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**Lack of protection of outsiders in dealings with trusts**

**by**

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## Lack of protection of outsiders in dealings with trusts

### Table of Contents

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Chapter 1	Introduction and problem statement.....	3
1 1	Introduction .....	3
1 1 1	Reasons for creating a trust.....	5
1 1 2	The “basic trust idea” .....	7
1 1 3	The “newer type of trust”.....	9
1 1 4	Who are “ <i>bona fide</i> outsiders?”.....	10
1 2	Problem statement: Scenarios relating to lack of outright protection of “ <i>bona fide</i> outsiders” in dealings with trusts.....	11
1 2 1	<i>Vrystaat Mielies (Edms) Bpk v Nieuwoudt and Nieuwoudt v Vrystaat Mielies (Edms) Bpk</i> .....	12
1 2 2	<i>Land and Agricultural Bank of South Africa v Parker</i> .....	13
1 2 3	<i>Nedbank Ltd v Thorpe</i> .....	14
1 2 4	<i>Van Zyl v Kaye</i> .....	16+
1 3	Consequences of a valid trust being “abused” compared to consequences of a “sham” or invalid trust.....	18
1 4	Research methodology and chapter outline.....	18
Chapter 2	An abused valid trust or the “alter ego”, compared to a “sham” and the consequences thereof .....	20
2 1	Introduction .....	20
2 2	The “sham” or invalid trust.....	21
2 3	Consequences of a “sham” or invalid trust.....	24
2 4	An abused valid trust or the “alter ego”.....	24
2 5	Consequences of an abused valid trust or the “alter ego” .....	28
2 6	Conclusion .....	30
Chapter 3	The history of third party protection in South African law of trusts.....	32
3 1	Introduction .....	32
3 2	<i>Land Agricultural Bank of South Africa v Parker</i> .....	32
3 2 1	Facts .....	32
3 2 2	Court’s judgment and <i>ad hoc</i> relief offered to the “ <i>bona fide</i> outsider” .....	33
3 3	<i>Nieuwoudt v Vrystaat Mielies (Edms) Bpk</i> .....	35
3 3 1	Facts .....	35
3 3 2	Court’s judgment and <i>ad hoc</i> relief offered to the “ <i>bona fide</i> outsider” .....	37
3 4	<i>Thorpe v Trittenwein</i> .....	38

3 4 1	Facts .....	38
3 4 2	Court's judgment and <i>ad hoc</i> relief offered to the "bona fide outsider" .....	39
3 5	<i>Nedbank Ltd v Thorpe</i> .....	40
3 5 1	Facts .....	40
3 5 2	Court's judgment and <i>ad hoc</i> relief offered the "bona fide outsider" .....	41
3 6	<i>Van der Merwe v Hydraberg Hydraulics CC; to Van der Merwe v Bosman</i> .....	42
3 6 1	Facts .....	42
3 6 2	Court's judgment and <i>ad hoc</i> relief offered to the "bona fide outsider" .....	43
3 7	<i>Khabola v Ralitabo</i> .....	46
3 7 1	Facts .....	46
3 7 2	Court's judgment and <i>ad hoc</i> relief offered to the "bona fide outsider" .....	46
3 8	<i>First National Bank v Britz</i> .....	47
3 8 1	Facts .....	47
3 8 2	Court's judgment and <i>ad hoc</i> relief offered to the "bona fide outsider" .....	49
3 9	<i>Rees v Harris</i> .....	50
3 9 1	Facts .....	50
3 9 2	Court's judgment and <i>ad hoc</i> relief offered to the "bona fide outsider" .....	51
3 10	Conclusion.....	52
Chapter 4	Proposed <i>ad hoc</i> solutions to the abuse of trust the form and development of the trust law .....	54
4 1	Introduction .....	54
4 2	The <i>Turquand</i> rule.....	57
4 3	Appoint an independent outsider as co-trustee.....	64
4 4	"Piercing the veneer" of a trust or "going behind the trust form" .....	68
4 5	Agency versus joint action rule .....	74
4 6	Possible development of certain provisions in the Trust Property Control Act 57 of 1988 .....	76
4 7	Conclusion .....	83
Chapter 5	Conclusion.....	85
BIBLIOGRAPHY	.....	88
Books.....	.....	88
Journal Articles .....	.....	90
Internet Sources.....	.....	92
Statutes and Regulations .....	.....	94
Case register.....	.....	95

## Chapter 1 Introduction and problem statement

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### 1 1 Introduction

The South African law of trusts is well established and can hold its own in comparison to other countries. It is correct to say that a unique South African law of trusts, based on Roman-Dutch law principles, but also influenced by the English law was developed by the legislature, courts and legal practitioners in order to satisfy modern requirements of practice.<sup>1</sup> In *Braun v Blann and Botha*<sup>2</sup> Joubert JA observed that South African courts have evolved and are in the process of evolving our own law of trusts by adapting the trust idea to the principles of our own law.

A trust in a narrow sense<sup>3</sup> is said to exist when one person (the founder) hands over or is bound to hand over the control of property to another (the trustee) which property and/or its proceeds is to be administered by the trustee for the benefit of some person or persons (the beneficiary) or in pursuance of an impersonal object.<sup>4</sup> Today the trust is regulated by the Trust Property Control Act.<sup>5</sup> The Act is not a complete codification of the law of trusts. Some aspects are still governed by the common law and developed in certain circumstances.<sup>6</sup> As a result of the Act a statutory definition of “trust” was introduced into South African law.<sup>7</sup> It is clear from the definition of “trust” that the persons involved in the establishment and administration of the trust are the founder, the trustee and the beneficiaries. The Act is devoted to regulate the control of trust property and to provide for matters connected therewith, such as establishing firmer control over trustees and their

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<sup>1</sup> *Braun v Blann and Botha* 1984 (2) SA 850 (A).

<sup>2</sup> 1984 (2) SA 850 (A) 859E-G.

<sup>3</sup> In a wide sense, a “trust” is a generic term referring to any legal arrangement in terms of which a functionary controls and administers property on behalf of another, or in pursuance of an impersonal goal – *Conze v Masterbond Participation Trust Managers* 1993 (3) SA 786 (C) 794D-E. This mini-dissertation only deals with a trust in a narrow sense.

<sup>4</sup> Abrie *et al Estates: & Financial Planning* (2003) 27-28.

<sup>5</sup> Act 57 of 1988 herein after “the Act”.

<sup>6</sup> For example, the juristic nature of the trust *inter vivos* and the fiduciary obligation of trustees.

<sup>7</sup> Stafford “A legal-comparative study of the Interpretation and application of the Doctrines of the sham and the alter-ego in the context of South African trust Law: The dangers of translocating company Law principles into trust law (2010) LLM Thesis 10

administration of the trust by the Master of the High Court,<sup>8</sup> all for the benefit of the beneficiaries. The Act imposes several duties on trustees and the most notable duty is the duty to act with care, diligence and skill.<sup>9</sup> Other duties in the Act include<sup>10</sup> the duty to lodge the trust instrument with the Master,<sup>11</sup> furnish the Master with an address for the service of notices and processes,<sup>12</sup> obtain written authorization from the Master to act as trustee,<sup>13</sup> bank all monies of the trust,<sup>14</sup> register and identify trust property,<sup>15</sup> protect trust documents,<sup>16</sup> account to the Master when requested to do so,<sup>17</sup> take reasonable remuneration,<sup>18</sup> and to perform all duties imposed by the trust instrument. Beneficiaries also enjoy rights and have privileges,<sup>19</sup> though not as a direct result of the Trust property Control Act; but as a result of the trust instrument. With the arrival of the “newer type of trusts”, trustees acting on behalf of “family business trusts”<sup>20</sup> engage in business dealings with “*bona fide* outsiders”,<sup>21</sup> binding

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<sup>8</sup> This is achieved by, for example, requiring trustees to lodge their trust instruments with the Master of the High Court - s 4 of the Act, to furnish the Master with an address for the service of notices and process - s 5 of the Act, and to obtain from the Master a written authorisation to act in the capacity of trustee - s 6 of the Act. Of prime importance is s 12 of the Act which clarifies the position in regard to personal estate of the trustee in relation to the trust property. Other important sections in the Act are s 13 which defines the powers of the court to vary provisions of the trust and s 9(2) which deals with the standard of care, diligence and skill required of a trustee in the performance of his duties and the exercise of his powers.

<sup>9</sup> S 9 of the Trust Property Act – this duty entails that a trustee is obliged to conduct the administration of a trust in the utmost good faith as a trustee and such standard of care is defined by the common law principle of a *bonus et diligens paterfamilias*.

<sup>10</sup> Stafford 29.

<sup>11</sup> S 4 of the Act.

<sup>12</sup> S 5 of the Act.

<sup>13</sup> S 6 of the Act.

<sup>14</sup> S 10 of the Act.

<sup>15</sup> Sec 11 of Act.

<sup>16</sup> S 17 of the Act.

<sup>17</sup> S 16 of the Act.

<sup>18</sup> S 22 of the Act.

<sup>19</sup> They may benefit either as capital and/or income beneficiaries, vested or discretionary beneficiaries, and /or have fixed or variable benefits.

<sup>20</sup> In *Land and Agricultural Bank of South Africa v Parker* 2005 (2) SA 77 (SCA) para [25], Cameron JA describes a “family trusts” as those designed to secure the interests and protect the property of a group of family members, usually identified in the trust deed by name or descent or by degree of kinship to the founder which is primarily used for carrying on a business for profit. With regard to a definition of a business trust, Pace states that the question whether a trust is a business trust or not only has a bearing on the so-called classification of trusts between private trusts and public trusts and has no specific meaning, even for tax purposes. The business trust is not really susceptible to an intrinsic description and can, therefore, only be defined at the hand of certain external factors or in terms of its surrounding circumstances. On its own, these are also not conclusive but are merely indicative of the purpose for which the trust was created. It is therefore not a separate kind of trust, but the terms “business” or “trading trust” merely refer to one of the uses or application possibilities of a trust. Pace refers to the reference in *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) 493F–G where Harms JA refers to “a newer type of trust” and the reference in *Parker* para [25] where Cameron JA refers to “certain types of business trusts” used by families - Pace and van der Westhuizen “Wills and Trusts” [http://dojcdnoc-ln1/nxt/gateway.dll?f=templates\\$fn=default.htm\\$vid=mylnb:10.1048/enu](http://dojcdnoc-ln1/nxt/gateway.dll?f=templates$fn=default.htm$vid=mylnb:10.1048/enu) (accessed 09 February 2015).

<sup>21</sup> See para 1 1 4 for the definition of a “*bona fide* outsider”.

trust property and thereby drawing the latter into the trust relationship. Often these outsiders do not know that they are actually dealing with trustees who are purportedly acting on behalf of a trust. When the “*bona fide* outsider” seeks to enforce a contract entered with the founder/ trustee, the latter will raise unscrupulous defences and use the “veneer of the trust” just to try to protect himself against fraud and dishonesty charges. “*Bona fide* outsiders” are also unaware of the consequences of such actions and tend to look to the Trust Property control Act for a remedy. It is then that they realize that the Act and the common law cannot assist in the predicament, and the only form of relief is through the courts. A prudent “*bona fide* outsider” may try to invoke the provisions of section 18<sup>22</sup> of the Trust Property Control Act to force disclosure of the trusts deed and other information from the Master. However, this may prove futile for the “*bona fide* outsider” who first has to make an application to the Master to inspect the trust deed, and the latter, in the exercise of his discretion may refuse access to the required documents because the “*bona fide* outsider” is not “*a person with sufficient interest in such documents*”.<sup>23</sup> As a result a question can be asked whether what measures are available in South Africa for the protection of the interest of “*bona fide* outsiders” who engage in business dealings with trusts.

The purpose of this dissertation is therefore to explore how the South African law of trusts often fails to protect the interests of “*bona fide* outsiders” in dealings with trusts and to provide possible solutions for the problem.

### 1 1 1 Reasons for creating a trust

*Inter vivos* trusts have become very popular and are used for a variety of purposes, mainly because of their flexibility and the relative ease with which they can be established.<sup>24</sup> For example, a founder may use a trust to protect and care for his minors and/or surviving spouse, to put some or all of his assets out of reach of

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<sup>22</sup> S 18 of the Act provides as follows: “Subject to the provisions of section 5(2) of the Administration of Estates Act, 1965 (Act 66 Of 1965), regarding the documents in connection with the estate of a deceased person, the Master shall upon written request and payment of the prescribed fee furnish a certified copy of any document under his control relating to trusts property to a trustee, or his surety or his representative or any other person who in the opinion of the Master has sufficient interest in such document.

<sup>23</sup> Own emphasis.

<sup>24</sup> *Land and Agricultural Bank of South Africa v Parker* 2005 (2) SA 77 (SCA) para [23] (hereafter *Parker*).

creditors or for purposes of estate planning in order to minimize estate duty on his death. Trusts continue to be popular for business purposes rather than the usual company, close corporation or partnership.<sup>25</sup> Cameron JA states as follows:<sup>26</sup>

“So long as the functions of trusteeship remain essentially distinct from the beneficial interests, there can be no objection to business trusts, since the mechanism of the trust form will conduce to their proper governance, which will in turn provide protection for outsiders dealing with them.”

Cameron JA basically emphasised that the use of the trust instrument as a vehicle to transact business, is not undesirable. The author is of the view that the Judge implies that a validly created trust which is administered properly by its trustees will not only contribute to the proper governance of business transactions undertaken by trustees in their dealings with “*bona fide* outsiders”, but will also provide the latter with some form of protection. The author supports this contention and will explore it further in chapter 4 below as one of the possible solution for the problems facing “*bona fide* outsiders” who have business dealings with trusts.

Trusts are being put to many uses in practice because of their flexibility and the relative ease with which they can be established<sup>27</sup> In *Parker*<sup>28</sup> the Supreme Court of Appeal observed as follows:

“The great virtue of the trust form is its flexibility, and the greater advantage of trusts is their relative lack of formality in creation and operation: ‘the trust is an all-purpose institution, more flexible and wide-ranging than any of the others’. It is the separation of enjoyment and control that has made this traditionally greater leeway possible. The courts and legislature have countenanced the trust’s relatively autonomous

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<sup>25</sup> Cameron *et al* *Honoré’s South African Law of Trusts* (2002) 19.

<sup>26</sup> *Parker* para [24]. See criticism by Theron “Regulering van die Besigheidstrust” *SALJ* 1991 277: a potential problem is the absence of any disclosure requirements for the business trust when dealing with the general public, especially in the light of its limited liability. There are views that the general public should be offered better protection in the form of legislation. See also Wunsh “Trading and Business Trusts” 1986 103 *SALJ* 561.

<sup>27</sup> Du Toit *South African Trust Law Principles and Practice* (2007) 169 – testamentary trusts are used to dispose of assets after death of the testator to the survivor, descendants and beneficiaries with limited capacity, to hold non-sub divisible property. *Inter vivos* trusts are used for estate and financial planning; see Du Toit (2007) 177-179.

<sup>28</sup> 2005 (2) SA 77 (SCA) 87 para [23]; also quoted in *Van der Merwe v Hydraberg Hydraulics CC; Van der Merwe v Bosman* 2010 (5) SA 555 (WCC) 567 para [33]

development and administration because the structural features of “the ordinary trust” tend to ensure propriety and rigour and accountability in its administration.”

It is because of its flexible nature that more trusts are now also used for business purposes.<sup>29</sup> It is also under these circumstances that “*bona fide* outsiders”, who are not party to the trusts,<sup>30</sup> are drawn into doing business with such trusts, often to their own detriment.<sup>31</sup> What happens is that the founder of the trust donates or sells assets to a trust in order to minimize estate duty or to put assets out of reach of creditors. All this is done under the pretext of severing ownership (or control) of the “trust property” from enjoyment. He often, however, does not have the actual intent to relinquish absolute control of the property. There is no actual divestment of ownership (or control) from enjoyment of the property in question. The founder continues to own (or control) the trust property and retains the income and/or some other benefit from it. On the face of it the arrangement, in general, seems lawful and impossible to prevent. However, “going behind the trust”<sup>32</sup> and its trust deed,<sup>33</sup> coupled with evidence of its administration, may reveal serious abuse, or misuse of the trust form, especially because issues of abuse of the trust are normally kept secret.

### 1 1 2 The “basic trust idea”

The “basic trust idea” is reflected in the definition of a “trust” in section 1 of the Act. Section 1 of the Act defines a trust as:

“...the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed

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<sup>29</sup> See criticism by Theron “Regulering van die Besigheids trust” (1999) *SALJ* 277.

<sup>30</sup> There are basically three parties to trusts, the founder, trustee(s) and a beneficiary or beneficiaries.

<sup>31</sup> See for example *MAN Truck & Bus (SA) Ltd v Victor* 2001 (2) SA 562 (NC); *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA); *Parker* 2005 (2) SA 77 (SCA); and *Nedbank Ltd v Thorpe* 2008 JOL 22675 (N) etc. See the discussion of the cases in ch 3.

<sup>32</sup> See ch 4 for the discussion on “going behind the trust”.

<sup>33</sup> This is why it is important for an *inter vivos* trust to have a written trust deed or “constitutive charter” lodged with the Master of the High Court, and if not, to arrange for the oral contract of trust to be reduced to writing as soon as possible and be lodged with the Master, as the provisions of the Act do not apply to an oral trust (since 31 March 1989 - s 2 of the Trust Property Control Act). This will also ensure the availability of a trust deed when a need arises to clarify matters of trust administration and to check compliance with the minimum requirements for a valid trust and the possibility of the abuse of “the core idea” or “the essential notion” underlying the trust form as a legal concept.

- (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or
- (b) to beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument or for the achievement of the object stated in the trust instrument.

but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estate Act<sup>34</sup>

The “basic trust idea”, or core idea of a trust, arises from this definition and is further interpreted by the courts<sup>35</sup> and legal practitioners. What is common throughout is that the trust concept entails the element of holding or administering property for a person or object other than the trustee.<sup>36</sup> Cameron *et al*<sup>37</sup> summarise the “basic trust idea” in his definition of a trust as a legal institution where a trustee administers property “separately” from his own property. In *Parker*,<sup>38</sup> Cameron JA reiterates the “basic trust idea” as “the separation of ownership (or control) from enjoyment.”<sup>39</sup>

The most important characteristic of the “basic trust idea” lies within the separation requirement. Failure to adhere to this basic guideline usually leads to an abuse or misuse of the trust figure for some personal gain or advantage by the founder and

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<sup>34</sup> Act 66 of 1965. According to the Act, ownership of the trust property may vest in either the trustee (ownership trust) or beneficiary (bewind trust). In a bewind trust (as denoted in part (b) of the s 1) ownership of the trust assets rests with the beneficiary and the trustee only administers the trust assets. In an ownership trust the founder hands over control and ownership of the trust assets to the trustee.

<sup>35</sup> *Braun v Blann and Botha* 1984 (2) SA 850 (A) 859F-G; Du Toit “Beyond Braun: An examination of some interesting issues from recent decisions on trusts” 2001 *TSAR* 123. Also *Parker* 86 para [19]

<sup>36</sup> *Goodricke v Registrar of Deeds, Natal* 1974 (1) SA 404 (N) 408.

<sup>37</sup> *Cameron et al* (2002) 1.

<sup>38</sup> *Parker* para [19].

<sup>39</sup> The court points out that though a trustee can be the sole beneficiary, the central notion is that the person entrusted with control exercises it on behalf of and in the interest of another, and that is the reason why a sole trustee cannot also be the sole beneficiary. Such a situation would embody an identity of interest that is inimical to the trust idea, and no would trust would come into existence.

his family.<sup>40</sup> The duties imposed on trustees, and the standard of care demanded of them, derive from the separation requirement. It is this separation that serves to secure diligence on the part of the trustee.<sup>41</sup> The same separation tends to ensure independence of judgment on the part of the trustee (an indispensable requisite of office) as well as careful scrutiny of transactions designed to bind the trust, since an independent trustee can have no interest in concluding transactions that may prove invalid.<sup>42</sup> Where a founder, trustee and his family fail to observe the “basic trust idea”, it often leads to an abuse of the trust form, forcing the wronged third party to constantly approach the court for recourse. It is the non-compliance with this separation requirement that leads to the most cases of abuse of the trust instrument. In the last decade there has been an increase in the abuse or misuse of the trust form. This increase in the abuse can be traced to the evolution of a so-called “newer type of trust” in South Africa.<sup>43</sup>

### 1 1 3 The “newer type of trust”

The essential notion of trust law is that enjoyment and control should be functionally separate.<sup>44</sup> However, this has changed and the change has come principally because certain types of business trusts have developed in which functional separation between control and enjoyment is entirely lacking. This is particularly so in the case of “family business trust” – those designed to secure the interests and protect the property of a group of family members, usually identified in the trust deed by name or by descendant or by degree of kinship to the founder.<sup>45</sup> In *Nieuwoudt v Vrystaat Mielies (Edms) Bpk Harms JA*<sup>46</sup> observed:

“The trust deed in this case is typical of a newer type of trust where someone, probably for estate planning purposes or to escape the constraints imposed by corporate law, forms a trust while everything else remains as before.”

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<sup>40</sup> See ch 3 below. See also Harding M “Importance of adhering to the basic trust idea in the formation and administration of trusts” (2012) LLM mini dissertation.

<sup>41</sup> *Parker* para [22].

<sup>42</sup> *Ibid.*

<sup>43</sup> In *Braun v Blann and Botha* 1984 (2) SA 850 (A) 859E-G Joubert JA predicted that the law of trust will evolve within the South African legal sphere. See *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) in ch 3 para 3 3 where the case is discussed.

<sup>44</sup> *Parker* para [19].

<sup>45</sup> *Parker* para [24]-[25].

<sup>46</sup> 2004 (3) SA 486 (SCA) 493 [17].

The main characteristic of the “newer type of trust” is the retention of ownership (or control) and enjoyment of the trust assets, by the founder/trustees by making use of the trust property as if it is still part of his/their personal property. The “basic trust idea” is abused in such cases because the trust form is employed not to separate beneficial interest from control, but to permit everything to remain ‘as before’, though now on terms that privilege those who enjoy benefit as before while simultaneously continuing to exercise control.<sup>47</sup> Often “*bona fide* outsiders” enter into detrimental business transactions with the so-called “newer type of trust”<sup>48</sup> simply because they are unaware of the consequences of such actions.

#### **1 1 4 Who are “*bona fide* outsiders?”**

“*Bona fide*” is a Latin phrase for good faith which means:

“Something genuine, lawful, or made or done in good faith, which signifies the mental state of honesty as to the truth or falsehood of a proposition or opinion, or as to the morality of conduct.”<sup>49</sup>

For purposes of this dissertation a “*bona fide* outsider” refers to any person, or entity, that has any dealings with a trust and as a result thereof might have a possible claim against the trustee (in his personal capacity), on the basis that the trustee might have abused the trust form or his position as trustee of the trust.

The most common form of abuse is by using the trust as an “alter ego” of the founder<sup>50</sup> and thus rendering the trust as a “veneer which can be pierced” and the founder/trustee runs the risk that trust assets may be treated as his own personal assets, thereby exposing those assets to attack by a person who might have a claim against the trust, such as;

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<sup>47</sup> *Parker* para [26].

<sup>48</sup> See *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) in ch 3 para 3 3 where the case is discussed.

<sup>49</sup> The Free Legal Dictionary at <http://legal-dictionary.thefreedictionary.com/bona+fide> accessed 19 July 2013.

<sup>50</sup> *Badenhorst v Badenhorst* 2005 (2) SA 253 (C).

- a) The South African Revenue Services in respect of estate duty on the founder/trustee's death in terms of section 3(3)(d) of the Estate Duty Act;<sup>51</sup>
- b) a personal creditor ( for example, a bank) upon insolvency;<sup>52</sup> and/or
- c) a trust creditor.<sup>53</sup>

Other possibilities which will not be elaborated on in this dissertation are:

- a) A divorcing spouse, pursuant to a court's discretion in terms of sections 7(3), 7(4) and 7(5) of the Divorce Act 70 of 1979;<sup>54</sup>
- b) A spouse upon dissolution of the marriage (by death or divorce) in the calculation of the accrual value in terms of section 3 of the Matrimonial Property Act 88 of 1984.<sup>55</sup>

## **1 2 Problem statement: Scenarios relating to lack of outright protection of “*bona fide* outsiders” in dealings with trusts**

The typical problem relating to lack of protection of “*bona fide* outsiders” will, for purposes of this dissertation, be explained through four scenarios. After examination of the Trust Property Control Act<sup>56</sup> it was clear that the Act does not provide any form of remedy for “*bona fide* outsiders” in their dealings with “family business trusts”. The moment the “*bona fide* outsider” realizes that he cannot invoke the provisions of the Trust Property Act to enforce performance in terms of the agreement, the next step is to ask the court to either declare the trust a “sham” or to “go behind the trust” to try and find assets against which it can be executed. The purpose of the scenarios below is to illustrate the dilemma facing “*bona fide* outsiders” in their business dealings with trusts.

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<sup>51</sup> *Badenhorst v Badenhorst* 2006 (2) All SA 363 (SCA).

<sup>52</sup> *Nedbank Ltd v Thorpe* 2008 JOL 22675 (N).

<sup>53</sup> *First Rand Limited trading inter alia as First National Bank v Britz* [2011] ZAGPPHC 119 20 July 2011 (unreported).

<sup>54</sup> *Badenhorst v Badenhorst* 2006 (2) All SA 363 (SCA).

<sup>55</sup> *Jordaan v Jordaan* 2001 (3) SA 288 (C); *Badenhorst v Badenhorst* 2006 (2) All SA 363 (SCA); see also *BC v CC* 2012 (5) SA 562 (ECP) and *MCM v JCM* (KZN) Case no: 9758/2011. See ch 2 para 2 3 for criticism of the *BC v CC* case.

<sup>56</sup> Para 1 1 above.

## 1 2 1 *Vrystaat Mielies (Edms) Bpk v Nieuwoudt*<sup>57</sup> and *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*<sup>58</sup>

In *Vrystaat Mielies (Edms) Bpk v Nieuwoudt*,<sup>59</sup> Nieuwoudt (in his capacity as one of two trustee of the JJ Boerdery Trust) concluded an agreement with C & W Landboudienste (the close corporation), in terms of which the close corporation purchased a certain quantity of mealies from the trust. The close corporation's rights under the agreement were subsequently ceded to Vrystaat Mielies (Edms) Bpk (the applicant in the court *a quo*). Later it transpired that Nieuwoudt had not been authorized by a resolution of the trustees to conclude the agreement, and that neither the close corporation nor Vrystaat Mielies had been aware of this state of affairs.<sup>60</sup>

The court held that the trust deed in question had authorized the contract and it had authorized the appointment of a single trustee to contract on behalf of the trust. The court allowed application of the *Turquand* rule,<sup>61</sup> and held that the fact that a single trustee had entered into the contract in the absence of a resolution by the trustees, and hence without actual authority to contract, did not render the contract voidable. The trust was accordingly bound to honour the agreement.

On appeal against the judgment of the court *a quo* the Supreme Court of Appeal in *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*,<sup>62</sup> had to determine whether there was a binding agreement between the parties. Harms JA (in passing) questioned the judgment in *MAN Truck & Bus (SA) Ltd v Victor*<sup>63</sup> where it was held that the *Turquand* rule applies to trusts. In the *MAN Truck* case a trustee had entered into a suretyship agreement without the knowledge and consent of his fellow trustee. The court ruled that the lack of consent was no defence to a claim based on suretyship

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<sup>57</sup> 2003 (2) SA 262 (O).

<sup>58</sup> 2004 (1) All SA 396 (SCA).

<sup>59</sup> 2003 (2) SA 262 (O).

<sup>60</sup> Para [4].

<sup>61</sup> In para [12] the court further held that the applicability of the *Turquand* rule to transactions between trusts and third parties was essential and had to be accepted *in casu*. Note that this decision was later reversed on appeal and the court left open the question of the applicability of the *Turquand* rule to business trusts. The applicability of the rule is also criticized by McLennan "Contracting with business trusts" (2006) 18 *SA Merc LJ* 329–335. More on the *Turquand* rule and doctrine of construction in ch 4.

<sup>62</sup> 2004 (1) All SA 396 (SCA).

<sup>63</sup> 2001 (2) SA 562 (NC).

agreement because the act of obtaining the co-trustee's consent was an act of internal management and claimant, on the basis of the *Turquand* rule, was entitled to assume that the act had been duly and properly performed.

On deciding the appeal Farlam JA contended that the *Turquand* rule does not apply in this case as the defence's case was based on the erroneous interpretation of clause 23.4 of the appellant's trust deed.<sup>64</sup> Farlam JA ordered that the case be referred back for trial, for evidence on how Nieuwoudt conducted the ordinary business of farming without being authorized thereto by his wife, the other trustee.

The *Turquand* rule was of no assistance to Vrystaat Mielies (Edms), the “*bona fide* outsider”. It is disheartening that the only question of law in the *Nieuwoudt* decision had to do with applicability of the *Turquand* rule and yet the court expressly stated that it was not going to express an opinion on the matter.<sup>65</sup> Save for confirming the joint trustee principle and pronouncing that the *Turquand* rule is not applicable to trusts, the court failed to offer any form of remedy to the “*bona fide* outsider”.

### **1 2 2 *Land and Agricultural Bank of South Africa v Parker*<sup>66</sup>**

Mr Parker formed a trust in 1992. The trust deed made provision for a complement of three trustees of which Mr Parker was one. At some stage one of the trustees resigned and the remaining trustee failed to appoint a third trustee until much later. The trust entered into agreements with Land and Agricultural Bank of South Africa (the outsider) and on the latter's insistence a third trustee was appointed. However, despite being appointed as a trustee, the third trustee was never consulted regarding trust matters and or decisions to be made regarding trust transactions. The trust was indebted to the outsider for an amount of R16 000 000.00.

In the court *a quo* the bank successfully obtained sequestration orders against Mr Parker and the trust. The sequestration order against the trust was set aside by the

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<sup>64</sup> Para [9].

<sup>65</sup> Para [9].

<sup>66</sup>2005 (2) SA 77 (SCA).

full bench<sup>67</sup> and this prompted the bank to approach the Supreme Court of Appeal to appeal against that decision.<sup>68</sup> On appeal, the full court<sup>69</sup> held that the trust deed required the consent of all three trustees to transact business, failing which the trust suffered from an incapacity that precluded action on its behalf and could not be bound, thus making the loans taken from the bank to be invalid. Fortunately, the case was decided on a technicality that the two trustees (Mrs Parker and the son) could not enter an appeal.<sup>70</sup> Cameron JA re-emphasised the importance of separation between control and enjoyment.<sup>71</sup> He stated that if a trust has proper separation between ownership and enjoyment the instrument will protect the outsiders dealing and transacting with them.<sup>72</sup> Where trustees are, however, also sole beneficiaries they will have no interest insuring that trust transactions are validly concluded, because it gives them the opportunity to evade and/or deny trust liability at a later stage.<sup>73</sup>

The appeal of the bank succeeded, and the sequestration order against the trust was reinstated. If it was not for the “technical” decision it seems that the “*bona fide* outsider” (the bank) would not have been protected and would have suffered damage.<sup>74</sup>

### **1 2 3 *Nedbank Ltd v Thorpe***<sup>75</sup>

During 1985 Mr Thorpe, an insurance broker by profession, created a family trust. The trustees of the trust were Mr Thorpe, his wife and their eldest son who were also beneficiaries of the trust. Thorpe moved all of the family’s growth assets out of their personal estate and into the trust which was substantially controlled by themselves as trustees. After resignation of his son as one of the trustees, the trust operated with Thorpe and his wife as the remaining trustees for a considerable time. It was during that period when the two trustees entered into an agreement with Nedbank

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<sup>67</sup> *Parker v Land Agricultural Bank of South Africa* 2003 (1) ALL SA 258 (T).

<sup>68</sup> Para [5].

<sup>69</sup> Para [11].

<sup>70</sup> Para [46].

<sup>71</sup> Para [19].

<sup>72</sup> Para [24].

<sup>73</sup> Para [29].

<sup>74</sup> See ch 3 below for a detailed discussion.

<sup>75</sup> 2008 JOL 22675 (N).

(the outsider) for a loan account of R16 million. Thorpe bound himself as surety for the debt.

Nedbank applied for an order provisionally sequestrating the estate of Mr Thorpe.<sup>76</sup> In its argument Nedbank submitted that Mr Thorpe had established various trusts through which he had effectively shielded his wealth from his creditors, thus frustrating the effort of his creditors to claim repayment of debts owing to them. The facts of the case were that when the trust fell behind on its installments for funds advanced to it by the bank, the latter instituted action against Mr Thorpe in his capacity as surety and co-principal debtor for the debts incurred by the trust.

It was contended that an investigation into the affairs of the trust would reveal that Mr Thorpe had unhindered control over the trust assets as well as funds held by the trust, which circumstances created a strong suspicion that Mr Thorpe was simply conducting his personal business through the trust and that the trust was simply the vehicle to do so.<sup>77</sup> There was a prospect that a forensic examination of the assets of the trusts would also reveal that the trust was a “mirage” used by Thorpe for his own commercial ends.<sup>78</sup> The estate of Thorpe was placed under provisional sequestration, but he made no effort to discharge this indebtedness. In the follow-up case, *Nedbank Ltd v Thorpe*,<sup>79</sup> the court conducted a thorough investigation into the trust and its affairs and noted several troubling activities<sup>80</sup> which led to Pillay J concluding as follows:

“It is indeed probable that the true and complete control of the trusts vested in the Respondent. There is in my view enough evidence to suggest that Bonavie Trust is the alter ego of the Respondent and is utilized by him for the purpose of receiving income generated from his various activities and at the same time his assets and wealth from his creditors.”

The court held that on the basis of the evidence before it, a trustee, duly appointed to

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<sup>76</sup> *Nedbank Limited v Thorpe* 2008 ZAKZHC 72.

<sup>77</sup> Para [49].

<sup>78</sup> Para [50].

<sup>79</sup> 2009 ZAKZPHC 44 (unreported, at <http://www.saflii.org/za/cases/ZAKZPHC/2009/44.html>).

<sup>80</sup> Paras [16] and [19]; also paras [23], [24] and [26].

Thorpe's estate would be in a far better position than the Applicant to fully investigate the way in which Thorpe has used the institution of trust to shield his wealth from his creditors.

#### **1 2 4 *Van Zyl v Kaye*<sup>81</sup>**

The facts and problem are briefly as follows:

The applicants, who are the provisional trustees of the insolvent estate of DH Kaye, have applied for orders declaring that two immovable properties, one in Cape Town, and the other in Plettenberg Bay, or the proceeds of any sale of such properties, may be treated as assets in the insolvent estate. The Cape Town property is registered in the name of the JGN Trust and the Plettenberg Bay property as the property of a company, Bella Densel 176 (Pty) Ltd. The applicants seek the court to disregard the veneer' of the Trust, or 'go behind' it, for the relief sought in respect of the Cape Town property.<sup>82</sup>

The trust in question was a family trust of which Kaye, his wife and an attorney were the trustees. The property owned by the trust was used by Kaye and his family as their family home.<sup>83</sup> The beneficiaries of the trust were Kaye, his wife and their descendants. However, it appeared from the financial records of the trust and company before court that their finances were accounted for as if they were part of a group of business entities over which Kaye had apparently effective personal control.<sup>84</sup>

According to the applicants' plea, the court had to determine whether two immovable properties must be treated as assets in the insolvent estate of Kaye. The only way the court could achieve that was by showing that the trust should be treated as a "sham"; in other words be declared as non-existent, or by showing that as a matter of fact the property did not vest in the trust. The court clarified the difference between

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<sup>81</sup> (1110/14) [2014] ZAWCHC 532; 2014 (4) SA 452 (WCC) (15 April 2014).

<sup>82</sup> Para [1].

<sup>83</sup> Para [7].

<sup>84</sup> Para [13].

finding that a trust is a “sham” and “going behind a trust form”. Binns-Ward J explained the difference as follows:

“Holding that a trust is a sham is essentially a finding of fact. Inherent in any determination that a trust is a sham must be a finding that the requirements for the establishment of a trust were not met, or that the appearance of having met them was in reality a dissimulation”

On the one hand, for the court to hold that the trust was not validly founded or the trust property in question had not validly vested in the trust there had to be allegations by the applicants that that was the case, and there was none before the court.<sup>85</sup> Even the evidence of the maladministration of the asset and funds of the trust was not enough to justify a finding that a trust is a “sham”, or that the trust does not exist or that an asset no longer vests in the trust. All that it does was to call into question the fitness of the trustees to hold office.<sup>86</sup>

Regarding “going behind the trust form”, on the other hand, the question entails accepting that the trust exists, but disregarding for given purposes the ordinary consequences of its existence. The court found that this might entail holding the trustees personally liable for an obligation ostensibly undertaken in their capacity as trustees, or holding the trust bound to transactions seemingly undertaken by the trustees acting outside the limits of their authority or legal capacity or in cases where the trustees treat the property of the trust as if it were their personal property and use the trust essentially as their “alter ego”.<sup>87</sup> As this is an equitable remedy, it is a remedy that will generally be given when the trust form is used in a dishonest or unconscionable manner to evade a liability or avoid an obligation and not in a situation where a creditor seeks relief against a debtor who is a trustee of a trust.<sup>88</sup>

The “*bona fide* outsiders” - the creditors in the insolvent estate of Kaye represented by the provisional trustees, were prejudiced by the court’s refusal of the application.

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<sup>85</sup> Para [20].

<sup>86</sup> Para [18].

<sup>87</sup> Para [21].

<sup>88</sup> Para [22].

Suffice it to say that the *Van Zyl v Kaye* case provides practical advice to “*bona fide* outsiders” on how to attack a trust.

The purpose of the four problem scenarios above is to highlight the problems “*bona fide* outsiders”, as parties to litigation, have to deal with where the founder/trustees of trusts they have claims against have assets of substantial value hidden behind the “veneer” of a trust while pleading poverty. A further discussion of the facts, forms of abuse and solutions to the problem scenarios highlighted above will be discussed in chapters 3 and 4.

### **1 3 Consequences of a valid trust being “abused” compared to consequences of a “sham” or invalid trust**

For purposes of this dissertation it is also important to point out that, where there is a dispute between a founder/trustee and a “*bona fide* outsider” regarding any business transactions, the courts often first examine the nature of the vehicle through which the business is conducted and the manner in which such entity was used. Whether a valid trust is merely abused by the founder/trustee, or is a “sham trust” is an important aspect to be considered, because of the consequences that arise from each situation or scenario and the effects thereof, either on the assets of the trust and/or the personal assets of the founder/trustees. In proposing possible solutions to the “*bona fide* outsider”, the dissertation will examine the concept of a “sham” or invalid trust, and the valid trust being abused or the “alter ego” and consequences thereof.<sup>89</sup>

### **1 4 Research methodology and chapter outline**

Chapter 2 focuses on the distinction between an abused valid trust or “alter ego” and a “sham” or invalid trust, with specific emphasis on the consequences that results from the abuse of this trusts form by a founder/trustees in their dealings with “*bona fide* outsiders”.

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<sup>89</sup> See ch 2 and ch 4 for a discussion of these concepts.

Chapter 3 focuses on a discussion on South African case law, with specific reference to instances of abuse of the trust form by the founder/trustee(s) and the resulting consequences. The chapter focuses on a number of cases since the decision of *Parker*, wherein this abuse has become an issue. The chapter will also focus on the *ad hoc* solutions by the courts in each appropriate case as possible solutions to the abuse of the trust form, with the aim to bring some protection for “*bona fide* outsiders” who have entered into business transactions with these trusts.

Chapter 4 explores the proposed *ad hoc* solutions to limiting the abuse of the trust form and the possible development of the South African law of trusts so as to ensure that trusts function in accordance with principles of business efficacy, sound commercial accountability and the reasonable expectations of “*bona fide* outsiders”.

## Chapter 2 An abused valid trust or the “alter ego”, compared to a “sham” and the consequences thereof

### 2 1 Introduction

The chapter aims to show the distinction between an abused valid trust or the “alter ego” and a “sham”, and the consequence each concept bears for “*bona fide* outsiders” who have entered into business transactions with the trust. The distinction is important as the consequences for each concept differ as will be seen below and in chapter 4. The distinction between a “sham” trust and the abuse of a valid trust is best explained by De Waal:<sup>90</sup>

“It has been argued that sham situations on the one hand, and abuse situations on the other, are approached from different theoretical angles. In the case of a sham, the question is whether a valid trust has been created at all. Here, the emphasis falls on the requirements for the creation of a valid trust; specifically that the founder must have the intention to create a trust. In the case of an abuse situation, the premise is that there is a valid trust, but that there may exist a justification for going behind the trust, and ignoring the trust for a particular purpose. However, the distinction between the two situations is not only important for theoretical clarity. It also has practical implications. The most important one – and the one to which I will briefly refer here – is that it is decisive for the application (or destination) of the trust assets. This, in turn, has implications for both the trust beneficiaries and third parties such as a trustee’s spouse or private creditors.”

According to De Waal, the distinction between a “sham” and/or using the trust as an “alter ego” and therefore abuse of a valid trust is not only important for theoretical clarity but also because it has practical implications for the application (or destination) of trust assets which, in turn, may affect both trust beneficiaries and third parties such as a trustee’s spouse or private creditors. The chapter examines each concept and the manner in which the trust assets, in each situation, are applied by the courts.

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<sup>90</sup> De Waal “The Abuse of the Trust (or: “Going Behind the Trust Form”): The South African Experience with Some Comparative Perspectives” 2011 *Rebels Zeitschrift* 1096.

## 2.2 The “sham”<sup>91</sup> or invalid trust

Until recently,<sup>92</sup> the concept of a “sham” trust was not acknowledged by South African courts instead, they tend rather to refer to the “abuse” of the trust figure, or even to using the trust as an “alter ego”. A “sham” transaction is defined by Diplock LJ in the English case of *Snook v London & West Riding Investments Ltd*<sup>93</sup> as follows:

“[A]cts done or documents executed are intended to give to third parties or to the courts the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) that the parties intended to create.”

The “sham” concept is best explained by Moffat a leading English authority on trust law as follows:<sup>94</sup>

“A sham transaction is one where ‘acts done or documents executed are intended to give to third parties or to the courts the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) that the parties intended to create’ (*Snook v London & West Riding Investments Ltd* [1967] 2QBD 786 at 802 per Diplock LJ). The Wyatt case was, in one sense, straightforward in that there were no separate trustees involved. There may, though, be more complex arrangements whereby, even though there is transfer of legal title in property to trustees apparently for certain beneficiaries – and therefore arguably not a sham ‘in form’ as there is a real trust - , the settlor has no intention that the purported beneficiaries should actually benefit from the assets. On the contrary, the real intention is that the trustees should hold the assets for the settlor and that the trust is therefore a ‘sham in substance’ if not ‘in form’ or, as it is sometimes termed, a partial sham. (See e.g. *Minwalla v Minwalla* [2005] 1 FLR 771 where a complex arrangement involved an offshore trust apparently to conceal beneficial ownership in assets in ancillary divorce proceedings). Although the matter is not beyond doubt in English

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<sup>91</sup> The Oxford English Dictionary defines a “sham” as a thing that is intended to be mistaken for something else, or that is not what it is intended or appears to be.

<sup>92</sup> *Khabola v Ralitabo* [2011] ZAFSHC 62 was the first decision, after *Parker*, that shows that the court will treat an arrangement purporting to be a trust in accordance with actual underlying relationship (in this case a business partnership). The *Khabola v Ralitabo* case is discussed further in ch 3 para 3.7.

<sup>93</sup> 1967 (2) QB 786 802.

<sup>94</sup> Moffat *Trust Law* (2009) 164.

law it seems that in such cases ‘unless [the real intention] is from the outset shared by the trustee (or later becomes so shared)’ the trust created will not be regarded as a “sham.”

What emerges from Moffat’s explanation is that the intention to create a valid trust from the inception of the trust is the key to determining whether a “sham” trust exists or not. The founder and/or trustee(s) must share the common intention to engage in this form of deception. It is also clear from the explanation that unless it can be shown that the founder had a real intention from inception to create a trust, and did not intend his beneficiaries to gain access to the assets and/or intended to retain control of the trust assets for himself or his family, the existence of a “sham” trust would have to be assumed. Van der Linde<sup>95</sup> asks a question whether a valid and legitimately created trust can later become a “sham”. He refers to a situation where both the founder and the trustee(s) share a new shamming intention at a later stage, where the trust was created validly during inception. The author is of the view that once a valid trust has been created from inception, it always remains a valid trust. Should it happen that the founder and trustee(s) of a valid trust collude that the trust property shall be held to the order of the founder only, so that the trustee(s) is merely doing the bidding for the founder without exercising his independent discretion, this will amount to breach of trust. The test for determining whether or not a transaction is a “sham” was formulated by Diplock J<sup>96</sup> in his judgement:

“As regards the contention of the plaintiff that the transaction between himself, Auto Finance and the defendant were a ‘sham’, it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create. But one thing, I think, is clear in legal principles, morality and the authorities...that for acts or documents to be ‘sham’, with whatever legal consequences follow from this, *all the parties thereto must have a common intention*

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<sup>95</sup> Van der Linde “Debasement of the core idea of a trust and the need to protect third parties” 2012 (75) *THRHR* 371.

<sup>96</sup> *Snook v London & West Riding Investments Ltd* 1967 (2) QB 786.

*that the acts or documents are not to create the legal rights and obligations which the appearance is creating.” (Own emphasis)*

The consequence of this statement has been influential in developing the so-called *Snook* test which has become the universal test for determining whether or not a transaction is a “sham”.<sup>97</sup> The author agrees with Stafford<sup>98</sup> when he argues that South African courts are not yet in agreement on how to conduct the test for intention as intended in the *Snook* test. This will be evident from the case discussion in chapter 3. What is of importance for purposes of this dissertation is that in a “sham” situation no valid trust comes into existence.

The recent decision of *Khabola v Ralitabo*<sup>99</sup> is an excellent example of a “sham” trust. One of the trustees of a business trust applied for an order setting aside the sale of certain trust property. His three co-trustees opposed the application and launched a counter-application for a number of orders (which are irrelevant for present purposes). The only issue the court had to decide was whether the applicant and the respondents had the required *locus standi* to bring the application and counter-application.<sup>100</sup> It transpired that the applicant was the founder of the trust, which was formed for acquiring agricultural land on which farming activities were to be conducted. The trust received a grant and acquired a loan to finance the purchase of the land. All the trustees were required to make monthly financial contributions for the repayment of the loan. Significantly, no beneficiaries were nominated in the trust deed.<sup>101</sup> Against this background, the court reached the conclusion that “the parties intended to form a partnership or some other association which was simulated as a trust”.<sup>102</sup> In other words, there was no intention to create a trust, but only a “simulation”. The court consequently gave effect to the real (and not the simulated) intention of the parties and held that a partnership had come into existence

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<sup>97</sup> Stafford 77.

<sup>98</sup> Stafford 176-178.

<sup>99</sup> [2011] ZAFSHC 62.

<sup>100</sup> Para [2].

<sup>101</sup> Para [3].

<sup>102</sup> Para [4].

In *Van Zyl v Kaye*,<sup>103</sup> Binns-Ward J highlighted the fact that in establishing that a trust is a “sham” and “going behind the trust form” entail two fundamentally different undertakings. When a trust is a “sham”, it does not exist and there is nothing to “go behind”.<sup>104</sup> He contends that holding that a trust is a “sham” is essentially a finding of fact and in determining those facts it must be proven that the requirements for the establishment of a trust were not met, or that the appearance of having met them was in reality a disguise.<sup>105</sup> Binns-Ward J<sup>106</sup> cited *Khabola v Ralitabo* case as an example of a “sham” trust, notwithstanding that the term is not used.

### 2 3 Consequences of a “sham” or invalid trust

The effect of a “sham” trust is that no valid trust has come into existence and neither the founder nor the trustee(s) will be able to rely on the so-called “trust deed” as representing the true position as the rights between the parties. This means that no effect can be given to the transaction and the “founder” remains owner of the “trust assets”.<sup>107</sup> Furthermore, neither the trustee nor the beneficiaries will acquire any rights with regard to these assets.<sup>108</sup> Thus, in the event a “*bona fide* outsider” manages to successfully argue that a trust is in fact a “sham” it could leave the founder/trustees with absolute beneficial interest in the “trust property” which is capable of being taxed, inherited by rightful beneficiaries or claimed by creditors. It does not end there, the founder/trustees might find themselves personally subject to tax penalties whilst at the same time losing any protection afforded to them by indemnities or exemption clauses of the so-called “trust deed”.

### 2 4 An abused valid trust or the “alter ego”

For a trust to be abused there needs to be a valid trust. For a valid trust to be created, the founder must comply with all the requirements for creating a valid

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<sup>103</sup> (1110/14) 2014 ZAWCHC 52; 2014 (4) SA 52 WCC para [16].

<sup>104</sup> *Ibid.*

<sup>105</sup> Para [19].

<sup>106</sup> Para [19] note 6.

<sup>107</sup> De Waal 2011 *Rabels Zeitschrift* 1097.

<sup>108</sup> *Ibid.*

trust.<sup>109</sup> If one or more of these requirements are not met, then no trust is established.

Of these requirements, the requirement that the founder must have the intention to create a trust is of particular importance.<sup>110</sup> If the intention is lacking, or the real intention is to create something different, no trust comes into existence.<sup>111</sup> It is possible that there could have been no intention on the part of founder to create a trust but only to use the name or shape of the trust institution to gain some or other advantage. De Waal points that it is exactly under these circumstances that it may be properly said that the “trust” in question is a “sham” in a sense that no trust comes into existence.<sup>112</sup>

The most cases of abuse of the trust form are using the trust as the “alter ego” of the founder and/or trustee. De Waal<sup>113</sup> points out that in the case of an abuse or misuse of a trust form, the premise is that there is a valid trust. However, this abuse of the trust figure is justification for “going behind the trust or piercing the veneer” of a trust form while a valid trust remains.

There is a difference between a “sham” and using the trust instrument as an “alter ego”. In the case of a “sham”, the question is whether a valid trust has been created at all. Whereas, in the case of the “alter ego”, the trust is by all means a valid trust, but there is evidence of abuse of the trust form or flawed administration of the trust property. Stafford<sup>114</sup> defines the “alter ego” concept as follows:

“In general terms, should it be proven that a party has the ultimate control of a trust, or that the trust is a creature wholly controlled by him- or herself as trustee or settlor, coupled with the capacity to derive benefit from the trust, then the trust may be

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<sup>109</sup> Cameron *et al* (2000)117 sets out the following as the requirements for the creation of a valid trust (a) the founder must intend to create a trust; (b) the founder’s intention must be expressed in a manner appropriate to create an obligation; (c) the trust assets must be described with reasonable certainty; (d) the trust must be formed with a specific object or purpose; and (e) the trust object must be lawful.

<sup>110</sup> Cameron *et al* (2002) 117. See De Waal 2011 *Rabels Zeitschrift* 1084 note 43 – In South African law an *inter vivos* trust is created by contract and the intention to create a trust must consequently be shared by the founder and the prospective trustee.

<sup>111</sup> De Waal 2011 *Rabels Zeitschrift* 1084.

<sup>112</sup> *Ibid.*

<sup>113</sup> *Ibid.*

<sup>114</sup> Stafford 121.

treated as the alter-ego of the trustee or settlor. Apart from the various mistakes made across the world in which the doctrine of the alter-ego is often amalgamated with the doctrine of the sham, clear evidence exists that the two are separate and distinct. Unlike a sham, an alter-ego trust is intended to be a genuine trust. There is no requirement of an intention to deceive or mislead. Although dealt with below, it is important to confirm at this stage that – correctly interpreted – the sham trust argument is therefore an independent cause of action, whereas the alter-ego argument is not. The consequence of this fundamental distinction is that an alter-ego trust, on its own, cannot be pierced.”

What emerges from the above statement is that a trust may be treated as the “alter-ego” of the founder/trustees should it be proven that a party has the ultimate control of the trust, or that the trust was a creature wholly controlled by him- or herself as founder/trustees, coupled with the capacity to derive benefit from the trust. Stafford<sup>115</sup> states that the case of the “alter ego” trust concerns *de facto* control of the trust property, but as to how much control is necessary is not clear. In *Badenhorst v Badenhorst*<sup>116</sup> the court noted that this control must be “*de facto*” and not necessarily “*de iure*”, as determined by taking into consideration both the terms of the particular trust instrument and evidence of how the practical affairs of the trust were conducted.

In the divorce case of *BC v CC*<sup>117</sup> the plaintiff sought an order directing, *inter alia*, that the value of assets held by a trust established by the husband should be taken into consideration in determining the accrual of his estate as intended in section 4 of the Matrimonial Property Act<sup>118</sup> Dambuza J<sup>119</sup> agreeing with the views of Byl AJ in *Smith v Smith*<sup>120</sup> said the following:

“It seems to me that in both ss 7(3) and (5) of the Divorce Act and s 4 of the Matrimonial Property Act a court has a duty, where the necessary allegations are made, to consider the evidence tendered to support such allegations in order to determine whether the relevant spouse is a *de facto* and /or beneficial owner of

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<sup>115</sup> *Ibid.*

<sup>116</sup> 2006 (2) SA 255 (SCA) para [9]; see also *Brunette v Brunette* 2009 (5) SA 81 (SE).

<sup>117</sup> 2012 (5) SA 562 (ECP).

<sup>118</sup> 88 of 1984.

<sup>119</sup> *BC v CC* 2012 (5) SA 562 (ECP) para [12].

<sup>120</sup> (SELD case No 619/2006).

assets. The ultimate answer lies in the evidence that will be led at the trial. But where the evidence proves true intention to hold assets on behalf of the trust, or the existence of a genuine trust, ie no *de facto* ownership by the spouse or no benefit derived therefrom, I doubt that it would be proper, even under the Divorce Act, to take into account the assets so held in determining redistribution. Similarly, where evidence proves true ownership of assets on behalf of a trust, it would be improper to take into consideration the value of such assets when considering accrual”

Clearly the court acknowledges the fact that where it is proven that there is *de facto* control of the trust property, the assets can be considered in determining the accrual of an estate. However, Dambuza JA’s reasoning that the determination of what assets fall to be considered in determining the accrual of an estate is ‘the same in both the Matrimonial Property Act and the Divorce Act’ is not correct. The author agrees with Ploos van Amstel J’s criticism of Dambuza JA’s reasoning In *MCM v JCM*,<sup>121</sup> where the learned Judge stated as follows:

“The amount of an accrual claim is determined on a factual and mathematical basis and is not a matter of discretion. What a spouse’s estate consists of is a factual enquiry. There is no warrant in the MPA to have regard to assets which do not form part of his estate on the basis that it would be just to do so. Nor is there a legal basis for an order that assets which in fact do not form part of his estate should be deemed to form part of it for purposes of determining the accrual of his estate. I should add that if a trustee behaves improperly with regard to trust assets and deal with them without the authority of the other trustees the law provides a remedy. It is not the case that a husband can with impunity treat trust assets as if they belong to him”

Ploos van Amstel J<sup>122</sup> correctly pointed out that a court should consider, as a question of law, whether assets owned by the trust should be taken into account in determining the accrual of the husband’s estate in terms of the Matrimonial Property Act only if averments are made in the pleadings that the husband, and not the trust, is *de facto* the owner of such assets and not merely deem such assets to be part of the husband’s estate, thereby implying that the *BC v CC* case was not decided correctly.

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<sup>121</sup> Case no: 9758/2011 para [17].

<sup>122</sup> Para [18].

In *Van Zyl v Van Zyl*<sup>123</sup> Gautschi AJ stated:

“A court is entitled to “lift” or “pierce” the “corporate veil”, which is done only in exceptional circumstances. A court has no general discretion to disregard the existence of a separate corporate entity whenever it considers it just or convenient to do so. One such instance where this is permitted is where the corporate entity is the alter ego of the controlling person. In an appropriate case, “the veneer of a trust can be pierced in the same way as the corporate veil of a company.”

## 2.5 Consequences of an abused valid trust or the “alter ego”

As already mentioned, the effect of a trust executed with the true intention is that a valid trust comes into existence. Both the trustees and the beneficiaries will acquire rights with regard to the trust assets.<sup>124</sup> This, according to De Waal, opens the door for the possibility that a court may “go behind the trust” and order the application of the trust assets for a purpose, or may order an alternative course of action.<sup>125</sup> De Waal states the following possibilities for a court:<sup>126</sup>

“The answer obviously depends on the circumstances of each particular case, but by way of summary, and with reference to the analysis of the cases above, the following are definite possibilities: (1) in the insolvency context, a court can order that trust assets should be made available for the satisfaction of a trustee’s private creditors; (2) in the matrimonial property law context, a court can order that trust assets should be counted as a trustee’s private assets for the purposes of a redistribution order at a divorce (thus making the trust assets available for the trustee’s spouse); (3) a court can hold a “delinquent” trustee personally liable for the performance of an obligation undertaken on behalf of the trust; or (4) a court can order that the trust be performed “as if the obligation had been properly incurred by the trustees acting in the capacity that they purported to act”.

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<sup>123</sup> [2014] JOL 31973 (GSJ) para [17].

<sup>124</sup> De Waal 2011 *Rabels Zeitschrift* 1097.

<sup>125</sup> *Ibid.*

<sup>126</sup> *Ibid.*

What emerges is that in an abuse situation the courts go behind the trust and order various solutions<sup>127</sup> depending on the circumstances of each particular case.

In *Van der Merwe v Hydraberg Hydraulics CC; Van der Merwe v Bosman (WCC)*<sup>128</sup> Binns-Ward J pointed out that the Hydraberg Property Trust bears the unwholesome hallmarks of the “newer type” of business trusts which are reflected not only in its structure, but also in the manner in which its affairs have demonstrably been conducted. The Judge further noted that the facts of the case before court afforded a classic example of an abuse of the trust from flowing directly from the conduct by Clarke and Bosman in respect of ownership of the fixed property with no distinction between their responsibilities as trustees and their expectations as beneficiaries.<sup>129</sup> Binns-Ward J<sup>130</sup> stated as follows:

“If it has been legally possible, this matter would be an appropriate case, in my judgement, to have disregarded the veneer of the trust form. This might have been done in one of two ways: By holding the delinquent trustees personally liable for performance, or by directing the trust to perform as if the obligation had been properly incurred by the trustees acting in the capacity that they purported to.... [42] Unfortunately, however, the formalities applying in respect of contracts of the alienation of land pose an insuperable obstacle to the course I would have wished to take.”

In the recent decision of *Van Zyl v Kaye*, Binns-Ward J<sup>131</sup> explained that “going behind the trust form” entails accepting that the trust exists, but disregarding the ordinary consequences of its existence. If a “*bona fide* outsider” succeeds proving the above, then the court will disregard the ordinary consequences of [the trust’s] existence and can, for example, declare trust assets to be assets in the trustee’s personal estate. The judge contended that “going behind the trust form” is a remedy that will generally be given when the trust form is used in a dishonest or unconscionable manner to evade a liability, or avoid an obligation, most likely as in

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<sup>127</sup> In some of the cases discussed in ch 3 our courts have used terminology which would have been more appropriate in the context of juristic persons, such as “lifting or piercing the corporate veil”, “disregarding the veneer of the trust form”. The use of this type of terminology in relation to trusts (which are not juristic persons) has been criticized.

<sup>128</sup> 2010 (5) SA 555(WCC) para [35].

<sup>129</sup> Para [39].

<sup>130</sup> Para [41].

<sup>131</sup> Para [21].

the present case, where the trustees treat the property of the trust as if it were their personal property and use the trust essentially as their “alter ego” – an all too frequent phenomenon in certain family and business trusts in which the trustees are both the effective controllers as well as the beneficiaries.

Binns-Ward J conceded as follows:<sup>132</sup>

“I am not aware of any matter in which a South African court has yet ‘pierced the veneer’ of a trust or gone behind it, although the court came close to doing so in *Van der Merwe*. The applicants’ reliance in support of their approach on the Supreme Court of Appeal’s judgment in *Badenhorst v Badenhorst* is misplaced. *Badenhorst* did not entail any disregard by the court of the trust involved in that case”.

Once more<sup>133</sup> this case highlights lack of clarity in our courts concerning the effect of the use of the expressions “alter ego trust” and “sham”. The expressions are often used interchangeably and with confusing effect.<sup>134</sup>

## 2 6 Conclusion

A trust can be validly established with the right intentions but become abused or misused by the founder/trustees in the course of events thereby turning into the “alter ego” of the founder/trustees.<sup>135</sup> On the other hand, the possibility of a “sham” trust can only be considered if from the outset the founder/trustees never had the real intention of creating a valid trust. Thus, drawing a distinction between a valid trust being abused and a “sham” trust is of importance because it implies different sets of consequences regarding the destination of the assets.

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<sup>132</sup> Para [23].

<sup>133</sup> Stafford 176 - “General principles are important in any legal system as their application ensures consistency, logicity and predictability. Admittedly, there are varying approaches abroad concerning the policies followed regarding “sham” and alter ego enquiries. What we do know, though, is that the majority of countries use Snook test in order to define and identify a sham trust. Unlike South Africa, each country has adopted and adhered to the approach, barring developments which have occurred by way of precedent. *In South Africa the lack of single, clearly defined principles has resulted in a number of overlapping rights, duties and other factors which the courts are to consider. The lack of continuity has undoubtedly led to the widespread confusion concerning these important principles*” Own emphasis.

<sup>134</sup> Para [28].

<sup>135</sup> This will be evident from the case discussions in ch 3.

It seems that in South African law of trusts, in the case of the abuse of a trust figure, the most common consequence is that a court can order that the trust assets should be made available for the satisfaction of a trustee's private creditors;<sup>136</sup> a court can order that trust assets should be counted as a trustee's private assets for the purposes of a redistribution order at a divorce;<sup>137</sup> a court can hold a "delinquent" trustee personally liable for the performance of an obligation undertaken on behalf of the trust;<sup>138</sup> or a court can order that the trust be performed "as if the obligation had been properly incurred by the trustees acting in the capacity that they purported to act".<sup>139</sup>

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<sup>136</sup> De Waal 2011 *Rabels Zeitschrift* 1097.

<sup>137</sup> *Ibid.*

<sup>138</sup> *Ibid.*

<sup>139</sup> *Ibid.*

## Chapter 3 The history of third party protection in South African law of trusts

### 3 1 Introduction

It will be evident from the case discussions below that the tendency to use the trust form as a “vehicle” to run family businesses without any change in the circumstances surrounding it is on the increase. This abuse of the trust form has exposed trusts to exploitation by founders and/or trustees, much to the disadvantage of the trust beneficiaries and/or creditors. Cameron JA<sup>140</sup> emphasised that there was nothing inherently wrong with using such a flexible instrument as a trust for such purposes, but drew attention to the emergence of the “newer type of trust” which exhibits a great scope for violation of the “basic trust idea” - that ‘*functional separation from ownership (or control) and enjoyment*’ of the trust property. The danger of the “newer type of trust” is the use of the trust merely as the “alter ego” or an extension of the founder’s and/or trustees’ personal estate. Since *Parker*, the courts, in a series of judgements, some of which are discussed in this chapter, have continued to emphasize the importance of adherence to the “basic trust idea” in the formation and administration of the trust.<sup>141</sup> This chapter focuses on the discussion of such cases (wherein the trust form was abused or misused and the resulting consequences), with specific reference to the form of *ad hoc* remedy for protection of each “*bona fide* outsider” who had business dealings with such trusts, through methods appropriate to each case.

### 3 2 *Land Agricultural Bank of South Africa v Parker*<sup>142</sup>

#### 3 2 1 Facts<sup>143</sup>

Mr Parker formed a trust in 1992. The trustees then were Mr Parker, Mrs Parker and the family attorney, one Mr Senekal. The beneficiaries were the Parkers and their descendants. Mr Senekal resigned as trustee in 1996 and was not replaced, despite a provision in the trust deed that “there shall always be a minimum of three trustees in office”. The Parkers were not deterred by this lack of a quorum of trustees, and continued to accept loans from the bank (the *bona fide* outsider) for which they

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<sup>140</sup> Para [24].

<sup>141</sup> Van der Linde 2012 *THRHR* 383 371.

<sup>142</sup> 2005 (2) SA 77 (SCA).

<sup>143</sup> *Parker* 78C-J.

supposedly bound the trust. The lack of separation between control and enjoyment resulted from the initial resignation by Mr Senekal, the total disregard of the provisions of the trust deed and the later appointment of the Parkers' son (also a beneficiary) as third trustee.<sup>144</sup> Despite being appointed as trustee, the son was never consulted regarding trust matters and/or decisions to be made regarding trust transactions. The trust was indebted to the bank (the “*bona fide* outsider”) in the amount of R16 000 000.00 (sixteen million rand). In the court a quo the bank successfully obtained sequestration orders against the trust and the Parkers personally. The sequestration orders of the Parkers were set aside by the court whereupon the bank approached the Supreme Court of Appeal.

### 3 2 2 Court's judgment and *ad hoc* relief offered to the “*bona fide* outsider”

The judgment of the majority per Cameron JA can be summarized as follows:

- (a) A sub-minimum of trustees cannot bind the trust. The trust deed required the consent of all three trustees to transact business, failing which the trust could not be bound and the loans taken from the bank had therefore been invalid.<sup>145</sup>
- (b) The joint action rule requirement entails that trustees must act together.<sup>146</sup> The Parkers (the majority) remained part of a three-trustee complement and it had to exercise its will in relation to that complement.
- (c) The case does not provide the opportunity for considering the application of the *Turquand* rule.<sup>147</sup>

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<sup>144</sup> Para [28].

<sup>145</sup> Para [10].

<sup>146</sup> Para [15] - “It is a fundamental rule of trust law, which this Court recently re-instated in *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*, that in the absence of contrary provision in the trust deed the trustees must act jointly if the trust estate is to be bound by their acts. The rule derives from the nature of the trustees' joint ownership of the trust property. Since co-owners must act jointly, trustees must also act jointly”.

<sup>147</sup> Paras [18] and [37.1]. The court suggested that the *Turquand* rule can provide a valuable remedy to a *bona fide* outsider who have transacted with a trust and is faced with a trustee's denial of properly delegated authority to bind the trust. The court remarked that “[W]ithin its scope the rule that outsiders contracting with an entity and dealing in good faith may assume that acts performed within its constitution and powers have been properly and duly performed, and are not bound to enquire whether acts of internal management have been regular, may well in suitable cases have a useful role to play in safeguarding outsiders from unwarranted contestation of liability of trusts that conclude business transactions.” The concept is discussed in ch 4.

(d) Even though evidence before the court did not justify “going behind the trust”. Cameron JA alluded to the fact that in situations where the trustees are also beneficiaries,<sup>148</sup> the debasement of the of trust functions means all too often that the duty for compliance with formalities and for ensuring that contracts lie within the authority conferred by the trust deed will be violated. But that does not mean that the courts are powerless to restrict or prevent this form of abuse of the trust form.<sup>149</sup> The courts will themselves in appropriate cases ensure that the trust form is not abused, as they have the power to evolve the law of trusts by adapting the trust idea to the principles of our law.<sup>150</sup> Cameron JA suggested that:

“It may be necessary to go further and extend well-established principles to trusts by holding in a suitable case that the trustees’ conduct invites the inference that the trust form was a *mere cover for the conduct of business ‘as before’* (own emphasis), and that the assets allegedly vesting in trustees in fact belong to one or more of the trustee and so may be used in satisfaction of debts to the repayment of which the trustees purported to bind the trust. Where trustees of a family trust, including the founder, act in breach of the duties imposed by the trust deed, and purport on their sole authority to enter into contracts binding the trust, that provide evidence that *the trust form is a veneer that in justice should be pierced in the interest of creditors* (own emphasis).”

(e) Two trustees could not represent the trust in Appeal to Full Court. After Mr Parker was placed under final sequestration he ceased to be trustee in terms of section 150(3) of the Insolvency Act,<sup>151</sup> and as a result the two trustees could not sign a petition for leave to appeal to the Supreme Court of Appeal.<sup>152</sup>

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<sup>148</sup> Para [19] “Though a trustee can also be a beneficiary, the central notion is that the person entrusted with control exercises it on behalf of and in the interest of another. This is why a sole trustee cannot also be the sole beneficiary: Such a situation would embody an identity of interest that is inimical to the trust idea, and no trust would come into existence.”

<sup>149</sup> Para [34].

<sup>150</sup> Para [37] “This power may have to be invoked to ensure that trusts function in accordance with principles of business efficacy, sound commercial accountability and reasonable expectations of outsiders who deal with them. This could be achieved through methods appropriate for each case”.

<sup>151</sup> Act 24 of 1936.

<sup>152</sup> Para [39] – [41] and para [46].

The *Parker* decision is a clear case of abuse of the trust by making the trust an “alter ego” of the parties.<sup>153</sup> The abuse was as a result of an identity of interests between trustees and beneficiaries, the Parkers used the trust form not to separate beneficial interest from control, but to permit everything to remain “as before”, though now on terms that privileged them as before while simultaneously continuing to exercise control. The court was not prepared to render the trust invalid instead it made the suggestion that it may be necessary to go further and extend well-established principles to trusts by holding in a suitable case that the trustees’ conduct invites the inference that the trust form was a “mere cover” for conduct of business as before, and that the assets allegedly vesting in the trustees, in fact belong to one or more of them.<sup>154</sup> Such asset may then be used to repay and satisfy debts to which the trustees purported to bind the trust.<sup>155</sup> Where trustees of a family trust, including the founder, act in breach of the duties imposed by the trust deed, and purport on their sole authority to enter into contracts binding the trust, it may provide evidence that the trust form is a “veneer that in justice should be pierced” in the interest of creditors.<sup>156</sup>

Unfortunately, in the *Parker* decision the evidence before court did not justify going behind the trust form since the “*bona fide* outsider” (the bank) did not set out to establish a case along these lines. The case was decided on the basis that two trustees could not present the trust in an appeal to the full court.<sup>157</sup>

### **3 3 Nieuwoudt v Vrystaat Mielies (Edms) Bpk**<sup>158</sup>

#### **3 3 1 Facts**

In *Vrystaat Mielies (Edms) Bpk v Nieuwoudt*,<sup>159</sup> Nieuwoudt (in his capacity as one of two trustee of the JJ Boerdery Trust) concluded an agreement with C & W Landboudienste (the close corporation), in terms of which the close corporation purchased a certain quantity of mealies from the trust. The close corporation's rights

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<sup>153</sup> As already noted the key to establish whether a trust is being abused as an “alter ego” is determined by considering how the trust has been administered during its lifetime.

<sup>154</sup> Van der Linde 2012 *THRHR* 373.

<sup>155</sup> *Ibid.*

<sup>156</sup> *Ibid.*

<sup>157</sup> Para [39].

<sup>158</sup> 2004 (1) All SA 396 (SCA).

<sup>159</sup> 2003 (2) SA 262 (O).

under the agreement were subsequently ceded to Vrystaat Mielies (Edms) Bpk (the applicant in the court *a quo*). Later it transpired that Mr Nieuwoudt had not been authorized by a resolution of the trustees to conclude the agreement, and that neither the close corporation nor Vrystaat Mielies had been aware of this state of affairs.<sup>160</sup>

The JJ Boerdery Trust contended that the agreement was void because of Nieuwoudt's lack of authority. The applicant (Vrystaat Mielies) approached the Court of first instance for an order declaring the agreement to be valid and enforceable. The court held that the trust deed in question had authorized the contract and it had authorized the appointment of a single trustee to contract on behalf of the trust. Thus, allowing the application of the *Turquand* rule,<sup>161</sup> the court held that the fact that a single trustee had entered into the contract in the absence of a resolution by the trustees, and hence without actual authority to contract, did not render the contract voidable. The trust was accordingly bound to honour the agreement.

On appeal against the judgment of the court *a quo* the Supreme Court of Appeal in *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*,<sup>162</sup> had to determine whether there was a binding agreement between the parties. Mr Nieuwoudt submitted and copy of the trust deed and as well as a copy of the letter of authority, and contended that there was no binding agreement because the decision to bind the trust was not taken unanimously.<sup>163</sup> In reply the respondents sought to rely on the *Turquand* rule by stating that the representative of the close corporation (one Fourie) had at no stage been informed by the appellants that there were two trustees or that two trustees had to sign the contract and that the appellants had not given Fourie a copy of the trust deed. The respondents further alleged that the fact that only one trustee signed the contract did not provide a defence for the appellants, mistakenly basing this averment on a certain clause in the trust deed.<sup>164</sup>

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<sup>160</sup> Para [4]

<sup>161</sup> In para [12] the court further held that the applicability of the *Turquand* rule to transactions between trusts and third parties was essential and had to be accepted *in casu*. This decision was reversed on appeal and the court left open the question of the applicability of the *Turquand* rule to business trusts. The applicability of the rule is also criticized by McLennan "Contracting with business trusts" (2006) 18 *SA Merc LJ* 329–335. See the discussion on the *Turquand* rule and doctrine of construction on ch 4.

<sup>162</sup> 2004 (1) All SA 396 (SCA).

<sup>163</sup> Para [5].

<sup>164</sup> Para [8].

### 3 3 2 Court's judgment and *ad hoc* relief offered to the “*bona fide* outsider”

Farlam JA contended that the *Turquand* rule does not apply in this case as the defence's case was based on the erroneous interpretation of clause 23.4 of the appellant's trusts deed.<sup>165</sup> Instead, he gave effect to the provisions of the trust deed. In his finding, the Farlam JA indicated that the nature of the flaw in the contract entered into by the trust was a “*lack of authority*” on the part of one trustee to contract on their own on behalf of the trust. He stated further that whether or not a trustee has the authority to act on behalf of a trust is not a matter of “*internal formality*” or “*internal management*” which, in terms of the *Turquand* rule, other contracting parties are entitled to assume has been properly performed.<sup>166</sup> What is clear from the judgment is that a “*bona fide* outsider” would not be entitled to assume, merely from the fact that one trustee can be authorized to exercise the powers of all of them, that such authorization has in fact been given.

Farlam JA ordered that the case be referred back for trial, for evidence on how Nieuwoudt conducted the ordinary business of farming without being authorized thereto by his wife, the other trustee.

The *Turquand* rule was of no assistance to the “*bona fide* outsider”, Vrystaat Mielies (Edms). It is disheartening that the only question of law in *Nieuwoudt* case had to do with applicability of the *Turquand* rule and yet the Court expressly stated that it was not going to express an opinion on the matter.<sup>167</sup> Save for confirming the joint trustee principle and pronouncing that the *Turquand* rule is not applicable to trusts, the court failed to offer any form of relief to the “*bona fide* outsider”. It would seem, however from the judgment of the court that a more successful line of attack by “*bona fide* outsiders” faced with a plea of invalidity of a contract by trustees in cases such as this, would be to rely on the principles of the law of agency.<sup>168</sup>

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<sup>165</sup> Para [9].

<sup>166</sup> Para [11].

<sup>167</sup> Para [9].

<sup>168</sup> Para [23].

### 3 4 *Thorpe v Trittenwein*<sup>169</sup>

#### 3 4 1 Facts

Thorpe was a founder of a trust of a family trust called Brian Edward Thorpe. Thorpe was a trustee of the trust together with his wife, Sharon Thorpe and one Allen Dixon. Thorpe entered into a deed of sale to purchase fixed property on behalf of the trust.<sup>170</sup> At all relevant times the trust had three trustees, but the contract of sale was signed on behalf of the trust by only Thorpe.<sup>171</sup> The purchase was subject to the seller obtaining certain township rights. After numerous delays these were eventually granted. However, for various reasons the transaction was delayed, until the appellants applied in the High Court for an order declaring the sale to be valid and enforceable. In the meantime the seller sought to cancel the contract. The matter came before AP Joubert AJ who dismissed the application with costs.

The sellers raised a number of defences two of which are of importance. One of the defences was that three documents said to constitute the deed of sale did not comply with the requirements of section 2(1) of the Alienation of Land Act.<sup>172</sup> The second defence the respondent contended that the absence of the written authority of Thorpe's co-trustees rendered the agreement of sale invalid for want of compliance with the provisions of section 2(1) of the Alienation of Land Act and that the invalidity could not be cured by an *ex post facto* ratification.<sup>173</sup> The defence was upheld by the court *a quo* and on this ground alone dismissed the application with costs.

Section 2(1) of the Act provides that no alienation of land “*shall ... be of any force or effect unless it is contained in a deed of alienation signed by the parties thereto or by their agents acting on their written authority.*” (Own emphasis) Scott JA pointed out that the object of the provision is to put the proof of the alienation of land beyond doubt and thereby in the public interest to avoid unnecessary litigation

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<sup>169</sup> 2007 (2) SA 172 (SCA).

<sup>170</sup> Para [2] – [6].

<sup>171</sup> Para [2].

<sup>172</sup> 68 of 1981.

<sup>173</sup> Para [7].

The question before the court was whether, in an agreement of sale of immovable property which was signed by one trustee (out of three) in the absence of such authority in the trust deed, such a trustee should be regarded as an ‘agent’ within the meaning of section 2(1) of the Alienation of Land Act. It was clear from the trust deed that there was nothing to suggest that the trustee may act on behalf of the other trustee without their authority, in actual fact the trust deed intended for the trustees to act jointly.<sup>174</sup>

### **3 4 2 Court’s judgment and *ad hoc* relief offered to the “*bona fide* outsider”**

In the judgment, Scott JA pointed to two basic trust principles, firstly, that a trust is not a juristic person, but merely ‘an accumulation of assets and liabilities’ or a ‘separate entity’. The trust assets and liabilities vest in the trustees and are administered by them. The trustees are not the agents of the trust or its beneficiaries. Secondly, unless the trust deed provides otherwise, trustees must act jointly in order for them to bind the trusts and it is in this respect that a trust differs from partnership.<sup>175</sup>

Having looked at the provisions of the trust, Scott JA pointed that there was nothing to suggest that a trustee was authorized to act on behalf of the other trustees without their authority. On the contrary, the deed clearly contemplated them jointly.<sup>176</sup> However, looking at Thorpe’s actions in the conduct of the trust businesses and in signing the agreement, Thorpe signed both as principal (he himself being a trustee) and as an agent (on behalf of the other trustees). This served as clear indication to the court that Thorpe was acting independently of his co-trustees, a clear indication of lack of separation between himself and the trust. A closer look of his actions further exemplified the actions of a partner in a partnership rather than those of a co-trustee.

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<sup>174</sup> Para [10].

<sup>175</sup> Para [12].

<sup>176</sup> Para [10].

In the light of the joint action principle and the provisions of section 2(1), and based on the facts of the case, the court came to the following decision:

- (a) As trustees must act jointly, unless the trust deed provides otherwise, the assent of a single trustee to a contract does not bind the trust. The trust deed in Thorpe contained no provision to the effect that a single trustee could act on behalf of the others without prior authority. Although the other two trustees were party to the decision to enter into the agreement of sale and actually did authorize Mr Thorpe to do so the authority of neither was in writing and give the requirements of section 2(1), it was indeed required.<sup>177</sup>
- (b) The contract was rendered void *ab initio* and the subsequent written ratification by the two co-trustees could not salvage it. The appeal accordingly had to be dismissed.

Scott JA concluded his judgment by applying the comment of Cameron JA in *Parker* to the actions of the trustees in the present matter; that the Brian Edward Thorpe trust is typical of the modern business or family trust in which there is blurring of the separation between ownership (or control) and enjoyment, a separation that is the very core of the idea of a trust. The situation had the effect that, although Thorpe wished to continue with the contract, the “*bona fide* outsider” decided to end it based on the fact that the trustees failed to act jointly. This is clearly one of those rare cases where the court came to the aid of the “*bona fide* outsider”.

### 3 5 *Nedbank Ltd v Thorpe*<sup>178</sup>

#### 3 5 1 Facts<sup>179</sup>

*Nedbank Ltd v. Thorpe*<sup>180</sup> case concerned an application for an order provisionally sequestrating the estate of Thorpe (the respondent). The bank (the applicant) alleged that Thorpe had established various family trusts (of which he was both a

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<sup>177</sup> Para [15].

<sup>178</sup> [2009] ZAKZPHC 44.

<sup>179</sup> The facts of the case as explained by De Waal 2011 *Rabels Zeitschrift* 1078 - 1079.

<sup>180</sup> *Nedbank Ltd v Thorpe* 2008 JDR 1237 (N).

trustee and a beneficiary), which he effectively used to “insulate his wealth from creditors and thereby to frustrate the efforts of his creditors to recover debts owed to them”.<sup>181</sup> The bank accordingly submitted that, if his estate were sequestrated, it would become possible to investigate his business affairs and to locate trust assets that in reality belonged to him in his private capacity.<sup>182</sup> Based on an analysis of the facts of the case, the Court concluded that there was indeed a “strong suspicion” that Thorpe was simply conducting his personal business through the trust.<sup>183</sup> It consequently granted the provisional sequestration order.

In the follow-up case, where the granting of a final sequestration order was considered, the issue of the true status of the trust and its assets was once again central.<sup>184</sup> Here the Court conducted a more thorough investigation into the trust and its affairs, and it emphasized the following aspects regarding Thorpe’s relationship with the trust: the trust deed provided that he could not be removed as trustee;<sup>185</sup> it was “apparent” that he controlled the trust and access to the funds held by the trust;<sup>186</sup> in a tax return his income was declared as “trustee remuneration”,<sup>187</sup> and the trust income allowed him to enjoy “an affluent lifestyle”.<sup>188</sup> It was therefore probable that “the true and complete control of the trusts” vested in Thorpe.<sup>189</sup> Moreover, there was enough evidence that he utilized the trusts to receive income generated by his various activities and to “insulate his wealth and assets” from his creditors.<sup>190</sup>

### **3 5 2 Court’s judgment and *ad hoc* relief offered the “*bona fide* outsider”**

K Pillay J concluded:<sup>191</sup>

“I am satisfied that, on the above evidence, a trustee, duly appointed to his estate, would be in a far better position than the Applicant to fully investigate the way in which

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<sup>181</sup> Para [4].

<sup>182</sup> Para [5].

<sup>183</sup> Para [49].

<sup>184</sup> *Nedbank Ltd v Thorpe* [2009] ZAKZPHC 44 (unreported, accessible at <http://www.saflii.org/za/cases/ZAKZPHC/2009/44.html>).

<sup>185</sup> Para [17].

<sup>186</sup> Para [18].

<sup>187</sup> Para [23].

<sup>188</sup> Para [24].

<sup>189</sup> Para [27].

<sup>190</sup> Para [27].

<sup>191</sup> Para [28].

the Respondent has used the institution of trust to shield his wealth from his creditors. That is quite apparent from a reading of the record of the section 65 enquiry that the greater powers of investigation accorded to a trustee will be required to fully investigate the Respondent's financial position, particularly in relation to the **Banavie Trust.**"

This case is a typical example of an insolvency case where the court granted a final sequestration order against a trustee's private estate because it foresaw the possibility of 'going behind the trust form', with the result that trust assets could eventually be used to satisfy the "*bona fide* outsider".<sup>192</sup>

### **3 6 Van der Merwe v Hydraberg Hydraulics CC; to Van der Merwe v Bosman<sup>193</sup>**

#### **3 6 1 Facts**

The applicants purchased a business from Hydraberg Hydraulics CC as well as the land on which the business was operated from the Hydraberg Trust (the trust), in terms of a single indivisible agreement. The trust deed provided that there was to be a complement of three trustees. However, the two trustees who managed the affairs of the trust simply ignored the existence of the third, so-called "independent" trustee, and did not involve him in the management of the trust nor did they consult him when the agreement in question was concluded. The trustees continued to conduct the trust's affairs as if they were the proprietary affairs of the founder/trustees personally.<sup>194</sup> The first application was for the rectification of the deed of sale to reflect the correct description of the trust and for an order directing the trust to effect transfer.<sup>195</sup> The second application sought to enforce a restraint of trade provision included in the sale agreement.<sup>196</sup> The applications were heard together.<sup>197</sup> As a result of the indivisibility of the agreement, the outcome of the applications hinged on whether the trust was bound to the agreement or not. The respondents (the trustees)

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<sup>192</sup> Para [28]. Such an order was in fact granted in the more recent case of *First Rand Limited Trading as First National Bank v Britz* [2011] ZAGPPHC 119 (unreported, accessible at <http://www.saflii.org/za/cases/ZAGPPHC/2011/119.html>). See the discussion of the case in para 3 8 below.

<sup>193</sup> 2010 (5) SA 555 (WCC).

<sup>194</sup> *Van der Merwe* para [36].

<sup>195</sup> Para [2].

<sup>196</sup> Para [3].

<sup>197</sup> Para [3].

claimed that the agreement was void, firstly, because only two out of the three trustees (Clarke and Bosman) had signed the agreement and the trust was thus not properly represented. Secondly, there had been no written authority from the trust, as required by section 2(1) of the Alienation of Land Act, to empower the two trustees to execute the agreement of sale as agents of the trust.<sup>198</sup>

The applicants (purchaser) maintained that the involvement of the absent trustee (Slabbert) had not been required, because the trust deed provided for a majority decision being binding upon dissenting or absent trustees and also because he had ceased to be a trustee by the time the sale agreement was signed. This and/or his discharge by the remaining trustees triggered the termination of his appointment as trustee in terms of the trust instrument. In the alternative, the applicants contended that, were the court to make a finding that Slabbert remained in office as trustee, then, the trustees should nevertheless be held bound to the agreement by reason of the *Turquand* rule.<sup>199</sup> Failing that, as second alternative, the circumstances of the matter were such that it would be competent for the court to “disregard the veneer of a trust” in order to give effect to the transaction.

### **3 6 2 Court’s judgment and *ad hoc* relief offered to the “bona fide outsider”**

The judgment by Binns-Ward J can be summarized<sup>200</sup> as follows:

- (i) The rule that co-trustees must act jointly derived from the nature of the trustees’ joint ownership of property. In the absence of a contrary provision in the trust deed, the trustees had to act jointly if the trust is to be bound by their acts. The provision in the trust instrument, allowing trustees to make decisions by a majority vote, did not amount to an exception to the rule that trustees must act jointly. It merely provided that a majority decision would bind dissenting or absent trustees. The minority was still required to act jointly with the other trustees in executing the resolution adopted by the majority.<sup>201</sup>

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<sup>198</sup> Para [9].

<sup>199</sup> Para [16].

<sup>200</sup> See also Van der Linde 2012 *THRHR* 373.

<sup>201</sup> Paras [14] and [16].

- (ii) A majority decision was still required to have been made at a quorate meeting of trustees. In order to have qualified as a meeting, all trustees in office should have been notified thereof, so that they were afforded an opportunity to participate in making a decision. Slabbert did not receive such notice.<sup>202</sup>
- (iii) Slabbert did not resign as trustee in any permitted manner. The clauses of the trust instrument relied on by applicants for the contention that Slabbert had ceased to be a trustee, did not, properly construed, support such a contention.<sup>203</sup>
- (iv) Since the trust instrument did not provide for a power to the trustees, authorising one or more of their number to make decisions on the trust's behalf, the *Turquand* rule could not find application. Even if it could have been applied, it would still not have resolved non-compliance with section 2(1) of the

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<sup>202</sup> Para [16]. This view is supported by the recent case of *Steyn v Blockpave (Pty) Ltd* 2011 (3) SA 528 (FB), which concerned certain points raised *in limine*. A resolution to authorise the institution of legal proceedings was taken by a majority of trustees in the absence and without the knowledge of the third marginalised trustee. The question was whether the trust was properly before the court. The third trustee was not consulted and did not attend the meeting. She was unaware of the meeting or its agenda. Rampai J summarised the position as follows (para 14): “The trust’s decisions have to be supported by a minimum of two trustees to be internally valid and binding on the body of three (annexure R9). The trustees’ meeting of 14 January 2010 was seemingly quorate because only one trustee was absent (clause 3.1 of the trust deed). The first and the second applicants attended the meeting. They could theoretically have taken the decision to sue the respondent on behalf of the trust, provided the third applicant was consulted in advance about this. Whether she was for or against such a decision would not have been an important matter, if only she had been properly consulted but outvoted by two to one out of the trust body of three.” Furthermore the court stated (para 34): “The plain truth is simply that there was no majority to speak of. There were only two trustees. The true character of the trust that we are here dealing with is tripartite. The trust body with a full complement of three trustees, as envisaged in the trust deed, was not in existence, and the trust estate was unable to operate.”

<sup>203</sup> Para [18]. Where a trustee chooses to resign “informally” (as Slabbert allegedly did in this case), rather than in accordance with the prescripts of s 21 of the Trust Property Control Act, or alternatively, the prescripts of the particular trust instrument, such purported resignation is ineffective and provides no justification for the remaining trustees to exclude the first-mentioned trustee from trustee decision-making. Such a situation could have serious consequences for the “resigning” trustee (who can be held personally liable by beneficiaries for breach of trust) as well as for the “remaining” trustees (it can be said that they debased the trust form by ignoring the independent trustee). The Act is silent on when the resignation of a trustee actually takes effect, namely, whether it can be the date of resignation, or the date on which the resignation is received by the Master, or what other date. For the sake of legal certainty, Pace and Van der Westhuizen *Wills and trusts* (2010) B6.2.4 - submit that the resignation can take effect (and the authority granted thus terminated), only after the Master has removed the name of the trustee from the letters of authority. This was confirmed in *Soekoe v Le Roux* (unreported case no 898/2007 OFSPD of 29/11/2007) where Rampai J, held: “I have already found that the respondent’s resignation on 10 October 2006 did not legally relieve him of his duties as a trustee. He remained legally accountable to his fellow trustees for the entire period until the Master of the High Court officially removed him from the office as a trustee. The respondent’s duties did not fall away when he resigned, but when he was replaced with the third applicant.” Trustees must make sure that the Master receives their resignation and that their names are removed from the letters of authority. The remaining trustees, equally, have an interest in ensuring that the name of the resigning trustee is removed before they enter into transactions with thirds.”

Alienation of Land Act, the remaining trustees not having been authorized in writing to act on Slabbert's behalf.<sup>204</sup>

- (v) Courts should, in deciding whether to “disregard the veneer of a trust”, be directed by the question whether it would be conscionable for a court to give credence to a natural person's disguise of him- or herself as a “trustee” of what was in reality treated by such person as his or her “own property”.<sup>205</sup>
- (vi) It would have been appropriate (in this matter) to have disregarded the veneer of the trust form, either by holding the delinquent trustees personally liable for performance, or directing the trust to perform as if the obligation had been properly incurred by the trustees acting in that capacity. However, while it would have been possible to disregard the veneer of the trust, the court could not ignore the *constituted legal concept (the trust)*<sup>206</sup> when it came to compliance with the peremptory requirements of applicable legislation.<sup>207</sup>

The court stated that the facts of the matter showed clearly that there was an abuse of the trust figure. What emerged further from the facts was the “*bona fide outsiders*” desperate plea for protection from the apparent abuse of the trust form by the trustees. Their alternate pleas to the court for a finding that Slabbert be regarded as if he was in office as trustee when the contracts were concluded was raised with the hope that the three trustees will nevertheless be held bound by the court to the agreement by reason of the *Turquand* rule. Failing which, then the court would consider “piercing the veneer” of the trust because the two remaining trustees conducted their personal affairs through the trust. Unfortunately none of the *ad hoc* solutions hoped for came to be. The lack of compliance with the formal requirements regarding the sale of land forced the court to dismiss the applications against the trustees.

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<sup>204</sup> Paras [28]–[29]. See the discussion by Olivier and Van den Berg *Trustreg en praktyk* (2006) 3–42. See also *Parker* para 14 84F/H, although the court later (para 18) stated that within its scope the rule may well, in suitable cases, have a useful role to play in securing the position of outsiders who deal in good faith with trusts that conclude business transactions. See, previously, *Man Truck and Bus (SA) Ltd v Victor* 2001 (2) SA 562 (NC); *Nieuwoudt supra*.

<sup>205</sup> Para [38]. See also paras 3 5–3 6 in ch 3, these chs form the basis for the discussion in paras 4 5.

<sup>206</sup> See ch 5 para 5 3.

<sup>207</sup> Para [42]. In terms of s 2 an alienation of land is of no effect unless contained in a deed of alienation of land signed by the parties or their agents acting on their written authority.

### 3 7 *Khabola v Ralitabo*<sup>208</sup>

#### 3 7 1 Facts

This case is considered as an excellent example of a case of a “sham”. The applicant is a trustee of a business trust known as Lithakali Development Trust which owned a piece of land on which farming activities were conducted. The land was sold to the fourth respondent and three other trustees cited is first, second and third respondents. The applicant sought an order setting aside the sale of the trust property in his personal capacity. The other co-trustees and the fourth respondents opposed the application.<sup>209</sup>

In this application it was agreed that the court must decide *locus standi* of the applicant and the co-trustees to bring in the applications against each other.<sup>210</sup> In terms of the trust deed Khabola is the founder and the other trustees, mere trustees. What was also apparent is the fact that the trust deed did not make provision for beneficiaries.<sup>211</sup> This lack of beneficiaries already posed a challenge to the validity of the trust because the trust object was not clearly defined in the trust deed as a required essentialia of a valid trust.

The basis of the trust was a joint venture in terms of which trustees would jointly acquire agricultural land on which farming activities would be were to be conducted and each had to contribute a monthly amount towards repayment of loans from the Land Bank and Department of Land Affairs.<sup>212</sup>

#### 3 7 2 Court’s judgment and *ad hoc* relief offered to the “bona fide outsider”

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<sup>208</sup> 2011 ZAFSHC of 24/03/2011.

<sup>209</sup> Para [1].

<sup>210</sup> Para [2].

<sup>211</sup> Para [3].

<sup>212</sup> Para [3].

“In deciding the question of whether the parties herein have locus standi to initiate legal proceedings against each other over the trust property, Moloi J<sup>213</sup> pointed at certain aspects must be considered:

“(a) from the above exposition and especially the contributions that the co-trustees were expected to make, it seem the parties intended to form a partnership or some other association which was simulated as a trust; and (b) Having found that the parties clearly had the formation of a partnership in mind from the onset and tacitly agreed to the applicant performing the role of a general manager, the alleged trust seems simulated. No meetings of trustees were held either. Of course the partners in a partnership have a right to sue each other.”

It is clear from above that the court treated the arrangement purporting to be a trust in accordance with actual underlying relationship, namely, a business partnership. The *‘intention and therefore the substance’* played an important role to unmask the trust as a “sham”. The consequence of the “sham” is that no valid trust came into being and this opened the opportunity for the court to proceed to hear the other aspects relating to the validity of the Deed of Sale, compliance with the Alienation of Land Act and the validity of the counter-application. The judgment affords an example of a “sham” trust, notwithstanding that the term is not used outright by the Judge.

### **3 8 First National Bank v Britz<sup>214</sup>**

#### **3 8 1 Facts**

In the case, FNB provided the Izani Trust (of which Britz and his wife were the only co-trustees) with an overdraft facility. Mr and Ms Britz entered into a suretyship agreement with FNB binding themselves as sureties and co-principal debtors with the Izani Trust in respect of the said overdraft facility.<sup>215</sup> The Izani Trust could not service its debt in respect of the overdraft facility, and eventually an amount of about

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<sup>213</sup> Paras [4] and [5].

<sup>214</sup> [2011] ZAGPPHC 119 of 20/07/2011.

<sup>215</sup> Para [5].

R563 363,46, plus interest, became due and payable ('outstanding amount') by the Izani Trust to FNB.

In the *case aquo*, judgment was granted in favour of FNB (the “*bona fide* outsider”) for repayment of the outstanding amount by the Izani Trust and Mr and Ms Britz (as sureties). The warrant of execution was subsequently issued against Mr and Ms Britz in their personal capacities and in their capacities as trustees of the Izani Trust.<sup>216</sup> When the sheriff went to the house where Mr and Ms Britz resided to execute the judgment, he could not find sufficient disposable assets to satisfy the warrant of execution. Britz and his wife said that they had donated the house, furniture and all of their movable assets to the 14 Ackermannstraat Trust (of which they were the only trustees). As a result, the sheriff could not attach the movable assets because they belonged to the 14 Ackermannstraat Trust and not Mr and Ms Britz in their personal capacities.

It transpired from the trust deed of the 14 Ackermannstraat Trust, among others, that

- (i) the Brizelle Trust was the sole beneficiary of the 14 Ackermannstraat Trust;
- (ii) the Brizelle Trust had power to remove and replace any trustee of the 14 Ackermannstraat Trust;
- (iii) the 14 Ackermannstraat Trust would exist until it was terminated by the trustees (Mr and Mrs Britz).
- (iv) the house where Mr and Mrs Britz resided was registered in the name of the Brizelle Trust;
- (v) Mr and Ms Britz were the only trustees of the Brizelle Trust;
- (vi) Mr and Ms Britz had power to appoint additional trustees; and
- (vii) Mr and Ms Britz and their children were the sole beneficiaries of the Brizelle Trust.

In order to attach assets purported to be owned by both the 14 Ackermannstraat Trust and the Brizelle Trust, FNB applied for a court order declaring all such assets

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<sup>216</sup> Para [11].

of Mr and Mrs Britz in their personal capacities and to be executed by FNB in order to recover the outstanding amount.<sup>217</sup>

FNB argued that the 14 Ackermannstraat Trust and the Brizelle Trust were the 'alter ego' of Mr and Ms Britz, and had it not been for the trust figure, they would have acquired the property, supposedly belonging to the said trusts, in their own names.<sup>218</sup>

### **3 8 2 Court's judgment and *ad hoc* relief offered to the “*bona fide* outsider”**

The court referred to the important principle set down in the case of *Badenhorst v Badenhorst* wherein it was stated that whether trust assets should be included in the husband's estate for purposes of redistribution in terms of section 7(3) of the Divorce Act, the *de facto* control of the trust assets by the husband must first be established. The court there held that the mere fact that the trust assets vested in the trustees and did thus not form part of the trustee's estate, did not *per se* exclude such assets from consideration when determining what had to be taken into account when making a redistribution order. The person who alleges that assets that purportedly belong to a trust in fact belong to a person, must prove that such person controlled the trust, and but for the trust would have acquired and owned the said assets in his or her own name and that such control must be *de facto* and not *de iure*.<sup>219</sup>

Mabuse J noted that from the circumstances it was evident that Mr and Ms Britz did not treat the trusts as a separate entity; instead it was used as their “alter ego” in which they consciously rearranged their financial affairs to frustrate the claims of their creditors.<sup>220</sup> By rearranging their financial affairs and using the trust as their “alter ego”, Mr and Ms Britz were divested of all their attachable property, leaving them at leisure to incur debts without the fear of the consequences of defaulting on such debts. Therefore, FNB was correct in submitting that the assets of the trusts in reality belonged to the Mr and Ms Britz in their personal capacity.<sup>221</sup>

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<sup>217</sup> Para [1].

<sup>218</sup> Para [22].

<sup>219</sup> Paras [43] and [44].

<sup>220</sup> Para [26].

<sup>221</sup> Para [27].

As it has become the norm with the “newer type of trusts”, the court alluded to the fact that this is but another case of the abuse of the trust instrument. Mabuse J concluded that Mr and Ms Britz did not treat the trusts as separate entities, but instead used them as their “alter egos”, administering the trusts affairs for their own benefit while frustrating the claims of the “*bona fide* outsiders” who contracted with them. The trusts were not “actually separate” from Mr and Ms Britz as trustees. The Judge, therefore, came to the conclusion that when trustees of a trust do not treat the trust as a separate entity, the corporate veil will be pierced. In order to establish piercing of the corporate veil, the “*bona fide* outsider” need only prove that the trustees have not treated the trust as a separate entity but as their “alter egos” in order to promote their private and personal interest, which was indeed the case here.<sup>222</sup>

Much to the delight of the “*bona fide* outsider” Mabuse J awarded them the relief sought by making the trusts’ assets executable for the personal debts of the Mr and Ms Britz.

### **3 9 *Rees v Harris*<sup>223</sup>**

#### **3 9 1 Facts**

Harris, a representative of various companies, alleged that the Aljebami Trust, of which Rees was a trustee, was merely the ‘alter ego’ of Rees. Harris also sought to hold Rees personally liable for losses incurred by the trust, in respect of investments it had made in an unlawful and fraudulent Ponzi scheme. Harris directed substantial amounts of monies to entities controlled by Rees, for further investment by Rees. After the fraudulent investments were uncovered, Rees had relocated to Switzerland. Basically, the case required the court on appeal to determine whether the assets of the Aljebami trust could be considered to be the assets of the trustee for purposes of conforming jurisdiction through attachment of assets. In order to bring Rees before

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<sup>222</sup> Para [63].

<sup>223</sup> 2012 (1) SA 583 (GSJ).

the South African courts, Harris sought to ‘pierce the veneer of the trust’ in order to attach the assets of the trust, as if the assets were those of Rees.

The court held that piercing of the veil is an exceptional act. The separate legal personality of a corporate entity is to be recognized and upheld, except in the most unusual circumstances. The circumstances where a court will disregard the distinction between a corporate entity and those who control it depend on a close analysis of the facts of each case, considerations of policy and judicial judgment. There must at the very least be some misuse or abuse of the distinction between the entity and those who control it, giving them an unfair advantage. There will be no piercing unless the members of the entity dominate the finances, policies and business practices, to the extent that the corporate entity had no separate mind, will or existence of its own in the relevant transaction.

Harris alleged that Rees was always the front man in relation to the investments. Rees would advise Harris as to the financial viability of the investments and Harris relied completely on the knowledge, know-how and candidness of Rees. Rees for all intents and purposes controlled all the assets of the Trust. Harris alleged that Rees used the alter ego of the trust to siphon investors’ funds through several of Rees’ bank accounts to perpetuate various frauds through a Ponzi scheme and was now hiding behind the veil of the trust. The court had to decide whether this justified the stripping of the separate legal personality of the trust.

### **3 9 2 Court’s judgment and *ad hoc* relief offered to the “*bona fide* outsider”**

The court confirmed that in appropriate circumstances the ‘veneer of a trust could be pierced’ in the same way as the corporate veil of a company and came to the conclusion that for the necessary inference to be drawn that a trust was indeed the ‘alter ego’ of the trustee, certain primary facts had to be proved.

Despite the fact that it was clear that the functional separation between control and enjoyment of the trust by Rees was lacking, the court found that there was nothing to suggest, on a balance of probabilities, that the assets of the Trust were in fact the assets of Rees in his personal capacity. Harris failed to discharge the burden of

proof to establish that Rees, exclusively of his wife who was his co-trustee, controlled the trust to such an extent that the assets of the Trust were effectively Rees' own.

### 3 10 Conclusion

The rippling effects of the *Parker* decision affected most of the decisions that followed. The author is of the view that the decisions made by Cameron JA presented plausible and effective solution for “*bona fide* outsiders” to trustees’ abuse of trusts. Even though there are a few uncertainties and lack of uniformity created by the exercise of judicial discretion in the cases discussed, it is clear that when it comes to the form of relief or protection available to “*bona fide* outsiders” in dealings with trust (where there was an apparent abuse of the trust form), the courts are more willing to “go behind the trust form” or “pierce the trust veil” and declare that the trust was used as an “alter ego” of the founder and/trustee than to declare a trust a “sham”.

It is clear from some of the case law discussed above that if one of the trustees of a trust, without consulting the other trustees, as he should, signs a contract, for example an agreement of sale of immovable property between the trust as purchaser and another as seller, this may have certain consequences: On the one hand, if the trustee, of whom the trust is the “alter ego”, wishes to end such contract on behalf of the trust, he may not be able to. The other party to the contract will be able to invoke the *Turquand* rule and accept that all the internal requirements have been properly and duly performed.<sup>224</sup> The situation may also have the effect that, although the trustee concerned wishes to continue with the contract, the other party may decide to end the contract as was the case in *Thorpe v Trittenwein*.<sup>225</sup> In the absence of the joint decision of the co-trustees (or the majority if that is all the trust deed requires), the assent of a single trustee to a contract will not bind the trust. The reason is the rule that requires co-trustees to act jointly.

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<sup>224</sup> Stander “Piercing the Veneer of the Trust in the South African Trust Law: Liability of Trustees of a Business Trust for Fraudulent Trading 2008 *Int. Insol. Rev.* 176.

<sup>225</sup> 2007 (2) SA 172 (SCA).

It is also clear from the other cases discussed that the consequence for the abuse of the trust form is that the assets (forming part of the abuse transaction) are regarded as the personal assets of the founder and/trustee. The founder and/or trustee are held personally liable and their personal assets are susceptible for redistribution orders in terms of the Divorce Act,<sup>226</sup> creditor's claims or claims by SARS.

Whereas, in the case of a "sham", the court will ignore the trust form entirely and give effect to the transaction between the parties involved. Recently in the case of *Khabola v Ralitabo*,<sup>227</sup> the court, without actually declaring that the Lithakali Trust is a "sham", treated an arrangement purporting to be a trust in accordance with the actual underlying relationship that it truly was. The court held that the 'trust' was in fact a partnership simulated as a trust, and the decision made available the opportunity for the court to proceed to hear other aspects relating to the validity of the Deed of Sale, compliance with the Alienation of Land Act<sup>228</sup> and the validity of the counter-application brought by the respondents.

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<sup>226</sup> 70 of 1970.

<sup>227</sup> *Khabola v Ralitabo* (5512/2010) [2011] ZAFSHC 62 (24 March 2011).

<sup>228</sup> 68 of 1981.

## Chapter 4 Proposed *ad hoc* solutions to the abuse of trust the form and development of the trust law

### 4 1 Introduction

Most commercial activities conducted between business entities and/or such entities and “*bona fide* outsiders” are governed by some form of legislation.<sup>229</sup> However same cannot be said for commercial activities conducted with trusts. The Trust Property Control Act is devoted to regulate the control of trust property and to provide for matters connected therewith,<sup>230</sup> but it is devoid of any protective measures for “*bona fide outsiders*” who conclude business transactions with trusts. The cases discussed in chapter 3 examined the reasons for abuse of the trust form and the resulting effect thereof on “*bona fide* outsiders” in dealings with trusts.<sup>231</sup> It appears, from the case law discussed that the courts are reluctant to outright declare certain “trusts” invalid, or as being a “sham” but would rather give *ad hoc* relief to “*bona fide* outsiders” through methods appropriate to each case.<sup>232</sup>

As already mentioned a trust can be validly established with the right intentions but become abused or misused by the founder/trustees in the course of events thereby turning into the “alter ego” of the founder/trustees. Consequences of an “alter ego” is that the trust form can be set aside to allow an affected “*bona fide* outsider” to “pierce the veneer” of the trust or the “*bona fide* outsider” could consider invoking the *Turquand* rule. On the other hand, the possibility of a “sham” trust can be considered if from the outset the founder and/or “trustees” never had the real intention of creating a valid trust. The consequence of which would be to disregard the simulated trust form and treat the arrangement in accordance with the actual underlying relationship.

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<sup>229</sup> For example, Company Law Act 71 of 2008 for companies, Close Corporations Act 69 of 1984 for close corporations, Consumer Protection Act 68 of 2008, National Credit Act 34 of 2005 etc.

<sup>230</sup> See note 6 above.

<sup>231</sup> See also Van der Linde and Lombard “Identity of interest between trustees and beneficiaries in so far as the object of the trust is concerned: Effect on validity: *Nel v Metequity Ltd*” 2007 *De Jure* 429.

<sup>232</sup> Van der Linde 2012 *THRHR* 372; *Parker* para [37].

In *Parker*,<sup>233</sup> Cameron JA proposed possible *ad hoc* solutions for protection of “*bona fide* outsiders” against the abuse of the trust form by trustees.

- Firstly, in passing, the court proposed the translocation of company law doctrine known as the *Turquand* rule as a possible solution to safeguard the interests of “*bona fide* outsiders.”<sup>234</sup>
- Secondly, the court directed that the Master should appoint an “independent outsider”<sup>235</sup> as co-trustee to every trust under which the trustees are all beneficiaries and the beneficiaries are all related to one another.<sup>236</sup>
- Thirdly, the court suggested that trustees’ conduct could justify the inference that the trust was a “mere cover for the trustees to conduct business as if the trust’s property vested beneficially in them personally, and that the trust form is, therefore, in reality a “veneer” that in justice should be “pierced” in the interest of third parties such as creditors.<sup>237</sup>
- Fourthly, the court opined that the inference may in appropriate cases be drawn that a trustee who concluded allegedly unauthorized transactions with a third party was in fact authorized by the full trustee-complement to conclude the transactions in question as their agent.<sup>238</sup>
- Lastly, the author is of the view that the spirit of the *Parker* decision throughout puts emphasis on the adherence to the basic principles of the law of trusts in South Africa and the administration thereof. The author is of the view that Cameron JA’s<sup>239</sup> judgment in *Parker* may be interpreted to imply that if founders/trustees in their dealings with “*bona fide* outsiders” were to adhere to these basic principles of trusts it may be conducive to proper governance of

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<sup>233</sup> 2005 (2) SA 77 (SCA).

<sup>234</sup> Para [37.1].

<sup>235</sup> The definition of and characteristics of an “independent outsider” or “independent trustee” are discussed in para 4 3 below.

<sup>236</sup> Para [35].

<sup>237</sup> Para [37.2].

<sup>238</sup> Para [37.2]; See also *Van der Merwe v Hydraberg Hydraulics CC; Van der Merwe v Bosman* 2010 (5) SA 555 (WCC) para [41].

<sup>239</sup> Para [24].

trusts, and that, in turn, would provide some measure of protection for “*bona fide* outsiders” having dealings with them.<sup>240</sup> This proposal is not explored further in the dissertation, but suffice it to say that some form of legislative intervention is needed, on the one hand, to ensure compliance with the basic principles of trusts by the founder/trustees and, on the other hand, to ensure - in a form of a checklist for example - that “*bona fide* outsiders” have satisfied themselves that the trust in question is indeed compliant with the basic principles of trusts and administration thereof.

The possibility of publicly disclosing trust documents to ensure that “*bona fide* outsiders” are privy to internal procedural requirements pertaining to the administration of the trust, is discussed in paragraph 4.6 as one of the proposals for development of the Trust Property Act. With regard to the development of a checklist for “*bona fide* outsiders”, the author proposes that the checklist<sup>241</sup> should consist of, amongst others, the following questions that would help establish compliance with important principles of trusts in terms of the validity and the administration of the trust in question:

- (a) Is the trust a valid trust? – This question could set out all requirements for a valid trust.<sup>242</sup> The list could bare a warning regarding the requirement of *intention to create a trust* as the most important requirement because it serves to set apart a valid trust from a “sham”.<sup>243</sup>
- (b) Have the trustees been issued with Letters of Authority<sup>244</sup> by the Master authoring them to act in that capacity?
- (c) Is the “basic idea of trusts” or core idea of trust adhered to? This entails asking the founder/trustees information that would enable the “*bona fide*

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<sup>240</sup> See also Ch 1 para 1.1.1.

<sup>241</sup> See also Hutchison “Pitfalls in dealing with trusts: lessons to be learned from recent decisions of the SCA” <https://www.ensafrica.com/news/pitfalls-in-dealing-with-trusts-lessons-to-be-learned-from-recent-decisions-of?Id=1612&STitle=private%20cliens%20ENSight> (accessed 13 February 2015).

<sup>242</sup> See ch 2 para 1.1 note 124; Cameron *et al* (2000) 117.

<sup>243</sup> De Waal “The abuse of the trust (or: going behind the trust Form)” 2012 *Rabels Zeitschrift* 1084.

<sup>244</sup> Sec 6(1) of the Act provides that any person whose appointment as trustee in terms of the trust instrument, s 7 or a court order comes into force after the commencement of this Act, shall act in that capacity only if authorized thereto in writing by the Master.

outsider” to determine whether there is a separation of beneficial ownership from control. The trustees are required to administer the assets under their control for the benefit of the beneficiaries of the trust.<sup>245</sup>

- (a) Who controls the trust or is the trust the “alter ego” of the founder/trustees? – A bona fide outsider could ask to check if there is an independent trustee appointed in compliance with the proposal in *Parker*?<sup>246</sup> A close identity of interests between trustee-beneficiaries, as in most family trusts, may create problems on the question of authorization of trustees.<sup>247</sup>

This chapter focuses on the solutions proposed to the abuse of the trust form in the *Parker* decision and the possibility of how each remedy could be invoked for the protection of the vulnerable “*bona fide* outsiders” in their business dealings with the “newer type of trusts”. The chapter will also examine possible development of certain provisions in the Trust Property Control Act with the aim to afford some measure of protection to “*bona fide* outsiders” who have business dealings with this “newer type of trusts”.

## 4 2 The *Turquand* rule

In terms of the decision in *Royal British Bank v Turquand*<sup>248</sup> - commonly known as the *Turquand rule* or the *indoor management rule* - a means by which third parties were protected was formulated by the courts as early as the mid-19th century. The rule states that, when a third party enters into a contract with a company, there is a legal presumption that all acts of the company's internal management have been properly carried out. It is important to note that, in circumstances where the *Turquand* rule applies, the company will be bound to the contract even if it is proved that the necessary acts of internal management were not carried out or were irregular or defective or that the representative of the company had no authority to bind the company (for example by way of a resolution). The presumption, in terms of

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<sup>245</sup> *Parker* para [19] citing *Estate Kemp v McDonald's Trustee* 1915 AD 491 498; *Crookes NO v Watson* 1956 (1) SA 277 (A) 292 D-E and *Braun v Blann and Botha* 1984 (2) SA 850 (A) 856G.

<sup>246</sup> Para [35].

<sup>247</sup> *Parker* [37.2].

<sup>248</sup> (1856) 119 ER 886.

the *Turquand* rule, arises by operation of law and becomes irrelevant whether or not the third party had read the company's memorandum and articles to find out what the necessary acts of internal management were.<sup>249</sup>

In the context of the law of trusts, trustees who enter into business transactions on behalf of a trust with “*bona fide* outsiders” need to be aware of and comply with the provisions in the trust deed and other legal formalities in order to ensure that the contract is valid and binding to all parties.<sup>250</sup> In the same breath, “*bona fide* outsiders” who seek to enter into business transactions with trusts also need to be aware of the requirements and formalities that ought to be followed in order for the trust to be bound by the actions of the trustees.

A trust cannot be bound by the actions of its trustees if the trustees were not authorized to act on its behalf or where they do not have the capacity to act as trustees. The powers, duties, authority and capacity of trustees are tabled in the provisions of the trust deed and trustees are expected to be well acquainted with the contents of the trust deed. The problem facing “*bona fide* outsiders” who deal with trusts is that they are unaware or fail to take into consideration the contents of the trust deed and may be ignorant of the fact that a trustee may be unauthorized or incapacitated to act on behalf of the trust.<sup>251</sup>

The problem is compounded by the fact that in South African law of trusts there are no disclosure requirements for trusts when dealing with the general public.<sup>252</sup> Unlike in company law, the general public is left with no form of protection in business dealings with trusts. Pace and Van der Westhuizen<sup>253</sup> are of the view that the general public should be offered better protection in the form of, for example, legislation compelling trustees to prepare full financial statements, or that they should print their names (as trustees) on letterheads, amongst others, and that

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<sup>249</sup> Tshiki “The *Turquand* rule vs the doctrine of ultra vires. The decision in *Mbana v Mquma Municipality* 2004 (1) BCLR 83 (Tk) analysed.” Also *Mineworkers' Union v Greyling* 1948 (3) SA 831 (A).

<sup>250</sup> Geach and Yeats *Trusts Law and Practice* (2007) 134.

<sup>251</sup> Geach and Yeats (2007) 135.

<sup>252</sup> *Nieuwoudt v Vrystaat Mielies Edms Bpk* 2004 (1) All SA 396 (SCA) paras [18] - [19]. Also *Van der Merwe v Hydraberg Hydraulics CC; Van der Merwe v Bosman* 2010 (5) SA 555 (WCC) para [27].

<sup>253</sup> Pace and Westhuizen (2010) B4 4.2.3.

trustees be made personally liable when, for instance a unauthorized application of trust capital leads to insolvency or illiquidity of the trust.

For instance, the company law avails the so-called “doctrine of constructive notice” to “*bona fide* outsiders” who have business dealings with the company. The “doctrine of constructive notice” entails that everyone dealing with the company is presumed to be fully acquainted with the contents of the company which have been made publicly.<sup>254</sup> However, in order to keep an outsider’s duty to make enquiries within reasonable bounds and to restrict it to matters which are granted publicity, the court in *Royal British Bank v Turquand*,<sup>255</sup> formulated what has become known as the *Turquand* rule. The *Turquand* rule serves to protect persons who contract with companies, for they usually have no way of knowing whether there has been some internal irregularity that would invalidate the contract. The company will consequently be bound by the contract even though matters of internal management and procedure may not all have been complied with. The *Turquand* rule has been adopted as part of the South African company law and has been held to apply also to cases involving trade unions and municipalities.<sup>256</sup> The question that follows is whether the *Turquand* rule is also available to “*bona fide* outsiders” who enter into business transactions with trusts.

The possibility of the applicability of the *Turquand* rule to trust was considered for the first time in *MAN Truck & Bus (SA) Ltd v Victor*<sup>257</sup> where the court held that the rule prevented the trustees of a trust from contending that one of the two trustees had not given its consent to the conclusion of the surety agreement.<sup>258</sup> However, in reaching this decision, the point that the rule does not apply to a trust because it is not a juristic person, as is the case of a company, was not argued or raised.<sup>259</sup>

In *Vrystaat Mielies (Edms) Bpk v Nieuwoudt*<sup>260</sup> the court held that the applicability of the *Turquand* rule to transactions between trusts and third parties was essential and

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<sup>254</sup> Beukes “Does the *Turquand* rule apply to internal requirements in a trust deed?” 2004 *SA Merc LJ* 264.

<sup>255</sup> (1856) 119 ER 886.

<sup>256</sup> *Legg & Co v Premier Tobacco* (1926) AD 132. Beukes 2004 *SA Merc LJ* 264.

<sup>257</sup> 2001 (2) SA 562 (NC).

<sup>258</sup> 570F-G and 571F-H.

<sup>259</sup> 571D-C.

<sup>260</sup> 2003 (2) SA 262 (O).

had to be accepted. On appeal in *Nieuwoudt NO v Vrystaat Mielies (Edms) Bpk*<sup>261</sup> the court stated through Cameron JA that it was not necessary to decide on the issue of the applicability of the *Turquand* rule in the context of a trust. Several objections were raised regarding the applicability of *Turquand* rule to trust. The first objection raised against applying the rule to trusts is that a trust deed's prescripts on prerequisites for co-trustees' actions is not a matter of internal management, but rather one that determines the scope of joint trustees' authority.<sup>262</sup>

In *Standard Bank v Koekemoer*,<sup>263</sup> Mpati DJP confirmed a further principle of the trust law that actual or constructive knowledge of the contents of a trust deed on the part of outsiders dealing with the trustees has to be showed before such outsider can be held liable.<sup>264</sup> Where the trust deed contained a prohibition on on-lending and a bank, when making a loan to the trust, was put in possession of a copy of the trust deed, and the trustees subsequently made an on-lending through the same bank, it was held the bank did not have actual knowledge of the prohibition which could, if actual knowledge had been established, render the loan agreement unenforceable.

In *Land and Agricultural Bank of South Africa v Parker*<sup>265</sup> the abuse of the trust form was concisely identified as the lack of separation of ownership (or control) from enjoyment of the trust property. This abuse of the trust form was becoming prevalent in the "newer type of trusts" the so-called "family business trusts". It was precisely in this context that the trustees' disregard of the deed's prescripts on trustee numbers as well as the joint-action rule occurred. Unsurprisingly, the court offered the *Turquand* rule as a possibility to safeguard the interests of "bona fide outsiders".<sup>266</sup> Cameron JA inadvertently sought to incorporate the doctrine of *Turquand* rule into the trust when he suggested that within its scope the [*Turquand*] rule may well in suitable cases have a useful role to play in securing the position of outsiders who deal in good faith with trusts that conclude business transactions,<sup>267</sup> even though it is

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<sup>261</sup> 2004 (3) SA 486 (T); [2004] 4 All SA 261 (SCA).

<sup>262</sup> Para [20]-[21].

<sup>263</sup> 2004 (6) SA 498 (SCA) 503D-504A.

<sup>264</sup> Para [12] and [13].

<sup>265</sup> 2005 (2) SA 77 (SCA).

<sup>266</sup> Para [37.1]. See also Du Toit 2013 (internet article)

<sup>267</sup> Para [18].

a known fact that the rule is reserved for entities clothed with a separate legal persona.<sup>268</sup>

Cameron JA<sup>269</sup> stressed the fact that it was imperative for outsiders dealing with trusts to inspect the trust deed to ascertain how many trustees ought to hold office at any given time, and to determine that at least the minimum required number is in fact holding office at the time of the contract. He agreed with Mpati DP<sup>270</sup> that an outsider dealing with a trust has a manifest interest in ensuring that trustees have authority to encumber the trust property. However, Cameron JA<sup>271</sup> pointed out that trust deeds may be complex, verbose and incomprehensible. His view is that while outsiders have an interest in self-protection, the primary responsibility for compliance with formalities and for ensuring that contracts lie within the authority conferred by the trust deed lies with the trustees.<sup>272</sup>

*The decision in Van der Merwe v Hydraberg Hydraulics CC; Van der Merwe v Bosman*,<sup>273</sup> is yet another case which dealt with abuse of the trust form. The applicants (purchaser) maintained that the involvement of the absent trustee (Slabbert) had not been required when the agreement was concluded because the trust deed provided for a majority decision being binding upon dissenting or absent trustees and also because he had ceased to be a trustee by the time the sale agreement was signed. Thus, as an alternate prayer, the applicants contended that, were the court to make a finding that Slabbert remained in office as trustee, then, the

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<sup>268</sup> A trust does not have legal personality, except for certain specified instances, such as for insolvency purposes, the trust estate is a “debtor” but not a “body corporate” (*Magnum Financial Holdings v Summerly* 1984 (1) SA 160 (W) 163) which means that a trust is to be sequestrated and not liquidated, for purposes of the National Credit Act 34 of 2005 a “juristic person” is defined in [section 1](#) as including: “a trust if (a) there are three or more individual trustees; or (b) the trustee is itself a juristic person”, for purposes of the Firearms Control Act 60 of 2000 a “juristic person” now also includes “a trust” ([s 1](#) of the Firearms Control Amendment Act 28 of 2006 amends [s 1](#) of the 2000 Act), for the purposes of the new Companies Act [71 of 2008](#) a trust is included in its definition in [section 1](#) of the term “juristic person”. The significance of this is that it does not impose upon the trust a general legal personality but that for purposes of the Companies Act and all corporate structures where trusts and companies are involved and where they are “related” as defined in s 1 of the Act, the implications are significant and since the decision in *Joubert v Van Rensburg* 2001 (1) SA 753 (W) and the subsequent judgment in *Mkangeli v Joubert* 2002 (4) SA 36 (SCA), the Deeds Registries Act 47 of 1937 was amended by inserting in section 102 of the Act a definition of “person” which includes a trust.

<sup>269</sup> Para [32].

<sup>270</sup> In the judgment of *Standard Bank of South Africa Ltd v Koekemoer* case no 73/03 judgment of 27 May 2004 para [12] – it is also a family trust that contested liability for a loan.

<sup>271</sup> Para 3[2].

<sup>272</sup> Para [33].

<sup>273</sup> 2010 (5) SA 555 (WCC).

trustees should nevertheless be held bound to the agreement by reason of the *Turquand* rule.<sup>274</sup> Binns-Ward J<sup>275</sup> contended that the *Turquand* rule could not avail the applicants in the current matter. The trust instrument did not provide a power to the trustees to authorise one or more of their number to make decisions on the trustees' behalf, or to act as principals in respect of the Trust's affairs, otherwise than jointly with all the trustees. Even if it did, the applicants would not have been entitled to assume that such authorisation had been granted. . In his judgment Binns-Ward J<sup>276</sup> held that even if the *Turquand* rule could be called in aid, the rule will not help where a trustee is required by statute to be authorized in writing by the other trustees to conclude any agreement on behalf of a trust in respect of the alienation of immovable property, in compliance with section 2(1) of the Alienation of Land Act.<sup>277</sup>

Once again this case, like its predecessors, failed to state outright whether the *Turquand* rule is available to the “*bona fide* outsider” seeking to stop the trustees’ defence that they were not properly authorized to or delegated by the co-trustees to bind the trust.

As a point of note, one cannot talk of the *Turquand* rule and not make mention of the doctrine of “constructive notice”, as the two doctrines are significant items for consideration in company law. An article by CGF Research which was reviewed by Cliffe Dekker Hofmeyr Inc states:<sup>278</sup>

“The *Turquand* rule has now been codified in the new Companies Act<sup>279</sup> in an arguably stricter form, and further the doctrine of constructive notice has been abolished save for very limited exceptions. In short, with the exception where a third party knew or ought to have reasonably known that they were dealing with a person in a company who was not authorized to transact, a third party may now safely presume that the people within the company are complying with both the Companies Act and their own internal

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<sup>274</sup> Para [25].

<sup>275</sup> Para [28] citing *Nieuwoudt* para [22] per Harms JA F (as he then was) citing *Legg and Co v Premier Tobacco Co* 1926 AD 132 139.

<sup>276</sup> Para [29]; cf *Thorpe and Others v Trittenwein and Another* 2007 (2) SA 172 (SCA).

<sup>277</sup> 68 of 1981.

<sup>278</sup> Article by CGF Research sourced 26 Nov 2014

[http://www.insurancegateway.co.za/LifeProfessionals/PressRoom/ViewPress/URL=Holding+Companies+Accountable++The+Turquand+Rule+1#.VHWpi\\_MaK0E](http://www.insurancegateway.co.za/LifeProfessionals/PressRoom/ViewPress/URL=Holding+Companies+Accountable++The+Turquand+Rule+1#.VHWpi_MaK0E).

<sup>279</sup> Act 71 of 2008.

procedures and policies. Moreover, that people who say they are authorized to transact on behalf of the company are in fact authorized to do so. If any person in the company claims their authorization falsely, or does so regardless of the company's procedures or permissions, the company may find itself having to honour its obligations contained through such a contract which is now legally enforceable. The company would then have to pursue appropriate recourse against its unauthorized agent, whether those be disciplinary measures or claims for damages under the sharpened personal liability provisions of the Act."

In the light of the above developments in the South African company law, the doctrine of "constructive notice" has to a large extent been abolished in order to bring our company law in line with that of other jurisdictions.<sup>280</sup> In this regard, a person will no longer be deemed to have knowledge of the contents of any company documentation simply because such documentation has been filed with the relevant authority or is available for inspection at the company's registered office. The doctrine of "constructive notice" will, however, still apply to specific provisions of a company's "Memorandum of Incorporation", provided that such company's "Notice of Incorporation" or a "Notice of Amendment" subsequently filed has specifically drawn the reader's attention to such specific provision.<sup>281</sup> These companies are referred to as ring-fenced companies or "RF". In the event where a company's Notice of Incorporation draws attention to the existence of a special condition in the Memorandum of Incorporation and the company's name includes the suffix "RF", any person and third parties will be deemed regarded as having received notice and having knowledge of the special condition. Any person, including third parties, are deemed to have knowledge of a company's restrictions and imitations once the company's Memorandum of Incorporation states that the company is a "RF" company and the said persons and third parties are unable to raise a defense that they were unaware of certain restrictions or limitations of the company in their dealings with the said company. Since the Memorandum of Incorporation is a public

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<sup>280</sup> S 15(2) of the Company Act.

<sup>281</sup> Section 15(2)(b) and (c) of the Company Act allows a company's powers to be restricted by informing the public that a company's powers are either limited or restricted where a company's name is followed by the expression "RF", an acronym for ring-fenced. Section 11(3)(b) states that in the event of a company's MOI including any provision to section 15(2)(b) and (c), restricting or prohibiting the amendment of any provision of the company's Memorandum of Incorporation, the company name must be followed by the expression "RF". Section 13(3) states that in the event of a company's Memorandum of Incorporation including any provision to section 15(2)(b) and (c), the Notice of Incorporation is required to stipulate all such prohibitions and restrictions and the said prohibition and restriction locations in the Memorandum of Incorporation.

document, the common-law doctrine of constructive notice then applies in this instance.<sup>282</sup>

The author is of the view that should the doctrine be incorporated as part of South African trust law as a result thereof, it would then be required that the doctrine be incorporated into the provisions of a trust deed by the parties to the trust. Meaning that trustees will have to draw the attention of the “*bona fide* outsider” seeking to transact with the trust to such provisions in the trust deed, alternatively the Master would have to allow unrestricted access of trust documents to “*bona fide* outsiders” who are able to show cause that they have an interest in the trust. In chapter 4 paragraph 4 6, writer outlines suggestions for the amendment of trust legislation.

Examining the case law discussed in chapter 3 and in this chapter, it seems as though the judicial authority now is leaning slightly against the idea of advancing the use of the *Turquand* rule for the protection of “*bona fide* outsiders”. However, the author supports the view by Cameron JA<sup>283</sup> that the *Turquand* rule may be extended to South African trust law as this will have a useful role to play in safeguarding “*bona fide* outsiders” from unwarranted contestation of liability by trusts conducting business transactions. Cameron JA<sup>284</sup> further contends that in the event the *Turquand* rule does not find application with the trust, the common-law rules of delegation will still apply.

### 4 3 Appoint an independent outsider as co-trustee

On the prevention of abuse of the trust form and the regulator powers of the Master Cameron JA<sup>285</sup> suggested that the Master of the High Court should ensure adequate separation by insisting on the appointment of an independent outsider as trustee to every trust in which (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to one another. On the qualifications and other requirements for the independent trustee, Cameron JA<sup>287</sup> stated:

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<sup>282</sup> Hefer “Ring-Fenced Companies and the Doctrine of Constructive Notice” (2012) <http://www.onlinemoi.co.za/ring-fenced-companies-and-the-doctrine-of-constructive-notice> (accessed 12 February 2015).

<sup>283</sup> *Parker* para [18] and [37.1].

<sup>284</sup> *Parker* para [37.2].

<sup>285</sup> Para [35].

<sup>287</sup> Para [36].

“The independent outsider does not have to be a professional person, such as an attorney or accountant: but someone who with proper realisation of the responsibilities of trusteeship accepts office in order to ensure that the trust functions properly, that the provisions of the trust deed are observed, and that the conduct of trustees who lack a sufficiently independent interest in the observance of substantive and procedural requirements arising from the trust deed can be scrutinised and checked. Such an outsider will not accept office without being aware that failure to observe these duties may risk action for breach of trust.

The South African courts and academics<sup>288</sup> have questioned the efficacy of this measure. Be that as it may, following the learned Judge’s pronouncement there was uncertainty in the Office of the Master on the implementation of the decision regarding the appointment of independent trustees. After deliberations and discussions amongst two Judges, the Chief Master, two Masters’ directors and a representative from the office of the State Law Advisors, it was resolved<sup>289</sup> that the pronouncement by Cameron JA in the *Parker* decision be elevated to one of the requirements for lodgement and registration of *inter vivos* “family business trusts” by amending the Master’s JM21: Memorandum. The Masters Circular, under the heading Registration of trusts and appointment of trustees, reads as follows:

“1. To ensure that the registration of trusts and the appointment of trustees by the Master of the High Court is in line with the Judgment of the Supreme Court of Appeal of *South Africa in Land Agricultural Bank of South Africa v JL Parker and TT Parker*, Case no: 186/2003, the JM21E and the Acceptance of Trusteeship form have been amended to exercise a stricter control in respect of the independence of trusts and compliance with the Trust Property Control Act, 57 of 1988, and to assist the Master in exercising his discretion when making an appointment.”

Paragraph 2 of the circular<sup>290</sup> reminds the Masters’ officials that each matter is to be decided upon its own merits by taking into account all the information placed before the Master as well as adherence to the *audi alteram* rule.

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<sup>288</sup> Kernick “Declaration of Independence 2007 *De Rebus* 27.

<sup>289</sup> The decision was translated into Master of the High Court Circular No. 2 of 2005 (18 July 2005).

<sup>290</sup> *Ibid.*

The practice in the Master's office is that if, on the face of it, the trust documents exhibits characteristics of a "family trust"<sup>291</sup> with clauses therein that suggests an intention or powers conferred on the trustees to conduct business, the Master may request the trustee to comply with the requirement for appointment of an independent trustee. The Master may refuse to exempt the trustees from furnish security, even if exempted by the trust deed, where the parties to the trust refuse to nominate an independent person.<sup>292</sup>

The pronouncement is implemented as follows within the 15 offices of the Master; with regard to trusts which are already registered in the office, the Master will be in a position to invoke the requirement for appointment of an independent trustee<sup>294</sup> only as a result of a complaint from person whose interests have been affected. Where the trust is registered for the first time in the office of the Master and it emerges that the trust is a "family business trust", the Master may insist on the appointment of an independent trustee as per the *Parker* decision. Unfortunately, the decisions in *Badenhorst v Badenhorst*<sup>295</sup> and *Jordaan v Jordaan*<sup>296</sup> have, proven that an independent (outsider) trustee may not necessarily have much influence as an individual trustee who has to act as part of a larger board of trustees, especially where the dominant trustee ignores him and treats trust assets as their "alter ego".

Kernick<sup>297</sup> noted that it would be nearly impossible from a practical point of view to appoint a truly independent trustee. He stated that the Master neither has the expertise or the time to decide, without legislative criteria, who would in any particular case be regarded as an independent trustee. Nor does the Master have the expertise to identify what qualities an independent trustee in a particular circumstance should have, without any guidelines. Kernick is of the view that the answer lies not only in appointing an independent person but in educating trustees, and discouraging them from introducing business ethics (or lack thereof) in the

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<sup>291</sup> According to Cameron JA in the *Parker* decision – a "family trust" is a trust designed to secure the interests and protect the property of a group of family members, usually identified in the trust deed by name or descent or by degree of kinship to the founder – *Parker* para [25].

<sup>292</sup> S 6(2) of the Trust Property Act read with para 2 of Circular No. 2 of 2005 (18 July 2005).

<sup>294</sup> In terms of s 7(2) of the Act.

<sup>295</sup> 2006 (2) SA 255 (SCA).

<sup>296</sup> 2001 (3) SA 288 (CPD).

<sup>297</sup> Kernick "Declaration of Independence" 2007 *De Rebus* 27 29.

context of a trust. The author is of the view that the education of and/or working towards ensuring that trustees are educated or at least working towards that can be resolved by the establishment of a central regulatory body for trustees, as the one envisaged for insolvency liquidators,<sup>298</sup> wherein trustees would be affiliated and regulated.

Du Toit<sup>299</sup> states that the duty to choose an independent trustee should perhaps lie solely with the founder of the trust, and sets out certain guidelines upon which the founder can look when making the important decision. The author submits that the criteria could work best only with new *inter vivos* trusts. However, with regard to trusts already registered in the Master's office, the Master would still use his discretion if required to make an appointment of a co-trustee in terms of section 7(2) of the Act. The author further believes that a solution lies with proper regulation by way of development and/or amendment of the South African law of trusts to reflect the decisions of the courts. Establishment of a central regulatory body wherein trustees would be affiliated could also serve as a pool or source for educated and accredited trustees from which founders and /or the Master could draw independent trustees.

In Van der Merwe,<sup>300</sup> Binns-Ward J stated:

“The independent trustee's position can in any event never prevail against that of Clarke and Bosman, who if they vote together will always constitute a majority. In theory the trust could operate with real functional separation between control and benefit were additional trustees to be appointed thereby overriding the otherwise controlling majority of the entrenched initially appointed beneficiary trustees or their successors”

Despite all the criticism above, to date all 16 offices of the Master of the High Court implement Cameron JA's recommendations in *Parker*, and do not exempt trustees

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<sup>298</sup> A Ministerial Policy intended to be the policy for the regulation of insolvency liquidators is still underway. See also Calitz “Some thoughts on state regulation of South African insolvency law” 2011 *De Jure* 290-318 – who recommends the design and development of a strong central government agency responsible for regulating South African insolvency law which will be vital in assuring public confidence in the system of regulation and supervision, and in the process of insolvency law.

<sup>299</sup> Du Toit “Choose your Trustee with Care” 2007 *JBL* 91.

<sup>300</sup> Para [53].

from furnishing security where parties refuse to nominate an independent trustee for a “family business trust”, that is a trust wherein (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to one another. Whether this measure is effective and how exactly does it protect the “*bona fide* outsider” is not clear as yet. Suffice it to say that the biggest challenge facing the office of the Master is that in most of the “family business trust” when the trustee lodge documents, from the face of it, all trustees bears the same surname, and when confronted about the independent trustee, they simply insist that one of the trustees, even though bearing the same surname, is not related to them, and is thus the independent trustee. Therefore, the Master’s control is of no effect because the measure is not clear and not legislated.<sup>301</sup>

#### 4 4 “Piercing the veneer” of a trust or “going behind the trust form”

Judicial discretion to disregard or negate a juristic person’s separate personality is a generally accepted principle of law. The separate juristic personality of a company can be disregarded based on the common law “piercing the veil” doctrine.<sup>302</sup> This doctrine was explicitly recognised as part of the South African legal system in *Lategan v Boyes*,<sup>303</sup> with the judiciary indicating that it has “no doubt that our Courts would brush aside the veil of corporate identity time and again where fraudulent use is made of the fiction of legal personality”.<sup>304</sup> In case of a close corporation,<sup>305</sup> the judiciary is endowed with statutory power to negate separate juristic personality, where it is found that “the incorporation of, or any act by or on behalf of, or any use of, that corporation, constitutes a gross abuse of the juristic personality of the corporation as a separate entity”.<sup>306</sup>

The doctrine of “piercing the veneer or corporate veil” is best described by Stafford as follows:<sup>307</sup>

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<sup>301</sup> The author’s proposal regarding this issue is noted in paragraph 4 6 below.

<sup>302</sup> Van der Linde and Lombard 2007 *De Jure* 429 436.

<sup>303</sup> 1980 (4) SA 101 (T).

<sup>304</sup> *Ibid.*

<sup>305</sup> *Ibid.*

<sup>306</sup> S 65 of the Close Corporations Act 69 of 1984.

<sup>307</sup> Stafford 125.

“A company’s separate existence is, by way of metaphor, described as a “veil”. This veil is said to separate the company from its directors and protect them from the claims of those who deal with the company. The corporate veil, then, is a fundamental aspect of company law and is a protective device for those who exist behind it. However, under limited circumstances, the courts may ignore the limited liability of the company or close corporation and “pierce the corporate veil” such that the members or directors of the company become liable for the actions of the entity, despite their separate identities. Consequently, the courts will treat the company’s executives as if they were the owners of the company’s assets and as if they were conducting the company’s business in their own personal capacities.”

It is clear that in the sphere of companies the veil piercing doctrine affords directors and members of the company extensive protection against liability from outsiders as a result of the “veil” that exist around the company as a juristic person. However, under limited circumstances, the courts may ignore the limited liability of the company or close corporation and “pierce the corporate veil” such that the members or directors of the company become personally liable for the actions of the entity, despite their separate identities. This was also emphasised in a leading decision of *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*<sup>308</sup> that “a court has no general discretion simply to disregard a company’s separate legal personality whenever it considers it just to do so” and that it is a “salutary principle that our Courts should not lightly disregard a company’s separate personality, but should strive to give effect to and uphold it”.<sup>309</sup>

With the arrival of the *Parker* decision, a new era of the law of trusts was prompted. In *Parker*,<sup>310</sup> Cameron JA emphasized that “*the core idea of the trust is the separation of ownership (or control) from enjoyment*” by the beneficiaries. The learned judge noted, however, that this functional separation between control and enjoyment is entirely lacking in certain “newer type of trusts”, namely the “family business trusts”.<sup>311</sup> And it is this blurring between ownership (or control) and

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<sup>308</sup> 1995 (4) SA 790 (A).

<sup>309</sup> Van der Linde and Lombard 2007 *De Rebus* 436.

<sup>310</sup> Para [19].

<sup>311</sup> Para [25].

enjoyment that in some cases would warrant “going behind the trust form”.<sup>312</sup> Referring to the *Nieuwoudt*<sup>313</sup> case Cameron JA,<sup>314</sup> stated:

“Harms JA drew attention to this ‘newer type of trust’ where for estate planning purposes or to escape the constraints imposed by corporate law assets are put into a trust ‘while everything else remains as before’. The core idea of the trust is debased in such cases because the trust form is employed not to separate beneficial interest from control, but to permit everything to remain ‘as before’...”

Cameron JA<sup>315</sup> stated that it is believed that this trustee’ conduct can justify the inference that the trust was a ‘mere cover for the trustees to conduct business as before’, as if the trust’s property vested beneficially in them personally, and that the trust form is, therefore, in reality a veneer that in justice should be pierced in the interest of third parties such as creditors. In *Van der Merwe v Hydraberg Hydraulics*<sup>316</sup> it was suggested that this may be done in one of two ways: by holding the delinquent trustees personally liable for performance or by directing the trust to perform as if the obligation had been properly incurred by the trustees acting in the capacity that they purported to act.

As seen from some of the case law discussed in chapter 3, most of the abuse of the trust form situation stemmed from the use of the trust as an “alter ego” of the trustees, and in some of those cases, “piercing the veneer” of the trust was the justifiable *ad hoc* solution suggested by the court. As an issue worth noting and which has been alluded to by Van der Linde<sup>317</sup> is the fact that South African courts use different terminology to describe the required action to be taken when the trust form is debased. Different courts use terms ranging from “piercing the corporate veil”,<sup>318</sup> “to lift or pull aside the corporate veil”,<sup>319</sup> “going behind the trust form”,<sup>320</sup> “the trust form to be seen as a veneer that in justice should be pierced in the

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<sup>312</sup> Para [19] as happened, for example, in *Badenhorst v Badenhorst* and *Jordaan v Jordaan*.

<sup>313</sup> 2004 (3) SA 486 (SCA) para [17].

<sup>314</sup> Para [26].

<sup>315</sup> Para [37.3].

<sup>316</sup> Para [39].

<sup>317</sup> Van der Linde 2012 *THRHR* 376.

<sup>318</sup> *Jordaan* para 34 301D.

<sup>319</sup> *FNB* para 7.

<sup>320</sup> *Parker* para [18]

interests of creditors”;<sup>321</sup> and even “a court is entitled to know the trust as separate entity”.<sup>322</sup> In *Van der Merwe*<sup>323</sup> the court distinguished between “lifting the corporate veil”, in the case of a juristic person, and “piercing the veneer”, in the event of a trust. Van der Linde recommends that the phrase “piercing the veneer of the trust” be used in the future by South African courts for uniformity.<sup>324</sup> The author supports the recommendation in view of the fact that a trust is not a legal (or juristic) person. To allow the usage of the language such as “piercing the corporate veil” or “to lift or pull aside the corporate veil”, will undermine the basic theoretical principle of the nature of trusts and may cause confusion.

The legal bases on which a court would be willing to ‘go behind the trust form’, would primarily be the abuse of or misuse of the trust. According to Van der Linde<sup>325</sup> the need for the required action is often described as follows:

“The trust form was a “*mere cover*” for the conduct of business “as before”; the trust was the “*alter ego*” of the founder; the trust was a “*vehicle*” through which the founder protected himself if the trust was found to be a “*sham*”; the trust as a “*vehicle*” for his business activities; the trust as a “*mirage*” used by the founder for his own commercial ends; conducting the trust’s affairs as if they were the proprietary affairs of the founder/trustees “*personally*”; an “*identity of interests*” between trustees and beneficiaries; or because it bears the unwholesome hallmarks of the “newer type” of business trusts.”

As to the question when the courts are willing to exercise the discretion to disregard a company’s separate legal personality, it is contended by Van der Linde and Lombard<sup>326</sup> that the law is far from settled. They contend that the courts would be willing to disregard a company’s separate personality in the following circumstances:

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<sup>321</sup> *Parker* para [37.3].

<sup>322</sup> *FNB* para [69].

<sup>323</sup> Para [38].

<sup>324</sup> Van de Linde 2012 *THRHR* 377 note 44.

<sup>325</sup> With reference to the following case law *Parker* para [37]; *Jordaan* para [33]; *Badenhorst* para [7]; Court *a quo* in *Badenhorst* 2005 (2) SA 253 (C) para [25]; *Badenhorst* para [10]; *Nedbank* para 50 para [25]; *Van der Merwe* para [36]; *Parker* para [19] and *Nel* para [9]; *Nieuwoudt* para [17] and *Thorpe* para [17] respectively.

<sup>326</sup> Van der Linde and Lombard 2007 *De Jure* 437.

- Where fraudulent use is made of juristic personality;<sup>327</sup>.
- In a subsequent case of *Botha*, the court went one step further and indicated that the corporate veil could be pierced in case of an unconscionable injustice (“onduldbare onreg”);<sup>328</sup>
- In cases where fraud, dishonesty or other improper conduct is found to be present,<sup>329</sup> this is in line with the formulation as was suggested by Domanski “Piercing the corporate veil – a new direction” 1986 SALJ 224).
- In cases where policy considerations also carried weight with the labour court, where it was decided to disregard separate corporate personality to enable employees to claim awards from juristic persons to whom the business of previous employers have been transferred, where the juristic persons were in fact the old employer in a different guise, for example *Esterhuizen v Million-Air Services CC (In Liquidation)*<sup>330</sup>
- According to the court in *Van der Merwe*, the decision to “disregard the veneer” of the trust, like one to “*pierce the corporate veil*” (in case of juristic persons) would be a decision to afford an *equitable remedy*. However, the court did not give any authority for the finding why equity forms the basis of the remedy.<sup>331</sup> As a result of certainty in this regard, Van der Linde and Lombard are of the view that the vague principles may have the advantage that they give the court enough space to disregard separate juristic personality where it feels it necessary to do so in order to ensure an equitable outcome.<sup>332</sup> Writer supports the views in Van Der Merwe and by Van der Linde and Lombard in view of the fact the law does not offer outright protection to “*bona fide* outsiders” and lack of certainty because of the various approaches thus far.

Recently in *Van Zyl v Van Zyl*<sup>333</sup> Gautschi AJ stated:

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<sup>327</sup> *Lategan v Boyes* 1980 (4) SA 101 (T).

<sup>328</sup> *Botha v Van Niekerk* 1983(3) SA 513 (W).

<sup>329</sup> *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 (4) SA 790 (A).

<sup>330</sup> 2007 JOL 19507 (LC).

<sup>331</sup> Van der Linde 2012 *THRHR* 377.

<sup>332</sup> Van der Linde and Lombard 2007 *De Jure* 437-438.

<sup>333</sup> 2014 JOL 31973 (GSJ) para [17].

“A court is entitled to “lift” or “pierce” the “corporate veil”, which is done only in exceptional circumstances. A court has no general discretion to disregard the existence of a separate corporate entity whenever it considers it just or convenient to do so. One such instance where this is permitted is where the corporate entity is the alter ego of the controlling person. In an appropriate case, “the veneer of a trust can be pierced in the same way as the corporate veil of a company.”

As for the question of deciding when it would be equitable to “pierce the veneer” of a trust and what test to use for that purpose, Van der Linde explains it as follows:<sup>334</sup>

“The question whether it would be (equitable) to “pierce the veneer” is whether or not it would be conscionable for a court to give credence to a natural person’s disguise of him- or herself as a trustee of what is in reality treated by such person as his or her own property. The question is now whether this test will in the future serve as a *general test* in the event of alleged abuse of the trust form and whether the well-known test in *Badenhorst* provided by the Supreme Court of Appeal, would not have sufficed. Is the *Badenhorst* test thus only applicable in a claim for trust assets to be included in the estate of one of the parties to a marriage?”

The “*Badenhorst* test” reads as follows:<sup>335</sup>

“To succeed in a claim that trust assets be included in the estate of one of the parties to a marriage there needs to be evidence that such party controlled the trust and but for the trust would have acquired and owned the assets in his own name. Control must be *de facto* and not necessarily *de iure*.”

As to the question of why a second test, it is not clear. However, it is submitted that either test could be applied successfully as both tests have the same object in view namely, to prove that the trust was not used for its intended purpose.<sup>336</sup>

Therefore, by availing the remedy to ‘go behind a trust form’ and “pierce the veil of a trust” used as the “alter ego” of trustees or an “abused trust” could be a good measure for protecting “*bona fide* outsiders” in business dealings with trusts.

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<sup>334</sup> Van der Linde 2012 *THRHR* 379.

<sup>335</sup> Para [39].

<sup>336</sup> Harding 48.

Writer supports the view that the “piercing remedy” be legislated as has already been suggested by some of the legal the authors.<sup>337</sup>

#### 4 5 Agency versus joint action rule

One of the fundamental rules of South African law of trusts states that unless a trust deed directs otherwise, co-trustees must always act jointly in their dealings on behalf of a trust.<sup>338</sup> This rule is referred to as the joint-action rule. The joint-action rule is explained with reference to co-trustees’ co-ownership of trust property. For example in the *Parker* decision the court stated:<sup>339</sup>

“It is a fundamental rule of trust law, which this Court recently restated in *Nieuwoudt NO v Vrystaat Mielies (Edms) Bpk*, that in the absence of contrary provisions in the trust deed the trustees must act jointly if the trust estate is to be bound by their acts. The rule derives from the nature of the trustees’ joint ownership of the trust property. Since co-owners must act jointly, trustees must also act jointly. Professor Tony Honoré’s authoritative historical exposition has shown that the joint action requirement was already being enforced as early as 1848. It has thus formed the basis of the trust law in this country for well over a century and half”

In view of the fact that trustees hold a single office irrespective of their number,<sup>340</sup> it follows that such trustees must act jointly with regard to the trust property vested in them.<sup>341</sup> It submitted that the joint-action rule is not confined to acts through which trustees alienate or encumber trust property; but that the rule encompasses all trustee conduct. Though the rule is generally unproblematic in regard to charitable trusts or trusts under which trustees merely conserve property for beneficiaries, the rule’s operation with regard to trusts used primarily to conduct business or to undertake some commercial activity has posed numerous challenges to the courts.

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<sup>337</sup> Voster "Misbruik as gevolg van die miskenning van die besigheidstrust as afsonderlike trustentiteit Nov (2011) LLM Thesis North West University.

<sup>338</sup> Du Toit “Co-trusteeship and the joint-action Rule in South African Trust Law” 2013 TRUST LAW INTERNATIONAL 27(1) 18 – 28 at <http://repository.uwc.ac.za/xmlui/bitstream/handle/10566/620/DuToitCo-trusteeship2013.pdf?sequence=1> (accessed 03 September 2013) See also *Nieuwoudt v Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA) para [16]; *Thorpe v Trittenwein* 2007 (2) SA (SCA) para [9]; *Lupacchini v Minister of Safety and Security* 2010 (6) SA 457 (SCA) para [2].

<sup>339</sup> Para [15].

<sup>340</sup> *Desai-Chilwan v Ross* 2003 (2) SA 644 para [21].

<sup>341</sup> *Lupacchini v Minister of Safety and Security* para [2].

Strict compliance with the joint-action rule can at times cause practical difficulties. This is why, for example, trust deeds often contain clauses providing that decisions may be taken by a majority vote among the trustees.<sup>342</sup> In *Parker*<sup>343</sup> Cameron JA referred to such a provision as an “abrogation” of the joint-action rule requirement.

As a solution to the joint-action rule’s demands, the trust deed could include a provision that permits a full trustee-complement to delegate powers to a lesser of its number or to an outsider. Unsurprisingly, South African trust deeds frequently contain provisions to this effect.<sup>344</sup> Another such inclusion in trust deeds to counter the demands of the joint-action rule is the nomination of one on the co-trustees as managing trustee with executive powers that can be exercised without the other trustees’ concurrence.<sup>345</sup> Another proposed solution to alleviate practical difficulties with the operation of the joint-action rule is the inference drawn by the court in appropriate cases that ‘a trustee who concluded allegedly unauthorized transactions with a “bona fide outsider” was in fact authorized by the full trustee-complement to conclude the transaction in question as the agent of the other trustees.’<sup>346</sup>

With regard to the latter solution, Harms JA observed in *Nieuwoudt v Vrystaat Mielies (Edms) Bpk*<sup>347</sup> that the trustees may expressly or impliedly authorize someone to act on their behalf and that person may be one of the trustees. The case of *Grainco (Pty) Ltd v Broodryk*<sup>348</sup> provides an excellent example of the scenario above. In *Broodryk* the trust conducted a farming business. It had only two trustees, the first defendant and his 82 year old mother (the second defendant). The joint-action rule was confirmed in the trust deed, in that it required all trustee decisions to be taken unanimously.<sup>349</sup> According to Cillie J, it would have been ‘naïve’ to think that the first defendant obtained the consent of the second defendant each time he conducted the trust’s business. The necessary inference was therefore that the first defendant had received a general authorization from the second defendant to manage the affairs of

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<sup>342</sup> De Waal 2012 *Annual Survey* 851.

<sup>343</sup> *Parker* para [17].

<sup>344</sup> Du Toit 2013 (internet article).

<sup>345</sup> Du Toit 2013. .

<sup>346</sup> *Parker* para [42].

<sup>347</sup> Para [23].

<sup>348</sup> 2012 (4) SA 517 FB.

<sup>349</sup> Para [6.1].

the trust.<sup>350</sup> However, the court still sounded a warning that, in that context, it should be kept in mind that a trustee who has been authorized by his co-trustees to sign a deed of alienation of land can, in terms of section 2(1) of the Alienation of Land Act,<sup>351</sup> only act on the other trustees' written authority. In the absence of such written authority, the contract is invalid *ab initio*.<sup>352</sup>

As to the balance of proof, Du Toit stated as follows:<sup>353</sup>

“The South African legal position on agent’s ostensible authority to act on behalf of a principal is clear: it is not the agent’s assurance regarding the existence or extent of his authority that is determinative, but rather the principal’s representation, verbally or by conduct, that the agent had authority to act in the manner he had done. Where, therefore, a third party who contracted with an unauthorized co-trustee can show on a balance of probabilities that the full complement, through earlier joint action, represented that the contracting trustee is indeed empowered to act as their agent, the trust will be bound by the contract at hand.”

The author agrees with Du Toit<sup>354</sup> that invoking implied authority may be an effective solution for “*bona fide* outsiders” to trustee’s abuse of trusts. It is predicted that this remedy will feature pertinently in the courts’ future decisions as a measure of protection for “*bona fide* outsiders” on trustee distasteful conduct.

#### **4 6 Possible development of certain provisions in the Trust Property Control Act 57 of 1988**

It is clear from the cases discussed in chapter 3 that there is uncertainty and lack of uniformity created by the exercise of judicial discretion in resolving disputes involving “family business trusts” and “*bona fide* outsiders”. Cameron JA<sup>355</sup> in the *Parker* decision sounds a warning:

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<sup>350</sup> Para [6.4].

<sup>351</sup> 68 of 1981.

<sup>352</sup> *Karsten v Hughes* (3069/2012) [2012] ZAFSHC 170 (3 September 2012), following the decision in *Thorpe v Trittenwein*.

<sup>353</sup> Du Toit 2013 (internet source).

<sup>354</sup> *Ibid*.

<sup>355</sup> Para [34].

“While outsiders have an interest in self-protection, the primary responsibility for compliance with formalities and for ensuring that contracts lie within the authority conferred by the trust deed lies with the trustees. Where they are also the beneficiaries, the debasement of trust function means all too often that this duty will be violated. [34] *The situation may in due course require legislative attention.*” (Own emphasis)

To heed Cameron JA’s call the author examines the possible development of certain provisions in the Trust Property Control Act. In chapter 1 the author already indicated that trusts are regulated by the Trust Property Control Act.<sup>356</sup> The Act is not a complete codification of the law of trusts. Some aspects are still governed by the common law and developed in certain circumstances. The purpose of the Act is to regulate the control of trust property and to provide for matters connected therewith for the benefit of the beneficiaries. The purpose of the Master of the High Court, as far as the Act is concerned, is to regulate the administration of trusts. In any society regulation of legal institutions is brought about when the institution does not function properly or as it should and government intervenes by either using force to compel compliance or incentives to ensure compliance. In trusts, the strategy employed by the Master to regulate the administration of trusts is to use the Act and trust deeds to compel adherence to wishes of the founder/trustee, wherein noncompliance can be punishable by, for example, removal of a trustee from office,<sup>357</sup> request for security<sup>358</sup> (even where the trustee has been exempted from furnishing security) and/or appointment of a trustee or co-trustee.<sup>359</sup>

There are three types of interests at stake in the regulatory relationship: (i) the “regulator” (the Master) who forces the regulated to behave in a certain way for the benefit of a third party; (ii) the “regulated” (the trustee) who is forced to change his or her normal behaviour for the benefit of the third party; and (iii) the “third party” (beneficiaries) whose interest are to be protected by the regulatory relationship. The

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<sup>356</sup> 57 of 1988.

<sup>357</sup> S 20 of the Act.

<sup>358</sup> S 6(2) of the Act.

<sup>359</sup> S 7(1) or s 7(2) of the Act.

relationship between the Master and the trustee is not aimed at service delivery but is aimed at delivery of obligations<sup>360</sup> for the benefit of the third party.

When examining the trust concept, we note that it entails the element of holding or administering property for a person or object other than the trustee.<sup>361</sup> It is also common knowledge that parties to a trust are a founder, trustee(s) and beneficiaries and the “*bona fide* outsiders” who have dealings with the trustees on behalf of the trust do are not catered for in the regulatory relationship. In the *Parker* decision, Cameron JA alluded to a “newer type of trusts” which has emerged, where family trusts engage in business dealings with “*bona fide* outsiders”, binding trust property and thereby drawing the latter into the trust relationship itself. Based on this, the author is of the view that the moment a “*bona fide* outsider” enters into a business transaction with a trustee or trustees on behalf of a trust with, the latter is impliedly drawn or incorporated into the regulatory relationship, though not as beneficiaries; but as “third parties” whose interest also ought to be protected within the regulatory relationship.

The method of regulation used by the Master in the Act<sup>362</sup> is a mild form of regulation which is mainly aimed at forced disclosure of information. This form of disclosure of information makes the information available to stakeholders to enable them to make their decisions based on that information. Cameron *et al*<sup>363</sup> states that the policy reflected in the Act is that state control over trusts should be limited to a minimum level and this is done by application to court and not through the office of the Master. However, in the *Parker* decision, Cameron JA stated:<sup>364</sup>

“The situation may in due course require legislative attention. But that does not mean that the Master and the courts are powerless to restrict or prevent abuses. The statutory system of trust supervision invests extensive powers in the Master. These include the power to appoint trustees in the absence of provision in the trust instrument, and to appoint any person as co-trustee of a serving trustee where he

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<sup>360</sup> Sparrow *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance*, Brookings Institution Press, Washington D.C., 2000. 53 – 65.

<sup>361</sup> *Goodricke v Registrar of Deeds, Natal* 1974 (1) SA 404 (N) 408. See the definition of trust in ch 1 para 1 1 2.

<sup>362</sup> 57 of 1988.

<sup>363</sup> Cameron *et al* (2002) 181.

<sup>364</sup> Para [34].

considers it “desirable”, notwithstanding the provisions of the trust instrument. In addition, trustees require written authorisation from the Master before they may act in that capacity.”

The arrival of this “newer type of trusts” wherein the trust form is debased, calls for intervention through the Master and amendment of legislation. On the one hand, the author suggests that in order to heed the call of Cameron JA and give effect to the *Parker* decision, the following amendments where “family business trusts” are concerned ought to be considered:

- (i) Amendment of the Trust Property Act to include a section on “family business trusts”<sup>365</sup> which will deal with the requirement for the appointment of independent trustees,<sup>366</sup>
- (ii) Similar to section 16<sup>367</sup> of the Act, inclusion of a section wherein trustees at the written request of “*bona fide* outsiders” who are about to enter into business dealings with the trust, are instructed to deliver to the outsider a list of documents, comprising of the trust deed, copies of the letters of Authority and a copy of a resolution wherein trustees are empowered to transact with the outsider and lodge proof thereof with the Master OR a letter instructing the Master to furnish bearer thereof with information listed in the letter,<sup>368</sup>
- (iii) Inclusion in section 1 “definitions” a definition of “*a person of sufficient interest*” to mean beneficiaries or “*bona fide* outsiders” who have or intends to have dealings with the trust.

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<sup>365</sup> See the definition of “family business trust” below as set out in the proposed amendments of the Trust Property Control Act.

<sup>366</sup> Refer to para 4.3 above.

<sup>367</sup> S 16 of the Trust Property Act provides “(1) A trustee shall, at the written request of the Master, account to the Master to his satisfaction and in accordance with the Master's requirements for his administration and disposal of trust property and shall, at the written request of the Master, deliver to the Master any book, record, account or document relating to his administration or disposal of the trust property and shall to the best of his ability answer honestly and truthfully any question put to him by the Master in connection with the administration and disposal of the trust property.

(2) The Master may, if he deems it necessary, cause an investigation to be carried out by some fit and proper person appointed by him into the trustee's administration and disposal of trust property.

(3) The Master shall make such order as he deems fit in connection with the costs of an investigation referred to in subsection (2).”

<sup>368</sup> This will ensure that “*bona fide outsiders*” who intend to have dealings with trusts have the information beforehand and can be held liable personally for any disinformation.

The suggested amendments could be effected in a form of a Bill (open to debate in a public forum) as follows:

**GENERAL EXPLANATORY NOTE:**

\_\_\_\_\_ Words underlined with a solid line indicate insertions in existing enactments

**BILL**

To amend the Trust Property Control Act, 1988, so as to further regulate the activities of certain types of trusts; and to provide for matters connected therewith.

**BE IT ENACTED** by the Parliament of the Republic of South Africa, as follows:-

**Insertion of the definition of “*family business trust*” in section 1 Act 57 of 1988**

1. The following definition is inserted after the definition of “*court*” in section 1 of the Trust Property Control Act, 1988:

“*family business trust*” means a trust designed to secure the interests and protect the property of a group of family members, usually identified in the trust deed by name or descent or by degree of kinship to the founder, which is primarily used for carrying on a business for profit.<sup>369</sup>

**Insertion of the definition of “*person with sufficient interest*” in section 1 Act 57 of 1988**

2. The following definition is inserted after the definition of “*Master*” in section 1 of the Trust Property Control Act, 1988:

“*person with sufficient interest*” includes –

- (a) A beneficiary of the trust, including a capital beneficiary;

<sup>369</sup> See the explanation in ch 1 para 1 1, note 21.

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- (b) Any person who is not the founder of the trust, a trustee or a trust or a beneficiary of a trust, but has a *bona fide* intent to enter into commercial or other business dealings with the trustees on behalf of the trust.

### **Insertion of section 7(3) after section 7(2) of Act 57 of 1988**

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3. The following section is inserted after section 7(2) of the Trust Property Control Act, 1988:
- (3) When the trust to be registered with the Master is a family business trust:
- (a) The Master shall appoint an independent third party, who must be an attorney or a chartered accountant, as trustee in addition to any number of trustees authorised by the trust instrument;
- (b) The fee of the trustee appointed in terms of section 7(3)(a) shall be paid by the trust, and shall be equal to the fee paid to the other trustees. If the other trustees are remunerated at different rates, the trustee appointed in terms of section 7(3)(a) shall receive remuneration equal to the remuneration paid by the trust to the best paid trustee.

### **Insertion of section 16A after section 16 of Act 57 of 1988**

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4. The following section is inserted after section 16 of the Trust Property Control Act, 1988:

#### **Compulsory disclosure of certain documents**

- 16A Any person with sufficient interest may apply to the Master for copies of:
- (a) The trust deed;
- (b) The certificate of appointment issued by the Master in terms of section 7;

- (c) A written resolution signed by all the trustees authorising one or more of them to act on behalf of all of them.

The Master shall, on receipt of this request, give copies of the documents to the requester if such documents are available or, if such documents are not available, instruct the trustee to prepare the said documents and hand them to the requester.

### **Amendment of section 22 of Act 57 of 1988**

5. Section 22 of the Trust Property Control Act, 1988 is amended as follows:

#### **Remuneration of the trustee**

22 A trustee, including a trustee appointed in terms of section 7(3)(a) and subject to the provisions of section 7(3)(b) of this Act, shall in respect of the execution of his duties be entitled to such remuneration as provided for in the trust instrument or, where no such provision is made, to a reasonable remuneration, which shall in the event of a dispute be fixed by the Master.

#### **Short title and commencement**

6. (1) This Act is called the Trust Property Control Act Amendment Act, 2015 and shall come into operation on a date determined by the President by proclamation in the Gazette.
- (2) This Act applies in respect all trusts lodged with the Master on or after the date of commencement of this Act.

The author is of the view that with the above suggestions, read together with the contents in paragraph 4 3 above, the Master will be placed in a position to better exercise his statutory system of trust supervision as envisaged in the *Parker* decision. The duty will be placed on trustees by the statute to comply and the Master will be able to force compliance by (i) insistence on the appointment of an

independent trustee or independent co-trustee,<sup>370</sup> (ii) requirement for security<sup>371</sup> for performance of trustee duties or exemption where there is proof of an independent trustee, and (iii) removal from office of a trustee who has furnished a “*bona fide* outsider” with wrongful information pertaining to the trust form or administration thereof.

#### 4 7 Conclusion

The court in *Parker* proposed four possible *ad hoc* solutions for protection of “*bona fide* outsiders” in business dealings with trusts. The author suggests Act<sup>372</sup>. Looking at the trust case law, the method which has been favoured by the courts to protect vulnerable “*bona fide* outsiders” in business dealings with trusts seems to be the action or measure of “piercing the veneer” of the trust or going behind the trust and holding the delinquent trustees liable personally for performance. The author is of the view that the proposal to amend the Trust Property Control Act for purposes of expressly including “*bona fide* outsiders” who conclude business dealings with trusts as “third parties whose interest are to be protected by the Master in regulatory relationship” (as discussed above) could go a long way in regulating the relationship between trustees and such “*bona fide* outsiders” and thus avoid protracted legal cases. More so, the Master as regulator would be in a position to enforce disclosure of certain information through the independent trustee in “family business trust”. In conclusion, the author supports the *ad hoc* solutions which have been proposed in the *Parker* decision for protecting “*bona fide* outsiders” in business dealings with trusts. The proposals are summarized as follows:

- The *Turquand* rule.<sup>373</sup>
- Appointment of independent trustees.<sup>374</sup>
- “Piercing of the veil” of a trust where abuse of the trust form is established.<sup>375</sup>

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<sup>370</sup> S 7(1) of the Act for instances where there is a vacancy in the office of trusteeship.

<sup>371</sup> S 6(2) of the Act.

<sup>372</sup> 57 of 1988.

<sup>373</sup> *Parker* 2005 (2) SA 77 (SCA).

<sup>374</sup> *Ibid.*

<sup>375</sup> *Ibid.*

- Drawing inference, in appropriate cases, that a trustee who concluded allegedly unauthorized transactions with a third party was in fact authorized by the full trustee-complement to conclude the transactions in question as their agent.<sup>376</sup>

Lastly, the author also proposes the amendment of the Trust Property Control Act to regulate forced disclosure of family business information<sup>377</sup> by the Master, insisting on the appointment of independent trustees in accordance with the *Parker* decision, insisting of security to the satisfaction of the Master where there is non-compliance and the removal of non-complaint trustees.

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<sup>376</sup> Para [37.2].

<sup>377</sup> As in s 16A of the proposed amendments to the Trust Property Control Act “Compulsory disclosure of certain documents” in para 4 6 on page 72 above.

## Chapter 5 Conclusion

The lack of outright protection for “*bona fide* outsiders” in dealings with trusts which has resulted from abuse or misuse of the “basic trust idea” was obvious throughout this dissertation. On examination of the Trust Property Control Act<sup>378</sup> it was clear that the Act was not designed to offer any form of remedy for “*bona fide* outsiders” who have dealings with “family business trusts”. The research turned to South African case law to examine how the courts have and continue dealing with the problem. On examination of case law, the courts’ effort to protect the vulnerable “*bona fide* outsiders” in dealings with trusts was uncovered and it varied from one case to the other.<sup>379</sup> It has, however, become clear that for the court to fully decide what action needs to be taken where there is a dispute between a founder/trustee and a “*bona fide* outsider”, it has to examine the nature of the vehicle through which the business is conducted and the manner in which such entity was used. A trust can be validly established with the right intentions, but become abused or misused by the founder/trustees in the course of events thereby turning into the “alter ego” of the founder/trustees. On the other hand, the possibility of a “sham” trust can only be considered if from the outset the founder and/or “trustees” never had the real intention of creating a valid trust.

It is clear that the South African law of trusts lacks clear measures for protecting “*bona fide* outsiders” who have business dealings with trusts. It has also become clear that “*bona fide* outsiders” resort to the courts for protection from scrupulous trustees through other measures, other than invoking the Trust Property Control Act.<sup>380</sup> For example, a “*bona fide* outsider” may ask the court to declare that a questionable trust form is in fact a “sham” or to go behind the trust form or “pierce the veneer of the trust” so as to enforce performance by the founder/trustees.

Chapter 3 is of importance in as far it brought to light the fact that the courts are reluctant to outright declare certain trusts invalid or as being a “sham” but would rather give *ad hoc* relief to “*bona fide* outsiders” through methods appropriate to

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<sup>378</sup> Ch 1 para 1 1.

<sup>379</sup> Refer to ch 3.

<sup>380</sup> Ch 1 para 1 1.

each case. Two forms of relief have thus far gained popularity with our courts, namely, declaring a trust form a “sham” or a valid trust the “alter” ego of the founder/trustee and thus the trust form a “veneer which can be pierced”

In a case of a “sham”, a court could make a finding that the trust form is in fact not a valid trust but a “sham” because the “*requirements for the establishment of a trust were not met or the appearance of having met them was in reality a dissimulation*”.<sup>381</sup> This entails that the trust does not exist. The consequences of a “sham” are that no effect can be given to the transaction and the “founder” remains owner of the “trust assets”.<sup>382</sup> Furthermore, neither the trustee nor the beneficiaries will acquire any rights with regard to these assets.<sup>383</sup> Thus, in the event a “*bona fide outsider*” manages to successfully argue that a trust is in fact a “sham” it leaves the founder/trustees with absolute beneficial interest in the “trust property” which is capable of being claimed by “*bona fide outsiders*”.

- (i) In the case of a valid trust being abused or the “alter ego”, the “*bona fide outsider*” could ask the court to “go behind the trust form” or “pierce the veneer of a trust”. The consequences of going behind the trust form will result in the following consequences: ordering that the trust assets be made available for the satisfaction of a trustee’s private creditors;<sup>384</sup>
- (ii) holding that a “delinquent” trustee be held personally liable for the performance of an obligation undertaken on behalf of the trust;<sup>385</sup> or
- (iii) ordering that the action be performed “as if the obligation had been properly incurred by the trustees acting in the capacity that they purported to act”.

Even though there is some uncertainty and lack of uniformity created by the exercise of judicial discretion in the cases discussed, it is clear that when it comes to a form of relief or protection available to “*bona fide outsiders*” in dealings with trust where

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<sup>381</sup> *Van Zyl v Kaye* para [19].

<sup>382</sup> De Waal 2011 *Rabels Zeitschrift* 1097.

<sup>383</sup> *Ibid.*

<sup>384</sup> *Nedbank Ltd v Thorpe* 2008 JOL 22675 (N).

<sup>385</sup> *First Rand Limited trading inter alia as First National Bank v Britz* [2011] ZAGPPHC 119 20 July 2011 (unreported).

there was an apparent abuse of the trust form, the courts are more willing to “go behind the trust form” or “pierce the veneer of the trust” and declare that the trust was used as an “alter ego” of the founder/trustees than to declare a trust a “sham”. In the words of Cameron JA<sup>386</sup> in the *Parker* decision, “*the situation may in due course require legislative attention*”. To heed the call in *Parker*, the author proposes the development of the Trust Property Control Act by inserting and/or amending it as follows:<sup>387</sup>

- (a) Amendment of the Trust Property Act to include a section on “family business trusts” which will deal with the requirement for the appointment of independent trustees;
- (b) Inclusion of a section in the Act wherein trustees at the written request of “*bona fide* outsiders” who are about to enter into business dealings with the trust, are instructed to deliver to the outsider a list of documents, comprising of the trust deed, copies of the letters of Authority and a copy of a resolution wherein trustees are empowered to transact with the outsider and lodge proof thereof with the Master OR a letter instructing the Master to furnish bearer thereof with information listed in the letter;

Inclusion in section 1 of the Act, “definitions” a definition of “a person of sufficient interest” to mean beneficiaries or “*bona fide* outsiders” who have or intends to have dealings with the trust.

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<sup>386</sup> Para [34].

<sup>387</sup> See the proposed Bill in ch 4 para 4 6 regarding proposed legislative amendments.

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