties. The latter trusts are familiar in the United States, and are now appearing in other jurisdictions. A corporate debtor will transfer all its long-term bond obligations to a trust company, together with debt securities on trust to pay off those bonds. The bonds are thus cleared from the corporation's books, and there is a substantial saving to the indebted company in thus discharging its bond obligations.

My thesis is that the present, and even more the future, offer a real challenge everywhere in the common law world to trust lawyer and general practitioner alike. In a world which in business terms is fast becoming a global village we cannot afford at the moment of demand to be found wanting. And if ingenuity is required of

the practitioner in the use of the express trust, no less is doctrinal precision required of our courts in fashioning the circumstances in which the new remedial trust is to apply. Here is another challenge, and a task calling for restraint and caution.

Donovan W.M. Waters*

*Professor of Law,
University of Victoria,
British Columbia,
Canada.