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SHAM TRUSTS

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I. INTRODUCTION

DOCUMENTS or arrangements which have been falsely created will not be permitted to "prevent [a court] from getting at the real truth of the matter"[1]: "if it [is] a mere cloak or screen for another transaction one [can] see through it".[2] Such documents or transactions are generally referred to as "shams". The courts' ability to "see through" the false façade of a sham has been widely discussed in the context of documents or arrangements which purport to create licences, rather than leases, in an attempt to avoid statutory protections granted to residential lease-holders,[3] and of transactions or arrangements which purport to avoid the payment of tax.[4] However, there has been much less discussion of the way in which the concept of sham intersects with the law of trusts. The leading practitioner texts on trusts contain only short discussions,[5] and the point has been discussed briefly in the practitioner literature.[6] This article seeks to offer a broader, conceptual understanding of the way in which the sham doctrine applies to trusts.

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1 *In re Watson* (1890) 25 Q.B.D. 27, 33 (C.A.).

2 *Yorkshire Railway Wagon Co.* v. *Maclure* (1882) 21 Ch.D. 309, 318 (C.A.).

3 See, *e.g.*, S. Bright, "Beyond Sham and into Pretence" (1991) 11 O.J.L.S. 136; S. Bright, "Avoiding Tenancy Legislation: Sham and Contracting Out Revisited" [2002] C.L.J. 146; B. McFarlane and E. Simpson, "Tackling Avoidance" in J. Getzler (ed.), *Rationalizing Property, Equity and Trusts* (London 2003) 135; M. Pawlowski, "Unlawful contracting out and sham devices" (2006) 10 L. and T. Rev. 147.

4 See, *e.g.*, B. McFarlane and E. Simpson, "Tackling Avoidance" in J. Getzler (ed.), *Rationalizing Property, Equity and Trusts* (London 2003), 135; J. Vella, "Departing from the Legal Substance of Transactions in the Corporate Field: The Ramsay Approach beyond the tax sphere" (2007) 7 J.C.L.S. 243.

5 D.J. Hayton (gen. ed.), *Underhill and Hayton's Law Relating to Trusts and Trustees*, 17th ed. (London 2007), pp. 78–82; J. Mowbray, L. Tucker, N. Le Poidevin, E. Simpson and J. Brightwell, *Lewin on Trusts*, 18th ed. (London 2008), pp. 92–99. The doctrine is given only scant attention in G. Thomas and A. Hudson, *The Law of Trusts* (Oxford 2004), pp. 29–30 and 838–840.

6 See, *e.g.*, D. Hayton, "When is a Trust not a Trust?" (1992) 1 J.I.T.C.P. 3; D. Brownbill, "When is a Sham not a Sham?" (1993) 2 J.I.T.C.P. 13; J. Mowbray, "Shams, Pretences, Blackmail and Illusion: Parts I and II" [2000] P.C.B. 28 and 105; D. Hayton, "Shams, Piercing Veils, Remedial Constructive Trusts and Tracing" [2004] J.L. Rev. 6; D. Harris, "No Such Thing as a Sham Trust" [2004] P.C.B. 95.

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There is value in this exercise for a number of reasons. First, it will be argued, contrary to the views of several commentators, that there is a doctrine of sham known to English law and that it does apply in the context of trusts. However, as will be seen, the doctrine is one whose concept and detailed application is still being worked out, and refined, over time. There is value, therefore, in developing a clear conceptual understanding of the role that the sham doctrine plays in the law of trusts for its own sake. Secondly, exploring the concept and operation of the sham doctrine in the contexts of trusts serves to highlight the fundamentally bilateral nature of trusts and thereby provides further evidence for Maitland's observation that it is "impossible so to define a contract that the definition shall not cover at least three quarters of all the trusts that are created".[7] Thirdly, as will become apparent, there are also several areas where the practical operation of the sham doctrine remains uncertain in the law of trusts. This flows from the fact that "lawyers find it difficult to grapple with the concept of sham".[8] A sounder conceptual understanding of the way in which the sham doctrine coheres with trust law generally can also assist in providing suggested ways of resolving these more practical problems.

II. Conceptual Considerations

The basic idea of the sham doctrine is well illustrated by reference to Diplock L.J.'s statement in *Snook* v. *London and West Riding Investments Ltd.*:

> it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.[9]

This *dictum* has acquired "canonical"[10] status, having been cited and adopted as an authoritative statement of the sham doctrine in common law jurisdictions around the world.[11] This is somewhat

[7] F.W. Maitland, *Equity*, 2nd ed. rev. by J. Brunyate (Cambridge 1936), p. 54.
[8] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [59] (Ch.D.).
[9] [1967] 2 Q.B. 786, 802.
[10] *A* v. *A* [2007] EWHC 99 (Fam), at [32].
[11] See, *e.g.*, (*i*) in England, *W.T. Ramsay Ltd.* v. *Inland Revenue Commissioners* [1982] A.C. 300, 337; *Welsh Development Agency* v. *Export Finance Co. Ltd.* [1992] B.C.L.C. 148, 160 and 186 (C.A.); *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [63]; *MacNiven* v. *Westmoreland Investments Ltd.* [2001] UKHL 6, [2003] 1 A.C. 311, at [4]; *Shalson* v. *Russo* [2003] EWHC 1637 (Ch), [2005] Ch. 281, at [187]; *Re Nurkowski* [2005] EWHC 336 (Ch), [2005] B.P.I.R. 842, 906; *A* v. *A* [2007] EWHC 99 (Fam), at [32]; *Painter* v. *Hutchison* [2007] EWHC 758 (Ch), at [110]; (*ii*) in Australia, *Sharrment Pty Ltd.* v. *Official Trustee in Bankruptcy* (1988) 82 A.L.R. 530, 537; *Associated Alloys Pty Ltd.* v. *ACN 001 452 106 Pty Ltd* [2000] HCA 25 (2000) 202 C.L.R. 588, at [35]; *Equuscorp Pty Ltd.* v. *Glengallan Investments Pty Ltd.* [2004] HCA 55 (2004) 218 C.L.R. 471, at [46]; (*iii*) in New Zealand, *Bateman Television Ltd.* v. *Coleridge Finance*

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surprising, as it is not at all clear that Diplock L.J. himself intended to create any such statement of law; he prefaced his observations with the comment that: "As regards the contention of the plaintiff that the transactions … were a 'sham,' it is, I think, necessary to consider what, *if any*, legal concept is involved in the use of this popular and pejorative word".[12] Nevertheless, his comments have been treated as an authoritative statement of the doctrine, indicating that the fundamental conceptual basis for the sham doctrine lies in the court's ability to see through acts or documents which are intended as a façade or disguise,[13] designed to conceal "the real truth of the matter".[14]

Before moving to consider a more precise account of the application of the sham doctrine in the context of trusts, two points ought to be noted. First, the sham doctrine is clearly not restricted in its application to trusts alone. *Snook* itself concerned the question whether a transaction, which purported to be a hire-purchase agreement, was in truth such an agreement, or was instead "a dressed-up arrangement for a loan on the security of the car",[15] which would have been invalid pursuant to statute. Similarly, the question in both *Yorkshire Railway Wagon Co.* v. *Maclure*[16] and *In re Watson*[17] was whether a purported sale and leaseback was in truth a secured loan. The doctrine has also been applied to gifts, as in *Chase Manhattan Equities Ltd.* v. *Goodman*.[18] And it has been applied in the context of trusts. Indeed, the application of the doctrine to trusts comes as no surprise given the doctrine applies to gifts, as many gifts are settled by way of trust. Thus, for example, in *Rahman* v. *Chase Bank (C.I.) Trust Co. Ltd.*,[19] the Jersey Royal Court held a trust invalid on the basis that it was a sham, as did the English courts in *Midland Bank plc* v. *Wyatt*,[20] *Minwalla* v. *Minwalla*[21] and *Painter* v. *Hutchison*.[22] In other cases, these courts have upheld trusts on the basis

Co. Ltd. [1969] N.Z.L.R. 794, 821 (C.A.); *Paintin and Nottingham Ltd.* v. *Miller Gale and Winter* [1971] N.Z.L.R. 164, 168 and 175 (C.A.); *Marac Finance Ltd.* v. *Virtue* [1981] 1 N.Z.L.R. 586, 593 (C.A.); *Official Assignee* v. *Wilson* [2006] 2 N.Z.L.R. 841, at [52]; (*iv*) in Canada, *Minister of National Revenue* v. *Cameron* [1974] S.C.R. 1062, 1068; and (*v*) in Jersey, *Grupo Torras S.A.* v. *Al-Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1, at [54].

[12] *Snook* v. *London and West Riding Investments Ltd.* [1967] 2 Q.B. 786, 802 (emphasis added).

[13] *Scott* v. *Commonwealth Commissioner of Taxation (No. 2)* (1966) 40 A.L.J.R. 265, 279 (H.C.A.); *Re State Public Services Federation, ex parte Attorney-General for Western Australia* (1993) 178 C.L.R. 249, 290; *Gould* v. *Gould* [1993] F.L.C. 80,423, 80,432.

[14] *In re Watson* (1890) 25 Q.B.D. 27, 33.

[15] *Snook* v. *London and West Riding Investments Ltd.* [1967] 2 Q.B. 786, 803.

[16] *Yorkshire Railway Wagon Co.* v. *Maclure* (1882) 21 Ch.D. 309.

[17] *In re Watson* (1890) 25 Q.B.D. 27.

[18] [1991] B.C.L.C. 897 (Ch.D.).

[19] [1991] J.L.R. 103.

[20] [1995] 1 F.L.R. 696 (Ch.D.).

[21] [2005] EWHC 2823 (Fam), [2005] 1 F.L.R. 771.

[22] [2007] EWHC 758 (Ch).

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that they were not shams,[23] but the jurisdiction to find a sham clearly existed if the facts had justified it. In other words, the doctrine is one of general application. This leaves open the issue of precisely how the doctrine applies in the context of trusts.

The second point that merits attention at this stage is of a more theoretical nature. Some commentators have argued that the reason for Diplock L.J.'s unease with the idea of the sham doctrine was that it does not in fact exist as a separate doctrine, but rather merely reflects (in a confused and confusing fashion) the normal issues surrounding construction of documents. For example, Bright has argued that "the *Snook* doctrine is easy to reconcile with contractual theory" as it merely "gives effect to the parties' intentions".[24] More recently, McFarlane and Simpson have argued that "there is no independent set of criteria justifying the finding of a sham [because] the task of the court is simply to ascertain the genuine intentions of the party or parties in circumstances where those intentions are relevant".[25] This point clearly needs to be addressed: if there is no independent sham doctrine, then one need not discuss its application to the law of trusts. Indeed, a question would then also arise, as to why numerous judges have apparently thought there to be some substance to the sham doctrine: why, for example, did Mustill L.J. consider that the sham doctrine "must be carefully distinguished" from the situation "where the language of the document (and in particular its title or description) superficially indicates that it falls into one legal category, whereas when properly analysed in the light of the surrounding circumstances it can be seen to fall into another"?[26]

It is suggested that there is substance in the sham doctrine. In a simplistic sense, the point made by Bright, McFarlane and Simpson is correct: at root, as the Court of Appeal recognised in *Watson*, the sham doctrine is concerned with identifying "the real truth of the matter"[27] or "the real transaction".[28] At a very abstract level, this is indistinguishable from the idea that the process of construction involves the court determining the content of the arrangement between the parties.[29] However, while these descriptions of the sham doctrine

[23] See, *e.g.*, *Grupo Torras S.A.* v. *Al-Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1; *Shalson* v. *Russo* [2003] EWHC 1637 (Ch), [2005] Ch. 281; *A* v. *A* [2007] EWHC 99 (Fam).

[24] S. Bright, "Beyond Sham and into Pretence" (1991) 11 O.J.L.S. 136, p. 140.

[25] B. McFarlane and E. Simpson, "Tackling Avoidance" in J. Getzler (ed.), *Rationalizing Property, Equity and Trusts* (London 2003) 135, p. 139.

[26] *Hadjiloucas* v. *Crean* [1988] 1 W.L.R. 1006, at 1019 (C.A).

[27] *In re Watson* (1890) 25 Q.B.D. 27, 33.

[28] *Ibid.*, at p. 40.

[29] The doctrine which appears to allow courts to ignore terms in agreements where those terms are included in order to evade the operation of a statute out of which the parties cannot contract (see, *e.g.*, *Bankway Properties Ltd.* v. *Pensfold-Dunsford* [2001] EWCA Civ 528, [2001] 1 W.L.R. 1369, at [43]) is not generally relevant in the context of trusts given most trusts legislation is default rather than mandatory in nature, and it has been treated by the House of Lords as

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and the process of construction are adequate in very generalised terms, both are insufficiently precise to identify the importance of the sham doctrine and its relationship with the normal process of construction of bilateral arrangements.

The legal process of construction is not as simple as "ascertaining the genuine intentions of the parties". Where parties have chosen to "channel"[30] their relations through certain legal forms, the courts necessarily apply a two-stage process when construing that arrangement: first, *ascertaining* what rights and obligations the parties intended to create, and second, *categorising* that set of rights and obligations as a matter of law.[31] If the parties have attached a label to their arrangement that incorrectly reflects the legal consequences of the rights and obligations which they have created, that label is ignored in favour of an accurate legal characterisation of the arrangement. In that context, it is true that there is no need of a separate sham doctrine: if parties have intentionally created a gift transaction, the fact that they have labelled it as a trust is of no consequence, but it does not make the gift a sham and nor does it make the trust a sham – there simply was no trust.[32] In other words, the sham doctrine is unnecessary at the second stage of the process, when the courts are categorising the rights and obligations of the parties. However, the doctrine of sham is crucially relevant at the first stage of the process, in that it identifies the material to which a court can and cannot have regard when ascertaining what rights and obligations the parties intended to create.

It is helpful at this point to compare the position which obtains when courts interpret written contracts. In that context, the primary source material for determining what the parties intended is the document which they have signed.[33] The document is interpreted to ascertain the meaning it "would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract".[34] However,

distinct from the sham doctrine: *MacNiven* v. *Westmoreland Investments Ltd.* [2001] UKHL 6, [2003] 1 A.C. 311, at [4]. Hence, the questionable legitimacy of that doctrine (see B. McFarlane and E. Simpson, "Tackling Avoidance" in J. Getzler (ed.), *Rationalizing Property, Equity and Trusts* (London 2003), 135, pp. 150–184) need not be addressed here.

[30] See L. Fuller, "Consideration and Form" (1941) 41 Colum. L. Rev. 799, p. 801.

[31] See, *e.g.*, *Street* v. *Mountford* [1985] 1 A.C. 809, 819; *Agnew* v. *Commissioner of Inland Revenue* [2001] UKPC 28, [2001] 2 A.C. 710, at [32]; H.G. Beale (gen. ed.), *Chitty on Contracts*, 29th. ed. (London 2004), para. [12–046].

[32] *cf.* the view that this is a sham: G. Thomas and A. Hudson, *The Law of Trusts* (Oxford 2004), p. 29.

[33] See, *e.g.*, K. Lewison, *The Interpretation of Contracts*, 3rd ed. (London, 2004), ch. 3; H.G. Beale (gen. ed.), *Chitty on Contracts*, 29th. ed. (London 2004), para. [12–043].

[34] *Investors Compensation Scheme Ltd.* v. *West Bromwich Building Society* [1998] 1 W.L.R. 896, 912 (H.L.); see also *Mannai Investment Co. Ltd.* v. *Eagle Star Life Assurance Co. Ltd.* [1997] A.C. 749, 767; K. Lewison, *The Interpretation of Contracts*, 3rd ed. (London, 2004), para. [3.11]; H. G. Beale (gen. ed.), *Chitty on Contracts*, 29th. ed. (London 2004), paras. [12–043] and [12–118].

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the "law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent"[35] along with their conduct subsequent to entering into the contract,[36] because such evidence is "unhelpful"[37] in ascertaining, in an objective sense, "the intention which reasonable people would have had if placed in the situation of the parties".[38] So much is well-known. What is perhaps less well-known is that the same position obtains when construing trusts:

> Lifetime settlements are no different from other documents in that the subjective intentions of their authors are irrelevant. What counts is the objective meaning that the words of the document convey to the court when considered as a whole in the light of the surrounding circumstances … the admissible circumstances do not include the subjective intention of the settlor.[39]

It should be emphasised here that, although trusts *can* be settled by way of unilateral declaration over the settlor's own property, by far the more common method of creating trusts is for the settlor to transfer property to a third party who agrees to hold that property on trust.[40] The court's focus when construing the terms of that bilateral arrangement is on the objective meaning that those terms would convey to a reasonable person, just as it is when construing contractual arrangements.[41]

[35] *Investors Compensation Scheme Ltd.* v. *West Bromwich Building Society* [1998] 1 W.L.R. 896, 913; see also *Prenn* v. *Simmonds* [1971] 1 W.L.R. 1381, 1384–1385 (H.L.); *Mannai Investment Co. Ltd.* v. *Eagle Star Life Assurance Co. Ltd.* [1997] A.C. 749, 772, 775 and 779; K. Lewison, *The Interpretation of Contracts*, 3rd ed. (London, 2004), para. [3.11]; H. G. Beale (gen. ed.), *Chitty on Contracts*, 29th. ed. (London 2004), para. [12–119].

[36] *James Miller and Partners Ltd.* v. *Whitworth Street Estates (Manchester) Ltd.* [1970] A.C. 583, 603, 606, 611 and 614–615; *L. Schuler A.G.* v. *Wickman Machine Tool Sales Ltd.* [1974] A.C. 235, 252, 260, 261–262, 265–270 and 272; K. Lewison, *The Interpretation of Contracts*, 3rd ed. (London, 2004), para. [3.12]; H. G. Beale (gen. ed.), *Chitty on Contracts*, 29th. ed. (London 2004), para. [12–126]. There is an established exception to this rule where the question at issue is the location of a boundary contained in a conveyance which is unclear or ambiguous, but this does not apply to contracts generally: *Watcham* v. *Attorney-General of the East Africa Protectorate* [1919] A.C. 533, 537 (P.C.); *Ali* v. *Lane* [2006] EWCA Civ 1532, at [25]–[36]; *Haycocks* v. *Neville* [2007] EWCA Civ 78, at [31].

[37] *Prenn* v. *Simmonds* [1971] 1 W.L.R. 1381, 1384.

[38] *Reardon Smith Line Ltd.* v. *Yngvar Hansen-Tangen* [1976] 1 W.L.R. 989, 996 (H.L.); see also *Mannai Investment Co. Ltd.* v. *Eagle Star Life Assurance Co. Ltd.* [1997] A.C. 749, 775, 779 and 782.

[39] J. Mowbray, L. Tucker, N. Le Poidevin, E. Simpson and J. Brightwell, *Lewin on Trusts*, 18th ed. (London 2008), para. [6–03]. See also *Vandervell* v. *Inland Revenue Commissioners* [1967] 2 A.C. 291, 312; *In re Z Trust* [1997] C.I.L.R. 248, 257.

[40] J. H. Langbein, "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale L.J. 625, pp. 672–675. On the relationship between trusts and contract generally, see Langbein, *ibid.*, at pp. 650–669 and F. W. Maitland, *Equity*, 2nd ed. rev. by J. Brunyate (Cambridge 1936), p. 54.

[41] For discussion of the historical move from a "will theory" of contract to one based on the objective appearance of agreement and the relevance of mistakes, see A. W. B. Simpson, "Innovation in Nineteenth Century Contract Law" (1975) 91 L.Q.R. 247 at pp. 265–269; R. Zimmermann, *The Law of Obligations* (Oxford 1996), ch. 19, esp. at pp. 600–602.; D. J. Ibbetson, *A Historical Introduction to the Law of Obligations* (Oxford 1999), ch. 12.

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Thus, for example, just as is the case when interpreting contracts, neither the subsequent conduct of the parties,[42] nor their subjective intentions,[43] 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. In other words, in conceptual terms, the relevance of the sham doctrine is that it justifies the court in stepping outside of the normal construction process in order to ascertain 'the truth of the matter' by reference to material which would normally be excluded as irrelevant to that process. This explains the various statements and comments in the cases which treat the sham doctrine as having a separate legal existence: as Munby J. explained recently, a claimant who argues that she is entitled to an interest under a trust, based on construction of the trust deeds and other considerations, makes a "diametrically different assertion"[44] to one who argues that the trust deed is a sham such that it should be ignored in determining the rights of the various parties. Where the pre-requisites of the sham doctrine are made out, the court has a reason for *ignoring*, rather than construing, the usual primary material (especially any written documents which the parties have signed) when it seeks to ascertain the rights and obligations of the parties. Thus, contrary to the argument advanced by McFarlane and Simpson, the pre-requisites for the sham doctrine *are* important as it is by employing those criteria that the courts have created a filtering process by which to decide what cases are dealt with outside of the normal rules of construction. This is done in order to ensure that the normal rules of construction are not circumvented without justification.

Bright's suggestion, that the sham doctrine "is operating as rectification",[45] is closer to the mark, although it is not sufficiently accurate either. As Treitel points out, the "remedy of rectification is based on a *mistake* in the recording of a previous oral agreement".[46] By contrast, as will be seen below, the sham doctrine is concerned not with mistakes but with positive intentions to record or act on the basis of something that was not truly agreed in order to mislead others.[47] In

[42] See, *e.g.*, J. Mowbray, L. Tucker, N. Le Poidevin, E. Simpson and J. Brightwell, *Lewin on Trusts*, 18th ed. (London 2008), para. [6–12]; *In re Z Trust* [1997] C.I.L.R. 248, 257.

[43] See, *e.g.*, *Commissioners of Inland Revenue* v. *Raphael* [1935] A.C. 96, 134–135; *Gissing* v. *Gissing* [1971] A.C. 886, 906; *Rabin* v. *Gerson Berger Association Ltd.* [1986] 1 W.L.R. 526, 531–532, 533, 534, 535 and 539 (C.A.); *In re Z Trust* [1997] C.I.L.R. 248, 257.

[44] *A* v. *A* [2007] EWHC 99 (Fam), at [29].

[45] S. Bright, "Beyond Sham and into Pretence" (1991) 11 O.J.L.S. 136, p. 140.

[46] E. Peel, *Treitel's Law of Contract*, 12th ed. (London 2007), para. [6–025] (emphasis original); see also J. McGhee (gen. ed.), *Snell's Equity*, 31st ed. (London 2005), para. [14–02].

[47] See section III below.

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that respect, it is palpably different from rectification and it should be understood as a distinct basis on which the courts will look to material other than that normally allowed when ascertaining the rights and obligations that the parties intended to create. In both rectification and sham cases, courts are faced with situations where the objective interpretation of the parties' documentation or conduct is at variance with the substance of their agreement, and so the courts look behind that objective appearance to get at the truth of the matter. However, the reasons for that variance – and hence the justification for departing from the normal objective construction – are very different in each of these two cases. In the context of rectification, the parties have simply made a mistake in recording their agreement. In the context of a sham allegation, the parties have directly conspired to record something that was not their agreement with the intention of misleading others.

For these reasons it is suggested that the sham doctrine exists separately from the doctrines governing normal contractual construction and cases of rectification, and that its application in the context of trusts merits further examination.

III. Intention to Mislead

Diplock L.J.'s classic statement of the sham doctrine in *Snook* has been quoted already.[48] It is clear from that statement that a sham only exists where the parties intended to generate a false or misleading appearance that certain rights and obligations had been created. This section of the article addresses a number of important aspects of this fundamental pre-requisite to the finding of a sham, particularly as it relates to trusts.

(a) Necessity of Intention

It was clear long before *Snook* that the parties must have had an intention to mislead before a sham would be found. In the absence of such an intention, the courts could not do other than give effect to the objective meaning of the parties' arrangements.[49] As Lindley L.J. observed in the *Maclure* case:

> If it were a mere cloak or screen for another transaction one could see through it, but once come to the conclusion that it was the *bonâ fide* real transaction between the parties, intended by both sides to operate according to its tenor, there is no mode that I know of of holding it illegal unless you find it prohibited by some Act of Parliament or void by reason of some principles of law.[50]

[48] Text accompanying note 9 above.
[49] Unless there was some other legal basis for not doing so.
[50] *Yorkshire Railway Wagon Co.* v. *Maclure* (1882) 21 Ch.D. 309, 318.

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The importance of identifying the parties' intention to mislead is reinforced in Arden L.J.'s important restatement of the sham doctrine in *Hitch* v. *Stone*:

> It is of the essence of this type of sham transaction that the parties to a transaction intend to create one set of rights and obligations but do acts or enter into documents which they intend should give third parties, in this case the Revenue, or the court, the appearance of creating different rights and obligations.[51]

In the context of trusts, this seems at first sight to be related in some way to Lord Langdale M.R.'s proposition in *Knight* v. *Knight*[52] that there cannot be a trust if it is unclear that the settlor intended to create a trust. In one sense, the application of the sham doctrine to trusts could be treated as no more than an application of this proposition, in that someone who purports to create a trust in order to mislead third parties does not have the intention to create a true trust (or, at least, the trust recorded in the sham documents). However, the prerequisites for application of the sham doctrine indicate that it is not, as Palmer has argued, simply "an aspect of the law relating to certainty of intention required for a valid trust"[53] and that it ought to be considered separately from that principle. Indeed, the *general* application of the sham doctrine[54] indicates that it cannot merely be a part of *trust law's* principle regarding certainty of intention. Trust law's certainty of intention principle is one of the mechanisms by which the courts try "to ensure that there are obligations that are administratively workable and capable of being 'policed' by the court".[55] The focus of the sham doctrine is different. It seeks to identify trusts which are administratively workable and perfectly capable of being policed as trusts but which are nonetheless subjectively intended by their creators as façades designed to conceal the true position. In other words, the certainty of intention principle generally focuses on the negative fact that the court has been unable to identify a clear objective[56] intention to create a trust, whereas the sham doctrine focuses on a positive finding that the parties involved subjectively *did not* intend to create a trust such as that recorded in the sham documents.

A second question regarding the requisite intention is whether it necessarily must be shown what rights and obligations the parties *did*

[51] [2001] EWCA Civ 63, [2001] S.T.C. 214, at [63].
[52] (1840) 3 Beav. 148, 172–173.
[53] J. Palmer, "Dealing with the Emerging Popularity of Sham Trusts" [2007] N.Z.L.Rev. 81, p. 92.
[54] See text accompanying notes 15 to 23 above.
[55] D. Hayton and C. Mitchell, *Hayton and Marshall's Commentary and Cases on the Law of Trusts and Equitable Remedies*, 12th ed. (London 2005), para. [3–01].
[56] *Grupo Torras S.A.* v. *Al-Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1, at [53(vi)].

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intend to create before the court can find a sham. Knox J. said in *Chase Manhattan* v. *Goodman* that "it is not necessary for the parties affirmatively to intend to enter into any particular transaction once it is shown that the ostensible transaction was a pretence".[57] Knox J.'s view is also consistent with Neuberger J.'s recent description of shams, which contains no reference to the need to establish what the parties did intend to take place: "A sham provision or agreement is simply a provision or agreement which the parties do not really intend to be effective, but have merely entered into for the purpose of leading the court or a third party to believe it is to be effective."[58]

This position makes perfect sense as a matter of strict logic, in that it ought to be possible to establish that something was intended as a false façade without necessarily needing to establish that for which it was intended to be a façade. Further, as *Snook* indicates, it is possible to create a sham without intending to create any new legal rights and obligations at all: Diplock L.J.'s description of the sham doctrine referred to the parties intending to give an appearance "different from the actual legal rights and obligations (*if any*) which the parties intend to create".[59] However, there are at least two reasons, at a practical level, to focus attention on the transaction that the parties did intend. The first reason concerns issues of proof. As will be seen below, courts operate on the basis of a presumption that documents are not shams.[60] Thus, for purely practical reasons (in order to overcome that presumption, so as to establish a sham), it may well be necessary to show what rights and obligations the parties *did* in fact intend in order to show that they *did not* intend the arrangements recorded in the sham documents: it will be far easier to convince a court that the parties did not intend *X* if one proves that the parties did in fact intend *Y* than it will be if one simply seeks to prove in the abstract that the parties did not intend *X*. The second practical reason concerns the consequences of finding a sham. As will be discussed below, the normal consequence of finding a sham is for the court to ignore the sham and to proceed on the basis of the true arrangement,[61] which is difficult where that true arrangement is unknown.

[57] *Chase Manhattan Equities Ltd.* v. *Goodman* [1991] B.C.L.C. 897, 922.
[58] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [59].
[59] *Snook* v. *London and West Riding Investments Ltd.* [1967] 2 Q.B. 786, 802 (emphasis added).
[60] See section IV*(a)* below.
[61] See section V below. (It is, of course, possible that the claimant merely wishes to avoid the sham transaction so that the *status quo ante* can be restored. Even that, however, involves a conclusion that the sham transaction was a sham, but also that the true arrangement was that no transaction was truly intended and so the true intention was to retain the *status quo ante*.)

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(b) Subjective Intention and Dishonesty

In *Hitch* v. *Stone*, Arden L.J. made clear that the relevant

> … test of intention is subjective. The parties must have intended to create different rights and obligations from those appearing from (say) the relevant document, and in addition they must have intended to give a false impression of those rights and obligations to third parties.[62]

The fact that the intention must be subjective flows from the fact that the very purpose of a sham transaction is to mislead third parties. To rely solely on the objective intention of the parties, ascertained in the normal way, would give direct effect to the sham: a sham can only work its mischief if its objective appearance is treated as the reality. This relates to the point made earlier regarding the conceptual difference between categorisation of transactions on the one hand and application of the sham doctrine so as to ignore those transactions on the other. If it is objectively clear that the parties did not intend a transaction of type *X* and in fact, as a matter of law, intended rights and obligations which constitute a type-*Y* transaction, then the courts are capable of treating the transaction as one of type-*Y* without need of any sham doctrine: they can simply categorise it as type-*Y*. Only where the objective appearance of the transaction is type-*X* do the courts need a justification to look behind the objective appearance in order to get at "the real truth of the matter". In the case of an allegation that the transaction is a sham, it is the parties' subjective intention which provides that justification, on the basis that the parties subjectively intended to mislead third parties.[63] It will, of course, often be the case that the "court is left with little direct evidence and is therefore required to draw inferences from the circumstances surrounding the relevant events",[64] but the important point is that the touchstone of that inquiry is the parties' subjective intention to mislead because it is that intention which justifies the court in departing from the normal process and rules of construction.

In *Midland Bank* v. *Wyatt*, the judge stated that "I do not believe it is necessary to establish a fraudulent motive to prove that the transaction was a sham or pretence transaction."[65] However, this has since been called into question, on the basis that "a finding of sham carries with it a finding of dishonesty".[66] In other words, while

[62] *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [66].
[63] Where the claim is for rectification, the justification for looking behind the objective appearance of the transaction is the fact that the parties mistakenly recorded something which did not objectively reflect their subjective agreement.
[64] *Sharrment Pty Ltd.* v. *Official Trustee in Bankruptcy* (1988) 82 A.L.R. 530, 544.
[65] *Midland Bank plc* v. *Wyatt* [1995] 1 F.L.R. 696, 698.
[66] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [59].

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dishonesty is not a formal pre-requisite for finding a sham, it clearly is a pre-requisite that there be an intention to mislead, and it is hard to see how it could be denied that there is "a degree of dishonesty"[67] in such a case.

(c) Commonality of Intention

A further requirement regarding intention is that it must be shown that a subjective intention to mislead others was shared by *all* parties to the sham. This was made plain by Diplock L.J. in *Snook*,[68] although it had been clear for some time before then,[69] and it has been adopted as a pre-requisite to finding a sham in numerous other cases, including cases where the allegation of sham related to a trust.[70] Thus, for example, in *Grupo Torras S.A.* v. *Al-Sabah*, the Jersey Royal Court rejected an argument that a discretionary trust was a sham because neither the trustee[71] nor the settlor[72] had any intention that the position should be anything other than as set out in the trust deed. Similarly, in *Re Nurkowski*, the trust was not a sham because it was not shown that the settlor had any intention to give a false impression by creating the trust, and nor was the trustee shown to have agreed to participate in any sham.[73] The requirement of commonality means that this conclusion can be reached even if only one of these two parties is not proven to have had the requisite intention. Thus, in *A* v. *A*, Munby J. could conclude that an allegation that a trust was a sham must fail, as a matter of law, where it was clear, as a matter of fact, that the trustees honestly and sincerely had intended to hold on the stated trusts.[74] And in *MacKinnon* v. *Regent Trust Co. Ltd.*, the Jersey Court of Appeal was able to reject an argument that a trust was a sham, irrespective of the trustee's intention, on the basis that the claimant refused to allege that the settlor (his mother) had any intention to mislead others.[75]

Two points now need to be considered. First, the conceptual rationale for requiring a common intention must be addressed. And

[67] *Ibid.*, at para. [46].
[68] *Snook* v. *London and West Riding Investments Ltd.* [1967] 2 Q.B. 786, 802 and 804.
[69] *Yorkshire Railway Wagon Co.* v. *Maclure* (1882) 21 Ch.D. 309, 314.
[70] *Bateman Television Ltd.* v. *Coleridge Finance Co. Ltd.* [1969] N.Z.L.R. 794, 821; *Paintin and Nottingham Ltd.* v. *Miller Gale and Winter* [1971] N.Z.L.R. 164, 168 and 175; *Bank of Credit and Commerce International (Overseas) Ltd.* v. *Akindele* [2001] Ch. 437 at 443, CA; *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [69]; *Shalson* v. *Russo* [2003] EWHC 1637 (Ch), [2005] Ch. 281, at [188] and [190]; *MacKinnon* v. *Regent Trust Co. Ltd.* [2005] JCA 066, [2005] W.T.L.R. 1367, at [19]–[20]; *Official Assignee* v. *Wilson* [2006] 2 N.Z.L.R. 841, at [52] and [106]; *A* v. *A* [2007] EWHC 99 (Fam), at [34].
[71] *Grupo Torras S.A.* v. *Al-Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1, at [194].
[72] *Ibid.*, at para. [197].
[73] [2005] EWHC 336 (Ch), [2005] B.P.I.R. 842, 913–914 (not challenged on appeal, *sub nom. Hill* v. *Spread Trustee Co. Ltd.* [2006] EWCA Civ 542, [2007] 1 All E.R. 1106, at [60]).
[74] *A* v. *A* [2007] EWHC 99 (Fam), at [49] and [86].
[75] *MacKinnon* v. *Regent Trust Co. Ltd.* [2005] JCA 066, [2005] W.T.L.R. 1367, at [19]–[21] and [32].

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secondly, it is necessary to address briefly some dicta which appear to contradict the need to show that all parties to the sham had an intention to mislead.

(i) The need for common intention

The rationale for requiring a common intention to mislead is best explained by reference to general legal principles regarding the importance of upholding the certainty of bilateral transactions. In general, the law places great weight on documents or arrangements which have been knowingly entered into. For example, where someone has conducted himself in such a way as to indicate objectively that he intended to create something which, as a matter of law, amounted to a trust, the courts will give effect to that intention by recognising a trust, even if it is unclear that the settlor understood subjectively that such was the legal effect of his conduct.[76] Courts can interfere, but only where a high threshold is met. Such is the balance drawn between the need for stability in bilateral transactions and the need to protect individuals against injustice. Thus, for example, if a person is fundamentally mistaken as to the effect of documents which he has signed,[77] or if *non est factum* can be made out (which amounts to the same thing in functional terms[78]), or if the document purports to comprise the exercise of a discretion but it is clear that the discretion was not even considered,[79] then the courts will interfere. But these doctrines impose very high thresholds, failing which the court refuses to interfere and the transaction is given effect according to its objectively ascertained meaning. The sham doctrine is another instance where the court will refuse to give effect to the apparent transaction, and again its threshold is set high in order not to destabilise unjustifiably the ability of legal actors to operate on the basis of the objective appearance of bilateral transactions. Thus, all parties to the sham must have had an intention to mislead others before the court will interfere with the transaction. A settlor who transfers property to a trustee to hold on trust, cannot set aside the trust merely because he secretly intended to retain the beneficial interest in the property if that intention was not made apparent to the trustee. Certainly, the settlor ought not to be able to set aside the trust *vis-à-vis* the trustee, as it would be grossly unfair in the context of such

[76] See, *e.g.*, *Paul* v. *Constance* [1977] 1 W.L.R. 527 (C.A.); *Re Chelsea Cloisters Ltd.* (1980) 41 P. and C.R. 98 at 103, 104–105 (C.A.).

[77] See, *e.g.*, *Walker* v. *Armstrong* (1856) 8 De G.M. and G. 531 (L.JJ.); *Wollaston* v. *Tribe* (1869) L.R. 9 Eq. 44 (M.R.); *In re Walton's Settlement* [1922] 2 Ch. 509; *Gibbon* v. *Mitchell* [1990] 3 All E.R. 338 (Ch.D.); see also the discussion in *Sieff* v. *Fox* [2005] EWHC 1312 (Ch), [2005] 1 W.L.R. 3811, at [94]–[112].

[78] See, *e.g.*, *Saunders* v. *Anglia Building Society* [1970] A.C. 1004, 1026.

[79] See, *e.g.*, *Wilson* v. *Turner* (1883) 22 Ch.D. 521 (C.A.); *Turner* v. *Turner* [1984] Ch. 100.

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a bilateral arrangement for the settlor to be able to sue the trustee for, for example, dissipating the property entirely in accordance with the stated trusts (although that result could potentially also be reached on the basis that the settlor is estopped from denying the existence of a trust). The most important consideration is whether a third party ought to be able to rely on the settlor's undeclared intentions in order to treat the trust as a sham *vis-à-vis* the trustee. That question need only be posed in order for the answer to be clear: third parties should have no standing to deny that a trust has been validly created merely because the settlor unilaterally had his "fingers crossed behind his back" when dealing with the trustee. As Rimer J. explained in *Shalson* v. *Russo*:

> I cannot understand on what basis a third party could claim, merely by reference to the unilateral intentions of the settlor, that the settlement was a sham and that the assets in fact remained the settlor's property. One might as well say that an apparently outright gift made by a donor can subsequently be held to be a sham on the basis of some unspoken intention by the donor not to part with the property in it. But if the donee accepted the gift on the footing that it was a genuine gift, the donor's undeclared intentions cannot turn an ostensibly valid disposition of his property into no disposition at all. To set that sort of case up the donee must also be shown to be a party to the alleged sham.[80]

Palmer has argued that it is the settlor's intention alone which should be determinative of whether a sham trust was created, differentiating trusts from contracts on the basis that trusts are fundamentally unilateral rather than bilateral.[81] Her argument is plausible where the trust has been declared wholly unilaterally over the settlor's own assets, without the involvement of any separate trustee. In this (relatively rare) situation, the only relevant intention is that of the settlor as he is also the trustee.[82] However, Palmer's contention is intended to apply to the more common bilateral declaration of trust as well. Her argument ignores a large body of authority to the contrary,[83] but it also ignores the importance of the point that the court needs a sound justification for ignoring the ordinary limits on the evidentiary material to which it may have regard when determining the existence and meaning of a transaction.[84] Palmer argues that "[w]here there is no

[80] *Shalson* v. *Russo* [2003] EWHC 1637 (Ch), [2005] Ch. 281, at [190]; see also *Grupo Torras S.A.* v. *Al-Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1, at [53]. Rimer J.'s analysis was endorsed by Munby J. in *A* v. *A* [2007] EWHC 99 (Fam), at [34]–[40].

[81] J. Palmer, "Dealing with the Emerging Popularity of Sham Trusts" [2007] N.Z.L.Rev. 81, pp. 93–99.

[82] *Painter* v. *Hutchison* [2007] EWHC 758 (Ch), at [111]–[112] and [115].

[83] See, *e.g.*, the cases mentioned in notes 70 to 75 above.

[84] See text accompanying notes 24 to 47 above.

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intention by the settlor to create a trust, there cannot be a trust".[85] On its own, this is true. However, as has been seen, this principle is not the focus of the sham doctrine and it does not justify the court ignoring a trust where the settlor's intention, objectively determined, was to create a trust and the trustee agreed to act on the basis of such a trust simply because the settlor subjectively and entirely secretly did not in fact intend to create it. Palmer herself recognises that "the settlor's intention is determined objectively".[86] If this is so, which it is, then for reasons already discussed, a court is not at liberty to ignore the existence of that objectively determined intention, and instead privilege the settlor's unilateral subjective intention, unless it has a justification for doing so. It is not so justified unless the settlor and the trustee *both* subjectively joined in a common intention to mislead third parties. To hold otherwise would unnecessarily and unjustifiably subvert the common law's commitment to the security of the objectively ascertained meaning of bilateral transactions.

(ii) Contrary Dicta

The second issue to be addressed in the context of the requirement that there be a commonality of intention is a couple of apparently contrary dicta. For example, in *Midland Bank* v. *Wyatt*, the judge said:

> I consider a sham transaction will still remain a sham transaction even if one of the parties to it merely went along with the 'shammer' not either knowing or caring about what he or she was signing. … I do not accept therefore the defendant's contention that it is a necessary requirement for the plaintiff to establish that both Mr Wyatt and Mrs Wyatt had a common intention that the declaration of trust signed by them was not intended to take effect and be acted upon by them as from the time of its execution.[87]

In *Hitch* v. *Stone*, Arden L.J. commented that "the law does not require that in every situation every party to the act or document should be a party to the sham",[88] which Singer J. has since treated as supporting the analysis in *Wyatt*.[89] With respect, Singer J.'s view is a misunderstanding of Arden L.J.'s position in *Hitch* v. *Stone*. Such a reading of Arden L.J.'s remarks seems odd in light of her firm reaffirmation in *Hitch* v. *Stone* of the requirement that common intention be established before a finding of sham is possible.[90] The

[85] J. Palmer, "Dealing with the Emerging Popularity of Sham Trusts" [2007] N.Z.L.Rev. 81, p. 97.
[86] *Ibid.*
[87] *Midland Bank plc* v. *Wyatt* [1995] 1 F.L.R. 696, 699–700.
[88] *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [85].
[89] *Minwalla* v. *Minwalla* [2005] EWHC 2823 (Fam), [2005] 1 F.L.R. 771, at [54].
[90] *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [69].

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explanation of her dictum above is not that it undermines the requirement for common intention, but rather that all that need be shown is a common intention on the part of all parties to the sham transaction, and not necessarily all parties to the document, to mislead others. The document at issue in *Hitch* v. *Stone* was a deed containing two transactions, involving two separate companies, Conteglade and Monarch. In effect, therefore, the deed had three parties, the Hitch family members, Conteglade and Monarch. The important point is that only one of the transactions (that involving Conteglade) was held to be a sham, while the other was not. There was no evidence that Monarch was party to the Conteglade sham, but Arden L.J. held this unnecessary on the basis that all of the parties to the Conteglade transaction (*i.e.*, the Hitches, their solicitor and Conteglade) did share a common intention to mislead. *Hitch* v. *Stone* does not support the proposition that the parties to a sham need not all have an intention to mislead. What it does support is the proposition that the focus of the sham doctrine is on the transaction itself, rather than on the document as a whole, so that parts of a document can constitute a sham even if other parts are perfectly valid.[91] But in order for that conclusion to be reached, the parties to the sham transaction must all have had an intention to mislead.

This leaves for consideration the status of the point made in *Wyatt*. One possibility is that the decision is simply wrong. It has been criticised on other grounds.[92] However, it seems preferable for the sham doctrine to apply where one party has an intention to mislead and the other simply goes along with that without caring what is happening. In other words, "the court in *Wyatt* was simply confirming that a party who goes along with a sham neither knowing or caring what he is signing (i.e. who is reckless) is to be taken as having the necessary intention".[93] This view has been confirmed in *A* v. *A*,[94] and it coheres with the way in which intention is treated elsewhere in trust law. For example, in *Agip (Africa) Ltd.* v. *Jackson*, Millett J. pointed out that consciously assisting in arrangements with an indifferent attitude towards the possibility that those arrangements are in fraud of others is not honest behaviour.[95] And in *Medforth* v. *Blake*, Scott V.-C. observed that "[s]hutting one's eyes deliberately to the

[91] See also *Carman* v. *Yates* [2004] EWHC 3448 (Ch), at [219]; *A* v. *A* [2007] EWHC 99 (Fam), at [58].
[92] See, *e.g.*, *Grupo Torras S.A.* v. *Al-Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1, at [57].
[93] *Ibid.*, at para. [58].
[94] *A* v. *A* [2007] EWHC 99 (Fam), at [52].
[95] [1990] 1 Ch. 265, 295 and 293. Such conduct also amounts to fraud for the purpose of determining whether a trustee may rely on an exemption clause contained in the trust instrument: *Armitage* v. *Nurse* [1998] Ch. 241, 251 (C.A.). Similarly, on the possibility of suspicion constituting sufficient knowledge for a claim in knowing receipt, see *Abou-Rahmah* v. *Abacha* [2006] EWCA Civ 1492.

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consequences of what one is doing may make it impossible to deny an intention to bring about those consequences".[96]

IV. Issues concerning Proof

Before moving to consider the consequences of a finding of sham, it is worthwhile considering some of the issues surrounding the proof of shams, particularly as they relate to the doctrine's application to trusts.

(a) Onus and Burden

The first points for consideration are the questions: who bears the onus of proving a sham?; and, what burden of proof must that person meet? Both issues can be dealt with relatively briefly. First, there is little authority on the point, but such authority as there is suggests, as one would expect, that the party asserting the existence of a sham bears the onus of establishing that. The Court of Appeal treated the onus in that fashion in *Mikeover Ltd.* v. *Brady*,[97] as did Neuberger J. in *National Westminster Bank plc* v. *Jones*[98] and Munby J. in *A* v. *A*.[99] Secondly, there seems no good reason why the ordinary civil burden of proof (*i.e.*, the balance of probabilities) ought not to apply, although this must be tempered by "the common sense proposition that in a formal document … one does not lightly accept that the parties have used the wrong words",[100] let alone words which intentionally misrepresent the true position. "An allegation of sham is a serious matter"[101] and so the courts will not lightly reach a conclusion of sham:

> there is obviously a strong presumption, even in the case of an artificial transaction, that the parties to what appear to be perfectly proper agreements on their face, intend them to be effective, and that they intend to honour and enjoy their respective obligations and rights. That that is so is supported by the fact that an allegation of sham carries with it a degree of dishonesty, and the court should be slow (but not naively or unrealistically slow) to find dishonesty.[102]

[96] [2000] Ch. 86, 103 (C.A.).
[97] [1989] 3 All E.R. 618, 626.
[98] [2001] 1 B.C.L.C. 98, at [68].
[99] *A* v. *A* [2007] EWHC 99 (Fam), at [69].
[100] *Mannai Investment Co. Ltd.* v. *Eagle Star Life Assurance Co. Ltd.* [1997] A.C. 749, 778. Similarly, in the context of rectification, the ordinary civil standard of proof applies but convincing proof is required: *Swainland Builders Ltd.* v. *Freehold Properties Ltd.* [2002] EWCA Civ 560, at [34].
[101] *A* v. *A* [2007] EWHC 99 (Fam), at [53].
[102] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [46]; see also at paras. [59] and [68].

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This reflects the normal approach to the burden of proof in civil cases, pursuant to which "the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the court concludes that the allegation is established on the balance of probability".[103]

(b) Relevant Evidence

The fact that it is the *subjective* intention of the parties to the sham which determines the existence of a sham indicates that the court cannot be confined to the four corners of the relevant documentation in reaching that conclusion, as Arden L.J. confirmed in *Hitch* v. *Stone*:

> It may examine external evidence. This will include the parties' explanations and circumstantial evidence, such as evidence of the subsequent conduct of the parties.[104]

It is at this point that the difference between a finding of sham and the ordinary process of construction by the court becomes most apparent, as Lord Jauncey of Tullichettle observed in *A.G. Securities* v. *Vaughan*:

> although the subsequent actings of the parties may not be prayed in aid for the purposes of construing the agreements they may be looked at for the purposes of determining whether or not parts of the agreements are a sham.[105]

However, it is worth emphasising Arden L.J.'s observation that evidence of subsequent conduct must be treated with caution when determining whether an arrangement was a sham: it is only relevant in that regard if it shows that the agreement was a sham from the outset, because:

> … the fact that parties subsequently depart from an agreement does not necessarily mean that they never intended the agreement to be effective and binding. The proper conclusion to draw may be that they agreed to vary their agreement and that they have become bound by the agreement as varied.[106]

This caveat is perhaps even more important in the context of trusts than it is in other contexts, because once a trust has been validly created, a subsequent agreement between trustee and settlor that the trust will be a sham merely exposes the trustee to a claim for breach of trust:

[103] *Re H (Minors)* [1996] A.C. 563, 586; see also *Hornal* v. *Neuberger Products Ltd.* [1957] 1 Q.B. 247, 258, 263–264 and 266–267 (C.A.).
[104] *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [65].
[105] [1990] 1 A.C. 417, 475; see also at p. 469 *per* Lord Oliver; *Grupo Torras S.A.* v. *Al-Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1, at [194(vi)].
[106] *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [68].

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> A trustee who has bona fide accepted office as such cannot divest himself of his fiduciary obligations by his own improper acts. If therefore, a trustee who has entered into his responsibilities, and without having any intention of being party to a sham, subsequently purports, perhaps in agreement with the settlor, to treat the trust as a sham, the effect is not to create a sham where previously there was a valid trust. The only effect, even if the agreement is actually carried into execution, is to expose the trustee to a claim for breach of trust and, it may well be, to expose the settlor to a claim for knowing assistance in that breach of trust.[107]

Thus, in *Nurkowski*, the trust was not a sham[108] and so the trustee acted in breach of trust when it made loans back to the settlor out of the trust fund.[109] Evidence as to the subsequent conduct of the trustee and settlor is relevant in finding a sham, but it must indicate that the parties both had the requisite intention to mislead *at the outset*.[110]

Similarly, while the artificiality of an arrangement is relevant evidence when determining whether it was a sham,[111] artificiality is not determinative of the existence of a sham:

> the fact that the act or document is uncommercial, or even artificial, does not mean that it is a sham. A distinction is to be drawn between the situation where parties make an agreement which is unfavourable to one of them, or artificial, and a situation where they intend some other arrangement to bind them. In the former situation, they intend the agreement to take effect according to its tenor. In the latter situation, the agreement is not to bind their relationship.[112]

Thus, for example, in *NatWest* v. *Jones*,[113] two farming partners formed a company and granted to it an agricultural lease over their farmland in an attempt to protect the farms from a mortgagee's power of sale. The artificiality of the arrangement was emphasised by the fact that one of the farmers did not even know what rent was owed under the tenancy of which he was a landlord. Nonetheless, Neuberger J. held that the arrangements did not constitute a sham as the mortgagee

[107] *A* v. *A* [2007] EWHC 99 (Fam), at [43]; see also D. J. Hayton (gen. ed.), *Underhill and Hayton's Law Relating to Trusts and Trustees*, 17th ed. (London 2007), para. [4.11].

[108] See note 73 above.

[109] *Re Nurkowski* [2005] EWHC 336 (Ch), [2005] B.P.I.R. 842, 913.

[110] Subsequent conduct can also potentially be relevant in proving that, although a transaction was a sham at its inception, the parties have altered the arrangement so that the original transaction now represents their true intentions and is no longer a sham: *A* v. *A* [2007] EWHC 99 (Fam), at [45].

[111] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [39].

[112] *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [67]; see also *A* v. *A* [2007] EWHC 99 (Fam), at [17]: "even in the Family Division … [t]he court cannot grant relief merely because the … arrangements appear to be artificial or even 'dodgy'."

[113] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98. This conclusion did not prevent the arrangements being unwound under the statutory powers contained in s.423 of the Insolvency Act 1986, dealing with transactions in fraud of creditors.

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had failed to establish the necessary intention to mislead: the arrangements, although artificial, were intended to be operated.[114] Similarly, trusts which are set up for charities, such as the Red Cross or Oxfam, with a power of appointment in favour of a wide-open class, are not necessarily shams.[115] Such trusts are artificial in the sense that it is generally clear that the settlor intended that the holder of the power of appointment would exercise it in favour of the settlor's family (or others) to the exclusion of the relevant charity, but such artificiality does not automatically equate to a finding of sham.

After discussing the relevance of artificiality in determining the existence of a sham in *NatWest* v. *Jones*, Neuberger J. added the following comment: "Indeed, it would seem to me to require very unusual circumstances before the court held that a transaction which was not artificial was in fact a sham."[116] This might be thought to suggest that shams are a wholly contained subset of artificial transactions. In a sense, however, this point merely depends on what is meant by the word "artificial", because the more "well-crafted" a sham is, the less likely that it will appear artificial, given its more realistic appearance will enhance the likelihood of it achieving its ultimate purpose of misleading third parties.

Another criterion, in addition to artificiality, which carries much weight in determining the existence or otherwise of a sham in the context of trusts is the degree to which the settlor is able to exercise control over the trustee's decision-making powers. For example, in *Rahman* v. *Chase Bank*, the settlor purported to create a trust, but the court found that he had "retained dominion and control over the trust fund throughout his lifetime".[117] The trust was a sham because the

> … trustee was never made master of the assets. [The settlor] intended to and in fact retained control of the capital and income of the trust fund throughout his lifetime and used the trust and the deed of appointment made under the trust to make testamentary dispositions.[118]

Similarly, in *Minwalla* v. *Minwalla*, Singer J. held that the settlor "never had the slightest intention of respecting even the formalities of the trust and corporate structures that had been set up at his direction … [his] intention always was that the resources were his and would

[114] In reaching this conclusion, Neuberger J. rejected an argument that the arrangements must have been intended to be genuine because they could not achieve their purpose if they were a sham: if such an argument were accepted, no arrangement would ever constitute a sham: *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [45].
[115] *R* v. *Dimsey* [2000] Q.B. 744, 773 (C.A.).
[116] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [39].
[117] *Rahman* v. *Chase Bank (C.I.) Trust Co. Ltd.* [1991] J.L.R. 103, 168.
[118] *Ibid.*

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continue to be his".[119] The trustees were also privy to the sham, in the sense that they "were willing to go along with all of [the settlor's] actions and did not … attempt at any stage to rein him in [and] were certainly prepared to go along almost totally passively with the way in which [the settlor] made plain he intended to manage and was managing this trust".[120]

However, it is important to emphasise in this context that the evidence of control over the trustee must be compelling. It is insufficient merely to point to instances where the trustee has acceded to requests from the settlor because, provided the trustee carefully considers all relevant circumstances, he or she may act perfectly properly by resolving in good faith to accede to such a request.[121] In *Grupo Torras* v. *Al-Sabah*, for example, the Jersey Royal Court rejected an allegation that a trust was a sham, despite the fact that the settlor had made numerous requests of the trustee and none of these had been rejected, as this evidence did not establish that the settlor was

> … in control (or substantial or effective control) of [the trust] … [The trustee] considered each request in good faith as an independent trustee, applied its mind to the issue at hand, decided whether to go along with the request and reached its own conclusion having regard to its fiduciary duties. [The trustee] paid great attention to the views of [the settlor] but it was perfectly in order for them to do so.[122]

Similarly, in *Shalson* v. *Russo*, it was argued that Mr Russo was the effective settlor of a trust and Rimer J. accepted that there was "no escaping that in material respects Mr Russo *was* endeavouring to deal with certain of the trust assets as if they were his own".[123] Nonetheless, the trust withstood the argument that it was a sham. The main reason for this conclusion was the fact that it had been settled by the trustee (using a power to re-settle earlier trusts which were valid), but Rimer J. also rejected an argument of sham based on Russo's control of the trust because it was not made out on the evidence: in particular, it was possible to point to specific examples where the trustee had refused to accede to Russo's requests as to disposition of the trust assets.

The question is one of degree: does the settlor have such a degree of control over the trustee's conduct that it is proper to infer that the settlor and the trustee entered into the supposed trust arrangement in order to mislead others into believing that the apparent trust was

[119] *Minwalla* v. *Minwalla* [2005] EWHC 2823 (Fam), [2005] 1 F.L.R. 771, at [57].
[120] *Ibid.*, at para. [58].
[121] *Charman* v. *Charman* [2005] EWCA Civ 1606, [2006] 1 W.L.R. 1053, at [12]; *A* v. *A* [2007] EWHC 99 (Fam), at [72].
[122] *Grupo Torras S.A.* v. *Al-Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1, at [510]; see also at para. [166].
[123] *Shalson* v. *Russo* [2003] EWHC 1637 (Ch), [2005] Ch. 281, at [195] (emphasis original).

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valid? It is important in this regard to emphasise that the mere fact that the trustee has abdicated some of its decision-making powers to the settlor after the trust was created does not necessarily indicate that the trust was a sham when it was originally created: such subsequent conduct may instead amount to no more than a breach of trust on the trustee's part (or potentially a valid delegation of powers by the trustee). But where the pattern of conduct indicates that the trustee has never exercised its discretionary powers and has always been prepared to act simply as the settlor directs, the court may legitimately conclude that both the settlor and the trustee never intended to give effect to the trust instrument and instead entered into it only in order to disguise the true arrangement. It is important to emphasise this high threshold: the mere inclusion in a trust instrument of a power for the settlor to revoke the trust, or to control the trust's investments, does not necessarily mean that the trust is a sham.[124]

Similarly, the inclusion of an overbroad exemption clause[125] in the trust instrument need not necessarily compel the conclusion that the trust is a sham. This must depend on the circumstances. For example, if A transfers property to B "on trust" but states that B shall not be held liable in any way for what B does with the property, one does not require application of the sham doctrine in order to conclude that the arrangement is not a trust. If the parties truly intended that B would not be held liable in any way for his stewardship of the property then the correct categorisation of the arrangement, as a matter of law, is that it is a gift rather than a trust, despite the parties' mislabelling it: as Grant M.R. remarked in *Morice* v. *Bishop of Durham*, "an uncontrollable power of disposition would be ownership, and not trust".[126] Alternatively, if the trust deed were more complicated and the overbroad exclusion clause were merely one of many clauses, it may be that a court would conclude, as a matter of construction of the document in the surrounding circumstances, that the clause cannot have been intended to operate as broadly as its terms suggest, in which case the clause could potentially be 'read down' so as not to exclude liability impermissibly.[127] If this is not possible as a

[124] See, *e.g.*, D. Hayton, "When is a Trust not a Trust?" (1992) 1 J.I.T.C.P. 3, pp. 3–4; J. Mowbray, "Shams, Pretences, Blackmail and Illusion: Parts I and II" [2000] P.C.B. 105, pp. 110–111; D. Harris, "No Such Thing as a Sham Trust" [2004] P.C.B. 95, p. 98.

[125] *i.e.*, one which purports to exclude "the irreducible core of obligations owed by trustees to the beneficiaries … which is fundamental to the concept of a trust". This 'irreducible core' is the "duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries": *Armitage* v. *Nurse* [1998] Ch. 241, 253 (C.A.).

[126] (1804) 9 Ves. 399, 405.

[127] See, *e.g.*, *Midland Bank Trustee (Jersey) Ltd.* v. *Federated Pension Services Ltd.* [1996] P.L.R. 179 (described as "a masterly judgment" by Millett L.J. in *Armitage* v. *Nurse* [1998] Ch. 241, 254).

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matter of construction, the court may take the clause as evidence supporting the view that the parties both had a subjective intention that the arrangement would operate in a way different from that represented by the trust deed: in other words, that the trust is a sham. However, in order to be confident in reaching that conclusion, a court would most likely require evidence beyond the exclusion clause alone, such as evidence of subsequent conduct which indicated that the parties had been operating on the basis of some different arrangement from that contained in the trust deed. In particular, evidence that the settlor continued to control the trust assets despite the terms of the trust purporting to vest that control in the trustee will be important, although such evidence will need to be compelling in order to justify a finding of sham, as has been seen.

(c) Relevance of Illegality

Another difficulty that can arise in the context of establishing that a particular trust was a sham flows from the fact that shams are often created for an illegal purpose. Such purposes include the disposal of assets in order that they cannot be made the subject of an order on divorce,[128] and a debtor transferring assets into the name of another with the intention to retain the beneficial interest in those assets but to be able to deceive creditors into thinking that the debtor no longer owns the assets.[129] If a third party is affected by the deception, they may be able to establish that it was a sham; in other words, that the intention to transfer was not genuine and that both parties intended the purported transferor to retain beneficial ownership of the assets but to be able to mislead third parties into believing that he or she did not in fact own the assets. The fact that the sham arrangement is illegal should have no effect on the ability of a third party to assert that it was a sham if the third party was not himself or herself involved in the illegal purpose. However, the fact that a sham has been created in order to give effect to an illegal purpose might prevent *the parties* to the sham from refusing to give effect to the sham transaction if one of them insists on acting on the basis of that transaction. This depends upon the impact of two principles regarding illegality. First, a party to a transaction for an illegal purpose is not precluded from recovering assets that were transferred pursuant to the transaction if that can be done without relying on the existence of the illegal purpose itself.[130] And secondly, a party to an illegal purpose can rely on the illegal purpose in

[128] *Lowson* v. *Coombes* [1999] Ch. 373, 378 (C.A.).
[129] *Tribe* v. *Tribe* [1996] Ch. 107, 116 and 123 (C.A.).
[130] *Tinsley* v. *Milligan* [1994] 1 A.C. 340, 368 and 375–376; *Tribe* v. *Tribe* [1996] Ch. 107,124.

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asserting a right to recover assets transferred pursuant to that purpose if that person withdraws from the illegal purpose before the purpose has been carried into effect in any way.[131]

These principles have the potential to impact upon sham trusts in a number of ways. It is helpful first to consider a scenario involving only two parties; for example, where A transfers property to B. If the purpose is to deceive A's creditors, there is no point in transferring property to B on trust for A, and so the transfer will most likely purport to be made to B absolutely. Where, however, A's creditors[132] are able to prove that the transfer was a sham, they can potentially gain access to the assets on the basis that they still belong to A beneficially.[133] It would be perverse were A and B's illegal purpose to prevent A's creditors from doing so. However, where A's creditors are not involved and the battle is between A and B (for example, if B tries to assert an absolute title to the property), the position depends upon timing and A's and B's identities. If A and B are father and child respectively, then if the creditors have been deceived in any way by the transfer, A cannot recover the assets from B because the presumed resulting trust in A's favour[134] is rebutted by the presumption of advancement,[135] which in turn cannot be rebutted by A because A cannot rely on proof of the illegal purpose to do so. On the other hand, if A and B are not related in that way, then A can recover the assets on the basis of the presumed resulting trust, which does not require proof of the illegal purpose.[136] Equally, even if A and B are so related, if A

[131] *Tribe* v. *Tribe* [1996] Ch. 107, 121–122, 124 and 132–133.

[132] The creditors will ordinarily exercise this right collectively, *via* a trustee in bankruptcy, but it might also be relevant (especially in sheriff's interpleader proceedings) where an individual creditor is seeking execution of a money judgment against A's assets. For a similar point in the context of freezing orders, see S. Gee, *Commercial Injunctions*, 5th. ed. (London 2004), paras. [13.007]–[13.028].

[133] In modern terms, the third parties will normally rely on statutory powers to set aside the disposition from A to B: see *e.g.*, Insolvency Act 1986, s. 423. Such powers have been available by statute since the Statute of Elizabeth 1571, but the principles of these provisions were said to have formed part of the common law long before then: *Cadogan* v. *Kennett* (1776) 2 Cowp. 432, 434; *Rickards* v. *Attorney-General* (1844) 12 Cl. and Fin. 30, 42 (H.L.). The common law concept is analogous to sham. (For the statutory history, see J. Armour, "Transactions Defrauding Creditors" in J. Armour and H. Bennett, *Vulnerable Transactions in Corporate Insolvency* (Oxford 2003), ch. 3, esp. at paras. [3.6]–[3.9].)

[134] On the basis of a gratuitous transfer: see, *e.g.*, *Tinsley* v. *Milligan* [1994] 1 A.C. 340, 371. Where the property transferred by A to B is land, the presumption of a resulting trust may not be available in any event: Law of Property Act 1925, s. 60(3); *Tinsley* v. *Milligan* [1994] 1 A.C. 340, 371; *Lohia* v. *Lohia* [2001] WTLR 101, 110–112; *Ali* v. *Khan* [2002] EWCA Civ 974, at [24].

[135] As to the continued vitality of the presumption of advancement, see *Antoni* v. *Antoni* [2007] UKPC 10, at [20].

[136] *Tinsley* v. *Milligan* [1994] 1 A.C. 340, 371; *Silverwood* v. *Silverwood* (1997) 74 P. and C.R. 453, 456 and 457–458 (C.A.). The perverse nature of the difference between this scenario and the one just mentioned has been noted by the courts (see, *e.g.*, *Tribe* v. *Tribe* [1996] Ch. 107, 118; *Silverwood* v. *Silverwood* (1997) 74 P. and C.R. 453, 458; *Lowson* v. *Coombes* [1999] Ch. 373, 385), but it depends on the operation of the presumption of advancement rather than anything peculiar to sham trusts. See also Law Commission, *Illegal Transactions: The Effect of Illegality on Contracts and Trusts* (CP 154 1999), paras. [3.22]–[3.24].

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withdraws from the illegal purpose before his creditors are deceived in any way, A is also entitled to recover the assets from B on the basis of the presumed resulting trust.[137]

In *Tribe* v. *Tribe*, Millett L.J. suggested that even where A and B are not sufficiently related for the presumption of advancement to apply, A might be prevented from recovering the assets pursuant to a resulting trust if the illegal purpose had been carried into effect.[138] This is extremely difficult to reconcile with *Tinsley* v. *Milligan*,[139] where the illegal purpose had been carried out and yet the House of Lords accepted that A could assert her interest in the property on the basis of a presumed resulting trust. Millett L.J. may have been referring to the fact that B could nonetheless seek to convince the court that A had a "genuine intention"[140] to transfer absolute title to B, thereby rebutting the presumption of a resulting trust. A might not be entitled to rely on the illegal purpose in order to counter that argument (whereas he could do so if he had withdrawn from the illegal purpose before it was carried out), but the question then becomes whether B can prove, with sufficient clarity to rebut the presumption of a resulting trust, that A intended an absolute transfer. Despite A being prevented from relying on the illegal purpose, B may nonetheless be unable to convince the court that A had a genuine intention to transfer absolute title (for example, where it is clear to the court that the true purpose was the illegal purpose of deceiving creditors) in which case B will have failed to rebut the presumption of a resulting trust and A can assert title. This is perhaps the better result on a policy basis, in any event, given A's deceived creditors should be able to re-open their settlements (for example, on the basis of fraudulent misrepresentation) and then enforce rights against A's assets, whereas they would have no claim against B's assets, even if the settlements with A are re-opened, unless statutory powers to set aside A's disposition are relied upon.

The position seems similar if, in order to deceive A's creditors, A transfers property to B to hold on trust for C, but the declaration of trust may alter the conclusion. It would not alter the result if A's creditors seek to assert that the trust is a sham; the illegal purpose does not prevent them from arguing that the trust was a sham, although they would need to establish that both A and B were involved in the sham. If B was not party to the sham, then the trust for C ought to stand impregnable against A's creditors, unless

[137] *Tribe* v. *Tribe* [1996] Ch. 107; see also *Symes* v. *Hughes* (1870) L.R. 9 Eq. 475, 479 (M.R.).
[138] *Tribe* v. *Tribe* [1996] Ch. 107, 129; see also *Lowson* v. *Coombes* [1999] Ch. 373, 385.
[139] *Tinsley* v. *Milligan* [1994] 1 A.C. 340. A similar observation is made in Law Commission, *Illegal Transactions: The Effect of Illegality on Contracts and Trusts* (CP 154 1999), para. [3.18].
[140] See, *e.g.*, *Tinker* v. *Tinker* [1970] P. 136, 142 (C.A.); *Vandenberg* v. *Palmer* (1858) 4 K. and J. 204, 215 (V.-C.).

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statutory powers to set aside A's disposition can be applied. Again, the more difficult question arises if A's creditors are not involved in the dispute: does A or C have a better claim to the assets? A would again attempt to rely on the presumption of a resulting trust, on the basis of a gratuitous transfer, but this would not be likely to avail him. Irrespective of whether the presumption of advancement applied between A and C, or of whether A had withdrawn from the illegal purpose before it was carried out, the declaration of trust ought to be sufficient to displace the presumption of a resulting trust in favour of A, and A could not rely on the illegal purpose in order to prove that there was no intention to create a trust in favour of C.

Similar considerations arise if A purports to declare himself trustee of the property for C, rather than interposing B as an independent trustee. In such a situation, A is both settlor and trustee, and so the finding of a sham depends solely on A's subjective intention.[141] However, this does not address the question whether A can assert that if the 'trust' was declared in furtherance of an illegal purpose. Again, A's creditors should be able to gain access to the assets in satisfaction of A's debts. However, where the creditors do not sue and the dispute is solely between A and C, there is authority which suggests that C could not assert the trust against A, suggesting that A can raise the sham argument despite the presence of an illegal purpose. In *Commissioner of Stamp Duties (Queensland)* v. *Jolliffe*,[142] a majority of the High Court of Australia held a husband could deny that he was holding assets on trust for his late intestate wife, despite his apparent declaration of trust over those assets in her favour, on the basis that it was clear that he did not intend the assets to belong to his wife. This decision ought not to be followed in England, for the following reasons. As Robert Walker L.J. noted in *Lowson* v. *Coombes*, "[t]he older authorities in this area of the law must now be read in the light of … *Tinsley* v. *Milligan* [and] *Tribe* v. *Tribe*."[143] The husband's claim in *Jolliffe* was essentially that, notwithstanding the apparent declaration of trust, his true intention was to effect an illegal purpose in that he wanted to earn more interest on his assets than was statutorily permitted.[144] Isaacs J. dissented from the majority's finding in favour of the husband on this basis: the husband ought not to be able to avoid the consequences of his declaration of trust "by

[141] *Painter* v. *Hutchison* [2007] EWHC 758 (Ch), at [111]–[112] and [115].
[142] (1920) 28 C.L.R. 178.
[143] *Lowson* v. *Coombes* [1999] Ch. 373, 382.
[144] Pursuant to statute, his deposit at the Queensland Government Savings Bank would earn 3½% interest on deposits up to £1,000, but not on further deposits, and he was prohibited from having more than one account with the Bank unless the other accounts were held as trustee for other persons.

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afterwards setting up his secret intention to defraud or break the law."[145] This view is more consistent with the modern English approach: A ought not to be able to assert the illegal purpose in order to deny the validity of the declaration of trust in favour of C, which suggests that C's claim ought to prevail over that of A.

This is subject to the qualification that A can rely on the illegal purpose in order to show that the trust in favour of C was a sham, and thereby retain beneficial ownership for herself, provided the illegal purpose was never carried into effect. In *Painter* v. *Hutchison*, for example, Mr. Painter transferred assets into his wife's name in an attempt to conceal them from the Inland Revenue. Apparently in furtherance of that scheme, Mrs. Painter then purported to declare a trust over the assets. In fact, the Revenue was never deceived in any way because Mr. Painter informed the Revenue of the existence of the assets before the declaration of trust was executed. The illegal purpose was never carried into effect and so Mrs. Painter was not prevented from asserting that the trust was a sham,[146] and was found to be the sole beneficial owner of the assets.[147]

V. Consequences of a Sham

The final issue to address regarding application of the sham doctrine to trusts is the consequences that flow where it is established that a trust was a sham.

It is not immediately obvious, on the basis of analysis from first principles, what consequence should follow from finding that the parties to an arrangement entered into it with the intention of misleading others. In one sense, the arrangement does not truly reflect what the parties intended, and so it could be considered void by analogy with the way in which the doctrine of *non est factum* operates.[148] On the other hand, the parties to the sham entered into it with an intention to mislead others, which is a fraudulent intent, suggesting that the transaction should perhaps instead be treated as merely voidable.[149] This latter view might be thought to explain more readily the possibility that a sham trust might nevertheless be given effect in favour of C in some of the examples just discussed.

[145] *Commissioner of Stamp Duties (Queensland)* v. *Jolliffe* (1920) 28 C.L.R. 178, 192. The majority decision has been followed in Australia, but predominantly for the proposition that in the absence of a clear declaration of trust, one will not be found where it is not clear that there was an intention to create a trust: see, *e.g.*, *Equuscorp Pty. Ltd.* v. *Jimenez* [2002] SASC 225, at [109]; *Associated Alloys Pty Ltd.* v. *ACN 001 452 106 Pty Ltd* [2000] HCA 25 (2000) 202 C.L.R. 588, [33]–[35].

[146] *Painter* v. *Hutchison* [2007] EWHC 758 (Ch), [122]–[128].

[147] Mr. Painter did not seek to rebut the presumption of advancement: *ibid.*, at para. [128(ii)].

[148] *Saunders* v. *Anglia Building Society* [1970] A.C. 1004, 1026.

[149] *Ibid.*; *Norwich and Peterborough Building Society* v. *Steed* [1993] Ch. 116, 130 (C.A.).

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However, the cases favour the view that a sham transaction is "void and unenforceable"[150] and "wholly invalid and of no effect".[151] This view is taken in order to give practical effect to the underlying purpose of the sham doctrine: to enable the court to "see through"[152] the false façade and "look at the real transaction".[153] It is also important that this approach be taken for the benefit of third parties who may have been adversely affected by the sham. Third parties who have been induced to enter into further transactions by reason of the existence of the sham transaction will normally have a right to rescind those further transactions on the basis of fraudulent misrepresentation.[154] However, third parties who are affected directly by the sham transaction (for example, creditors or the Revenue who want access to assets that are being "hidden" behind the sham transaction) would not normally have standing to seek an order setting aside the sham if it is merely a voidable transaction.[155] It is clear, for example, that the Revenue must argue that the sham transaction is void in order to be able to tax on the basis of the *current* position as to beneficial ownership, as Arden L.J. explained in *Hitch* v. *Stone*:

> The Revenue must show that cl. 2 is ineffective, not simply that it was voidable. No authority has been cited to us which would suggest that a sham transaction could on its own be other than a void transaction. There being no statutory provision in point here, that consequence would in my judgment follow.[156]

The necessary consequence of this approach is that the court must also determine what are the true arrangements between the parties. This may not be difficult, in that it is possible that the arrangement was that the parties' respective positions prior to the sham transaction were not in fact intended to alter at all, in which case the *status quo ante* is the true arrangement. However, where the sham was a false façade for a different transaction

> … the court has to grapple with what the effect of the true arrangements are in law and equity by reference to the principles that would govern litigation between the participants in the sham

[150] *Midland Bank plc* v. *Wyatt* [1995] 1 F.L.R. 696, 707; see also *Chase Manhattan Equities Ltd.* v. *Goodman* [1991] B.C.L.C. 897.

[151] *Rahman* v. *Chase Bank (C.I.) Trust Co. Ltd.* [1991] J.L.R. 103, 168; see also *Minwalla* v. *Minwalla* [2005] EWHC 2823 (Fam), [2005] 1 F.L.R. 771, at [60]; *Grupo Torras S.A.* v. *Al–Sabah* [2003] JRC 092, [2004] 1 W.T.L.R. 1, at [522]; *Carman* v. *Yates* [2004] EWHC 3448 (Ch), at [173].

[152] *Yorkshire Railway Wagon Co.* v. *Maclure* (1882) 21 Ch.D. 309, 318.

[153] *In re Watson* (1890) 25 Q.B.D. 27, 40.

[154] See, *e.g.*, *Shalson* v. *Russo* [2003] EWHC 1637 (Ch), [2005] Ch. 281, at [108]; E. Peel, *Treitel's Law of Contract*, 12th ed. (London, 2007), paras. [9-075]–[9-083]; J. McGhee (gen. ed.), *Snell's Equity*, 31st ed. (London 2005), para. [13-08].

[155] Such parties may, of course, be empowered by statute to seek orders setting aside transactions that are not otherwise void: see, *e.g.*, Insolvency Act 1986, s. 423.

[156] *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [87]; see also *Sieff* v. *Fox* [2005] EWHC 1312 (Ch), [2005] 1 W.L.R. 3811, at [78].

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> as to their respective interests. This involves ascertaining their agreement and intentions and may be complicated by (i) the point that the purpose of, or motive for, the pretence or sham is to defraud creditors (and is thus tainted by illegality), and (ii) questions relating to the presumption of advancement and resulting, constructive and implied trusts.[157]

This compares unfavourably, from the court's perspective,[158] with the broad discretion which the court is given under certain statutes to "make such order as it thinks fit",[159] but it is the appropriate proprietary response to the sham transaction in the absence of any statutory justification for acting otherwise: "It is a fundamental error to think that, because certain property rights are equitable rather than legal, such rights are in some way discretionary."[160]

A further consequence of the sham being void is the potential difficulty this creates where innocent third parties have somehow become embroiled in the workings of the sham arrangement before the court has found it to be a sham, which is quite possible as regards complex commercial sham transactions. Neuberger J. pointed out in *NatWest* v. *Jones* that this "should not stand in the way" of the conclusion that the original transaction was a sham, because "it can scarcely lie in the mouth of either [party to the sham] to contend that the [sham] agreement does not exist as against the [innocent third party] in such circumstances".[161] The language here clearly reflects the possibility of the innocent third party asserting an estoppel against the parties to the sham, which Arden L.J. also mentioned as a possibility in *Hitch* v. *Stone*.[162] It is difficult to see why such a claim would not succeed in most cases involving shams.

In *Hitch* v. *Stone*, Arden L.J. also raised the question "whether the transaction would cease to be void",[163] notwithstanding it having been void from the outset, if an innocent third party argued that it had acquired rights apparently created by the sham transaction. This is probably unnecessary if the estoppel analysis is applied robustly, but it is also worth mentioning that the suggestion that a void transaction could somehow be revivified is not as strange as might first appear. The important point is that the concept of a transaction being "void" is not as final or as absolute as the word suggests. For example, it is clear that a lease granted by a mortgagor in breach of covenants created in the mortgage is a perfectly valid lease so far as the

[157] *Carman* v. *Yates* [2004] EWHC 3448 (Ch), at [173]; see also at para. [246].
[158] *Ibid.*, at para. [174].
[159] See, *e.g.*, Insolvency Act 1986, s. 423(2).
[160] *Foskett* v. *McKeown* [2001] 1 A.C. 102, 109.
[161] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [60].
[162] *Hitch* v. *Stone* [2001] EWCA Civ 63, [2001] S.T.C. 214, at [87].
[163] *Ibid.*

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mortgagor and tenant are concerned, yet it is entirely void *vis-à-vis* the mortgagee.[164] Similarly, in the context of trusts, numerous cases have held that trusts have been validly created notwithstanding that the trustee disclaimed the trust property. A disclaimer renders the transfer of title void *ab initio*, but "the true meaning is that, not in regard to all persons and for all purposes is the case to be treated as though the legal estate had never passed".[165] It is perfectly possible, therefore, for a sham transaction to be considered void and yet be capable of creating rights enforceable by innocent third parties. The effect of the sham transaction being void, rather than voidable, is well summarised by Charles J. in *Carman* v. *Yates*:

> a conclusion that a document, agreement or provision is a sham or pretence does not make it void, or of no effect, for all purposes. Rather if there is a sham or pretence: (i) the parties will not be able to rely on it as representing the true position as to the rights and obligations they have created and the court can ignore it in determining what those rights are, and (ii) as against an innocent third party it cannot lie in the mouths of the pretenders to assert to the disadvantage of that innocent third party that the transaction is a sham, or pretence, and thus of no effect.[166]

This approach works where there is only one innocent third party involved. The situation may, of course, be complicated even further "where the interests of one innocent party, who contends that the agreement is a sham, clash with the interests of another innocent party, who contends that it is genuine".[167] In *NatWest* v. *Jones*, Neuberger J.'s reaction to this hypothetical difficulty was to recognise it as "a problem which will have to be considered if and when it arises".[168] In *Carman* v. *Yates*, Charles J. took that statement as "an indication that when a sham or pretence is established the court has some flexibility as to what the rights and interests of the persons who have entered into it, and those who are affected by it, are".[169] With respect, it seems unlikely that this is precisely what Neuberger J. meant in *NatWest* v. *Jones*. It is suggested that the difficulties inherent in such a situation are better dealt with by being mediated through settled doctrines, such as estoppel and rights to rescind, rather than by

[164] See, *e.g.*, *Quennell* v. *Maltby* [1979] 1 W.L.R. 318, 323 (C.A.); *Britannia Building Society* v. *Earl* [1990] 1 W.L.R. 422, 428 (C.A.).
[165] *Mallott* v. *Wilson* [1903] 2 Ch. 494, 501; see also *Re Parsons* [1943] 1 Ch. 12, 15–16 (C.A.); *Re Stratton's Disclaimer* [1958] 1 Ch. 42, 54 (C.A.). The effect of the disclaimer is that the intended trustee never owes any duties to the beneficiaries, but the settlor ends up holding on trust after the disclaimer causes the property to revert to him or her.
[166] *Carman* v. *Yates* [2004] EWHC 3448 (Ch), at [219].
[167] *National Westminster Bank plc* v. *Jones* [2001] 1 B.C.L.C. 98, at [60].
[168] *Ibid.*
[169] *Carman* v. *Yates* [2004] EWHC 3448 (Ch), at [220].

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reference to an unconstrained judicial discretion.[170] An estoppel with respect to property can create an equity which is capable of having proprietary effect,[171] as can equities to rescind,[172] such that normal principles regarding the priority of competing equities[173] can potentially be employed to settle disputes between multiple innocent third parties in this sort of scenario.

VI. Conclusions

In summary, it is suggested that there is a doctrine of sham known to English law and that it applies in the context of trusts. The doctrine is concerned with situations where the parties to an apparently valid transaction have purported to enter into it in order to mislead third parties. The relevance of the sham doctrine, and the difference between it and normal processes of construction, lies in the fact that it justifies the court in ignoring (as opposed to construing) the usual primary material regarding that transaction, and focusing its attention instead on all other material factors which indicate the arrangement that the parties in fact intended.

In determining whether the transaction is a sham, the court is therefore concerned with the subjective intentions of the parties to the transaction. Before a transaction can be ignored as a sham, *all* of the parties to the transaction must be shown to have had the requisite intention to mislead third parties, in order that the sham doctrine does not unjustifiably destabilise bilateral transactions. Similarly, the onus

[170] The remedy in an estoppel claim is at the court's discretion: see *Gillett* v. *Holt* [2001] Ch. 210, 235 (C.A.); *Jennings* v. *Rice* [2002] EWCA Civ 159, [2003] 1 F.C.R. 501, at [22]–[36] and [43]–[56]; *Cobbe* v. *Yeoman's Row Management Ltd.* [2006] EWCA Civ 1139, [2006] 1 W.L.R. 2964, at [120]. However, like all equitable discretionary remedies, this discretion is exercised according to settled principles, rather than in an unconstrained manner: *Warman International Ltd.* v. *Dwyer* (1995) 182 C.L.R. 544, 559; *Ultraframe (U.K.) Ltd.* v. *Fielding* [2005] EWHC 1638 (Ch), at [1579]; J. McGhee (gen. ed.), *Snell's Equity*, 31st ed. (London 2005), paras. [7–129] and [12–04]. For commentary on the factors that courts take into account in deciding on the appropriate remedy in estoppel claims, see S. Gardner, "The Remedial Discretion in Proprietary Estoppel" (1999) 115 L.Q.R. 438; S. Gardner, "The Remedial Discretion in Proprietary Estoppel – Again" (2006) 122 L.Q.R. 492.

[171] This has now been made explicitly clear by statute for registered land (Land Registration Act 2002, s. 116,), but it was the better view as regards proprietary estoppel in any event: see R. J. Smith, "How Proprietary is Proprietary Estoppel?" in F. D. Rose (ed.), *Consensus Ad Idem* (London 1996), 235; C. Harpum, *Megarry and Wade's Law of Real Property*, 6th ed. (London 2000), paras. [13-028]–[13.032]; Law Commission, *Land Registration for the Twenty-First Century*, Law Com No. 271 (London 2001), para. [5.30]; *Birmingham Midshires Mortgage Services Ltd.* v. *Sabherwal* (1999) 80 P. and C.R. 256, 263 (C.A.).

[172] D. Fox, "Equities to Rescind and Interests under Resulting Trusts" [2000] C.L.J. 444, 446; R. Nolan, "Dispositions involving fiduciaries: the equity to rescind and the resulting trust" in P. B. H. Birks and F. D. Rose (eds.), *Restitution and Equity* (London 2000), 119, pp. 126–139; R. P. Meagher, J. D. Heydon and M. J. Leeming, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies*, 4th ed. (Sydney 2002), para. [4–145]; J. McGhee (gen. ed.), *Snell's Equity*, 31st ed. (London 2005), para. [13–19].

[173] For the principles as to priority between competing equities, see, *e.g.*, R. P. Meagher, J. D. Heydon and M. J. Leeming, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies*, 4th ed. (Sydney 2002), ch. 8; J. McGhee (gen. ed.), *Snell's Equity*, 31st ed. (London 2005), ch. 4.

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of establishing a sham rests on the party asserting that the transaction is a sham. This may create difficulties in the context of trusts, because many sham trusts will have been created with an illegal purpose in mind, and the parties to that illegality are barred from pleading it in order to make out a case of sham.

The consequences of finding that a trust was a sham are less clear, but it is suggested that it makes most sense if the sham trust is treated as void, with the caveat that issues of estoppel and rights to rescind will need to be borne in mind when that conclusion is given effect *vis-à-vis* innocent third parties.

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