

Sham Trusts

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The classic description of the ‘sham’ doctrine is found in the following passage from Lord Diplock’s judgment in *Snook v London and West Riding Investments Ltd*:

But one thing, I think, is clear in legal principle, morality and the authorities ... that for acts or documents to be a “sham”, with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.¹

Although a contract law case, the *Snook* doctrine has long been applied to the law of trusts. The allegation that a trust is a sham is typically made when a settlor, desirous of avoiding the effects of an insolvency, a large tax bill or a division of assets on divorce, purports to divest himself of his assets by settling them upon trust. The trust declared is often a discretionary one where the settlor is named as a beneficiary and, in practice, he retains a great deal of control over the trust fund. Interested parties (usually creditors, the revenue authorities or the settlor’s spouse) may then allege that the declaration of trust is no more than a ‘sham’, the ‘truth of the matter’ being that the settlor never divested himself of the assets.

To give an example, take the Australian case of *Raftland Pty Ltd v Federal Commission of Taxation*² where three brothers controlled the ‘Raftland’ unit trust and had turned a substantial (and taxable) profit. They took steps to acquire another unit trust, the ‘E & M trust’, which had substantial tax losses. They resolved to make the E & M trust a beneficiary of the Raftland unit trust. It was found, however, that the brothers had no intention ever to distribute assets to the E & M trust. Their ‘real’ or ‘true’ intention was not to make E & M a beneficiary of the trust, but to offset the tax liabilities of E & M against the taxable profits of the Raftland trust. This was held to amount to a sham, with Kirby J stating:

The key to a finding of a sham is the demonstration, by evidence or available inference, of a disparity between the transaction evidenced in the

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¹[1967] 2 QB 786, 802, citing *Yorkshire Railway Wagon Co v Maclure* (1882) 21 ChD 309

Stoneleigh Finance Ltd v Phillips [1965] 2 QB 537.

² [2008] HCA 21.

documentation (and related conduct of the parties) and the reality disclosed elsewhere in the evidence. Where, for example, the evidence shows a discordance between the parties' legal rights or obligations as described in the documents and the actual intentions which those parties are shown to have had as to their legal rights and obligations, a conclusion of sham will be warranted.³

The *Raftland* case illustrates the difficulties in conceptualising this area of law: in what sense did the brothers 'not intend' to make E & M a beneficiary of the trust; is it the inner 'subjective' mental state that is important, or the intention expressed in communications; is the court effectively making the settlor's motives justiciable? These questions go to the very heart of the 'certainty of intention' requirement in trusts.

A. Two views on Sham Trusts

How are we to make sense of the decision in *Raftland*? Despite expressing a clear intention in declaring a trust in favour of the E & M unit trust, the court, applying the sham doctrine, held that there was no validly declared trust. Broadly speaking, there are two views on the operation of the sham doctrine.

First, some argue that sham is not, in itself, a distinct doctrine in the law of trusts. It is trite law that express trusts have a 'certainty of intention' requirement, meaning that a settlor must intend the creation of a trust over specific rights. In proving a sham, the argument goes, a litigant is doing no more than establishing that the certainty of intention requirement has not been met. Jessica Palmer, an advocate of this approach, argues:

[S]hams are arrangements whose appearances do not reflect the underlying actual intention or purpose of the relevant parties. In the trusts context, a trust will be a sham where the settlor did not actually intend to create a trust. The doctrine of sham trusts is hence an aspect of the law relating to certainty of intention required for a valid trust. Where the settlor did not intend to create a trust, no trust exists because the required certainty of intention is absent.⁴

³ [2008] HCA 21, [145].

⁴ J Palmer, 'Dealing with the Emerging Popularity of Sham Trusts' [2007] NZLR 81, 92. One of the authors of the present piece made a similar argument in the context of sham licenses granted by landlords wishing to avoid the protection afforded to the tenant by the grant of a lease. See B McFarlane and E Simpson, 'Tackling Avoidance', in J Getzler (ed) *Rationalising Equity and Trusts* (LLP, London 2003).

To apply this argument to *Raftland*, the court, in concluding that trust was a sham, was simply reaching the conclusion that there was no intention to declare a trust. In this sense, whilst sham may describe the motivation of the defendants in the case, it adds little to the legal analysis.

The second, and alternate, view holds that sham is a distinct doctrine, separate from the certainty of intention requirement. This was most clearly articulated in the New Zealand case of *Official Assignee v Wilson*.⁵ In rejecting Palmer's argument, Robertson and O'Reagan JJ stated:

The two situations (valid trust and sham trust) do not fall into combination. The finding that a purported trust is void as a sham does not amount to an invalidation of a trust. It is not the trust as such which is the sham. There is no trust to be a sham. It is the documentation that is the sham.⁶

The notion that the sham doctrine is distinct from the standard 'certainty of intention' requirement has been forcefully advocated by Matthew Conaglen. Conaglen has argued that the sham doctrine requires a litigant to establish different facts from those that are relevant to the standard 'certainty of intention' requirement. Specifically, when a sham is pleaded the court looks to material outside of the trust deed in order to ascertain the subjective intention of the settlor. This is distinct, the argument goes, from the normal 'certainty of intention' inquiry, where the court looks to the terms of the trust deed in order to ascertain the objective intention of the settlor. As Conaglen states:

[N]either the subsequent conduct of the parties, nor their subjective intentions, are considered when ascertaining what rights and obligations the parties intended to create by the trust documents which they signed. The importance of this in the context of the sham doctrine is that it is precisely these sorts of factors that *can* be considered in order to determine whether an arrangement is a sham.⁷

There are perhaps two ways in which the sham doctrine, so far as it exists, is distinct from the normal 'certainty of intention' requirement. The first, according to Conaglen, is that it is a subjective inquiry. The certainty of intention inquiry is normally considered an objective one, where a court attempts to ascertain what the settlor's words meant, not what he meant by them. If, by pleading sham, a litigant must establish the settlor's subjective state of mind – what he 'actually' meant – then the inquiry becomes a very different one. Second, the sham doctrine may be distinct

⁵ [2008] 3 NZLR 45.

⁶ [2008] 3 NZLR 45, 55.

⁷ M Conaglen, 'Sham Trusts' [2008] CLJ 176, 182. See also M Conaglen, 'Trusts and Intention' in E Simpson and M Stewart (eds) *Sham Transaction* (OUP, Oxford 2013).

at an evidential level, in the sense that it permits the court to consider a wider range of material in ascertaining the settlor's intention. Conaglen alludes to this idea in the above quote when he refers to the subsequent conduct of the parties, evidence which is often excluded by the parol evidence rule in normal 'certainty of intention' inquiry.

If Conaglen is correct, and sham is a distinct doctrine, separate from the certainty of intention requirement, then this may have important consequences for how it is pleaded by litigants. For one, it may have a bearing on the burden of proof. A party alleging the existence of a trust bears the burden of establishing the settlor's intention. However, if sham is a separate doctrine which requires a litigant to establish a separate fact (namely the negative fact that no trust was intended), then it would appear that the burden should shift to the party denying the existence of a trust. Second, it may have implications for the remedies available. If sham is no more than a failure to establish certainty of intention, then no trust ever comes into existence, and proprietary rights under a trust are never created. If sham is separate, however, then the position may be more complicated. It may be that a trust does come into existence, but the sham makes it void or voidable. What then happens to rights purportedly created under the trust? Finally, and most importantly, the status of sham determines what a litigant must prove in order to establish his case. If sham is a separate doctrine, then it follows that a litigant must establish a different set of facts to those which are relevant to the 'certainty of intention' requirement (otherwise sham and 'certainty of intention' become conceptually indistinguishable). If sham is a separate doctrine then what are these separate facts?

This article will ask whether Conaglen is correct to argue that sham is a distinct doctrine, separate from the 'certainty of intention' requirement. We will consider the two purported features of the doctrine – that it is a subjective inquiry and that it permits the admission of parol evidence – in turn. We will also consider a final conceptualisation of the doctrine, which is that it is a specialised form of 'rectification'.

In conducting this analysis we will argue that Conaglen is wrong to suggest that sham is separate from the normal 'certainty of intention' doctrine. We accept that the normal 'certainty of intention' inquiry is an objective one that depends on the communicated mental state of the settlor. However, we will argue that when a sham has been pleaded in the decided cases, the courts have not, as Conaglen suggests, switched to a subjective inquiry. Rather, we will show that courts' attitude in sham cases continues to be an objective one.

B. Sham as a Subjective Inquiry

The principal claim made by Conaglen is that sham is distinct from the ‘certainty of intention’ requirement because the former, unlike the latter, involves a subjective inquiry. As he argues:

... the certainty of intention principle generally focuses on the negative fact that the court has been unable to identify a clear objective intention to create a trust, whereas sham doctrine focuses on the positive finding that the parties involved subjectively *did not* intend to create a trust such as that recorded in the sham documents.⁸

This argument has found support in the case law. In *Raftland*, for instance, we find several references to a search for the ‘real’ or ‘actual’ intention of the settlor, and Kirby J, when describing the sham doctrine, states:

The test as to the parties’ intentions is subjective. In essence, the parties must have intended to create rights and obligations different from those described in their documents.⁹

In *Official Assignee v Wilson* Glazebrook J expressly endorsed Conaglen’s views:

In my view, where a sham is alleged, the search is for the subjective intent that the transaction is a sham. After all, the whole point of a sham is that it is intended to have an effect other than the effect it would have if looked at objectively.¹⁰

In order to test this conceptualisation of the sham doctrine, two things must be established. The first is that the normal ‘certainty of intention’ requirement does, as asserted in these quotes, involve an *objective* inquiry into the settlor’s mental state. Second, that when a sham is pleaded, the court switches to a *subjective* inquiry.

1. Do courts construe declarations objectively?

The first question that must be asked is whether Conaglen is correct to say that the normal approach to ascertaining a settlor’s intention is an objective one. Before answering the question it is first necessary to explain what ‘objectivity’ means in the trusts context. Most attempts to define objectivity draw some distinction between the

⁸ [2008] CLJ 176, 184.

⁹ [2008] HCA 21, [146].

¹⁰ [2008] 3 NZLR 45, 64.

meaning attached to a statement by the speaker, and the meaning conveyed to the addressee, or a reasonable person in the addressee's position.¹¹ The facts of *Byrnes v Kendle*¹² provide an illustration. The defendant in the case, using both his own and his then wife's savings, had acquired freehold title to a house. He then executed a trust deed, which stated, amongst other things, that he held the title 'on trust' for the benefit of himself and his then wife. Following his separation from his wife, and her assigning her interest to her son (the claimant), a dispute arose as to the payment of rent, as the defendant had permitted his own son to live at the premises rent free. If there was a trust of the freehold, with the claimant holding a beneficial interest, then it was clear that he was entitled to the receipt of rent. The defendant attempted to introduce evidence that he believed, in executing the deed, that he was merely undertaking to share the sale value of the land should he ever sell it in the future, and hence no trust was ever created. The dispute in the case, therefore, was whether the 'certainty of intention' requirement for the establishment of a trust had been satisfied. The case illustrates how objective and subjective inquiries can point in different directions. A subjective approach— what did Mr Kendle mean by his words 'on trust'? – would result in there being no trust as Mr Kendle meant no more than a promise to split the proceeds of sale in the future. An objective approach – what would the reasonable addressee understand the words 'on trust' to mean? – would result in a trust, those words clearly conveying an intention to settle the title in this way.

The High Court of Australia decided that the latter inquiry, the objective one, was appropriate in the trusts context, Heydon and Crennan JJ stating:

... the "intention" referred to is an intention to be extracted from the words used, not a subjective intention which may have existed but which cannot be extracted from those words. This is as true of unilateral declarations of alleged trust as it is of bilateral covenants to create an alleged trust.¹³

Whilst this appears to make the position in Australian law clear, the issue is a controverted one. The High Court was strongly influenced by the position in contract law, where it is well established that a court should objectively construe the terms of a contract.¹⁴ Yet some may be reluctant to push the analogy with contract too far. Trusts, it must be noted, are often unilateral, in the sense that their creation depends entirely on the settlor's exercise of his power to create a trust. The resulting focus on the settlor's intention, to the exclusion of any other party such as the trustee or beneficiary, may lead some to favour a subjective approach. This tendency may be

¹¹ J Spencer, 'Signature, Consent and the Rule in *L'Estrange v Graucob*' [1973] CLJ 103, 106. For discussion of the extent of the objective theory on contract law, and whether there is any room for a subjective inquiry, see D McLauchlan, 'Objectivity in Contract' (2005) 24 UQLJ 479, 484 and 'The Contract the Neither Party Intends' (2012) 29 JCL 26

¹² [2011] HCA 26, [114].

¹³ *ibid* [114].

¹⁴ See generally D McLauchlan, 'Objectivity in Contract' (2005) 24 University of Queensland Law Journal 479.

particularly strong where the settlor is acting gratuitously: if Mr Kendle, for instance, was under no obligation to divest himself of the value of his title, then why should he be bound by a construction that he never intended? There is an obvious temptation to favour a subjective approach in the context of trusts law. This is perhaps encouraged, as Heydon and Crennan JJ note, by the ‘... constant repetition of the need to search for an “intention to create a trust”...’.¹⁵ Indeed, the conclusions of the High Court are undermined somewhat by the suggestion that Mr Kendle should be able to plead ‘rectification’ so as to bring the declaration of trust into line with his subjective state of mind.¹⁶ This potential contradiction is considered further in the final part of this paper.

There is some evidence of a subjective approach to interpretation in trusts law. The best example is the problematic Australian case of *Commissioner of Stamp Duties (QD) v Jolliffe*.¹⁷ Under a statute it was illegal for an account holder to hold a second account at a bank, except where the second account is held on trust for another. The defendant, already holding an account, deposited money in a second account and made a declaration to the bank that he held it on trust for his sisters. The defendant subsequently denied the existence of a trust. His argument succeeded as the court permitted him to introduce evidence that, notwithstanding his declaration of trust, his real intention was to retain title to the fund and earn interest on it. As this intention was never disclosed (until the legal proceedings), it could only be ascertained by conducting a subjective inquiry into the defendant’s mental state; an objective inquiry – what meaning did the defendant convey to a reasonable person in the position of the bank? – would yield nothing other than an intention to create a trust as that is all that was communicated.

It is sometimes asked whether *Jolliffe*, which has now been overruled in Australia by *Byrnes v Kendle*, ever represented the legal position in England. *Lewin on Trusts*,¹⁸ in citing the case in successive editions, appeared to support the view that *Jolliffe* is correct in English law, and one can certainly find some support for it in the old case law. In the nineteenth century case of *Field v Lonsdale*¹⁹, which involved facts almost identical to those found in *Jolliffe*, the Master of the Rolls, Lord Langdale, refused to give effect to the obvious (objective) meaning of the defendant’s declaration of trust over the second bank account:

... the only intention was to evade the provisions of the Act of Parliament [prohibiting a second account], and not to create a trust. The declaration is, therefore, ineffectual, and the claim must be dismissed.²⁰

¹⁵ *ibid.*

¹⁶ *ibid* 115.

¹⁷ (1920) 28 CLR 178.

¹⁸ *Jolliffe* is cited in the 11th to 16th edition of *Lewin*.

¹⁹ (1850) 13 Beavan 78, 51 ER 30.

²⁰ (1850) 13 Beavan 78, 81; 51 ER 30, 31.

Yet *Joliffe*, and similar cases like *Field v Lonsdale*, despite never being expressly rejected in the English courts, are clearly inconsistent with principles developed in relation to the certainty of intention requirement. Specifically, the cases do not square with the traditional exclusion of evidence of an undisclosed or secret intention. It is not mental states per se which constitute trusts, but the communication of them. Indeed, this was pointed out in *Joliffe* in the strong dissenting judgment of Isaacs J:

It is just as improper morally to permit a man who has openly undertaken such a trust to escape his conscientious obligation by reason merely of a secret mental reservation not to fulfil what he has openly undertaken. An open declaration of trust is therefore an expression of intention that is final and beyond recall.²¹

Trusts may be unilateral, in the sense of depending solely on the settlor's decision to exercise his power to create a trust, but they also impose duties on some and create rights for others. The consequences of the creation of a trust for persons other than the settlor make it entirely reasonable for the law to insist on some act of communication. This is evident from the need for a 'declaration' in order to establish an express trust.²² To 'declare' a trust a settlor must 'manifest'²³, or communicate, his intention to another. This was emphasised by French CJ in *Byrnes v Kendle* where he said: '... the relevant intention in such a case is that manifested by a declaration of trust.'²⁴ Secret intentions do not pass this threshold and, hence, are irrelevant to the question of whether or not a trust has been constituted. As Megarry J said in *Re Vandervell*, 'To yearn is not to transfer.'²⁵

What we have established so far is that a basic requirement for the creation of an express trust is the communication of intention by the settlor. We may now ask how these acts of communication are interpreted by the courts: do courts attempt to ascertain what the settlor meant by his words, or do they ask what a reasonable person would understand those words to mean? Whilst the law of trusts does not have the same body of case law on this issue as that found in contract law, there is more than enough evidence to show that the courts ask the latter question, i.e. the inquiry is an objective one.

²¹ (1920) 28 CLR 178, 187.

²² The classic statement of the need for a declaration is found in Lord Nottingham's judgment in *Cook v Fountain* where he said: '[E]xpress trusts are declared either by word or writing; and these declarations appear either by direct or manifest proof, or violent and necessary presumption' - (1676) 3 Swan 585, 591; 36 ER 984, 987.

²³ Mowbray et al (eds), *Lewin on Trusts* (18thed, Sweet & Maxwell, London 2008) 4-01. The need for a 'declaration' does not require the settlor to use, orally or in writing, the specific words 'I declare ...'. For instance, in *Paul v Constance* [1977] 1 WLR 527, the settlor was held to have constituted a trust over a sum of money merely by saying that the money 'is as much yours as mine'.

²⁴ (2011) 243 CLR 253, 263.

²⁵ *Re Vandervell* (No 2) [1974] 1 Ch 269, 294.

Perhaps the leading case on this issue is the House of Lords decision in *Commissioners of Inland Revenue v Raphael*.²⁶ A testator had left money to his son on the condition that the son settle it on a trust with specific terms. The son attempted to follow his father's instructions. However, the wording he used when settling the trust was clearly incompatible with the conditions set out in the will and, consequently, the gift failed. The son attempted to save the gift by arguing that the terms of the trust that he had settled should be interpreted subjectively, so that the words carried the meaning he had hoped for, namely a meaning consistent with the conditions set out in the will. Rejecting the argument, Lord Wright said: 'It must be remembered at the outset that the court, while it seeks to give effect to the intention of the parties, must give effect to that as expressed, that is, it must ascertain the meaning of the words actually used.'²⁷ What the son desired the words to mean, therefore, was wholly irrelevant.

2. Who is the reasonable addressee?

Although these cases may make the objective approach secure in English law, we must still consider the specific form of objectivity that is applied. We have seen that an objective approach inquires into what meaning was reasonably conveyed by the settlor's words. The difficulty in asking this question, however, is that a settlor's words can reasonably convey different meanings to different persons. Take the nineteenth century charitable trust case of *Shore v Wilson*²⁸ where a testatrix left a sum of money on trust for 'poor and Godly preachers of Christ's holy gospel.' To a detached observer, who shares the testatrix's language, but little else, the words can reasonably be understood to mean that any person of the Christian faith is a potential beneficiary. However, to the persons to whom the will was addressed (the trustees), who were aware that the testatrix was a strict Calvinist, the words could reasonably be understood to refer to a much narrower group of people, namely those belonging to the non-conformist group. Tindal CJ, in a much cited speech, said that evidence could be introduced to show that '... besides their general common meaning, [the words] have acquired, by custom or otherwise, a well-known peculiar idiomatic meaning ... in the particular society of which [the testatrix was] former a member ...'²⁹ For Tindal CJ, the important question is what meaning was conveyed to a reasonable person in the position of the trustees.

Declarations of trust are acts of communication that, if successful in creating a trust, must instantiate a legal relationship between the settlor, trustee (if a different person) and beneficiary. Let us say that a purported settlor, alone in his living room, says 'I declare myself trustee ...'. Aside from the difficulties of proving this, it is

²⁶ [1935] AC 96. See also *Twinsectra Ltd v Yardley* [2002] 2 AC 164, [71].

²⁷ [1935] AC 96, 142.

²⁸ (1842) 9 Cl & Finn 355, 8 ER 450.

²⁹ (1842) 9 Cl & Finn 355, 567; 8 ER 450, 533.

unlikely, as a matter of law, that this can constitute a trust. The settlor's intention must, at some point, be communicated to the relevant parties, namely the trustee and beneficiary. As declarations of trust are acts of communication addressed to specific persons, then it logically follows that the court, when interpreting the declaration, should ask what meaning is conveyed to the addressee (i.e. the trustee or beneficiary). This is sometimes referred to as 'promisee objectivity', or 'addressee objectivity'.³⁰ The difficulty that can arise is that a settlor may have different addressees in mind when he makes a declaration. His words could be directed towards the putative trustee or beneficiary; or he may have some third party, such as the court, his creditors, or the revenue authorities, at the front of his mind when he makes a declaration of trust. Given that a settlor's words can convey different meanings to different persons, which perspective does the court adopt for the purposes of construction?

It is not clear if this question has been explicitly addressed in the trusts context.³¹ Some guidance may be found in the doctrine of secret trusts. Such trusts arise where a testator is desirous of settling some of his estate on trust for a particular beneficiary on his death, but does not wish to disclose this in his will.³² Instead, the testator purports to make a gift in his will to a donee, but privately communicates to the donee that he is to take it upon trust for the beneficiary. To a detached observer, who sees nothing but the will, the transaction has the desired effect of looking like an outright gift to the donee; but to the donee, who is privy to other private communications, a very different meaning is communicated. Secret trusts are similar to sham trusts, in the sense that the settlor deliberately conveys different message to different persons. What courts have long held in the context of secret trusts is that it is the testator's intention as conveyed to the donee that counts, not the impression given to the detached observer who just sees the will. Sham trusts, as we will see, follow this pattern. When a sham is pleaded, courts consider what meaning is conveyed by the settlor to the putative trustee or beneficiary, not a detached observer.

3. Are 'sham trusts' construed subjectively?

The first premise of Conaglen's argument, that courts adopt an objective approach when construing a declaration of trust, is correct. We must now ask whether the sham

³⁰ W Howarth, 'The Meaning of Objectivity in Contract' (1984) 100 LQR 265, 267.

³¹ In contract law it is clear that the court asks what meaning was reasonably conveyed to the other party to the contract, rather than some third party. An example is *Hartog v Colin Shields* [1939] 3 All ER 566 where the defendant was aware that the claimant had made a mistake in offering the defendant a number of hare skins at a certain price 'per lb', when all of the preceding negotiation had been conducted in terms of price 'per skin'. To a reasonable person in the position of the purchaser, who is aware of previous communications and the market practice, it would be obvious what the vendor intended.

³² e.g. *McCormick v Grogan* (1869) LR 4 HL 82.

doctrine operates differently by conducting a subjective inquiry. The evidence for this, as we will see, is rather thin.

Let us begin by considering cases where the sham allegation has succeeded, leading to the conclusion that there is no trust. In *Raftland Pty Ltd v Federal Commission of Taxation*, a case discussed at the beginning of this chapter, three brothers who owned the Raftland unit trust executed a trust deed which declared that another unit trust, the E & M trust, was a beneficiary under the Raftland trust. However, the owners of the E & M trust, who were paid some \$250k by the three brothers, were led to the clear understanding that they would receive no further payments as beneficiaries once the trust had been declared. The parties had a clear agreement, therefore, that, notwithstanding the declaration of trust, the E & M trust was not entitled to a beneficial interest in the Raftland trust. In holding the declaration of trust to be a sham, the court was of the view that it was giving effect to the subjective intention of the parties. This view seems to be based on the idea that the ‘objective intention’ was encoded in the written declaration of trust and, and, in looking at the ‘reality’ behind the declaration, the court’s approach had become a subjective one. As Kirby J said: ‘In other words, where it is legally warranted, sham analysis affords the court a ground for ignoring, instead of merely construing, the primary documentary material in determining the rights and obligations of the parties.’³³

In ignoring the written declaration of trust, was the court giving effect to the subjective intention of the parties? We would suggest that it was not. It is important to recall that when it conducts an objective inquiry the court does not adopt a detached perspective, and ask what the settlor’s words mean to a distant observer. Rather, it puts itself in the position of the person to whom the words were addressed, which, in the case of *Raftland*, would be the purported beneficiary, the E & M unit trust. The crucial point is that the owners of the E & M unit trust were privy to two separate communications: first, the written declaration of trust, which conveys a clear intention to make the E & M unit trust a beneficiary; second, private oral statements that conveyed precisely the opposite intention, that the ‘declaration’ was to have no legal effect and they would not be beneficiaries. A person in the position of the E & M unit trust would reasonably understand that three brothers had no intention to make the E & M unit trust a beneficiary under the Raftland trust. The outcome in the case is perfectly explicable under normal principles of objective construction.

A similar case where the sham allegation succeeded is that of *Midland Bank v Wyatt*³⁴ where the defendant, worried about his business failing, purported to declare title to his land upon trust for his wife and his daughter. His wife signed the declaration, after which the defendant put the document in his safe, and continued to

³³ [2008] HCA 21, [143].

³⁴ [1997] 1 BCLC 242. See also *A v A* [2007] EWHC 99; *Minwalla v Minwalla* [2004] EWHC 2823; *Painter v Hutchison* [2007] EWHC 758.

deal with the freehold title. The court held that the declaration was a sham. Crucial to this finding was the wife's evidence that when she signed the declaration she had no idea what she was putting her name to, and was not aware of the 'import or effect' of the document.³⁵ Whilst an intent to declare a trust may be readily inferred by a third party who merely reads the trust deed, the defendant had deliberately ensured that no such intention was communicated to his wife, the purported beneficiary. As the court stated, the wife knew 'nothing about' the trust.³⁶ An objective approach, which asks what meaning was conveyed to the defendant's wife, yields nothing, as there was no communication of the intention to create a trust. It was this lack of communication, not the defendant's subjective mental state, that led the court to conclude that there was a sham.

The strongest evidence that courts do not switch to a subjective approach when sham is pleaded can be found in cases where the allegation has not been proved. The leading English case is *Shalson v Russo*³⁷ where the defendant, who was the sole beneficiary of a trust worth approximately £39m, instructed the trust company to resettlement the trust fund on a discretionary trust for the defendant and his family. The claimant argued that this was a sham, as the defendant was implicated in a number of fraudulent schemes and had resettled the trust so as to protect himself from potential claims. Rimer J held that even though the defendant may not have had the intention to divest himself of his equitable interest, he never disclosed this to the trustee and, hence, it was something that the law could not take cognisance of. Rimer J said:

The settlor may have an unspoken intention that the assets are in fact to be treated as his own and that the trustee will accede to his every request on demand. But unless that intention is from the outset shared by the trustee (or later becomes shared), I fail to see how the settlement can be regarded as a sham.³⁸

So far as the defendant in the case had an intention to retain his assets under the trust, this was never communicated to the trustee or any other party and, hence, could only be disclosed by a subjective inquiry. Consequently, the allegation that the trust was a sham failed.

The irrelevance of uncommunicated mental states is further supported by the case of *In re Esteem's Settlement*.³⁹ The defendant, a former director of the claimant company, had defrauded the company of several million dollars and had settled part of this sum on a trust. As in *Shalson v Russo*, it was strongly suspected that the defendant had no intention of parting with his ownership of the money, but this was

³⁵ *ibid* 252.

³⁶ *ibid* 252.

³⁷ [2005] Ch 281.

³⁸ [2005] Ch 281, 342.

³⁹ [2003] JLR 188.

not communicated to the trustee, who had been instructed to hold the trust funds in the normal way. Again, the court held that an uncommunicated intention, which can only be disclosed by a subjective inquiry, could have no legal effect. Birt DB gave the following example of the absurd results that would follow if secret mental states could determine the rights created:

Let us suppose a case in which A executes a formal deed of gift of his car to B but, unknown to B, secretly intends that he should really only lend the car to B so that he retains the beneficial interest in the car. The car is delivered to B who then treats it as his own for many years. A continues to say nothing of his secret intention.⁴⁰

Just as it would be wrong for A to insist that the car remained his in this example, the defendant's secret intention in *re Esteem* to retain his assets could not prevent the creation of a trust. Most would agree with this as a statement of principle, and the example illustrates why courts should not start to conduct subjective inquiries merely because a litigant has pleaded sham in a particular case.

Critics of this approach may attempt to explain the outcome in these cases on different grounds. Palmer, for instance, tries to explain the inability of a settlor to lead evidence of an uncommunicated intention to retain assets on the basis of an estoppel:

... the trustee may rely on estoppel principles to prevent the settlor from acting unconscionably because he or she has led the trustee to believe that the trust was valid and genuine and cannot therefore rely on its invalidity against the trustee.⁴¹

Palmer's point is that the settlor, having deliberately given the impression of an intention to create a trust, cannot then lead evidence of an entirely different mental state. However, whilst estoppel may explain why the settlor is precluded from pleading evidence of an uncommunicated intention to sham, it would not explain why a third party, such as the creditors in *Shalson v Russo* and *In re Esteem's Settlement*, were prevented from doing so. The only explanation for this is that uncommunicated mental states are fundamentally irrelevant given that intention is assessed objectively.

A second explanation for the outcome in these cases, advocated by Conaglen, is that allegations of sham require a litigant to show that the 'shamming intention' was common to both the settlor and trustee. The requirement for a common intention is mentioned in the classic *Snook* definition, where, it will be recalled, Lord Diplock said:

⁴⁰ [2003] JLR 188, 216.

⁴¹ Palmer, 'Dealing with the Emerging Popularity of Sham Trusts' [2007] NZ Law Rev 81, 104.

... all the parties thereto must have a *common intention* that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating ...⁴²

For Conaglen, the outcome in *Shalson v Russo* and *In re Esteem's Settlement* makes sense as the requirement that '... *all parties* to the sham must have ... an intention to mislead ...'⁴³ was not met in either case.

The view that there must be a 'common intention' to sham has support in the case law. In *A v A*, for instance, Munby J said:

... a trust will not be a sham – in my judgment cannot as a matter of law be a sham – if *either* (i) the original trustee(s), *or* (ii) the current trustee(s), were not, because they lacked the relevant knowledge and intention, party to the sham at the time of their appointment.⁴⁴

Conaglen, we would suggest, is correct to say that an allegation of sham will not be made out unless it can be shown that the settlor and trustee have a 'common intention' to sham. Yet, it is our view that this does not support Conaglen's overall thesis that the sham inquiry is a subjective one. Rather, the need to show a common intention supports precisely the opposite view, namely that the court is conducting an objective inquiry. The reason for this is that a 'shamming intent' can only be common to both the settlor and trustee if the former has *communicated* it to the latter. In the absence of a common intention, where the settlor has not disclosed his wish to retain his assets to the trustee, an allegation of sham will fail because it would hang entirely upon the settlor's subjective state of mind.

To conclude this section, just because a court is looking behind the written declaration of trust does not mean that it is adopting a subjective approach. As we have seen, the objective approach employed in trusts law requires the court to ask what the settlor's words meant *to a reasonable person in the position of the addressee*. Such a person in sham cases (usually the trustee, but sometimes a beneficiary) is privy not just to the 'declaration of trust', but to other communications which inform the 'trustee' of the settlor's desire to keep hold of his assets. To ask – what would a reasonable person in the position of the 'trustee' have understood the settlor to mean? – therefore, naturally forces the court to 'look behind' the declaration of trust as the trustee was privy to other communications.

C. Sham as a Rule of Evidence

⁴² *Snook* (n 1) (emphasis added).

⁴³ Conaglen, 'Sham Trusts' (n 7) 188 (emphasis added).

⁴⁴[2007] EWHC 99, [49].

So far we have seen that the sham doctrine is indistinguishable from the standard ‘certainty of intention’ requirement in the sense that both involve an objective inquiry into the settlor’s mental state. We will now ask whether sham is distinctive in a different sense, namely as an evidential rule. Specifically, we will ask whether the sham doctrine consists of an exception to the rule that parol evidence is normally excluded when a settlor has executed a declaration of trust. In the *Raftland* case there are several statements that suggest that this is what the ‘sham doctrine’ permits a court to do. Kirby J noted that under the ordinary ‘certainty of intention’ requirement, ‘... courts will ordinarily give legal effect to documents according to their language, [but] sham analysis is an exception to that conventional approach.’⁴⁵ The suggestion here is that when sham is pleaded the court is permitted to look behind the written declaration, something which it is not normally able to do, when ascertaining the intention of the parties. So whilst the inquiry may remain, fundamentally, an objective one, sham permits the court to consider a wider range of material when ascertaining the intention of the settlor.

The strongest suggestion that this is the role of the ‘sham doctrine’ comes from the Canadian case of *Antle v R*.⁴⁶ The husband in the case, in an attempt to avoid capital gains tax, purported to transfer his shares in a company to a trustee on trust for his wife; his wife then purported to sell the shares and make a loan of the proceeds back to her husband. Whilst written documents were executed recording each stage of the ‘transaction’, in fact the shares were never transferred to a trustee, and no money was ever paid to the husband. The husband, citing the parol evidence rule, attempted to argue that the court was only able to consider the written documentation, and was not permitted to look at other factors, when construing his intention. In rejecting the argument, the court was in effect rejecting the application of the parol evidence rule to the case, with Noel JA stating:

It would be a surprising result if courts were bound by the formal expression of the parties and could not look to the surrounding circumstances, including the conduct of the parties, in ascertaining whether the intent to settle a trust is present.⁴⁷

In looking behind the declaration of trust at other factors, the court came to the view that there was a clear sham and no trust had been validly declared. What this suggests is that the ‘sham doctrine’ may be understood as an exception to the rule that courts are usually prohibited from looking at parol evidence where parties have committed their declaration of trust to a written document.

⁴⁵[2008] HCA 21, [144].

⁴⁶ [2010] FCA 280.

⁴⁷ [2010] FCA 280, [11].

In order to test this version of the ‘sham doctrine’ we must first say something about the parol evidence rule and the significance of a settlor committing his intention to declare a trust to writing.⁴⁸ Whilst there is no legal requirement for a settlor to do this, should he decide to, then the normal inference to be drawn is that the settlor has intended the trust to be constituted according to the terms expressed in the writing. This is best illustrated by the leading case on parol evidence in the context of trusts, *Rabin v Gerson*,⁴⁹ where the claimant, after seeking an opinion from counsel, expressed the wish to advance money to a Jewish educational association upon a charitable trust. However, the trust deed subsequently drafted by the counsel and executed by the claimant did not properly reflect this, and the words used in the deed were held to mean that there was an absolute transfer to the association. The claimant wished to introduce into court the opinion that they had received from counsel in order to demonstrate that their intention had been to transfer the money upon trust. Rejecting the argument, Fox LJ said: ‘Such evidence, I think, is simply parol evidence of the intention of the grantor ... The result, in my view, is that the opinions cannot be referred to generally for the assistance that their contents may give.’⁵⁰ It is worth pausing to consider this. Given that the claimant, prior to the execution of the deed, may well have expressed an intention to transfer funds on trust rather than absolutely, and given that the counsel’s opinion may be evidence of this, why would the court exclude it when it conducts the certainty of intention inquiry? The trust deed was not a formal requirement, in that there was no need to execute it in order to constitute the trust. Why then, in searching for the settlor’s intention, are we not permitted to consider, in addition to the trust deed, prior communications or statements that shed light on the settlor’s intention? The answer to this is that the claimant, in executing the trust deed, clearly intended the transfer to take effect on the terms *contained in the deed*. This is what Fox LJ alluded to when he described the opinion as ‘parol evidence’.

Although a trust deed may not be a formal requirement in most cases, when a settlor executes one, the normal inference is that the settlor intends to be bound by the terms of the deed and, consequently, previous expressions of intention are substituted by the written terms. We would not be giving effect to the settlor’s intention, therefore, if we were to look behind the trust deed to other communications.⁵¹ By contrast, where a settlor has not intended the trust to take effect on the terms contained in the trust deed, then there is logically no reason why extrinsic evidence of other communications cannot be admitted in order to ascertain his intention.⁵² This was made clear in *Hawke v Edwards*⁵³ where Jordan J, discussing the parol evidence

⁴⁸ R Stevens, ‘Objectivity, Mistake and the Parol Evidence Rule’ in E Peel and A Burrows (eds), *Contract Terms* (OUP, Oxford 2007).

⁴⁹ [1986] 1 WLR 526.

⁵⁰ [1986] 1 WLR 526, 531.

⁵¹ Stevens (n 48) 107.

⁵² *Walker Property Investments v Walker* (1947) 177 LT 204.

⁵³ *Hawke v Edwards* (1947) 48 SR (NSW) 21.

rule in the context of contract law, made clear that it has no application to cases outside of its logic:

When two persons enter a contract, they may constitute it in writing ... or they may, in the course of entering into the contract which is not constituted by writing, bring into existence writing which relates to it but is not intended by them to constitute it. In the latter type of case, although the writing, if relevant, may be given in evidence, its existence does not preclude the reception of oral evidence of the terms of the contract ... To make [the parol evidence] rule of exclusion operative, it is necessary that it should be intended by the parties that the written document should be a complete record of their bargain.⁵⁴

Under this conception of the parol evidence rule, the rule is not a technical one of evidence, but is just a way of giving effect to the intention of the parties. As such, there is a logically prior question of whether the document is genuinely intended to be the sole source of obligations. Where parties have intended their transaction to take effect according to the written terms, then a court would be ignoring their intention if it were to look behind the document at other facts. However, where the parties have not so intended, there is no reason why the court is not permitted, in attempting to ascertain the relevant intention, to look at evidence other than the document.

This conceptualisation of the ‘parol evidence’ rule explains why it can have no application in cases where a sham is alleged. The essence of the sham allegation is precisely that the settlor *did not intend* to be bound by the terms of the trust deed that he executed. In *Antle v R*,⁵⁵ although the settlor wished to give the impression of settling a trust, his intention, objectively assessed, clearly showed that he did not wish to arrange his affairs according to the written declaration. The parol evidence rule can have no application to the facts of the case because it is outside of the logic of the rule. Sham is not, therefore, an exception to the parol evidence rule, but simply a case where the rule can have no application.

D. Sham as a form of rectification

The final question we will ask is whether sham can be explained on the same basis as the doctrine of rectification. Just as ‘sham trusts’ are said to be an exception to the basic principles for ascertaining the settlor’s intention to create a trust, so too is the doctrine of rectification. An interesting question, that may shed some light on both

⁵⁴ibid 22.

⁵⁵ [2010] FCA 280 (Canada).

doctrines, is whether the facts of a sham case could be pleaded as a claim for rectification.

In *Allnutt v Wilding* Mummery LJ explained that the process of rectifying a trust deed ‘... involves bringing the trust document into line with the true intentions of the settlor as held by him at the date when he executed the document.’⁵⁶ The remedy is available, he continued, when ‘... owing to a mistake in the drafting of the document, it fails to record the settlor’s true intentions.’ To give an example, take the case of *Re Farepak Food and Gifts Ltd*⁵⁷ where a company, about to go bankrupt, told its solicitor that it desired to protect customers paying funds into their customer account by declaring a trust over the account. However, when the trust deed was drafted by the solicitor, the wrong account number, which referred to an empty account, was recorded. This mistake in the recording of the settlor’s intention needed to be remedied by rectifying the document so as to make it reflect the settlor’s prior communication.

The conceptual similarity between rectification and sham becomes clear when one sees that rectification is commonly thought of as a subjective process. The objective approach to interpretation of a settlor’s mental state can lead to results that are sometimes seen as unfair. Take *Byrnes v Kendle*, where the defendant, in declaring his freehold title on trust, argued that he meant no more than a promise to share the proceeds of the sale of the land should he ever sell it. Given that the transaction was purely voluntary, it may seem unfair to hold him to the effect of his words if that effect was never desired by him. Perhaps to mitigate the asperity of this objective approach, it was suggested that a rectification claim could be brought, so as to bring the deed into line with Mr Kendle’s subjective intentions.⁵⁸ The clearest endorsement of this view of rectification comes from the recent case of *Day v Day*.⁵⁹ A mother, who had a freehold title to land, instructed a solicitor to draft a deed which would make her son, the defendant, a joint tenant of the legal estate. The solicitor, probably acting under the influence of the defendant, went beyond these instructions and also included a declaration of trust in the deed, with the son as a beneficiary. The court rectified the deed, with the reference to the trust in favour of the son being expunged, and being replaced with a trust for the benefit of the mother. Etherton LJ said:

What is relevant in such a case is the subjective intention of the settlor. It is not a legal requirement for rectification of a voluntary settlement that there be an outward expression or objective communication of the settlor’s intention
...⁶⁰

⁵⁶ [2007] EWCA Civ 412, [11].

⁵⁷ [2006] EWHC 3272, [2008] BCC 22.

⁵⁸ *Byrnes v Kendle*[2011] HCA 26.

⁵⁹ [2014] Ch 114.

⁶⁰ [2014] Ch 114, 122.

This view has also found favour amongst some academics. Paul Davies, for instance, writes: ‘It is entirely appropriate that rectification should operate as a *subjective* ‘safety-valve’ from the objectivity of the common law rules of interpretation. This is how equity can *complement* the common law.’⁶¹

This ‘subjective’ view of rectification shares an obvious similarity with the ‘sham trust’ cases: in both cases the settlor has said one thing but has meant another. Take the case of *Joliffe* where, it will be recalled, the settlor declared a trust over a second bank account in favour of his sister. He successfully argued that his real (uncommunicated) intention was to retain his rights in the account absolutely, and the declaration was no more than a ploy to avoid a rule against holding more than one account at the bank. The facts in the case are an example of a divergence between what was said and what was meant. If rectification has the purpose of bringing written documents into line with the settlor’s subjective state of mind, could Mr Joliffe have structured his claim as one for rectification?

One objection to such a move would be to focus on Mr Joliffe’s motive in misstating his intention. In the normal rectification case the difference between the expressed meaning and the subjective state of mind of the settlor is the result of a mistake, as the settlor chooses the wrong words to encode his thoughts. By contrast, in *Joliffe* the difference between what was said and what was meant was entirely deliberate, as Mr Joliffe’s purpose was to deceive third parties. Should this make a difference? This depends on who brings the claim for rectification. If it was Mr Joliffe who argued that his written declaration should be brought into line with his secret ‘real’ intention, then a bar to rectification may come into play. Mr Joliffe, in attempting to give the impression to third parties of a trust, but promising himself that he retained the fund, was trying to have his cake and eat it, and the courts would rightly be reluctant to assist him in so doing. However, if it is a third party who brings the rectification claim, should it make a difference that it is a case of deception rather than mistake? We would suggest that it should not. Let us say that it is the revenue, for instance, who is arguing that Mr Joliffe’s trust deed should be rectified (and hence that he should be taxed on the basis that he owns the account absolutely). Could Mr Joliffe object to this claim for rectification by saying, ‘Aha, the misleading impression I gave in the trust deed was not the result of mistake, but was deliberate!’. Such an objection would make little sense. Indeed, a deliberate misstating of intention should ground a stronger case for rectification than a mistaken one.

This discussion of *Joliffe* is entirely hypothetical as the claim was not pleaded as one for rectification. However, if the purpose of rectification is to bring the written declaration into line with the settlor’s ‘real’ intention, then we can see no reason why a rectification claim would not succeed on the facts of *Joliffe*. This is a rather startling

⁶¹ P Davies, ‘Rectifying the Course of Rectification’ (2012) 75 MLR 412, 421.

conclusion, and it highlights a fundamental problem with the subjective view of rectification. It may be recalled that earlier in this article it was argued that the decision in *Joliffe* does not represent English law. The English law of trusts is clear in stating that an uncommunicated mental state, that can only be disclosed by conducting a subjective inquiry, is legally irrelevant. As such, were *Joliffe* decided today in an English court, the court would give effect to Mr Joliffe's communicated intention and ignore his secret one. However, if the court could easily reach the opposite conclusion, and give effect to Mr Joliffe's secret intention to retain the bank account, merely by treating it as a claim for rectification, then the jurisdiction to rectify would seriously undermine the law's objective approach to interpretation. It is to be questioned whether the law can tolerate such a contradiction in its doctrines.

This article is not the place to develop arguments concerning rectification. Yet it is worth noting that there is another conception of the doctrine that would not lead to the strange results discussed in the last paragraph. Professor Stevens has recently argued that rectification does not involve a subjective inquiry, but is better understood as an exception to the parol evidence rule. To explain this, let us say that a settlor orally states to a trustee that he wishes to create a trust on terms *xyz*, and then executes a trust deed which contains terms *abc*. If the settlor has intended the trust to take effect on the terms communicated in the trust deed, then we are prohibited, by the parol evidence rule, from considering his earlier communication when ascertaining his intention. What rectification does, as Stevens explains, is to rescind the settlor's intention to be bound by the terms contained in the document; the error in the recording of the settlor's intention in the document allows the court to ignore the settlor's wish that the trust take effect subject to those written terms only.⁶² The consequence of this is that, in the example, when attempting to ascertain the settlor's intention, the court is not confined to examining the words contained in the deed (which point to terms *abc*), but can also examine the earlier oral communication (which points to terms *xyz*). The important point is that it does not follow, from this description of rectification, that the court must switch from an objective inquiry to a subjective one. If rectification merely permits the court, when conducting the 'certainty of intention' inquiry, to look at communications of intention prior to those contained in the trust deed, then there is no reason why it should not construe those earlier communications in the normal objective way. This conception of rectification would have been of no assistance to Mr Joliffe as there were no earlier communications in the case: Mr Joliffe's 'shamming' intention was never disclosed.

This objective view of rectification is conceptually similar to the type of allegation made when a sham is pleaded. The crucial feature of rectification under Stevens' account is that it is an exception to the parol evidence rule, and hence it permits a court to consider the settlor's earlier oral communications. When a sham is pleaded, the essence of the allegation is that the parol evidence rule should not apply

⁶²Stevens (n 48) 119.

in the first place as the settlor does not intend to be bound by any words contained in the trust deed. To put it a little differently, there is no room for the doctrine of rectification to apply in sham cases as the court is already permitted to consider parol communications.

Conclusion

The principal conclusion in this piece is that sham is not a separate doctrine within the law of trusts. If we begin with a clear understanding of the operation of the parol evidence rule, and how it interacts with the rules for ascertaining a settlor's intention, then we see there is no need to explain 'sham trusts' under a separate principle. The main allegation made when sham is pleaded is that the settlor did not intend the trust to take effect on the terms set out in the trust deed. As we have seen, if this is established, then it simply means that a court is not confined to looking at the written document when ascertaining the settlor's intention, but can look to other oral communications (which may disclose the 'shamming intention'). Its attitude towards those oral communications continues to be an objective one in that the court asks what meaning is reasonably conveyed to the addressee. If a settlor has privately communicated to a trustee that, notwithstanding the 'declaration', no trust is in fact intended, then the normal objective inquiry can give effect to this.