Editorial

Illegal trusts

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Abstract

Illegal trusts revisited.

Illegal trusts

The Panama Papers, considered in our recent Editorial for Issue 5, raise the question of the law's attitude to trusts set up to conceal a property acquired through criminal activity. The starting point is *Holman v Johnson*[1] where the claimant (based in Dunkirk) sold tea to the defendant, knowing that he would smuggle it into England. The claimant brought an action for non-payment of bills of exchange. The defendant contended that the contract was unlawful and could not be enforced. Lord Mansfield CJ upheld the payment obligation as the claimant had done nothing unlawful. He formulated the following principle:

> No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise from ex turpi causa, or the transgression for a positive law of this country, there the court says he has no right to be assisted.

The application of this principle to trusts is not straightforward. The starting point is the House of Lords decision in *Tinsley v Milligan,* which concerned a property purchased jointly but registered in Ms Tinsley's sole name. The reason for this was to facilitate fraudulent benefit claims by Ms Milligan. Both Ms Tinsley and Ms Milligan were parties to the fraud and enjoyed the proceeds of it. When their relationship broke down, Ms Tinsley sought to rely on sole title to oust Ms Milligan from the property. Ms Milligan counterclaimed for a declaration of joint ownership. The question was whether the couple's illegal arrangement prevented Ms Milligan from establishing her entitlement. The House of Lords considered that a person can enforce proprietary rights provided he or she does not need to rely on the illegal contract. Ms Milligan was able to establish her interest without relying on her own illegality. Her interest arose from her contribution to the purchase price, leading to a presumption of a resulting trust. Ms Milligan had no need to prove why the property was conveyed into Mr Tinsley's name alone. The fact of Ms Milligan's contribution to the purchase was all that mattered and gave rise to a resulting trust. This might have been rebutted by a presumption of advancement or gift. Had this presumption arisen, Ms Milligan would not have been able to rely on the fraudulent purpose to rebut it. This would have involved her relying on her illegality, a test that the Law Commission considered arbitrary.[2]

The *Tinsley* approach was modified by Lord Wilson in the Supreme Court in *Allen v Hounga.*[3] Miss Hounga, a 14 year old, had entered the country from Nigeria on six months visitor visa. She was employed by Mrs Allen as a home help. This was a

1. (1775) 1 Cowp 341, 343.
2. This view was supported by Law Commission in consultation paper published in 1999 [*Illegal Transactions: The Effects of Illegality on Contracts and Trusts* (CP No 154)] as uncertain, arbitrary, and in need of reform.
3. [2014] UKSC 47.

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criminal offence.[4] Following her dismissal, Miss Hounga issued proceedings in the employment tribunal for, *inter alia*, unlawful discrimination in relation to her dismissal. Although she was successful before both the employment tribunals, and the Employment Appeal Tribunal, the Court of Appeal allowed Mrs Allen's appeal on the basis that the illegality of the contract of employment formed a material part of Miss Hounga's complaint, so that to uphold that complaint would be to condone the illegality.

Lord Wilson considered the reliance test (and other tests) were unsatisfactory, failed to take account of underlying policy considerations and was therefore the subject of some considerable criticism He favoured a test which took greater account of policy objectives in this area. For this purpose, he framed four questions (with his answers supplied):

> Q: Did the tribunal's award of compensation to Miss Hounga allow her to profit from her wrongful conduct in entering into the contract? A: No it was an award of compensation for injury to feelings consequent on her dismissal, in particular the abusive nature of it;
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> Q: Did the award permit evasion of a penalty prescribed by the criminal law? A: No, Miss Hounga has not been prosecuted for her entry into the contract and, even had a penalty been thus imposed on her, it would not represent evasion of it.
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> Q: Did the award compromise the integrity of the legal system by appearing to encourage those in the situation of Miss Hounga to enter into illegal contracts of employment? A: No, the idea is fanciful
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> Q: Conversely, would application of the defence of illegality so as to defeat the award compromise the integrity of the legal system by appearing to encourage those in the situation of Mrs Allen to enter into illegal contracts of employment? leading to some uncertainty in this important area of law. A: Yes, possibly: it might engender a belief that they could even discriminate against such employees with impunity.

Hniazdzilau v Vajgel[5] concerned ownership of shares in an English Company, Benet Invest Limited, which Mr Hniazdzilau had arranged for Mr Bronovets to form to indirectly acquire a property in Minsk. The claimant (or his companies) had funded this purchase. But, his evidence was that this source of funding had been concealed, to avoid a tax charge in Belarus. This involved the creation of fictitious invoices, which were designed to give the impression that the funds were derived from BIL's trading. This gave rise to a defence based on illegality. Mr Jeremy Cousins QC (sitting as a deputy) considered that *Tinsley* had not been overruled and did not consider that Mr Hniazdzilau was reliant on illegality (his primary case being that he was beneficially entitled to the shares in BIL). The judge applied the *Hounga* test, concluding:

> The equity arises from the fact of payment of the monies and the intentions of the parties, not from entering into any illegal contract.
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> Mr Hniazdzilau would remain liable to prosecution despite a finding in his favour.
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> Upholding an equity on the facts of this case would not encourage others to enter into illegal contracts, nor would it encourage the making of illegal payments, in the sense of misappropriating monies, because the funds concerned were Mr Hniazdzilau's.
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> Application of the defence of illegality in a case such as this might encourage dishonest persons to cheat those who pay them by accepting payment of monies knowing that they are paid on a particular basis, while having every intention of 'going back' on arrangements once the payment is safely banked.

These matters are considered further in an excellent article in this Issue by Clifford Darton. He explains that this is not the last word on the subject. The conflict between *Tinsley* and *Hounga* tests is likely to be resolved by the Supreme Court in *Patel v Mirza*[6] on which judgment is pending.

4. s 24 of the Immigration Act 1971.
5. [2016] EWHC 15 (Ch).
6. The Court of Appeal's decision being reported as [2014] EWCA Civ 1047.

Trusts, Confidentiality and Corruption

The Panama Papers raise other questions too.

One is the role which confidentiality should now play in today's world. The International Commission of Investigative Journalists (ICIJ) Offshore leaks database explicitly (and properly) acknowledges that:

> There are legitimate uses for offshore companies and trusts. We do not intend to suggest or imply that any persons, companies or other entities included in the ICIJ Offshore Leaks Database have broken the law or otherwise acted improperly.[7]

The ICIJ clearly values confidentiality: according to its website under the heading 'Leak to Us', it 'encourages whistleblowers everywhere to securely submit all forms of content that might be of public concern' and is in the process of deploying 'a new system that will allow whistleblowers to leak confidential information to ICIJ securely without revealing their identity'.[8]

It is no doubt comforting to those who are about to breach their own obligations of confidentiality that the ICIJ will itself treat their conduct confidentially, as indeed journalists regularly promise their sources.

Tempting as it is to view this as an example of double standards, there need to be taken into account the defences available to a person accused of breaching confidence where the maintenance of confidentiality would enable the covering-up of crimes, civil wrongs, or serious misdeeds of public importance. The test is applied widely in England (the so-called public interest plea),[9] whereas in other jurisdictions such as Australia a narrower principle, still applicable in the context of illegality, is known as the iniquity principle.[10]

The authorities also highlight the nature of the disclosure which may be permitted and, in *Legal Practitioners Complaints Committee v Mark T QC*,[11] the distinction between reports to the proper authorities and to a newspaper was noted.

The immediate problem with the application of this principle in the present context is that, as the ICIJ website recognizes, some at least of those whose confidential information has been revealed have not broken the law or otherwise acted improperly. There would seem to be no proper basis for the release of their confidential information, and an argument on the part of the person who made it available that he or she simply did not know which of the persons affected by the disclosure were not guilty of any unlawful or improper conduct and which were guilty hardly justifies the action taken.

Once again, the position is complicated in the context of cases involving corruption because the proper authorities (viewed in the conventional sense) may themselves be parties to the corruption and accordingly have no interest whatsoever in its disclosure—indeed, an interest in its remaining secret.

In overturning the Court of Appeal decision in *Lister & Co v Stubbs*,[12] the Supreme Court in *FHR European Ventures LLP v Cedar Capital Partners LLC*,[13] noted:

> As Lord Templeman said giving the decision of the Privy Council in *Attorney General for Hong Kong v Reid*,[14] '[b]ribery is an evil practice which threatens the foundations of any civilised society'. Secret commissions are also objectionable as they inevitably tend to undermine trust in the commercial world. That has always been true, but concern about bribery and corruption generally has never been greater than it is

7. <https://offshoreleaks.icij.org/#_ga=1.127278216.463603002.1459848293> accessed 4 June 2016.
8. <https://www.icij.org/securedrop#_ga=1.164492602.463603002.1459848293> accessed 4 June 2016.
9. *JSC BTA Bank v Mukhtar Ablyazov and others* [*2014*] *EWHC 2788; Gartside v Outram* (1856) 26 LJ Ch and s 113.
10. *Corrs Pavey Whiting and Byrne v Collector of Customs (Vic)* [1987] FCA 266; (1987) 14 FCR 434; *British American Tobacco Australia Limited v Gordon & Ors* (No 3) [2009] VSC 619.
11. [2009] WASAT 42.
12. (1890) 45 Ch D 1.
13. [2014] UKSC 45 at [42].
14. [1994] 1 AC 324, 330H.

now—see for instance, internationally, the *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* 1999 and the United Nations *Convention against Corruption* 2003, and, in the United Kingdom, the *Bribery Acts* 2010 and 2012.

The complexities associated with the suppression of corruption and recovery of its proceeds were on display at the anticorruption Summit convened by the UK Prime Minister in May earlier this year. One can only admire the dignity and candour of the Nigerian President after reports were published of another confidential discussion (this time between the Queen and the UK Prime Minister) in which his country was described as 'fantastically corrupt'. Instead of taking diplomatic umbrage, he admitted it was true but somewhat pointedly asked the question what was being done in the countries where the proceeds of corruption were held to make them available to their beneficial owner, the Nigerian government. The question posed is the question of how to provide an effective remedy when the true victims have no standing to sue and those who ought to sue on their account are disinclined or unable to do so.

A comparable question arises in the context of company law with the application of the rule in *Foss v Harbottle*,[15] but in that case the law makes appropriate provision for the circumstances that the company to which a wrong has been done fails for improper reasons to pursue its rights: in such a case, the minority shareholders are entitled to take the proceedings which the company ought to have taken.

Since the decision of the Supreme Court in *FHR European Ventures LLP v Cedar Capital Partners LLC*, there is no doubt as to the status of the proceeds of corruption: they belong to the victim. And any knowing accessory to corrupt conduct can be personally liable. Accessories in this context can include professionals—indeed, it was the position of a solicitor that was used as an example by Lord Nicholls of Birkenhead in *Royal Brunei Airlines Sdn Bhd v Tan*[16] as a person who might be liable, even in the context of an unknowing breach of trust by another.

Lord Nicholls continued:

> It is against this background that the question of negligence is to be addressed. This question, it should be remembered, is directed at whether an honest third party who receives no trust property should be liable if he procures or assists in a breach of trust of which he would have become aware had he exercised reasonable diligence. Should he be liable to the beneficiaries for the loss they suffer from the breach of trust?
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> The majority of persons falling into this category will be the hosts of people who act for trustees in various ways: as advisers, consultants, bankers, and agents of many kinds. This category also includes officers and employees of companies, in respect of the application of company funds. All these people will be accountable to the trustees for their conduct. For the most part they will owe to the trustees a duty to exercise reasonable skill and care. When that is so, the rights flowing from that duty form part of the trust property. As such they can be enforced by the beneficiaries in a suitable case if the trustees are unable or unwilling to do so. That being so, it is difficult to identify a compelling reason why, in addition to the duty of skill and care vis-à-vis the trustees which the third parties have accepted, or which the law has imposed upon them, third parties should also owe a duty of care directly to the beneficiaries. They have undertaken work for the trustees. They must carry out that work properly. If they fail to do so, they will be liable to make good the loss suffered by the trustees in consequence. This will include, where appropriate, the loss suffered by the trustees being exposed to claims for breach of trust.
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> Outside this category of persons who owe duties of skill and care to the trustees, there are others who will deal with trustees. If they have not accepted, and the law has not imposed upon them, any such duties in

15. (1843) 67 ER 189.
16. [1995] UKPC 4.

favour of the trustees, it is difficult to discern a good reason why they should nonetheless owe such duties to the beneficiaries.

There remains to be considered the position where third parties are acting for, or dealing with, dishonest trustees. In such cases the trustees would have no claims against the third party. The trustees would suffer no loss by reason of the third party's failure to discover what was going on. The question is whether in this type of situation the third party owes a duty of care to the beneficiaries to, in effect, check that a trustee is not misbehaving. *The third party must act honestly*. The question is whether that is enough.

In agreement with the preponderant view, their Lordships consider that dishonesty is an essential ingredient here. There may be cases where, in the light of the particular facts, a third party will owe a duty of care to the beneficiaries. As a general proposition, however, beneficiaries cannot reasonably expect that all the world dealing with their trustees should owe them a duty to take care lest the trustees are behaving dishonestly. (emphasis added)

To the extent that persons facilitating the handling the proceeds of corruption themselves act dishonestly they are at risk of being held accountable at the hands of the beneficiaries.

The problem, then, is not one of identifying the entitlement of appropriately qualified persons to make a claim against the corrupt, but of ensuring that access to the courts is available in appropriate circumstances to challenge the misconduct involved.

This is no minor issue of interest only to pettifogging equity lawyers and accountants. According to *The Economist*,[17] missing funds in the Nigerian oil sector are over 10 times the size of the country's annual education budget, and about 15 times the size of the annual health budget. Missing funds from arms deals, although less, total 60 per cent of the missing oil money. On a military level, the 2014 near collapse of the Iraqi army has been attributed to corruption.[18]

Still less is it possible to pretend that these are problems for far-away countries, which should be resolved within the framework of their own legislative, administrative, and judicial institutions. The consequences of state failure in Africa and the Middle East are now painfully all too apparent in Europe given the refugee issue.

Corruption is a crime of the powerful. It is, in many ways, the ultimate breach of trust. And courts and legislators should be astute to ensure the availability of appropriate remedies.

To date, the world has focused on regulatory remedies, particularly in the form of anti-money-laundering controls. These have certainly had an effect on the availability of banking services through the so-called de-risking process. It is less clear what effect they have actually had in suppressing corruption. Such statistics as are available suggest returns which are derisory. Certainly, something more is called for.

That requires both remedies and access to finance to support those seeking the remedies. Class actions and litigation funding provide some of the answers: in addition, a statutory right to commence proceedings anywhere assets can be found, in return for a proportion of the recovery might be permitted. Precedents for such an approach can be found in the prize jurisdiction of Admiralty courts. And it should be remembered that the formal abolition of slavery in the (then) British Empire (other than India) effected by the Slavery Abolition Act 1833 was preceded by other, effective, measures regulating the participation of British ships in the trade (Slave Trade Act 1807) and regulating commercial engagement with persons engaged in slavery (Slave Trade Act 1824).

The sophisticated and effective remedies Equity affords victims of breaches of trust should not be overlooked by those charged with fashioning an appropriate legislative response to corruption.

17. The Economist, London. 12 May 2016.
18. DD Kirkpatrick, 'Graft Hobbles Iraq's Military in Fighting ISIS', *New York Times* (New York, 23 November 2014).