

DOES A TRUSTEE'S FIDUCIARY DUTY TO THE TRUST PROHIBIT THE PURCHASE OF A TRUST ASSET?

Kuttel v Master of the High Court and Others (819/2021) [2022] ZASCA 156 (16 November 2022)

A transaction in which one's interest and duty conflict is generally not countenanced by the law. Thus, when a person in a fiduciary relationship purchases property in respect of which that relationship applies – e.g. when an executor of a deceased estate purchases property from the estate or when a trustee purchases property from the trust that he administers - conflict presents. What has crystallized from case law is that such transactions can, in exceptional circumstances, proceed if safeguards are in place, such as that a co-executor or co-trustee consents to the transaction which is otherwise bona fide and at arm's length. Where immovable property is involved, the court's oversight must be obtained in addition.

This conflict was debated in this matter, where a trust beneficiary attacked the acquisition of share assets of the trust, by two trustees. The attack was unsuccessful because, firstly, the sale of shares (as opposed to the sale of immovable property) did not require a court's consent, and secondly, because the trustees acted with transparency, with consent of other co-trustees and in good faith in an arm's length transaction.

The judgment provides practical insight into how such transactions must be approached, in order to allow for the exception from the general prohibition.

The Judgment can be viewed [here](#).

FACTS

Mr Kuttel and his wife set up the Padjoy Trust (the 'Trust') in March 1981. They had three sons. The trust deed provided that when both parents have passed away, the Trust's capital was to be distributed equally between their three sons, Peter, Francois and Adrian. Before that time, its assets were to be administered to ensure that Mr and Mrs Kuttel could enjoy their retirement years to the fullest.

Initially there were five trustees, including Francois and Adrian and two were independent trustees.

Peter, who has lived in the US for 30 years, was never a trustee. There was enmity between Peter and his father, in particular, as well as with the family more generally, which probably also contributed to him being the only beneficiary who is not a trustee.

In 2012, the trustees decided to re-structure the Trust's substantial assets. This was concluded in mid-2013. The purpose of the exercise was explained by the independent trustees to Peter upon his enquiry during 2017 as being, amongst other reasons, to: (a) provide liquidity in the Trust to fund the founder and his wife's retirement; (b) make certain cash distributions to Francois and Adrian, in accordance with the founder's wishes and in order to equalize their benefits with those that Peter had previously received; (c) consolidate the rope-making businesses of three entities (including Southern Ropes Pty Ltd ('Southern Ropes') at their fair value, in Grace Investments Thirty-Two (Pty) Ltd ('Grace Investments'); and (d) consolidate the remainder of the family's assets into the Trust, which would ultimately be shared by the three brothers equally.

This re-structuring included that the Trust's 81,6% shares in the business, Southern Ropes, were sold to Grace Investments for some R32 million. (Grace Investments is, in turn, owned in equal shares by two Namibian trusts that were established for the benefit of Francois and Adrian respectively, and their families.)

Peter was not informed of the Trust's re-structuring at the time. He only found out about it in 2017. On making enquiries with the trustees, he was informed that the purchase price of the Southern Ropes shares was 81.6 % of the average of two independent valuations procured for the very purpose of ascertaining their fair market value. He was also informed that the transaction had no effect on the Trust's balance sheet as one asset had simply been substituted for another of equal value.

Peter took exception to not having been informed of the transaction at the time. He said that had he known about the intention to sell the shares in Southern Ropes, he would have made a 'counter-offer' to purchase the shares. Also, despite the two independent valuations serving as the basis for the determination of the purchase price, he said the transaction was not an arms-length transaction.

Peter began a process to have himself appointed as a trustee, but this was unsuccessful. He then reverted to the attack on the Southern Ropes transaction on the basis that a court's confirmation is required for the purchase of immovable property by a trustee even when co-trustees have authorized the sale and that, in this case, the sale of the shares amounted to the sale of immovable property. For this reason, he alleged that the contract of sale was invalid and that the shares had to be returned by Grace Investments to the trustees.

Peter thus launched an application in the High Court, Cape Town for an order, amongst others, declaring the agreement concluded between the trustees and Grace Investments for the sale of the Trust's shares in Southern Ropes unlawful.

The application was unsuccessful and that Court also refused leave to appeal. The present matter deals with Peter's appeal to the Supreme Court of Appeal for an order that he may appeal the High Court judgment. In the Supreme Court of Appeal, Peter claimed that:

- a. A court's confirmation should have been obtained for the Southern Ropes transaction, with the result that the transaction was invalid.
- b. The transaction was, in any event, not open and *bona fide* and had to be set aside as a result.
- c. He was treated in an unfair way because he was not informed of the restructuring and that, on account of this, the transaction was invalid.

HELD

The trust deed and the decision to restructure: background

- The trust deed did not have a provision that required that beneficiaries be notified or consulted when the trustees exercised the discretionary powers granted to them in the trust deed, and, in any event, the shares in Southern Ropes were sold at fair market value, independently determined. The trust deed further did not require that beneficiaries or any other party should be afforded an opportunity to bid for the shares in such an instance.
- The trustees decided to sell the Southern Ropes shares as part of the restructuring and to realise an asset that would ensure that the founder and his wife could live out their remaining years in comfort, as was the intention of the trust deed.
- The facts showed that decisions concerning the restructuring were not taken lightly. The trustees considered the issue with care and took legal and tax advice from prominent attorneys in South Africa and another in the United States of America. After having done so, the trustees applied their minds, considered the purpose of

the restructuring process, the purposes for which the Trust was established and they decided to sell the Southern Ropes shares at an independently-determined market value. The trustees in any event had the power to sell the shares and invest the proceeds 'in such manner as they shall determine'. The trustees were further empowered to 'make such investments as they shall in their sole and entire discretion from time to time determine'; and they also had the power to purchase both immovable and movable property and to sell, either by public auction or private treaty, 'any immovable or movable property held in trust by them in such manner and at such times as they shall from time to time determine'.

- Adrian and Francois 'openly and in good faith disclosed their interests in the transactions before the agreements were concluded (their interests, in any event, already being known) and obtained the consent of all of the trustees'.

Judicial confirmation of the transaction

- Peter argued that the failure by the trustees to obtain judicial confirmation of the Southern Ropes transaction resulted in its invalidity, this because "modern custom" dictated that a court's confirmation was required - at least for the purchase of immovable trust property by a trustee (even when a co-trustee has confirmed it).
- The response hereto was two-fold: First, it is so that when a person in a fiduciary relationship purchases property in respect of which that relationship applies – such as, typically, when an executor of a deceased estate purchases property from the estate, or when a trustee purchases property from the trust that they administer – the general rule is that such person is incapable of binding the estate/trust which he or she is administering. The underlying principle is the universally respected one that no transaction where interest and duty conflict should be countenanced by the law.
- But the general rule is subject to exceptions, being instances where the circumstances are such as to guarantee that the terms of the contract is not influenced by the conflict between the purchaser's interest and his duty (as executor, administrator, trustee, etc), for instance, where he has openly and in good faith sought and obtained the consent of a co-administrator (or co-trustee or co-executor, as the case may be) who was capable of bringing an independent mind to bear on the question as to whether the contract would be for the benefit of the estate.
- There is a final, additional safeguard that applies in some cases. In South Africa, the practice has become settled of requiring the confirmation of the court in every case of the sale of immovable property belonging to a deceased's estate to an executor, similarly also in the case where trust property is bought by a trustee.
- However, and as the second answer to the question, the purchase of shares is not the same as the purchase of immovable property. In this regard, Peter argued that the sale of shares, when the company concerned owns immovable property, is akin to the sale of the company's immovable property. This proposition is fundamentally flawed and cannot succeed.

Was the transaction open and bona fide?

- In cases in which a co-trustee obtains the consent of their co-trustee to purchase trust property, the sale must, in addition, be open and *bona fide*.
- In this matter, the independent trustees had explained how the trustees took their decision. First, Francois and Adrian disclosed their interests and did so openly and in good faith, although the other trustees obviously knew of those interests. Secondly, they took independent advice from separate attorneys. Thirdly, they obtained two independent valuations of the fair market value of the shares and set the purchase price with

reference to the average of the two valuations. Fourthly, the trustees applied their minds to their powers in terms of the trust deed, the purpose of the restructuring and the purposes for which the Trust had been established. Fifthly, having done so, they satisfied themselves that neither the Trust nor the beneficiaries would be prejudiced by the transaction. Sixth, the trustees also satisfied themselves that neither Francois nor Adrian had abused their power by acting contrary to the best interests of the beneficiaries. Finally, having gone through this process, the trustees consented to the transaction.

- There was therefore no basis for an attack on the fairness of the valuations or that the purchase of the shares by Grace Investments was not open and *bona fide*.

Was there unfair differentiation?

- Peter alleged that he should have been informed of the Southern Ropes transaction and that the failure on the part of the trustees to do so was 'disconcerting, unfair and inappropriate' and, had he been informed, he would, in all probability, have offered a higher purchase consideration for the shares.
- However, the trust deed did not require of trustees to give such notification or opportunity to make an offer, to beneficiaries or third parties. In fact, their powers under the trust deed were wide and of a discretionary nature. They could realise assets or investments 'in such manner as they shall determine'; invest assets 'as they shall in their sole and entire discretion' determine and acquire and dispose of movable and immovable property 'in such manner and at such times as they shall from time to time determine', amongst other things.
- Peter, as a beneficiary had no right to be informed of the trustees' plans or to be offered an opportunity to bid for the Southern Ropes shares. His rights were restricted to his equal share of the capital on vesting. That contingent right was safeguarded by the trustees by the open and bona fide nature of the Southern Ropes transaction, the fair process for determining the purchase price and the zero-sum effect of the transaction on the assets of the Trust.

CONCLUSION

The application for leave to appeal therefore failed.