Trusts, Contracts and Covenants

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Introduction

For about a century,[1] courts showed a marked reluctance to use trust principles to mitigate the rigours of the doctrine of privity.[2] Of course, if a contract or deed provided expressly that the rights it created were to be held upon trust for a third party, effect would be given to that intention. Such cases, however, were relatively unusual. Ordinarily, a person who was not a party to a contract or indenture could not enforce it, although a range of exceptions to the doctrine of privity evolved over time.[3] Blind insistence upon the privity doctrine attracted the criticism of both judges and learned writers; it tended to defeat the intention of the parties to an arrangement, producing consequences that were inconvenient or unjust. Of late, however, courts have demonstrated a greater willingness to use trust principles in order to permit third parties to enforce contracts.[4] This trend calls for a re-consideration of how trust principles intersect with the doctrine of privity in the context of both contracts and voluntary deeds of settlement.

Although contracts for the benefit of third parties and covenants to settle property for the benefit of volunteers are considered frequently in isolation, indeed often in different textbooks, they both present similar problems. For example, consider a contract where A promises B to pay a sum of money to C. This raises the issue of whether B holds the benefit of the promise or trust for C. Similarly, by a deed of settlement, A may promise to transfer property to B to hold upon

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1 See *In re Empress Engineering Co* (1880) 16 Ch D 125.

2 In regard to contracts the doctrine is taken to have been settled by *Tweddle v Atkinson* (1861) 1 B & S 393.

3 DW Greig and JLR Davis, *The Law of Contract* (Law Book Company, 1987) pp 999-1049.

4 *Re Australian Elizabethan Theatre Trust* (1991) 102 ALR 681 at 693; *Bahr v Nicolay (No 2)* (1988) 164 CLR 604 at 618-619; *CSR Ltd v The New Zealand Insurance Co* [1993] 7 ANZ Insurance Cases 61-193 at 78,196; *Elsa Holdings Ltd v Butts* (1986) 6 NSWLR 175 at 189-190; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 at 120-121, 140, 146-148, 156, 166; *Winterton Constructions Pty Ltd v Hambros Australia Ltd* (1991) 101 ALR 363 at 370-371; cf *Walker v Corboy* (1990) 19 NSWLR 382 at 390, 395-396.

trust for C, a volunteer. This raises the issue of whether the benefit of the covenant to settle property is held upon trust for C. In both cases C is a volunteer, a person who has not provided consideration, and a person who is not a party to the arrangement. C would be able to enforce the promise were it held upon trust, though not otherwise in most instances.

The issue of whether the benefit of a contract or covenant is in law the subject matter of a trust is usually said to depend upon intention, either the intention of both of the parties who are in privity, or one of them, though in some instances a trust may arise independently of intention.[5] But what is meant by 'intention' in this context is usually problematic, for it is rarely expressed. In the past, this search for intention has provoked divergences of judicial opinion,[6] reflected in authorities which defy reconciliation.[7] The manner in which the search is to be conducted, however, has been clarified by the recent work of the courts.

Whilst both contractual promises for the benefit of third parties and gratuitous promises to settle property upon strangers ordinarily require a search for intention, or at least depend upon similar principles, in the two cases the search may be conducted in a different spirit. Contracts that purport to confer benefits upon third parties present different issues of judicial policy than do covenants to settle property on trust. Strong reasons abound for allowing third parties to enforce contracts for their benefit through the medium of a trust. Enforcement by the third party may permit proper effect to be given to the business purposes of the contracting parties; enable commercial schemes to be brought to fruition; and/or reduce the likelihood that one contracting party will receive valuable consideration but fail to carry out his or her part of the bargain. Voluntary covenants to settle property, by contrast, do not so clearly call for enforcement. Their purpose is often less weighty, for they serve no role in business planning. A failure to enforce a covenant to settle property, moreover, does not result in the covenantor keeping valuable consideration for which she provides no recompense: the covenant is voluntary. Accordingly, this paper considers separately contracts for the benefit of third parties and covenants to settle property.

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5 Two cases are particularly relevant here: *Bahr v Nicolay (No 2)* (1988) 164 CLR 604 and *Carson v Wood* (1994) 34 NSWLR 9 at 17-18, 26.

6 The older cases are discussed in a series of articles by JG Starke in the *Australian Law Journal*, particularly 'Contracts for the Benefit of Third Parties, Part III' (1948) 21 *ALJ* 455.

7 GH Treitel, *The Law of Contract* (8th ed, Sweet & Maxwell Ltd, 1991) p 562.

I Contracts for the Benefit of Third Parties

Despite a growing dissatisfaction with the doctrine of privity, our courts have found no direct means to overcome its inadequacies. In *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd*,[8] a majority of the High Court refused to abandon the doctrine: it is part of the skeletal structure of our law. Statutory reform has occurred in some jurisdictions, yet the doctrine still holds most Australian states in its implacable grasp. At least for the immediate future, trust principles offer the best hope of relief to litigants who seek to enforce contracts that purport to confer benefits upon them but to which they are not parties.

Our courts now appear more ready than at any time in the last century to use trust principles as the servant of the law of contract. Changes in judicial attitude have been both subtle and profound. These changes demand answers to questions that have not been raised often in recent generations, questions that were of little significance before the discussion in *Trident* of the relationship between trust law and contract law.

The subtle revolution

Recent decisions have not abrogated established legal doctrine; rather they have altered the way in which that doctrine is understood and the spirit in which it is applied.[9] Our law has always recognised that a trust of the benefit of a contract might be created in either of two ways: a contract, on its proper construction, might constitute one of the parties to it a trustee for a third party; or one of the parties, outside the contract, might declare themselves as holding their contractual rights for the third party. In either event, the third party could sue upon the contract, joining the trustee as an additional defendant.[10]

Whilst this has long been established doctrine, for perhaps a century our courts exhibited considerable reluctance to construe a contract which makes no express reference to a trust as having created one. Indeed, the presumption was against such a construction. Judges said that it was 'not legitimate to import into the contract the idea of a trust when the parties have given no indication that such was their intention'[11] and that the court 'ought not be astute to discover

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8 (1988) 165 CLR 107.

9 See authorities cited in note 4 above.

10 *Harmer v Armstrong* [1934] Ch 65; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 at 135, 148; *Vandepitte v Preferred Accident Insurance Corporation of New York* [1933] AC 70.

11 *Re Schebsman* [1944] Ch 83 at 89 per Lord Greene MR.

indications of such an intention'.[12] Although courts admitted that 'by the use possibly of unguarded language'[13] a party to a contract might create a trust without knowing it, nevertheless an intention to create a trust had to appear clearly from the language of the contract, when read in the circumstances in which it was used. This seemed to imply that it was insufficient that a contract purposed to confer enforceable rights upon a third party; the contract had to show an intention to carry that purpose into effect by adoption of the legal machinery of the trust, machinery adopted consciously, for the most part.

The High Court in *Trident*[14] repudiated the previous restrictive approach, endorsing the earlier dicta of Fullagar J in *Wilson v Darling Island Stevedoring and Lighterage Co Ltd*,[15] where he stated that '[i]t is difficult to understand the reluctance which courts have sometimes shown to infer a trust.' Justice Deane ascribed this reluctance to a failure to appreciate the nature of the intention required to create an express trust of the benefit of a contractual promise.[16] His Honour affirmed that an intention to create such a trust might be formed by a person who is unaware of the nature of a trust, a person who 'would be bemused by the information that the chose in action constituted by the benefit of a contractual promise is property and uncomprehending of the distinction between law and equity'.[17] The other members of the Court, with the exception of Gaudron J, indicated that they too were in agreement with the views of Fullagar J.[18]

The new approach

As long as courts were unwilling to find that contractual promises were held upon trust for third parties, the question of when they would do so could be accorded a cursory response: they would do so rarely and with reluctance. Such a response is no longer adequate, yet the present law is difficult to define.

It is contended that a contractual promise will be held upon trust for a third party if it is intended that he or she is to enjoy a right to performance of the promise and in the circumstances a trust is the appropriate mechanism to give effect to that intention. This approach

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12 Id at 104 per du Parcq J.

13 Ibid.

14 (1988) 165 CLR 107.

15 (1956) 95 CLR 43 at 67.

16 (1988) 165 CLR 107 at 147.

17 Ibid.

18 Id at 120-121 per Mason CJ and Wilson J; at 140 per Brennan J; at 156 per Dawson J; at 166 per Toohey J.

enjoys weighty judicial support. In *Bahr v Nicolay (No 2)*,[19] Mason CJ and Dawson J in their joint judgement stated, in regard to a contract which conferred a benefit upon a third party:

> If the inference to be drawn is that the parties intended to create or protect an interest in a third party and the trust relationship is the appropriate means of creating or protecting that interest or of giving effect to the intention, then there is no reason why in a given case an intention to create a trust should not be inferred.[20]

In *Trident* this view was endorsed both by Dawson J,[21] who cited the above passage with approval, and by Deane J, who said:

> In the context of such a contractual promise, the requisite intention should be inferred if it clearly appears that it was the intention of the promisee that the third party should himself be entitled to insist upon performance of the promise and receipt of the benefit and if trust is, in the circumstances, the appropriate legal mechanism for giving effect to that intention.[22]

These dicta accord with the criteria traditionally used in other spheres in determining whether ambiguous transactions create trusts or other legal relationships.[23] Outside the contractual sphere, courts have long determined whether a transaction raises a trust by looking to the pattern of rights and duties it attempts to create. If that pattern coincides sufficiently with the rights and duties that flow typically from the creation of a trust, the transaction will be said to give rise to a trust. Little reason appears to exist for refusing to extend this approach to contracts for the benefit of third parties; the dicta in *Bahr* and *Trident* are to be welcomed.

It is debatable whether the joint judgment of Mason CJ and Wilson J in *Trident* is fully congruent with the joint judgment of Mason CJ and Dawson J in *Bahr*. Although Mason CJ and Wilson J refer with evident approval to authorities in which a trust of contractual rights was inferred readily from the circumstance that a contract was made for the benefit of a third party, their Honours recognised that this is not of itself sufficient to raise a trust. They advert to the importance of the issues of whether the third party is to be able to sue on the contract and whether the contracting parties are to enjoy freedom to

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19 (1988) 164 CLR 604.

20 Id at 618-619.

21 (1988) 165 CLR 107 at 156.

22 Id at 147. Later, at page 149 of the report, his Honour refers to the joint intention of both promisor and promisee.

23 See, for example: *Re Frame* [1939] Ch 700; *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567; *Re Kayford* [1975] 1 All ER 604; *Re Chelsea Cloisters Ltd (in liquidation)* (1981) 41 P & CR 98; *Walker v Corboy* (1990) 19 NSWLR 382; cf *Re Armstrong* [1960] VR 202.

vary or remake the contract. And whilst they insist that the promisee must have a 'sufficient intention to create a trust', they state that this intention may be imputed[24] rather than expressed. The most appropriate view is that the analysis of Mason CJ and Dawson J in *Bahr* underlies the judgment of Mason CJ and Wilson J in *Trident* and is to be treated as a development of it.

However important the conclusion that an intention to create a trust will be imputed to the contracting parties where the third party is entitled to insist upon performance and where a trust is the appropriate mechanism to give effect to that intention, such a conclusion nevertheless carries analysis but part of the way. The conclusion itself raises two further questions that are by no means easy to answer: How is a court to determine the circumstances in which a contract is intended to confer enforceable rights upon a third party? Under what circumstances is a trust the appropriate mechanism to achieve that result? These questions are in a sense inextricably bound together, yet they must be separated for purposes of exposition. It is convenient to consider the second question first.

An appropriate mechanism

Even if the contract evinces a clear intention to confer enforceable rights upon a third party, a trust may not be the most appropriate mechanism to give effect to that intention. Unwelcome consequences may flow from the recognition of a trust, including the imposition of onerous fiduciary obligations upon one of the parties to the contract, the promisee. In particular, the freedom of action of the promisee might be restricted in a way never contemplated by the contracting parties.

A major reason for the reluctance of courts in the past to treat the benefit of a contract as the subject of a trust was a fear that recognition of a trust would circumscribe the freedom of contracting parties to vary or rescind the contract between them.[25] Courts believed that a trustee-promisee, as a fiduciary, could agree only to changes in the underlying contract that were in the interests of the third-party

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24 (1988) 165 CLR 107 at 121. Their Honours' use of the word 'imputed' is somewhat surprising: it perhaps conveys the idea that under the doctrine of commercial necessity, terms that the parties to a contract have not considered may be implied by the court. The interplay of contractual and trust principles leads to a recognition of express trusts to which the parties have not directed their minds, underlining the importance of rules governing the construction of documents.

25 *Cleaver v Mutual Reserve Fund Life Association* [1892] 1 QB 147; *Re Englebach's Estate* [1924] 2 Ch 348; *Winterton Constructions Pty Ltd v Hambros Australia Ltd* (1991) 101 ALR 363 at 365; cf *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 at 121, 140.

beneficiary. Consequently, they were unwilling to find that a trust of the benefit of a contract had been created unless they were satisfied that the promisee intended to surrender this freedom of action.

This analysis, however, fails to recognise the inherent flexibility of the trust. A trust may be revocable or irrevocable, or revocable until the occurrence of a particular event, such as a change of position by a third party. Justice Fullagar stated in *Wilson v Darling Island Stevedoring and Lighterage Co Ltd*:

> I cannot see why it should be necessary that such a trust [a trust of the benefit of a contract] should be irrevocable; a revocable trust is always enforceable in equity while it subsists.[26]

At first sight this dictum might appear to conflict with a clear rule of the law of trusts: any trust is irrevocable unless a power of revocation is reserved by the settlor.[27] There is however, no inconsistency. If a trust of contractual rights is implied by a court,[28] it must mirror the presumed intention of the parties, including their intention as to whether the contract may be revoked or varied without regard to the interests of the third-party beneficiary. Where parties to an agreement intended to retain power to change their contractual obligations without regard to the interests of others, they may be taken to have established a revocable trust, a trust subject to an implied power of revocation. As the trust is based on the presumed intention of the parties, whether it is revocable or irrevocable must also be determined by their intention in that regard.

A promisee who possesses power to revoke a trust in her capacity as settlor may do so in her own interest and without regard to the interest of the third party. The promisee enjoys this power not as trustee, but as a creator of the trust and hence is not subject to fiduciary duties in its exercise.[29] Accordingly, she may join with a promisor in modifying or revoking the contract as they see fit, at least until the third party has acted in reliance upon the contract.

A different view was adopted recently by Cohen J in *CSR Ltd v The New Zealand Insurance Co Ltd.*[30] His Honour stated that a trustee who

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26 (1956) 95 CLR 43 at 67.

27 *Mallott v Wilson* [1903] 2 Ch 494.

28 As noted above, the process of interpretation of a contract may result in an intention to create a trust being ascribed to parties although they have not considered the question. The trust, although for analytical purposes 'express', is an implied term of the contract.

29 Cf HAJ Ford and WA Lee, *Principles of the Law of Trusts* (2nd ed, Law Book Company, 1990) pp 18-19, 684-685; cf *Lock v Westpac Banking Corporation* (1991) 25 NSWLR 533 at 602.

30 [1993] 7 ANZ Insurance Cases 61-193.

holds contractual rights on trust for a stranger to a contract, and who has a power to vary the trust, cannot use the power to the detriment of the stranger, without the consent of the stranger. It is submitted, however, that Cohen J failed to distinguish the position of a trustee who enjoys a power of variation in the capacity of trustee, and a trustee who enjoys the power independently of that role. Admittedly, if a trustee enjoys a power to vary or revoke a trust purely in his or her capacity as a trustee, this power is subject to fiduciary duties.[31] But this is not ordinarily the position of a promisee-trustee who has established an impliedly revocable trust for the benefit of a third party. The implied power of revocation is usually enjoyed in the capacity as creator of the trust. Indeed, when a court recognises that a promisee-trustee has an implied power of revocation, this implication is made solely to enable the promisee-trustee to modify or destroy the trust[32] and vary or rescind the contract, without regard to the interests of the beneficiaries. The power of a promisee-trustee, therefore, cannot be controlled by fiduciary obligations.

Australian courts continue to take into account the reservation by the parties to a contract of a right to vary or rescind it, when called upon to determine whether the benefit of the contract is held upon trust for a stranger to the contract. In *Winterton Constructions Pty Ltd v Hambros Australia Ltd*,[33] the court gave some weight to whether the contracting parties intended to reserve the right to vary their contract. Hambros, a merchant bank, granted Pan a loan facility to enable it to acquire land and to have an office block constructed on it. As work on the building proceeded, Pan was entitled to draw down loan moneys, which Hambros distributed to construction contractors, according to Pan's directions. Subsequently Pan entered into a contract with Winterton for the erection of the office block. Winterton sued Hambros to recover moneys under the financial agreement with Pan, alleging, inter alia, that the benefit of that contract was held upon trust for it. This portion of Winterton's pleadings was struck out by Gummow J in the Federal Court of Australia. He concluded that the financial agreement between Hambros and Pan was intended to confer rights solely upon Pan, not to confer rights upon the company selected as builder for the project. In reaching this conclusion, his Honour placed some reliance upon the consideration that 'both borrower and lender intended to keep alive their rights to vary

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31 Ford and Lee, *Principles of the Law of Trusts*, p 684; cf *Metropolitan Gas Co v The Federal Commissioner of Taxation* (1932) 47 CLR 621.

32 Cf *Elder's Trustee and Executor Company v Symon* [1934] SASR 435; *Re Manifold Settlements* [1965] VR 197.

33 (1991) 101 ALR 363.

consensually between them the terms of their obligations',[34] yet this was merely one consideration taken into account; other considerations included the fact that Pan did not intend to undertake fiduciary obligations towards Winterton and that the doctrine of commercial necessity did not support Winterton's claim.

Although our courts properly give some weight to whether a contract is subject to variation or revocation, too much weight was placed upon this consideration in the past. The right to vary or revoke a contract is not inconsistent with the existence of a trust that may be varied or revoked.

Third-party rights

The two-part test of whether the benefit of a contract is held upon trust for a stranger to it was, as noticed above, enunciated by Mason CJ and Dawson J in *Bahr* and by Deane and Dawson JJ in *Trident*. One part of the test was considered in the last section of the paper. The other is now examined: is a third party intended to have a right to insist upon performance of the contract?

This test is crucial in determining whether a contract is held upon trust, but is difficult to apply. Unless the test is satisfied, the third party could not be regarded as a trust beneficiary, for a beneficiary has the right to sue the promisor, by joining the promisee-trustee as a party to the action.[35] Absence of such a right excludes all possibility of a trust. However, the contract itself will not ordinarily specify the third party's rights. As Mason CJ and Wilson J state in *Trident*,[36] albeit in a different context, the contracting parties are unlikely to have turned their attention to the question of whether the third party should enjoy a right to enforce the contract.

The court, therefore, must determine how the contracting parties would have resolved the question had they considered it, taking into account the language of the contract and the circumstances in which it was made. This process of construction to determine whether a trust arises was explained by Mason CJ and Wilson J in *Trident*, where their Honours stated:

> In divining intention from the language which the parties have employed the courts may look to the nature of the transaction and the circumstances, including commercial necessity, in order to infer or impute intention ...[37]

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34 *Winterton Constructions Pty Ltd v Hambros Australia Ltd* (1991) 101 ALR 363 at 371.

35 See note 4 above.

36 (1988) 165 CLR 107 at 123.

37 Id at 121.

The task, clearly, is not limited to assigning meaning to specific words or of attaining logical inference from them; the reference to commercial necessity indicates that the broad doctrines governing the implication of contractual terms must be taken into account in reaching a conclusion.

Since the rights of the third party are to be determined through a construction of the contract, one might suppose the courts would seek the joint intention of promisor and promisee. Whilst this is the better view, *Trident* yields conflicting dicta concerning whose intention should be ascertained. Chief Justice Mason and Wilson J stated that the person whose intention is determinative is the promisee, not both parties to the contract.[38] Justice Deane, however, saw the relevant intention as that of the promisor and promisee 'who might both be regarded as settlors'[39] for this purpose. Justice Brennan appears to agree with Deane J.[40] Later authorities have not resolved the conflict.[41]

Justice Deane's approach in *Trident* seems preferable to that of Mason CJ and Wilson J. In assessing the language of the contract in the light of circumstances in which it was made and the purpose it was to serve, a court may discover more by viewing the matter from the perspective of the promisee rather than by viewing it from the perspective of the promisor: the promisor's primary purpose will ordinarily be simply to receive the consideration provided by the promisee.[42] Yet the court ought not lean so far towards the perspective of the promisee that the construction it places on the contract could not have been anticipated by the promisor: the promisor should be in a position at the date the contract is made to judge the scope of his or her potential liability.[43]

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38 Ibid.

39 Id at 148.

40 Id at 140.

41 In *Winterton Constructions Pty Ltd v Hambros Australia Ltd* (1991) 101 ALR 363, Gummow J noted the conflicting views and appeared to incline slightly to that of Deane J on the ground that the nature of the obligations of the promisee to the promisor was a relevant consideration.

42 DM Summers, 'Third Party Beneficiaries and the Restatement (Second) of Contracts' (1982) 67 *Cornell Law Rev* 880 at 896.

43 HG Prince, 'Perfecting the Third Party Beneficiary Standing Rule Under Section 302 of the Restatement (Second) of Contracts' (1984) 25 *Boston College Law Rev* 919.

More specific considerations

The question of whether a particular contract evinces an intention to confer enforceable rights upon a third party is essentially one of construction; circumstances affect cases to such an extent that few generalisations can be made. Nevertheless, certain considerations tend to demonstrate the required intention: perhaps, for example, a contract evinces a clear intention to benefit a third party; perhaps performance is promised to the third party; or perhaps the contract is unlikely to be enforced adequately unless the third party is permitted to do so. The significance of an intention to benefit a third party or direct contractual promise are considered in this section of the paper. The problem of adequate enforcement is discussed in a later section.

A trust will not arise merely because the contracting parties evince an intention to benefit a third party,[44] for they may not be meant to enjoy enforceable rights. Nevertheless, such an indication of intention is an important first step on the road to a trust. In the absence of such an intention, the third party has no claim to enforceable rights. Yet discernment of an intention to benefit a third party requires attention to an important distinction.

It is important to distinguish a contract made for the benefit of a third party from a contract the performance of which would merely be of benefit to them. For example, a contract between A and B which requires A to pay $50,000 to C may indirectly benefit D, a creditor of C, although the contracting parties have not attempted to benefit D. Clearly D could not seek to enforce the contract as a beneficiary under a trust, for the contract is not intended to confer a benefit upon him or her, although D seeks to benefit from the performance of the contract. The distinction is further illustrated by *Visic v State Government Insurance Office*,[45] a case which turned on the common law, not trust principles. An employer took out an indemnity policy with respect to liability for injuries suffered by his employees. Counsel for an injured employee argued that the employer's policy was intended for the benefit of employees and that the injured employee, having obtained judgment for common law damages against the employer, was entitled to claim the damages directly from the insurance company under a common law exception to the privity doctrine established by *Trident*. Justice Seaman J rejected this submission. The insurance policy was not directly intended to confer a benefit on the employee;

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44 *Re Clay's Policy of Assurance* [1937] 2 All ER 548; *Re Foster* [1938] 3 All ER 357; *Ryder v Taylor* (1936) 36 SR(NSW) 31; *Vandepitte v Preferred Accident Insurance Corporation of New York* [1933] AC 70; *Green v Russell* [1959] 2 QB 226 at 241.

45 (1990) 3 WAR 122.

the employee was merely a person who would benefit in an incidental way from enforcement of the policy.

The distinction between direct and incidental benefits is of considerable significance. However, in practice its application will prove problematic unless the intention of the contracting parties is clearly stated. On one hand, as noted above, a person may benefit from performance of a contract, though the contract is not intended to confer a benefit on her; but on the other hand, a person may be intended to benefit from a contract, though its primary purpose is to benefit another. For example, a commercial agreement requiring a promisor to pay money to a third party may be designed primarily to benefit the promisee, though the third party is also intended to benefit.[46] In many cases, it is difficult to determine whether one purpose of a contract, perhaps a secondary purpose, is to confer a benefit upon a third party or whether that is merely an incidental consequence of the contract.

These difficulties are largely avoided if a contract makes a direct promise to the third party, for ordinarily this demonstrates an intention to confer a benefit upon them.[47] Whilst such a contractual promise is unnecessary and may be insufficient to confer enforceable rights,[48] it is of high importance, as *Trident* illustrates. In that case, a company took out a public liability insurance policy which defined 'the insured' as including the company and its contractors. One of the company's contractors negligently injured a workman in circumstances which fell within the ambit of the policy. The contractor was allowed to recover against the insurer under the insurance contract, although it was not a party to the contract. Whilst the contractor had not pleaded that it was a beneficiary under a trust of the policy, Deane J came within a short step of finding that a trust existed. Taking into account both the nature of the policy and its form,[49] his Honour stated that it was difficult to conceive of any real possibility that further evidence would negative an intention to create a trust, but because of the state of the pleadings he was prepared to remit the question to the court below. Two other members of the High Court appeared to favour a trust approach, though they did not rest their decision on this ground.[50]

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46 Prince, note 43 above at 933 ff.

47 Compare *Re Schebsman* [1944] Ch 83 and *In re Stapleton-Bretherton* [1941] Ch 482, cases in which promisees were entitled to claim performance of contracts despite promises to third parties.

48 For example, see *Cleaver v Mutual Reserve Fund Life Association* [1892] 1 QB 147.

49 (1988) 165 CLR 107, 148-154.

50 Id at 156 (Dawson J), 166 (Toohey J).

Whilst a contractual promise to a third party is of considerable significance, the third party may be a beneficiary of a trust of a contract although no express promise is made to them. This proposition is illustrated by *Bahr v Nicolay (No 2)*.[51] Vendors sold land to a purchaser by a contract which provided that at a certain date the vendors might re-purchase the land. The purchaser subsequently sold the land to a further purchaser by a contract under which the second purchaser acknowledged that the first vendors were entitled to re-purchase the land, but the first vendors were not parties to this contract and it contained no express promise to them. Chief Justice Mason and Dawson J,[52] distinguishing *Re Schebsman*[53] and *Green v Russell*,[54] held that the second contract created a trust in favour of the head vendors - an express trust. Their Honours stated, as noted above, that if parties intend to create or protect an interest in third parties, and the trust relationship is the appropriate means of creating or of protecting or of giving effect to such an interest, the court should infer an intention to create a trust.[55]

The judgment of Brennan J[56] and the joint judgment of Wilson and Toohey JJ[57] in *Bahr* suggest a possible alternative route to the enforcement of contracts for the benefit of third parties: imposition of a constructive trust. Justices Wilson and Toohey held that as the second purchaser had gained title to the land on the terms that he would be bound by the rights of the first vendor, the first vendor was entitled to a constructive trust or at least a personal equity with respect to the land. Justice Brennan said that a purchaser who undertakes that the transfer to him shall be subject to the interests of another acts unconscionably if he subsequently denies the interest of the other. Equity will impose a constructive trust to prevent this unconscionable conduct.[58] Although apparently limited in scope, *Bahr* at least opens the way to further development of the constructive trust approach.[59]

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51 (1988) 164 CLR 604.

52 Id at 618-619.

53 [1944] Ch 83.

54 [1959] 2 QB 226.

55 (1988) 164 CLR 604 at 618-619.

56 Id at 653-655.

57 Id at 638-639.

58 Id at 654.

59 See also *Carson v Wood* (1994) 34 NSWLR 9, discussed below.

Contractual doctrines

As stated above, whether the benefit of a contract is held upon trust for a stranger to it depends ordinarily upon the correct construction of the contract. A discussion of third party beneficiaries would, accordingly, be incomplete without a brief consideration of two doctrines of contract law: the doctrines concerning standard implied terms and ad hoc implication of contractual terms.

(a) Ad hoc implication of contractual terms

Implication of contractual terms may call for a greater or lesser degree of judicial intervention. Sometimes a court is asked merely to recognise what is implicit in the language of a contract when read in the light of the circumstances in which it was written,[60] or to take into account a course of dealing between the parties to a contract. Sometimes it ascribes to the parties an intention to adopt an unexpressed term 'which it is presumed that the parties would have agreed upon had they turned their minds to it',[61] provided that, 'it is clearly necessary to imply the term in order to make the contract operative according to' their intention.[62] Judicial technique thus ranges from a traditional application of the principles of interpretation to the doctrine of necessity and other more far-reaching doctrines, one technique often shading imperceptibly into another.

The doctrine of necessity may apply in either a business or a non-business context. Where a contract is not part of a business transaction the court will give it 'such efficacy as both parties must have intended that ... it should have'.[63] In business transactions the court will give a contract 'such business efficacy ... as must have been intended...'.[64] Nevertheless, the court is slow to intervene on the grounds of necessity: it is not enough that it is reasonable to imply a term; it must be necessary to do so,[65] that is, necessary 'to make an agreement work, or, conversely, in order to avoid an unworkable

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60 *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 at 262-263.

61 *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 346.

62 *Heimann v Commonwealth of Australia* (1938) 38 SR(NSW) 691 at 695 per Jordan CJ.

63 *The Moorcock* (1889) 14 PD 64 at 68.

64 *The Moorcock* (1889) 14 PD 64 at 68; *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 52 ALJR 20 at 26-27.

65 *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 346; contra, *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1892) 26 NSWLR 234 per Priestly JA at 257-258.

situation'[66] in a business sense. The criteria for the application of the commercial necessity doctrine were adumbrated by members of the Privy Council in *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council,*[67] in which it was stated that for a term to be implied on this ground:

> (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.[68]

The requirement that an implied term be so obvious that it goes without saying creates considerable difficulty. Unless both contracting parties would have consented to the inclusion of the term had they considered it, the term must be rejected.[69] A court cannot treat a term which is adverse to the interests of one of the parties at the date the contract is made as a term to which both parties would have agreed.

At first sight, a term to the effect that a contractual right be held upon trust for a stranger to the contract seems so artificial and technical that ordinary business people would not say 'it goes without saying', even if they were aware of the nature of a trust. Nevertheless the doctrine of commercial necessity was applied in this context by the New South Wales Court of Appeal in *Elsea Holdings Ltd v Butts,*[70] a decision referred to with approval by Mason CJ and Wilson J in *Trident.*[71] An Australian insurance company, Ipec, which wished to enter the London re-insurance market, incorporated a company for this purpose, Southlands. As Southlands' paid-up capital was relatively

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66 *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* (1977) 52 ALJR 20 per Lord Wilberforce and Lord Morris of Borth-y-Gest at 29; cf *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 per Priestly JA at 257-258; A Phang 'Implied Terms Again' [1994] *JBL* 255.

67 (1978) 52 ALJR 20.

68 Id at 26. See also *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 347, 404; *Secured Income Real Estate (Australia) Ltd v St Martin Investments Pty Ltd* (1979) 144 CLR 596 at 606; *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 66, 95, 117, 121, 139; *Vroon BV v Foster's Brewing Group Ltd* [1994] 2 VR 32 at 68-71.

69 *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1985) 160 CLR 226 at 241.

70 (1986) 6 NSWLR 175 at 189-190 per Samuels JA, Kirby P concurring; cf *Winterton Constructions Pty Ltd v Hambros Australia Ltd* (1991) 101 ALR 363 at 371.

71 (1988) 165 CLR 107 at 121.

small, English brokers would not place business with it unless they were satisfied it had adequate backing. Accordingly, Ipec gave each broker who placed its clients' business with Southlands a deed under seal whereby Ipec agreed to guarantee the liabilities of Southlands. One deed of guarantee was issued to Fenchurch, which carried on business as a broker. On the basis of this deed, Fenchurch and at least two related companies placed their clients' business with Southlands. Applying the doctrine of commercial necessity, the NSW Court of Appeal held that Fenchurch was a trustee of the guarantee for itself, its related companies, and their clients. The insurance business had been placed with Southlands solely by reason of the guarantee given by Ipec and upon the understanding that it covered the Fenchurch group of companies and their clients. That justified the implication of a trust.

In *Elsea* the Court of Appeal did not ask whether at the date of the guarantee Ipec and Fenchurch would have regarded the implication of a term that the guarantee should be held upon trust as so obvious that it went without saying. Proof was not demanded that the parties were aware of the legal niceties of the trust and of its advantages in their situation. It was sufficient that it went without saying that the companies in the Fenchurch group and their clients should be entitled to enforce the guarantee. On that basis, the trust was supplied by the court. A trust may arise for the benefit of a stranger to a contract although the contracting parties have not adverted to the machinery though which the third party is to enjoy enforceable rights. Under the doctrine of commercial necessity the implication of a trust may be justified if the contracting parties would say that it was so obvious that the third party should enjoy enforceable rights that it went without saying, and a trust was the appropriate way of giving effect to those rights. The doctrine is but one application of the principles in *Bahr* and *Trident* discussed above.

In certain instances, the implication of a trust as a matter of construction may be necessary to ensure that a promisor who receives valuable consideration in return for a promise to benefit a third party does not break the promise with relative impunity. In other instances, considerations of practical convenience may require that the third party be entitled to institute proceedings in the name of the promisee.

Instances in which a promisor is able to breach a contract with relative impunity, unless a trust for the benefit of a third party is implied according to contractual principles, may be unusual now, for two reasons. Courts today show a greater willingness than in the past to allow a promisee to recover substantial damages if a promisor breaches a contract for the benefit of a third party, although the law remains unsettled. The traditional view was that unless the promisee

suffers loss personally as a result of the breach[72] he or she could recover nominal damages only.[73] But in *Trident* two judges refused to treat this proposition as an absolute rule: Brennan J suggested that a promisee who is neither a trustee nor an agent may recover substantial damages if she would be accountable to the third party for the proceeds;[74] Gaudron J regarded the law as unclear.[75] Moreover, where damages are an inadequate remedy, the promisee may obtain specific performance of the promise for the benefit of the third party.[76] Nevertheless, although specific performance is available in a wide variety of situations, in some circumstances it will not be a suitable remedy.[77] In those circumstances, courts may show a greater readiness to infer that the benefit of a contract is held upon trust for the third party, so as to prevent injustice.[78]

Even when a promisee would be entitled to specific performance, the purpose of a contract and the relationship between the parties to it may require that a promise be held upon trust for the third party because they cannot, in the absence of a trust, compel a promisee to sue for specific performance.[79] If, for example, a contract purports to confer a significant entitlement upon a third party but, by reason of the nature of the contract, the promisee would not wish to undertake

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72 *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460 per Windeyer J at 501; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 per Mason CJ and Wilson J at 119, per Dawson J at 158; cf Brennan J at 138-139.

73 *West v Houghton* (1879) 4 CPD 197; *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460 per Windeyer J at 501-502; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 per Mason CJ and Wilson J at 118; *Woodar Investment Development Ltd v Wimpey Construction (UK) Ltd* [1980] 1 WLR 277; [1980] 1 All ER 571.

74 (1988) 165 CLR 107 at 139.

75 Id at 173; cf *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460 per Windeyer J at 501.

76 *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460 per Barwick CJ at 478; per Windeyer J at 503; *Beswick v Beswick* [1968] AC 58 at 82, 89, 101-102; *Woodar Investment Development Ltd v Wimpey Construction (UK) Ltd* [1980] 1 WLR 277; [1980] 1 All ER 571; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 per Mason CJ and Wilson J at 119-120; per Brennan J at 138; per Dawson J at 158; per Gaudron J at 173; cf Deane J at 144.

77 *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 per Mason CJ and Wilson J at 120, referring in particular to *Jackson v Horizon Holidays Ltd* [1975] 1 WLR 468; [1975] 3 All ER 92.

78 Cf *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 per Brennan J at 140; per Dawson J at 155-156. In some instances, a constructive trust may be imposed to avoid injustices.

79 (1988) 165 CLR 107 at 120.

the hazard and expense of enforcing it, or enforcement by the promisee would be impracticable, as in *Trident*, because of the multiplicity of possible disputes or the complexity of the factual issues they might raise, then the circumstances are particularly appropriate for the inference of a trust. If a trust arises, the third party may sue on the contract, naming the promisee as an additional defendant, a defendant who is unlikely to enter an appearance for no substantial relief is sought against him or her,[80] the real dispute being between the third party and the promisor.

(b) Standard implied terms

Certain terms are implied into all contracts of a defined category, unless excluded by the provisions of a particular contract. The terms are in the nature of a legal incident of the category of contract and are described as standard implied terms.

Standard implied terms may be derived from either of two distinct doctrines.

Standardised contracts

When people frequently enter into contracts of a standard kind, over the course of time standard terms evolve and apply automatically to all such contracts, unless excluded. In the past, such standard implied terms have arisen out of trade usage, the usage of conveyancers, and prior authorities in which courts have implied terms on an ad hoc basis either to give efficacy to a particular agreement or to complete a contract which is apparently incomplete. Although terms of this kind find their source in the courts' attempts to effectuate the intention of the parties, over the course of years they have taken on the quality of rules of law, albeit rules that can be excluded by agreement.

A trust for the benefit of a stranger to a contract has never been implied on this basis.

Necessary Incidents

A term may be implied as a necessary incident of a category of contract[81] in circumstances (at least in the United Kingdom) in which

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80 But see L Wilson 'Contracts and Benefits for Third Parties' (1987) 11 *Sydney Law Rev* 230 at 236-237.

81 *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 345-346; *Lister v Romford Ice and Cold Storage Co* [1957] AC 555; *Liverpool City Council v Irwin* [1977] AC 239; *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] AC 80; *Scally v Southern Health and Social Services Board* [1992] AC 294; *Byrne v Australian Airlines Ltd* (1994) 120 ALR 274 at 285-286, 315; cf *Vroon BV v Foster's Brewing*

the doctrine of commercial necessity is inapplicable[82] and in which no business usage or custom is proved. The term is based upon broad considerations,[83] not upon the presumed intention of the parties. A term implied under this doctrine applies to all contracts of a class or kind, unless excluded by a particular contract.

A term will not be implied into a category of contract merely because that would be reasonable; the implication must be necessary.[84] Only such terms are to be read into a class of contract 'as the nature of the contract itself implicitly requires'.[85]

The requirement that a term implied under this doctrine be one necessary to all contracts of a defined type was thought to severely restrict the scope of the doctrine.[86] A recent decision of the House of Lords, however, indicates that this apparent obstacle may be overcome by a narrow definition of the class of contract to which a term applies. In *Scally v Southern Health Board,*[87] four doctors were employed by Northern Ireland health boards pursuant to contracts that entitled them to acquire additional units in a superannuation scheme on advantageous terms. This valuable right could be exercised only within twelve months of the entry into force of certain regulations, or the commencement of employment, if later. The four doctors joined the superannuation scheme but were not informed of their rights to take up additional units in it, and consequently did not apply to do so within the time limit. They subsequently sued their employers, alleging that it was an implied term of their contracts of service that their employers would take reasonable steps to bring to notice their right to take up additional units in the superannuation scheme. The doctors succeeded in their claim; the alleged term was held a necessary incident of their contract of service.

Group Ltd [1994] 2 VR 32 at 69; GS Morris, 'Implied Terms in United Kingdom Employment Law' [1991] *JBL* 33.

82 *National Bank of Greece v Pinios Shipping Co No 1* [1990] AC 637 at 645; *Scally v Southern Health and Social Services Board* [1992] AC 294.

83 *Scally v Southern Health and Social Services Board* [1992] AC 294.

84 *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] AC 80 at 104; *National Bank of Greece v Pinios Shipping Co No 1* [1990] AC 637 per Lloyd LJ at 644-646; *Scally v Southern Health and Social Services Board* [1993] AC 294 at 309.

85 *Liverpool City Council v Irwin* [1977] AC 239 per Lord Wilberforce at 254; *National Bank of Greece v Pinios Shipping Co No 1* [1990] AC 637 per Lloyd LJ at 646.

86 A Phang, 'Implied Terms Revisited' [1990] *JBL* 394; GS Morris, 'Implied Terms in United Kingdom Employment Law' [1991] *JBL* 33; A Phang, 'Implied Terms Again' [1994] *JBL* 255 at 258-59.

87 [1992] 1 AC 294.

The House of Lords was able to reach this result by defining narrowly the class of contracts to which the term applied. The term did not apply to all contracts of service, only those that satisfied three strict conditions: the contract was not negotiated directly between the employer and employee; it enabled rights to be acquired only if the employee took appropriate steps; and the employee could not be expected to be aware of the rights unless they were drawn to his or her attention. Previously it had been thought that a term could not be implied as a necessary incident of a class of contracts, unless the class had been recognised in the past as a traditional, recurrent category of contract. *Scally* shows that the categories of contracts are not fixed. New categories of contracts may be recognised to allow new terms to be implied upon broad considerations. The decision in *Scally* is more remarkable in that the business efficacy doctrine was inapplicable on the facts of the case. The more narrowly a class of contract is defined, the closer the necessary incidents doctrine comes to occupying ground previously thought to be governed by the business efficacy doctrine.

The doctrine that a term may be implied as a necessary incident of a category of contract has not as yet been employed to raise a trust in favour of a stranger to a contract, though this step may be taken in the future. Some sixty years ago, Corbin suggested that all contracts for the benefit of third parties should be enforced through use of the trust device thus avoiding the doctrine of privity of contract.[88] Subsequent authority offers no support for the rule and, indeed, is inconsistent with it, as is evidenced by the notorious variability of pre-*Trident* decisions in this area of law. The courts, rather, have adopted a case-by-case approach[89] which may restrict the scope of the necessary incidents doctrine.

In *Trident* Deane J might have used the present doctrine in support of his analysis, but did not do so. Nevertheless, his Honour stated that implied contractual promises may be perceived more readily in some classes of contracts than in others, adding that it would be difficult to envisage a class of contract in which the creator of a trust would be more readily discernible than policies of liability insurance of the kind

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88 AL Corbin, 'Contracts for the Benefit of Third Persons' (1930) 46 *LQR* 12 at 17, 43-45.

89 The older cases are discussed in a series of articles by J G Starke in the *Australian Law Journal*, particularly 'Contracts for the Benefit of Third Parties, Part III' (1948) 21 *ALJ* 455; Glanville Williams, 'Contracts for the Benefit of Third Parties' (1943) 7 *MLR* 123 at 131; Myers, 'Third Party Contracts' (1953) 27 *ALR* 175 at 177; *Bahr v Nicolay (No 2)* (1988) 164 CLR 604 at 618; *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107.

before him.[90] Yet, his Honour refused to accept that a trust would be imputed invariably, even in such a case.[91]

(c) A possible alternative: the constructive trust[92]

As shown above, a third party can enforce a contract for his or her benefit if the parties to it evince an intention that the contractual rights be held upon trust for the third party. Yet in certain circumstances, the third party may acquire rights regardless of the intention of the contracting parties, pursuant to a constructive trust. Should a breach of an undertaking to confer proprietary rights upon a third party or to recognise the party's rights in property be unconscionable, a court will sometimes impose a constructive trust in order to avoid injustice.

This occurred in *Bahr v Nicolay (No 2)*.[93] As noted above, a purchaser gained title to land pursuant to a contract which required him to honour the rights of a third party in regard to the land. A majority in the High Court held that the title of the purchaser was subject to a constructive trust (or equity) for the benefit of the third party.[94] The third party's rights were proprietary. This decision may be confined to cases in which a person *acquires* title to land on the basis of an undertaking to give effect to the rights of a third party contained within it.

The decision of the New South Wales Court of Appeal in *Carson v Wood*,[95] if correct, appears at first sight to be of wider significance. Though complex, the facts in essence were as follows. A company, Woodson (Sales) Pty Ltd (hereafter 'Woodson') owned certain trademarks.[96] Two families, the Woods and the Carsons, owned the shares in Woodson equally, through certain trusts. As part of a re-organisation of their business interests, the families agreed that the shares in Woodson owned by the Carson family should be transferred to the Wood family but that Woodson should transfer its trademarks to a third party, an as-yet unidentified shelf company in which the two families would have equal rights. The shares in Woodson were

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90 *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107 at 148.

91 Id at 150.

92 As this paper concerns third-party volunteers, the doctrine of resulting trusts is not considered. This doctrine may be relevant if a person who is not party to a contract furnishes consideration under it.

93 (1988) 164 CLR 604.

94 Id at 653-655 per Brennan J, at 638-639 per Wilson and Toohey JJ.

95 (1994) 34 NSWLR 9.

96 The Wood family had originally owned the trademarks, but the Carson family purchased an interest in them and they were subsequently transferred to Woodson.

duly transferred and the two families took up equal shareholdings in a specially acquired shelf company, Lifpark Pty Ltd, but owing to an oversight the trademarks were not transferred to it. When relations between the two families broke down, the Wood family kept the trademarks, relying on its control of Woodson. The Carson family could not obtain specific performance of the agreement to transfer the trademarks to Lifpark Pty Ltd, as the transfer required the consent of the Registrar of Trademarks, and this had not been sought. The Court of Appeal imposed a remedial constructive trust over the trademarks in favour of the two families in equal shares. The trust was not in favour of Lifpark Pty Ltd because the two families' shared-control of that company would have produced a stalemate, as the company was merely a vehicle to ensure that the families had equal rights with respect to the trademarks. Had Lifpark Pty Ltd been a suitable recipient of rights, apparently it would have been the beneficiary under the constructive trust.[97] Justice Clarke (Kirby P concurring) said that in the circumstances, it was inequitable and unconscionable for the Wood family to persist in its claim to sole ownership of the trademarks. The appropriate remedy was the declaration of a constructive trust. His Honour explained:

> Viewed in its modern context, the constructive trust can properly be observed as a remedial institution which equity imposes regardless of actual or presumed agreement or intention ... to preclude the retention or assertion of beneficial ownership of property to the extent that such retention or assertion would be contrary to equitable principle.[98]

In both *Bahr* and *Carson* the subject of the constructive trust was property, real or personal, not the contract for the benefit of the third party in regard to it. This was inevitable. In contracts for the benefit of a third party, the relevant breach is committed by the promisor, not the promisee. Accordingly, any remedy must be awarded against the promisor; the promisee has not wronged the third party. As the promisor cannot have contractual rights against himself, any proprietary remedy awarded against him must attach to real or personal property in his hands, the real or personal property which is the subject of the contract.

This conclusion entails that the constructive trust solution to the enforcement of contracts for the benefit of third parties is of restricted scope. An award to a third party of a constructive trust over property owned by the promisor in effect elevates the third party to the

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97 This is implicit in the explanations offered by Clarke and Sheller JJA as to why the trademarks were held upon trust for the two families rather than for the company.

98 (1994) 34 NSWLR 9 at 18. Sheller JA formulated the principle in similar terms at 26.

position of a secured creditor who will be entitled to priority over the unsecured creditors of an insolvent promisor and perhaps over certain secured creditors as well. The trust has important potential implications under our bankruptcy law and under the general principles of property law. Whilst third parties should be permitted to enforce contracts made for their benefit, strong and compelling reasons are required for granting them preference over general creditors and other claimants to property. Admittedly, the promisor has wronged the third party. The wrong, however, even if unconscionable, does not necessarily justify a deferral of the rights of others. The remedy of a constructive trust is too sweeping for universal use[99] and, at all events, is available only where the contract to be enforced is in respect to specific property owned by the promisor at the date of the legal proceedings.

The express trust solution to contracts for the benefit of third parties has major advantages over the constructive trust solution. The express trust solution is not limited to contracts with respect to property; and it does not ordinarily confer on the third party a priority or preference over strangers to the contract. Why use nerve gas to kill a fly?[100]

II Covenants to Settle Property on Volunteers

A settlor (S) may by deed under seal covenant with a covenantee (T), to transfer property to T upon trust for a third party volunteer (B). In that event, will the benefit of the covenant to settle property be held by T on trust for B or will a trust arise only when the property itself is

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99 These considerations apply with equal force to covenants to settle property for the benefit of third party volunteers. Presumably, a constructive trust for the benefit of a third party to a contract or covenant could not be revoked by the parties to the instrument out of which it arose, a further consideration that limits the usefulness of the constructive trust approach.

100 DM Paciocco, 'The Remedial Constructive Trust: A Principled Basis For Priorities over Creditors' (1989) 68 *Can Bar Rev* 315. In regard to third party rights, express trusts have come to play a role usually assigned to constructive trusts. At page 146 of *Trident* (1988) 165 CLR 107, Deane J explained that:

> In the course of his judgement in *Wilson v Darling Island Stevedoring* Fullager J pointed to the fact that 'equity could and did intervene in many cases' involving circumstances in which the common law requirement of privity of could operate unjustly 'by treating the *promisee* as a trustee of a promise made for the benefit of a third party, and allowing the third party to enforce the promise, making the *promisee-trustee*, if necessary, a defendant in an action against the promisor'. (Emphasis added).

transferred to T? If the former, then immediately once the deed is executed, a trust of S's covenant to settle property arises, so that B can insist that T enforce the covenant. If the latter, B cannot compel T to enforce the covenant against S, for no trust will come into existence until the property is transferred to T. Which solution is correct depends upon whether S intends that T should hold the property when settled upon trust for B, or intends that T should also hold the covenant to settle it, in the meantime, on trust for B. The latter trust is not created by S in so many words; if it is to be derived as a matter of construction or imposed as a matter of law the step requires justification in the light of established doctrine.

This section of the paper is concerned with the circumstances in which a covenant to settle property will itself be held upon trust for the benefit of a volunteer who is not a party to the covenant. It is not concerned with the rights of persons who are within the consideration of a covenant or who are parties to it although they have not furnished consideration, for two reasons. First, persons who are within the consideration of a covenant to settle property enjoy equitable rights over the property: if the settlor owns the property at the date of the covenant, the rights of those within the consideration arise from that date; if the settlor does not own the property at that date, their rights arise from the date the settlor acquires it.[101] Second, persons who are parties to a covenant to settle, although they furnish no consideration, may enforce the covenant at common law in an action for damages for breach of covenant.[102] Third party volunteers, however, can rely on neither of these principles.

A deed of settlement containing a covenant to settle property on a third-party volunteer may either be entirely voluntary or be made for valuable consideration. For example, a covenant to settle property upon an illegitimate child[103] who has not provided consideration is an entirely voluntary covenant. By contrast, a covenant to settle property upon a settlor's next-of-kin found in a marriage settlement[104] is a covenant for the benefit of third-party volunteers contained in a settlement for valuable consideration, though the next-of-kin are not providing the marriage consideration. Regardless of whether a deed or settlement is entirely voluntary or made for valuable consideration, the rights of third party volunteers are ordinarily dependant upon

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101 *Pullan v Koe* [1913] 1 Ch 9; *Tailby v Official Receiver* (1888) 13 App Cas 523.

102 *Cannon v Hartley* [1949] 1 Ch 213; *Re Cavendish-Browne's Settlement* [1916] WN 341; *Sonenco (No 77) Pty Ltd v Silvia* (1989) 89 ALR 437 at 452-453 per Ryan and Gummow JJ.

103 *Fletcher v Fletcher* (1844) 4 Hare 67; 67 ER 564.

104 For example, see *Re Pryce* [1917] 1 Ch 234.

whether the benefit of the covenant to settle property is held upon trust for them.

A major difference between contracts for the benefit of third parties and covenants to settle property lies with the person to whom performance is due. With respect to contracts for the benefit of third parties, performance is ordinarily due to the third party, a fact which, in the absence of a trust, may affect the measure of damages recoverable by the promisee in the event of a breach of contract. In the case of a covenant to settle money or property for the benefit of a third-party volunteer, performance is due to the covenantee. If the covenant is to pay a sum of money, the covenantee may recover that sum as a debt; if the covenant is to settle property, the covenantee may recover, it seems, the value of the property.[105] But in the absence of a trust, the third party volunteers cannot require the covenantee to enforce the covenant.

A trust of a covenant to settle property might arise in either of two ways. First, the deed of covenant might itself disclose the requisite intention. Secondly, in regard at least to a covenant that is entirely voluntary, the covenantor might declare a trust outside the deed, as long as the relevant formalities are complied with.[106] In regard to the first method, a deed might either expressly state that the benefit of the covenant is to be held upon trust for the third party volunteers,[107] or such an intention might be inferred, taking into account the deed's language and the circumstances in which it was made. An example of such a clause to be included in a deed of settlement, stating that the benefit of the covenant to settle property is to be held on trust for a volunteer, is not found in the precedent books or in any of the reported cases. What is to be found in the precedent books and the authorities is a covenant by a settlor to transfer property to a trustee who is to hold that property on the trusts recited in the deed. A typical clause provides that 'any property ... vested in the trustees

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105 RP Meagher and WMC Gummow (eds), *Jacobs' Law of Trusts in Australia* (5th ed, Butterworths, 1986) p 91; DJ Hayton, *Underhill's Law Relating to Trusts and Trustees* (14th ed, Butterworths, 1987) p 130; JL Barton 'Trusts and Covenants' (1975) 91 *LQR* 236 at 238; DW Elliott, 'The Power of Trustees to Enforce Covenants in Favour of Volunteers' (1960) 76 *LQR* 100 at 112; D Goddard, 'Equity, Volunteers and Ducks' (1988) *Conv* 19; *Re Cavendish-Browne's Settlement* [1916] WN 341; *Cannon v Hartley* [1949] Ch 213; *Ward v Audland* (1847) 16 M & W 862. A contrary view is espoused by WA Lee, 'The Public Policy of Re Cook's Settlement Trusts' (1969) 85 *LQR* 213.

106 *Conveyancing Act* 1919 (NSW) s 23C; *Property Law Act* 1958 (Vic) s 53; *Conveyancing and Law of Property Act* 1884 (Tas) s 60(2).

107 See DJ Hayton, *Underhill's Law of Trusts and Trustees* (14th ed, Butterworths, 1987) p 126.

pursuant to their [the parties'] covenant shall be held upon trusts hereby declared ...'[108] As the subject matter of the trust is expressed to be the property when settled, any trust of the promise to settle the property must arise as a matter of inference or in accordance with other principles of construction.[109]

It is contended below that in seeking to infer a trust for the benefit of a third-party volunteer from the language of a deed, similar, though not identical, principles apply to covenants as govern contracts, though the application of those principles is affected profoundly by differences in context. Before exploring this contention, however, it is convenient to consider the case of the settlor who creates a trust of the benefit of a covenant to settle property by conduct or by words not embodied in the deed of covenant.

Direct statement of intention concerning voluntary covenants

In the preceding discussion, a distinction was drawn between covenants to settle property on a third-party volunteer contained in deeds made for valuable consideration, and such settlement covenants in deeds not supported by consideration, the latter being described as deeds which are entirely voluntary. If an entirely voluntary deed does not embody complete expression of the settlor's intention, arguably direct evidence of intention to create a trust may be received by a court and given effect to, subject to any requisite statutory formalities being observed.[110] This contention is based on the special rules which govern gratuitous dispositions of property.

When a donor transfers title to property gratuitously, evidence may be led to prove whether the donee is to take beneficially or upon trust for another. Thus, in *Hodgson v Marks*[111] an elderly lady transferred her house to her lodger, pursuant to an oral agreement that the lodger would hold the house on trust for her. Although the oral agreement was unenforceable by reason of s 53(1) of the *Law of Property Act* 1925 (UK),[112] evidence was admissible to prove that the lodger took the

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108 JH Redman and JM Lightwood (eds), *The Encyclopaedia of Forms and Precedents* (2nd ed, Butterworths, 1925) pp 243, 279, 405; also see *Fletcher v Fletcher* (1844) 4 Hare 67; 67 ER 564.

109 The possibility that a constructive trust may be imposed by the court is also considered below.

110 *Hodgson v Marks* [1971] Ch 892; *Vandervell v Inland Revenue Commission* [1967] 2 AC 291; cf *Re Armstrong* [1960] VR 202.

111 [1971] Ch 892.

112 12 & 13 Geo 5, c16; *Conveyancing Act* 1919 (NSW) s 23C; *Property Law Act* 1974 (Qld) s 11; *Law of Property Act* 1936 (SA) s 29; *Conveyancing and Law of Property Act* 1884 (Tas) s 60(2); *Property Law Act* 1958 (Vic) s 53; *Property Law Act* 1969 (WA) s 34.

property merely as trustee, though there was no presumption of resulting trust.[113]

A gratuitous promise under seal to settle property on trust for a volunteer is arguably governed by a similar principle even in the absence of a presumption of resulting trust, a proposition supported by the speech of Lord Upjohn in *Vandervell v IRC*.[114] Vandervell caused title to shares to be vested in the Royal College of Surgeons which, at Vandervell's request, granted an option to purchase the shares to Vandervell Trustees Ltd, the trustee of various Vandervell family trusts. The option was under seal but was not granted for consideration. After large dividends on the shares had been both declared and paid, Vandervell Trustees Ltd exercised its option to purchase the shares. The basic issue before the House of Lords was whether the option had been held by the trustee company beneficially or as trustee and, if as trustee, upon what trusts. It was decided that the option was held by the company as trustee for Vandervell. On the issue of whether the company took the shares as a trustee, Lord Upjohn, in the leading judgment, did not rely upon the language of the deed of option nor upon a presumption of resulting trust. Instead, his Lordship examined the 'known facts'[115] to determine whether the trustee company took the property beneficially or not. His Lordship adopted the analysis of the facts found in the judgments of Diplock LJ and Wilmer LJ in the Court of Appeal,[116] both of whom took into account direct evidence of the settlor's intention that the company should take the shares as a trustee only.

Implied terms of covenants

As stated above, where there is no admissible evidence of a settlor's intention, the courts will adopt a similar approach to the construction of covenants as to the construction of contracts. Unless the court is prepared to impose a constructive trust,[117] any trust for the benefit of a third party volunteer must be expressly stated in the deed or derived through a process of construction. No other approach is possible.

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113 *Law of Property Act* 1925 (Eng) s 60; cf *Conveyancing Act* 1919 (NSW), s 44(1); *Property Law Act* 1974 (Qld) s 7(3); *Property Law Act* 1958 (Vic) s 19A(3); *Property Law Act* 1969 (WA) s 38. Tasmania and South Australia do not have corresponding legislation.

114 [1967] 2 AC 291. Lord Pearce concurred with Lord Upjohn. Lords Reid, Donovan and Wilberforce delivered separate speeches.

115 Id at 315.

116 [1966] Ch 261 at 290, 292, 293.

117 This possibility is discussed below.

Standard implied terms

In certain instances, terms may automatically be read into deeds of settlements or agreements to create trusts, or the operation of these instruments may be affected by rules of construction or by presumptions. The doctrine of executory trusts[118] provides an illustration. Where a settlor expresses a general intention as to the terms of the trusts so created, the document executed amounts to little more than instructions for the preparation of some further instrument. In this situation, the settlor's property is subjected to an immediate trust; but the trust, though binding, is said to remain executory until a further instrument is executed. Executory trusts are construed quite differently to executed trusts. In the case of marriage articles that give rise to executory trusts, usual clauses that are not expressed in the articles are treated as terms of the trust and certain strong presumptions, including presumptions in favour of the children of the marriage,[119] are routinely adopted by the courts. The doctrine of executory trusts, however, must be distinguished from the doctrines which govern covenants to settle property. In the case of an executory trust, both the intention to create an immediate trust and the property subjected to it is clearly stated - only the terms of the trust are ill defined. In the case of a covenant to settle, an intention to create an immediate trust of the covenant is often not stated. Moreover, most covenants to settle do not contemplate the execution of a further deed of settlement, the covenant often being itself embodied in a formal deed of settlement. The techniques applicable to executory trusts have not been extended to other parts of the law of trusts.

It is true that in certain other instances where no trust is expressed, a trust may arise through the operation of presumptions or rules of construction. Thus, a power to appoint property amongst a class of objects may, in some circumstances, imply a trust in default of appointment for the members of the class.[120] Again, a testamentary gift of residue to executors to apply as they think fit does not confer any beneficial interest on them: a trust arises by implication.[121] In addition, a testamentary gift to an unincorporated association for its

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118 For a recent discussion of the doctrine see *Davis v Richards & Wallington Industries Ltd* [1990] 1 WLR 1511 at 1537-1538.

119 *Sackville West v Homesdale* (1870) LR 4 HL 543.

120 *Perpetual Trustee Co Ltd v Tindale* (1940) 63 CLR 232 at 261-267; *Re Scarisbrick* [1951] Ch 622 at 635; *Tatham v Huxtable* (1950) 81 CLR 639 at 649; Ford and Lee, *Principles of the Law of Trusts*, pp 163-164, who state that the question is one of inference or implication from the instrument.

121 *Yeap Cheah Neo v Ong Cheng Neo* (1875) LR 6 PC 381; *Re Chapman* [1922] 2 Ch 479; *Horan v James* [1982] 2 NSWLR 376. Whether a gift confers a beneficial interest upon the executor is a matter of construction: *Re Chapman*.

general purposes is read, prima facie, as creating a trust for the members of the association, perhaps subject to their rights and duties as members of the association.[122]

Ordinarily, however, courts do not find express trusts through resort to firm presumption or rule of construction. In particular, they do not do so in regard to covenants to settle property,[123] despite a suggestion by several writers that for theoretical reasons such a step would be appropriate.[124] If covenants, whatever their nature, do give rise to trusts for the benefit of volunteers who are not parties to the covenants,[125] it is on an *ad hoc* basis.

Ad hoc implication of trusts of covenants to settle

Principles similar to those which govern the construction of simple contracts govern the construction of deeds. Indeed, when a covenant is in consideration of money or money's worth, the relevant principles are identical.[126] When a covenant, however, is entirely voluntary or is given in consideration of marriage, differences emerge in regard to principles and their application: in such circumstances the doctrine of commercial necessity is ordinarily inapplicable; and application of basic principle may be affected by factors, discussed below, which are irrelevant to the construction of simple contracts.

Although the courts have from time to time considered whether the benefit of a covenant to settle property is held upon trust for a third-party volunteer, the relevant cases do not explore the basic principle systematically. Accordingly, it is necessary to turn to authorities in

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122 *Leahy v Attorney-General (NSW)* [1959] AC 457; *Re Goodson* [1971] VR 801 at 812, 814. As *Leahy* demonstrates, the principle is no more than a prima facie principle of construction of the instruments.

123 *Re Cook's Settlement Trusts* [1965] Ch 902; *Re Kay's Settlement* [1939] Ch 329; *Re Pryce* [1917] 1 Ch 234; *Re D'Angibau* (1880) 15 Ch D 228; *Re Plumptre's Marriage Settlement* [1910] Ch 609; *Re Ellenborough* [1903] 1 Ch 697; *Gandy v Gandy* (1884) 30 Ch D 57.

124 See: JA Hornby, 'Covenants In Favour of Volunteers' (1962) 78 *LQR* 228; JD Feltham, 'Note' (1982) 98 *LQR* 17.

125 See for example: *Bridges v Bridges* (1852) 16 Beav 315; *Re Cavendish Browne's Settlement Trust* [1916] WN 341; *Commissioner of Stamp Duties v Hopkins* [1945] 71 CLR 35; *Cox v Barnard* (1850) 8 Hare 310; *Fletcher v Fletcher* (1844) 4 Hare 67; *Lamb v Vice* (1840) 6 M & W 467; *Lomas v Wright* (1832) 2 My & K 269; *Williamson v Codrington* (1750) 1 Ves Sen 511.

126 *Prenn v Simmonds* [1971] 3 All ER 237 at 239-241; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 348-349; *Seddon v Senate* (1810) 13 East 63 at 74 per Lord Ellenborough CJ; cf *Abbott v Middleton* (1858) 7 HLC 68 at 93 per Lord Cranworth; cf *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 at 537-538.

which closely related issues arose concerning wills, deeds of trust involving other issues, and instruments of gift. Four questions will be discussed in this and the next two sections of the paper: What material may be taken into account in the construction of a covenant to settle property upon volunteers?; how should the material be assessed?; what special factors affect the construction of such covenants?; and whether a discretion may be conferred upon a trustee to enforce or not enforce covenants to settle property.

As in the construction of simple contracts, in the construction of covenants to settle property the court will read the language used in the light of the circumstances in which it was made, including the relationship of the parties.[127] For example, if the language of a will is ambiguous 'you may place yourself, so to speak, in his [the testator's] arm-chair, and consider the circumstances by which he was surrounded when he made his will to assist you in arriving at his intention'.[128] *A fortiori*, the same rule applies to inter vivos covenants to settle property.

This approach was applied to the construction of instruments of gift in *Re Australian Elizabethan Theatre Trust*.[129] Donations were made to the Australian Elizabethan Theatre Trust on standard forms which stated that the donations were unconditional, but permitted donors to express preferences for the moneys to be passed on to arts organisations nominated by them. In holding the donations were not held upon trust for the nominated arts organisations, Gummow J took into account not merely the words used in the forms but also two circumstances: donations were intended to attract tax advantages that would not accrue if they were held upon trust for the nominated organisations; and the practice of the donee was not to pay donations into a separate trust account or treat them as trust moneys in the books of account. His Honour affirmed that he was entitled to look 'to the nature of the transaction and the relevant circumstances attending the relationship between' the donor and donee.[130] The same approach would be appropriate in the construction of a covenant to settle property.

In assessing the language of a covenant in the light of admissible evidence, the judicial techniques used are similar to those that apply to contracts. Thus when a deed of covenant is ambiguous, the court will seek to give a reasonable meaning to it. In the context of a

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127 *Re Australian Elizabethan Theatre Trust* (1991) 102 ALR 681 at 693, 695 (instrument of gift).

128 *Boyes v Cook* (1880) 14 Ch D 53 at 56.

129 (1991) 102 ALR 681.

130 Id at 693.

gratuitous deed of trust, Lord Upjohn stated in *Re Gulbenkian's Settlement*[131] that:

> It is ... the duty of the court by the exercise of its judicial knowledge and experience in the relevant matter, innate common sense and desire to make sense of the settlor's or parties' expressed intentions, however obscure and ambiguous the language that may have been used, to give a reasonable meaning to that language if it can do so without doing complete violence to it.[132]

Moreover, in construing a deed of trust that is ambiguous, a court will lean towards a reading of it which effectuates rather than invalidates its provisions,[133] or which gives effect to its general purpose rather than defeats it,[134] though it may not do so when one construction is clearly preferable to the other.[135] As Harman LJ said in *Re Baden's Deed Trusts*:[136]

> the court is at liberty, if the considerations on both sides seem evenly balanced, to lean towards that which may effectuate rather than frustrate the settlor's intentions . . . I by no means hold that the court may take this course by flying in the teeth of the provisions of the deed, so that the weaker view may prevail because it is likely to have an effectual result ...[137]

As stated above, two questions are of prime importance in determining whether the benefit of a contract is held upon trust for a stranger to it: is the third party intended to enjoy enforceable rights, and is a trust the appropriate means of giving effect to those rights?[138] Both of these questions must also be relevant to whether a covenant to settle property is held upon trust for prospective beneficiaries. Unless a covenant is meant to confer immediate rights upon them, a trust is clearly contrary to a covenantor's intentions;[139] and unless a trust is appropriate in the circumstances, it ought not be implied in the absence of clear indications in the deed of covenant that a trust is intended.

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131 [1970] AC 508.

132 Id at 522; cf *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 at 537-538.

133 *Re Baden's Deed Trusts* [1969] 2 Ch 388 at 400 per Harman LJ; *Inland Revenue Commissioners v Williams* [1969] 3 All ER 614 at 618.

134 *Abbott v Middleton* (1858) 7 HLC 68 at 94 per Lord St Leondard.

135 *Inland Revenue Commissioners v Williams* [1969] 3 All ER 614 at 618.

136 [1969] 2 Ch 388.

137 Id at 400.

138 *Bahr v Nicolay (No 2)* (1988) 164 CLR 604 at 618-619.

139 Cf *Re Pitt Rivers* [1902] 1 Ch 403.

As the settlor will rarely advert to the question of whether the third party is to enjoy enforceable rights, great weight will be placed upon whether such a right is necessary to give the deed the efficacy it is intended to have. It is in regard to the doctrine of necessity that important differences emerge between contracts and covenants. First, the doctrine of commercial necessity, though significant in the construction of contracts, ordinarily plays no part in the construction of deeds of covenant that are not supported by a consideration of money or money's worth, for such deeds usually serve a family rather than a business purpose. Second, whatever its form, the doctrine of necessity plays a less significant role in regard to covenants for several reasons: the covenantor's conscience is not bound; and the covenant's social or economic role is, ordinarily, at best weak. These considerations are explored in the paragraphs that follow.

Some important differences

The economic and social role of a covenant to settle property is dissimilar to that of a contract. Contracts serve major functions in economic exchange and in business planning and coordination, as well as in the allocation of economic resources. Moreover, when contractual promises are relied upon, alternative business opportunities may not be explored, let alone exploited. By contrast, covenants to settle property upon trust are of more marginal significance in that they do not foster economic exchange or business planning, involve loss of no alternative business opportunities, and merely redistribute wealth without adding to it.[140] Reliance upon these covenants is ordinarily slight, for those entitled under them often are not identified until many years after the covenant is made. Even when a covenant to settle property upon volunteers forms part of a marriage settlement, a form of settlement that once performed important functions, enforcement of the covenant now serves no good purpose, as is shown below. Accordingly, courts are subject to less pressure to find that a covenant to settle property is held upon trust for volunteers than they are to find that a contract for the benefit of third parties is so held.

Moreover, moral principle does not dictate that gratuitous promises be performed regardless of the circumstances,[141] the strict common law rules concerning enforcement of covenants reflecting ethical

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140 MA Eisenberg, 'Donative Promises' (1979) 47 *Uni Chicago Law Rev* 1 at 4.

141 *Re Brook's Settlement Trust* [1939] 1 Ch 993 at 998-999; *Re Ellenborough* [1903] 1 Ch 697, 700; P Atiyah, *Essays on Contract* (Clarendon Press, 1986) Ch 8; Eisenberg, 'Donative Promises'(1979) 47 *Uni Chicago Law Rev* 1 at 1-18; S Stoljar, 'Keeping Promises: the Moral and Legal Obligation' (1988) 8 *Legal Studies* 258; S Stoljar, 'Enforcing Benevolent Promises' (1989) 12 *Sydney Law Rev* 17; cf *Re Ralli's Will Trust* [1964] Ch 288.

consideration imperfectly, whatever the conveniences of those rules.[142] If promisors have acted improvidently in entering into a covenant, or if their circumstances have changed later to such an extent that they cannot both keep their promises and discharge their duties to creditors and families, or if promisees are guilty either of serious misconduct towards the promisors or of ingratitude, then promisors are morally justified in refusing to carry out their promises, at least unless the promises have been acted upon. This is recognised by both the French and German legal systems, which provide defences to actions to enforce gratuitous promises based on a promisor's change of circumstances and a promisee's wrongful acts.[143] Neither common law nor equity has become entangled in these difficult and complex concerns: common law enforces all gratuitous covenants, equity none. In the absence of special circumstances, moral principle does not require that equity always yield to the common law by artificially imputing to a covenantor an intention that the benefit of a covenant to settle property be held upon trust for a third party volunteer. Ethical principle is more complex than the common law.

Further, a covenant to settle property differs from a contract for the benefit of a third party in that a covenant may ordinarily be enforced quite satisfactorily by the covenantee-trustee, who may recover full damages for its breach.[144] Admittedly, in the absence of a trust, a covenantee-trustee is not obliged to enforce a covenant to settle property[145] for, *ex hypothesis*, the third-party volunteers enjoy no present rights. Yet the existence of rights in the covenantee-trustee ensures that the covenant has a legal operation, which tends to weaken a possible inference that the covenant is held upon trust. It is true that in one class of case,[146] courts have directed covenantee-trustees not to enforce covenants to settle property, but this

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142 L Fuller, 'Consideration and Form' (1941) 41 *Columbia Law Rev* 799.

143 Eisenberg, note 140 above at 13-18; Stoljar, note 141 above, at 35. In certain limited circumstances, Australian courts now recognise the defence of an adverse change of position: *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353.

144 DJ Hayton, *Underhill's Law Relating to Trusts and Trustees* (14th ed, Butterworths, 1987) p 130; D Goddard, 'Equity, Volunteers and Ducks' (1988) *Conv* 19; RP Meagher and WMC Gummow (eds), *Jacobs' Law of Trusts in Australia* (5th ed, Butterworths, 1986) p 91; *Cannon v Hartley* [1949] Ch 213; *Sonenco (No 77) Pty Ltd v Silvia* (1989) 89 ALR 437 at 453-454.

145 *Re Pryce* [1917] 1 Ch 234 is an example.

146 *Re Kay's Settlement* [1939] Ch 329; *Perpetual Trustee Co v Willers* (1955) 72 WN(NSW) 244.

constitutes a special exception which does not weaken general principle, as appears below.

The capacity of a covenantee-trustee to enforce a covenant to settle property, however, is not always inconsistent with the benefit of the covenant being held upon trust for the prospective beneficiaries under a proposed settlement. In certain instances, it may be unsatisfactory for the rights of the prospective beneficiaries to depend entirely, or at all, upon the discretion of the covenantee-trustee, a consideration which may call for a covenant to be held on an implied trust.[147] For example, where a covenantor is under a moral obligation to a prospective beneficiary, or where a covenant is not to be performed during the lifetime of the covenantor and the trustee-covenantee may be particularly reluctant to enforce it, a court might infer that a covenantee is trustee of the covenant for the prospective beneficiaries.

Judicial control of covenantees

It has been urged however, that as a matter of principle covenantees can never enjoy a discretion as to whether to enforce a covenant to settle property, because such a discretion would be inconsistent with the role of a trustee.[148] But, *ex hypothesis*, until the property is settled, the covenantee is not a trustee. Moreover, the premise upon which this argument is based appears mistaken. Rights of beneficiaries are often determined by trustees, for example, through the medium of powers of appointments or discretionary trusts, doctrines having been developed to ensure that trustees act honestly.

Admittedly, in the case of wills, Australian courts have refused to permit trustees to determine whether a trust should be created. A testator cannot confer power upon a trustee to determine whether to establish a trust for a single individual[149] unless, perhaps, the will contains a gift over in default of appointment;[150] nor can a testator create a hybrid exhaustive discretionary trust.[151] This doctrine of non-

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147 An example is found in the circumstances of *Fletcher v Fletcher* (1844) 4 Hare 67; 67 ER 564.

148 JA Hornby, 'Covenants in Favour of Volunteers' (1962) 78 *LQR* 228; J Martin (ed), *Hanbury and Maudsley, Modern Equity* (13th ed, Stevens, 1985) p 123; but cf PH Pettit, *Equity and the Law of Trusts* (6th ed, Butterworths, 1989) p 100; *Re Richardson* [1892] 1 Ch 379; and *Fletcher v Fletcher* (1844) 4 Hare 67 at 78.

149 *Lutheran Church of Australia South Australia District Inc v Farmers' Co-operative Executors and Trustees Ltd* (1970) 121 CLR 628.

150 *In the Estate of Langley* [1974] 1 NSWLR 46.

151 *Tatham v Huxtable* (1950) 81 CLR 639 per Fullagar J; *Horan v James* [1982] 2 NSWLR 376.

delegation of testamentary power[152] has been severely criticised,[153] however, as being productive of arbitrary distinctions, lacking an historical basis.[154] The rule has been overturned in at least one Australian state[155] and it has never been applied to powers created *inter vivos*. Assuredly, it does not offer a satisfactory model for the development of the law in regard to covenants to settle.

The example of powers of appointment and discretionary trusts created *inter vivos* are more instructive; they indicate that a court may control the right of a covenantee-trustee to enforce a covenant to settle without imposing a duty to exercise the right. Powers of appointment exemplify three approaches to judicial control.[156] First, a trustee may enjoy a bare power of appointment, for example a general power, free of any equitable duties;[157] secondly, a trustee may enjoy a bare fiduciary power of appointment, the exercise of which the court will control through the imposition of stringent equitable duties, without imposing a duty to exercise it; thirdly, a trustee may enjoy a trust-power, which the court will again control through the imposition of stringent equitable duties and will require the trustee to exercise.[158] The second case demonstrates that a trustee may be subjected to equitable obligations, including an obligation to give real and genuine consideration to the exercise of a power, although he or she is not obliged to exercise it.[159] Clearly, equity might equally well prevent a covenantee-trustee from corruptly exercising her rights under a covenant to settle property without imposing a duty to exercise them. A duty to act properly is not inconsistent with a discretion whether to exercise a right or power.

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152 See also *Gerhardy v South Australia Auxiliary to the British Foreign Bible Society Inc* (1982) 30 SASR 12; *Public Trustee v Vodjdani* (1984) 49 SASR 236.

153 R Sundberg, 'The Status and Authority of the Decision in *Tatham v Huxtable*' (1974) 48 *ALJ* 527; JF Keeler, 'Delegation of Testamentary Power' (1971-72) 4 *Adelaide Law Rev* 210 at 214; IJ Hardingham, 'The Rule Against Delegation of Will Making Power' (1973-74) 9 *Monash Uni Law Rev* 650.

154 *Horan v James* [1982] 2 NSWLR 376 at 381 per Hutley JA.

155 *Succession Act* 1981 (Qld) s 64.

156 *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 at 545-546; *Re Hay's Settlement Trust* [1981] 3 All ER 786.

157 *Dowdle v Coppel* [1987] VR 1024. A further illustration is provided by Warner J in *Mettoy Pension Trustees Ltd v Evans*, note 156 above, at 545.

158 For example, *McPhail v Doulton* [1971] AC 424.

159 *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513; *Karger v Paul* [1984] VR 161.

Such an approach is readily applicable where a covenant to settle is part of a broader, fully constituted settlement of which the covenantee is trustee. As the rights under the covenant are conferred upon the trustee of the settlement by reason of his or her office, it is natural that those rights should be controlled through the imposition of fiduciary obligations. A similar solution is available, if it is desirable, when a covenant is not part of a broader scheme. In certain circumstances, courts have treated parties who have taken steps on a road leading to a well-recognised fiduciary relationship as being already subject to fiduciary duties. Thus, the High Court has held that people who enter into negotiations for the creation of a partnership may owe fiduciary duties to each other.[160] A covenantee with whom a covenant to settle property is made is surely in a similar position, for if the property is transferred to the covenantee he or she will hold the property subject to the trusts indicated by the covenant,[161] the covenant itself perhaps embodying the declaration of trust.[162] Even prior to a transfer of the property to be settled to the covenantee, a court could prevent the covenantee from deriving a profit from his or her position or otherwise acting corruptly, by imposing fiduciary obligations upon the covenantee.

Accordingly, in order to control a covenantee adequately, it is unnecessary to infer that the benefit of the covenant is held upon trust, thereby imposing a duty upon the covenantee to enforce the covenant; and imposition of such a duty might prove undesirable, particularly as the financial position of the covenantor or the relationship between the covenantor and the prospective beneficiary may change materially in the period following execution of the covenant. Indeed, substantial advantages might accrue in many instances from allowing a covenantee, a person likely to be close to the covenantor, a discretion as to whether to sue on the covenant. A court should be slow to treat a covenant to settle property as subject to a trust unless the covenantee ought not, in the circumstances, enjoy a discretion as to whether to enforce it.[163]

It has been urged, however, that unless the benefit of a covenant to settle property is held upon trust for the prospective beneficiaries, unfortunate consequences would follow: if the covenantee became bankrupt, the benefit of the covenant would vest in his or her trustee

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160 *United Dominion Corporation Ltd v Brian Pty Ltd* (1985) 157 CLR 1; cf *Hill v Rose* [1990] VR 129.

161 *Re Adlard* [1954] Ch 29; *Re Bowden* [1936] Ch 71; *Re Tilt* (1897) 74 LR 163; *Re Ralli's Will Trust* [1964] Ch 288.

162 RH Maudsley, 'Incompletely Constituted Trusts' in R Pound et al (eds), *Perspectives of Law* (Boston, Little, Brown, 1964) pp 251-252.

163 For example, as in *Fletcher v Fletcher* (1844) 4 Hare 67.

in bankruptcy, who would be obliged to enforce it for the benefit of creditors;[164] if the covenantee died, the right to sue would form part of her estate, available for the payment of her debts.[165] Neither of these contentions is correct. First, on the covenantee's bankruptcy, provided the covenant was held by the covenantee subject to fiduciary obligations, the benefit of the covenant would not be available to creditors.[166] Indeed, a right to enforce a chose in action which is of no benefit to a bankrupt does not vest in his trustee under s 116 of the *Bankruptcy Act* 1966 (Cth);[167] and property which does vest in the trustee vests subject to the same equities as affected the property in the bankrupt's hands.[168] Secondly, as the covenantee could not resort to the covenant to pay creditors, neither could his or her personal representative. Indeed, as noted above, if the covenantor transferred property to the covenantee, the property would be subject to the trusts of the covenant;[169] likewise if the covenantee recovered the property by enforcing the covenant, the trust would be fully constituted, so that the property could not be used for extraneous purposes.

It has also been objected[170] that a trust cannot be constituted by the covenantee recovering damages for breach of covenant because a trust must be constituted either with the settlor's consent,[171] or by an act of the settlor[172] or his agent. This contention is inconsistent with the rule which applies to covenants supported by consideration[173] and with

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164 JA Hornby 'Covenants in Favour of Volunteers' (1962) 78 *LQR* 228 at 232.

165 Id at 233.

166 Cf *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 at 548; *Wilson v Metro Goldwyn Mayer* (1980) 18 NSWLR 730 at 736; *Re William Makin & Sons Ltd* [1992] PLR 177 at 183; *Simes & Martin Pty Ltd (In liquidation) v Supree* (1990) 55 SASR 278 at 288; *Re Burton* (1994) 126 ALR 557. But see *Icarus (Hertford) Ltd v Driscroll* [1989] PLR 1.

167 *Davies v The ES & A Bank Ltd* (1934) 7 ABC 210 at 213-215; W Deane, L Bohringher and N Fernon, *McDonald, Henry and Meek's Australian Bankruptcy Law and Practice* (4th ed, Law Book Company, 1968) p 263.

168 Id p 255; M Hunter, *Williams' Law and Practice in Bankruptcy* (7th ed, 1958) p 251; *Re Clark* (1894) 2 QB 393 at 410.

169 *Re Adlard* [1954] Ch 29; *Re Bowen* [1936] Ch 71; *Re Tilt* (1897) 74 LT 163; *Re Ralli's Will Trust* [1964] Ch 288.

170 Hayton, *Underhill's Law Relating to Trusts and Trustees,* pp 130-131; DJ Hayton and Marshall, *Cases and Commentary on the Law of Trusts* (9th ed, Stevens, 1991) pp 232-233; *Re Brook's Settlement Trusts* [1939] Ch 993; contra *Re Ralli's Will Trusts* [1964] Ch 288.

171 *Re Bowden* [1936] Ch 71.

172 *Brennan v Morphett* (1908) 6 CLR 22.

173 *Davenport v Bishopp* (1843) 2 Y & CCC 451.

the decision of Buckley J in *Re Ralli's Will Trust*.[174] In this case, a trust was completely constituted when property which the covenantor had promised to settle became vested in the covenantee in his capacity as trustee of another settlement.[175] Moreover, by entering into a covenant to settle property, a covenantor surely impliedly consents to the covenantee constituting the trust by enforcing the covenant to settle, unless perhaps special circumstances support a conclusion that the benefit of the covenant is held upon resulting trust for the covenantor.

Despite the objections raised in the literature, three possible constructions of a covenant to settle property upon trust are open to a court. First, the covenant may be held upon trust for the beneficiaries under the settlement. Second, the covenantee may enjoy a discretion whether to enforce the covenant subject, however, to fiduciary duties. Third, in special circumstances, the benefit of the covenant might be held upon trust for the covenantor, a solution which would enable the covenantor to direct that the covenant not be enforced, but would not render it entirely nugatory; if the covenantor transferred the property to the covenantee a trust would arise.[176] The preferable result in any given case will depend largely on the nature of the covenant and the relevant circumstances, taking into account the matters adverted to above. Although the appropriate solution may be affected by the kind of covenant in issue, space does not permit a detailed analysis of the various types of covenant considered in the books, useful as that might be. A short discussion of two types of covenants appears below by way of illustration: the first type of covenant is one likely to be held upon trust for a third party volunteer; the second type is unlikely to be held on trust, in the absence of an express declaration in the deed of covenant.

Specific covenants

Ex-nuptial children

During the eighteenth and nineteenth centuries, courts invariably enforced covenants to settle property upon ex-nuptial children of a settlor.[177] In such cases a settlor's conscience was bound, for he had a moral obligation to provide for the child; enforcement of the covenant

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174 [1964] Ch 288.

175 However, *Re Ralli's Will Trusts* [1964] Ch 288 is contrary to *Re Brook's Settlement Trust* [1939] Ch 993 and perhaps *Brennan v Morphett* (1908) 6 CLR 22, but *Re Brook's Settlement Trust* appears to be inconsistent in turn with *Re Bowden* [1936] 1 Ch 71.

176 Hayton, *Underhill's Law Relating to Trusts and Trustees*, pp 130-137.

177 For example, see *Williamson v Codrington* (1750) 1 Ves Sen 511; *Lomas v Wright* (1833) 2 My & K 769; *Fletcher v Fletcher* (1844) 4 Hare 67.

benefited the community by relieving the parish of its obligation to provide; and until about 1840,[178] moral obligation might be treated as consideration. Moreover, after the death of the covenantor, the covenantee could not be relied upon to enforce the covenant unless he or she was bound to do so, for the covenantor's wife and legitimate children would often be affronted by the covenant[179] and implacably opposed to its enforcement. If, after 1840, a covenantee did not enforce such a covenant, in the absence of a trust no one had standing to do so, unlike the position with regard to marriage and family settlements.

The approach of the court to this problem is illustrated by the well-known case of *Fletcher v Fletcher*.[180] A settlor covenanted with trustees that his executors would pay a large sum of money to them within twelve months of his death, the money to be held upon trust for such of the settlor's two natural sons as should live to attain the age of 21 years and survive him. The trustees declined to enforce the covenant. Viscount Wigram held that the covenant could be enforced by a surviving illegitimate child on the grounds that the benefit of the covenant was held upon trust for him. If the benefit of the covenant were not held upon trust for the illegitimate son, the covenant would be virtually without purpose; clearly, the covenantee could not be relied upon in such a case to enforce the covenant. To use a modern formula, one may envisage that if the settlor were asked whether his son should be entitled to enforce the covenant, should the covenantee refuse to do so, the settlor would reply: 'yes, it goes without saying'.[181]

A variety of other kinds of covenants to settle property may also be held upon trust for prospective beneficiaries of a contemplated settlement of property. A covenant made by a de facto couple to regulate their financial obligations, for example, would surely be enforced, if need be, through the trust device, subject to considerations of public policy and overriding legislation.[182] So also would a covenant to transfer moneys to trustees which is given by a party to legal proceedings in order to settle the litigation ordinarily raise a trust of the covenant in favour of the class to be benefited.

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178 *Eastwood v Kenyon* (1840) 11 Ad & El 438.

179 For example, see *Williamson v Codrington* (1750) 1 Ves Sen 511 at 514.

180 (1844) 4 Hare 67; cf *Commissioner of Stamp Duties (Queensland) v Hopkins* (1945) 71 CLR 351 at 369.

181 *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 52 ALJR 20 at 26.

182 *De Facto Relationships Act* 1984 (NSW); *De Facto Relationships Act* 1991 (NT); *Property Law Act* 1958 (Vic), Part IX; cf *Sonenco (No 77) Pty Ltd v Silvia* (1989) ALR 437. Other States do not appear to have such legislation.

Indeed, whenever a covenant to settle property is of such significance that its enforcement ought not be left within the discretion of a covenantee, the court would carefully consider whether, in the circumstances, a trust should be inferred. Yet, because such a trust rests upon the presumed or inferred intention of the promisor, an intention to create a trust should not be inferred where it would operate unreasonably or inequitably against the promisor.[183]

Marriage settlements

The kinds of trusts most frequently created in the past were marriage and family settlements. A marriage settlement was one made or agreed to be made before and in consideration of marriage. Family settlements, or re-settlements, adjusted property rights within a family, usually on the eldest son coming of age, and were governed by rather different considerations to those which applied to marriage settlements. The two types of settlement, though clearly distinct, have sometimes been confused in the literature.[184] A covenant to settle property contained either in a marriage settlement (or marriage articles),[185] or in a family settlement[186] cannot be enforced by a volunteer who is not a party to the covenant. But a covenant contained in a marriage settlement (or in marriage articles) can be enforced by the husband or wife and also by the issue, who are treated as if they were parties to, and gave consideration for, the covenant.[187]

The principle that a covenant to settle property contained in a marriage settlement cannot be enforced by third party volunteers, unless the covenantor evinces a clear intention to hold it upon trust for them, although often criticised,[188] is soundly based. This is shown

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183 Cf *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 52 ALJR 20 at 27.

184 JL Barton, 'Trusts of Covenant' (1975) 91 *LQR* 236; JA Hornby 'Covenants in Favour of Volunteers' (1962) 78 *LQR* 228 at 234; DW Elliott, 'The Power of Trustees to Enforce Covenants in favour of Volunteers' (1960) 76 *LQR 100.*

185 *Re D'Angibau* (1880) 15 Ch D 228 especially at 242; *Re Anstis* (1886) 31 Ch D 596 at 607 per Lindley LJ; *Re Pryce* [1917] Ch 234; *Re Plumptre's Marriage Settlement* [1910] 1 Ch 609 especially at 618; cf *Davenport v Bishopp* (1843) 2 Y & CCC 451 (affirmed (1846) 1 Ph 698).

186 *Re Cook's Settlement Trust* [1965] Ch 902; *Re Kay's Settlement* [1939] Ch 329.

187 *Harvey v Ashley* (1748) 3 Atk 607 at 610; *Hill v Gomme* (1841) 5 M & C 250 at 254; *Attorney-General v Jacobs Smith* [1895] 2 QB 341; *Re Cook's Settlement Trust* [1965] Ch 902.

188 Eg JL Barton, 'Trusts and Covenants' (1975) 91 *LQR* 236; DW Elliott, 'The Power of Trustees to Enforce Covenants in Favour of Volunteers'

by the purpose of such covenants and the relationship between the parties affected by it.

In the eighteenth and nineteenth centuries, marriage settlements, whether or not they contained covenants to settle property, served two primary purposes. First, prior to the enactment of the Married Women's Property Legislation[189] they protected a wife's property from her husband, who on marriage would otherwise acquire title to her personal chattels and an interest in her lands.[190] Secondly, in a society in which the members of an elite were established in life at marriage, if not on coming of age, marriage settlements provided financially for the married couple, their children and perhaps grandchildren.[191] If one spouse died without leaving issue who lived to acquire a vested interest in the property settled, a well-drawn settlement specified who was entitled to the property on the death of the surviving spouse: property provided on behalf of the husband became his absolutely; property provided on behalf of the wife passed to her next-of-kin in certain circumstances. But the purpose of marriage settlements was to protect the wife and provide for both spouses and their joint issue, not to provide for the next-of-kin, persons whose identities were unknown at the date of the settlement. Underscoring the primary purpose of marriage settlement, in the 1920s eminent counsel stated:

> extraneous trusts are neither supported by the marriage consideration nor justified by the reasons the marriage furnishes for either spouse making the settlement.[192]

Covenants to settle after-acquired property contained in marriage settlements were ordinarily intended for the protection of a wife by extending the operation of the settlement to property acquired by her during her marriage.[193] This was necessary before the Married Women's Property Legislation because the common law rules, which applied so harshly to wives, caught both property owned by a wife at the date of her marriage and property acquired by her during the

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(1960) 76 *LQR* 100; JD Feltham, 'Note' (1982) 98 *LQR* 17; JA Hornby, 'Covenants in Favour of Volunteers' (1962) 78 *LQR* 228.

189 *Married Women's Property Act* 1882 (Eng) 45 & 46 Vict c 75; *Married Women's Property Act* 1886 (NSW); *Married Women's Property Act* 1884 (Vic); *Married Women's Property Act* 1883 (Tas).

190 16 *Hals* (2nd ed, 1935) pp 613-618; *Snell's Principles of Equity* (11th ed by Archibald Brown, 1894) pp 367-386.

191 *Abbott v Middleton* (1858) 7 HLC 68 at 93; *Re Plumptre's Marriage Settlement* [1910] 1 Ch 609 at 615.

192 JH Redman and JM Lightwood (eds), *The Encyclopaedia of Forms and Precedents* (2nd ed, Butterworths, 1925) p 20.

193 They rarely affected a husband's property: id at p 11.

marriage. After the enactment of the legislation the common law rules were largely abrogated but for a time wives were thought to need protection against their own improvidence.[194] By the turn of the century, however, covenants to settle after-acquired property were no longer covenants usually inserted in marriage settlements, for they had ceased to be necessary to protect wives.[195] One must suppose that their use in deeds of settlement after that date more often reflected a slavish adherence to precedents than a real desire to benefit next-of-kin. Accordingly, covenants to settle after-acquired property should not be treated as held upon trust, unless the provisions of a marriage settlement clearly require that result.

Moreover, third party volunteers have no moral claim to enforce covenants to settle contained in marriage settlements. A failure by the covenantor to perform the covenant ordinarily leaves the volunteers in no worse situation than if the covenant had not been made, reliance upon the covenant being rare. Further, whilst parents are morally bound to provide for their offspring, usually they are under no obligation to provide for their collateral relatives. Furthermore, pursuant to most marriage settlements executed before the second half of this century, property contributed to the settlement by a wife would pass ultimately, if she died in the lifetime of her husband without surviving issue, to her own next-of-kin, not to her husband's relatives. The benefits she received from her husband did not place her under a moral obligation to her own next-of-kin on the principle that she who receives the price of a promise should perform it.

In addition, enforcement of a wife's covenant to settle after-acquired property at the instance of her next-of-kin would frequently work unintended, inequitable and harsh results by depriving her of an absolute interest in her own property in circumstances in which the purpose of the marriage settlement was frustrated. This is illustrated by the well-known case of *Re Pryce*.[196] A marriage settlement executed after the commencement of the *Married Women's Property Act* 1882 (UK)[197] required a wife's after-acquired property to be settled on the wife for life, then upon the husband for life with remainder, if there were no surviving issue of the marriage, to the wife's next-of-kin. In 1904 the husband gave certain property to the wife; in 1907 he died leaving his wife surviving him. The trustees of the settlement commenced proceedings to determine whether the property given by

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194 Cf *Constantinidi v Ralli* [1935] Ch 427; cf *Re Plumptre's Marriage Settlement* [1910] 1 Ch 609 at 615.

195 *Re Maddy's Estate* [1901] 2 Ch 820.

196 [1917] 1 Ch 234; cf *Perpetual Trustee Co (Ltd) v Willers* (1955) 72 WN(NSW) 244.

197 45 & 46 Vict c 75.

the husband fell within the terms of the after-acquired property clause and whether they should sue the wife to recover it. Justice Eve held that although the property fell within the scope of the covenant, the benefit of the covenant was not held upon trust for the next-of-kin and the trustees should not enforce it.

Although the decision has been subjected to severe criticism,[198] Justice Eve's conclusion that the benefit of the covenant to settle property was not held upon trust for the next-of-kin appears unexceptional. The parties were unlikely to contemplate that the covenant would be enforced if the purpose of the settlement of which it was part were frustrated: they surely could not have expected or intended that the wife would be deprived of absolute enjoyment of her own property for the benefit of her next-of-kin.[199] Nor was the wife guilty of a breach of faith in failing to observe the covenant. But another aspect of his Lordship's judgment does cause difficulty. A direction by Eve J that the trustees take no steps to enforce the covenant is not adequately supported by his Lordship's reasoning. If this direction is to be justified, it must be on the principle that in circumstances such as those in *Pryce* the covenant to settle is held on trust for the covenantor[200] because its enforcement by the covenantee would produce an unintended and unfair result.

Covenants to settle after-acquired property contained in marriage settlements do not appear to have been enforced by volunteers after the enactment of the *Married Women's Property Act* 1882 (UK),[201] yet circumstances alter cases to such an extent that it would be unwise to suppose that a fixed rule has emerged which prevents such covenants being held by implication upon trust for third party volunteers. The purpose of a particular settlement, for example, may be wider than merely to provide for spouses and their issue; that purpose may require a covenant to settle be enforceable by third parties. Nevertheless, a covenant to settle property contained in a marriage settlement is not ordinarily the subject matter of a trust for the covenantor's next-of-kin.

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198 See, for example, JL Barton, 'Trusts and Covenants' (1975) 91 *LQR* 236; DW Elliott, 'The Power of Trustees to Enforce Covenants in Favour of Volunteers' (1960) 76 *LQR* 100; JA Hornby, 'Covenants in Favour of Volunteers' (1962) 78 *LQR* 228; RP Meagher, and JRF Lehane, 'Trusts of Voluntary Covenants' (1976) 92 *LQR* 427.

199 Cf Ford and Lee, *Principles of the Law of Trusts*, p 117; *Re Plumptre's Marriage Settlement* [1910] 1 Ch 609 (gift by husband to wife; wife predeceased husband, dying intestate).

200 Cf Hayton, *Underhill's Law Relating to Trusts and Trustees*, pp 130-131.

201 As to the position prior to this legislation see *Davenport v Bishopp* (1843) 2 Y & CCC 450 at 460.

The work of the court in regard to family settlements[202] and re-settlements[203] raises other questions of policy which lie outside the scope of this paper.[204]

A possible alternative: the constructive trust[205]

As the benefit of a covenant to settle property may be treated as the subject matter of a trust for the intended beneficiaries of the proposed settlement (where that is appropriate), resort to the doctrine of constructive trusts appears largely superfluous. As far as the present author is aware, constructive trusts have never been employed by the courts in this context.

Should a role exist for the constructive trust, it must be at the margins of the law. A covenantee who fails to enforce a voluntary covenant to settle property does not behave unconscionably for, *ex hypothesis*, she owes no duties to the third parties.[206] Moreover, a covenantor does not behave unconscionably in failing to honour a covenant, unless she is under a moral obligation to carry it out, which will rarely be the case.[207] Even where the covenantor acts in a manner that is unconscionable, the constructive trust approach is less satisfactory than the express trust analysis. As argued above in regard to contracts, imposition of a constructive trust may unsettle property rights and unfairly affect the covenantor's creditors. It is only where a covenantor is under a moral obligation to carry out her promise, but an express trust cannot be recognised, that the constructive trust will have a role to play. Such cases, it is submitted, are likely to be unusual.

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202 For example, see *Re Kay's Settlement* [1939] Ch 329.

203 *Re Cook's Settlement Trusts*[1965] Ch 902.

204 In *An Introduction to the Law of Trusts* (Clarendon Press, 1990) at pp 69 ff, S Gardner suggests that courts were unwilling to enforce covenants to settle because trusts restricted the free alienation of property. This suggestion must be doubted. In this century, changes in judicial attitudes to strict settlements are admittedly evident but these changes appear to be connected with alterations in revenue laws and social structures: revenue laws have made strict settlements unwise and the custom of providing financially for children on their marriage or attainment of majority has fallen into disfavour.

205 Resulting trusts will not arise in favour of third-party volunteers.

206 The position is different if an express trust has been declared, but in that case a constructive trust is redundant.

207 The question of moral obligations is explored at length above.

Conclusions

A comparison of the courts' approach to contracts for the benefit of third parties on the one hand and covenants to settle property on the other uncovers issues and solutions, common ground and differences that might otherwise escape attention. The common ground is most evident in regard to the creation of a trust of a contractual or voluntary promise by declaration of the promisee outside of the contract or deed in issue. Subject to compliance with any necessary formalities, a contractual promisee may, by words not embodied in a contract, validly declare themselves trustee of the contractual promise for the benefit of a third party, unless for a special reason the promisee is incapable of forming the subject matter of a trust. Equally, the grantor of a covenant that is entirely voluntary may, by words not embodied in the covenant, declare a trust of the covenant for the benefit of the prospective beneficiaries of a proposed settlement. The law with respect to contracts for the benefit of third parties and voluntary covenants to settle property is in this respect similar.

The difference between a contract and a covenant is most evident when a third party seeks to establish that the provisions of the instrument impliedly create a trust of a promise for his or her benefit. Of course, the rights of the third party are clear if the contract or deed provides expressly that the benefit of a promise is to be held upon trust for him or her, yet such cases are rare. Ordinarily, the existence of a trust for a third party is a matter of inference. Here the formal approach of the courts to contracts and covenants is similar: in both cases the language of the instrument, the circumstances in which it was made, and the relationship between the parties will all be weighed. But the manner in which this material is assessed in the two instances, especially in regard to the doctrine of necessity, presents as many differences as similarities. Considerations of commercial necessity are of high importance in the construction of many contracts but are usually irrelevant in the construction of covenants to settle property. Moreover, application of the broader doctrine of necessity to contracts on one hand and covenants on the other is affected by three influences: first, a contractual promisor's conscience is ordinarily bound but a covenantor's conscience may not be bound; secondly, contracts play an important economic role but a covenant to settle property may today serve no useful social or economic purpose; thirdly, no adequate mechanism may be available in a number of cases to enable a contract for the benefit of a third party to be enforced in the absence of a trust, but a covenant to settle property may be enforced fully by the covenantee unless the circumstances are exceptional. Further, in certain instances, to permit enforcement of a covenant to settle property through the trust device may produce

inequitable and unintended results that, typically, are not produced by enforcement of a simple contract.

The work of the courts in regard to covenants to settle property has often been misunderstood. Most criticism of it has been misguided.