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When is a trust a sham?

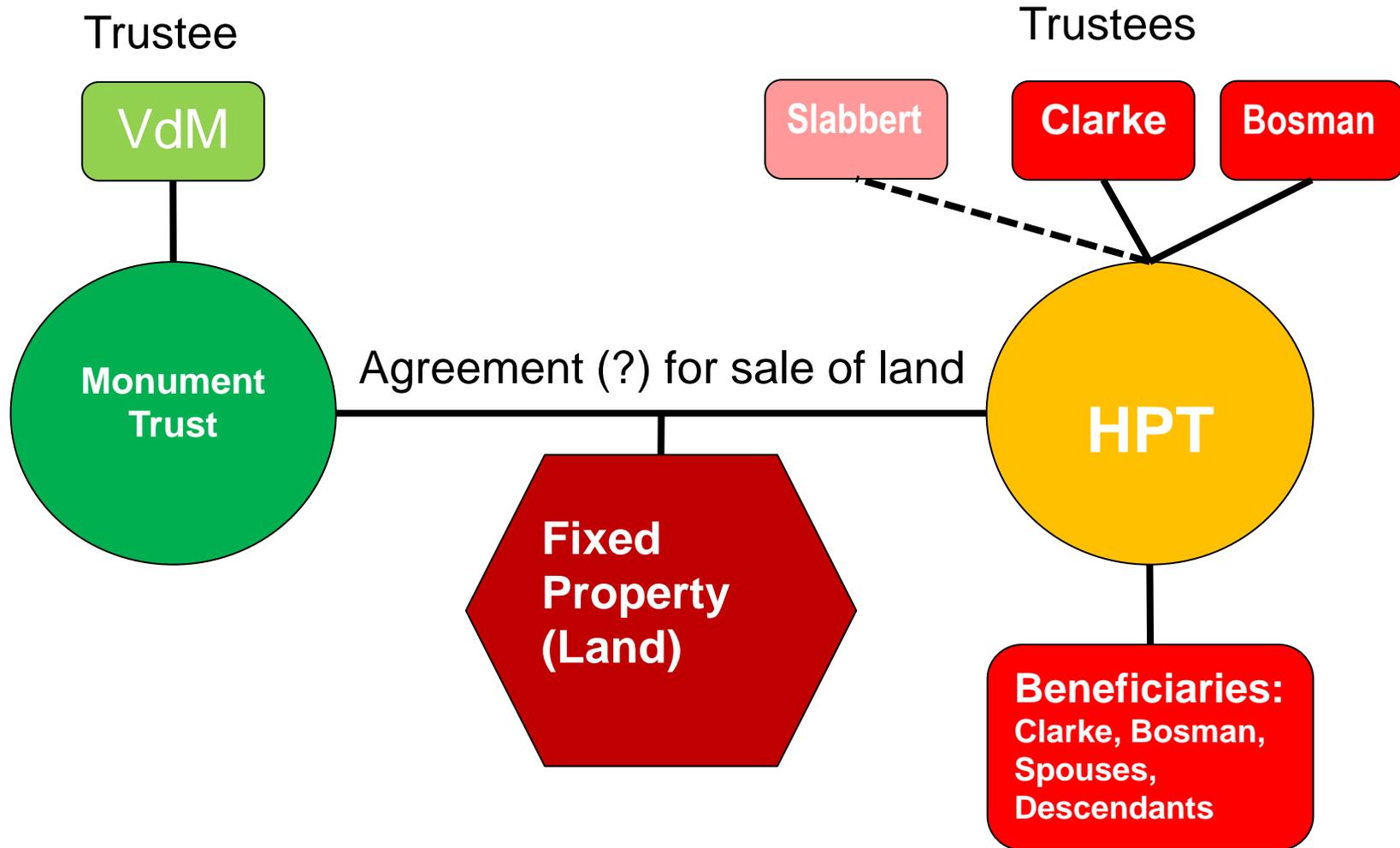
Louis van Vuren

- Van der Merwe & Others v Hydraberg Hydraulics CC & Others, 2010(5) SA 555 (WC)
- The “Sham”-doctrine
- The Alter Ego
- “Piercing the corporate veil”
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 - Jordaan v Jordaan
 - Landbank v Parker
 - Badenhorst v Badenhorst
 - Zazeraj v Jordaan
- What does all this mean?
- Other solutions for the Hydraberg conundrum?

Van der Merwe NO & Others v Hydraberg Hydraulics CC & Others, 2010(5) SA 555 (WC)

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- Sale agreement for land entered into between VdM in capacity as trustee of Monument trust and two of three trustees of Hydraberg Property Trust (HPT).
- Third trustee (Slabbert) of HPT played no role and, according to him, he had resigned. He was not informed of any meeting where decision was taken to sell or of any such decision.
- VdM asked court to order immediate transfer of the property.
- Clarke and Bosman (two trustees of HPT) respond that they were not authorised to bind HPT and sale agreement thus invalid. This is clearly to get out of a contract they have lost enthusiasm for.

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- WCHC (Binns-Ward J) deals extensively with facts and requirements for valid action by trustees
- Court, based on equity considerations, wanted to disregard “veneer” of trust, because of patent dishonesty and unscrupulousness of Clarke and Bosman.
- However, found that even that would not help VdM, as requirement for authorisation in writing in Alienation of Land Act is “insuperable”.
- Therefore, when dealing with a trust, call for a copy of the trust deed and study it

The “Sham” - doctrine

- This has its origins in English law
- The principle goes back to at least 1882 when an English court ruled that a document or arrangement can be disregarded:

“... if it is a mere cloak or screen for another transaction ...” Yorkshire Railway Wagon Co. v Maclure (1882) 21 Ch D 309 at 318

- RB Stafford in LL.M thesis at Rhodes University quotes Diplock LJ in Snook v London and West Riding Investments Ltd, [1967] 2 QB 786 at 802:

I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. But one thing, I think, is clear in legal principle, morality and the authorities... that for acts or documents to be a ‘sham’, with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.”

Six step test for a sham

- Stafford suggests a six step test for a sham after comparative study of different jurisdictions:
 - Ask what was the genuine intention of the parties
 - Consider the legal character of the agreement
 - Ascertain the nature of the transaction systematically and objectively
 - Hear oral evidence as to the intention of the parties, if necessary
 - Draw inferences both from accepted evidence and rejected evidence
 - Determine whether existence of a sham is more likely than not

- This is where the trust is essentially another person (usually the settlor or previous owner of the assets) in another form, where there is identity of interests between the two.
- Basically two instances of alter ego:
 - Where the settlor or previous owner is a trustee and the other trustees are his puppets and do his bidding (the so-called “supine” trustee(s) referred to in **Badenhorst**); or
 - Where the trust is wholly controlled by the settlor and trustee and he/she has the capacity to derive benefit from it.
- Van der Linde as well as Stafford say SA courts have conflated sham and alter ego

Piercing the corporate veil

- Company law doctrine that court can go behind the façade of a company to hold company liable for actions of functionaries or hold functionaries liable for liabilities of the company.
- SCA has stated the principle that the corporate veil will not be pierced lightly on mere equity grounds, but only if there is fraud, dishonesty or other serious justification.
- Trusts do not have legal personality and it is therefore not really comparable with companies in this regard - trustees have to act jointly and own the assets jointly in their capacity as trustees.

What happened in SA Trust Law?

- Thorpe v Trittenwein
- Jordaan v Jordaan
- Landbank v Parker
- Badenhorst v Badenhorst
- Zazeraj v Jordaan

- Thorpe entered into a deed of sale to purchase fixed property as trustee on behalf of a trust on 8-12-2000.
- The trust was already in existence and Letters of Authority issued.
- The purchase was subject to the seller obtaining certain township rights.
- After numerous delays these were eventually granted.
- For various reasons, the seller now reneged and the trust sought to force performance by the seller.
- The trust deed provided for three trustees at all time.

- The Alienation of Land Act 68 of 1981 - Section 2(1) of the Act reads:
‘No alienation of land after the commencement of this section shall, subject to the provisions of section 28, be of any force or effect unless it is contained in a deed of alienation signed by the parties thereto or by their agents acting on their written authority.’
- Thorpe signed the offer as trustee on 8-12-2000. In Court he confirmed that the other trustees had verbally approved his signing of the offer.
- His action was confirmed by a minute of a meeting held by the trustees on 3-10-2003
- The Court found that Thorpe had exceeded his powers as whilst the co-trustees may have been in agreement to the purchase, their approval had not been granted in writing, consequently no contract.
- *“Those who choose to conduct business through the medium of trusts of this nature do so no doubt to gain some advantage, whether it be in estate planning or otherwise. But they cannot enjoy the advantage of a trust when it suits them and cry foul when it does not. If the result is unfortunate, Thorpe has himself to blame.” (at par 17)*

Jordaan v Jordaan, 2001 (3) SA 288 (C)

- Mr Jordaan created various trusts and placed assets of substantial value and growth potential in them.
- He was a discretionary income beneficiary and his children the capital beneficiaries.
- At all relevant times he was in effective control of the trusts and the other trustees followed his instructions.
- In divorce proceedings, his estranged spouse claimed that the trusts were just him in another guise.
- He set up a further trust when the marriage was already irreparably damaged with the explicit purpose of frustrating his wife's claims.
- Court ordered that he must pay a capital amount to his wife to make a “clean break” and that the trust assets be taken into consideration when determining an equitable amount.
- Alter ego? Yes. Sham? ??

Landbank v Parker, [2004] 4 All SA 261 (SCA)

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- The Parkers (husband and wife) were two of three trustees of a family trust with first their accountant and later their son as third trustee.
- When they entered into certain contracts for financing, it was only the two of them in office as trustees.
- The trust deed required three trustees at all time.
- SCA (Cameron JA) held that the trust deed is the trust's constitution and that non-compliance with the requirements contained in it renders the actions of the trustees void.
- Therefore, actions taken when there were fewer trustees than required by the trust deed are void and cannot be ratified.
- Cameron speaks of the “debasement” of the trust form where there is no separation of effective control and enjoyment.
- Alter ego? Sham?

- Mr and Mrs Badenhorst married young and soon after that Mr Badenhorst inherited the family farm.
- He transferred assets to a trust of which his father was settlor and he and his brother were the trustees.
- He built up substantial wealth in his own name, as did his wife.
- In divorce proceedings Mrs B claims that she is entitled to a settlement that includes the value of assets in the trust as it is his alter ego.
- Court a quo held that the trust is not a sham and that only if it declares the trust a sham can the court take the assets into account.
- SCA finds the trust Mr B's alter ego and takes the value into consideration in divorce settlement order.
- Serious questions about the correctness of this judgement. Evidence that Mr B always consulted his brother and that proper book entries were made.

- Following on well-known Jordaan v Jordaan, divorce case from 2002 in which WCHC held that Mr Jordaan treated three trusts as his alter ego and ordered that the assets in the trusts be taken into account in the divorce settlement.
- Mr Jordaan had since 2002 utilised the assets for his own benefit. He was a trustee of the trusts but not a beneficiary. Amended the deeds with the other trustees to appoint himself a beneficiary.
- Curator of his blind son, a beneficiary of the trusts, brought application to protect son's interests.
- Jordaan alleges that the trusts are null and void after previous judgement.
- WCHC held this not so - assets in trusts were only taken into account in divorce proceedings and as trustee he was obliged to act in the best interests of all beneficiaries, not only himself.

What does all this mean?

- SA Courts clearly averse to ruling trusts “shams”, but willing to look through the trust in divorce cases for purposes of an equitable distribution in “alter ego” cases.
- What about the rights of the beneficiaries other than the feuding parties?
- E.g. Potgieter case – what if Potgieter was still alive – divorce?
- Also in Potgieter SCA held that the overriding principle of the Constitution was the Rule of Law as embodied in the Legality Principle – mere equity cannot trump that. Echoed in Hydraberg.
- Why should co-trustee spouses be allowed to be “supine” and shirk their fiduciary duty by allowing the “dominant” spouse to call the shots and only allege “alter ego” and “sham” once the marriage is on the rocks?
- Can a trust start as valid and later become a sham?
- Legislative development?

Another Solution to Hydraberg?

- Prof. Van der Linde remarks the following:
 - Contracts know the fundamental value of good faith
 - The Constitution is based on fairness and equity
 - Should the courts or the legislature not develop values of good faith to underpin the actions of trustees?
 - Is it necessary, or is the fiduciary duty sufficient and can the trustees be held personally liable for their actions?
- Stafford mentions the possibility that, in case of a sham trust, the trustees could be held to their void actions by holding that they are then partners.
- Court could declare trust a sham and hold trustees personally liable for performance?

Thank you to:

- Prof. Anton van der Linde (University of Pretoria) for his as yet unpublished article:
Debasement of the core idea of the trust and the need to protect third parties
- Mr RB Stafford (LL.M student – Rhodes University) for his LL.M thesis:
A legal-comparative study of the interpretation and application of the doctrines of the sham and the alter-ego in the context of south african trust law:
The dangers of translocating company law principles into trust law

