Self-dealing: rigours and risks

Brudenell-Bruce *offers salutary lessons about the self-dealing rule, as Simon Atkinson explains*

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'*Brudenell-Bruce* provides a restatement of the law relating to estoppel by deed and applies principles of construction to deeds and consent orders.'

For chancery practitioners *Brudenell-Bruce (Earl of Cardigan) v Moore and Cotton* [2012] provides valuable guidance in a number of areas. The judgment of Newey J touches on the construction of deeds, the distinction in land law between fixtures and chattels, and self-dealing by trustees.

A case of artistic differences

Brudenell-Bruce concerned trusts affecting the estate of the family of the claimant, the Earl of Cardigan (the estate trusts).

The question that sparked litigation was this: were the trustees of the estate trusts entitled to sell paintings that were hanging in Savernake Lodge, one of the estate properties and the home of the claimant-tenant?

The defendant trustees believed that financial pressures necessitated the selling of the paintings. The claimant, a beneficiary of the trusts and a former trustee, contended that the defendants were not entitled to sell the paintings without his consent.

Complex asset structures

The claimant's family had owned the Savernake Forest estate in Wiltshire for nearly 1000 years. By the time of litigation the estate included over a dozen houses.

In the 1940s the estate had been held by a company owned by the claimant's grandfather (51%) and father (49%). Between 1949 and 1951 the company was replaced by a partnership. The estate was conveyed by deed in 1951 to the claimant's grandfather and father to be held on trust for sale as part of the partnership property; these were the estate trusts. Although the original partnership agreement could not be found, Newey J inferred that the partnership property also included (or came to include) the paintings and other chattels [6].

Various intergenerational changes were made to the partnership over the years. In May 1987 the claimant was appointed his 49% share in the partnership assets absolutely. The remaining 51% share was settled on trust for the claimant's children (the 1987 trust). The partnership was thereafter carried on by the claimant and the trustees of the 1987 trust.

In 1987 the claimant was appointed a trustee of the estate trusts; in 1994 he was also appointed a trustee of the 1987 trust. As of 1994 the claimant and a Mr Shorey, the family solicitor, were the only trustees of both the 1987 trust and the estate trusts.

In 2003 Mr Shorey retired as trustee and a Mr Ford was appointed in his stead.

Figure 1 on p9 shows the asset structure as at 2003:

Additional background facts

In 1999 Savernake Lodge was leased to the claimant for 20 years at a peppercorn rent. The claimant was a co-trustee at the time of the demise. Prior to the lease being granted, he resided in Savernake Lodge as licensee with his then wife and two teenage children.

In 2007 Mr Ford issued proceedings against the claimant for alleged breaches of trust. These were eventually compromised by means of a Tomlin order. This required the removal of Mr Ford and the claimant as trustees of the estate trusts and the removal of the claimant as a trustee of the 1987 trust. The Tomlin order also provided for the partnership to be wound up as soon as reasonably practicable after the appointment of new trustees of the estate trusts. Title to the partnership assets was then to be vested in the new trustees to be held as to 51% and 49% shares for the trustees of the 1987 trust and the claimant respectively.

Deeds of retirement and appointment were duly executed in November 2008. Mr Ford and Mr Cotton were appointed trustees of the 1987 trust; Mr Moore and Mr Cotton, the defendants, were appointed trustees of the estate trusts. The deed relating to the estate trusts (the 2008 deed) contained a recital which stated that it was 'intended that the property now in the Trusts' was to be transferred to or under the control of the defendants as the new trustees. The recitals also stated that the 'assets of the Trusts are identified in the Second Schedule'. Part 2 of the Second Schedule comprised a list of pictures, including the paintings hanging at Savernake Lodge.

Despite the appointment of the defendants as trustees of the estate trusts, the partnership had not been wound up by the time of the litigation.

Issues for determination

The claimant advanced two arguments in support of his contention that the defendants were not entitled to sell the paintings without his consent:

- The paintings belonged to the partnership (of which he was a partner). The paintings were not held by the trustees of the estate trusts.
- In any event, the paintings in Savernake Lodge were leased to him as part of the property's furniture, fixtures and fittings.

The defendants challenged both of these arguments. They additionally sought to have the lease set aside on the basis that the claimant, as one of the then co-trustees, had contravened the self-dealing rule by demising Savernake Lodge to himself.

Newey J held that:

- The paintings no longer belonged to the partnership; the 2008 deed vested title to the paintings in the defendants as trustees of the estate trusts.
- The paintings were not leased to the claimant.
- The defendant trustees were entitled to have the lease set aside.

Issue 1: title to the paintings

The first issue turned primarily on the construction of the 2008 deed. The judgment does, however, contain a valuable restatement of the doctrine of estoppel by deed.

The claimant asserted that under the terms of the Tomlin order the partnership assets would only vest in the trustees of the estate trusts upon the winding up of the partnership; as this had yet to occur, the paintings remained in the partnership.

The defendants argued that the effect of the 2008 deed was to vest title to the paintings in themselves as trustees. Further, the claimant was estopped from suggesting otherwise; he had agreed with the wording of the recitals in the 2008 deed.

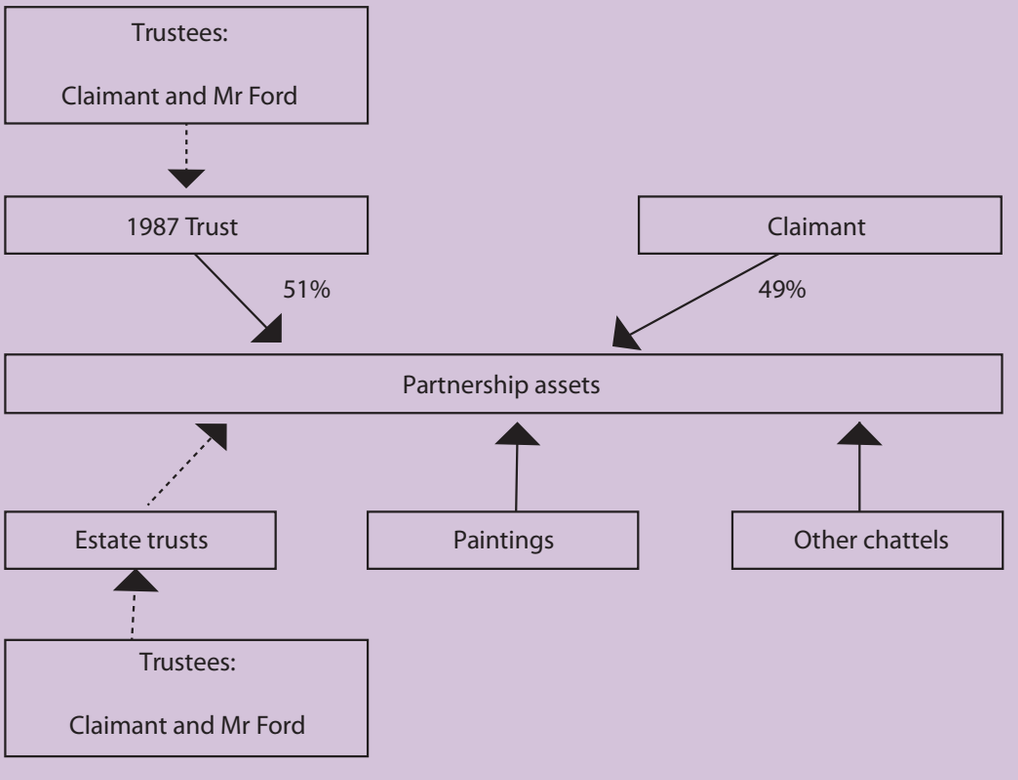
Newey J dealt first with the question of estoppel: [23]-[24]. Relying on *Greer v Kettle* [1938], the judge stated the law to be as follows:

> ... if a recital contains a statement which a party to the deed is to be taken to have agreed to admit as true, the statement is binding on him.

Newey J held that the recital was intended to settle whether the items listed in the second schedule were 'Assets of the Trusts'. The claimant was accordingly estopped from contending that the paintings remained partnership property.

The judge additionally held that that as a matter of construction the

Figure 1: The asset structure as at 2003



2008 deed did transfer the paintings to the defendants: [25]. Applying the well-known principles of construction, Newey J concluded that a reasonable person would understand the 2008 deed to be transferring the assets listed in the second schedule, including the paintings, to the defendants.

Issue 2: furniture, fixtures, fittings and fastenings

The second issue is of particular interest for land law practitioners; the judgment addresses in some detail those perennially thorny questions: what is a fixture and what is a chattel? This case reveals how difficult it can be (absent express indications in the lease itself) to establish that paintings are fixtures.

Savernake Lodge was demised to the claimant together with 'the use of all the Landlords' furniture fixtures and fittings in or on the premises.' Newey J held that the paintings were neither furniture, fixtures nor fittings.

In the judge's view, the term 'furniture' connotes items such as 'tables, chairs and desks which have a function other than decoration'. While paintings might be said to help furnish a room, artwork, being essentially decorative, would not naturally be considered furniture [30].

Nor did Newey J consider the paintings to be 'fixtures'. The test for determining whether an item is a fixture or a chattel was not disputed: [31]–[32]. A court must consider:

- the degree to which the chattel has become annexed to the land; and
- the purpose of such annexation (see *Holland v Hodgson* [1872]; *Berkley v Poulett* [1977]).

Large hooks had been drilled into the wall to hang the larger paintings, an extensive burglar alarm had been fitted, and the main room in Savernake Lodge had been upholstered so as to match one of the paintings: [28]. Despite these facts, and despite the claimant's assertion that the paintings formed a unified collection associated with the claimant's family (unlike the 'heterogeneous collection' in Berkley), the judge held that the paintings were not fixtures: [34]-[35]. Endorsing the observation of Stamp LJ in Berkley that:

> ... [f]ramed pictures are hung on or fixed to walls for their better enjoyment as pictures, however much they may beautify the rooms in which they are found.

Newey J held that the transaction was voidable because the trustees had, in breach of fiduciary duty, failed to take into account relevant matters – the interests of the claimant's children – when agreeing the terms of the lease.

Newey J stated that there was no good reason for the position to be different with the paintings [35].

As to 'fittings', the judge noted that the term is often used in combination with 'fixtures' (as in Berkley, where the additional term was apparently not considered material) [37]. The term 'fitted' would not naturally apply to paintings, which are hung rather than fitted. Newey J also considered the value of the paintings to be important; had the parties intended such valuable items to be included in the lease, the trustees might have been expected to refer to them expressly.

Lastly, the judge considered the term 'fastenings', which appeared in the tenant's yielding-up covenant but not in the demise. Newey J was of the opinion that this word would refer more naturally to an attachment rather than to the thing attached. In any event the 'furniture fixtures and fastenings' to be yielded up need not correspond precisely with the 'furniture fixtures and fittings' demised: [38].

Issue 3: self-dealing

The third issue will be of most interest to trust practitioners. The judgment reiterates the rigour with which the self-dealing rule will be applied by courts.

Newey J took as his starting point the restatement of the rule in *Tito v Waddell (No. 2)* [1977] (para 41):

> ... if a trustee sells the trust property to himself, the sale is voidable by any beneficiary *ex debito justiciae*, however fair the transaction. The rule is a severe one which will apply however honest the circumstances and fair the price. Quoting from Lewin, Newey J emphasised that the self-dealing rule is based not only upon the principle that a trustee cannot be both seller and buyer, but also upon the wider principle that a trustee must not put themselves in a position where there is a conflict or possible conflict between their interest and duty.

The claimant argued that the self-dealing rule ought not to apply for four reasons:

- He had not chosen to place himself in a position of conflict; he had been put in such a position by the settlors and the terms of the estate trusts.
- The beneficiaries of the estate trusts (being the claimant in his personal capacity and the claimant and Mr Shorey as the then trustees of the 1987 trust) had in any event concurred in the grant of the lease.
- The defendants were barred from seeking to have the lease set aside by reason of acquiescence/laches.
- Modern authorities show that the rule will not always be applied with its traditional severity.

As to the first argument, the claimant relied upon *Sargeant v National Westminster Bank plc* [1990]. In that case a testator had let his farms to his three children, who farmed them in partnership. The children were also appointed (along with the testator's wife) as executors and trustees under the testator's will. Several years after the death of the testator and his wife, one of the children died intestate. The surviving two children exercised an option in the partnership deed to acquire the third child's share. They also sought to purchase the freehold of one of the farms and to sell the rest. The administrators of the third child's estate claimed that the estate was entitled to a one-third share of the vacant possession value of the farms; the two surviving children could not sell the farms during the currency of the tenancies as their interests as tenants would conflict

with their duties as trustees. The Court of Appeal disagreed. Although the children were in a position where their duties and interests might conflict, they had not placed themselves in that position; they had been put there mainly by the grant of the tenancies, the provisions of the testator's will and the contractual arrangements to which the deceased child was also a party. It was held inappropriate for the court to intervene where there was no evidence that the surviving children had not discharged their fiduciary obligations.

Newey J distinguished *Sargeant*. In the present case the claimant was not an original trustee of either the estate trusts or the 1987 trust; the potential for conflict between interest and duty did not arise until his appointments as trustee. The claimant had voluntarily accepted these appointments, thereby raising the prospect of conflict [47].

Newey J also rejected the claimant's second argument on two grounds. First, the judge relied on the case of *Re Thompson's Settlement* [1986] to show that the self-dealing rule applies stringently in cases where a trustee concurs in a transaction that cannot be carried into effect without their concurrence and in relation to which the trustee has an interest or owes a fiduciary duty to another [49].

Secondly, Newey J held that the transaction was voidable because the trustees had, in breach of fiduciary duty, failed to take into account relevant matters – the interests of the claimant's children – when agreeing the terms of the lease [51]–[56]. Although the claimant did not consider the lease to be contrary to the interests of the beneficiaries of the 1987 trust, he had failed to ask himself whether the lease was in fact in their interest. As to Mr Shorey, the self-dealing rule had not crossed his mind partly because of the nature of the estate and partly because of the manner in which the estate had been administered in the past.

This line of reasoning was an application of the so-called rule in *Re Hastings-Bass*, although Newey J did not expressly refer to the rule by name. The judge relied upon Lloyd LJ's restatement of the *Re Hastings-Bass* rule given in *Pitt v Holt* [2011]. The Supreme Court has very recently upheld the Court of Appeal's decision to the extent that the decision turned on the rule in *Re Hastings-Bass*. In particular, the Supreme Court confirmed the requirement for there to be a breach of fiduciary duty before the rule can operate [73].

The claimant's third argument was as follows. It would be unconscionable to allow the defendants to invoke the self-dealing rule at this remove of time: the lease had been executed in 1999; five people had been trustees of the estate trust in the intervening period; and the defendants had held office since November 2008.

Newey J was unconvinced by these arguments. He held that, since the claimant had been a trustee until November 2008, he was not entitled to rely on the trustees' failure to challenge the lease prior to that date. Nor would the claimant be prejudiced by the lapse of time; the defendants were not seeking payment in respect of past occupation nor were they seeking to evict him.

As to the fourth argument, the claimant cited *Edge v Pensions Ombudsman* [2000] to show that the self-dealing rule will not always apply with its traditional severity. In *Edge* the trustees of a pension scheme had decided to reduce employer and employee contributions and to increase pension entitlements to active members in order to reduce a surplus in the fund; the trustees did not, however, confer any additional benefits on pensioners. Upon receiving complaints from pensioners, the Ombudsman held, *inter alia*, that those trustees who had been appointed by employers or by members had breached their duty not to put themselves in a position of conflict of interest. The Court of Appeal disagreed, however.

Newey J distinguished *Edge* on the basis that the Court of Appeal's reasoning depended largely on pension scheme rules which had no parallel in the present case. Although the judge noted that there are exceptional circumstances in which the self-dealing rule may not apply, no such exceptional circumstances existed here.

Lessons for practitioners

Brudenell-Bruce makes essential reading for chancery practitioners.

It provides a restatement of the law relating to estoppel by deed and applies principles of construction to deeds and consent orders.

For land lawyers the case offers valuable guidance in respect of that sometimes fine distinction between fixtures and chattels.

As for trustees and their advisers, the case sounds several salutary warnings. First, and most importantly, it highlights the legal traps which exist particularly in family trusts where individuals may be both trustees and beneficiaries. Family arrangements may be informal and/or may arise from long-established custom. Such arrangements may not have been scrutinised fully by trustee-beneficiaries. In those circumstances the risks of a trustee acting in breach of fiduciary duty are increased.

Secondly, solicitor trustees must be alert to the risk that lay co-trustees may not be fully aware of the obligations and rigours of trusteeship and may be 'taking their cue from the professional'. Solicitor trustees may find that they have to explain to their lay counterparts various tenets of trust law, such as the self-dealing rule or the rule in *Re Hastings-Bass*.

Thirdly, the judgment emphasises the scope of, and the severity with which courts will apply, the self-dealing rule. Cases in which the self-dealing rule has not been applied remain the exception rather than the rule. Trustees who seek to extricate themselves from the rule's reach face a decidedly uphill battle in court. ■

Berkley v Poulett
[1977] 1 EGLR 86
Edge v Pensions Ombudsman
[2000] Ch 602
Greer v Kettle
[1938] AC 156
Re Hastings-Bass
[1975] Ch 25
Holland v Hodgson
(1872) LR 7 CP 328
Futter v Futter (with Pitt v Holt)
[2011] WTLR 623 CA;
[2013] WTLR 977
Re Thompson's Settlement
[1986] Ch 99
Sargeant v National Westminster Bank plc
(1990) 61 P&CR 518
Tito v Waddell (No. 2)
[1977] Ch 106