



Scottish Law Commission  
*promoting law reform*

## Report on Variation and Termination of Trusts

Laid before the Scottish Parliament by the Scottish Ministers under section 3(2) of the Law Commissions Act 1965

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<sup>1</sup> Amended by the Scotland Act 1998 (Consequential Modifications) (No 2) Order 1999 (SI 1999/1820).



# SCOTTISH LAW COMMISSION

*Item No 3 on our Seventh Programme of Law Reform*

## **Report on Variation and Termination of Trusts**

To: Ms Cathy Jamieson MSP, Minister for Justice

We have the honour to submit to the Scottish Ministers our Report on Variation and Termination of Trusts.

(Signed)

JAMES DRUMMOND YOUNG, *Chairman*

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Michael Lugton, *Chief Executive*  
19 February 2007



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# Part 1 Introduction

## The Trust Law Review

1.1 This is the first Report which we have submitted in our review of trust law. It follows upon Discussion Paper No 129, *Variation and Termination of Trusts*, published in December 2005 and contains our recommendations with regard to two distinct matters: firstly, variation and termination of private trusts and, secondly, reorganisation of public trusts. We are grateful to all those who responded to the Discussion Paper.<sup>1</sup> We intend to submit a report on matters contained in the other discussion papers we have already published<sup>2</sup> by the end of 2009 when the current Seventh Programme of Law Reform terminates.

## Variation and termination of private trusts

### *The present law*

1.2 Part 2 of this Report outlines the present law in relation to both extra-judicial variation and judicial approval of variation of private trusts. As regards extra-judicial variation, where all possible beneficiaries of the trust are of full age and capacity and there are no continuing trust purposes which require retention of trust property by the trustees, the beneficiaries may agree among themselves to bring the trust to an end or, probably, to vary its terms, even if this does not accord with the wishes of the truster. Variation or termination cannot, however, proceed by agreement among the beneficiaries where one or more of them lack the capacity to agree (for example because they are children), or where there are unborn or unascertained beneficiaries. In such circumstances, an application may be made to the Court of Session under section 1 of the Trusts (Scotland) Act 1961 for approval on behalf of the minor, unborn or unascertained beneficiary of an arrangement terminating the trust or amending its terms. The court may approve the arrangement if satisfied that it is not prejudicial to any of the persons upon whose behalf its approval is sought. The court may also authorise a scheme which varies or terminates an alimentary liferent, provided that certain conditions are satisfied.

1.3 In relation to variation both by extra-judicial agreement and by judicial approval, Scots law follows English law in placing greater emphasis on the wishes of the beneficiaries than those of the truster. By way of contrast, many states of the United States require an application to the court in any case in which the truster is not a party to the agreement varying the trust provisions. The court may approve the modification or termination of the trust only if satisfied that what is proposed is not inconsistent with a material purpose of the trust. In Part 3 we explain why we do not recommend adoption of the US "material purpose" doctrine in Scotland.

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<sup>1</sup> A list of consultees who submitted a written response to the Discussion Paper is at Appendix B.

<sup>2</sup> Discussion Paper No 123 on *Breach of Trust*, Discussion Paper No 124 on *Apportionment of Trust Receipts and Outgoings*, both published in September 2003, Discussion Paper No 126 on *Trustees and Trust Administration*, published in December 2004 and Discussion Paper No 133 on *The Nature and Constitution of Trusts*, published in October 2006.

## *Summary of our recommendations*

1.4 In Part 4 we make recommendations for reform of the law in relation to variation or termination of trusts by agreement. As there is some uncertainty regarding the extent of the entitlement of beneficiaries who are all of full age and capacity to agree to the termination of a trust or to the variation of its provisions, we recommend that this be confirmed by statute.<sup>3</sup> We discuss whether a parent as legal representative should have power to consent on behalf of a child to the variation or termination of a trust, bearing in mind that there could be a conflict of interest between parent and child, and recommend that it should be clarified by statute that the parent does not have such a power.<sup>4</sup> At present a 16 or 17 year old beneficiary does not have capacity to consent to a variation or termination of the trust and we recommend that this should continue to be so.<sup>5</sup> We recommend, however, that it should continue to be competent for consent to be given on behalf of an adult beneficiary with incapacity.<sup>6</sup> Finally, we recommend a minor change in the law to remove the need for court approval of the variation or termination of an alimentary liferent created by a woman in favour of herself in an ante-nuptial marriage contract.<sup>7</sup>

1.5 In Part 5 we make a number of recommendations for reform of the statutory provisions regarding judicial approval of arrangements to vary or terminate trust provisions. These are intended to facilitate the obtaining of court approval of arrangements varying trust provisions in certain circumstances where this is not possible under existing law. It would however remain necessary that all ascertained and traceable beneficiaries of full age and capacity with non-negligible interests agree to any arrangement.<sup>8</sup> We recommend that the existing statutory provisions might be amended in order to permit the court to approve a scheme despite the possibility of the occurrence of certain highly improbable events, such as the birth of a child to an elderly man or woman.<sup>9</sup> This solution is not appropriate where an interest, however remote, has already come into existence, and in such circumstances we recommend that the court should be given power to approve an application for variation without requiring to be satisfied that there is no prejudice to a person with an interest of negligible value and that the trustees should be relieved of liability should the interest emerge unexpectedly, whilst leaving open the possibility of a claim by the person whose interest has emerged against the beneficiaries of the variation.<sup>10</sup> We recommend a broadening of the range of factors to which the court should have regard in assessing whether or not a proposed scheme is prejudicial to a person on whose behalf approval is sought.<sup>11</sup> We also recommend that the court should have power to approve an arrangement on behalf of an untraceable beneficiary, provided that the court is satisfied that the beneficiary in question is not prejudiced by the variation.<sup>12</sup> Two clarifications of the present law are also recommended: firstly, that consent of the truster to a proposed arrangement is not required<sup>13</sup> and, secondly, that an arrangement may take the form of a re-settlement of

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<sup>3</sup> See paras 4.1-4.4 below.

<sup>4</sup> See paras 4.5-4.16 below.

<sup>5</sup> See paras 4.17-4.18 below.

<sup>6</sup> See paras 4.19-4.22 below.

<sup>7</sup> See paras 4.22-4.23 below.

<sup>8</sup> See paras 5.34-5.37 below.

<sup>9</sup> See paras 5.19-5.22 below.

<sup>10</sup> See paras 5.13-5.18 below.

<sup>11</sup> See paras 5.23-5.28 below.

<sup>12</sup> See paras 5.30-5.33 below.

<sup>13</sup> Para 5.38.

the whole or part of the trust estate.<sup>14</sup> Finally, we make a recommendation, based upon a proposal originally contained in an earlier discussion paper,<sup>15</sup> that applications for approval of arrangements be presented in the Outer House instead of the Inner House as is presently the case.<sup>16</sup> Legislation which would give effect to these recommendations is contained in Part I of the draft Bill annexed to this Report.

## Reorganisation of public trusts

### *The present law*

1.6 In Part 6 we turn to consider the reorganisation of public trusts which are not charities. The Charities and Trustee Investment (Scotland) Act 2005 has introduced a comprehensive new regime for the regulation of charities, including charitable trusts, in Scotland. This regime includes a mechanism whereby the new Office of the Scottish Charity Regulator ("OSCR") may approve a reorganisation scheme amending the constitution of a charity where, for example, the existing provisions have ceased to provide a suitable and effective method of using the trust property. The 2005 Act does not, however, apply to public trusts not entered in the charities register, which remain governed by the provisions of sections 9 -11 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 and which, except in the case of small trusts, require a court application for approval of a reorganisation scheme. An educational endowment falls within the 2005 Act if its governing body is a charity; if not, it remains subject to a different reorganisation regime applicable to endowments which is contained in the Education (Scotland) Act 1980. In addition, the Court of Session has a common law jurisdiction in exercise of the *nobile officium* to approve a *cy-près* scheme in certain circumstances, notably where there is an initial failure of the trust purposes but where the truster has demonstrated a general charitable intention.

### *Summary of our recommendations*

1.7 In our view there is no good reason for having so many different procedures operating in relation to different types of public trust. Our principal recommendation is that all charities and all public trusts (whether or not charities and whether or not taking the form of an educational or other endowment held by a body) should in principle be brought within the same rules for approval of a reorganisation scheme.<sup>17</sup> We recommend new rules which are based partly upon the provisions of the 2005 Act and partly upon the 1980 statutory provisions which continue to apply to endowments whose governing body is not a charity. In our view these provide the necessary degree of flexibility while continuing to have due regard to the spirit of the originating trust deed. As regards the question of who should have power to approve a reorganisation scheme for a trust which is not a charity, we recommend that this should be given to OSCR.<sup>18</sup> Finally, we recommend that where in a *cy près* application the court is satisfied that the necessary charitable intention has been demonstrated, it should have power in appropriate cases to remit the application to OSCR to

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<sup>14</sup> Para 5.42.

<sup>15</sup> Discussion Paper No 126 on *Trustees and Trust Administration*.

<sup>16</sup> See paras 5.43-5.44 below.

<sup>17</sup> See Recommendations 15 and 16 at para 6.24 below.

<sup>18</sup> See paras 6.25-6.26 below.

consider the detail of the proposed scheme.<sup>19</sup> Legislation which would give effect to these recommendations is contained in Part 2 of the draft Bill annexed to this Report.

### **Advisory Group**

1.8 We have been assisted throughout by an Advisory Group comprising both practitioners and academics, whose members are listed in Appendix C. Members of the Group commented on policy papers, a draft of the Discussion Paper and a draft of the Report containing the draft Bill. We are very grateful to them for their helpful and practical comments on all these papers. We are also grateful to Dr Patrick Ford of the Charity Law Research Unit, University of Dundee, for his helpful comments and advice.

### **Legislative competence**

1.9 The recommendations in this Report relate to the variation and termination of private trusts, and the reorganisation of non-charitable public trusts, none of which are reserved matters under the Scotland Act 1998. They therefore lie within the legislative competence of the Scottish Parliament.

1.10 In our view our proposals if enacted would not give rise to any breach either of the European Convention on Human Rights or of European law.

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<sup>19</sup> See paras 6.27-6.30 below.

## Part 2 Private trusts: the present law

### Extra-judicial termination of trusts

2.1 In certain circumstances a trust may be brought to an end by the beneficiaries prior to the date, or occurrence of the event, specified by the truster. This is generally known as the rule in *Miller's Trustees*. In the case of *Miller's Trustees v Miller*,<sup>1</sup> a testator directed his trustees to hold property for his second son until the latter attained age 25. The property was to vest on his attaining age 25 or on marrying with the consent of the trustees after attaining age 21. The son married with the trustees' consent after attaining age 21 but before reaching 25, and called on the trustees to make over the capital to him. In view of the existence of a number of previous conflicting decisions, a court of seven judges heard the case and held, by a 5-2 majority, that the son was entitled to have the capital made over to him despite the testator's direction that it should not be paid until he attained age 25. Lord President Inglis stated:<sup>2</sup>

"There is, in my opinion, a general rule, the result of a comparison of a long series of decisions of this Court, that where by the operation of a testamentary instrument the fee of an estate or parts of an estate, whether heritable or moveable, has vested in a beneficiary, the Court will always, if possible, relieve him of any trust management that is cumbrous, unnecessary, or expensive. Where there are trust purposes to be served which cannot be secured without the retention of the vested estate or interest of the beneficiary in the hands of the trustees, the rule cannot be applied, and the right of the beneficiary must be subordinated to the will of the testator. But I am not aware of any case in which the mere maintenance of a trust arrangement without any ulterior object or purpose has been held to be a trust purpose in the sense in which I have used that term."

Lord McLaren's rationale was somewhat different:<sup>3</sup>

"It seems to me that a beneficiary who has an estate in fee has by the very terms of the gift the same right of divesting the trustees, and so putting an end to the trust, which the truster himself possessed, because under a gift in fee the grantee acquires all the rights in the property which the truster had to give. It seems to me to be not only an unsound proposition in law, but a logical impossibility, that a person should have an estate in fee, and that some other person should at the same time have the power of withholding it. This I understand to be a well-settled principle. It is laid down by writers of authority on the law of England, and I have never had any doubts about its being the law of Scotland...."

There are only two exceptions, so far as I know, to the operation of this general rule, as I understand it, and these are founded on civil disability – I mean the case of marriage and the case of minority or mental incapacity. The case of minority or mental incapacity is only an apparent exception, because the trustees are only possessors in the character of the guardians of the estate of a beneficiary who is not in the position to manage the property for himself...."

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<sup>1</sup> (1890) 18 R 301.

<sup>2</sup> *Ibid* at 305, Lord Justice-Clerk Macdonald, Lord Rutherford Clark and Lord Adam concurring.

<sup>3</sup> *Ibid* at 310.

2.2 In view of continuing differences of opinion, and some doubt as to the *ratio* of *Miller's Trustees*, the matter was brought before the whole court for reconsideration in *Yuill's Trustees v Thomson*.<sup>4</sup> In this case a testator directed the trustees to retain the shares of certain capital beneficiaries after they had attained a vested interest, and to pay them neither capital nor income so long as their fathers should be alive. The majority held that the beneficiaries were entitled to receive their shares of capital. The rule in *Miller's Trustees* was stated as follows:<sup>5</sup>

"The principle of that decision is that when a vested, unqualified and indefeasible right of fee is given to a beneficiary of full age, he is entitled to payment of the provision notwithstanding any direction to the trustees to retain the capital of the provision, and to pay over the income periodically, or to apply the capital or income in some way for his benefit. The proposition is qualified in the opinion of Lord President Inglis by the addition that, where there are trust purposes to be served which cannot be secured without the retention of the vested estate or interest of the beneficiary in the hands of the trustees, the rule cannot be applied, and the right of the beneficiary must be subordinated to the will of the testator."

This formulation contains elements of both of the majority opinions in *Miller's Trustees* set out above, and has since been accepted as an authoritative expression of the rule.

2.3 The practical consequence of the rule is that the will of the truster is subordinated to that of a beneficiary of full age and capacity. The truster's intention that the property should remain subject to the trust provisions after an adult has obtained a vested interest is overridden although in *Miller's Trustees* this was qualified by the proviso that there are no other continuing trust purposes, such as a liferent or annuity, to be implemented. The equivalent rule in English law is known as the rule in *Saunders v Vautier*.<sup>6</sup>

2.4 The particular decisions of the court in *Miller's Trustees* and in *Yuill's Trustees v Thomson* concern only the entitlement of an individual beneficiary whose interest is vested and indefeasible. The rule has, however, been regarded as wider, entitling beneficiaries whose interests (whether vested or not) when taken together amount to the whole interest in the trust fund to join together and require that the trust be terminated and the capital distributed. There is little direct Scottish authority for this interpretation of the rule. In *Gray v Gray's Trustees*,<sup>7</sup> which preceded *Miller's Trustees* itself, Lord Gifford observed:<sup>8</sup>

"When, in a private trust, every possible beneficiary desires and consents to a particular course being adopted – all the beneficiaries being of full age and *sui juris* – and none of them being placed under any restraint or disability by the trust-deed itself – then no-one has any right or interest to object, and the Court will not interfere to prevent the sole and unlimited proprietors doing what they like with their own."

More recently, in *Earl of Lindsay v Shaw*,<sup>9</sup> under reference to *Gray v Gray's Trustees*, Lord Justice-Clerk Thomson observed:

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<sup>4</sup> (1902) 4 F 815.

<sup>5</sup> *Ibid* at 819 in the opinion of Lord President Balfour, Lord Adam, Lord McLaren and Lord Kinneir; Lords Kyllachy, Stormonth, Darling and Low and Lord Justice-Clerk Macdonald concurring.

<sup>6</sup> (1841) Cr & Ph 240. This case was among the authorities cited to the court in both *Miller's Trs* and *Yuill's Trs v Thomson*, though it is not referred to in any of the opinions delivered.

<sup>7</sup> (1877) 4 R 378.

<sup>8</sup> *Ibid* at 383. See also Lord Justice-Clerk Inglis at 382.

<sup>9</sup> 1959 SLT (Notes) 13.

"Trusts are created by trusters for the benefit of certain nominated beneficiaries and trustees are appointed merely to see that the interests of the beneficiaries are protected. If the beneficiaries being of full age and sound sense discharge their benefits, the trustees have no interest to prevent them doing so or to attempt to protect them from themselves. In such circumstances trustees are administrators, not nursemaids. This is so elementary as hardly to need authority ..."

2.5 It is important to emphasise that the wide interpretation of the rule in *Miller's Trustees* applies even where the interests of the beneficiaries have not yet vested. In such cases it could be said that there are still trust purposes to be served, but the wide interpretation permits the beneficiaries to demand payment nonetheless. On the other hand, a common feature of the cases mentioned above is that all of the beneficiaries were of full age and capacity. This is a prerequisite for the application of the rule: the existence of a minor or incapable adult beneficiary precludes termination of the trust by agreement among the beneficiaries. So, for example, it is not open to the major beneficiaries alone to agree to terminate the trust even where the terms of the agreement would plainly be for the financial benefit of a child. It follows, logically, that the rule does not envisage the distribution of any part of the trust capital to a minor or *incapax* beneficiary.

### **Extra-judicial variation of trusts**

2.6 There is no clear authority for the proposition that beneficiaries who would together have the capacity to terminate a trust also have the capacity to vary its terms so that the property remains in trust but is subject to altered trust provisions. The rule in *Miller's Trustees* is concerned specifically with the right of a beneficiary of full age to demand that property to which he has a vested, indefeasible right be made over to him. In *Gray's Trustees*,<sup>10</sup> the trustees considered it necessary to seek the court's approval of a scheme altering the terms of the trust. It seems, however, that if a beneficiary has a right to direct that trust assets be made over to him absolutely, it must follow that this right extends to directing that these assets be made over to a third party (such as new trustees) or, provided that the trustees are willing to continue to act as such, that the assets be held by them for new or amended purposes. Similarly, if the beneficiaries together are entitled to demand that the trust be brought to an end, it follows that they may together decide that the purposes shall be varied. This is clearly established in England.<sup>11</sup> Again, the only situation envisaged is where all the beneficiaries (whether or not with vested interests) are of full age and capable of consenting and where they do in fact all agree to vary the terms of the trust. The existence of a minor or incapable adult beneficiary would preclude variation by agreement in the same way as it precludes premature termination by agreement.

2.7 Although there is no direct authority, the same principle would appear to apply to a variation by consent which affects only part of the trust fund. Provided that all the possible beneficiaries in that part of the fund are of full age and consent to a variation of the terms, as a matter of principle, it should not be necessary to obtain the consent of a beneficiary with an interest which is unaffected by the proposed change. It is important, however, to distinguish

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<sup>10</sup> See para 2.4 above.

<sup>11</sup> The rule in *Saunders v Vautier* has been stated as follows: "If the beneficiaries are adults under no disability and entitled between them to the whole beneficial interest they can terminate the trust and divide the trust property between them": Underhill & Hayton, *Law of Trusts and Trustees* (16<sup>th</sup> edn, 2003), p 27. In *IRC v Holmden* [1968] AC 685, Lord Wilberforce observed at 713: "If all the beneficiaries under the settlement had been *sui juris*, they could, in my opinion, have joined together with the trustees and declared different trusts which would supersede those originally contained in the settlement".

between, on the one hand, an interest which is unaffected by the variation and, on the other hand, an interest which is not *adversely* affected by it. In the latter situation, consent of the beneficiary in question is needed even if the absence of prejudice is obvious.

### Alimentary liferents

2.8 An interest in the income of a trust, such as a liferent or annuity, may be declared by the truster to be "alimentary", in which case particular restrictions attach to it.<sup>12</sup> The alimentary liferent is a peculiarly Scottish institution, fulfilling a role broadly similar to that of the protective trust under English law and the spendthrift trust in the United States. Its principal features are that, as a general rule:

- It may not be renounced or assigned by the beneficiary after he or she has entered into enjoyment of it;<sup>13</sup>
- It cannot be arrested by creditors except to the extent that instalments of income have actually fallen due to the beneficiary.

The protection afforded by the alimentary restriction is, however, effective only in so far as it is of reasonable amount, having regard to the circumstances of the beneficiary. The liferent provision is arrestable (and, probably, assignable) in so far as it is in excess of a sufficient alimentary income. The court will not, however, approve an assignation by the alimentary beneficiary of part of the provision on the basis of an estimate of future alimentary needs, as this would be to favour current general creditors over future alimentary creditors.<sup>14</sup> It is not competent for a person to create an interest in his or her own favour with an alimentary restriction, with a view to protecting future income from creditors.<sup>15</sup>

2.9 Use of alimentary liferents in Scots law has in the past been closely bound up with ante-nuptial marriage contracts. They were regularly used as a means of protecting the wife's property from dissipation by her husband during the subsistence of his *jus mariti* and *jus administrationis*, ensuring that recourse could not be had to her assets to satisfy the husband's business or personal debts. They have also been used, and continue to be used, outside the context of marriage contract trusts as a means of protecting a beneficiary from his or her own financial weaknesses. In modern practice it is possible to utilise an alimentary liferent in making provision, in either an *inter vivos* or a *mortis causa* trust, for a beneficiary who, though of full age, is not regarded by the truster as wholly reliable in his or her use of an income entitlement. It is also used to protect funds from claims by a beneficiary's spouse in the event of divorce. The fact that an alimentary liferent cannot be discharged by the beneficiary means that it is not competent for a trust containing such a provision to be terminated by the extra-judicial consent of all the beneficiaries, or to be varied by consent in any way which affects the interest of the alimentary liferenter.

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<sup>12</sup> No specific form of wording is required in order to create an alimentary right, but the most common means of achieving the restriction is to declare the interest to be alimentary.

<sup>13</sup> See eg *Douglas Hamilton v Duke and Duchess of Hamilton's Trs* 1961 SC 205, Lord President Clyde at 219.

<sup>14</sup> *Cuthbert v Cuthbert's Trs* 1908 SC 967. Alimentary debts have been defined as "all articles of annual expenditure required for the comfort, or suitable to the situation of the party"; *Greig v Christie* (1837) 16S 242, Lord Fullerton at 244.

<sup>15</sup> Prior to 1984 it was competent for a woman (though not a man) to create an alimentary provision in her own favour in an ante-nuptial marriage contract. This power (which echoed the English "restraint on anticipation") was abolished by the Law Reform (Husband and Wife) (Scotland) Act 1984, s 5(1)(a).

## Judicial approval of arrangements for variation and termination of trusts

2.10 Section 1 of the Trusts (Scotland) Act 1961 (referred to in this Report as "the 1961 Act") currently provides as follows:

"(1) In relation to any trust taking effect, whether before or after the commencement of this Act, under any will, settlement or other disposition, the court may if it thinks fit, on the petition of the trustees or any of the beneficiaries, approve on behalf of –

(a) any of the beneficiaries who because of any legal disability or by reason of nonage or other incapacity is incapable of assenting, or

(b) any person (whether ascertained or not) who may become one of the beneficiaries as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, so however that this paragraph shall not include any person who is capable of assenting and would be of that description, or a member of that class, as the case may be, if the said date had fallen or the said event had happened at the date of the presentation of the petition to the court, or

(c) any person unborn,

any arrangement (by whomsoever proposed, and whether or not there is any other person beneficially interested who is capable of assenting thereto) varying or revoking all or any of the trust provisions or enlarging the powers of the trustees of managing or administering the trust estate:

Provided that the court shall not approve an arrangement under this subsection on behalf of any person unless it is of the opinion that the carrying out thereof would not be prejudicial to that person.

(2) For the purposes of the foregoing subsection a person who is of or over the age of 16 years but has not attained the age of 18 years shall be deemed to be incapable of assenting; but before approving an arrangement under that subsection on behalf of any such person the court shall take such account as it thinks appropriate of his attitude to the arrangement.

(3) [...]<sup>16</sup>

(4) Where under any trust such as is mentioned in subsection (1) of this section a trust purpose entitles any of the beneficiaries (in this subsection referred to as 'the alimentary beneficiary') to an alimentary liferent of, or any alimentary income from the trust estate or any part thereof, the court may if it thinks fit, on the petition of the trustees or any of the beneficiaries, authorise any arrangement varying or revoking that trust purpose and making new provisions in lieu thereof, including, if the court thinks fit, new provision for the disposal of the fee or capital of the trust estate or, as the case may be, of such part thereof as was burdened with the liferent or the payment of the income:

Provided that the court shall not authorise an arrangement under this subsection unless –

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<sup>16</sup> Repealed by the Age of Legal Capacity (Scotland) Act 1991, s 10(2), Sch 2.

(a) it considers that the carrying out of the arrangement would be reasonable, having regard to the income of the alimentary beneficiary from all sources, and to such other factors, if any, as the court considers material, and

(b) the arrangement is approved by the alimentary beneficiary, or, where the alimentary beneficiary is a person on whose behalf the court is empowered by subsection (1) of this section or that subsection as extended by subsection (2) of this section to approve the arrangement, the arrangement is so approved by the court under that subsection.

(5) Nothing in the foregoing provisions of this section shall be taken to limit or restrict any power possessed by the court apart from this section under any Act of Parliament or rule of law.

(6) In this section the expression 'beneficiary' in relation to a trust includes any person having, directly or indirectly, an interest, whether vested or contingent, under the trust."

2.11 Section 1 of the 1961 Act introduced judicial approval of variation or termination of trusts into Scots law. This followed upon a similar reform for England and Wales in the Variation of Trusts Act 1958. In both jurisdictions, the reform was driven largely by tax-related considerations. The Scottish legislation followed upon a report by the Law Reform Committee for Scotland, in which it was observed:<sup>17</sup>

"...The provisions of the old fashioned settlement were designed to preserve the settled property for successive generations. Under modern conditions, particularly looking to the impact of taxation, such provisions, so far from preserving settled property, may have the opposite effect. ...If the income be substantial and payable to a single liferenter, it may be largely absorbed by tax; if capital cannot be paid over to beneficiaries, but must be retained until the death of a liferenter, it may be largely swallowed up by estate duty, with the principle of aggregation swelling the exaction in many cases."

2.12 The purpose of the English 1958 Act and of the Scottish legislation which followed it was to facilitate the variation and termination of trusts in circumstances where the beneficiaries were not all of full age and capable of consenting to an extra-judicial arrangement. The court was given power to approve an arrangement on behalf of the incapable, unborn and unascertained beneficiaries provided that (in the Scottish formulation) it is satisfied that the carrying out of the arrangement is not prejudicial to any such person. Approval is thus given on behalf of individual beneficiaries: the court is in effect being asked to supply the missing consents rather than to consider whether or not the arrangement as a whole is desirable. All ascertained beneficiaries of full age must consent or the scheme cannot proceed. The truster has a right to participate in the process but does not have a veto on the variation which (if the statutory test is satisfied) will be approved even if this is contrary to the truster's wishes either as expressed in the trust deed or at the time of the application.

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<sup>17</sup> Law Reform Committee for Scotland, Ninth Report, *The Powers of Trustees to Sell, Purchase or Otherwise Deal with Heritable Property; and the Variation of Trust Purposes*, Cmnd 1102 (1960), para 41.

2.13 The effect of section 1(1)(b) of the 1961 Act, which deals with persons who are not beneficiaries but may become beneficiaries in the future, was explained by the court in *Buchan, Petitioner*<sup>18</sup> as follows:

"Its general purpose is clear – namely to deal with the situation where a bequest is made to a class of persons, the members of that class being ascertainable only at some date in the future or on some future event (eg the expiry of a liferent the vesting of the fee being postponed till then). The precise members of the class cannot be known until it is ascertained who survives and who predeceases the date or the event when the right vests in each.

But the matter could not be left on the basis that the court can approve on behalf of all such persons, for several of them may be over 21<sup>19</sup> years of age already and able to give consent themselves. Hence the concluding portion of section 1(1)(b). The effect of this concluding portion of the paragraph is to exclude from the possible members of the class on whose behalf the court may grant approval any person who is capable of assenting to the petitioners' proposals and who would be a member of the class if the members of the class fell to be ascertained at the date of the presentation of the petition. This is, of course, to some degree an arbitrary provision, but its justification is that otherwise highly elaborate contingencies of survival and of the emergence of issue would be involved, and great expense would be imposed in many cases on the parties to cover all possible contingencies and to serve the petition on all possibly interested parties, however remote their interest."

A significant consequence of the "concluding portion" of section 1(1)(b) is that the court is relieved of the duty of considering whether the arrangement is prejudicial to a person who is capable of assenting, and so need not refuse consent if such a person is prejudiced (provided, of course, that that person gives consent himself or herself). It should also be noted that the court's reference to "a class of persons" should not be read as a reference to a class such as "the children of X". Such persons will already have an interest – whether vested or contingent – and are not therefore persons "who *may become* beneficiaries". It should be read rather as a reference to a class such as the heirs or next-of-kin of a particular individual, whose identity cannot yet be determined.<sup>20</sup> It might also refer to the future spouse of a person who is not married.

2.14 Section 1(4) of the 1961 Act deals with alimentary liferents, and addresses the inability of an alimentary liferenter to renounce such a liferent after having entered into enjoyment of it. The court is empowered to authorise an arrangement on behalf of an alimentary liferenter provided (i) that the court considers it is reasonable to do so, having regard to the amount of the liferenter's income from all sources at the date of the application, and such other factors, if any, as the court considers material and (ii) the alimentary beneficiary consents or, if incapable of consenting, the court approves the arrangement on his or her behalf under section 1(1).

2.15 In a series of applications made shortly after the 1961 Act took effect,<sup>21</sup> the court took the opportunity to give guidance on how the requirements of section 1 might be met, and to

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<sup>18</sup> 1964 SLT 51 at 52.

<sup>19</sup> See para 2.17 below.

<sup>20</sup> See also *Knocker v Youle* [1986] 2 All ER 914 at 917, Warner J, discussing the corresponding (but not identical) provision in the English 1958 Act.

<sup>21</sup> Eg *Colville Petitioner* 1962 SC 185; *Robertson & Others, Petrs* 1962 SC 196; *Findlays Petrs* 1962 SC 210; *Tulloch's Trs, Petrs* 1962 SC 245; *Young's Trs, Petrs* 1962 SC 293.

lay down procedural guidelines which continue to be followed today. Since the initial period when the ground rules were being established, there have been few reported cases on the operation of section 1, and almost no adversarial proceedings. Hearings normally proceed on the basis of the documents lodged and the statements of fact made in the petition and by counsel at the bar. The procedure is reasonably expeditious and hearings normally last less than an hour. It is understood that there are approximately five or six such applications each year.

2.16 Many early applications under the 1961 Act had the object of bringing trusts to an end by partitioning the fund on an actuarial basis between the liferenter on the one hand and the persons prospectively or contingently interested in the fee on the other. Mitigation of tax has continued ever since to be the primary reason for applications under the Act, although the particular reasons for wishing to vary trusts have changed as tax law has developed. Following the extension of estate duty to discretionary trusts in 1969, a large number of schemes had the purpose of converting discretionary trusts into other forms of settlement, such as accumulation and maintenance trusts. This trend continued during the early years of capital transfer tax in the late 1970s when, for a transitional period, reduced rates of tax applied to capital distributions out of discretionary trusts. By the 1980s most of the "old fashioned settlements" described by the Law Reform Committee of Scotland<sup>22</sup> had been brought to an end or had been converted into more tax-efficient vehicles. However, with the introduction and subsequent restriction of capital gains tax hold-over relief in relation to property leaving trusts, a further category of arrangements has developed in which charges to capital gains tax are avoided or at least postponed by prolonging income interests, so that beneficiaries' interests in capital do not vest until they attain an age such as 50 or 60 instead of the age of, say, 25 or 30 specified in the trust deed. It is understood that a significant proportion of the applications recently made under section 1 of the 1961 Act have been along these lines.

2.17 At the time of enactment of the 1961 Act, the age of majority was 21. It was reduced to 18 by the Age of Majority (Scotland) Act 1969, whereupon persons aged between 18 and 20 became capable of consenting to arrangements varying or terminating trust provisions and the court's power of approval ceased to apply to them. When the age of legal capacity was further reduced to 16 by the Age of Legal Capacity (Scotland) Act 1991, special provision was made for consent to variation and termination of trusts. A person aged 16 or 17 is deemed to be incapable of assenting to such variation or termination, so that court approval on his or her behalf is still required, but the court must take such account as it thinks appropriate of the beneficiary's attitude to the arrangement.<sup>23</sup>

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<sup>22</sup> See para 2.11 above.

<sup>23</sup> Trusts (Scotland) Act 1961, s 1(2), as substituted by Age of Legal Capacity (Scotland) Act 1991, Sch 1.

## Part 3      The policy issue: whose wishes prevail?

### Introduction

3.1 In the Discussion Paper we addressed an underlying policy issue which is common to extra-judicial variations and variations requiring judicial approval, namely the question whether the will of the truster or the will of the current beneficiaries ought to prevail. As Scots law presently stands, there is consistency between the common law relating to extra-judicial termination of trusts and the judicial approval procedure contained in section 1 of the Trusts (Scotland) Act 1961. The common law proceeds upon the basis that if all beneficiaries consent to the termination of the trust or to the variation of the terms upon which the trust property is held, no-one, not even the truster, has an interest to object. The 1961 Act proceeds upon the same basis and extends it by allowing the court to supply approval on behalf of beneficiaries who are incapable of consenting, on being satisfied that no prejudice will be sustained by such beneficiaries. The truster is entitled to be heard but has no power to veto the beneficiaries' proposed scheme.

3.2 A stark example of the consequences of this approach in the context of judicial variation is afforded by the English case of *Goulding v James*.<sup>1</sup> The testatrix had bequeathed the residue of her estate to her daughter for life, with the remainder<sup>2</sup> to the testatrix's grandson, contingently upon his attaining age 40, which failing to the grandson's issue. The daughter and grandson, both of whom were of full age, sought approval of a variation in terms of which the capital would be divided between them absolutely, subject to retention of a fund for the grandson's unborn issue, to cover the contingency of his failing to survive to age 40. The trustees drew the court's attention to evidence that the testatrix had made the bequest in this form because she distrusted her son-in-law and wished to ensure that he could not obtain control of the capital. Reversing the decision of Laddie J, the Court of Appeal held that the truster's intentions and wishes had no relevance to the question for the court which was simply whether or not there was benefit to the unborn beneficiaries on whose behalf approval was sought.

3.3 An application to court was necessary in *Goulding v James* because the grandson's interest was contingent and therefore there were other interests, ie those of his unborn issue which required to be protected. Had the grandson had a *vested* interest in the fee, subject only to his mother's life interest then, following the English equivalent of the rule in *Miller's Trustees*, the daughter and grandson could simply have agreed between themselves to terminate the trust and divide the fund.<sup>3</sup> The policy issue which arises is whether there is a need for any additional restrictions to be put in place to prevent beneficiaries from disturbing the truster's scheme in this way, at least without some court involvement.

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<sup>1</sup> [1997] 2 All ER 239.

<sup>2</sup> ie the fee, in Scots terminology.

<sup>3</sup> The mere fact that the grandson's interest was not vested would not of itself have precluded variation by agreement if all interests, vested or otherwise, had been held by persons of full age.

## The "material purpose" doctrine

3.4 Such restrictions exist in the legal systems of most of the states of the United States. In *Clafin v Clafin*,<sup>4</sup> for example, the trustor directed his trustees to pay part of the residue of his estate to his son in instalments: \$10,000 at age 21, \$10,000 at age 25, and the balance at age 30. Having reached the age of 21 and having attained a vested interest in the fund, the son sought payment of the whole fund. The Supreme Judicial Court of Massachusetts upheld the trustor's scheme for payment, observing:

"...A testator has the right to dispose of his own property with such restrictions and limitations, not repugnant to law, as he sees fit, and ...his intentions ought to be carried out, unless they contravene some positive rule of law, or are against public policy..."

Courts in other states followed suit.

3.5 The test established by *Clafin v Clafin* came to be known as the "material purpose" rule. It may be stated as follows: a trust cannot be terminated prior to the time fixed for termination, even though all the beneficiaries consent, if termination would be contrary to a material purpose of the trustor. The rule is of particular significance in relation to so-called "spendthrift trusts": ie trusts containing provisions intended to protect beneficiaries against their own lack of financial responsibility. Spendthrift trusts resemble alimentary liferents under Scots law in that the beneficiary's interest is non-assignable but differ in that (i) the trustee has a discretion as to how much, if any, of the income produced by the trust fund to pay over to the beneficiary, and (ii) an interest in fee can (in most states) be subject to a spendthrift restriction. A spendthrift provision has generally been regarded as a material purpose of a trust: hence it may not be varied or terminated by consent of all of the beneficiaries including the person for whose protection the provision was conceived.<sup>5</sup>

## Need for reform?

3.6 Although the current Scottish approach and the US approach have different starting points, neither is absolute in its preference of one interest over the other. Not all purposes are regarded by US law as "material", requiring continuance against the wishes of the beneficiaries. Equally, Scots law has always recognised that a trustor may declare certain types of interest to be alimentary, thereby preventing renunciation in pursuance of an agreement among beneficiaries without court authorisation under section 1(4) of the 1961 Act. The question is whether, as a matter of policy, there is a need for the introduction of further restrictions on the circumstances in which trusts may be brought to an end or modified in pursuance of an agreement among beneficiaries.

3.7 In the Discussion Paper, we expressed a provisional view that there is no such need. In many cases, when all possible beneficiaries are of full age and capacity, this will be a strong indication that the trust purposes have run their course so that there is no merit in prolonging the trust unnecessarily or of requiring the beneficiaries to incur the expense of a court application in order to bring it to an end. There is a strong argument that if a trust has been created for the benefit of a group of people of full capacity who wish to rearrange their affairs, then they should be permitted to do so. Against that it may be said that there are

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<sup>4</sup> 20 NE 454 (Mass 1889).

<sup>5</sup> A result similar to that arrived at by Scots law with regard to alimentary interests.

circumstances in which one of the trust's purposes is to protect the interest of a beneficiary against himself or against the risk of loss to a third party such as a creditor or a former spouse. In the Discussion Paper we recognised the desirability of a trust being able to impose restrictions which provide effective protection in such circumstances but expressed the view that the present law affords sufficient scope for this. So far as trust capital is concerned, some degree of protection can be obtained by postponing vesting in capital. For example, in the common situation of an accumulation and maintenance trust, vesting in a beneficiary is postponed until attainment of a specified age not exceeding 25. This is likely to preclude variation or early termination by extra-judicial agreement among beneficiaries because there will probably be unborn or unascertained beneficiaries with an interest contingent upon the primary beneficiaries failing to survive to age 25. But, as *Goulding v James* demonstrates, the trust's wishes can still be overcome in such cases by means of an application to the court. In order to avoid even this possibility, ultimate disposal of the trust capital may be left to the discretion of the trustees or, alternatively, may be made subject to a power of appointment exercisable by a beneficiary on death in favour of a specified class such as his or her issue. As regards income, a beneficiary's right may be limited to an alimentary interest in order to restrict the possibility of attachment by or assignment to creditors or a former spouse. In all such cases termination by agreement among beneficiaries would not be competent.<sup>6</sup>

3.8 There was very little support among our consultees for the statutory importation into Scots law of the "material purpose" doctrine. One member of our Advisory Group considered that the rule had merit in recognising that trusts are usually set up for protective purposes. The consensus, however, was that the trust's views should not override those of the beneficiaries. The Court of Session judges observed that if such a rule were introduced it would probably become normal practice in well drafted trusts to stipulate that the trust purposes could be varied by agreement among the beneficiaries without recourse to the trust. The statutory provision would then apply only to trusts where trusters were not properly advised, or where they had a particular reason for wishing to retain control. The latter category of cases can, as we have observed, be accommodated by the existing law.

3.9 As we observed at the beginning of this Part of our Report, this policy issue arises both in relation to extra-judicial variation by agreement and in relation to judicial approval of variation. In the light of the responses which we have received, we do not recommend the introduction of a rule along the lines of the United States "material purpose" doctrine. We therefore recommend as follows:

1. **It should remain competent:**
  - (a) **for a trust to be varied or terminated by agreement among beneficiaries (where all are of full age and capacity); or**

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<sup>6</sup> If for example the interest of the testatrix's daughter in *Goulding v James*, discussed above, had been an alimentary liferent under Scots law, the court could not have approved the arrangement dividing the trust capital without having been satisfied that in all the circumstances it was reasonable to do so: Trusts (Scotland) Act 1961, s 1(4).

**(b) for the court to approve an arrangement varying or terminating a trust on behalf of incapable, unborn or unascertained beneficiaries, regardless of whether the variation or termination is inconsistent with a material purpose of the trust.**

(Draft Bill, Part 1)

## Part 4            Extra-judicial variation and termination of private trusts

### Statutory expression of the common law rule

4.1     In Part 2 above we outlined the rule in *Miller's Trustees* as it is presently understood following its re-statement in *Yuill's Trustees v Thomson*.<sup>1</sup> We noted that there is little direct authority for the proposition that the rule can be regarded as sufficiently wide to entitle all of the beneficiaries, if of full age and capacity<sup>2</sup> and all consenting, to join together and require either (a) that the trust be terminated or (b) that the trust fund shall in future be held by the trustees under altered trust provisions.<sup>3</sup> In the Discussion Paper we suggested that if, as we proposed, it remained competent for a trust to be varied or terminated by agreement among beneficiaries of full age and capacity, it would be desirable for a rule in such terms to be given statutory expression.

4.2     Most consultees considered that this would indeed be desirable. Some were of the view that statutory re-statement of the rule was unnecessary. The Court of Session judges emphasised that we should make clear in this Report that we did not regard this as a change to the existing law. We confirm that it is not our intention to change the law, provided that the current law is assumed to be in accordance with the wider interpretation of the rule in *Miller's Trustees*.<sup>4</sup> We recommend statutory re-statement because the rule which we propose is not as clearly stated in existing case law as one might wish. We consider that it should also be made express that the beneficiaries' entitlement in such circumstances would include power to agree to require the trustees to make over the trust property to other trustees to be held for new trust purposes. The rule would apply to private trusts created by will or by *inter vivos* disposition but would not extend to trusts created by enactment or Royal Charter.

4.3     We consider that beneficiaries who are all of full age and capacity should be entitled to agree on one further matter, namely that the powers of the trustees to manage or administer the trust estate should be enlarged or restricted in accordance with the beneficiaries' agreement. Enlargement of trustees' powers of management and administration is presently one of the alterations which may be approved by the court on an application under section 1 of the Trusts (Scotland) Act 1961 (discussed in Part 5 of this Report).<sup>5</sup> We recommend that it be confirmed by statute that such alteration can be made by agreement among beneficiaries where all are of full age and capacity. It may also be that the beneficiaries would wish to agree to restrict the trustees' powers (for example, to impose

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<sup>1</sup> See para 2.2.

<sup>2</sup> Or which are not natural persons, such as charities.

<sup>3</sup> See paras 2.6-2.7.

<sup>4</sup> Ie that where all beneficiaries are of full age and capacity they may agree to vary or terminate the trust even where not all interests have vested.

<sup>5</sup> The court also has power under s 5 of the Trusts (Scotland) Act 1921 to authorise trustees to do any of the acts mentioned in s 4 of that Act, even if this is at variance with the terms or purposes of the trust, on being satisfied that it is expedient for the execution of the trust.

restrictions on the scope of investments which they may make), and it seems appropriate for the legislation also to provide for this to be done.

4.4 As is the case under the present law, there will be no requirement that the truster, if alive, has to consent to the variation or termination unless he or she is also a beneficiary of the trust. If, however, an interest had been declared by the truster to be alimentary, variation or termination by agreement would continue to be excluded. Subject to that exception, our recommendation is as follows:

- 2. It should be confirmed by statute that where every person with an interest, whether vested or contingent, in property held in trust is of full age and capacity or is not a natural person, those persons may agree, without the need to obtain court approval of the agreement:**
  - (a) to vary the purposes for which the trust property is held;**
  - (b) to terminate the trust in whole or in part;**
  - (c) to direct the trustees to make over the trust property to other trustees to hold for new trust purposes; or,**
  - (d) to enlarge or restrict the powers of the trustees to manage or administer the trust estate.**

(Draft Bill, sections 1(1), (2) and 2(2))

#### **Consent to extra-judicial variation on behalf of a child**

4.5 The statutory expression of the rule in *Miller's Trustees* which is recommended in paragraph 4.4 above would permit extra-judicial termination only where all the persons with an interest in the trust were of full age and capacity. It would not apply where there is a beneficiary with a vested or contingent interest who is under the age of 18, as such a person has no capacity to consent to the extra-judicial variation or termination of a trust.<sup>6</sup> This reflects the current position in terms of which the approval of the court is sought on behalf of beneficiaries who are under the age of 18 as well as unborn and unascertained beneficiaries. We now address the question whether a parent or other legal representative should have capacity to consent to an extra-judicial variation on behalf of a child up to the age of 16.<sup>7</sup>

4.6 Under the Children (Scotland) Act 1995, a parent has responsibility to act as legal representative in relation to his or her child.<sup>8</sup> As such, the parent has power to administer any property belonging to the child and to act in or give consent to any transaction where the child is incapable of so acting or of consenting on his or her own behalf.<sup>9</sup> "Transaction" is defined as in the Age of Legal Capacity (Scotland) Act 1991, and includes the giving by any person of any consent having legal effect and the taking of any step in civil proceedings.<sup>10</sup>

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<sup>6</sup> Trusts (Scotland) Act 1961, s 1(2).

<sup>7</sup> The power of a parent or guardian to act as the legal representative of a child ceases when the child attains 16, Children (Scotland) Act 1995, ss 1(2) and 7(5).

<sup>8</sup> S 1(1)(d). A guardian has the same power under s 7(5).

<sup>9</sup> S 15(5).

<sup>10</sup> 1995 Act, s 15(1); Age of Legal Capacity (Scotland) Act 1991, s 9.

When acting as legal representative, the parent is obliged to act as a reasonable and prudent person would act on his or her own behalf and is liable to account to the child for any intrusions with the child's property. Subject to those duties and to the terms of any court order in relation to the exercise of parental responsibilities and rights, the parent is entitled to do anything which the child, if of full age and capacity, could do in relation to that property.<sup>11</sup> On one view, therefore, a parent has been given statutory power by the 1995 Act to consent on behalf of his or her child to the termination or variation of a trust. The contrary view is that since section 1(2) of the 1961 Act deems persons aged between 16 and 18 to be incapable of consenting without court approval,<sup>12</sup> it is implicit so far as children *under* the age of 16 are concerned that legal representatives lack the necessary power to consent to a variation without court approval.<sup>13</sup> In practice, applications continue to be made to the Court of Session for approval of trust variation arrangements on behalf of children under 16. We are not aware of any variations which have proceeded extra-judicially utilising a legal representative's powers under the 1995 Act.

4.7 In the Discussion Paper we suggested that there was no qualitative distinction to be made between this type of "transaction" and others to which a legal representative has power to consent and that power to consent to a trust variation could be seen as the natural consequence of the reforms to Scots law which were effected by the 1995 Act. We noted in particular that it is generally accepted that legal representatives have power to execute extra-judicial post-death deeds of variation (usually to achieve tax savings) on behalf of their children. We suggested that there was a strong case for making clear that there was no general exception in this regard to the powers of legal representatives, the effect of which would be to confirm that it was unnecessary to apply to the court for approval in any case where the only obstacle to extra-judicial agreement was the existence of a child under 16.

4.8 The principal objection to permitting a parent as legal representative to consent on behalf of a child is that in many schemes for variation or termination of a trust there is a conflict of interest between them. For example, the primary purpose of the variation might, for example, be to release capital from the trust fund to the legal representative in his or her individual capacity. Of course, the protections afforded by sections 9 and 10 of the 1995 Act would apply when a legal representative gave consent to a trust variation. Those protections are (i) the obligation of a trustee to seek a direction from the Accountant of Court as to the administration of a capital sum in excess of £20,000 which requires to be made over to a parent to be held on behalf of a child; (ii) the specification of the standard of care (to act as a reasonable and prudent person would act on his or her own behalf) required of the legal representative; and (iii) the obligation to account to the child on demand after the child has attained 16.<sup>14</sup> The question which we posed in the Discussion Paper was whether something more is required to protect the child against irreparable financial loss arising from a breach by the legal representative of his or her duty to the child. Not all situations in which a parent is required to administer a child's property are as likely to give rise to a conflict of interest as is the variation of a family trust.

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<sup>11</sup> Children (Scotland) Act 1995, s 10(1).

<sup>12</sup> As amended by the Age of Legal Capacity (Scotland) Act 1991, Sch 1, para 27 and Sch 2. See also *ibid* s 1(3)(f)(iii), preserving the practice of appointing a curator *ad litem* to persons aged 16 and 17.

<sup>13</sup> See eg Wilkinson and Norrie, *Parent and Child* (2<sup>nd</sup> edn, 1999), paras 15.57–15.58.

<sup>14</sup> The parent would also have a duty under s 6 of the 1995 Act to have regard so far as practicable to the views of the child concerned, taking account of the child's age and maturity. A child aged 12 or more is presumed to be of sufficient age and maturity to form a view.

4.9 We suggested a range of possible approaches.<sup>15</sup> One was to make no specific provision for consent to be given to a trust variation by a legal representative on behalf of a child other than to make clear that such a course of action is competent under the present law. If, however, it was considered that some protection was required, we proposed the following alternatives:

- (i) Make legislative provision for consent to be given by a legal representative subject to the latter being satisfied regarding the same matters as to which the court would require to be satisfied.
- (ii) Make legislative provision for consent to be given by a legal representative but only where no conflict exists between the interest of the child and the interest of the legal representative in a personal capacity.
- (iii) Make legislative provision for consent to be given by a legal representative in all circumstances (ie as options (i) or (ii) above), but for the approval of the trustees (including at least one trustee who has no interest as a beneficiary in the trust) to be required in any case where a conflict exists between the interest of the child and that of the legal representative.
- (iv) A variant of this option, which would address the difficulty of influence, would be to make legislative provision for the legal representative's consent to be approved by the Accountant of Court.

4.10 Opinions among our consultees were significantly divided. The majority of consultees who responded considered that legal representatives should be given power to consent to a variation or termination of a trust on behalf of a child who is incapable of consenting, seeing this as an opportunity to save unnecessary court procedure. One consultee saw no distinction in principle between a legal representative's power to consent to a trust variation and his or her power to consent to any other transaction. Others,<sup>16</sup> however, regarded the problem of conflict of interest as an insuperable obstacle to granting power to a legal representative to consent on a child's behalf. These difficulties would, it was suggested, be magnified if the child had to establish, some years later, that there had been a breach of duty by his or her legal representative.

4.11 Responses to the range of possible approaches to protection of the child's interest set out above disclosed further differences of opinion. None of our consultees supported the view that there was no need to protect the child against the risk of loss due to conflict of interest, but there was no clear preference among our suggested approaches to protection. The objections to the various alternatives may be summarised as follows:

- (i) (Legal representative to be satisfied regarding same matters as court in judicial approval of variation) Some consultees considered that this would lead to complexity in setting out the conditions to be satisfied. Moreover, there would be no independent scrutiny of whether the legal representative had fulfilled that duty.

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<sup>15</sup> Discussion Paper, para 4.15.

<sup>16</sup> Including the Court of Session judges and the Faculty of Advocates.

(ii) (Consent only where no conflict) Almost all variations will give rise to such a conflict of interest, and there is little point in legislating for the small minority which do not. Nor will it always be obvious whether or not a conflict exists.

(iii) (Approval by trustees, including at least one disinterested trustee, required) It would be very difficult to define whether a trustee is or is not disinterested, and to determine whether a trustee is truly acting uninfluenced by the primary beneficiaries.

(iv) (Approval by Accountant of Court required) The Accountant of Court is not a lawyer and is not therefore the appropriate person to give approval in relation to a matter of legal complexity.

A further suggestion made (by the Scottish Law Agents Society) was that the trustees should have power to appoint a suitable person (such as an experienced solicitor unconnected with the trust) to report to them on the appropriateness of the proposed scheme.

4.12 We are persuaded that options (iii) and (iv) do not provide satisfactory solutions for the reasons stated, and we doubt whether the suggestion by the Scottish Law Agents Society has any practical advantage over a court application. We also accept that the protection afforded by option (i) is incomplete and depends upon an assumption that the legal representative will properly perform his or her duty to the child, despite the likely existence of a conflict of interest.

4.13 A further difficulty which we identified in the Discussion Paper is that of the consequence of an extra-judicial variation having proceeded on the basis of the consent of a legal representative given improperly, for example consent given under option (ii) above by a parent/trustee who in fact did have a conflict of interest. In such a case the variation could be (a) void; (b) voidable at the instance of an interested party, including the child on attaining full age; or (c) effective, subject to a personal right of action by the child against the parent for any loss sustained as a result of the implementation of the arrangement. The disadvantage of the variation being either void or voidable is that it may be difficult or impossible to reverse the arrangement after implementation. The disadvantage of giving the child only a personal right against the parent is that it may prove to be worthless. Those consultees who were opposed to giving parents power to consent on behalf of children pointed out that such difficulties supported their view.

4.14 Permitting consent to be given by a legal representative on behalf of a child who is incapable of consenting would go further in facilitating extra-judicial trust variation and termination than has hitherto been done in any of the other jurisdictions which have enacted a trust variation procedure based on the English model. Having given the matter further consideration in the light of the responses received, we are persuaded that it is not appropriate to go so far. We are not satisfied that we have identified a solution to the problem of conflict of interest, and we do not think that it would be worth legislating for the small number of cases in which no such conflict could arise. We are mindful also that some trusters will deliberately set up the trust in such a way as to ensure that a child beneficiary's parents *cannot* exercise influence over the application of trust funds.

4.15 Under section 7 of the 1995 Act, a child's parent may, subject to the requirements of that section, appoint a person to be guardian of the child in the event of the parent's death. Once appointed, a guardian has the same responsibility as the parent had to act as the

child's legal representative. The question arises as to whether a guardian should also be precluded from consenting to variation or termination of a trust on behalf of the child. It may be that conflicts of interest will not arise in such a high proportion of cases where the legal representative is a guardian as opposed to a parent, but they may still arise where, for example, the guardian is a close relative of the deceased parent. We do not therefore consider that guardians should be treated differently from parents in this regard.

4.16 Given that doubt exists as to whether the 1995 Act currently permits a legal representative to consent to a variation on behalf of a child, we consider that the conclusion which we have reached ought to be reflected in a specific exception to the powers of legal representatives in order to make clear that they may not competently give such consent. This will require an appropriate amendment to be made to the 1995 Act. We recommend as follows:

3. **The powers of a parent or guardian in exercise of the responsibility to act as a child's legal representative should not include power to approve a variation or termination of a trust on the child's behalf.**

(Draft Bill, Schedule 1, paragraph 4)

#### *Beneficiaries aged 16 or 17*

4.17 As noted above,<sup>17</sup> a beneficiary aged 16 or 17 is presently deemed to be incapable of consenting to an arrangement varying or terminating a trust, although the court is required when approving an arrangement on behalf of such a person to take such account as it thinks appropriate of the beneficiary's attitude to the arrangement. In the Discussion Paper we invited comment on whether beneficiaries aged 16 and 17 should be given capacity to consent on their own behalf. We observed that it would be anomalous if the need for application to the court could be avoided where all of the beneficiaries were under 16 but could not be avoided where some were aged 16 or 17. That particular anomaly will not arise in the light of our recommendation above that parents should not have power to consent to a trust variation on behalf of a child under 16. We noted also that difficult issues arose as to whether consent by a 16 or 17 year old should be open to challenge by the beneficiary after attaining the age of 18,<sup>18</sup> and as to whether such consent should be capable of prior ratification.<sup>19</sup> We invited comment on whether the right of challenge should be excluded and, if so, whether the trustees should be required to satisfy themselves that the beneficiary had received independent advice.

4.18 Opinions of consultees were again divided. Some considered that there was nothing to distinguish consent to a trust variation from other transactions which can be entered into by 16 and 17 year olds. The majority, however, were not in favour of giving them full capacity to consent. Some considered that the issues were too technical and complex. Others were concerned about the risk of improper influence by a parent with a conflicting

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<sup>17</sup> See para 4.5.

<sup>18</sup> Under the 1991 Act, s 3, which permits a person aged under 21 to apply to the court to set aside a transaction entered into when he was 16 or 17 on the ground that it was a "prejudicial transaction", ie one which an adult, exercising reasonable prudence, would not have entered into and which has caused or is likely to cause the adult substantial prejudice.

<sup>19</sup> On application to the sheriff under s 4 of the 1991 Act by all parties to a proposed transaction with a 16 or 17 year old.

interest in the proposed variation. We share the latter concern which seems to us to arise just as sharply in relation to 16 and 17 year olds as it does for younger beneficiaries. The possibility of challenge by a beneficiary after attaining age 18 would create formidable practical difficulties, yet it would be anomalous to exclude the right of challenge in this situation alone. As we are not recommending that parents should have power to consent on behalf of children under 16, there is no strong reason to change the existing law in relation to beneficiaries aged 16 but less than 18. We accordingly recommend as follows:

4. **A person aged 16 or 17 should continue to be deemed to be incapable of agreeing to the variation or termination of a trust, but the court is required to take such account as it thinks appropriate of the beneficiary's attitude to the arrangement.**

(Draft Bill, sections 2(4)(a) and 6 and Schedule 1, paragraph 3)

#### **Consent to extra-judicial variation on behalf of adult beneficiaries with incapacity**

4.19 Section 1 of the 1961 Act provides for court approval of a trust variation on behalf of any beneficiary who is incapable of assenting "by reason of nonage or other incapacity". It is therefore competent for the court to approve an arrangement on behalf of an adult who lacks the capacity to give his or her consent. Alternative methods of obtaining consent on behalf of an incapable adult have been available since the entry into force of the Adults with Incapacity (Scotland) Act 2000. An order appointing a guardian to an adult may confer power to deal with such particular matters in relation to the property, financial affairs or personal welfare of the adult as may be specified in the order<sup>20</sup> or, alternatively, power to manage the property or financial affairs of the adult more generally.<sup>21</sup> By virtue of the appointment, the guardian has power to act as the adult's legal representative.<sup>22</sup> Another possibility created by the 2000 Act is that an intervention order may be granted authorising the appointee to take such action in relation to the adult's property, financial affairs or personal welfare as is specified in the order.<sup>23</sup> Either of these routes could be used to enable consent to a variation to be given on behalf of the adult without the need for an application under the 1961 Act (although there will, of course, have had to have been a prior court application to obtain the guardianship or intervention order). A further possibility is that prior to the adult becoming incapable, power to consent to a trust variation could have been given to a continuing attorney whose power of attorney is registered with the Public Guardian.<sup>24</sup>

4.20 It would, of course, remain competent for court approval to be sought on behalf of an adult with incapacity. We can envisage situations in which parties would for practical reasons require, or at least prefer, to seek court approval on behalf of such a beneficiary rather than to carry out the scheme without court involvement. These might include the following:

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<sup>20</sup> Adults with Incapacity (Scotland) Act 2000, s 64(1)(a).

<sup>21</sup> *Ibid*, s 64(1)(d).

<sup>22</sup> *Ibid*, s 64(3). Adrian Ward, *Adult Incapacity*, (2000), para 10-42 expresses the view that child law may, with appropriate caution, be a source of guidance as to the scope of "legal representation" in relation to adults with incapacity.

<sup>23</sup> *Ibid*, s 53(1), (5).

<sup>24</sup> *Ibid*, s 19.

- where a guardian unreasonably refuses consent;
- where a guardian reasonably refuses consent on the ground that the decision whether or not to consent is narrow, and he or she would prefer not to be accountable for it;
- where a guardian is reluctant to take responsibility for granting consent because of a conflict of interest between himself or herself on the one hand and the incapable adult on the other.

The court would no doubt wish to be informed why its consent was being sought on behalf of a live, ascertained beneficiary, but this could be dealt with by appropriate averments in the petition and in oral submissions.

4.21 In the light of the availability of the options described in paragraph 4.19 above, we do not think that any change in the law is necessary. However, if the rules on extra-judicial variation or termination are to be put on a statutory basis as we recommend in Recommendation 2 above, then express provision should be made for consents on behalf of incapable adults. We therefore recommend as follows:

- 5. It should continue to be competent for approval to be given to a variation or termination on behalf of an adult with incapacity.**

(Draft Bill, section 2(3))

### **Extra-judicial variation or termination of alimentary liferents**

4.22 Under the present law an alimentary liferent (or other alimentary interest) may not be varied or terminated after the liferenter has entered into possession without the authorisation of the court under section 1(4) of the 1961 Act.<sup>25</sup> We have considered whether to propose that such authorisation should no longer be required for the liferenter to agree, along with the other beneficiaries, to bring an alimentary liferent to an end, or to vary it, or to remove the alimentary restriction. The effect of such a change would be to render the alimentary protection revocable at the will of the beneficiaries, which would often be contrary to the wishes of the trustor who thought fit to declare the liferent to be alimentary when the trust was created. In the Discussion Paper we expressed the view that such a change is not desirable. One of our reasons for recommending that Scots law should not follow the US "material purpose" doctrine was that a Scottish trustor has the facility of creating an alimentary liferent in circumstances where it is wished to protect a beneficiary from creditors or a former spouse or, indeed, from the beneficiary's own folly. It seems to us that the alimentary liferent continues to have a role to play and we do not wish to propose a change which would have the effect of hastening its demise. None of our consultees expressed disagreement with this conclusion. With one exception, therefore, we do not recommend legislative change which would permit the termination or variation of trust provisions creating an alimentary liferent, including the removal of an alimentary restriction, without court authorisation.

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<sup>25</sup> See further paras 2.8-2.9 above.

4.23 As just noted, there is one exceptional case where we consider that it would be desirable to permit variation or termination without court approval. Prior to 1984 it was competent for a woman to create an alimentary liferent in favour of herself in an ante-nuptial marriage contract. The rationale behind this exception to the general rule that a person may not create an alimentary restriction in his or her own favour was explained by Lord President Clyde in *Douglas Hamilton v Duke and Duchess of Hamilton's Trustees*:<sup>26</sup> namely, to ensure that a wife's property did not fall under her husband's *jus mariti* and *jus administrationis*. This rationale is long obsolete. The right of a woman to create an alimentary liferent in her own favour in an ante-nuptial marriage contract was abolished in 1984,<sup>27</sup> and as time passes there will be fewer and fewer of such liferents. In a series of cases it was held that, in absence of clear words to the contrary, such a liferent ceased to be alimentary after the death of the husband, whether or not there were surviving issue of the marriage.<sup>28</sup> We consider that there is now no benefit in requiring court authorisation of the variation or termination of an alimentary liferent which was created by a wife in favour of herself, as opposed to having been created by a third party in her favour, even where the marriage continues to subsist. Most of our consultees agreed.

4.24 We therefore recommend that:

6. **(a) Where a woman who, prior to 1984, created an alimentary interest in her own favour in an ante-nuptial contract of marriage wishes to vary or terminate that interest, authorisation by the court under section 1(4) of the Trusts (Scotland) Act 1961 should no longer be required.**
  
- (b) There should be no other change to the existing law under which the variation or revocation of an alimentary interest after the beneficiary has entered into possession of it requires the authorisation of the court.**

(Draft Bill, section 5)

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<sup>26</sup> 1961 SC 205.

<sup>27</sup> Law Reform (Husband and Wife) (Scotland) Act 1984, s 5 in relation to contracts entered into on or after the coming into force of the Act on 24 July 1984.

<sup>28</sup> *Dempster's Trs v Dempster* 1949 SC 92; *Sturgis's Trs v Sturgis* 1951 SC 637; *Neame's Trs v Neame* 1956 SLT 57; *Strange & Anor, Petrs* 1966 SLT 59; *Pearson & Ors, Petrs* 1968 SLT 46.

# Part 5            Judicial approval of variation or termination of private trusts

## Introduction

5.1     In this Part we make recommendations for reforms to the law presently contained in section 1 of the Trusts (Scotland) Act 1961 regarding judicial approval of arrangements varying or terminating private trusts. These are mostly intended to address difficulties which arise from time to time in the practical operation of section 1(1), and our recommendations would extend the circumstances in which an application to court for approval of the variation or termination of a trust could be made. They do not apply to trusts created by Act of Parliament or Royal Charter, or to special types of trust such as pension scheme trusts and unit trusts. Nor are they, by their nature, likely to be of any relevance to trusts created in a commercial context. Reorganisation of public trusts is dealt with separately in Part 6 of this Report.

5.2     The background to the 1961 Act is summarised in Part 2 above. It effected a very useful and successful reform. We suggested in the Discussion Paper that, more than 40 years after the passing of the 1961 Act, further reform may be desirable. In certain respects the present procedure has shown itself to be inflexible, especially when addressing remote theoretical contingencies. Another concern is that in addressing the question of absence of "prejudice" the Court of Session has looked solely to economic prejudice whereas in England the corresponding requirement, namely that the arrangement should be for the "benefit" of the person on whose behalf approval is sought, has been more broadly interpreted. The consequence of these shortcomings is that applications under section 1 are sometimes reduced to an intellectual exercise in which possible courses of action have to be discarded because of risks which may be wholly theoretical. A common example is where the potential "prejudice" would arise in the event of the birth of further issue to, say, a 75-year old man.

5.3     Our purpose in putting forward amendments to the present law was to remove some of the obstacles which preclude the court from approving an arrangement. We therefore invited comment on possible amendments to the existing statutory provisions with regard to the following matters, which we address in turn below:

- the court's approach to highly improbable events, including the possibility of exoneration of trustees from claims by remote beneficiaries should the improbable occur (paragraphs 5.4-5.22);
- the scope of the definition of "prejudice" or "benefit" to persons upon whose behalf the court is asked to approve an arrangement (paragraphs 5.23-5.28);
- approval on behalf of untraceable adult beneficiaries (paragraphs 5.30-5.33);

- approval on behalf of adult beneficiaries who decline to consent (paragraphs 5.43-5.37);
- the need for consent of the truster (paragraph 5.38);
- miscellaneous procedural aspects (paragraphs 5.39-5.44).

### Highly improbable events

5.4 As has already been noted, the common law background against which section 1 of the 1961 Act was enacted was the rule in *Miller's Trustees*, which had been interpreted as permitting variation of trust provisions by agreement only where *all* persons with an interest in the trust, however remote and improbable, consented to the variation. In an application under the 1961 Act the court supplies approval on behalf of beneficiaries who are incapable of giving agreement. The definition of "beneficiary" in section 1(6) reflects the common law background: the expression includes "any person having, directly or indirectly, an interest, whether vested or contingent, under the trust." The practical consequence of this is that there are cases where, because of the risk of occurrence of an improbable series of events, the court cannot be satisfied that there is no possibility of prejudice to a person upon whose behalf approval is sought. This problem has been exacerbated in recent years by the withdrawal from the market of all the insurance companies who had, in the past, been willing to underwrite the occurrence of remote contingencies by a single-premium insurance policy.

5.5 Arrangements to vary trusts usually consist of an adjustment of the respective rights of the persons most immediately interested in the trust capital and income. The court will, however, be concerned to ensure that the effect of such adjustments is not to cause prejudice to other interests which have not yet emerged and, indeed, may never emerge. Most of the possibilities envisaged fall into two categories, namely (i) the risk of a death or series of deaths causing a remoter interest to emerge, and (ii) the risk of birth of issue.

#### *Emergence of remote interest*

5.6 The fact that a series of deaths may cause a very remote interest to emerge means that the persons who would become entitled in these circumstances have an interest in the trust and not merely a *spes successionis*. This interpretation of the statutory provisions has latterly been confirmed in England. In *Knocker v Youle*,<sup>1</sup> the trust deed, which dated from 1932, directed the trustees to pay income to the truster's daughter A, and on her death to hold the trust fund for such persons as she might appoint; which failing, her share was to be added to a share held for the truster's son on similar terms. There was then an ultimate trust in favour of the truster's four sisters and their issue in equal shares *per stirpes*. At the time of the application to vary the trust provisions, the persons who would become entitled under the ultimate trust provisions were numerous, and some were resident in Australia. The question was whether the court could approve the arrangement on their behalf, as persons falling within section 1(1)(b) of the (English) 1958 Act ("any person (whether ascertained or not) who may become entitled, directly or indirectly, to an interest under the trusts as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, ..."). Warner J held that he could not

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<sup>1</sup> [1986] 2 All ER 914.

approve the arrangement on their behalf, because they already had an interest; they were not persons who "may become entitled to an interest". Only they themselves could consent to the variation.

5.7 A different and more pragmatic approach has been taken by the Court of Session. The facts of *Phillips & Others, Petitioners*<sup>2</sup> were not dissimilar to those of *Knocker v Youle*. The testator provided that on his wife's death the income of the residue of his estate was to be paid to his four children and to the issue of predeceasing children, and that on the death of the last survivor of his children the capital was to be paid in certain proportions to the issue then alive of his children. In the event of all of his children dying without leaving issue, the residue was to be divided among various charities and remote relatives. The question addressed by the court was whether it was necessary to protect the interests of any persons falling within the longstop category or to obtain the consent of those of full age and capable of consenting. The court held that it was not necessary. Lord President Clyde stated:<sup>3</sup>

"The number of persons or bodies that fall within that class is very substantial and service has not been effected upon those members of this class who are under twenty-one years of age. Those who are older and the charities mentioned in the testamentary writings have not received intimation of the present proceedings. ... In our view, however, their interest is so remote and so negligible that they do not qualify as beneficiaries within the meaning of section 1(6) of the Act and need not be therefore provided for in the scheme. That subsection must be given a reasonable construction and it can never have been intended to include persons whose interest is so remote as to be negligible. If parties choose to make an arrangement outside the scheme for the protection of this group of persons, they are of course free to do so ...."

The decision in *Phillips* has proved useful in trust variation practice because it has enabled arrangements to be approved without the need to intimate the proceedings to, and obtain the consent of, distant relatives with negligible interests. However, we consider that the solution which it provides is not entirely satisfactory. In the first place it is difficult to justify on the wording of the Act. The definition of "beneficiaries" in section 1(6) to which Lord President Clyde made reference uses the same language as the English statute, and it is not easy to find fault with Warner J's decision in *Knocker v Youle* that no restriction should be placed on the words "any person having, directly or indirectly, an interest, whether vested or contingent, under the trust". Secondly, it should be noted that in *Phillips* the court did not approve the arrangement on behalf of any of the persons with the remote interests: it simply found it unnecessary to approve on behalf of such persons. This, as is evident from the last sentence quoted above, leaves the trustees unprotected in the (very unlikely) eventuality that these interests emerge and the persons concerned claim their entitlement under the original trust provisions. Some trustees reasonably take the view that this exposure is unacceptable, particularly where the trust fund is large and insurance against emergence of the interests cannot be obtained. We consider that a more transparent and straightforward approach to the problem of very remote interests would be desirable.

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<sup>2</sup> 1964 SC 141.

<sup>3</sup> *Ibid* at 150-151.

### *Risk of birth of issue*

5.8 The second category of case which we identified above is where there is a risk of birth of issue who, if born, would have an interest in the trust. This risk cannot be actuarially calculated and, as such, has never been insurable. In consequence, it has often constituted a block on a possible variation. For example, assume that property is held in an accumulation and maintenance trust for the children of A, with a share of capital vesting in each child at age 40, subject to a destination over to another branch of the family should none of the children attain that age. A has three children, aged 25, 22 and 20. The children wish to bring the trust to an end, subject to making appropriate provision for the contingency that one or more of them might die prior to attaining age 40. This latter contingency may be addressed by retaining a fund equivalent to (or, in practice, a little greater than) the actuarial value of the interests of the persons who would become entitled to shares of the fund should any of A's children fail to attain age 40. However it is not possible to address, by insurance or retention of a fund or otherwise, the possibility that further children, who would also be entitled to shares of capital, may yet be born to A. The trust cannot therefore be terminated. In this example, if A was a male aged, say, 45, then the risk of birth of further children might be real. On the other hand if A was aged 70 then the likelihood of the birth of further children of A, though biologically possible, might in reality be negligible.

5.9 There is no presumption that a male attains an age at which he ceases to be a potential parent. The matter was considered in a different context in *Munro's Trustees v Monson*,<sup>4</sup> in which trustees presented a special case to determine whether they were bound, or at least entitled, to pay out trust capital to a beneficiary on the assumption that two males then aged 81 and 76 would not have male issue. The court applied a test of "high improbability" and found that as a matter of fact the risk of birth of male issue was minimal. The trustees were held entitled to denude, subject to the granting of an indemnity by the recipient. Even on these facts, however, Lord Justice-Clerk Grant regarded the matter as "a very narrow one". The case is of limited assistance in the context of judicial variation of trusts. It has not hitherto been the practice of the court in such applications to be satisfied that a personal indemnity by a beneficiary affords sufficient protection (by way of assurance that if the improbable event occurred, the necessary funds would be available to satisfy the emerging claims) to the persons upon whose behalf approval is sought. There are no reported cases in which satisfaction of the test of "high improbability" has been regarded as sufficient to meet the requirements of section 1(1) of the 1961 Act.

5.10 The approach taken by the courts in relation to women has been that, prior to 1936, the same test of "high improbability" was applied in determining whether trustees were entitled to pay out capital to the beneficiaries. In *G's Trustees v G*,<sup>5</sup> however, it was held that there was a presumption against a woman aged 53 or more having a child. This appears to have been simply a presumption of fact, based upon the medical evidence of the day. This decision is still relied upon in applications under the 1961 Act as indicating that certain theoretical possibilities of birth of issue may be disregarded by the court. We doubt whether such reliance can now be justified. Whatever may have been the situation in 1936, it is no longer the case, as a matter of fact, that all women have passed child-bearing age by 53. Nor does the presumption take account of child birth possibilities created by IVF technology.

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<sup>4</sup> 1965 SC 84.

<sup>5</sup> 1936 SC 837.

Indeed, since the amendments to the law which gave rights of succession to adopted children, the presumption has not taken account of the possibility of adoption of a child by a woman aged 53 or over, or by a man of any age.

5.11 We consider that the powers of the courts in relation to the disregarding of the possibility of a future birth require to be clarified and, to a certain degree, extended to permit judicial variations to proceed in circumstances in which the risk of prejudice from such a birth is negligible.

#### *Recommendations for reform*

5.12 In our view a distinction can be drawn between the two situations described above: the first where an interest exists but is so remote that it is unlikely to materialise, and the second where an interest does not yet exist and is not likely ever to exist.

5.13 *Remote interest in existence.* We address first the situation of beneficiaries with remote interests which are in existence at the time when the application to court is made.<sup>6</sup> Depending upon the terms of the trust, there may be a large number of such beneficiaries. Service of the petition upon them all, and appointment of curators *ad litem* to those under age, could give rise to considerable inconvenience with no real practical utility. It might, for example, involve disclosure of private financial circumstances to distant relatives who would not otherwise be privy to such details and who have no genuine need to be aware of them. At present, as we have noted, this situation is dealt with by means of the court regarding such persons as falling outside the definition of "beneficiary" in section 1(6) of the 1961 Act. While this allows the variation to proceed, it affords no protection to the trustees in the (unlikely) eventuality that the remote contingency materialises. If the fund were sufficiently large this might be of concern to the trustees, particularly as it is unlikely that insurance against this risk could be obtained.<sup>7</sup>

5.14 We considered two possible solutions. The first was to give the court power to approve an arrangement on behalf of a beneficiary whose interest was so remote as to have a negligible value. The court would not require to be satisfied that the arrangement was not prejudicial; instead it would require to be satisfied that the interest was of so little value that any prejudice should be disregarded. We have concluded that the court could not be given power to remove or diminish such interests, regardless of whether they are held by persons of full age or by incapable beneficiaries, as this would be incompatible with the beneficiaries' rights under Article 1 of the First Protocol to the European Convention on Human Rights. Article 1 states as follows:

"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law..."

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<sup>6</sup> We include in this category unborn beneficiaries who would become entitled to an interest on birth and where it cannot be said that there is no reasonable prospect of their birth.

<sup>7</sup> For example, there might be a beneficiary who, in a very remote and unlikely contingency requiring the predecease of a large number of persons, would become solely entitled to a trust fund worth, say, £5 million. Because the contingency is so unlikely to emerge, the beneficiary's interest may be actuarially valued at less than £1.

An interest in a trust, however remote, is an economic interest which would constitute a "possession" for the purposes of this Article.

5.15 In *James v United Kingdom*,<sup>8</sup> the European Court of Human Rights confirmed that a compulsory transfer of property from one individual to another for no reason other than to confer a private benefit on a private party could not be "in the public interest". A variation of trust provisions which had the consequence of removing or diminishing a beneficiary's interest, however remote, could therefore constitute a breach of Article 1 of the First Protocol. An appropriate analogy might be a National Lottery ticket. The value of a ticket prior to the draw taking place is small – less than the price paid for it. Allowing the court to approve an arrangement which terminates a very remote interest in a trust could be likened to giving the court power to order the destruction of the ticket. The probability of the owner sustaining any prejudice is extremely low, but it is not non-existent. For these reasons we do not consider that it would be compatible with the Convention to enact legislation which would permit the court to approve an arrangement on behalf of any person whose interest was thereby removed or diminished, however negligible the actuarial value of that interest might be.

5.16 A second solution, and the one which we prefer,<sup>9</sup> is to give the court power to exonerate the trustees from future claims by persons with interests which have negligible value at the time of the court hearing. It should be noted that exoneration is not equivalent to approval of the arrangement on behalf of the remote beneficiary in that it does not cut off the possibility of a future claim by the beneficiary for his or her entitlement under the original trust provisions if the contingency emerged. The risk of such a claim passes to the persons benefiting from the variation. Our view is that if the risk is to remain alive (as we think it must), it is reasonable to leave it resting with those persons rather than with the trustees. Again we see no reason why our recommendation should prevent applications from being disposed of as they are at present; any change being in the substance of the interlocutor pronounced by the court. In addition to a finding that it was unnecessary to approve the arrangement on behalf of remote beneficiaries, there would be an exoneration of the trustees from liability in the event that any such interest emerged. Wherever the court considered an interest to be negligible it could, as at present, decide to dispense with service of the proceedings on the beneficiary in question.

5.17 The legislative approach which we recommend is:

- (i) to give statutory effect to the decision in *Phillips* by permitting the court to approve an arrangement without satisfying itself either (a) that the arrangement is not prejudicial to any beneficiary upon whose behalf approval of the court would otherwise be required, or (b) that a beneficiary of full age and capacity has consented to it; provided in each case that the court is satisfied that the interest of the beneficiary in question is of negligible value; and
- (ii) to elaborate upon *Phillips* by empowering the court to exonerate the trustees from liability in the event that the interest emerges.

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<sup>8</sup> (1986) 8 EHRR 123, para 40.

<sup>9</sup> And which is consistent with the decision of Warner J in *Knocker v Youle*, see para 5.6 above.

Questions may arise as to the level at which the value of an interest becomes sufficiently small to be described as "negligible" so that the court need not take account of it in deciding whether to approve the arrangement. In the Discussion Paper we expressed the provisional view that the expression should not be rigidly defined and that, as at present, it should be left to the court to determine what is or is not, in a particular case, properly to be regarded as a negligible value.

5.18 Our proposal that there should be statutory exoneration for trustees in these circumstances was enthusiastically received by almost all of our consultees. The Court of Session judges regarded it as appropriate to meet a practical difficulty which was incapable of solution other than by legislation. The only doubt which was expressed was as to whether it was possible to distinguish between interests of negligible and non-negligible value. Most consultees, however, felt that this was a matter which could be left to the court (as it is at present), to be determined in the circumstances of a particular application. We agree, and accordingly we recommend as follows:

**7. (a) The court should be empowered by statute to approve an arrangement varying or revoking trust purposes without requiring to be satisfied either:**

**(i) that the arrangement is not prejudicial to any beneficiary upon whose behalf approval of the court would otherwise be required, or**

**(ii) that a beneficiary of full age and capacity has consented to it,**

**provided in each case that the court is satisfied that the interest of the beneficiary in question is of negligible value.**

**(b) In such circumstances, the trustees should be relieved by statute of liability for any loss sustained by a beneficiary, whether or not of full age and capacity, whose interest was determined to be of negligible value but which subsequently emerges.**

(Draft Bill, section 4)

5.19 *Interest not in existence.* In the second situation which we identified, ie where an interest does not yet exist and the court is satisfied that it is highly unlikely that there will ever be a person in existence to own and enjoy it, we consider that there is no "possession" for the purposes of Article 1 of the First Protocol. It would therefore be in compliance with the United Kingdom's Convention obligations to amend the current legislation to permit the court to approve an arrangement varying a trust despite the theoretical possibility of the birth of a person who would, either by virtue of being born or by satisfying some further contingency, become entitled to an interest which would defeat or diminish other interests in the trust. We see practical advantages in such an amendment. This type of situation cannot presently be dealt with by means of a retained fund nor insured against and is therefore, as matters stand, capable of constituting an insuperable obstacle to a proposed variation.

5.20 At present the court has power under section 1(1)(b) of the 1961 Act to approve an arrangement on behalf of "any person (whether ascertained or not) who may become one of the beneficiaries as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons". Thus, for example, the court may approve a variation on behalf of the unborn members of an unascertainable class of beneficiaries, such as "the heirs *in mobilibus* of X" who cannot be ascertained until X dies, provided that it is satisfied that there is no prejudice to them. We proposed in the Discussion Paper that the court's power should be extended to permit approval of an arrangement *despite* the possibility of prejudice to unborn – or indeed unascertained – persons, but only if the court was satisfied that there was no reasonable likelihood of the interest of such persons coming into existence. Certain risks other than birth of issue, such as the possibility of a person marrying, would also fall within the scope of our proposal: for example, where the person concerned is very old and lacks the mental capacity to marry. We suggested that the expression "no reasonable likelihood" struck the appropriate balance by way of guidance to the court which is called upon to assess the chance of the interest coming into existence. We also invited comment on whether any more detailed guidance should be included in the statute with regard to satisfaction of the selected test.

5.21 All of our consultees who responded to this proposal supported it. Most were content with the formulation of "no reasonable likelihood", which was felt to be familiar from every day court practice. No-one considered that there was a need for detailed guidance as to the criteria for satisfaction of the test.

5.22 The change will have consequences for trust variation practice in cases in which this new provision is utilised. Evidence will be required to support the petitioners' contention that there is no reasonable likelihood of the interest coming into existence. This might, in appropriate circumstances, consist of medical evidence of infertility. Alternatively, or in addition, it could consist of an affidavit by the putative parent explaining why it could be safely accepted by the court that there was no reasonable likelihood of the birth – or indeed adoption – of issue. We do not envisage that anything by way of a continuing personal guarantee or indemnity would be demanded as a condition of approval. We can see no reason why the change should prevent applications from being disposed of as they are at present, by a hearing without oral evidence. The beneficial effect of the change will be to permit approval by the court of arrangements which, as matters stand, would be refused as a consequence of the existence of highly improbable risks. We recommend as follows:

- 8. The court should have power to approve an arrangement notwithstanding the possibility of prejudice to an unborn or unascertained person, provided that the court is of the opinion that there is no reasonable likelihood that the interest of that person will come into existence.**

(Draft Bill, section 3(2))

## Definition of "prejudice"

5.23 There is a difference in wording between the English and the Scottish legislation in relation to the matter upon which the court is required to be satisfied. The proviso to section 1(1) of the (English) Variation of Trusts Act 1958 reads as follows:

"Provided that ... the court shall not approve an arrangement on behalf of any person unless the carrying out thereof *would be for the benefit of that person.*"

The proviso to section 1(1) of the Trusts (Scotland) Act 1961 is as follows:

"Provided that the court shall not approve an arrangement under this subsection on behalf of any person unless it is of the opinion that the carrying out thereof *would not be prejudicial to that person.*"

(Emphasis supplied)

5.24 In one respect the Scottish provision affords greater flexibility than the English version. There is no need in Scotland to demonstrate positive benefit to persons upon whose behalf the court is asked to approve the arrangement; it is sufficient that the scheme does not leave them worse off. This can be useful where, for example, the arrangement provides for a "trade-off" between two interests, leaving neither of them better or worse off as a result. On the other hand, the difference in expressions has led to a difference in interpretation in respect of which the English courts have taken a more expansive view. It is clear from the English case law that, in deciding whether an arrangement is for the benefit of a person, the court is entitled to consider more than purely material benefit.<sup>10</sup> Conversely, the English courts have refused arrangements which were clearly to a beneficiary's economic advantage on the ground that this was outweighed by educational and social disadvantage.<sup>11</sup>

5.25 There is very little Scottish authority on the interpretation of the parallel provision in section 1(1) of the 1961 Act. Such dicta as there are in the reported cases tend to indicate that the court will look only to the presence or absence of economic prejudice.<sup>12</sup> There is none which suggests the contrary. The usual practice is to address only economic prejudice. It seems likely that the Scottish court would take a sufficiently broad view of "prejudice" to allow postponement of vesting to protect an irresponsible beneficiary, on the basis that this would not be to his or her financial prejudice in the longer term. It is less likely that the court would go further and sanction a scheme which was clearly to a beneficiary's financial disadvantage on the ground that there was a non-economic benefit such as, say, increased opportunities for long-term tax and estate planning for the beneficiary and unborn issue together as a family. Nor would the court approve an arrangement which extended the class of beneficiaries to include adopted children even if this might be regarded as desirable

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<sup>10</sup> See eg *In re T's Settlement Trusts* [1964] Ch 158; *Re C L* [1969] 1 Ch 587; *Re Remnant's Settlement Trusts* [1970] Ch 560. In the last case the court approved a variation deleting a forfeiture clause which excluded from benefit persons who were, or were married to, Roman Catholics. Pennycuik J held that it was for the benefit of all members of the family (including those whose entitlements would be reduced by deletion of the forfeiture clause) that this source of family friction should be removed.

<sup>11</sup> Eg *Re Weston's Settlements* [1969] 1 Ch 223, 245, Lord Denning MR.

<sup>12</sup> See eg *Young's Trs, Petrs* 1962 SC 293, Lord President Clyde at 301; *Pollok-Morris & Others, Petrs* 1969 SLT (Notes) 60, in which the court refused an arrangement which would have extended the class of discretionary beneficiaries to include adopted children.

in the interest of family harmony.<sup>13</sup> It might be argued that the word "prejudice" lends itself less to a broad interpretation than the word "benefit". This can be contrasted with the position of an incapable adult whose guardian may be authorised to make gifts, for example in order to avoid tax liabilities, out of the adult's estate.<sup>14</sup>

5.26 Most jurisdictions which have enacted trust variation legislation have followed the English wording. The requirement in New Zealand and in Western Australia, however, is that the arrangement is not to the person's "detriment".<sup>15</sup> In Tasmania the matter is dealt with in greater detail. The court must be satisfied that the exercise of its powers would be in the interest of each person on behalf of whom the court is asked to approve the arrangement, and in so determining the court must have regard to:

- any financial benefit to that person;
- the absence of any financial disadvantage to that person;
- any non-financial benefit to that person;
- the welfare of the family of that person;
- any other circumstances that are advanced for or against the proposed arrangement.<sup>16</sup>

5.27 We invited comment in the Discussion Paper as to whether the Scottish legislation should be amended to make clear that in assessing the question of prejudice the court may have regard to factors other than economic advantage or disadvantage to the beneficiary in question. We cited the provision quoted above from the Tasmanian Act as an illustration of how legislation could make clear that the court may have regard to considerations other than pure financial prejudice. The majority of our consultees were of the view that an amendment along these lines was desirable although the Court of Session judges and the Faculty of Advocates doubted whether there was any need for amendment. Our view is that it is desirable for the court to have power to take non-economic considerations (including the welfare of members of the family of the beneficiary in question) into account and that it is not sufficiently clear that they can do so under the current legislation.

5.28 We accordingly recommend as follows:

**9. In assessing the question of prejudice, the court should have regard to the following factors in addition to economic advantage or disadvantage to the beneficiary in question:**

- (i) any non-economic benefit or detriment to the beneficiary;**
- (ii) the welfare of any member of the beneficiary's family; and**

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<sup>13</sup> Eg *Pollock-Morris, Petrs* 1969 SLT (Notes) 60

<sup>14</sup> Adults with Incapacity (Scotland) Act 2000, s 66.

<sup>15</sup> Trustee Act 1956, s 64A(1) (New Zealand); Trustees Act 1962, s 90(2) (Western Australia).

<sup>16</sup> Variation of Trusts Act 1994, s 14 (Tasmania).

**(iii) such other matters as seem to the court appropriate.**

(Draft Bill, section 3 (1), (3))

5.29 Section 1 of the 1961 Act is framed in terms of conferring a discretion<sup>17</sup> on the court to approve an arrangement if satisfied that it would not be prejudicial to any person upon whose behalf approval is required. Our view is that such a general discretion will become unnecessary if the court is expressly empowered to have regard to the factors set out in Recommendation 9 above. Our draft Bill<sup>18</sup> accordingly removes the existing unfettered discretion and requires the court to give approval if satisfied that the arrangement is not prejudicial to any such person.

**Approval on behalf of untraceable beneficiaries**

5.30 The court presently has no power under section 1 of the 1961 Act to approve an arrangement on behalf of untraceable beneficiaries. This will not always constitute an insuperable barrier to variation of the trust provisions. It may, for example, be possible to establish that an interest is of negligible value so that the court may dispense with service and find it unnecessary to approve the arrangement on behalf of the person in question.<sup>19</sup> This appears to be what happened in *Morris, Petitioner*<sup>20</sup> in which the court found it unnecessary that the consent of an untraceable beneficiary with a remote interest be exhibited to the court. For reasons discussed elsewhere in this Report,<sup>21</sup> this is not satisfactory from the standpoint of the trustees as they are left unprotected should the claim later emerge.

5.31 The real difficulty is where there is an untraceable beneficiary whose identity is ascertainable and who is of full age so that the court has no power to approve the arrangement on his or her behalf and who has a non-negligible interest which would be affected by the variation. In such circumstances it would, as the law stands, be pointless for the other beneficiaries to proceed with an application as it would be futile. In the Discussion Paper we suggested that it would be helpful to amend the existing law in order to permit the court to approve an arrangement on behalf of such a person, subject to it being satisfied that the scheme was not prejudicial to that person's interests. It would be for the petitioner to satisfy the court that there would be no such prejudice, using the same methods as are currently used in relation to the interests of persons who are incapable of consenting on their own behalf. The means used to protect the missing beneficiary's interest would depend on the circumstances of each case but might, for example, consist of retaining a fund equivalent to the actuarial value of the interest.

5.32 The effect of such approval would be to remove the possibility of future challenge if the beneficiary re-appeared and claimed to have been prejudiced by the arrangement because of, for example, the emergence of an unlikely contingency. Power to approve on behalf of an untraceable beneficiary exists or has been recommended for introduction in

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<sup>17</sup> "...the court may, if it thinks fit,... approve...any arrangement..."

<sup>18</sup> S 3(1).

<sup>19</sup> See Recommendation 7 at para 5.18 above.

<sup>20</sup> 1985 SLT 252. The report is brief, but the reference in it to *Phillips* 1964 SC 141 suggests that not only was the beneficiary untraceable, but also that her interest was of negligible value.

<sup>21</sup> See para 5.7.

various other jurisdictions. We would propose to follow recommendations made in other jurisdictions<sup>22</sup> by providing that the court would require to be satisfied that reasonable steps had been taken to trace the whereabouts of the beneficiary in question. It does not seem to us that there is a need for statutory specification of the steps which would require to be taken to trace the beneficiary.

5.33 Our consultees agreed with these proposals. We accordingly recommend as follows:

**10. The court should have power to approve an arrangement on behalf of a person who has not been traced, provided that the court is satisfied that:**

- (a) reasonable steps have been taken to trace the person; and**
- (b) the proposed arrangement would not be prejudicial to that person's interests.**

(Draft Bill, section 2(4)(e) and (7))

**Approval on behalf of adult beneficiaries who decline to consent**

5.34 Another situation in which a variation may be prevented from proceeding is where there is a beneficiary of full age whose consent to the arrangement is required but who withholds consent despite the fact that he or she would sustain no prejudice as a result of the scheme. Certain jurisdictions permit the court to approve an arrangement on behalf of such a non-consenting beneficiary. The US Uniform Trust Code<sup>23</sup> for example, provides for approval to be given despite the absence of consent of a beneficiary (whether because the beneficiary refuses consent or is untraceable or otherwise). The court must be satisfied (1) that if all the beneficiaries had consented, the trust could have been modified, and (2) that the interests of a beneficiary who does not consent will be "adequately protected".

5.35 As we have noted,<sup>24</sup> in Scotland, the theoretical basis underpinning court approval of a variation is the rule in *Miller's Trustees*. In an application under the 1961 Act the court supplies approval on behalf of beneficiaries who are incapable of giving agreement. It would be inconsistent with this underlying rationale of consensus (and deemed consensus) to permit the court to supply approval on behalf of non-consenting adult beneficiaries even where they would sustain no prejudice. Without a consistent theoretical foundation, it is more difficult for the courts to reach a view as to how to resolve any dispute which arises in relation to the operation of the statute. On the other hand, it may be regarded as unfair to consenting beneficiaries, and to those upon whose behalf the court is called upon to approve an arrangement, that the scheme can be vetoed by persons who *ex hypothesi* are no worse off as a consequence of it. One possible approach would be to give the court power to approve an arrangement on behalf of a non-consenting adult who is not prejudiced thereby,

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<sup>22</sup> Ireland (Law Reform Commission *Report on the Variation of Trusts*, LRC Report No 63, 2000) and British Columbia (British Columbia Law Institute *Report on the Variation and Termination of Trusts*, BCLI Report No 25, 2003).

<sup>23</sup> S 411(e).

<sup>24</sup> Paras 2.1-2.5 above.

if in all the circumstances the court considers it to be in the interests of the beneficiaries of the trust (including the non-consenting beneficiary) to do so.

5.36 We invited comment on whether it should remain necessary to obtain the consent of all ascertained and traceable beneficiaries of full age and capacity with a non-negligible interest in the trust. There was no consensus among our consultees. The majority, however, were not in favour of giving the court power to approve a scheme on behalf of a non-consenting beneficiary. It was pointed out that to do otherwise could be regarded as expropriation of the non-consenting beneficiary's property. Our impression that refusal of consent by adult beneficiaries is not a common problem in practice was confirmed by the Court of Session judges.

5.37 We accept the views of the majority and do not propose any change in the law in this regard. Instead, we recommend as follows:

- 11. It should remain necessary to obtain the consent of all ascertained and traceable beneficiaries of full age and capacity provided that they have a non-negligible interest in the trust.**

(Draft Bill, section 2)

### **Consent of the trustee**

5.38 Consistently with our recommendation that a doctrine of material interest should not be introduced,<sup>25</sup> we consider that it should be made clear that the consent of the trustee (in that capacity) to the proposed arrangement is not required. We do not propose altering the current practice whereby the trustee is entitled to receive notice of the petition and to be heard on the question which is being addressed by the court, namely that of prejudice to beneficiaries upon whose behalf the court's approval is sought. However, the trustee's consent should not, in our view, be a pre-requisite of court approval. Nor should the trustee be regarded for these purposes as a "beneficiary" by virtue only of his or her radical right in the event that the trust fails altogether. We recommend as follows:

- 12. It should be confirmed by statute that consent of the trustee in that capacity to the proposed arrangement is not required.**

(Draft Bill, section 7)

### **Miscellaneous procedural aspects**

#### *Right to make the application*

5.39 In terms of section 1(1) of the 1961 Act, an application may be made by "the trustees or any of the beneficiaries". There is no equivalent restriction in the Variation of Trusts Act 1958. The current practice in Scotland when there is no beneficiary of full age with an interest to make the application is for the trustees to present the petition. In the Discussion Paper we invited responses to the question whether there was a need to extend the right to

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<sup>25</sup> See Part 3 of this Report.

make an application in Scotland to persons other than the trustees and the beneficiaries. None of our consultees considered that there was such a need. We accept this view and make no recommendation for change in this regard. The current position is preserved by section 2(6) of the draft Bill annexed to this Report.

### *Representation of parties*

5.40 The ground rules for representation of parties were laid down at an early stage in *Robertson & Others, Petitioners*<sup>26</sup> and *Findlays, Petitioners*.<sup>27</sup> According to the procedure prescribed in these cases, where there are no disputed facts and provided there are separate counsel to represent the conflicting interests, the same solicitors may instruct them all. We do not recommend any statutory change to this procedure.<sup>28</sup> It has sometimes been questioned whether the expense of separate representation by counsel is justifiable. In most cases counsel instructed by consenting parties play a very minor role in the proceedings. They do, however, often play an important role prior to the hearing in expressing views on and proposing changes to the arrangement in the interests of the parties whom they represent. Moreover, amendments are frequently made to the arrangement immediately prior to or during the hearing, and it seems necessary for each separate interest<sup>29</sup> to have a representative present to assess the consequences of an amendment for that interest especially where separate solicitors have not been instructed. If there were no-one present to consider the matter from the point of view of each conflicting interest, the matter might have to be adjourned to another day with the resultant increase in delay and expense.

### *Public or private hearings*

5.41 Hearings are currently conducted in public. Concerns have sometimes been expressed that private family financial arrangements may be discussed in a public court. These concerns are most likely to arise in relation to families in whom the media take an interest. We do not recommend any change to present practice. Hearings in private would be difficult to justify especially against the background of Article 6 of the European Convention on Human Rights which requires public hearings. In practice, financial details are provided to the court in documentary form and the figures are seldom discussed expressly in the course of the hearing. It does not appear to us, and none of our consultees suggested otherwise, that there is any undue exposure of details of family finances.

### *Arrangement effecting a re-settlement*

5.42 Some difficulty has arisen in England as to whether the terms of the Variation of Trusts Act 1958 were sufficiently wide to encompass a re-settlement.<sup>30</sup> It was held that an arrangement which effected a revocation and re-settlement could be described as a variation, provided that the "substratum" of the original trust remained. Only then could it be said that the arrangement was merely varying the trust, though the means employed were

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<sup>26</sup> 1962 SC 196, Lord President Clyde at 203-4.

<sup>27</sup> 1962 SC 210, Lord President Clyde at 214.

<sup>28</sup> We understand, however, that in practice it is becoming more common for separate solicitors to be instructed in the light of professional regulations regarding conflicts of interest and in particular to advise on the taxation consequences of the proposed scheme for different members of the class of beneficiaries.

<sup>29</sup> An interest may of course be shared by several persons in which case there is a single representation of all of those sharing the interest.

<sup>30</sup> See *In re Ball's Settlement Trusts* [1968] 1 WLR 899; *In re Holt's Settlement* [1969] Ch 100.

wholly different and the form was completely changed. Such concerns have not been shared by the Scottish courts. A variation in Scotland may or may not amount to a re-settlement. It has been common in the past (though less so in current practice) for an arrangement to include a provision stating that "...from the operative date [usually the date of the court's interlocutor] the whole trust purposes and provisions of the trust deed shall come to an end and be determined". Clearly this may amount to re-settlement, as was acknowledged by the court in *Aikman, Petitioner*.<sup>31</sup> One practical consequence is that fresh accumulation periods may be included in the new trust provisions. We suggested in the Discussion Paper that if section 1 is to be substantially re-written, an express reference to re-settlement could be included in order to put the matter beyond doubt. Some respondents considered that there was no such need; others regarded it as a useful clarification. We recommend as follows:

- 13. It should be confirmed by statute that an arrangement may take the form of the creation of a new trust in relation to the whole or part of the trust estate.**

(Draft Bill, section 1(2)(c))

#### *Allocation of petitions for variation or termination of trusts*

5.43 In our earlier Discussion Paper on *Trustees and Trust Administration*,<sup>32</sup> we proposed the transfer of applications under section 1 of the 1961 Act from the Inner House to the Outer House. We suggested that this business was not necessarily so complex or important that it justified being heard by three senior judges and that the volume of appeals in relation to trust variations would not be large enough to negate the benefit of the applications being dealt with by courts lower than the Inner House. This view was echoed by the Court of Session judges in their response to the Discussion Paper on Variation and Termination of Trusts. They regarded this as the procedural matter most urgently in need of reform, and pointed out that transfer to the Outer House with a power to remit to the Inner House in any case of particular difficulty would bring the rules for private trust variations in line with those generally followed now for reorganisation of public trusts.

5.44 The allocation of business as between the Inner House and Outer House is a matter to be dealt with by rules of court rather than by legislation. Nevertheless, in the light of the judges' comments and the favourable response which we received to the proposal in our earlier Discussion Paper, we consider it is appropriate to recommend as follows:

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<sup>31</sup> 1968 SLT 137, Lord President Clyde at 141: "...the arrangement fundamentally and almost completely supersedes the original trust provisions and in effect makes a new settlement."

<sup>32</sup> Discussion Paper No 126, para 5.52 and Proposal 24(2).

14. **The Rules of the Court of Session should be amended in order to permit a petition for approval of an arrangement varying or terminating private trusts to be presented in the Outer House, subject to a power given to the judge to remit the application to the Inner House in any case of particular difficulty.**

# Part 6 Reorganisation of public trusts

## Development of the present law

6.1 In this Part of the Report we consider the reorganisation of public trusts. A public trust is a trust which is created for the benefit of the public at large, or of a section of the public, rather than for the benefit of a class of individuals specified by the truster. In contrast to a private trust, its terms can be enforced by a member of the public with an existing or contingent interest, or by the Lord Advocate in the public interest. Most, but not all,<sup>1</sup> public trusts can also be described as charitable trusts. However, the word "charitable" is problematic because it can be used in more than one sense. The exact scope of the word "charitable" at common law in Scotland has always been unclear. At one time the expressions "charitable purpose" and "charity" meant only the relief of poverty.<sup>2</sup> In later cases it was held that religious purposes and educational purposes were charitable, and that use of these expressions rendered a bequest sufficiently certain to be valid.<sup>3</sup> In practice, since one of the most important features of charitable status is obtaining the benefit of tax reliefs, the technical English meaning of "charity" and "charitable" which applies in Scotland for tax purposes<sup>4</sup> has overshadowed any different meaning which the word may have had in Scots law. Examples of public trusts which are not "charitable" either under Scots common law or under English law applied for tax purposes, are trusts for political purposes, and trusts for social purposes which fall short of being charitable because they are not solely for the benefit of persons in need of financial support.<sup>5</sup> Although such trusts lack the charitable ingredient, they share with charities a need for public accountability. The meaning of "charitable" has recently been complicated further by the new statutory definition of a "charity" for the purposes of the Charities and Trustee Investment (Scotland) Act 2005, to which we refer as "the Charities Act", discussed below.<sup>6</sup>

6.2 Before 1990, the only means by which the terms of public trusts (including charitable trusts) could be altered was by means of an application to the *nobile officium* of the Court of Session for approval of a *cy près* scheme. This was, and remains, competent (i) where there is gift for a public purpose but the truster has not specified the means by which the purpose is to be effected; (ii) where there is initial failure of the trust purposes but a general charitable<sup>7</sup> intention can be discerned in the terms of the settlement; and (iii) where there is a bequest to a particular charitable object which fails after the bequest has taken effect.<sup>8</sup> The court will not apply the *cy près* doctrine in cases of initial failure unless the terms of the

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<sup>1</sup> In contrast to the position under English law, it is possible in Scotland at common law for a trust to be a public trust without being a charitable trust.

<sup>2</sup> *Baird's Trs v Lord Advocate* (1888) 15R 682.

<sup>3</sup> *Allan's Exrs v Allan* 1908 SC 807; *Wink's Exrs v Tallent* 1947 SC 470.

<sup>4</sup> *IRC v Pemsel* [1891] AC 531; *Inland Revenue v Glasgow Police Athletic Association* 1952 SC 102; 1953 SC (HL) 13.

<sup>5</sup> "To increase the virtue and happiness of persons who are already virtuous and happy is essentially benevolent, but is not necessarily charitable": *Caldwell's Trs v Caldwell* 1920 SC 700, Lord Skerrington at 702. For a recent discussion see *Russell's Exr v Balden* 1989 SLT 177.

<sup>6</sup> See para 6.4.

<sup>7</sup> Ie in the wider sense of public trust purposes generally, see *Davidson's Trs v Arnott* 1951 SC 42.

<sup>8</sup> For fuller discussions, see *The Laws of Scotland (Stair Memorial Encyclopaedia)*, vol 3, paras 1107-1121 and vol 24, paras 85-101; Wilson and Duncan, *Trusts, Trustees and Executors* (2<sup>nd</sup> edn, 1995), ch 15.

bequest evince such general charitable intention, as opposed to an intention to benefit only a specific body or purpose.<sup>9</sup> Where, for example, a bequest is made to a defunct institution, it is more difficult to establish a general charitable intention than in the case of a bequest to an institution which has never existed. If no such intention can be established, the bequest will lapse and the subject matter will fall into residue or intestacy, as the case may be. In exercising its jurisdiction, the court must select the scheme most "nearly in accordance with the original purpose for which the fund was established".<sup>10</sup>

6.3 The circumstances in which public trusts could be reorganised were widened significantly by sections 9 to 11 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990. (As noted below, these provisions are superseded by the Charities Act so far as "charities", ie bodies entered in the Scottish Charity Register, are concerned. They remain applicable to public trusts which are not "charities" as so defined.) Three new possibilities were introduced in 1990, as follows:

(i) The court<sup>11</sup> may approve a scheme for the variation or reorganisation of the trust purposes if satisfied:

- that they have been fulfilled or can no longer be given effect to;
- that they provide a use for only part of the trust estate;
- that they were expressed by reference to an area or a class of persons which has ceased to be suitable or appropriate, or as regards which administration of the trust estate has ceased to be practicable; or
- that since the trust was constituted, they have become adequately provided for by other means, or have ceased to be such as would qualify for charitable status, or have ceased in any other way to provide a suitable and effective method of using the trust property.<sup>12</sup>

Regard must be had to the spirit of the trust deed or other document constituting the trust. The proposed scheme must enable the resources of the trust to be applied to better effect, consistently with the spirit of the trust deed,<sup>13</sup> and with regard being had to changes in social and economic conditions since the time when the trust was constituted.<sup>14</sup> Applications must be intimated to the Scottish Ministers who may enter proceedings in the public interest.<sup>15</sup>

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<sup>9</sup> The various tests which have been formulated are set out in Wilson and Duncan, *op cit*, para 15-04.

<sup>10</sup> *Kirk Session of Prestonpans v School Board of Prestonpans* (1891) 19 R 193, 199 (Lord President Robertson).

<sup>11</sup> Ie the Court of Session; 1990 Act, s 9(4). A power contained in s 9(5) to extend jurisdiction to the sheriff court has not been exercised.

<sup>12</sup> 1990 Act, s 9(1).

<sup>13</sup> Described in *Inverclyde Council v Dunlop* 2005 SLT 967 as an "elusive concept".

<sup>14</sup> 1990 Act, s 9(2).

<sup>15</sup> *Ibid*, s 9(6). The supervisory powers which were conferred upon the Lord Advocate by the 1990 Act were in practice exercised on his behalf by the Scottish Charities Office. They were transferred to the Scottish Ministers by means of the Transfer of Functions (Lord Advocate and Secretary of State) Order 1999 (SI 1999/678) and the Scotland Act 1998, s 53 and exercised in relation to charities by the Office of the Scottish Charity Regulator established by the Charities and Trustee Investment (Scotland) Act 2005.

(ii) In the case of a "small" trust, ie a trust with an annual income<sup>16</sup> not exceeding £5,000, the trustees may in any of the circumstances set out in subparagraph (i) above pass a resolution that the trust purposes shall be modified, or that the whole of the assets should be passed to another public trust, or that the trust should be amalgamated with one or more other public trusts.<sup>17</sup> The resolution must be advertised locally. Details of the scheme and of its advertisement, and of any objections received, must be provided by the trustees to the Scottish Ministers,<sup>18</sup> who may direct the trustees not to proceed with the scheme.<sup>19</sup>

(iii) In the case of a trust with an annual income not exceeding £1,000 whose constituting deed prohibits the expenditure of trust capital, the trustees may decide to expend capital if (i) the income is too small to enable the trust purposes to be achieved, and (ii) either there is no prospect of achieving an amalgamation under section 10 or expenditure of capital is more likely to achieve the trust purposes.<sup>20</sup> Their decision must be advertised locally and intimated to the Lord Advocate who may apply to the court for an order prohibiting such expenditure.

The *cy præs* jurisdiction of the Court of Session was expressly preserved as an alternative to an application under the 1990 Act. In certain circumstances, notably initial failure of trust purposes, application for approval of a *cy præs* scheme remains the only competent means of proceeding.

### Charities

6.4 The Charities and Trustee Investment (Scotland) Act 2005 (to which we refer as "the Charities Act") introduced a comprehensive new regime for the regulation of charities in Scotland. A body (including a trust) will not be a "charity" for the purposes of the Act unless and until it has been registered by the Office of the Scottish Charity Regulator ("OSCR") in the Scottish Charity Register. In order to be registered, a body must meet "the charity test", which it will do only if (a) its purposes consist only of one or more of the charitable purposes listed in section 7(2) *and* (b) it provides or intends to provide "public benefit" in Scotland or elsewhere.<sup>21</sup> There is no longer a presumption that a body whose objects are the relief of poverty or advancement of religion or education is a charity. It is clear that there will continue to be public trusts which are not charitable according to the new definition. The ranks of non-charitable public trusts may well be increased by trusts which either are unable to satisfy the new public benefit requirement or choose not to register as a charity.

6.5 The procedure for reorganisation of charities, including those which take the form of a charitable trust, has been significantly amended by the Charities Act.<sup>22</sup> Section 39 provides a mechanism whereby a "reorganisation scheme" varying the constitution of a

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<sup>16</sup> Ie the income of the trust for the financial year to which its most recent statement of accounts relates (1990 Act, s 15(1)).

<sup>17</sup> 1990 Act, s 10(1)–(3).

<sup>18</sup> Public Trusts (Reorganisation) (Scotland) (No 2) Regulations 1993 (SI 1993/2254). See also footnote 15 above.

<sup>19</sup> 1990 Act, s 10(14).

<sup>20</sup> 1990 Act, s 11; 1993 Regulations, reg 7.

<sup>21</sup> Charities Act, ss 5(1) and 7(1).

<sup>22</sup> Ss 39–43. At the time of writing only s 43 is in force (as from 1 April 2006, Charities and Trustee Investment (Scotland) Act 2005 (Commencement No 3, Transitional and Savings Provision) Order 2006 (SSI 2006/189)). Sections 39–42 will come into force on 31 May 2007 (Charities and Trustee Investment (Scotland) Act 2005 (Commencement No 4) Order 2007 (SSI 2007/117)).

charity, transferring its property to another charity, or amalgamating the charity with another charity, may be approved by OSCR without the need for an application to the court. An application must be made in the first instance by the charity to OSCR which must be satisfied that one of the "reorganisation conditions" is satisfied in relation to the charity. The conditions, set out in section 42(2), largely repeat in more concise form the conditions for court approval of a reorganisation under section 9 of the 1990 Act. One new condition is added, namely that a provision of the charity's constitution, other than a provision setting out its purposes, can no longer be given effect to or is otherwise no longer desirable.<sup>23</sup> Also retained from the 1990 Act is the requirement that the proposed reorganisation scheme must enable the resources of the charity to be applied to better effect for charitable purposes, consistently with the spirit of its constitution, and with regard being had to changes in social and economic conditions since the time when it was constituted.<sup>24</sup> OSCR has power under section 39 to approve the reorganisation scheme. Alternatively, OSCR may, of its own accord or if asked to do so by the charity trustees, apply under section 40 to the Court of Session for approval of the scheme by the court. It is no longer competent for the charity itself to apply to the Court of Session for approval under section 9 of the 1990 Act.<sup>25</sup> Nor are the alternative procedures for "small" trusts in sections 10 and 11 of the 1990 Act now available to charities.

6.6 The provisions of the Act do not apply to any charity constituted under a Royal charter or warrant or under any enactment.<sup>26</sup> The Court of Session's *cy præs* jurisdiction is expressly preserved,<sup>27</sup> and circumstances such as initial failure which fall outwith the "reorganisation conditions" continue to require to be dealt with by a common law application. As regards non-charitable public trusts, following consultation, the Scottish Executive stated:<sup>28</sup>

"Now that it has been decided that all reorganisations of charities should be considered by OSCR, with an appeal to the Scottish Charities Appeal Panel, rather than to the sheriff court, it is considered that it is no longer appropriate for OSCR to oversee the reorganisation of non-charitable trusts. OSCR is the charity regulator, with no real remit for non-charitable bodies, and it is not considered appropriate that the Scottish Charities Appeal Panel should act as an appellate body for non-charitable public trusts. It has therefore been decided to exclude non-charitable public trusts from the reorganisation provisions of the Bill, and leave the current regime of the 1990 Act in place for all such trusts at present. The Scottish Executive will ask the Scottish Law Commission to take the 1990 Act regime into account in its ongoing programme of work to review trust law."

Reorganisation of public trusts which are not registered as charities under the 2005 Act therefore continues, for the time being, to be governed by sections 9 to 11 of the 1990 Act.

#### *Educational and other endowments*

6.7 Special provisions presently contained in the Education (Scotland) Act 1980 apply to endowments, defined as "any property, heritable or moveable, dedicated to charitable

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<sup>23</sup> S 42(2)(c).

<sup>24</sup> S 40(1)(b)(i).

<sup>25</sup> Charities Act, Sch 4, para 7(e), inserting a new exception in s 15(9) of the 1990 Act.

<sup>26</sup> *Ibid*, s 42(5).

<sup>27</sup> *Ibid*, s 42(4).

<sup>28</sup> Policy Memorandum relative to the Charities and Trustee Investment (Scotland) Bill, para 72.

purposes",<sup>29</sup> but excluding subscriptions or fines paid by members of societies and bequests for the benefit of members or their families. The Act is principally concerned with "educational endowments", ie "any endowment which has been applied or is applicable in whole or in part, whether by the declared intention of the founder, or by the consent of the governing body, or in pursuance of any scheme approved under any Act or of any provisional order or by custom or otherwise, to educational purposes", including payments towards the cost of professional training and apprenticeship fees, the provision of maintenance, clothing and other benefits, and the payment of grants for travel.<sup>30</sup> Local authorities are given power to prepare schemes which, inter alia, alter the purposes for which certain educational endowments, generally those with a local connection, are held.<sup>31</sup> The governing body of an educational endowment not managed by a local authority may apply to the court for approval of a scheme for the future government and management of the endowment.<sup>32</sup> A scheme may, inter alia, provide for any of the following: altering the purposes to which such endowments are applied and the conditions and provisions regarding such application; grouping, amalgamating, combining or dividing such endowments; altering the constitution of the governing body or uniting two or more existing governing bodies; or altering powers of investment of the funds. In deciding whether or not to approve the scheme, the court must have regard to:

- (a) the spirit of the intention of the founders as embodied either in the original deed constituting the endowment where it is still the governing instrument, or in any previously-approved scheme;
- (b) the interest of the locality to which the endowment belongs;
- (c) the possibility of effecting economy in administration by the grouping, amalgamation or combination of any two or more endowments; and
- (d) the need for continuing the provision from endowments of competitive bursaries at universities, colleges of education or other educational institutions of a similar character.

6.8 Somewhat curiously, the Education (Scotland) Act 1980 also deals with non-educational endowments<sup>33</sup>, providing for applications to be made to the Court of Session in certain circumstances by the governing body for approval of a scheme for the future government and management of the endowment.<sup>34</sup> The Lord Advocate is also empowered to present a petition to the court for such a scheme.<sup>35</sup>

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<sup>29</sup> Education (Scotland) Act, s 122(1).

<sup>30</sup> *Ibid.* Educational endowments are excluded from the scope of the 1990 Act by s 15(9) of the latter Act.

<sup>31</sup> *Ibid.*, s 105(1). See also s 112 which contains requirements regarding notification and advertisement of a proposed scheme, with the possibility of a public local inquiry if objections are received.

<sup>32</sup> *Ibid.*, s 105(4A), inserted by the Education (Scotland) Act 1981, Sch 6, para 4(g).

<sup>33</sup> Eg for maintenance of graves, although on its terms, the Act is capable of applying to any property which is "dedicated to charitable purposes", ie very widely indeed.

<sup>34</sup> Education (Scotland) Act 1980, s 108. The circumstances are not the same as those applicable to educational endowments or those applicable to charitable or non-charitable public trusts which are not endowments.

<sup>35</sup> *Ibid.*, s 108A.

6.9 With effect from 1 April 2006, the provisions of the Education (Scotland) Act 1980 ceased to apply to schemes for reorganisation of educational and other endowments whose governing body is a charity.<sup>36</sup>

### Summary

6.10 The consequence of the various statutory interventions described above is that there are now five different procedures for variation of the terms of a public trust, as follows:

(i) If the trust is a "charity", ie is entered in the Scottish Charity Register (including an educational endowment whose governing body is a charity), and one or more of the "reorganisation conditions" in the Charities Act is met, an application for approval of a reorganisation scheme may be made to OSCR.

(ii) If the trust is a public trust (other than a body managing an educational endowment) but is not a "charity", and one or more of the conditions in section 9 of the 1990 Act is met,<sup>37</sup> an application for approval of a reorganisation scheme may be made to the court.

(iii) In the case of a public trust which is not a "charity" and which is a small trust, a reorganisation scheme may be effected by a resolution of the trustees, advertised and intimated as described above.<sup>38</sup>

(iv) If an endowment, including an educational endowment, is governed by a body which is not a "charity", an application for approval of a scheme varying the terms of its governing instrument may be made to the court under the Education (Scotland) Act 1980.

(v) If a trust, whether charitable or not, has failed in any of the circumstances described in paragraph 6.2 above, an application may be made to the *nobile officium* of the Court of Session for approval of a *cy près* scheme.

### Criticisms of the present law

6.11 In the Discussion Paper we expressed the view that it was unsatisfactory that there should be so many different procedures for reorganisation of different types of public trust. In most cases, only one of the various possibilities is competent. The dividing line between charitable and non-charitable trusts (according to either common law criteria or the English law criteria applied for revenue purposes) may be a fine one. The position has been further complicated by the fact that a "charity" for the purposes of the Charities Act is simply a body registered under that Act. Moreover, the fact that it has been considered appropriate to replace the special regime for reorganisation of educational endowments whose governing bodies are charities by the provisions of the Charities Act underlines the fact that there is a substantial overlap between educational endowment trusts and other public trusts. We suggested that it would be desirable in principle for there to be a single set of criteria for

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<sup>36</sup> *Ibid*, s 42(6) and s 43, the latter inserting a new subsection (4) in the Education (Scotland) Act 1980, s 122; Charities and Trustee Investment (Scotland) Act 2005 (Commencement No 3, Transitional and Savings Provision) Order 2006 (SSI 2006/189).

<sup>37</sup> Which are not precisely the same as those now applicable to charities.

<sup>38</sup> Para 6.3 above.

approval of an application for reorganisation of public trusts (including bodies managing endowments) regardless of whether or not the trust was charitable.

6.12 Prior to enactment of the Charities Act, the complexity of the web of statutory procedures had been criticised in a paper produced for the Scottish Executive Central Research Unit by the Charity Law Research Unit.<sup>39</sup> Among the proposals made in that paper were:

- replacement of the various categories of organisation by two types: the Scottish charity and the public trust. The concept of the "endowment", whether educational or non-educational, would be abandoned;<sup>40</sup>
- application of the same reorganisation provisions to Scottish charities and to public trusts not registered as charities.<sup>41</sup>

Since then the situation has been rendered more, and not less, complex by the introduction of the new procedure of application by charities to OSCR for approval.

6.13 We also suggested in the Discussion Paper that there would be advantages in broadening the scope of the statutory application procedure beyond the existing "reorganisation conditions" or "gateways" in section 42(2) of the Charities Act. We noted that somewhat broader grounds for reorganisation already existed for educational endowments. The decision of Lord President Hope in *Mining Institute of Scotland Benevolent Fund Trustees, Petitioners*<sup>42</sup> confirmed that the court must take a strict approach to determining whether any of the statutory criteria has been met, and suggests that the statutory gateways, even as reformulated in the Charities Act, may be unnecessarily restrictive. It may be noted in particular that the only gateway applicable to the management and administration of the charity requires "that a provision of the charity's constitution... can no longer be given effect to or is otherwise no longer desirable".<sup>43</sup> This does not in terms permit a scheme whose purpose is to introduce additional administrative provisions as opposed to removing or amending existing ones.

### **Proposals for reform**

6.14 The primary focus of this part of our work has been public trusts which were excluded from the new statutory provisions concerning reorganisation of charities contained in sections 39-43 of the Charities Act. In our view, however, it would be highly undesirable to perpetuate the current situation in which different criteria and procedures apply to charities registered under the Charities Act on the one hand and public trusts not registered under the Act on the other. Consultees who responded to the Discussion Paper on this point agreed. We would regard it as a missed opportunity if the conditions and procedures for reorganisation of charities and other public trusts, including those taking the form of endowments, were not brought into alignment.

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<sup>39</sup> Charity Law Research Unit, *Public Trusts and Educational Endowments* (Scottish Executive Central Research Unit) 2000.

<sup>40</sup> *Ibid*, para 9.3.

<sup>41</sup> *Ibid*, para 9.24.

<sup>42</sup> 1994 SLT 785 (Outer House).

<sup>43</sup> Charities Act, s 42(2)(c).

6.15 The simplest way to achieve this would be to re-enact the provisions of sections 39-42 of the Charities Act in terms which extend them to public trusts (including endowments) which are not registered as charities under that Act. The objection which was made to this at the time when the Charities Bill was introduced,<sup>44</sup> namely, that OSCR is the charity regulator with no real remit for non-charitable bodies, could be met either by extending the remit of OSCR to include non-charitable public trusts or by creating a parallel supervisory body to approve – and to present applications for court approval of – schemes for reorganisation of non-charitable public trusts. Of these alternatives we would favour the former as being more likely to produce consistency of approach to public trusts as a whole. We understand that this is also OSCR's initial view.

6.16 We have, however, considered whether the opportunity presented by alignment of charitable and non-charitable public trusts should be taken to re-assess the criteria which must be met before a reorganisation scheme may be approved, whether by OSCR or by the court. We have already noted<sup>45</sup> that the present criteria for reorganisation of endowments, whether educational or non-educational, are broader than those applicable to charities under the Charities Act and to public trusts under the 1990 Act. We can see no good reason why, as a consequence of a simplification exercise, endowments should find themselves subject to a more restrictive reorganisation regime than before (although we recognise that this is what has already occurred in relation to endowments whose governing body is a charity). An alternative solution is to broaden the grounds of reorganisation of charities and public trusts generally.

6.17 At present a scheme for reorganisation of a public trust (whether or not a charity registered under the Charities Act) must satisfy two requirements:

- (i) one of the statutory reorganisation conditions, must apply to the trust;<sup>46</sup> and
- (ii) the scheme must enable the resources of the trust to be applied to better effect consistently with the spirit of the trust's constitutive document, having regard to changes in social and economic conditions since the time when the trust was constituted.<sup>47</sup>

The effect of this two-part test is that the statutory mechanism may be used only in circumstances where difficulties have arisen in relation to the operation of the trust which are of sufficient gravity to jeopardise its continued effective operation. The need to fulfil one of the "reorganisation conditions" renders the mechanism unsuitable for use where the trust is capable of continuing operation but could, in the view of the trustees, provide greater public benefit if a particular amendment were made either to its purposes or to its management provisions. In our view this inhibits its usefulness. Proper regard must, of course, be paid to the intentions of the creator of the trust as evidenced by the trust's constitutive document, but we consider that this is assured by the second part of the two-part test. We also consider that the phrase "consistently with the spirit of its constitution" is sufficiently descriptive of the test to be applied in determining whether or not a proposed reorganisation adequately respects the intentions of the trust's creator.

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<sup>44</sup> See para 6.6 above.

<sup>45</sup> See para 6.7 above.

<sup>46</sup> 1990 Act, s 9(1); 2005 Act, s 42(2); see paras 6.3 and 6.5 above respectively.

<sup>47</sup> 1990 Act, s 9(2); 2005 Act, ss 39(1)(b) and 40(1)(b).

6.18 During the period of public consultation which preceded publication of the Bill which became the Charities Act, the need to retain "reorganisation conditions" similar to those in the 1990 Act did not feature as a prominent issue. In the Discussion Paper we observed that we saw advantages in broadening the scope of the statutory mechanism in certain respects, and this view was supported by consultees. The Charity Law Research Unit suggested in its response that there might be merit in going beyond the range of "triggering" circumstances envisaged in the reorganisation conditions, and that the provisions of the Education (Scotland) 1980 Act might serve as a useful model. We agree, and have concluded that the reorganisation conditions do not fulfil a useful purpose and could be removed altogether. One consequence would be to remove any distinction between a scheme to vary the trust purposes on the one hand and a scheme to amend the management and administrative provisions of the trust on the other. The sole criterion to be applied by OSCR (or other statutory body) or by the court in deciding whether or not to approve the scheme would be the better application of the trust's resources, consistently with the spirit of the trust's constitutive document. This would enable applications to be made where, for example, the class of potential beneficiaries has become small but not non-existent, and where the management provisions in the trust deed have become unsatisfactory but not unworkable. At the same time, the intention underlying the creation of the trust would continue to be respected.

6.19 Such a criterion would closely mirror one of the current requirements in relation to both educational and non-educational endowments, namely that special regard be had "to the spirit of the intention of the founders" as embodied in the original constitutive deed or in any subsequently-approved scheme.<sup>48</sup> The 1980 Act also requires the court to have special regard to the interest of the locality to which the endowment belongs and to the possibility of effecting economy in administration by the grouping, amalgamation or combination of any two or more endowments. We think that these are useful provisions which deserve to be retained and applied, in appropriate cases, to public trusts generally. In relation to public trusts for educational purposes, we propose the retention also of the fourth matter to which regard must presently be had in relation to educational endowments, namely the need for continuing the provision from endowments of competitive bursaries at universities, colleges and other educational institutions of a similar character.

6.20 A restructuring of the legislation in this way has the further advantage of rendering much of the existing legislation in relation to schemes for reorganisation of "endowments" unnecessary. This legislation has a long history, dating back to the 19<sup>th</sup> century and thus pre-dating the statutory reorganisation regimes in the 1990 Act and the Charities Act. Because of the wide definition of "endowment" in the 1980 Act,<sup>49</sup> there is considerable overlap between the applicability of the two regimes. An endowment as defined is, in substance, simply the capital of a public trust, as it is dedicated to charitable purposes. Provided that a sufficiently flexible regime is put in place, we see no reason to keep in force much of the legislation presently contained in Part VI of the 1980 Act. On the other hand, Part VI also contains provisions concerning the registration of educational endowments which have not been brought within the scope of the Charities Act, and concerning the auditing of their accounts. It is not within the scope of our project to consider administrative

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<sup>48</sup> See para 6.7 above.

<sup>49</sup> *Ibid* .

regulation of public trusts and accordingly we make no recommendations regarding them. Under the terms of our draft Bill they remain in force and are kept in the 1980 Act.

#### *Educational endowments managed by local authorities*

6.21 A large number of educational endowments are managed by local authorities. Many of these are small and relate to a particular locality. We consider that our recommendations in relation to reorganisation criteria should apply to such endowments in order to maintain consistency among all forms of public trust. As noted above,<sup>50</sup> endowments whose governing body is a charity have already been removed from the 1980 Act regime. The principal effect of our recommendations would therefore be that the procedure in section 105 of the 1980 Act would cease to apply to an endowment held in trust by an education authority itself rather than by a separate governing body. The procedure for publicising draft reorganisation schemes (including the possibility of a public local inquiry if objections are made) in section 112 of the 1980 Act would be replaced by an application by the education authority to OSCR for approval of a proposed scheme.

#### *"Small" trusts*

6.22 We noted in the Discussion Paper that the provisions of the 1990 Act in relation to "small" trusts have been disapplied to charities registered under the Charities Act, and that the same would occur in relation to public non-charitable trusts if a parallel regime for extra-judicial approval of reorganisations were to be created. In their response the Charity Law Research Unit suggested that the retention of "small" trusts provisions should not be too readily dismissed as there may be circumstances where this would be preferable to an application to the statutory body responsible for approval of reorganisations.

6.23 In relation to charities, it was a feature of the policy underlying the Charities Act that the "small" trusts procedures should be replaced by the new procedure consisting of application to OSCR for approval, on the basis that the latter offered a quicker and cheaper method of reorganisation. We see no reason to distinguish between charities and other public trusts in this regard. We do not therefore recommend the retention of the provisions of sections 10 and 11 of the 1990 Act.

6.24 In the light of the conclusions set out above, we recommend as follows:

- 15. There should be a single set of statutory criteria for approval of schemes for reorganisation of public trusts (including bodies holding educational and non-educational endowments in trust), whether or not registered as charities under the Charities and Trustee Investment (Scotland) Act 2005.**
- 16. The criteria for approval of a reorganisation scheme should be:**
  - (a) that the scheme will enable the resources of the trust to be applied to better effect consistently with the spirit of its constitution, having regard to changes in social and economic conditions since the trust was constituted;**

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<sup>50</sup> Para 6.9.

- (b) **that special regard should be had, where appropriate:**
- (i) **to the interest of any locality with which the trust is closely connected;**
  - (ii) **to the possibility of effecting economy in administration by amalgamating two or more trusts.**

(Draft Bill, sections 11 and 14)

### **Responsibility for approval of reorganisation schemes**

6.25 We noted above<sup>51</sup> the view of the Scottish Executive that it was not appropriate for OSCR to oversee the reorganisation of public trusts which are not charities. In the Discussion Paper we suggested that an overseer be appointed to fulfil the same function as that fulfilled by OSCR for charities. We further suggested that it would be desirable for an officer within OSCR, exercising a distinct, non-charity jurisdiction, to carry out this function. Our consultees all agreed that this function should be carried out within OSCR; some suggested that the function should simply be taken on by OSCR itself. Having considered the matter further, we are persuaded that there is no need to create a parallel overseer, and that the function ought to be exercised by OSCR itself. The criteria for approval of reorganisation which we recommend above are identical for charities and for public trusts which are not charities. The character of OSCR as an independent regulator with quasi-judicial functions is equally suitable for public trusts as it is for charities registered under the Act: the latter are, after all, merely a sub-group of the former. The skills and experience required to deal with applications for reorganisation of public trusts are the same as those required in relation to charities. It would in our view make little sense to create a parallel procedure, with a consequent increase in cost, if in practice the work is to be done by the same individuals. Another advantage of conferring this function on OSCR would be to give it a role in approving an application by a public trust which is not a charity where the purpose of the reorganisation is to enable it to meet the charity test and obtain registration.

6.26 The point has also been raised that appeals against a decision of OSCR in relation to an application for approval of a reorganisation scheme lie to the Scottish Charity Appeals Panel, and there is a question as to whether it is appropriate for this body to be given jurisdiction in relation to public trusts which are not charities. In our view, this too is an issue of nomenclature rather than of substance. If the criteria against which a decision of OSCR is to be assessed are the same in relation to charities and other public trusts, then it is in our view appropriate for a single body to have the task of assessment. We therefore recommend as follows:

- 17. The Office of the Scottish Charity Regulator should have responsibility for receiving and approving extra-judicial applications for reorganisation of public trusts which are not registered as charities under the Charities Act, and for applying to the Court of Session for approval of a reorganisation scheme for such a trust .**

(Draft Bill, sections 9 and 10)

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<sup>51</sup> Para 6.6.

## **Cy près schemes: initial failure of trust purposes**

6.27 As we have observed,<sup>52</sup> the *cy près* jurisdiction covers three situations:

- where a gift is made for public purposes but the trustor has failed to supply the necessary mechanism to carry it out;
- where there is an initial failure such as a bequest to a non-existent or defunct institution, or a direction which is impossible to carry out, but where the trustor has evinced a "general charitable intention"; and
- where there is a supervening failure after the bequest has taken effect, and there is no destination-over specified by the trustor in the eventuality of such failure.

Most cases of supervening failure will fall within the scope of the statutory reorganisation provisions which we recommend but the first two situations, being defects which prevent the trust purposes from taking effect, will not. In the Discussion Paper we invited comment upon the possibility of extending the statutory provisions to encompass such cases. We also sought views on whether the common law requirement of "general charitable intention" provided a suitable criterion for determining whether, in the case of initial failure, the approval of a *cy près* scheme was appropriate.

6.28 We noted in the Discussion Paper that there is a significant practical difference between cases of initial failure on the one hand and reorganisation of existing public trusts on the other. In the former case there may be persons (such as those who will benefit if the bequest lapses) with a personal interest to oppose the application for approval of a scheme. Clearly their interests must be accommodated in any extra-judicial procedure for determination of the question whether the terms of a bequest evince the necessary charitable intention. It may indeed be thought that this is a matter which should simply be left to the court. Our consultees were divided on this issue. Some, including the Charity Law Research Unit and the Law Society of Scotland, favoured leaving questions of initial failure to be resolved by the court. We are persuaded by this view. Because there are private interests involved, it appears to us that it is inappropriate for the validity of a bequest to be determined by extra-judicial body such as OSCR. The draft Bill annexed to this Report accordingly continues to preserve the power of the court to approve a *cy près* scheme.

6.29 Where the court holds that the requisite "general charitable intention" has been established, it will then consider whether or not to approve the *cy près* scheme proposed in the application. We consider that there may be scope for involvement of OSCR at this stage of the proceedings. It would be undesirable for a scheme which is intended by the parties to create a charitable trust to be approved by the court but then to be refused registration by OSCR on the ground that its terms fail to meet the "charity test" in terms of the Charities Act. This risk could be removed if, having held that the bequest was valid, the court had power to remit the proposed scheme to OSCR for consideration and report on such matters as the court considered appropriate including, for example, whether in OSCR's view the charity test was met. In the light of OSCR's response, the court would decide whether or not to approve the scheme. Such a remit would not always be appropriate: for example, where the

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<sup>52</sup> Para 6.2 above.

applicants did not intend to apply for registration of the trust as a charity, the court might find a remit unnecessary.

6.30 We therefore recommend as follows:

- 18. The statutory reorganisation procedure should not be widened to include cases of initial failure of a bequest or failure by a trustor to supply the necessary mechanism to carry out a bequest, which should continue to be dealt with by the court under the common law *cy prè*s jurisdiction.**
- 19. Where the court is satisfied that it is appropriate that a *cy prè*s scheme be effected, it should have power to remit the application to the Office of the Scottish Charity Regulator to report on such matters as seem to the court appropriate.**

(Draft Bill, section 13)

## Part 7 List of Recommendations

1. It should remain competent:
  - (a) for a trust to be varied or terminated by agreement among beneficiaries (where all are of full age and capacity); or
  - (b) for the court to approve an arrangement varying or terminating a trust on behalf of incapable, unborn or unascertained beneficiaries, regardless of whether the variation or termination is inconsistent with a material purpose of the trust.

(Paragraph 3.9)
2. It should be confirmed by statute that where every person with an interest, whether vested or contingent, in property held in trust is of full age and capacity or is not a natural person, those persons may agree, without the need to obtain court approval of the agreement:
  - (a) to vary the purposes for which the trust property is held;
  - (b) to terminate the trust in whole or in part;
  - (c) to direct the trustees to make over the trust property to other trustees to hold for new trust purposes; or,
  - (d) to enlarge or restrict the powers of the trustees to manage or administer the trust estate.

(Paragraph 4.4)
3. The powers of a parent or guardian in exercise of the responsibility to act as a child's legal representative should not include power to approve a variation or termination of a trust on the child's behalf.

(Paragraph 4.16)
4. A person aged 16 or 17 should continue to be deemed to be incapable of agreeing to the variation or termination of a trust, but the court is required to take such account as it thinks appropriate of the beneficiary's attitude to the arrangement.

(Paragraph 4.18)
5. It should continue to be competent for approval to be given to a variation or termination on behalf of an adult with incapacity.

(Paragraph 4.21)

6. (a) Where a woman who, prior to 1984, created an alimentary interest in her own favour in an ante-nuptial contract of marriage wishes to vary or terminate that interest, authorisation by the court under section 1(4) of the Trusts (Scotland) Act 1961 should no longer be required.

(b) There should be no other change to the existing law under which the variation or revocation of an alimentary interest after the beneficiary has entered into possession of it requires the authorisation of the court.

(Paragraph 4.24)

7. (a) The court should be empowered by statute to approve an arrangement varying or revoking trust purposes without requiring to be satisfied either:

- (i) that the arrangement is not prejudicial to any beneficiary upon whose behalf approval of the court would otherwise be required, or
- (ii) that a beneficiary of full age and capacity has consented to it,

provided in each case that the court is satisfied that the interest of the beneficiary in question is of negligible value.

(b) In such circumstances, the trustees should be relieved by statute of liability for any loss sustained by a beneficiary, whether or not of full age and capacity, whose interest was determined to be of negligible value but which subsequently emerges.

(Paragraph 5.18)

8. The court should have power to approve an arrangement notwithstanding the possibility of prejudice to an unborn or unascertained person, provided that the court is of the opinion that there is no reasonable likelihood that the interest of that person will come into existence.

(Paragraph 5.22)

9. In assessing the question of prejudice, the court should have regard to the following factors in addition to economic advantage or disadvantage to the beneficiary in question:

- (i) any non-economic benefit or detriment to the beneficiary;
- (ii) the welfare of any member of the beneficiary's family; and
- (iii) such other matters as seem to the court appropriate.

(Paragraph 5.28)

10. The court should have power to approve an arrangement on behalf of a person who has not been traced, provided that the court is satisfied that:
  - (a) reasonable steps have been taken to trace the person; and
  - (b) the proposed arrangement would not be prejudicial to that person's interests.

(Paragraph 5.33)
11. It should remain necessary to obtain the consent of all ascertained and traceable beneficiaries of full age and capacity provided that they have a non-negligible interest in the trust.

(Paragraph 5.37)
12. It should be confirmed by statute that consent of the trustor in that capacity to the proposed arrangement is not required.

(Paragraph 5.38)
13. It should be confirmed by statute that an arrangement may take the form of the creation of a new trust in relation to the whole or part of the trust estate.

(Paragraph 5.42)
14. The Rules of the Court of Session should be amended in order to permit a petition for approval of an arrangement varying or terminating private trusts to be presented in the Outer House, subject to a power given to the judge to remit the application to the Inner House in any case of particular difficulty.

(Paragraph 5.44)
15. There should be a single set of statutory criteria for approval of schemes for reorganisation of public trusts (including bodies holding educational and non-educational endowments in trust), whether or not registered as charities under the Charities and Trustee Investment (Scotland) Act 2005.

(Paragraph 6.24)
16. The criteria for approval of a reorganisation scheme should be:
  - (a) that the scheme will enable the resources of the trust to be applied to better effect consistently with the spirit of its constitution, having regard to changes in social and economic conditions since the trust was constituted;
  - (b) that special regard should be had, where appropriate:
    - (i) to the interest of any locality with which the trust is closely connected;

- (ii) to the possibility of effecting economy in administration by amalgamating two or more trusts.

(Paragraph 6.24)

- 17. The Office of the Scottish Charity Regulator should have responsibility for receiving and approving extra-judicial applications for reorganisation of public trusts which are not registered as charities under the Charities Act, and for applying to the Court of Session for approval of a reorganisation scheme for such a trust .

(Paragraph 6.26)

- 18. The statutory reorganisation procedure should not be widened to include cases of initial failure of a bequest or failure by a trustor to supply the necessary mechanism to carry out a bequest, which should continue to be dealt with by the court under the common law *cy præs* jurisdiction.

(Paragraph 6.30)

- 19. Where the court is satisfied that it is appropriate that a *cy præs* scheme be effected, it should have power to remit the application to the Office of the Scottish Charity Regulator to report on such matters as seem to the court appropriate.

(Paragraph 6.30)

# Appendix A

## Variation of Trusts and Charities (Scotland) Bill

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# Variation of Trusts and Charities (Scotland) Bill

An Act of the Scottish Parliament to make provision regarding the variation and termination of private trusts; to make provision regarding the approval of reorganisation schemes in relation to charities and public trusts; and for connected purposes.

## PART 1

### PRIVATE TRUSTS

#### **1 Arrangements to vary or terminate trust, etc.**

- (1) An arrangement to which subsection (2) applies may be made with agreement or approval given in accordance with section 2 by or on behalf of—
  - (a) each beneficiary, and
  - (b) each potential beneficiary,of the trust in question.
- (2) This subsection applies to an arrangement which—
  - (a) varies the purposes of a trust,
  - (b) terminates a trust in whole or in part,
  - (c) creates a new trust in relation to all or part of a trust estate, or
  - (d) varies any or all of the powers of the trustees to manage or administer a trust estate.
- (3) This section is subject to sections 4 and 5.

#### NOTE

This Part implements Recommendations 1 to 13 concerning private trusts. It has the effect of implementing Recommendation 1 as sections 1 to 8 do not contain any provisions preventing a variation or termination of a trust which is inconsistent with a material purpose of the trust.

Section 1 makes provision for both judicial and extra-judicial variation or termination of trusts. So far as extra-judicial variation is concerned, subsections (1) and (2) implement Recommendation 2 by putting into statutory form what is thought to be the existing common law rule that a trust can be varied or terminated by all the beneficiaries and potential beneficiaries (as defined in section 8) of the trust agreeing to that course of action. Where a beneficiary lacks capacity to agree or is not yet in existence or is presently unascertainable, an appropriate approval on his or her behalf is necessary: see section 2, subsections (3) and (4).

Subsection (2) describes the ways in which a trust can be varied or terminated. Paragraph (c) gives effect to Recommendation 13 by making it clear that all or part of the trust property can be resettled into a new trust.

## **2 Agreement to, and approval of, arrangement**

- (1) Agreement or approval is effective for the purposes of section 1(1) only if it is given in accordance with this section.
- (2) Agreement may be given by a beneficiary or potential beneficiary where that person—
  - (a) is aged at least 18 and not incapable, or
  - (b) is not a natural person.
- (3) Approval on behalf of a person who is incapable may be given by any person authorised to give that approval under—
  - (a) the Adults with Incapacity (Scotland) Act 2000 (asp 4), or
  - (b) the law of a country other than Scotland.
- (4) Approval may be given by the court on behalf of—
  - (a) a person who is under the age of 18,
  - (b) a person who is incapable,
  - (c) a potential beneficiary (other than such a beneficiary who falls within subsection (6)),
  - (d) an unborn person, or
  - (e) a person who is untraceable.
- (5) The powers of the court under this section are exercisable in relation to a trust on the petition of the trustees or any of the beneficiaries.
- (6) A potential beneficiary falls within this subsection if that person—
  - (a) is—
    - (i) aged at least 18 and is not incapable, or
    - (ii) not a natural person, and
  - (b) would be of the specified description or a member of the specified class (as referred to in the definition of “potential beneficiary” in section 8), as the case may be, if—
    - (i) the date referred to in that definition, or
    - (ii) the event so referred to had happened,at the date of the hearing of the petition in question.
- (7) A person is “untraceable” for the purposes of subsection (4)(e) if—
  - (a) that person has not been traced, and
  - (b) the court is satisfied that reasonable steps have been taken to trace that person.

### NOTE

This section, which also applies both to judicial and to extra-judicial variation or termination of a trust, sets out the circumstances in which agreement of a beneficiary or approval on behalf of a beneficiary is required.

Subsection (1) implements Recommendation 11 and continues the 1961 Act regime in terms of which, with very minor exceptions, all capable beneficiaries must agree to any variation or termination; the court's role being restricted to supplying approval on behalf of those from whom agreement cannot be obtained.

Subsection (2) implements Recommendation 2. Agreement to a variation or termination can be given by a beneficiary or a potential beneficiary who is 18 or over and capable (section 2(2)(a)). Section 2(2)(b) provides that a non-natural person, such as a company or a corporate charity, can agree.

Subsection (3) implements Recommendation 5. It confirms the existing position whereby a guardian or person authorised by an intervention order or other document under the Adults with Incapacity (Scotland) Act 2000 (or the law of a foreign jurisdiction) may agree on behalf of an adult beneficiary or potential beneficiary who is incapable of consenting. Such agreement by an authorised person is an alternative to court approval, see section 2(4)(b).

Subsection (4), paragraphs (a) to (d) re-enact the existing provisions in section 1 of the Trusts (Scotland) Act 1961. Retention of 18 as the minimum age in paragraph (a) for agreeing to a trust variation or termination partially implements Recommendation 4.

Court approval on behalf of an incapable adult (paragraph(b)) remains an alternative to agreement by the guardian or other authorised person under section 2(3) and implements Recommendation 5.

Paragraph (c), together with section 2(6), partly implements Recommendation 1(b) as it reproduces the substance of section 1(1)(b) of the Trusts (Scotland) Act 1961. Potential beneficiaries are defined in section 8. They are those who do not have at the date of the hearing of the petition even an indirect or contingent interest in the trust but who may acquire an interest at some future date or on the happening of some future event.

Recommendation 1(b) is also partly implemented by paragraph (d) whereby the court may approve on behalf of an unborn person.

Paragraph (e) is a new provision which, together with section 2(7), implements Recommendation 10. It allows a variation or termination to proceed even though one or more beneficiaries who would otherwise have to agree cannot be traced. Their agreement is replaced by the approval on their behalf by the court.

Subsection (5) An application to the court for approval of an arrangement for variation or termination of a trust may currently be made, and is to continue to be made, only by the trustees or any of the beneficiaries.

Subsection (6) carries forward the policy of the proviso to section 1(1)(b) of the Trusts (Scotland) Act 1961. It restricts the category of potential beneficiaries on whose behalf the court can approve the arrangement. Excluded from the requirement for court approval are persons who are 18 or over and are capable and who also fall within paragraph (6)(b) and are identifiable persons or individuals. Any such persons must agree to the arrangement themselves. To fall within paragraph (6)(b) a potential beneficiary must be identifiable as being in the relevant class or of the relevant description if the date or event that is referred to in the trust had taken place at the date of hearing the petition. One example of potential beneficiaries is the class of the heirs of an individual who has not yet died. The heirs cannot be ascertained until that individual dies with the result that they have no present interest but are merely potential beneficiaries. The court cannot approve on behalf of those who would qualify as heirs if the individual were taken to die at the date of hearing the petition but they must consent themselves. If, however, there are unborn or underage heirs then court approval on their behalf is both competent and necessary.

Subsection (7) This sets out what is meant by an untraceable person. The court must be satisfied that those promoting the arrangement have taken steps which are reasonable in the circumstances of the case to locate a missing beneficiary.

### **3 Giving of approval by court**

- (1) Except in the circumstances specified in subsection (2), the court is to give approval under section 2(4) only if it is of the opinion that the carrying out of the arrangement in question would not be prejudicial to the person on whose behalf the approval is given.

- (2) The circumstances referred to in subsection (1) are where the court is giving approval on behalf of an unascertained or unborn person under paragraph (c) or (d) of section 2(4) and it is satisfied that there is no reasonable likelihood—
  - (a) of the event taking place which would make the unascertained person a beneficiary, or
  - (b) of the unborn person being born.
- (3) In considering under subsection (1) whether the carrying out of an arrangement would be prejudicial to a person, the court may have regard to—
  - (a) any economic or other benefit which the person is likely to receive from the arrangement,
  - (b) any economic or other detriment which the person is likely to sustain in consequence of the arrangement,
  - (c) the welfare of any member of the person’s family, and
  - (d) such other matters as seem to the court appropriate.

NOTE

Subsection (1) sets out the general rule that the court is only to approve an arrangement on behalf of a beneficiary or potential beneficiary if it thinks that the arrangement would not prejudice any persons who cannot consent for themselves and on whose behalf the court is therefore giving approval.

Subsection (2) provides an exception to the general rule in subsection (1) and implements Recommendation 8 of the Report. No court approval on behalf of an unborn or unascertained beneficiary will be required if the court is satisfied that there is no reasonable likelihood that the event which would make an unascertained person a beneficiary (or potential beneficiary) will occur, or that someone who if born would be a beneficiary (or potential beneficiary) will be born. The proposed arrangement could therefore go ahead even if it would remove such a potential interest. Thus if T sets up a trust for his children and he has two existing children who want to terminate the trust and be paid the capital then the court will need to approve the arrangement on behalf of T’s unborn children and must consider whether they would be prejudiced by the arrangement. However, if T is an 80 year old widower then the court may be satisfied that the possibility of him having further children is so remote that it can be ignored. Evidence in the shape of medical and other reports may have to be presented in order to satisfy the court in less extreme cases. An example of an unascertained person who had only a theoretical possibility of becoming a beneficiary might be the potential spouse of an incapable 85 year old person. If a person was, against all expectation, born or ascertained after the arrangement was finalised, he or she will have no claim against the trustees or the other beneficiaries for any loss sustained as a consequence of the variation.

Subsection (3) extends the current law by increasing the factors which the court may consider in evaluating prejudice when deciding whether to approve an arrangement on behalf of a beneficiary who cannot consent. It implements Recommendation 9 and ensures that the court can take into account more than economic factors. For example, a trust provision in favour of the current children of a man which it is proposed to extend to include an adopted child might be approved on behalf of the current underage children as this would promote harmony within the family.

**4 Person with interest of negligible value**

- (1) Where an arrangement to which section 1(2) applies is made in respect of a trust, the trustees are not liable to a beneficiary for loss sustained as a consequence of the making of the arrangement if that beneficiary is a person who falls within subsection (2).
- (2) A person falls within this subsection if—

- (a) that person was a beneficiary or potential beneficiary when the arrangement was made,
- (b) no agreement to, or approval of, the arrangement was given in accordance with section 2 by or on behalf of that person, and
- (c) prior to the arrangement being made, the court (on the petition of the trustees or any of the beneficiaries) was satisfied that—
  - (i) the interest of that person was so remote as to be of negligible value, or
  - (ii) in the event of that person becoming a beneficiary, the person’s interest would be so remote as to be of negligible value.

NOTE

This section, which gives effect to Recommendation 7, enables an arrangement to proceed without the agreement of, or court approval on behalf of, a beneficiary or potential beneficiary if the court is satisfied that the person in question has a negligible interest in the trust. It gives statutory effect to the decision of the Court of Session in *Phillips and Others, Petitioners* 1964 SC 141.

In contrast to section 3, the effect of the arrangement proceeding without the agreement of, or approval on behalf of, persons with negligible interests is not to remove their interests. If the unlikely event or series of events causing the interest to emerge were to occur after implementation of the arrangement, their entitlement under the trust prior to variation would remain. However subsection (1) protects the trustees from claims by such persons whose right of action would lie instead against those who have benefited from the variation.

**5 Arrangements to vary or revoke alimentary purposes**

- (1) Where a beneficiary has entered into enjoyment of an alimentary liferent of, or any alimentary income from, the trust estate or any part of it, an arrangement to vary or revoke the alimentary purpose in question requires the authorisation of the court under this section as well as agreement or approval given in accordance with section 2.
- (2) The court may give authorisation under subsection (1) if it considers that the carrying out of the arrangement would be reasonable, having regard to the income of the beneficiary from all sources, and to such other factors, if any, as the court considers material.
- (3) The powers of the court under this section are exercisable in relation to a trust on the petition of the trustees or any of the beneficiaries.
- (4) Subsection (1) does not apply to an alimentary purpose created by a woman in her own favour prior to section 5 of the Law Reform (Husband and Wife) (Scotland) Act 1984 (c.15) coming into force on 24th July 1984.
- (5) In this section, “alimentary purpose” means a trust purpose entitling a beneficiary to an alimentary liferent of, or any alimentary income from, the trust estate or any part of it.

NOTE

This section substantially re-enacts section 1(4) of the Trusts (Scotland) Act 1961 with one minor change. Implementing Recommendation 6, subsection (4) provides that court authorisation is not required in respect of the variation or termination of an alimentary purpose created by a woman in her own favour before 24<sup>th</sup> July 1984. She is therefore able to agree to it herself. In terms of sections 5 and 10(2) of the Law Reform (Husband and Wife)(Scotland) Act 1984 it has been incompetent for women to create alimentary provisions in their own favour since 24<sup>th</sup> July 1984.

## **6 Views of 16 and 17 year olds**

- (1) Where the court is considering whether—
  - (a) to give, on behalf of a relevant person, approval under section 2(4) to an arrangement, or
  - (b) to authorise under section 5 an arrangement in a case where the alimentary beneficiary is a relevant person,the court is to take such account as it thinks fit of the relevant person’s attitude to the arrangement.
- (2) In subsection (1), “relevant person” means a person who is aged 16 or 17 and is not incapable.

### NOTE

This section gives effect to part of Recommendation 4 of the Report. It re-enacts the existing law whereby a person under the age of 18 has no capacity to agree to a trust variation or termination. The court has and in terms of subsection (1) will continue to have to take account of the views of a 16 or 17 year old in deciding whether or not to approve a trust variation or termination on his or her behalf. Subsection (1)(b) extends this to authorisation of a variation or revocation of an alimentary purpose.

Under subsection (2), section 6 does not apply to a 16 or 17 year old who is incapable. A guardian or other authorised person may agree to an arrangement on his or her behalf (section 2(3)) or the court may approve it on his or her behalf (section 2(4)(b)).

## **7 Agreement of trustor not required**

An arrangement such as is referred to in section 1(2) or 5(1) may be made without the agreement of the trustor unless that person is, other than by virtue of being the trustor, a beneficiary or potential beneficiary of the trust in question.

### NOTE

This section implements Recommendation 12. Its purpose is to make clear that the agreement of the trustor to an arrangement for variation or termination of the trust is not required. It might otherwise be argued that the trustor is a beneficiary or potential beneficiary because of the radical right to receive the trust property if all the other trust purposes fail. If however the trustor happens to be a beneficiary then his or her agreement (or approval on his or her behalf by the court) is required before the arrangement can proceed.

## **8 Interpretation of Part 1**

In this Part—

“beneficiary”, in relation to a trust, means a person having, directly or indirectly, an interest, whether vested or contingent, under the trust;

“the court” means the Court of Session;

“potential beneficiary” means a person (whether ascertained or not) who is not a beneficiary but may become a beneficiary as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons; and

“trust” means a trust taking effect under any will, settlement or other disposition, but does not include a public trust.

#### NOTE

The definition of "beneficiary" is taken from section 1(6) of the Trusts (Scotland) Act 1961 and the definition of 'potential beneficiary' is based upon section 1(1)(b) of that Act. For further details see the notes on section 2(6).

The definition of "trust" excludes public trusts. The 1961 Act did not exclude such trusts but the variation provisions were designed for, and were in practice applied only to, private trusts.

## PART 2

### CHARITIES AND PUBLIC TRUSTS

#### **9 Reorganisation schemes: applications by charity or public trust**

- (1) OSCR may, on the application of a charity or the trustees of a public trust, approve a reorganisation scheme proposed by the charity or trustees.
- (2) The Scottish Ministers may by regulations made by statutory instrument make such provision as they think fit in relation to the procedure for making and determining applications under this section.
- (3) Such regulations may in particular make provision about—
  - (a) the form and manner in which applications must be made,
  - (b) publication of proposed reorganisation schemes,
  - (c) the period within which OSCR must make a decision on an application,and may make different provision in relation to different types of charity or public trust.
- (4) A statutory instrument containing regulations under this section is subject to annulment in pursuance of a resolution of the Scottish Parliament.

#### NOTE

This Part implements Recommendations 15 to 19 concerning charities and public trusts. Its purpose is to enable all public trusts and charities to be reorganised extra-judicially by the Office of the Scottish Charity Regulator (OSCR) or by the Court of Session on application by OSCR. It therefore supersedes most of Part VI of the Education (Scotland) Act 1980 dealing with reorganisation of educational and non-educational endowments, sections 9 to 11 of the Law Reform (Miscellaneous Provisions)(Scotland) Act 1990 dealing with reorganisation of public trusts and sections 39 to 43 of the Charities and Trustee Investment (Scotland) Act 2005 dealing with reorganisation of charities. These superseded provisions are repealed in Schedule 2.

Section 9 partly implements Recommendation 17. Subsection (1) enables OSCR to approve a reorganisation scheme put before it by a charity or by the trustees of a public trust which is not a charity. Subsection (2) sets out what can be done by means of a reorganisation scheme. "Charity" means a body entered on the register of charities under the Charities and Trustee Investment (Scotland) Act 2005, whether it takes the form of a public trust, a company or a corporation.

Subsections (2) to (4) give the Scottish Ministers power to make regulations to deal with the procedure for applications to OSCR under this section. They are based upon sections 39 (2), (3) and 103 of the 2005 Act.

## **10 Reorganisation schemes: applications to the court**

- (1) OSCR may, of its own accord or at the request of a charity or the trustees of a public trust, apply to the court for approval of a reorganisation scheme proposed by the charity, the trustees or OSCR.
- (2) A charity or the trustees of a public trust may enter appearance as a party in proceedings on an application under subsection (1) in relation to that charity or trust.
- (3) OSCR must, not less than 28 days before making an application under subsection (1), notify the charity or trustees in question of its intention to do so.

### NOTE

This section implements the remainder of Recommendation 17. Subsection (1) enables OSCR to apply to the Court of Session for approval of a reorganisation scheme that either it or the trustees or charity has proposed. OSCR may decide to apply to the court itself or it may, but is not bound to, make an application if requested to do so by the trustees or the charity. Only OSCR has the power to apply to the court for approval under section 10.

Subsection (2) enables the body being reorganised to take part in OSCR's application. In terms of subsection (3) OSCR must let the trustees or the charity know that it intends to make that application at least 28 days before it does so. These subsections are derived from subsections (3) and (4) of section 40 of the 2005 Act.

## **11 Approval of reorganisation schemes**

- (1) A reorganisation scheme may be approved only if OSCR or the court, as the case may be, is satisfied that the scheme will—
  - (a) enable the resources of the charity or public trust to be applied to better effect consistently with the spirit of its constitution, having regard to changes in social and economic conditions since the charity or trust was constituted, or
  - (b) enable the charity or public trust to be administered more effectively.
- (2) In deciding whether to approve a reorganisation scheme, OSCR or the court is to have particular regard (where relevant) to—
  - (a) the interests of any locality with which the charity or public trust to which the scheme relates is closely connected, and
  - (b) any economy in administration which will be effected by a proposal in the scheme to amalgamate two or more charities or public trusts.
- (3) In deciding whether to approve a reorganisation scheme in relation to a public trust the property of which is held for educational purposes, OSCR or the court is to have particular regard (where relevant) to the need for continuing the provision from such trusts of competitive bursaries at institutions specified in schedule 2 to the Further and Higher Education (Scotland) Act 2005 (asp 6) or other educational institutions of a similar character.

### NOTE

This section implements Recommendations 15 and 16 and sets out the conditions that must be met before the court or OSCR may approve a reorganisation. It brings the reorganisation conditions for charities and public trusts (including educational and other endowments) into line with one another.

Subsection (1) sets out the conditions for reorganisation and is a composite of elements from the Charities and Trustee Investment (Scotland) Act 2005, the Law Reform (Miscellaneous Provisions)(Scotland) Act 1990 and the Education (Scotland) Act 1980. It omits the "gateways" presently contained in section 42(2) of the 2005 Act. Like the 1980 Act, and unlike the 2005 and 1990 Acts, paragraphs (a) and (b) are expressed in terms of outcomes which OSCR or the court has to be satisfied that the proposed reorganisation will achieve. Subsection (1)(b) is included so as to allow reorganisations to take place which enable the charity or trust to be run more effectively. For example, under subsection (1)(b) the trustees could be given additional administrative powers or the scope of the beneficiaries could be increased even though the trust was not unworkable as presently constituted.

Subsections (2) and (3) are derived from the 1980 Act. Subsection (3) applies to educational endowments and carries forward the substance of section 105(2)(d) of the 1980 Act.

## **12 Approved schemes**

- (1) A charity or the trustees of a public trust may, despite any provision of the constitution of the charity or trust having contrary effect, proceed with any variation, transfer or amalgamation for which an approved reorganisation scheme makes provision.
- (2) Neither a charity nor the trustees of a public trust are liable to any person for loss sustained as a consequence of an approved reorganisation scheme.

### **NOTE**

Subsection (1) is derived from section 41 of the 2005 Act. It clarifies that, once a reorganisation scheme has been approved by OSCR or the court, the charity or the trustees may implement the terms of the reorganisation irrespective of whether there are provisions in the constitution of the charity or public trust prohibiting such a reorganisation.

Subsection (2) has been inserted in order to make it clear that the body which has been reorganised is not liable for any loss sustained as a result of the reorganisation.

## **13 Cy près schemes**

- (1) Nothing in this Part affects the power of the court to approve a cy près scheme.
- (2) When considering an application relating to a cy près scheme, the court may remit the application to OSCR in order for that body to report to the court on such matters as seem to the court appropriate.

### **NOTE**

Subsection (1) preserves the common law relating to the approval by the Court of Session of cy près schemes for public trusts, whether or not they are charitable. Both the 1990 Act and the 2005 Act contain the same savings provision. The broader reorganisation conditions in this Bill should mean that the cy près jurisdiction for reorganisation of existing public trusts will hardly ever be required. Cy près applications will, however, remain available to provide administrative machinery to enable a public trust to function where the trust had omitted to do so, or to substitute another scheme where the wishes of a trustor with general charitable intention prove incapable of realisation. Retention of the cy près jurisdiction for such situations implements Recommendation 18.

Subsection (2) implements Recommendation 19 and provides that if the court decides that a cy près scheme should go ahead then it may remit the application to OSCR to report to the court on the issues that the court deems appropriate. For instance, if the cy près scheme is designed to enable the trust to become a charity under the 2005 Act then the court might remit the application to OSCR so that can OSCR can

confirm that it would meet the charity test under the 2005 Act. On receipt of the report from OSCR the court would then decide whether to approve the scheme.

## **14 Interpretation of Part 2**

- (1) In this Part, a “reorganisation scheme”, in relation to a charity, is a scheme for—
  - (a) variation of the constitution of the charity (whether or not in relation to its purposes),
  - (b) transfer of the property of the charity (after satisfaction of any liabilities) to another charity (whether or not involving a change to the purposes of the other charity), or
  - (c) amalgamation of the charity with another charity.
- (2) In this Part, a “reorganisation scheme”, in relation to a public trust, is a scheme for—
  - (a) variation of the constitution of the trust (whether or not in relation to its purposes),
  - (b) transfer of the property of the trust (after satisfaction of any liabilities) to a charity or another public trust (whether or not involving a change to the purposes of the charity or other trust), or
  - (c) amalgamation of the trust with a charity or another public trust.
- (3) In this Part—

“charitable purposes” means the purposes set out in section 7(2) of the Charities and Trustee Investment (Scotland) Act 2005 (asp 10);

“charity” means a body entered in the Scottish Charity Register, other than such a body constituted under a Royal Charter or warrant or under an enactment;

“constitution”—

- (a) in relation to a charity established under the Companies Acts, means its memorandum and articles of association,
- (b) in relation to a public trust or a charity which is a body of trustees, means the trust deed or whatever other writing exists in relation to the basis on which the trust property is held,
- (c) in relation to a Scottish charitable incorporated organisation (within the meaning of section 49 of the Charities and Trustee Investment (Scotland) Act 2005), has the meaning given in section 50 of that Act, and
- (d) in relation to any other charity, means the instrument which establishes it and states its purposes;

“the court” means the Court of Session;

“education authority” means a council constituted under section 2 of the Local Government etc. (Scotland) Act 1994 (c.39);

“educational purposes” includes—

- (a) payments towards the cost of professional training and apprenticeship fees,
- (b) the provision of maintenance, clothing and other benefits, and
- (c) the payment of grants for travel;

“OSCR” means the holder of the Office of the Scottish Charity Regulator;

“public trust” does not include—

- (a) a trust the trustees of which are a charity, or
- (b) a trust constituted under an enactment; and

“trustees”, in relation to a public trust, includes an education authority or other body holding the trust property for charitable purposes.

#### NOTE

Subsections (1) and (2) set out the definition of a reorganisation scheme for charities and public trusts respectively. They are modelled on section 105(1) of the 1980 Act, section 9(3) of the 1990 Act and section 42(3) of the 2005 Act. While the funds of a public trust can be handed over to a charity, the reverse is not allowed.

Subsection (3) contains further definitions.

The definition of "charitable purposes" refers to the first part of the "charity test" in the 2005 Act, the other part of that test being the public benefit requirement in section 8 of that Act.

A charity constituted by Royal Charter or warrant is excluded from the Bill's reorganisation provisions, following a similar exclusion in section 42(5) of the 2005 Act. Such a charity would be reorganised by variation of the Royal Charter or by warrant of the Privy Council. Educational purposes are defined for the purpose of section 11(3) of the Bill where an educational endowment is being reorganised. The definition is taken from section 122 of the 1980 Act.

Trusts which are constituted by an enactment (ie primary or subordinate legislation) must be reorganised by amending the enactment or following any procedure therein.

The definition of "trustees" includes local authorities holding trust property for charitable purposes. This is intended to make it clear that they are the trustees of educational and other endowments, which are best regarded as the assets of a public trust.

## PART 3

### GENERAL

#### 15 Application

- (1) This Act applies to—
  - (a) trusts which have come into operation before, as well as to trusts coming into operation after, and
  - (b) charities which have been entered in the Scottish Charity Register before, as well as to charities entered in that Register after,the passing of this Act.
- (2) Nothing in Part 1 affects any court proceedings which have been commenced prior to that Part coming into force.
- (3) Nothing in Part 2 affects any court proceedings which have been commenced prior to that Part coming into force.

**16 Modification and repeal of enactments**

- (1) Schedule 1, which modifies enactments, has effect.
- (2) The enactments mentioned in the first column of schedule 2 are repealed to the extent specified in the second column.

**17 Short title and commencement**

- (1) This Act may be cited as the Variation of Trusts and Charities (Scotland) Act 2007.
- (2) This section comes into force on Royal Assent.
- (3) The remaining provisions of this Act come into force in accordance with provision made by the Scottish Ministers by order made by statutory instrument.

SCHEDULE 1  
*(introduced by section 16(1) )*  
MODIFICATIONS OF ENACTMENTS

*The Education (Scotland) Act 1980 (c.44)*

- 1 (1) The Education (Scotland) Act 1980 is amended as follows.
- (2) In section 118—
- (a) for the words “endowment to which section 105 of this Act extends” substitute “educational endowment (other than an excepted educational endowment)”, and
  - (b) for the words from “education” to “the endowment” substitute “appropriate education authority”.
- (3) In section 120(1), for the words from “educational” to “extend” substitute “excepted educational endowment”.
- (4) In section 120(2)—
- (a) for the words “to which section 105 of this Act extends” substitute “(other than an excepted educational endowment)”,
  - (b) in paragraph (a), for the words from “words” to “extend” substitute “word “excepted””, and
  - (c) in paragraph (b), for the words from ““education” to “endowment” substitute “appropriate education authority”.
- (5) In section 122(1)—
- (a) after the definition of “the Act of 1878”, insert—
    - ““appropriate education authority” means, in relation to an educational endowment, the education authority for the area in which any educational establishment to which the endowment relates is situated or, where the endowment relates to no particular such establishment, the education authority for the area in which the beneficiaries of the endowment are required under its governing instrument to reside or with which they are so required to have some other connection;” and
  - (b) after the definition of “endowment”, insert—
    - ““excepted educational endowment” means—
      - (a) a university endowment,
      - (b) the Carnegie Trust,
      - (c) a theological endowment,
      - (d) a new endowment,

- (e) an endowment which relates in whole or part to an educational establishment not managed by an educational authority, other than an endowment which so relates solely by reason of the inclusion among its purposes of the award of prizes, bursaries or similar benefits to persons who attend or have attended educational establishments or other institutions not managed by an educational authority, and
- (f) an educational endowment having no limitation either as to the area in which any educational establishment to which it relates is situated or as to the area in which any of its beneficiaries are required under its governing instrument to reside or with which they are so required to have some other connection;”.

(6) In section 122(2), the words “in the opinion of the Court of Session” are repealed.

NOTE

Paragraph 1 contains modifications to Part VI of the Education (Scotland) Act 1980 consequent on removal of the provisions relating to the reorganisation of endowments.

*The Married Women’s Policies of Assurance (Scotland) (Amendment) Act 1980 (c.56)*

- 2 In section 4 of the Married Women’s Policies of Assurance (Scotland) (Amendment) Act 1980—
- (a) for the words “section 1 of the Trusts (Scotland) Act 1961” substitute “section 2 of the Variation of Trusts and Charities (Scotland) Act 2007”, and
  - (b) for the words “the said section 1” substitute “section 2 of that 2007 Act”.

*The Age of Legal Capacity (Scotland) Act 1991 (c.50)*

- 3 In section 1(3) of the Age of Legal Capacity (Scotland) Act 1991—
- (a) after paragraph (d), insert—
    - “(da) confer on any person under the age of 18 years the legal capacity to give agreement to an arrangement to which section 1(2) of the Variation of Trusts and Charities (Scotland) Act 2007 applies;”, and
  - (b) in paragraph (f)(iii), for the words “section 1 of the Trusts (Scotland) Act 1961” substitute “section 2(4) of the Variation of Trusts and Charities (Scotland) Act 2007”.

NOTE

Paragraph 3 gives further effect to Recommendation 4. It inserts into the Age of Legal Capacity (Scotland) Act 1991 provisions which state that those under the age of 18 continue to lack capacity to agree to a variation or termination of the trust of which they are beneficiaries.

*The Children (Scotland) Act 1995 (c.36)*

- 4 In section 10 of the Children (Scotland) Act 1995—
- (a) in subsection (1)(b), after the word “Act” insert “and to subsection (1A) below”, and

(b) after subsection (1), insert—

“(1A) Subsection (1)(b) above does not entitle a person to give approval on behalf of a child to an arrangement to which section 1(2) of the Variation of Trusts and Charities (Scotland) Act 2007 applies.”.

NOTE

Paragraph 4 implements Recommendation 3. It amends section 10 of the Children (Scotland) Act 1995 to make clear that a parent or guardian does not have power to approve a variation or termination of a trust on behalf of a child.

*The Charities and Trustee Investment (Scotland) Act 2005 (asp 10)*

5 (1) The Charities and Trustee Investment (Scotland) Act 2005 is amended as follows.

(2) In section 71(m), for “39(1)” substitute “9(1) of the Variation of Trusts and Charities (Scotland) Act 2007”.

(3) In section 72(2), after paragraph (b) insert—

“(ba) in the case of a decision referred to in paragraph (m) of that section, the person who made the application in question,”.

NOTE

Paragraph 5 applies to public trusts the provisions for review and appeal (to the Scottish Charity Appeal Panel and the Court of Session) in the 2005 Act against a decision of OSCR refusing a proposed reorganisation.

SCHEDULE 2  
*(introduced by section 16(2))*

REPEALS

<i>Enactment</i>	<i>Extent of repeal</i>
Trusts (Scotland) Act 1961 (c.57)	Section 1. In section 6(1), the definition of “the court”.
Age of Majority (Scotland) Act 1969 (c.39)	In Part I of Schedule 1, the entry relating to the Trusts (Scotland) Act 1961.
Education (Scotland) Act 1980 (c.44)	Sections 80(2), 105 to 110, 112, 114, 117, 118A, 121 and 122(3).
Education (Scotland) Act 1981 (c.58)	Paragraphs 4 to 9, 11, 13, 15, 17, 18(b), 19 and 20 of Schedule 6.

<i>Enactment</i>	<i>Extent of repeal</i>
Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 (c.40)	Sections 9 to 11 and 15.
Age of Legal Capacity (Scotland) Act 1991 (c.50)	Paragraph 27 of Schedule 1.
Local Government etc. (Scotland) Act 1994 (c.39)	Paragraph 118(6) of Schedule 13.
Charities and Trustee Investment (Scotland) Act 2005 (asp 10)	Sections 39 to 42. Paragraph 7 of schedule 4.

# Appendix B

## Consultees who submitted written comments on Discussion Paper No 129

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Court of Session Judges

Faculty of Advocates

Law Society of Scotland

Scottish Law Agents Society

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# Appendix C

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