# The Role of Tracing in Claiming

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# Abstract

The central tenet of tracing theory is that in certain circumstances it is possible to show that one asset stands in the place of another, such that any claims in relation to the original asset can be transmitted to its substitute. Since at least 2001 academic and judicial orthodoxy has been that this is done by following the path of value from one asset to the other, and can be aided in more complex cases by the application of evidential rules or presumptions. These ideas are at the heart of existing accounts of proprietary claims against trustees who deal with trust assets without authority, and personal and proprietary claims against strangers to the trust. They are also at the heart of calls to 'unify' the rules of tracing at law and in equity, removing existing distinctions drawn between claimants who are owed fiduciary duties and those who are not.

In this thesis it is argued that there are no independent processes of following and identifying value, and that the language of 'tracing value' has lent the appearance of neutrality and conceptual unity to disparate heads of fiduciary and non-fiduciary liability. Most importantly, it has led to the assumption that in any case in which a claimant can demonstrate that a series of transactions links some right in the defendant's hands with a right previously held by or for the claimant, the claimant can claim that right. In this thesis it is argued that far from creating an arbitrary practical obstacle for claimants seeking to trace and locate value, the fiduciary relationship is at the heart of the justification for any claim that exists to a new right in the hands of someone else.

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# Table of Abbreviations

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| **ABQB** | Alberta Court of Queen's Bench |
| **Atk** | Atkyn's Chancery Reports |
| **B & M** | Baker and Milsom, *Sources of English Legal History* |
| **Bro CC** | Brown's Chancery Cases |
| **Carth** | Carthew's King's Bench Reports |
| **CLC** | Australian Company Law Cases |
| **CLR** | Commonwealth Law Reports |
| **DLR** | Dominion Law Reports |
| **HCA** | High Court of Australia |
| **HKCFI** | Hong Kong Court of First Instance |
| **JCA** | Jersey Court of Appeal |
| **Keny** | Kenyon's Notes of Cases |
| **Ld Raym** | Lord Raymond's King's Bench & Common Pleas Reports |
| **M & S** | Maule & Selwyn's King's Bench Reports |
| **NSWCA** | New South Wales Court of Appeal |
| **NSWSC** | New South Wales Supreme Court |
| **NZCA** | New Zealand Court of Appeal |
| **ONSC** | Ontario Superior Court of Justice |
| **P & CR** | Property & Compensation Reports |
| **PWMS** | Peere Williams' Chancery & King's Bench Cases |
| **SASR** | South Australia State Reports |
| **SCC** | Supreme Court of Canada |
| **SCR** | Supreme Court Reports, Canada |
| **SLR** | Singapore Law Reports |
| **Str** | Strange's King's Bench Reports |
| **Taunt** | Taunton's Common Pleas Reports |
| **Vern** | Vernon's Chancery Reports |
| **WAR** | Western Australia Reports |
| **WASC** | Western Australia Supreme Court |
| **VR** | Victorian Reports |

# Table of Cases

**England and Wales (Including Privy Council)**

**Australia**

**Canada**



**Hong Kong**



**Jersey**



**New Zealand**



**Singapore**

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# Chapter One: Introduction

## I. Introduction

There are few areas of private law as complex as tracing. Lionel Smith made several important strides in 1997 with the publication of his monograph *The Law of Tracing*.[1] In the introduction to that text he wrote:

> The fundamental idea underlying tracing is that sometimes, for certain legal purposes, one asset stands in the place of another. A claim which could have been made in relation to the original asset is allowed in relation to the new asset… Tracing is the process which can allow the transmission of that claim to the new asset.[2]

But such assertions, he said were 'deceiving in their simplicity'.[3] And so they have proven to be. Burrows begins his chapter on tracing in the most recent edition of *The Law of Restitution* with the words, 'It is not easy to describe what tracing is'.[4] Indeed, whether tracing belongs at all in a text on unjust enrichment is a question to which the answer is far from clear.[5]

From a practical perspective, there are several fundamental questions involving the application of tracing principles to which we do not yet have conclusive answers: we remain divided on the significance of the interposition of a debt between

[1] Lionel D. Smith, *The Law of Tracing* (OUP 1997).
[2] Ibid 3.
[3] Ibid. Almost a decade later Smith claimed 'I am still not sure that I understand it very well.' Lionel Smith, 'Tracing' in A. Roger (ed), (OUP 2006) 118.
[4] Andrew Burrows, *The Law of Restitution* (3rd edn, OUP 2011) 117.
[5] See e.g. *Foskett v McKeown* [2001] 1 AC 102, 108-110 (Lord Browne-Wilkinson), 112 (Lord Steyn); 115 (Lord Hoffmann), 126 (Lord Hope); 127 (Lord Millett); R. B. Grantham and C. E. F. Rickett, 'Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?' [1997] New Zealand Law Review 668; Ross Grantham and Charles Rickett, 'Tracing and Property Rights: the Categorical Truth' (2000) 63 MLR 905; C. Rotherham, 'Tracing Misconceptions in Foskett v McKeown' 11 Restitution Law Review 57; Peter Birks, 'Property, Unjust Enrichment and Tracing' (2001) 54 CLP 231; Andrew Burrows, 'The Relationship between Unjust Enrichment and Property: some Unresolved Issues' in J. Edelman and S. Degeling (eds), *Unjust Enrichment in Commercial Law* (Thomson, Sydney 2008).

acquisition of a right and payment;[6] even though there is a long-established consensus that a bank account cannot be conceptualised as a linear progression of independent debts,[7] we have not yet altogether outgrown the process of appropriating debits and credits chronologically;'[8] we are not altogether sure whether there are independent rules of tracing for common law and equitable claims,[9] and whether the latter require proof of a fiduciary relationship;[10] we are not sure how, if at all, the rule that money 'has no ear-mark' applies to bank accounts,[11] and we do not know whether the defence of change of position can be raised in an action that depends upon tracing.[12] All of this is disheartening for lawyers tasked with applying the rules and principles of tracing to cases involving increasingly complex payment mechanisms.

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[6] Lionel Smith, 'Tracing into the Payment of a Debt' (1995) 54 CLJ 290; Matthew Conaglen, 'Difficulties with Tracing Backwards' (2011) 127 LQR 432. In *Moffatt v Crawford* [1924] St R Qd 241 tracing through the payment of a debt was not permitted. Yet the exercise was conducted without comment in the House of Lords in *Foskett v McKeown* [2001] 1 AC 102. In 2014 Arden LJ in *Relfo v Varsani* [2014] EWCA Civ 360 resurrected the idea, suggested by Scott VC in the Court of Appeal in *Foskett* and applied in *Conlan v Connolly* [2011] WASC 160, that the intention with which payment is made is crucial to tracing through the payment of a debt. In Canada and Jersey, backward tracing has received more favourable treatment: *Agricultural Credit Corp. of Saskatchewan v Pettyjohn* 1991 Carswell Sask 172; *Brazil v Durant* [2013] JCA 071.

[7] *Foskett v McKeown* [2001] 1 AC 102, 128; *Rea v Russell* [2012] NZCA 536 [42].

[8] The Court of Appeal in *Barlow Clowes International Ltd v Vaughan* [1992] 4 All ER 22 considered that *Clayton's Case: Devaynes v Noble* (1816) 1 Mer 529, 35 ER 781 would apply, except where it was impracticable or unjust. But courts have been quick to find the condition for this exception met: *El Ajou v Dollar Land Holdings plc* (1995) 69 P & CR D25; *Russell-Cooke Trust Co v Prentis* [2002] EWCH 2227 ; *Commerzbank AG v IMB Morgan Plc* [2004] EWHC 2771 (Ch), [2005] Lloyd's Rep 298. See now: *National Crime Agency v Robb* [2014] EWHC 4384; *Charity Commission for England and Wales v Framjee* [2014] EWHC 2507, [2015] 1 WLR 16 [48]. Other common law jurisdictions do not apply it: *Windsor Mortgage Nominees Pty Ltd v Cardwell* (1979) CLC 40-540.

[9] See e.g. *Agip (Africa) Ltd v Jackson* [1991] Ch 547, 566 (Fox LJ); *Compaq Computer Ltd v Abercorn Group Ltd (t/a Osiris)* [1991] BCC 484, cited in *FG Wilson (Engineering) Ltd v John Holt & Co (Liverpool) Ltd* [2013] EWCA Civ 1232, [2014] 1 WLR 2365, [65]; Peter Birks, 'Overview: Tracing, Claiming and Defences' in Peter Birks (ed), *Laundering and Tracing* (OUP 1995) 299-300; Paul Matthews, 'The Moral and Legal Limits of Common Law Tracing' in P. Birks (ed), *Laundering and Tracing* (OUP 1995). See most recently *London Allied Holdings v Lee* [2007] EWHC 2061 [256] and *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535 [44].

[10] Smith, *The Law of Tracing* (OUP 1997), 120-130. *Shalson v Russo* [2005] Ch 281, 314-315 (Rimer J).

[11] See e.g. *Kirk v Webb* (1698) Prec Ch 84, 24 ER 41; *Whitecomb v Jacob* (1710) 1 Salk 160, 91 ER 149; *Sayers, Ex Parte* (1800) 5 Ves Jr 169, 31 ER 528; *In Re West of England and South Wales District Bank* (1879) 11 Ch D 772; *Re Hallett's Estate* (1880) 13 Ch D 696; *Sinclair v Brougham* [1914] AC 398.

[12] Peter Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 209-210.

There are, however, some points of departure common to all orthodox accounts of tracing:[13] (i) there is a distinction between following, which is a purely factual exercise involving the location of a physical thing, and tracing, which is an exercise that involves the application of legal rules to determine whether one asset is the product of another; (ii) the latter is conducted by following the path of value from one to the other, and can be aided in more complex cases by the application of certain rules or presumptions; and (iii) both following and tracing are distinct from claiming.

The goal of this thesis is to demonstrate that the language of 'tracing value' has led to the appearance of conceptual unity where none exists. Most importantly, it will be argued that the 'fundamental idea' of tracing – the process of demonstrating that one asset stands in the place of another – has very little part to play in the operative facts by which a claim against either a fiduciary or stranger to the fiduciary relationship is established.

Unraveling the little existing consensus that we have on an area of peculiar complexity is not obviously a step forward, but this thesis will attempt to provide a clear and straightforward template for those claims that are typically explained by reference to tracing. The contribution that this thesis seeks to make is thus both theoretical and practical. And the latter is important: as the way in which we use and understand money changes, and the speed and frequency with which transactions are executed grows, it becomes increasingly imperative that the rules surrounding the recovery of funds are settled.

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[13] See e.g. Peter Birks, 'The Necessity of a Unitary Law of Tracing' in Robert Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997); Birks, 'Overview: Tracing, Claiming and Defences' in Birks (ed), *Laundering and Tracing* (OUP 1995); Smith, *The Law of Tracing* (OUP 1997); *Foskett v McKeown* [2001] 1 AC 102 128; *Ultraframe (UK) Ltd v Fielding (No. 2)* [2005] EWHC 1638 [1461], [1472]; *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156, [65]-[66].

Part I of this thesis considers the nature of the exercises that we call 'following' and 'tracing'. It argues that looking for a continuous stream of value has led us to define 'transactional link' anomalously,[14] and that the identification, construction and characterisation of transactions is a normative process that depends fundamentally upon intention.[15] This permits us to approach and deal simply with instances of clearing and credit.

Part II considers the justification for and scope of proprietary claims against trustees acting outside their authority, and those personal and proprietary claims against non-fiduciaries that are typically explained by reference to principles of following and tracing. It is argued that the foundation for the proprietary liability of fiduciaries – trustees or otherwise – is not any connection between the claimant and some new asset in the hands of the fiduciary, but rather the rule that a fiduciary is accountable *in specie* for any rights acquired within the scope of their fiduciary endeavour, which obligation is enforced in equity as a trust.[16] And it is argued that the best understanding of the cumulative effect of the decisions in *Pennell v Deffell*,[17] *Re Hallett's Estate*,[18] *Re Oatway*,[19] and *Foskett v McKeown,*[20] is that fiduciaries are accountable for any rights acquired by exploiting an opportunity that arises within the scope of the fiduciary endeavour, subject to an indemnity for any loss that will be suffered by the fiduciary as a result of such a claim.[21]

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[14] As a process of identifying the legal mechanisms by which a particular result is obtained. See e.g. Conaglen, 'Difficulties with Tracing Backwards' (2011) 127 LQR 432. This is discussed at length in Chapter Three.
[15] See e.g. *In Re George Inglefield Ltd* [1933] Ch 1; *AG Securities v Vaughan; Antoniades v Villiers* [1988] 3 WLR 1205; *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988.
[16] *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223. This is discussed in Chapter Four.
[17] *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551.
[18] *Re Hallett's Estate* (1880) 13 Ch D 696.
[19] *Re Oatway* [1903] 2 Ch 356.
[20] *Foskett v McKeown* [2001] 1 AC 102.
[21] Chapter Five.

It is argued that there are important theoretical differences between cases involving fiduciary duties, and those which do not, and that existing authority for proprietary claims against non-fiduciaries in circumstances in which the defendant acquires a new right, not previously held by or for the claimant, is weak.

In what remains of this chapter, the orthodox account of tracing will be examined and a new approach outlined.

## II. Foundational Concepts

### A. Following and Tracing: Drawing the Line

One of the first and most important theoretical steps taken in *The Law of Tracing* was to establish unequivocally the distinction between following and tracing.[22] In Smith's words:

> Following is generally a simple matter, involving the physical location of a tangible thing… In contrast, the context of tracing is substitution. Tracing identifies a new thing as the potential subject matter of a claim, on the basis that it is the substitute for an original thing which was itself the subject matter of a claim.[23]

Although this distinction is now well-known,[24] prior to 2001 our cases,[25] and much of our academic material,[26] drew no terminological distinction between the exercises of following the path of a physical thing and identifying an exchange of assets.

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[22] See also Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997); Birks, 'Overview: Tracing, Claiming and Defences' in Birks (ed), *Laundering and Tracing* (OUP 1995).
[23] Smith, *The Law of Tracing* (OUP 1997) 6.
[24] See e.g. *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156 [65]-[69]; Burrows, *The Law of Restitution* (3rd edn, OUP) 117.
[25] *Whitecomb v Jacob* (1710) 1 Salk 160, 91 ER 149; *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551; *Re Hallett's Estate* (1880) 13 Ch D 696; *Re Oatway* [1903] 2 Ch 356; *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721.
[26] J. Ames, 'Following Misappropriated Property into its Product' (1906) 19 Harvard Law Review 511; A. W. Scott, 'The Right to Follow Money Wrongfully Mingled with other Money' (1913) 27 Harvard Law Review 125; R. M. Goode, 'The Right to Trace and its Impact in Commercial Transactions'

The language of 'tracing' first surfaced almost 150 years ago in *Frith v Cartland*.[27] That case concerned a bankrupt, Edwards, who had converted certain bills entrusted to him by the claimants into cash, and had used that cash, together with money of his own, to obtain letters of credit and foreign bills and notes. Edwards was then adjudicated bankrupt, and the case concerned the competing claims of the claimants and Edwards' assignees in bankruptcy.

The term 'tracing' does not appear in the arguments of counsel, nor in the authorities cited by them.[28] Rather, they argued: 'The principle simply is that we are entitled to follow the funds, and that when the bankrupt mixed them with other funds, and drew from the whole, the presumption is that he dealt with his own fund, and not with the trust fund'.[29] Nevertheless, Page Wood VC held that, 'so long as the trust property can be *traced and followed* into other property into which it has been converted, that remains subject to the trust'.[30]

Most of our leading authorities use the terms in this way – synonymously and interchangeably,[31] often omitting 'tracing' altogether.[32] In these cases, therefore, following accounts for both: (i) the process of tracking the path of some original asset; and (ii) demonstrating that some asset stands in the place of another.

Throughout the last 15 years, Lord Millett's judgment in *Foskett v McKeown* has provided a template for academics and judges seeking to explain and apply the

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(1976) 92 LQR 360. Cf Dale A. Oesterle, 'Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC §9-306' (1982) 68 Cornell L Rev 172.

[27] *Frith v Cartland* (1865) 2 Hem & M 417, 71 ER 525.

[28] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721; *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551

[29] *Frith v Cartland* (1865) 2 Hem & M 417, 71 ER 525, 526.

[30] Ibid, emphasis added.

[31] See e.g. *Re Hallett's Estate* (1880) 13 Ch D 696, 709, 710 (Jessell MR); *Re Oatway* [1903] 2 Ch 356, 359 (Joyce J); *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 274, 282. *Lipkin Gorman v Karpnale* [1991] 2 AC 548, 566 (Lord Templeman), 573 (Lord Goff). See most recently *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535 [44].

[32] E.g. *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721; *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551.

principles of tracing.[33] The facts are well-known. A trust had been set up to facilitate property development in the Algarve for the benefit of a group of investors. The trustee, Murphy, in breach of trust, used some of the trust money to pay for two of five premiums on his life insurance policy, before committing suicide. When they discovered what had happened, the beneficiaries of the trust sought to establish a claim to two fifths of the insurance payout, some £400,000. That claim was successful. In a judgment that benefited from Smith's monograph and an article published in the same year by Birks,[34] Lord Millett explained that there is an important difference between the exercises of following and tracing: following is 'the process of following the *same* asset as it moves from hand to hand', whilst tracing is 'the process of identifying a *new* asset as the substitute for the old'.[35]

Subsequent cases have embraced this distinction.[36] New orthodoxy accordingly insists that the line between following and tracing is between originals and substitutes: following is the process of locating *x*, which has passed from one set of hands to another, whilst tracing is the process of identifying *y* as the product of *x* (regardless of the current location of *x* or *y*). As Lewison J put it in *Ultraframe (UK) Ltd v Fielding*, 'The cases involving following and tracing generally involve identifiable assets and their substitutes. Following involves the same asset; tracing involves identifying substitutions'.[37]

**B. Tracing Value**

[33] *Foskett v McKeown* [2001] 1 AC 102.
[34] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997); Smith, *The Law of Tracing* (OUP 1997).
[35] *Foskett v McKeown* [2001] 1 AC 102, 127 (Lord Millett), emphasis added.
[36] See e.g. *Ultraframe (UK) Ltd v Fielding (No. 2)* [2005] EWHC 1638 [1461], [1472]; *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156, [65]-[66].
[37] *Ultraframe (UK) Ltd v Fielding (No. 2)* [2005] EWHC 1638 [1472].

The terms 'following' and 'tracing' are not obviously antonymous. To trace, from the Latin *trahere* (to 'draw' or 'drag') is 'to mark out or follow the course of something':[38] progeny trace ancestors; children trace drawings, and a hook is attached to a fishing line by a 'trace'. To 'follow' can similarly mean to 'keep to or trace the course of':[39] hikers follow paths and signposts, we 'follow in someone's footsteps' when we emulate their chosen course, and a 'follow-spot' is a spotlight that tracks a performer on stage. The explanation for why the terms bear so much semantic similarity lies in the manner in which *y* is identified as the product of *x*. In Smith's words:

> Consider the simplest case in which the plaintiff's asset is exchanged by a defendant for some other asset, and the plaintiff wants to trace into the new asset. The only connection which the plaintiff has to the new asset is that it was acquired with the old asset. That is why we say that we trace value: it is the only constant that exists before, through and after the substitution through which we trace.[40]

In short, the difference between following and tracing is not a difference in the nature of the activity carried out, but rather its object: when we trace we follow the path of value; when we follow, we follow the path of things. As Lord Millett put it in *Foskett v McKeown*, 'The claimant claims the new asset because it was acquired in whole or in part with the original asset. What he traces, therefore, is not the physical asset itself but the value inherent in it'.[41]

It is manifest that in tracing discourse value does not bear its ordinary meaning: it matters neither that the market values of the respective assets differ,[42] nor

[38] A. Stevenson (ed) *Shorter Oxford English Dictionary on Historical Principles*, vol 2 (6th edn, OUP 2007).
[39] Ibid, emphasis added.
[40] Smith, *The Law of Tracing* (OUP 1997) 119.
[41] *Foskett v McKeown* [2001] 1 AC 102 128.
[42] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.

that the economic positions of the parties are unaffected by the substitution.[43] In Chapter Three it will be demonstrated that 'value', in tracing, refers more specifically to the potential for exchange inherent in any assignable right, and that the process of 'tracing value' is the process of demonstrating that the new asset was acquired by exploiting that potential.[44] So, the orthodox account of tracing is that if T, a trustee, holds title to a £10 note on trust for B, and buys with it a bottle of wine, B can trace the exchange potential of title to the note into that of title to the wine, and can claim the latter.

Rarely, of course, are facts so simple: most cases involve bank accounts, and ordinarily the value of the account into which the claimant seeks to trace has been constituted from several different sources.[45] Such facts produce what is usually termed a 'mixed fund',[46] and the claimant in such a case has recourse to what are called the 'rules of tracing' to help him to show, as a matter of evidence and by analogy with the rules for following into physical mixtures, which units of value in the account are his own.[47] In Birks' words:

> The proof of a substitution or a chain of substitutions almost invariably encounters difficulties with which ordinary proof by evidence cannot cope. When money has been paid into an account (a substitution of money for a chose in action) it is usually not possible to show by evidence exactly when those particular units of value were withdrawn (a second substitution, inverting the first)... The rules of tracing turn out on examination to be rules for breaking that kind of evidential impasse.[48]

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[43] *Foskett v McKeown* [2001] 1 AC 102.
[44] See in particular the text accompanying fn 41-48.
[45] *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551; *Frith v Cartland* (1865) 2 Hem & M 417, 71 ER 525; *Re Hallett's Estate* (1880) 13 Ch D 696; *Re Oatway* [1903] 2 Ch 356; *James Roscoe (Bolton) Ltd v Winder* [1915] 1 Ch 62; *Relfo v Varsani* [2014] EWCA Civ 360.
[46] Smith, *The Law of Tracing* (OUP 1997) Chapter 5.
[47] Charles Mitchell, Paul Mitchell and Stephen Watterson (eds), *Goff & Jones: The Law of Unjust Enrichment* (8th edn, Sweet & Maxwell 2010) 179
[48] Peter Birks, 'On Taking Seriously the Difference between Tracing and Claiming' (1997) 11 TLI 2, 4.

It is generally thought that these rules are not available to all claimants. Giving the judgment in *Taylor v Plumer*,[49] Lord Ellenborough is understood to have described the limitations of tracing at common law:

> [T]he product of or substitute for the original thing still follows the nature of the thing itself, as long as it can be ascertained to be such, and the right only fails when the means of ascertainment fail, which is the case when the subject is turned into money, and mixed and confounded in a general mass of the same description.[50]

In *Re Diplock* Lord Greene MR said:

> The common law approached [tracing] in a strictly materialistic way. It could only appreciate what might almost be called the "physical" identity of one thing with another. It could treat a person's money as identifiable so long as it had not become mixed with other money. It could treat as identifiable with the money other kinds of property acquired by means of it, provided that there was no admixture of other money.[51]

Although the historical foundation for the rule is widely acknowledged to be weak,[52] it is generally thought that a claimant who cannot point to a fiduciary relationship at the start of the story is confined to tracing at common law.[53] In Fox LJ's words in *Agip (Africa) Ltd v Jackson*, 'there must be a fiduciary relationship which calls the equitable jurisdiction into being'.[54]

So, we trace value, and a claimant who seeks to trace on the basis of some common law right, in the absence of a fiduciary relationship, cannot assert a claim if

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[49] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721.
[50] Ibid [575].
[51] *Re Diplock* [1948] Ch 465, 518.
[52] S. Khurshid and P. Matthews, 'Tracing Confusion' (1979) 95 LQR 78; Lionel Smith, 'Tracing in *Taylor v Plumer*: Equity in the Court of King's Bench' [1995] LMCLQ 240; Smith, *The Law of Tracing* (OUP 1997), 168. This is discussed more fully in Chapters Four and Six.
[53] Compare Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997) 242, where Birks asserts that the requirement of a fiduciary relationship has now been 'swept away' with *Shalson v Russo* [2005] Ch 281, [102]-[104] (Rimer J).
[54] *Agip (Africa) Ltd v Jackson* [1991] Ch 547, 566.

it will require him to establish a connection with a fund into which money has been paid from multiple sources.

### C. Tracing and Claiming

The process of tracing is regularly distinguished from that of claiming. Tracing is considered to be a process of identifying value that 'prepares the way for the assertion of rights and the grant of remedies'.[55] In Birks' words:

> People store wealth in different ways, in gold, in shares, in land, in bank accounts, as the case may be. And they turn their wealth over from one store to another, day by day substituting land for cash, cash or shares and so on. The work which tracing does, as and when necessary, is to track the passage of value through such substitutions.[56]

This idea was reiterated by Lord Millett in *Foskett v McKeown*:

> Tracing is the process of identifying a new asset as the substitute for the old. Where one asset is exchanged for another, a claimant can elect whether to follow the original asset into the hands of the new owner or to trace its value into the new asset in the hands of the same owner…. Tracing is thus neither a claim nor a remedy. It is merely the process by which a claimant demonstrates what has happened to his property, identifies its proceeds and the persons who have handled or received them, and justifies his claim that the proceeds can properly be regarded as representing his property.[57]

More recently, in *Armstrong v Winnington* Stephen Morris QC said:

> "[T]racing" is neither a basis for a claim (or a cause of action) nor a remedy granted by a court. Rather it is a means, or process, of identifying an asset as being a substitute for an asset originally held by the claimant. It is a "step along the way" in the bringing of a claim.[58]

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[55] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997) 242.
[56] Ibid.
[57] *Foskett v McKeown* [2001] 1 AC 102, 127-128.
[58] *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156 [65].

Of course, the fact that one can follow or trace does not mean that one can claim, nor does it dictate a particular kind of claim. Yet the distinction between tracing and claiming is taken more seriously than this: there is generally considered to be something wholly factual or non-normative about the exercise of tracing. This is manifest in Lord Steyn's words in *Foskett v McKeown*: 'In truth tracing is a process of identifying assets: it belongs to the realm of evidence. It tells us nothing about legal or equitable rights to the assets traced'.[59]

So, orthodoxy holds that not only does the ability to trace fail to determine the claims that follow, it is also, in an important sense, 'preliminary' to claiming.[60] It is this distinction that lies at the heart of calls to "unify" the rules of tracing at law and in equity. In Birks' words:

> An exercise of identification either can or cannot be conducted. It would be absurd to suppose that it could be conducted vigorously and resourcefully only on Mondays and Thursdays, and it is *prima facie* no less absurd to assert that it can be so conducted only by a plaintiff who has managed to attract the attention of equity. 'Equity' is not a reason. The *prima facie* absurdity can only be displaced by finding a convincing reason why some plaintiffs, but not others, should be allowed to overcome evidential difficulties.[61]

In short, tracing is considered to be a neutral process of identification, altogether independent from any claims that might result. As such, it cannot be conducted differently according to whether the resulting claim is a common law or equitable claim,[62] and it cannot be affected by the existence or otherwise of a fiduciary relationship.

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[59] *Foskett v McKeown* [2001] 1 AC 102, 113.
[60] Smith, *The Law of Tracing* (OUP 1997) 11.
[61] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997) 243.
[62] See *Foskett v McKeown* [2001] 1 AC 102, 128 (Lord Millett). Compare *Shalson v Russo* [2005] Ch 281 [103]-[104] (Rimer J).

## III. Persistent Problems

### A. Clearing and Credit

This insistence that tracing is in some sense 'neutral',[63] a process of following value through a chain of direct substitutions, has presented serious challenges for claimants seeking to trace in any case involving one or more bank transfers. Clearing is generally thought to create a problem of mixing, with which the common law cannot deal,[64] whilst the interposition of credit requires a claimant to conduct an exercise that has been termed 'backward tracing',[65] by which he demonstrates that his funds were used to discharge a debt with which another asset was acquired.

It is, of course, impossible to trace into an asset if funds are simply paid into an overdrawn account.[66] But suppose T, who holds an account in which stands £100 on trust for B, acquires title to a bicycle, for which he pays the following day with money misappropriated from the trust: can B trace from the trust funds into title to the bicycle? For some the case is no more difficult than an ordinarily sale: the debt is simply a 'red herring'.[67] Indeed, the default rule in a sale of goods is that title passes at the time that the agreement is made rather than at the time of payment or delivery, so that if the parties have not expressed any contrary intention, a period of credit is inevitable.[68] And in a bank transfer, funds are often credited to the recipient's account before they are debited from the transferor's.[69] For others the debt is a logical

[63] Birks, 'Overview: Tracing, Claiming and Defences' in Birks (ed), *Laundering and Tracing* (OUP 1995) 291.
[64] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 286.
[65] *Bishopsgate Investment Management Ltd v Homan* [1995] Ch 211, 216 (Dillon LJ).
[66] *Director of the Serious Fraud Office v Lexi Holdings plc* [2008] EWCA Crim 1443, [2009] QBD 376 [50]; *Rea v Russell* [2012] NZCA 536.
[67] Smith, 'Tracing into the Payment of a Debt' (1995) 54 CLJ 290, 294.
[68] Sale of Goods Act 1979 s18 Rule 1.
[69] See e.g. *Agip (Africa) Ltd v Jackson* [1990] Ch 265.

roadblock: in exchange for the bicycle T assumes an obligation, and it is the release of that obligation that is acquired in return for the payment of £100.[70]

These problems have led to increasingly odd distinctions: a claimant can trace at common law when the banks have a common correspondent, but cannot if they do not;[71] a claimant can trace at common law through payment by cheque,[72] but not bank transfer,[73] unless (possibly) the transfer is simply from one branch to another;[74] a claimant cannot trace at all into a debt, unless (possibly) the debtor,[75] or even the creditor,[76] intends all along that the claimant's funds will be used to meet it.

The development of modern payment mechanisms has brought a new urgency to the quest for coherence. Statistics from the European Central Bank from 2012 show that the total number of non-cash payments in the EU increased by 4.2 per cent to 94.5 billion in 2012 compared with the previous year. The number of credit transfers within the EU increased in 2012 by 3.0 per cent to 25.7 billion. Between 1987 and 1993 90 per cent of payments in Britain were made in MB (notes and coins).[77] By 2009 that figure had fallen to 59 per cent.[78] In 2013 it had fallen to 52 per cent, and it is predicted by the UK Payments Council to fall below 50 per cent in 2015, and 45 per cent by 2018.[79] In 2010 the Payments Council also recorded that the mean value of a cash transaction, £9.30, was considerably lower than other payment mechanisms.[80]

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[70] Conaglen, 'Difficulties with Tracing Backwards' (2011) 127 LQR 432.
[71] *Agip (Africa) Ltd v Jackson* [1990] Ch 265; *Nimmo v Westpac Banking Corp* [1993] 3 NZLR 218.
[72] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.
[73] *Agip (Africa) Ltd v Jackson* [1990] Ch 265.
[74] *Hongkong and Shanghai Banking Corp Ltd v United Overseas Bank Ltd* [1992] 1 SLR 579.
[75] *Foskett v McKeown* [1998] Ch 265 284 (Sir Richard Scott VC).
[76] *Relfo v Varsani* [2014] EWCA Civ 360, [63] (Arden LJ).
[77] D. Humphrey, L. Pulley and J. Vesala, 'Cash, Paper and Electronic Payments: a Cross-Country Analysis' (1996) 28 Journal of Money, Credit and Banking 914, 914-915.
[78] UK Payments Council, *The Way we Pay 2010* (2010: online).
[79] UK Payments Council, *UK Cash & Cash Machines 2014*, (6 June 2014: online).
[80] UK Payments Council, *The Future for Cash in the UK* (March 2010: online).

**B. Tracing at Common Law**

The misunderstanding of the decision in *Taylor v Plumer* is now well-documented.[81] That case involved the competing claims of the assignee in bankruptcy of Walsh, Plumer's agent, and Plumer, to the proceeds of assets that had been misappropriated by Walsh. Although the case has been cited several times for the common law's incapacity to deal with mixed funds,[82] it is now widely recognised that the success of the common law claim depended entirely upon the recognition of a trust: the proceeds would only have fallen outside the ambit of a bankruptcy statute that subjected everything in the hands of the agent to distribution to his creditors if Walsh was a trustee of title to them.[83] As such, *Taylor v Plumer* is an exceedingly poor foundation for independent tracing rules at law.[84]

A great deal of academic and judicial ink has been depleted in arguing for a single set of rules at law and in equity.[85] Yet in 2014, the Supreme Court reaffirmed the idea that common law tracing is 'much more limited than equitable tracing'.[86] Burrows argues that:

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[81] Khurshid and Matthews, 'Tracing Confusion' (1979) 95 LQR 78; Smith, 'Tracing in *Taylor v Plumer*: Equity in the Court of King's Bench' [1995] LMCLQ 240; Smith, *The Law of Tracing* (OUP 1997) 168. This is discussed more fully in Chapters Four and Six.

[82] See e.g. *Banque Belge pour l'Etranger v Hambrouck* [1921] 1 KB 321, 326-327 (Bankes LJ); *Diplock v Wintle* [1947] Ch 716, 744-745 (Wynn-Parry J).

[83] An Act for the further Description of a Bankrupt, and Relief of Creditors against such as shall become Bankrupts, and for inflicting of corporal Punishment upon the Bankrupts in some special Cases 21 Jac 1. Cap 19. 1623. See *L'Apostre v Le Plaistrier* 1 P Wms 318, B R M (1708); *Copeman v Gallant* (1716) 1 P Wms 314, 24 ER 404; *Godfrey v Furzo* (1733) 3 Peere Williams 185, 24 ER 1022.

[84] This is explored further in Chapter Four. See in particular the text accompanying fn 19-46.

[85] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997); Birks, 'On Taking Seriously the Difference between Tracing and Claiming' (1997) 11 TLI 2. In *Jones v Trustee of FC Jones & Sons* [1997] Ch 159 Millett LJ called the distinction 'unfortunate though probably inevitable' (17), but in *Foskett v McKeown* [2001] 1 AC 102 argued, with the benefit of the intermediate publication of Smith, *The Law of Tracing* (OUP 1997) and Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997) and an explanation for unification, that it ought to be abolished (128).

[86] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535 [44]. See also *Shalson v Russo* [2005] Ch 281 and *London Allied Holdings v Lee* [2007] EWHC 2061.

> However unsound the historical basis for the difference between common law and equitable tracing may have been exposed to be, it does not follow that we now have fused tracing rules. Too much water has since passed under the bridge – including, relatively recently, the Court of Appeal in *Agip (Africa) Ltd v Jackson* and the House of Lords in *Lipkin Gorman v Karpnale Ltd* – for one to be able to assert that the most accurate interpretation of the law is that there is no difference between common law and equitable tracing.[87]

But precisely what we mean by 'tracing at common law' is not altogether clear.[88] Since the procedural unification of equitable and common law actions,[89] we cannot mean tracing in a common law court. It is generally accepted that the distinction between common law and equitable tracing is that if one has and asserts a legal claim one traces and claims at law,[90] and – although academic opposition has been vociferous – that without a fiduciary relationship one cannot trace and claim in equity.[91] But unless the defendant purports to deal on the claimant's behalf,[92] or does something to transfer title, in any case in which a claimant seeks to assert a claim to some product of a right initially held by or for the claimant, the claimant cannot automatically acquire a better right to possession than that which the defendant has. If the claimant has a property right it must be a right to the defendant's right, or, in other words, a trust.[93]

This is particularly important where the subject matter of the claim is a debt. In *Trustee of FC Jones v Jones* Mr Jones had drawn cheques in his wife's favour on his insolvent firm. She used the funds credited to her account to speculate

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[87] Burrows, *The Law of Restitution* (3rd edn, OUP 2011) 124.
[88] This is discussed in Chapter Six. See in particular the text accompanying fn 21-39.
[89] The Judicature Acts 1873-175.
[90] David Fox, *Property Rights in Money* (OUP 2008) 256.
[91] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 290 (Millett J).
[92] *Marsh v Keating* (1834) 2 Cl & Fin 250, 6 ER 1149.
[93] Lionel Smith, 'Simplifying Claims to Traceable Proceeds' 125 LQR 338. See also Ben McFarlane and Robert Stevens, 'The Nature of Equitable Property' (2010) 4 Journal of Equity 1; Tatiana Cutts, 'The Nature of Equitable Property: a Functional Analysis' (2012) 6 Journal of Equity 44.

successfully in potato futures.[94] The trustee in bankruptcy was held entitled to claim all of the proceeds of her investments, on the basis that:

> [A]s from the date of the act of bankruptcy the money in the bankrupts' joint account at Midland Bank belonged to the trustee. The account holders had no title to it at law or in equity. The cheques which they drew in favour of the defendant were not "void" or "voidable" but, in the events which happened, they were incapable of passing any legal or equitable title. They were not, however, without legal effect, for the bank honoured them. The result was to affect the identity of the debtor but not the creditor and to put the defendant in possession of funds to which she had no title.[95]

Millett LJ described the trustee in bankruptcy's claim as 'exclusively proprietary. He claims the money because it belongs to him at law or represents profits made by the use of money which belonged to him at law'.[96]

There is little to commend such reasoning,[97] and it continues to cause confusion. In *Armstrong v Winnington* Stephen Morris QC considered that the decision provided support for the existence of a 'common law proprietary restitutionary claim': 'the asset in respect of which the claimants (originally) asserted their legal title was the balance of sums standing in the bank account at Raphael's bank. That was a chose in action'.[98] But this makes very little sense at all: in the context of a debt, 'title' can mean nothing other than the personal claim vested in the creditor. The effect of Mrs Jones' investment was to vest in her a claim against the bank to a sum of money, which debt could only ever have been owed to her. The decision in *Jones*, therefore, 'is tantamount to accepting that the claimant can unilaterally compel the legal assignment of a chose in action to him or herself, and substitute him or herself as the creditor in the relationship',[99] which would make it

[94] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.
[95] Ibid 166-167.
[96] Ibid 168.
[97] This is considered in more depth in Chapter Six. See in particular the text accompanying fn 21-39.
[98] *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156 [89].
[99] Fox, *Property Rights in Money* (OUP 2008) 194

impossible for the debtor to know from whom he could get a good receipt.[100] The view that does much less damage to the rationality of principles of commercial law is that Mrs Jones held the debt on trust.[101] Whether such a claim can be justified is explored in Chapter Six.

Less well documented is the problem with the application of Lord Ellenborough's words to bank accounts.[102] In Scott's words, the picture often drawn of the different capabilities of common law and equitable tracing is of 'that poor mutt, the common lawyer, being able to grasp the identity of specific coins, but retiring mouth agape in baffled amazement once they are mixed with other coins'.[103] But despite the many references to an account as a 'mixed fund',[104] a bank account is not a situation in which assets have been 'mixed and confounded in a general mass of the same description'.[105] The context of payment into an account the value of which has been constituted by several sources is not that of a mixture.[106] A bank account is a single debt.[107] Precisely what it is that distinguishes a debt created by the payment of money from a single source from a debt created by the payment of money from multiple sources is not at all clear.

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[100] As Birks puts it: 'Suppose Mrs Jones had taken her £50,000 from the brokers and disappeared with it. On such facts some agile footwork would have been necessary in order to explain exactly why the brokers should not be liable to pay the same sum over again, to the trustee, as being the only person who could give them a good receipt.' Birks, 'On Taking Seriously the Difference between Tracing and Claiming' (1997) 11 TLI 2, 7. Since the money had been paid into court, the decision is in fact only authority for the competing claims between the trustee in bankruptcy and Mrs Jones. See Fox, *Property Rights in Money* (OUP 2008) 193. The better view of the case is that the debt was owed to Mrs Jones, who held it on trust for the firm. See Smith, 'Simplifying Claims to Traceable Proceeds' 125 LQR 338, 347.

[101] Smith, 'Simplifying Claims to Traceable Proceeds' 125 LQR 338, 347.

[102] This is discussed more fully in Chapter Two. See in particular the text accompanying fn 87-111.

[103] Michael Scott, 'The Right to 'Trace' at Common Law' (1966) 7 University of Western Australia Law Review 463, 470.

[104] To list but a few: *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551; *Re Hallett's Estate* (1880) 13 Ch D 696; Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997); Smith, *The Law of Tracing* (OUP 1997); *Relfo v Varsani* [2014] EWCA Civ 360; *Arif v Anwar* [2015] EWHC 124 [85].

[105] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721.

[106] This is discussed more fully in Chapter Two.

[107] *Foskett v McKeown* [2001] 1 AC 102, 128 (Lord Millett).

## C. Justifications for Liability

The difficulties with tracing are much deeper rooted than a cursory reading of the cases reveals. They go not only to executing the process of tracing, but also to characterisation of the claims that result, and the firm distinction between tracing and claiming does not survive close analysis altogether intact.

The concern that first prompted the distinction between following and tracing was that physical changes in form (which require no legal explanation) would be confused with claims to substitute rights (which do).[108] So, if A has a car that B paints red, we know that the car is the same car, though it looks a little different. It will still be the same car if B has it crushed, though it looks very different. By contrast, if B takes A's £10 note and exchanges it for a bottle of wine, the two rights (to the £10 note and to the bottle of wine) are demonstrably different. In Smith's words, 'the original asset does *not* exist in a new form after the transaction: that is a misleading metaphor'.[109]

Yet it is also generally thought that it is by virtue of tracing value from one asset to another that the original claim is transmitted to its traceable proceeds. In Smith's words:

> [W]e trace value: it is the only constant that exists before, through and after the substitution through which we trace. It exists in a different form after the substitution, and that is what can justify a claim to the new asset.[110]

The beneficiary's proprietary claim to the original trust assets is accordingly thought to be at the heart of the justification for his claim to any new rights acquired by the

[108] Smith, *The Law of Tracing* (OUP 1997) 7.
[109] Ibid 119 (emphasis original).
[110] Ibid 119.

trustee in their place.[111] This is the 'simplest case',[112] in which the beneficiary's claim is 'readily understandable':[113] the beneficiary establishes a claim to the product of the right originally held for him by tracing value from the latter to the former. In the same way, if a stranger to the trust asset acquires the product of a right held on trust for the beneficiary, the beneficiary can trace from the original trust right to the new right in the hands of the third party, and can either assert a claim to that new right, or can assert a personal claim in knowing receipt. Understood thus, the law of tracing is thought either to explain in its entirety a claim that arises in respect of a new right acquired by a trustee, or by a third party from a trustee,[114] or to do so as part of the broader law of unjust value transfers.[115] These arguments are presented as alternatives,[116] with no third way.

In addition to the possible determination of available defences,[117] this has important practical consequences. Since we think of the value of the original asset as inhering in some way in the new asset, there is something that appears inevitable about the creation of a claim to it. This creates the opposite problem from that which we encounter in relation to periods of credit: rather than no assets into which we can trace, suddenly there are too many assets. In Smith's words:

> If a thief steals my car, and swaps it for a boat, it could be that I become the owner of the boat. On the other hand, the normal rule is

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[111] See e.g. Peter Millett, 'Proprietary Restitution' in S. Degeling and J. Edelman (eds), *Equity in Commercial Law* (Lawbook Co) 315; Burrows, *The Law of Restitution* (3rd edn, OUP) 118;
[112] *Foskett v McKeown* [2001] 1 AC 102, 130 (Lord Millett). See also Graham Virgo, *The Principles of Equity and Trusts* (OUP 2011) 626 in which *Foskett v McKeown* is described as a 'model case'.
[113] Burrows, *The Law of Restitution* (3rd edn, OUP 2011) 118.
[114] Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005).
[115] Birks, 'Property, Unjust Enrichment and Tracing' (2001) 54 CLP 231; Birks, *Unjust Enrichment* (2nd edn, OUP 2005); Burrows, *The Law of Restitution* (3rd edn, OUP 2011).
[116] *Foskett v McKeown* [2001] 1 AC 102.
[117] If the justification for such claims is unjust enrichment, then change of position might be available. See Birks, *Unjust Enrichment* (2nd edn, OUP) 209-210.

> that my ownership of the car survives the transfer of possession to the one who acquired it. Do I then own both the car and the boat?[118]

Birks presents a similar problem, which he terms 'geometric multiplication':

> Recipient One receives £1,000 of Plaintiff's money and buys with it a silver cup, handing the money to the seller. Recipient Two, who though he gives value knows the money's provenance. Recipient Two then uses the £1,000 to buy a painting. Recipient One finds that the silver cup is an antique of great value and sells it to Recipient Three for £50,000 with which he buys shares. What does Plaintiff own? The vested interest approach leads inexorably to the conclusion that he owns One's shares, and Two's painting. In addition the very valuable silver cup, which unlike money is not at law vulnerable to bona fide purchase, must be his too, at least until it falls within an exception to *nemo dat*.[119]

Birks found his solution in the nature of the claim. We have cases on either side of the debate over the nature of the beneficiary's claim in respect of a substitute right acquired by a trustee: it might be a 'fully-vested interest' (a trust),[120] or it might be a proprietary interest that is more easily defeated.[121] For Birks, that division lay at the bottom of resolution of this problem, or, at the very least, made it less pressing.[122] But it is difficult to see how altering the strength of the claim solves the problem of geometric multiplication: the beneficiary of a trust, so long as he is of full legal capacity, has a power to collapse it and require the trustee to transfer the trust rights to him, whether other rights and duties are or are not present.[123] The beneficiary's proprietary interest is, in that sense, always 'potential', and it is not clear why the breadth of the category against whom the power can be asserted affects the peculiar

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[118] Smith, *The Law of Tracing* (OUP 1997) 322. See also P. Birks, *An Introduction to the Law of Restitution* (OUP 1985) 394.
[119] Peter Birks, 'Mixing and Tracing: Property and Restitution' [1992] 45 CLP 69, 95. See also Norman Palmer and Ewan McKendrick (eds), *Interests in Goods* (2nd edn, LLP, London 1998) 230-231.
[120] *Cave v Cave* (1880) 15 Ch D 639 ; *Foskett v McKeown* [2001] 1 AC 102.
[121] *In Re Ffrench's Estate* (1887) 21 LR Ir.
[122] Birks, 'Mixing and Tracing: Property and Restitution' [1992] 45 CLP 69, 95.
[123] *Saunders v Vautier* (1841) EWHC Ch J82. The consensus is that other rights and duties are not present where the recipient is innocent: *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195. This is explored further in Chapter Seven.

problem of the multiplication of interests. The result we want to bring about is that the claimant has *one* interest, not lots of weak ones.

In fact, there is nothing inevitable about the conclusion that the claimant in either example has more than one claim – in conversion, against the thief. What we need to know is when and why a claimant who can demonstrate that an asset in respect of which he had a claim can assert a claim to its product. Despite multiple assertions to the contrary in our highest court,[124] it cannot simply be a matter explained in its entirety by property principles: property manifestly is not, on its own, a reason for liability.[125]

The problem is even more acute when one considers claims against third parties. We typically explain proprietary claims against defendants who receive funds misappropriated from beneficiaries as actions to vindicate the beneficiaries' continuing equitable title.[126] And the personal liability of knowing recipients is generally explained according to a similar idea, as an action for possession of trust assets adverse to the claim of the beneficiary.[127] But such characterisations are problematic, for two reasons: first, most of our knowing receipt cases involve the dissipation of funds from company accounts, which are a debt owing to the company at law,[128] so that there is no 'trust asset' that could have been misappropriated, and no

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[124] *Foskett v McKeown* [2001] 1 AC 102 108, 109 (Lord Browne-Wilkinson), 115 (Lord Hoffmann), 127, 132 (Lord Millett).

[125] See e.g. Birks, 'Property, Unjust Enrichment and Tracing' (2001) 54 CLP 231. Compare: e.g. Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co); Grantham and Rickett, 'Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?' [1997] New Zealand Law Review 668; Grantham and Rickett, 'Tracing and Property Rights: the Categorical Truth' (2000) 63 MLR 905; Charles Rickett, 'Old and New in the Law of Tracing' in S. Degeling and J. Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005). This debate is considered in depth in Chapter Four.

[126] *Pilcher v Rawlins* (1871-72) LR 7 Ch App 259; *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195; *Credit Agricole Corporation and Investment Bank v Papadimitriou* [2015] UKPC 13.

[127] Peter Birks, 'Receipt' in P. Birks and A. Pretto (eds), *Breach of Trust* (Hart Publishing 2002) 225. See *Williams v Central Bank of Nigeria* [2014] UKSC 10, [2014] 2 WLR 355 [31].

[128] *BCCI v Akindele* [2001] Ch 437; *Shalson v Russo* [2005] Ch 281; *Relfo v Varsani* [2014] EWCA Civ 360.

equitable property right that could persist; second, a bank transfer does not involve the transfer of any independent asset to which it is possible to have or claim title.[129] At most, the recipient acquires a new right, to whatever is the new sum total in the account. 'Tracing value' in such a case is at best a conclusion: we still need to know why the claimant – if he can – can assert a claim in respect of a new right not previously held by or for the claimant.

## IV. Rethinking Tracing

In this thesis it will be demonstrated that an important misstep was made in *Taylor v Plumer*, which brought to the fore the 'exchange product' theory of liability. It will be argued that the better understanding of proprietary claims against trustees who deal with trust assets without authority is that a beneficiary – like any principal – can claim, as a matter of primary right, anything acquired by their fiduciary in the course of the fiduciary office.[130] The exchange by a trustee of trust assets is one way of demonstrating that the trustee is acting within the scope of his office,[131] but it is not the only way.[132] It will be argued that there is a critical difference between cases in which a right is acquired by a defendant who owes fiduciary duties to the claimant, and those in which a right is acquired by a non-fiduciary: in the former, but not the latter, the claimant can assert a proprietary claim.

[129] *R v Preddy* [1996] AC 815.
[130] *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223; *Regal (Hastings) Ltd v Gulliver* [1942] 2 AC 134; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535.
[131] E.g. *Foskett v McKeown* [2001] 1 AC 102.
[132] E.g. *Sugden v Crossland* 65 ER 620; (1856) 3 Sm & G 192.

# Part I: Following and Tracing

# Introduction

Part I of this thesis considers the exercises known as 'following' and 'tracing'. 'Following' is defined as the process of locating a tangible or intangible thing or right, and Chapter Two deals with the boundaries of this process. Most importantly, it considers those of the rules applicable to physical things that have been transposed to the context of bank accounts, and it explains why such analogies do not help us to understand the reasons for and scope of liability.

Chapter Three considers tracing, understood as the process of determining when one asset can be considered to be the product of another, such that the claimant's claim is transmitted from one to the other. In Chapter Three it is argued that the insistence that there is some continuous thread that, because it is 'in the very nature of things',[1] can be established independently of intention has led us to overcomplicate the process of demonstrating a transactional link. The parties' intentions are at the heart of the identification, construction and characterisation of transactions. This, it will be demonstrated, allows us to deal simply with the problems created by clearing and credit.

[1] Christopher Hare, 'Tracing Value and the Value of Tracing' (2013) 24 JBFLP 249, 266.

# Chapter Two: Following

## I. Introduction

One of the first distinctions drawn in *The Law of Tracing* is between following and claiming. In Smith's words:

> The exercise of following is necessary to establish certain claims, but it is not a claim or a right in itself. It is just the physical exercise of finding where something is, or at least where it has been. By itself, if does not make anyone liable.[1]

Certainly, following cannot on its own complete a reason for liability, but in this chapter it will be demonstrated that much of what is typically dealt with under the heading 'following' in fact involves the allocation (or reallocation) of claims,[2] and as such is shaped by normative considerations.[3]

The second part of this chapter deals with attempts to apply these rules to bank accounts. It is argued that these attempts, which disguise the need to articulate clearly the justifications for the existence of scope of liability, are misguided.

## II. Following Things and Rights

### A. Following Things

Following is not peculiar to law. We can follow all sorts of things as they move from one location to another – cars, aeroplanes, people, molecules, atoms, even energy. Sometimes we apply legal rules in order to determine whether the thing that we are

[1] Smith, *The Law of Tracing* (OUP 1997) 10.
[2] E.g. the conversion of title into co-ownership (*Buckley v Gross* (1863) 3 B & S 566, 122 ER 213); the subordination of wrongdoers' claims (*Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)* [1988] QB 345) and disapplication of nemo dat in the context of physical money (*Miller v Race* (1758) 2 Keny 189, 96 ER 1151).
[3] E.g. the comparative fault of the parties; the economic benefit of a steady circulation of money.

following counts as the same thing, though it has been altered in some way.[4] And sometimes the object of following is a legal construct, the movement of which takes place against a backdrop of legal mechanisms.[5] But the process of following is not inherently legal.

Most of the time, Smith tells us, following is 'a physical exercise of finding a tangible thing'.[6] This is ordinarily the most intuitive kind of following, although even this kind of following is not wholly without ambiguity. Following could, for instance, apply to any, or all, of the following examples, where the object is (i) the bicycle or (ii) title to it:

> **Example 2.1:** B steals A's bicycle. A follows the bicycle.
>
> **Example 2.2:** A sells B a bicycle, but keeps it for B to collect. A follows title to the bicycle.
>
> **Example 2.3:** A sells B a bicycle.
>
> **Possibilities:**
>
> (i) A follows the bicycle.
> (ii) A follows title to the bicycle

Although following might describe tracking the path of title to things (**Examples 2.2 and 2.3**) it is not typically so used. Rather, it is used to indicate tracking of the *thing* (**Examples 2.1 and 2.3**), so that the claimant can assert a pre-existing title to it (**Example 2.1**). In Smith's words, 'The grammatical object of 'to follow' is 'tangible

[4] See e.g. *Borden (UK) Ltd v Scottish Timber* [1981] Ch 25; *Hendy Lennox v Grahame Puttick* [1984] 1 WLR 485; *Re Peachdart Ltd* [1984] Ch 131.
[5] E.g. where the facts involve the assignment of rights.
[6] Smith, *The Law of Tracing* (OUP 1997) 69.

thing",[7] and it 'reveals those persons who have interfered with the rights which the plaintiff holds in the thing being followed'.[8]

In *Jones v De Marchant* a husband took beaver skins previously gifted to his wife and had them, along with other skins to which he had title, made into a fur coat, which he gave to his mistress.[9] Treating the coat as an amalgam of the furs the court held that the wife could follow and assert title to the furs in the hands of the mistress.

Following is also, of course, possible where the taking of possession does not amount to a breach of duty. In *Aluminium Industrie Vaassen BV v Romalpa Aluminium* the seller, a Dutch company, supplied aluminium foil on retention of title terms to an English company, Romalpa Aluminium Ltd ("Romalpa"), which went into receivership without making payment in full.[10] One of the seller's claims was in respect of unprocessed foil. The court held that it could follow and assert title to that foil in the hands of Romalpa.

In *Armour v Thyssen* Thyssen Edelstahlwerke AG ("Thyssen") sold steel strip to engineering manufacturers, Carron Co Ltd ("Carron"), on terms that reserved title in the steel until all debts owing to the suppliers were paid.[11] The cutting of steel did not, said Lord Ross, amount to the creation of a new thing, so that when Carron went into receivership, Thyssen was held able to follow and recover the strip.

In *Re Peachdart* the seller, Freudenberg Leather Co. Ltd ("Freudenberg"), supplied leather on retention of title terms to the buyer, Peachdart Ltd ("Peachdart"), to make handbags.[12] When Peachdart went into receivership, the receiver conceded that Freudenberg could follow the unused leather into its hands and assert title to it.

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[7] Ibid 68.
[8] Ibid 15.
[9] *Jones v De Marchant* (1916) 28 DLR 561
[10] *Aluminium Industrie Vaassen BV v Romalpa Aluminium* [1976] 1 WLR 676.
[11] *Armour v Thyssen Edelstahlwerke AG* [1991] 2 AC 339.
[12] *Re Peachdart Ltd* [1984] Ch 131.

So, following ordinarily refers to the process of locating a physical thing in order to assert some pre-existing title to it, irrespective of the reason for which the claimant was dispossessed.

**B. The End of Following**

If the thing followed is no longer identifiable, the exercise of following is at an end. With it, of course, disappears the original claim: once grapes have been manufactured into wine, title to the grapes disappears along with its object; once the wine in a bottle has been consumed, title to the wine disappears with the wine.

Although stated simply here, such cases in fact created serious problems for private law claims in the Middle Ages: detinue was an action for the recovery of a thing to which the plaintiff had title, so that the destruction of the identity of that thing – whether in good or bad faith – automatically defeated any claim. Indeed, Simpson argues that it was precisely this problem that led to the development of the action on the case that we now know simply as 'conversion'.[13] In his words:

> [T]he action on the case for conversion comes into the law to fill a gap in the applicability of the action of detinue, where the older action did not lie, because the plaintiff, through the operation of the doctrine of *specificatio*, is unable to show that the property in the goods is vested in him.[14]

[13] A. W. B. Simpson, *Legal Theory and Legal History: Essays on the Common Law* (The Hambledon Press 1987) 102-103. In a Yearbook case of 1479 the plaintiff counted that he had bailed cases of silver to the defendant, and that the defendant had broken them open and converted them to his own use: *The Case of the Silver (sic Simpson: Legal Theory and Legal History)* Y B 18 Edw IV, f 23, pl 5. The action failed because detinue would have been available: the silver was still there, and the plaintiff still had title to it. In his judgment, Choke J referred to an earlier case: 'So lately there was an action sued here, and the plaintiff counted that he bailed to the defendant certain cloth of gold and that he had made clothes of it, and, because it appeared to the court that he could not recover the thing itself, the action was upheld.' The conclusion Simpson draws from the difference between the two cases is that 'to convert cloth into clothes destroys the identity of the subject matter of the bailment, and operates as *specificatio*, whereas merely to break up a [case], whilst not making a new thing of the pieces, does not.' Simpson, *Legal Theory and Legal History: Essays on the Common Law* (The Hambledon Press 1987) 102.

[14] Simpson, *Legal Theory and Legal History: Essays on the Common Law* (The Hambledon Press 1987) 102-103.

Now, of course, detinue has been superseded altogether by conversion, and there is no action that guarantees the recovery of a physical thing, altered or unaltered. The modern context of specificatio has been the attempted retention of title to goods that are anticipated by seller and buyer to be used, and are so used, in the course of some manufacturing process, where the buyer subsequently becomes insolvent. No single test has emerged from the cases, but in determining whether property has been extinguished, the factors that have been considered most significant are: (i) the practical reversibility of the manufacturing process; (ii) the respective value of contributing parts and product,[15] and (iii) the parties' intentions.[16]

In *Borden v Scottish Timber* the claimants supplied resin to the defendants for use in manufacturing chipboard.[17] The court held that 'the very existence' of the resin had been destroyed by the production of the chipboard, so that there was nothing to which the claimants could seek to assert a continuing title.[18] In *Re Peachdart*, Vinelott J held that the parties must have intended that the seller's title to leather incorporated in the manufacturing process was extinguished as soon as it ceased to have any value as a raw material.[19] In *Hendy Lennox v Grahame Puttick*, by contrast, the court considered that there was no loss of identity where it was possible to restore the product to its original constituent parts, permitting a seller to recover engines that had been incorporated by the buyer into generating sets. Staughton J held that 'they just remained engines, albeit connected to other things'.[20]

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[15] Duncan Webb, 'Title and transformation: who owns manufactured goods?' [2000] Journal of Business Law 513, 522.
[16] *Re Peachdart Ltd* [1984] Ch 131, 142 (Vinelott J).
[17] *Borden (UK) Ltd v Scottish Timber* [1981] Ch 25.
[18] Ibid 41 (Bridge LJ).
[19] *Re Peachdart Ltd* [1984] Ch 131, 142. It is, of course, open to the buyer to grant to the seller a new claim in respect of the new thing. As the manufactured goods are likely to be worth considerably more than the original components, any such claim is likely to be in the nature of a charge: *Clough Mill Ltd v Martin* [1985] 1 WLR 111. Since that charge is unlikely to be registered, such claims are likely to fail.
[20] *Hendy Lennox v Grahame Puttick* [1984] 1 WLR 485, 494.

The parties can, of course, allocate to the claimant a claim in respect of the product. But such a claim does not, and could not, depend upon the affirmation of a pre-existing title.[21] Rather, it is a new claim, and, if the product is worth more than the original goods, it will almost certainly be in the nature of a charge.[22]

### C. Following Rights

In all of the cases so far considered, the object of the following exercise was the physical thing in respect of which title was asserted. In law, however, we just as often follow rights: if A sells B a car for £1000 on credit, and A assigns his right to be paid £1000 to C, we can follow the right to be paid £1000 from A to C. In *Foskett v McKeown*, considered in the previous chapter, a trustee misappropriated trust funds, using them to pay for two out of five premiums on a life insurance policy, before assigning the policy to trustees to hold on trust for his children. In order for the claimants to trace into the payout, they therefore had to establish a claim to the right to future payment represented by the policy, follow that policy to the assignees, before tracing into the proceeds of those rights.

And it is not only rights in the strict Hohfeldian sense (those with corresponding duties) that can be followed. *Armstrong v Winnington* concerned a claim brought by Armstrong DLW GmbH ("Armstrong") for the value of carbon dioxide emission allowances that had been transferred from its account to that of Winnington Networks Ltd ("Winnington") as a result of an email fraud perpetrated upon Armstrong by a third party.[23] Under the EU Emission Trading Scheme large

[21] *Borden (UK) Ltd v Scottish Timber* [1981] Ch 25, 44 (Templeman LJ).
[22] *Re Bond Worth* [1980] Ch 228. Compare the decisions in *Aluminium Industrie Vaassen BV v Romalpa Aluminium* [1976] 1 WLR 676 and *Associated Alloys Pty Ltd v Metropolitan Engineering & Fabrications Pty Ltd* [2000] HCA 25 as to equitable claims to proceeds.
[23] *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156.

emitters of carbon dioxide must return to the government an amount of emission allowances ("EUAs") to the government that is equivalent to their emissions in that year. Companies may trade EUAs provided that, at the end of the year, the company can return enough EUAs to cover its emissions for that year. If it cannot, it will be fined. Winnington agreed to purchase 21,000 such EUAs from Zen Holdings Ltd ("Zen"). As a result of an email fraud, 21,000 EUAs were transferred from Armstrong to Winnington. Winnington then immediately sold on the 21,000 EUAs and paid the purchase price to Zen.

Armstrong's claims were twofold: a claim to 'vindicate' its persisting rights in the EUAs by securing payment of their value, and, in the alternative, a claim for restitution of unjust enrichment. The judge held that an EUA was not a "right". Rather, he said, 'it represents at most a permission (or liberty in the Hohfeldian sense) or an exemption from a prohibition or fine'.[24] That liberty was recognisable by a unique reference number, so that 'to the extent that Armstrong's claim is based upon receipt by Winnington of the EUAs into its account, then that claim does not involve any question of tracing, but rather it is a case of "following" the original asset'.[25]

Though the judgment is confusing, this much seems correct. Hohfeld, though he avoided use of the term, suggested that 'liberty', if it meant anything, meant 'privilege'.[26] In Hohfeld's scheme, a 'privilege' was the jural opposite of a duty: if X has a privilege of entering onto land, he does not have a duty to stay off. An EUA, which is a 'no duty' not to emit carbon dioxide, is a privilege to emit carbon dioxide, the presence of which prevents an obligation to pay from arising. That privilege is transferable by striking it from one registry account and entering it in another. The

[24] Ibid, 848.
[25] Ibid, 178.
[26] W. Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning* (W. Cook ed, Reprinted edn, Greenwood Press 1978) 42.

EUA is then returnable to the government only by the account holder into which the EUA has been entered. In *Armstrong v Winnington* Armstrong, who could show that the EUA's received by Winnington were the same privileges formerly held by it, was able follow them into Winnington's registry account.

So, we can follow things, we can follow rights, and we can follow privileges that do not amount to claim-rights. So long as the thing or right is identifiably the same thing or right, though it is not in the same location, we are following.

## III. Following and Claiming

One of the first and most important contributions made by Smith in *The Law of Tracing* was to distinguish both following and tracing from claiming. Following, he says, simply involves the identification of a physical thing, the establishment of a claim to which depends upon other operative facts.[27] At a basic level, this must be true: the fact that one can follow a particular object is manifestly insufficient to demonstrate that one can claim.[28] And insofar as following involves the proof by evidence of the geographical location of a physical thing it is altogether devoid of normative considerations. But much of what we consider to belong to the realm of following in fact involves the allocation, or reallocation, of claims. This section considers the manner in which English private law deals with multiple contributors to mixtures of homogenous things, and the rule that money 'has no ear-mark'.

[27] Smith, *The Law of Tracing* (OUP 1997) 10-11.
[28] Birks, 'Overview: Tracing, Claiming and Defences' in Birks (ed), *Laundering and Tracing* (OUP 1995) 291.

## A. Mixtures

Where two or more homogenous things were mixed accidentally so as to become practically inseparable, the Roman law conclusion was that it was for the judge to establish which thing belonged to whom. This exercise was not a reallocation of title in respect of a mixture, but an affirmation of pre-existing title. So, where corn belonging to two parties becomes inseparably aggregated:

> [T]he corn is no more made common property than there would be a common herd if Titius' cattle were mixed with yours, and if either of you holds the whole of the corn, the other will have an action in rem for the amount of his grain, it being a matter for the judge to estimate which grain is whose.[29]

Despite Bracton's best attempts to incorporate the Roman rule,[30] English law took a long time to arrive at a similar result. For several centuries title was simply held to pass to whomever had control where goods were irrevocably mixed,[31] so that for the finder (if not the bailee)[32] the response of '*non detinet*' to an allegation of wrongful detention could be understood in its most literal sense.[33]

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[29] Institutes of Justinian 2.1.28.

[30] Henry of Bratton, *Bracton de legibus et consuetudinibus Angliae - On the laws and customs of England*, vol II (S. Thorne ed, Selden Soc : Harvard UP 1968-77) 47.

[31] *Anon* Yale Law Sch MS GR297, p244; *Smoote v Futball* (1593) CUL MS Dd 10 51, fo 7v; Poph 33, pl 2. See J. H. Baker, *An Introduction to English Legal History* (4th edn, OUP 2002) 382.

[32] Distinctions between the two bases for liability (agreement and a right to possess) emerge clearly in the denial. Merely being out of possession, or otherwise being unable to identify the goods bailed, did not excuse a bailee if he was to blame for that fact. *Anon* BL MS Hargrave 4, fo 110v, pl 18 (CP); B & M 302. In one case the defendant attempted to rely upon his inability to deliver: *Brown*: 'If you bail to me a thing which is wastable, as a tun of wine, and I perchance drink it up with other good fellows, you cannot have detinue, inasmuch as the wine is no longer *in rerum natura' Anon* YB 20 Hen VI f 16, pl 2. Newton CJ was not persuaded, concluding that detinue was indeed the appropriate form of action. In another case Fitzherbert J drew a distinction between bailment and finding: 'For where a man comes into possession by bailment he is chargeable by force of the bailment, and if he bails them over or they are taken out of his possession he is still chargeable to his bailor by force of the bailment. It is otherwise, however, when a man comes to the goods by finding, for there he is not chargeable except by reason of the possession, and if he is lawfully out of possession before the person entitled brings his action, he is not chargeable' *Anon* YB Pas 27 Hen VIII, fo 13 pl 35, LC MS Law MS 15, sub dat 27 Hen VIII, fo 28v (CP).

[33] S. Milsom, *Historical Foundations of the Common Law* (2nd edn, OUP 2009) 272.

> In this writ the plaintiff shall recover the thing detained, and therefore it must be so certain as it may be known, and that cause it lyeth not for money out of a bag or chest; and so of corn out of a sack, and the like, these cannot be known from other.[34]

A solution to the hardship that this rule created was not found until the nineteenth century, and it was a different solution from that which Roman law adopted. Rather than requiring the judge to fill the gap in evidence by establishing, once and for all, which corn belonged to whom, the English approach was simply to treat the contributors as title-holders in common of the mixture, changing each contributor's claim from a claim to an identifiable thing to a claim to an identifiable share.[35]

In *Buckley v Gross* various quantities of tallow were deposited in warehouses on a bank of the Thames.[36] A fire destroyed the warehouse and the tallow melted and flowed down into the main sewers and on into the river, from which some of it was gathered. Blackburn J concluded that 'the legal effect of such a mixture would be to make the owners tenants in common in equal portions of the mass'.[37]

For Smith, if this is the correct characterisation of the parties' claims, then it is a tenancy in common 'of an unusual sort'.[38] First, he says, a contributor is at liberty to take his share, whereas 'a tenancy in common can generally only be severed by

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[34] E. Coke, *The First Part of the Institutes of the Laws of England*, vol II (F. Hargrave and C. Butler eds, 18th Revised edn, London: J & W Clarke, R. Pheney and S. Brooke 1823) 286. A very similar passage can be found in Blackstone's Commentaries: 'In this action, of detinue, it is necessary to ascertain the thing detained, in such manner as that it may be specifically known and recovered. Therefore it cannot be brought for money, corn, or the like: for that cannot be known from other money or corn; unless it be in a bag or a sack, for then it may be distinguishably marked.' See also *Anon* BL MS Add 36941, fo 35v, LI MS Maynard 87, fo 145v, CUL MS LI 3, 8, fo 160 (CP)

[35] See *Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)* [1988] QB 345, 364-365.

[36] *Buckley v Gross* (1863) 3 B & S 566, 122 ER 213.

[37] Ibid, 574. See also *Glencore International AG v Metro Trading International Ltd* [2001] 1 Lloyd's Rep 284. That case concerned the mixing in storage of oil. Moore-Bick J held that 'the contributors to the bulk would become co-owners of the bulk in proportion to the quantity of oil which each had contributed to it' (107).

[38] Smith, *The Law of Tracing* (OUP 1997) 75.

agreement or court order'.[39] Second, he points that whilst it amounts to conversion to refuse to divide the mixture,[40] or to dispose of the commonly owned property,[41] it is 'generally understood to be the rule at common law that it is not conversion for one tenant in common to dispose of the commonly owned property'.[42]

The operation of section 20A-B of the Sale of Goods Act 1979, incorporated by the Sale of Goods (Amendment) Act 1995, are now instructive on both points. Section 20A permits pre-paying buyers of goods in bulk to acquire an interest in common, and section 20B provides that any such co-owner is deemed to consent to a delivery or removal of goods out of the bulk by another co-owner, insofar as those goods fall within the co-owner's undivided share. It is made manifest that no cause of action will accrue to any against a person acting in accordance with these provisions, in reliance on deemed consent. If it ever was peculiar, the kind of co-ownership recognised in *Buckey v Gross* must now, therefore, be regarded as run of the mill.

This conversion of claims to specific assets into co-ownership is not a rule that either is or applies a rule of evidence: it is a rule that determines the relative size and nature of their claims. And it is a useful rule: once the parties' interests have been determined, subsequent problems of evidence disappear. In particular, it is no longer necessary to determine whose goods are affected by any depletion to the mixture: the parties' shares in the mixture are unaffected, though the amount they can recover from it declines rateably. This is often described as an application of the principle of

[39] Ibid 75. It should be noted that the provisions Smith cites relate to land (The Law of Property Act s15-16) and there are independent reasons for the unique treatment of applications to sell land and divide proceeds.
[40] *Moore v Erie* (1897) 7 Lansing 39.
[41] *Jackson v Anderson* (1811) 4 Taunt 24, 128 ER 235; *Wiles v Woodward* (1850) 5 Exch 557, 155 ER 244.
[42] Smith, *The Law of Tracing* (OUP 1997) 75. Smith does acknowledge that this view is not universally held: *Mayhew v Herrick* (184) 7 CB 229, 137 ER 92; *Coleman v Harvey* [1989] 1 NZLR 723

*pari passu*,[43] but it is no more than a continuation of the logic of proportionate shares: even if the thing to which the shares relate shrinks or is depleted in some manner, the shares in it remain the same.

We have a different rule for wrongdoers, which is often described as an application of the rule that 'everything is presumed against a wrongdoer'.[44] In *Indian Oil Corporation Ltd v Greenstone Shipping* the owners of a vessel chartered to transport Russian crude oil from a Russian port to India mixed the Russian oil with their own crude oil already on board.[45] The mixture could not be separated for practical purposes and the receivers claimed to be entitled to delivery of all the oil on board. Staughton J held, citing *Buckley v Gross*, that both parties were tenants in common of the mixture.[46] However, he also drew from *Armory v Delamirie* the proposition that if doubt remains either as to quantity or quality, the wrongdoer must bear the loss: 'if the wrongdoer has destroyed or impaired the evidence by which the innocent party could show how much he has lost, the wrongdoer must suffer from the resulting uncertainty'.[47] The innocent party would thus be entitled to claim first from the mixture as much as was necessary to meet their initial contribution (though no more), so that the wrongdoer suffered any losses that had occurred to the mixture.[48]

*Armory v Delamirie* did indeed involve an evidential uncertainty.[49] In that case a chimney sweep's boy found a ring containing a jewel that he took to be valued. The jeweler took the jewel and refused to return it. Since he had prevented the court from

[43] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP) 257.
[44] Birks, *An Introduction to the Law of Restitution* (OUP 1985) 368
[45] *Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)* [1988] QB 345.
[46] Ibid, 370.
[47] Ibid, 369.
[48] Ibid 370-371.
[49] *Armory v Delamirie* (1722) 1 Str 505, 93 ER 664.

ascertaining the value of the jewel, Pratt CJ directed the jury to award the plaintiff the value of the finest jewel that the socket would hold.

In *Greenstone Shipping*, by contrast, the facts were clear. Having concluded that the parties held the mixture in common, the judge would have had no problem in determining the parties' shares: depletion affected the mixture, certainly, but not the shares relating to it. He did not have to engage in the same exercise as the Roman judge: dividing grain and thereby attributing loss. The conclusion that the innocent party could claim from the mixture an amount equal to their contribution does not, therefore, follow from the conclusion that the parties are tenants common in equity.[50] The best explanation is that the decision has the effect of awarding the innocent party a security interest for the amount of his contribution.

**B. 'Money has no Ear-mark'**

It was with reference to the rule that 'money has no ear-mark' that specific relief against an agent for money paid to him by a third party was denied as early as 1710, in *Whitecomb v Jacob*.[51] The rule is often thought to refer to the practical

[50] In Birks' words, 'it is not very easy to explain that gloss on the conclusion for co-ownership, the logic of which is that each party owns every quantum of the mass in the given proportions': Birks, 'Mixing and Tracing: Property and Restitution' [1992] 45 CLP 69, 74.

[51] *Whitecomb v Jacob* (1710) 1 Salk 160, 91 ER 149. See also *Kirk v Webb* (1698) Prec Ch 84, 24 ER 41; *In Re West of England and South Wales District Bank* (1879) 11 Ch D 772. It is generally thought that the term 'ear-mark' developed from the practice, described by Ault, of giving cattle a town mark to distinguish them in the event of inter-commoning. W. Ault, *Open-Field Farming in Medieval Europe: A Study of Village By-laws* (Reprint edn, Routledge 2013) 2848. The Stevenson (ed) *Shorter Oxford English Dictionary on Historical Principles*, vol 2 (6th edn, OUP 2007) records it as: 'a mark in the ear of a sheep or other animal, serving as a sign of ownership.' The first recorded use of the word 'ear-mark' in this way is, however, not until the C16th. In Edmund Spenser's *Prosopopeia*, published in 1591, can be found the words: 'Least we like rogues should be reputed, for eare marked beasts abroad be bruted.' There is a good chance that this is not, in fact, the root of the term 'earmark'. It was more common practice throughout the Middle Ages to *brand* cattle, not to mark or cut their ears, a practice amusingly described by Chaucer in his *Miller's Tale*: 'And he was redy with his iren hoot, And Nicholas amidde the ers he smoot. Of gooth the skin an hande-brede aboute, The hole culter brende so his toute.' See also W. H. Wheeler, *A History of the Fens of South Lincolnshire, being a description of the rivers Witham and Welland and their estuary, and an account of the reclamation, drainage, and enclosure of the fens adjacent thereto* (2nd edn, Boston 1897) 36-37. It seems probable, therefore that

impossibility of distinguishing individual notes and coins.[52] In fact, although the Royal Mint achieved a monopoly over coining in the sixteenth century, a great many of the coins in circulation bore the mark of their maker – a practice that was made mandatory by statute as early as 1363.[53] The most that we could say, therefore, is that it would be difficult, but not impossible, to identify particular coins. Identifiable or not, however, the rule is that money cannot be followed where it reaches the hands of a bona fide purchaser. This is not a conclusion about the available evidence, but a normative principle: in order to secure the currency of money, individuals must be able, cheaply and easily, to acquire confidence in the title that they receive.[54]

*Ford v Hopkins* involved an action in trover for lottery tickets.[55] It was found that the plaintiff had given the tickets in question to a goldsmith to receive the money due on them, and that the goldsmith had given a note to pay him so many lottery-tickets. Holt J held that title to the notes had not passed and gave judgment for the plaintiff. He said:

> If bank notes, Exchequer notes, or million lottery tickets, or the like are stolen or lost, the owner has such an interest or property in them,

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the word actually comes from 'ear' (plough) in Middle English, not from 'ere' or 'eris' (ears) at all. The Old Testament of the 1611 King James bible refers to 'ear' in this context on multiple occasions: Genesis 45:6: 'For these two years hath the famine been in the land: and yet there are five years, in the which there shall neither be earing nor harvest.'; Deuteronomy 21:4 'And the Elders of that citie shall bring downe the heifer vnto a rough valley, which is neither eared nor sowen, and shall strike off the heifers necke there in the valley.'; 1 Samuel 8:12: 'And hee will appoint him Captaines ouer thousands, and captaines ouer fifties, and will set them to eare his ground, and to reape his haruest, and to make his instruments of warre, and instruments of his charets.'; Isaiah 30:24: 'The oxen likewise and the yong asses that eare the ground, shall eate cleane prouender which hath bene winnowed with the shouell and with the fanne.' 'Merk', 'mearc' or 'mere' (mark) originally meant 'boundary'. So, 'ear-mark' may refer to the boundaries of the plough strips of the common land. The first use of the phrase 'money has no ear-mark' is in Marvell's *Fanaticka*: 'fanatick money hath no ear-mark.'

[52] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721, 726 (Lord Ellenborough).

[53] It was enacted by the Statute 37 Edward III c.7 that every master goldsmith should 'have a mark by himself, which mark shall be known by them assigned by the King to survey their work.' In 1576 it was enacted by 18 Eliz. c. 15 that a goldsmith must set his mark on all wares before sale. That statute imposed a penalty for touching as "good" any gold or silver wares in which fraud or deceit should afterwards be found. In 1697 a further statute was enacted (8 Wm. III. c. 8) whereby wrought plate was to be stamped with marks of a different kind from those used previously. C. J. Jackson, *English Goldsmiths and their Marks* (2nd edn, Dover Publications Inc 1965) 8, 15, 18.

[54] Fox, *Property Rights in Money* (OUP 2008) 52-59.

[55] *Ford v Hopkins* (1700) 1 Salk 283, 91 ER 250, 284.

> as to bring an action, into whatsoever hands they are come. Money or cash *is not to be distinguished* but these notes or bills are distinguishable, and can not be reckoned as cash; and they have distinct marks and numbers on them.[56]

So, the rule is not that money *cannot* be distinguished, but that the law *will not* distinguish it. And the reason why the law will not distinguish money for the purposes of allowing a claimant to claim it from an innocent recipient who has given value is that, in order to function effectively as money, the recipient of it must have confidence in the value of its credit to him.

In *Miller v Race* Lord Mansfield held that trover did not lie for bank notes, because 'A bank-note is constantly and universally, both at home and abroad, treated as money, as cash; and paid and received, as cash; and it is necessary, for the purposes of commerce, that their currency should be established and secured'.[57] His Lordship said:

> It has been quaintly said, "that the reason why money can not be followed is, because it has no ear-mark:" but this is not true. The true reason is, upon account of the currency of it: it can not be recovered after it has passed in currency. So, in case of money stolen, the true owner can not recover it, after it has been paid away fairly and honestly upon a valuable and bona fide consideration: but before money has passed in currency, an action may be brought for the money itself.[58]

Of the decision in *Ford*, Lord Mansfield considered:

> [T]his must be a very incorrect report of that case: it is impossible that it can be a true representation of what Ld. Ch. J. Holt said. It represents him as speaking of bank-notes, Exchequer-notes, and million lottery tickets, as like to each other. Now no two things can be more unlike to each other, than a lottery-ticket, and a bank-note. Lottery tickets are identical and specific: specific actions lie for them. They may prove extremely unequal in value: one may be a prize; another, a blank. Land is not more specific, than lottery-tickets are… bank notes are not like lottery-tickets, but money.

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[56] Ibid 204. The report for *Kendar v Milward* (1702) 2 Vern 440, 23 ER 882 decided in two years later, states that 'money had no ear-mark, and could not be followed when invested in a purchase.'
[57] *Miller v Race* (1758) 2 Keny 189, 96 ER 1151 [459].
[58] Ibid [457]-[458].

The first reason for Lord Mansfield's refusal to accept the analogy between bank notes and lottery tickets is that 'specific actions lie' for the latter. That can be disregarded, since it is precisely the point at issue. The second is that lottery tickets can be wildly divergent in value. But that goes to establish fungibility, not identifiability. In other words, *even if* a bank note could be identified as a matter of fact, since its face value (not any other potential value) is all that matters to the holder, it is interchangeable with all other bank notes of the same value. The same is, of course, true of coins. In fact, the driving force behind his Lordship's dissatisfaction with *Ford* was that, 'No dispute ought to be made with the bearer of a cash-note; in regard to commerce, and for the sake of the credit of these notes, though it may be both reasonable and customary, to stay the payment, till inquiry can be made, whether the bearer of the note came by it fairly, or not'.[59] In short, in order to secure their easy currency, the rule that money has no ear-mark ought, Lord Mansfield argued, to be applicable equally to bank notes.

Because it is a rule designed to protect innocent recipients of money from any defect in his title that might otherwise exist, it does not apply to the acquisition of money *mala fides*. In *Clarke v Shee & Johnson* Lord Mansfield said:

> Where money or notes are paid *bona fide*, and upon a valuable consideration, they never shall be brought back by the true owner; but where they come mala fide into a person's hands, they are in the nature of specific property; and if their identity can be traced and ascertained, the party has a right to recover. It is of public benefit and example that he should: but otherwise, if they cannot be followed and indentified, because there it might be inconvenient and open a door to fraud.[60]

[59] Ibid [459]-[460].
[60] *Clarke v Shee & Johnson* (1774) 1 Cowp 197, 98 ER 1041, [200].

In *Wookey v Pole* Best J held that the decision in *Miller v Race* applied equally to exchequer notes, saying that 'it has long been established that the right to money is inseparable from the possession of it'.[61] On this point he concluded:

> It is not because the loser cannot know his money again that he cannot recover it from a person who has fairly obtained the possession of it; for if his guineas or shillings had some private marks on them by which he could prove they had been his, he could not get them back from a bona fide holder. The true reason of this rule is, that by the use of money the interchange of all other property is most readily accomplished. To fit it for its purpose the stamp denotes its value, and possession alone must decide to whom it belongs.[62]

He continued: 'I conceive that the representative of money, which is made transferrable by delivery only, must be subject to the same rules as the money which it represents'.[63]

This requires closer examination. Bank notes are bearer bills: possession is enough to engage the payment obligation. We could say that that is sufficient protection for recipients, and it might well have been in 1700, when the validity of promissory notes as negotiable instruments was in doubt.[64] However, their negotiability was confirmed later by the Bills of Exchange Act 1704, and has not been doubted since. And if it is one of the functions of a bill to operate as transferable credit, then it follows that the same reasons for ensuring security of receipt apply to bank notes as apply to coins. Holt J himself decided in 1698 that there can be no trover for bills of exchange acquired for value and without notice 'by reason of the course of trade' despite the many protections awarded to holders in due course.[65]

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[61] *Wookey v Pole* (1820) 4 B & Ald 1, 106 ER 839, 6.
[62] Ibid 7.
[63] Ibid 6.
[64] *Williams v Williams* (1693) Carth 269; *Potter v Pearson* 2 Ld Raym 759; *Clerke v Martin* 2 Ld Raym 757; *Buller v Crips* (1703) 6 Mod 29.
[65] *Anon* 1 Salkeld's Reports 126.

So, the rule that money 'has no ear-mark' is a rule that disapplies the ordinary principle that an individual cannot pass a better claim than he has, enabling a recipient of money to be absolutely confident in his ability to use that sum to discharge his own liabilities of a value equal to the face value of the cash, which aids the ready circulation of physical notes and coins. It is, in short, a normative principle with a foundation in economic policy.

## IV. Following, Claiming and Bank Accounts

The rules for homogenous physical mixtures, and the rule that title follows possession (and the qualification to it, in cases of bad faith) have all been transposed to the context of bank accounts, and examples abound of contexts in which judges have relied upon the conceptual plausibility of bank money as an independent asset to which it is possible to have and retain title. It is, of course, tempting to reason analogically, particularly in the context of current accounts, the value of which will ordinarily have been constituted by several different sources. But a bank transfer does not involve the transfer of any asset that can be followed from one set of hands to another, and a bank account cannot be conceptualised as a mixed fund: such metaphors, it will be seen, stand in the way of recognition that such decisions as we make about the scope of liability in respect of bank accounts are fundamentally normative.

### A. Bona Fide Purchase and Bank Money

Despite the absence of any physical manifestation, courts continue to describe the process of asserting a claim against a recipient of bank funds as a process of following

and asserting a pre-existing title. By analogy with the decisions considered in the previous section, that title is thought to persist through the steps of a bank transfer, so long as the recipient is not a bona fide purchaser.

*Sinclair v Brougham* concerned the division of assets of a building society that was found to have borrowed funds from depositors for *ultra vires* purposes. The House of Lords held that it was possible for depositors to follow some of their money, which should be distributed *pari passu* between depositors and shareholders according to the amounts respectively credited to them in the books of the society. Lord Haldane said:

> If it be outside the power of a statutory society to enter into the relation of debtor and creditor in a particular transaction, the only possible remedy for the person who has paid the money would on principle appear to be one in rem and not in personam, a claim to follow and recover specifically any money which could be earmarked as never having ceased to be his property.[66]

If the claimant does consent to the payment, but only on the basis that a particular event will take place, the reason why the claimant can claim back the payment is generally explained according to the idea that the defendant's title to the money is itself defeasible or incomplete.[67] In *McDonald v Dennys Lascelles Ltd*, Dixon J explained that under a contract for sale of land involving prepayment of some part of the purchase price, the vendor's 'title to retain the money has been considered not to be absolute but conditional upon the subsequent completion of the contract'.[68] In *Baltic Shipping v Dillon* Mason CJ said: 'Quite apart from entire contracts, the parties may provide, expressly or impliedly, that the obligation to pay or the right to retain moneys paid in advance is conditional upon completion of the contract'.[69]

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[66] *Sinclair v Brougham* [1914] AC 398, 414
[67] Cf F. Wilmot-Smith, 'Reconsidering "Total" Failure' (2013) 72 CLJ 414.
[68] *McDonald v Dennys Lascelles Ltd* [1933] HCA 25; (1933) 48 CLR 457, 477.
[69] *Baltic Shipping Co v Dillon* [1993] HCA 4, (1993) 176 CLR 344 [8].

Understood thus, the conceptual basis for money claims following a failure of purpose looks a great deal like the reason why the claimant was able to recover back the unused leather in *Re Peachdart*: to the extent that the parties agree that a good title passes only upon performance of a thing agreed, the failure to perform that thing renders the defendant's possession of it adverse.

The metaphor of physical money is equally prevalent in equitable claims. In *ITS v GP Noble Trustees* Mr Anthony Morris was wrongfully credited with £4,890,000 from various pension schemes.[70] He paid £1,480,000 to his former wife, Mrs Morris, to satisfy his liability under a consent order. Mrs Morris was initially a *bona fide* purchaser: she gave value in the form of agreeing not to pursue any further claims for ancillary relief in return for the sum paid under the consent order. However, she later succeeded in having the consent order set aside, on the basis that Mr Morris' disclosure in the ancillary relief proceedings had been deliberately and materially deficient. Lloyd LJ considered that equitable title of the beneficiaries 'subsisted in the money after the payment to her', and, since Mrs Jones had acquired notice prior to the new order, ITS, was held to be entitled to recover the entire £1,480,000.[71]

The difficulty with this kind of reasoning is manifest: 'money in an account' is not an independent asset to which it is possible to have and retain title. As Lord Millett put it in *Foskett v McKeown*:

> We speak of money at the bank, and of money passing into and out of a bank account. But of course, the account holder has no money at the bank… There is merely a single debt of an amount equal to the final balance standing to the credit of the account-holder.[72]

[70] *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195 [101].
[71] Ibid [101]
[72] *Foskett v McKeown* [2001] 1 AC 102, 127-128.

Where a bank transfer is executed, neither that debt, nor any part of it, is transferred from payor to payee. In *R v Preddy* the defendants, who had procured the transfer of funds as part of a fraudulent mortgage scheme, could not be convicted of obtaining property 'belonging to another' for the purposes of the Theft Act 1968 because, as Lord Jauncey explained:

> When a sum of money leaves A's account his chose in action *quoad* that sum is extinguished. When an equivalent sum is transferred to B's account there is created in B a fresh chose in action being the right to demand payment of that sum from his bank.[73]

Indeed, at one level of abstraction, a bank transfer does not, in fact, alter the parties' rights and obligations at all.[74] In *Evans v European Bank*, proceeds of fraud were paid into an account with European Bank. At about the same time, European Bank deposited an equivalent amount in its own name with Citibank. After considering Lord Millett's judgment in *Foskett v McKeown* Spigelman CJ said:

> [I]n property law, the new "asset" constituted by the European Bank deposit with Citibank, was not, to use Lord Millett's terminology, a "substitute for the old [asset]", constituted by the Benford deposit with European Bank. That "old asset" has never been transformed or "substituted" into any thing. The funds had been employed by the bank, but the "old asset" always existed and still exists. The Benford account was always in credit, whether as a deposit account or as a current account. There was no occasion on which the value inherent in the account, which Benford held as trust property, had become located in the value inherent in the deposit with Citibank. No process of the character referred to by Lord Millett as 'substitution' has occurred.[75]

This passage was reiterated and followed in *Hillig v Darkinjung Pty Ltd*.[76] Of course, the *bank* might enter into a transaction in order to fulfil an instruction to credit someone's account – the processes of clearing and settlement are precisely this – but

[73] *R v Preddy* [1996] AC 815 841.
[74] *N Joachimson v Swiss Bank Corporation* [1921] 3 KB 110, 127.
[75] *Robb Evans of Robb Evans & Associates v European Bank Limited* [2004] NSWCA 82 [139].
[76] *Hillig v Darkinjung Pty Ltd* [2006] NSWSC 1217 [20].

it might not: if the transfer is made from one account with it to another account with it, then there is no transaction at all.

At a different level of abstraction, a bank transfer *does* involve a transaction, because the content of the individual's right to repayment changes: a right to demand £100 is not the same thing as a right to demand £1000 or 1p. As Staughton J put it in *Libyan Arab Foreign Bank v Bankers Trust*:

> An account transfer means the process by which some other person or institution comes to owe money to the Libyan Bank or their nominee, and the obligation of Bankers Trust is extinguished or reduced pro tanto. 'Transfer' may be a somewhat misleading word, since the original obligation is not assigned (notwithstanding dicta in one American case which speak of assignment); a new obligation by a new debtor is created.[77]

In McFarlane's words, if B transfers $100 to A, 'B loses a right to claim $100 from B's bank, and A acquires a right to claim $100 from A's bank'.[78] Here, however we must be careful. Unless A's account stands at $0 prior to the transfer, A's claim is not to $100, but $100 plus whatever the original balance stood at. So, a bank transfer of $100 from B to A, where B and A each have $1000 prior to the transfer ought to be analysed as follows: B begins with a claim to $1000 and ends with a claim to $900, and A begins with a claim to $1000 and ends with a claim to $1100. Each has given up and acquired a claim.

So, however we choose to conceptualise a funds transfer, any asset that the transferee acquires is not the asset lost by the claimant. Nothing passes from payor to payee but a 'stream of electrons'.[79] We cannot follow bank funds, so that if there is an explanation for a claim against the beneficiary of a funds transfer, it cannot be that the claimant's (legal or equitable) title persists. And importantly, since the recipient of a

[77] *Libyan Arab Foreign Bank v Bankers Trust* [1989] QB 728, 750.
[78] Ben McFarlane, 'Trusts and Knowledge: Lessons from Australia' in J. Glister and P. Ridge (eds), *Fault Lines in Equity* (Hart Publishing 2012) 175.
[79] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 286.

funds transfer already *has* absolute security of receipt, there is no force behind the logic of disapplication of *nemo dat*: once participating banks have acted on the payment instruction the transfer is irrevocable.[80] The rule that *bona fide* recipients of money for value and without notice acquire a perfect title does not have any bearing whatsoever on bank accounts. In 1880 *Re Hallett's Estate* Jessel MR held that the rule that money had no ear-mark was 'no longer good law'.[81] In truth, however, it was no longer good fact.

**B. Bank Accounts and Mixed Funds**

The rules applicable to the irreversible mixing of homogenous assets are applied by analogy, to the context of bank accounts, on the basis that 'a bank account which receives multiple credits is, metaphorically, an incorporeal mixture'.[82] Ames calls it a 'confusion of funds'.[83] In *Foskett v McKeown* Lord Millett considered that 'the same principle operates whenever the mixture consists of fungibles, whether these be physical assets like oil, grain or wine or intangibles like money in an account'.[84]

In Smith's words:

> [W]hen there is a mixed substitution, one person's value is indistinguishably mixed with another's in the new asset. Tracing in this situation is therefore best conducted by analogy to the established rules for *following* through physical mixtures of indistinguishable things.[85]

We call these the 'rules of tracing', and they are generally considered to aid a claimant to locate 'his' units of value within a mixed fund:

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[80] *The Brimnes* [1973] 1 WLR 386; *Tayeb v HSBC Bank* [2004] EWCH 1529, [2004] 4 All ER 1024.
[81] *Re Hallett's Estate* (1880) 13 Ch D 696, 714 (Jessell MR).
[82] Birks, 'On Taking Seriously the Difference between Tracing and Claiming' (1997) 11 TLI 2 4.
[83] Ames, 'Following Misappropriated Property into its Product' (1906) 19 Harvard Law Review 511 520.
[84] *Foskett v McKeown* [2001] 1 AC 102 141.
[85] Smith, *The Law of Tracing* (OUP 1997) 160.

> When money has been paid into an account (or, for that matter, into a bucket, if money were often so kept) and there are subsequent drawings out, it is usually not possible to show by evidence exactly when those particular units of value were withdrawn… It follows that either the tracing exercise must be regarded as generally foiled by payment into a bank account or it must be supported by artificial presumptions. It has been found possible to support it with presumptions.[86]

In fact, however, the orthodox approach to so-called 'mixed funds' is not a process of locating value, but – like the rules for physical mixtures – a process of allocating claims: contributors are considered to be equitable co-owners in proportion to their contribution, and any depletion to the mixed fund changes only the size of recovery, not the nature or scope of the parties' claims.

In *Re Diplock* Caleb Diplock's will directed his executors to apply his residuary estate 'for such charitable institutions or other charitable or benevolent object or objects in England' as they should in their absolute discretion think fit. The executors distributed a significant portion of the residue among several charities before the bequest was held to be invalid.[87] The claims of Diplock's next-of-kin against the executors or their estates were compromised, but a number of actions, both personal and proprietary, proceeded against the charities. Some of the money had been paid into various charities' general accounts. Delivering a joint judgment, their Lordships held that 'Where the contest is between two claimants to a mixed fund made up entirely of moneys held on behalf of the two of them respectively and mixed together by the fiduciary agent, they share pari passu, each being innocent'.[88]

A competing rule has been derived from the decision in *Clayton's Case*, and has come to be known by that name. That case concerned claims to the estate of

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[86] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997) 254.
[87] *Re Diplock* [1941] Ch 253.
[88] *Re Diplock* [1948] Ch 465, 539.

William Devaynes.[89] Devaynes had been a partner in the banking firm of Devaynes, Dawes, Noble and Co. He died in 1809 with a considerable estate, which he had bequeathed to the defendants Noble, Cockerell, and Booth upon trust for his son, also William Devaynes. After the death of Devaynes senior, the other partners continued the banking business under the same firm. When the firm became insolvent, the question that arose was whether Devayne's estate was liable in respect of partnership debts owed at his death. One class of creditors was represented by Clayton, and consisted of those who, after Devaynes' death, had continued to deal with the surviving partners both by drawing out and paying in money. In Chancery (but not at common law), joint debtors were considered to be severally liable, so the claimants proceeded in equity against Devaynes' estate for the balance due to them at the time of his death.

Clayton had an account with the bank and had also deposited exchequer bills for £500 each with the bank, which exchequer bills were sold without the knowledge or consent of the creditor, and the produce, £1035, was applied to meet the exigencies of the house. Clayton's balance was £1713 at the time of Devaynes' death. He withdrew £1260 after it, before making any deposits, leaving a balance of £453. He subsequently made a series of deposits and withdrawals. Between the death of Devaynes and the bankruptcy, the payments made to Clayton by the surviving partners, amounting to £1260, exceeded the amount of his balance (£1717) and the produce of the exchequer bills (£1035) together. His payments, however, were much larger than his receipts, so that at the time of bankruptcy his account balance was greater than it had been at the time of Devaynes' death. Clayton's eventual claim was to £453.

[89] *Clayton's Case: Devaynes v Noble* (1816) 1 Mer 529, 35 ER 781.

Laying down what would come to be known as 'the rule in Clayton's Case', Sir William Grant MR said:

> There is a fund of £1000 to draw upon, and that is enough. In such a case, there is no room for any other appropriation than that which arises from the order in which the receipts and payments take place, and are carried into the account. Presumably, it is the sum first paid in, that is first drawn out. It is the first item on the debit side of the account, that is discharged, or reduced, by the first item on the credit side.[90]

That decision was applied in *Pennell v Deffell* to determine the respective claims of a trustee and beneficiaries in respect of an account to which the trustee had contributed both trust funds and his own funds.[91] Although the rule was again recognised in *Barlow Clowes International v Vaughan*,[92] and more recently in *Charity Commission for England and Wales v Framjee*,[93] courts have been reluctant to apply it, and have preferred to recognise, as in *Re Diplock*, that the claims of innocent parties deplete rateably.[94]

The position of those who wrongfully mix bank funds is also treated analogically to physical mixtures. In *Re Hallett's Estate* Hallett misappropriated trust funds and Russian bonds belonging to a client, Cotterill.[95] He sold them and credited the proceeds to his personal account. He died insolvent, and the trustees and Cotterill

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[90] Ibid 792-793.
[91] *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551.
[92] *Barlow Clowes International Ltd v Vaughan* [1992] 4 All ER 22.
[93] *Charity Commission for England and Wales v Framjee* [2014] EWHC 2507, [2015] 1 WLR 16.
[94] *Russell-Cooke Trust Co v Prentis* [2002] EWCH 2227 [55]-[56]; *Commerzbank AG v IMB Morgan Plc* [2004] EWHC 2771 (Ch), [2005] Lloyd's Rep 298 [52]-[50]. Other common law jurisdictions do not apply it: *Windsor Mortgage Nominees Pty Ltd v Cardwell* (1979) CLC 40-540. In *Charity Commission for England and Wales v Framjee* [2014] EWHC 2507, [2015] 1 WLR 16 Henderson J said: 'I can deal briefly with the Clayton's Case approach, because nobody submits that it should be followed in the present case. Quite apart from the arbitrary way in which it favours the recipients of later donations over the recipients of earlier donations, the evidence establishes that it would be prohibitively expensive to attempt to reconstruct the accounts of the Dove Trust over the last ten years in order to ascertain the precise order in which payments in were matched by payments out. Furthermore, the authorities establish that, although the rule in Clayton's Case 1 Mer 572 is probably still the default rule in England and Wales which has to be applied in the absence of anything better, it may be displaced with relative ease in favour of a solution which produces a fairer result' [49].
[95] *Re Hallett's Estate* (1880) 13 Ch D 696.

brought proprietary claims to his account, which claims were successful. One of the questions concerned the effect of withdrawals to the account prior to the time of the claim. The Court of Appeal held that those withdrawals could only have the effect of decreasing the sum that Hallett could recover.[96] Lord Jessel MR used the following analogy:

> The simplest case put is the mingling of trust moneys in a bag with money of the trustee's own. Suppose he has a hundred sovereigns in a bag, and he adds to them another hundred sovereigns of his own, so that they are commingled in such a way that they cannot be distinguished, and the next day he draws out for his own purposes £100, is it tolerable for anybody to allege that what he drew out was the first £100, the trust money, and that he misappropriated it, and left his own £100 in the bag? It is obvious he must have taken away that which he had a right to take away, his own £100.[97]

His Lordship continued:

> What difference does it make if, instead of being in a bag, he deposits it with his banker, and then pays in other money of his own, and draws out some money for his own purposes? Could he say that he had actually drawn out anything but his own money? His money was there, and he had a right to draw it out, and why should the natural act of simply drawing out the money be attributed to anything except to his ownership of money which was at his bankers.[98]

Baggallay LJ explained the decision in the same way:

> I receive a cheque for £100 on a trust account, it will not be required for a few days, and it is too large a sum to be kept in my desk, I pay it into a bank, and on the following day receive £100 on my own private account, and not wanting it for a few days I pay it into the same account; I require £50 or £100 for my own purposes before the time arrives fur requiring any money for trust purposes, and I accordingly draw against the mixed fund for the £50 or £100. Can any reason be assigned why in this latter case, as well as in the former, I should not, as between myself and my cestui que trust, have the honest intention attributed to me of drawing against my own private funds, and not against the trust fund, though it was the first paid in?[99]

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[96] Ibid 727-728.
[97] Ibid 727-728.
[98] Ibid 727-728.
[99] Ibid 735.

The effect of the decision is thus the same as *Greenstone Shipping*: the wrongdoer's claim is subordinated to that of the claimant. Birks explains the operation of the decision in *Re Hallett's Estate* as 'the most powerful presumption' in Equity's toolkit: 'The underlying idea… is that where a wrongdoer creates an evidential difficulty, that difficulty will be resolved against his interest, save so far as he can himself discharge the onus of proving the contrary'.[100] Again, however, if according to the principles in *Sinclair v Brougham* and *Re Diplock*, the parties are equitable tenants in common of the account, there is no evidential problem to solve. If the metaphor of mixtures fits, the better interpretation of the decision is that it involved the recognition of a charge.[101]

Application of the rule in *Re Hallett's Estate* has one important limit, which has come to be known as the 'lowest intermediate balance' rule. In *James Roscoe v Winder* a company sold its business to Wigham. Wigham agreed to get in the book debts of the business owing on or before April 30, 1913, and to pay over to the company all moneys received by him on account of them. Thereafter all debts outstanding were received on Wigham's account only. The gross amount of the book debts so owing was £623l. Wigham collected that sum and credited it to his private bank account.

By May 21, 1913, he had drawn out almost all the money standing to his credit. Subsequently, he paid in funds of his own, and drew on the account for his own purposes, with the result that on his death there was a credit balance of £358. In an action by the company against the trustee of Wigham's property under an

[100] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997) 255.
[101] *Re Hallett's Estate* (1880) 13 Ch D 696, 711.

administration order in bankruptcy, the company claimed to have a charge on Wigham's account for the £455. That claim failed. The judge considered that:

> Certainly, after having heard *In re Hallett's Estate* stated over and over again I should have thought that the general view of that decision was that it only applied to such an amount of the balance ultimately standing to the credit of the trustee as did not exceed the lowest balance of the account during the intervening period.[102]

Smith explains the decision as follows:

> If £100 of the plaintiff's value was paid into the account, and at some subsequent time the balance was £60, then the plaintiff cannot assert, on the principles of tracing, that more than £60 of her value remains in the balance. It would be contrary to the notion of tracing. Regarding the £60, it is impossible to say whether or not it came from the plaintiff; the account is an indistinguishable mixture of value; but this impossibility is resolved in her favour against a wrongdoer. But regarding the other £40, there is no impossibility; we know that it was withdrawn, since the balance was only £60. It cannot be in the account any longer. The law allows evidential difficulties, and thus impossibilities, to be resolved against the wrongdoer; but it does not allow findings contrary to the evidence.[103]

The rule is thus said to be 'a limit of logic and evidence:'[104] just as the claimant's claim necessarily disappears if the contents of a physical bulk to which the claimant has contributed are destroyed, so will it if the account into which his funds are paid reaches £0.

There is one rule with which there is no analogy outside the context of fiduciary relationships. This is the rule that, if the trustee has made a successful investment by withdrawing funds from the mixture, the beneficiary can choose to locate his interest in that investment.

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[102] *James Roscoe (Bolton) Ltd v Winder* [1915] 1 Ch 62, 69.
[103] Smith, *The Law of Tracing* (OUP 1997) [202].
[104] Lionel Smith, 'Tracing in Bank Accounts: the Lowest Intermediate Balance Rule on Trial ' (2000) 33 Can Bus LJ 75, 80.

*Re Oatway* involved a creditor's action in respect of the administration of the estate of Lewis John Oatway, a solicitor, who died insolvent in 1902.[105] The defendant, Christiana Mary Oatway, was his sole executrix. In the course of the administration a question arose as to proper distribution of the proceeds of sale of 1000 shares in a company called the Oceana Company.

The testator and Maxwell Skipper had been appointed co-trustees under the will of Charles Skipper, deceased. In 1899 and 1900 sums were advanced in breach of trust out of Charles Skipper's estate to Maxwell Skipper upon the security of a mortgage of an undivided share of certain real estate to which he was entitled under his grandfather's will. In 1901 Maxwell Skipper went abroad, having given Oatway a power of attorney. Oatway sold Maxwell Skipper's reversionary interest for the sum of £7000, which was paid into Oatway's own bank account, which at that time was in credit by £771. He did not replace the £3000 which had been advanced to Maxwell Skipper out of Charles Skipper's trust estate. Oatway made further payments into the account, and drew out far greater sums. Oatway then used the account to buy the Oceana shares for £2137. The credit balance of his account then stood at £6635. After paying for the shares, Oatway paid further sums into the account, but subsequently exhausted the whole amount standing to his credit.

Maxwell Skipper took out a summons asking for an order that the sum of £2474, being the proceeds of the Oceana shares, be paid to him either in his personal capacity or as trustee under the will of Charles Skipper. It was argued for the defendant that the investment in the shares was made at a time when his own contribution to the balance of the account exceeded the price of the shares, so that he had been entitled to withdraw that sum and apply it to the purchase. Joyce J held that

[105] *Re Oatway* [1903] 2 Ch 356.

the proceeds of the shares were held on trust on the basis that Oatway 'never was entitled to withdraw the £2137 from the account, or, at all events.... freed from the charge in favour of the trust, unless or until the trust money paid into the account had been first restored.[106]

*Re Oatway* is usually understood to stand for the rule that the beneficiary can 'cherry-pick': he can either say that 'his funds' are still sitting in the account, or he can say that 'his funds' were used to acquire the new right. Understood thus, and co-existent with the rule in *Re Hallett's Estate*, *Re Oatway* looks extremely difficult to explain: in the former, both Jessel MR and Baggallay LJ held that the reason why a misbehaving trustee suffers any loss in the first instance is because the honest intention is attributed to him of withdrawing *that which he was entitled to withdraw*. In *Pennell v Deffell* Knight Bruce LJ presented this as a true presumption, considering that the trustee: 'would, in the absence of evidence that he intended a wrong, be deemed to have intended and done what was right'.[107] Yet in *Re Oatway* we are told that that the reason why a trustee is liable for any new rights acquired with the trust account is that he is *not entitled to withdraw any funds*, or not entitled to withdraw them free from the charge.

Each explanation is equally flawed. It is tempting to think of an account, by analogy with a store of physical coins, as if it were a series of divisible claims, so that if A has £100 in his account he has 10 claims to £10, or 100 claims to £1, or even 10000 claims to 1p.[108] But a bank account is *not* a series of distinct debts owed from banker to customer.[109] The effect of paying money into an account, or withdrawing

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[106] Ibid 361.
[107] *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551, 555-556.
[108] This was the misstep taken in *Clayton's Case: Devaynes v Noble* (1816) 1 Mer 529, 35 ER 781.
[109] *Foskett v McKeown* [2001] 1 AC 102 128 (Lord Millett). See also *Re Footman Bower & Co Ltd* (1961) 1 Ch 443, 450 (Buckley J).

money from an account, is simply to replace whatever debt exists at the time of the transaction with a new right to a different sum.

> **Example 2.4:** A's account stands at £100. He withdraws £50 in five £10 notes.

In such a case there is no gap in the available evidence. We know exactly what has happened: A had a right to £100, and he now has a right against his bank to £50 and title to five £10 notes.

This is so even if we take the example of several sums pad into an account from which sums are subsequently withdrawn:

> **Example 2.5:** F holds an account on trust for P. Its value is £100. F's personal account stands at £100. F transfers £50 from the trust account into his personal account, without P's permission. F then withdraws £50, using it to purchase a painting, which turns out to be worth £2m.

The effect of the first transaction is to replace the trust right with a right to £50, and the right representing F's personal account with a right to £150. The effect of the second transaction is to replace the latter with a right to £100 and title to a painting. If there is a reason why P can assert a claim to the painting, it cannot be because of any presumption that enables us to fill a gap in the available evidence, because there are no gaps to fill.

The terminology of 'mixed funds', and the application by analogy of the rules for dealing with physical mixtures, have hitherto disguised what are now revealed clearly to be normative decisions about the scope of liability. It is only by removing those metaphors, and treating bank accounts as unitary debts, that any serious analysis can be undertaken of the justification for the decisions in these cases.

# V. Conclusion

Smith was correct to call following a 'simple matter'.[110] Ordinarily, it involves the location of a physical thing in order to assert a pre-existing title to it, which exercise is defeated by the destruction or fundamental alteration of the thing, or by the acquisition of money for value and without notice. When the exercise of following becomes impossible, because the thing has become irreversibly mixed with other identical things, we have rules that govern the allocation of claims. We also have rules that enable claimants to determine the location of rights, and govern their destruction in cases involving bona fide acquisition for value. Each of these rules is generally well-understood. Difficulties arise only when one seeks to transpose them to the context of a bank account, in which they have no place.

[110] Smith, *The Law of Tracing* (OUP 1997) 6.

# Chapter Three: Tracing

## I. Introduction

A simple idea unites contemporary tracing theory across the common law world: we trace by following a continuous thread – value – from one right to another.[1] Tracing's 'central case' is a straightforward one: if T buys a bottle of wine with a £10 note, title to which he holds on trust for B, B can track the path of value from T's title to the note to T's title to the wine. And he can do this irrespective of the fact that T intended to use money from his own account, or could have bought the wine without the trust money. In this sense 'intention does not influence the exercise of tracing'.[2]

In this chapter it is argued that 'tracing value' does not explain the process of linking two or more accounts through a funds transfer. That process is one of identifying a transactional link, which process the terminology of tracing has led us to clothe with a meaning that is altogether anomalous. Like any transaction, we cannot work out its content and character without reference to the intention of the parties, deduced from the agreement as a whole. This, it is argued, provides a straightforward method for dealing with instances of credit and clearing.

[1] See e.g. *Kwai Hung Realty Co Ltd v Yip Fung Sheung* [1997] HKEC 683; *Foskett v McKeown* [2001] 1 AC 102; *Hillig v Darkinjung Pty Ltd* [2006] NSWSC 1217 ; *Waxman v Waxman* [2002] CarswellOnt 3047, [2002] OTC 443; *Grant v St. Marie* 2005 CarswellAlta 71, 2005 ABQB 35, [2005] AWLD 1355; *Pacific Electric Wire & Cable Co Ltd v Texan Management Ltd* [2008] 4 HKLRD 349; *CY Foundation Group v Cheng Chee Tock* [2012] 1 HKLRD 532; *Eaton v LDC Finance Limited* [2012] NZHC 1105; *Wee Chiaw Sek Anna v Ng Li-Ann Genevieve* [2013] SGCA 36.
[2] Smith, *The Law of Tracing* (OUP 1997) 139.

## II. Tracing and Rights

The orthodox account of tracing insists that, whilst the context of following is original things or rights, the context of tracing is substitutes. So, if tracing is the process of identifying *y* as the product of *x*, the first question is: what *are x* and *y*?

It is clear that *x* and *y* can be rights: almost all of our so-called 'tracing' cases involve rights against banks,[3] brokers,[4] insurers,[5] or the bundle of rights represented by a share in a corporate entity.[6] But where the story involves things *and* rights, the object of substitution is less obvious:

> **Example 3.1:** B steals A's bicycle and swaps it with C for a scooter.
>
> **Possibilities:**
>
> (i) A follows the bicycle; or
> (ii) B shows that the scooter is the product of the bicycle.
>
> **Example 3.2:** A mistakenly transfers title to his bicycle to B, but keeps the bicycle in his garage. B swaps title to the bicycle with C for title to a scooter, all the time leaving the bicycle in A's garage.
>
> **Possibilities:**
>
> (i) A follows the bicycle; or
> (ii) A shows that the scooter is the product of the bicycle; or
> (iii) A shows that B's title to the scooter is the product of B's title to the bicycle.

The idea that tracing is concerned with the exchange of things was central to Birks' understanding of tracing. For Birks, wealth was either 'abstract' ('a single fund with a monetary value')[7] or discrete ('wealth as an inventory of distinct items such as

[3] E.g. *El Ajou v Dollar Land Holdings* [1993] 3 All ER 717.
[4] E.g. *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.
[5] E.g. *Foskett v McKeown* [2001] 1 AC 102.
[6] E.g. *Re Oatway* [1903] 2 Ch 356.
[7] Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 69.

a house, car, jewels, money, bank accounts, bonds shares, and so on').[8] Tracing, he argued, was concerned only with discrete wealth.[9] Whatever the particular thing exchanged – a watercolour painting,[10] a Rolls Royce in a garage,[11] a yacht,[12] gold or land[13] – a claimant could trace if he could show that one thing had been used to acquire another.[14] On this account, whenever the facts involve an exchange – one thing for another – tracing is the story of the new thing received in the place of the old:

> If B steals A's bike and gives it to C and C gives it to D, A may be able to 'follow' the bike into D's hands. But this is not tracing because the property is the same (the bike) and A is simply following it into a new person's hands. Tracing is concerned with new property, not new people.[15]

The terminology associated with this view of tracing is ubiquitous. Tracing is, we are told, an inquiry into 'whether the [claimed thing] was the product of, or substitute for, the original thing'.[16] The same language can be found in *Romalpa*,[17] and *Re Peachdart*,[18] and in *Borden v Scottish Timber* Bridge LJ used it throughout his judgment in reaching the conclusion that the claimant could not trace:

> Suppose cattle cake is sold to a farmer, or fuel to a steel manufacturer, in each case with a reservation of title clause, but on terms which permit the farmer to feed the cattle cake to his herd and the steelmaker

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[8] Ibid.
[9] Peter Birks, 'Change of Position and Surviving Enrichment' in William Swadling (ed), *The Limits of Restitutionary Claims: a Comparative Analysis*, vol 17 (United Kingdom National Committee of Comparative Law 1997) 60.
[10] Birks, 'Mixing and Tracing: Property and Restitution' [1992] 45 CLP 69, 84.
[11] Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 198.
[12] Birks, 'On Taking Seriously the Difference between Tracing and Claiming' (1997) 11 TLI 2, 4.
[13] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997) 242.
[14] Birks, 'Change of Position and Surviving Enrichment' in Swadling (ed), *The Limits of Restitutionary Claims: a Comparative Analysis*, vol 17 (United Kingdom National Committee of Comparative Law 1997) 60-61.
[15] A. Burrows, E. McKendrick and J. Edelman, *Cases and Materials on the Law of Restitution* (OUP 2005) 647.
[16] *Agip (Africa) Ltd v Jackson* [1991] Ch 547, 565 (Fox LJ).
[17] *Aluminium Industrie Vaassen BV v Romalpa Aluminium* [1976] 1 WLR 676, 691 (Goff LJ)
[18] *Re Peachdart Ltd* [1984] Ch 131, 139 (Vinelott J).

> to fuel his furnaces… in these cases the seller cannot trace into the cattle or the steel.[19]

Certainly, a great many things can be exchanged or substituted: if A lends B a book in return for B's ticket to the cinema, we could say that the ticket is the substitute of the book. But it is not only things that can be substituted in this way. If A has title to a bicycle and exchanges it for title to a scooter (which he need not do by delivery of the bicycle), he has substituted his title to the bicycle for title to the scooter. Someone who has title to a thing and possession of it can, therefore, substitute either the thing or the title to it, or both.

To return to our examples, if tracing is concerned with things, A can prove a substitution in **Example 3.1** but not in **Example 3.2**: A cannot very well argue that the scooter was acquired in exchange for the bicycle (which remains throughout in A's hands). If, by contrast, substitution is interested in rights, A can prove a substitution in **Example 3.2**, but not in **Example 3.1**: A, though he may follow the bicycle, cannot show that B's title to the scooter, is a substitute of his own, better, title (which still exists in his hands). Rather, it is the substitute of B's title to the bicycle.

The latter understanding of substitution has little unambiguous linguistic support. In *Romalpa* the primary claim asserted by the seller was not, in fact, to the foil but to the proceeds of sale of the foil.[20] Although the language of things is used throughout the case itself, Robert Goff LJ explained in *Clough Mill v Martin* that *Romalpa* concerned the question of whether sellers could trace 'their title' into money which was the proceeds of sale by the buyers of aluminium foil supplied by the sellers.[21] Of course, the rights represented by the proceeds of sale were not the *same* rights that the sellers held in respect of the foil. They were new rights, and the

[19] *Borden (UK) Ltd v Scottish Timber* [1981] Ch 25, 41.
[20] *Aluminium Industrie Vaassen BV v Romalpa Aluminium* [1976] 1 WLR 676.
[21] *Clough Mill Ltd v Martin* [1985] 1 WLR 111 (emphasis added).

question was whether the sellers could nevertheless assert an absolute equitable proprietary interest in respect of them, on the basis that they represented rights in respect of which the parties had created a fiduciary relationship. The court in *Romalpa* – though in very few such cases since – [22] concluded that they could.

Though the language of most of our cases and academic literature does not frame substitution in this way, this is manifestly correct. In the above example, B's continued possession of the bicycle does not, on any sensible understanding of the body of law that we call 'tracing', affect whether or not he can trace and claim title to the scooter. Whether the story involves only rights, or whether it involves rights and things, substitution is only ever interested in the location of rights, not the location of things.

We are now in a position to return to our examples:

**Example 3.1:** B steals A's bicycle and swaps it with C for a scooter.

A can follow the bicycle.

> **Example 3.2:** A mistakenly transfers title to his bicycle to B, but keeps the bicycle in his garage. B swaps title to the bicycle with C for title to a scooter, all the time leaving the bicycle in A's garage.

A can by tracing demonstrate that B's title to the scooter is the product of B's title to the bicycle.

The next question is, if tracing is concerned with connecting two different rights, how do we show that two different rights are connected: in short, what do we trace?

[22] See e.g. *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v Arbuthnot Factors Ltd* [1988] 1 WLR 150; *Compaq Computer Ltd v Abercorn Group Ltd (t/a Osiris)* [1991] BCC 484.

## III. What do we Trace?

Our 'core' tracing case is as follows:

> **Example 3.3**: T, who holds a £10 note on trust for B, buys with it a bottle of wine without B's authority.

It is generally thought that B can trace a continuous path of value from T's title to the note into T's title to the wine, and can claim the latter. In Birks' words:

> The exercise invariably begins from a point at which it was undoubtedly the case that a certain number of units of value, measurable in money but not necessarily in the form of money, were held by a particular person, and the exercise aims to discover whether all of those units of value can be said to have passed into other assets so that they, the original units of value, are held by the defendant in those assets.[23]

This use of the phrase 'unit of value' would look odd to an economist. Ordinarily, 'unit of value' is employed to describe calibration of the scale of value: just as a pound is a unit of weight, a pound sterling is a unit of value. And just as a pound – as a unit of measurement – cannot 'move' from one set of scales to another, a unit of value cannot move from one asset to another. In what follows it is demonstrated that 'value' in tracing refers, not to exchange value or wealth, but to the potential for exchange inherent in an assignable right, and that the description of value moving from one asset to another expresses the continuity supplied by the actor who makes the exchange.

### A. Exchange Value

Exchange is fundamental to the quantitative comparison of different things. Imagine a market of 10 people, in which there is a limited supply of apples and pears. If each of

[23] Peter Birks, 'Persistent Problems in Misdirected Money: A Quintet' [1993] LMCLQ 218, 230.

those 10 people wants an apple, this tells us that apples are valued by the group, but it does not, of itself, tell us anything about their value compared with other the things that those people might want. If 10 people want an apple, whilst only 5 want a pear, we can see that a smaller number of people in the group value pears. But we do not yet have a yardstick according to which we can measure the relative values of apples and pears. For this we must introduce the concept of exchange.

If 5 of our 10 people want apples, and each of them has a pear, and the other 5 of our 10 people want pears, and each has an apple, the apple group and the pear group might wish to swap. That they are *able* to swap gives them a choice: which do they value more, apples or pears? If the apple group all decide that they value pears more, and the pear group all decide that they value apples more, they probably will swap. So, an exchange occurs when two or more persons place different values on two or more commodities, and it allows us to express the prediction that (prior to that exchange) 'apples are worth pears', or 'the exchange value of an apple is a pear'. We often, therefore, distinguish 'exchange value' (a prediction about what one is likely to obtain in return for ones commodities) from 'realising the exchange value' (what one does, as a matter of fact, obtain in return for ones commodities).

Whether the statement that 'apples are worth pears' holds true will depend upon the cumulative desires of the market and the supply of apples and pears. If we flood our hypothetical market with pears, and desire for pears and apples remains the same, the exchange value of an apple might be or become 10 pears. In *Benedetti v Sawiris*, in order to illustrate the fact that market value is 'specific to a given place at a given time',[24] Lord Reed cites a passage from Vanity Fair in which the battle of Waterloo causes demand for horses to soar, so that Becky Sharp realises a price for

[24] *Benedetti v Sawiris* [2013] UKSC 50, [2013] 3 WLR 351, 389.

her horses far in excess of the ordinary price.[25] Just as it can soar, so too can market value plummet: in the early spring of 1637, at the height of the so-called 'tulip mania' a Dutch merchant named François Koster paid 6650 guilders for a few dozen tulip bulbs. Less than a week later, the same bulbs in the same market were worth less than 665 guilders.[26]

So, we can measure the exchange value of apples by reference to a quantity of pears and *vice versa*, and the quantity of pears that apples are worth, or apples that pears are worth, will depend both upon the cumulative desires of players in the market, and the supply of apples and pears to that market.

Of course, exchange value is not actually expressed by reference to apples and pears, but by reference to a third thing – money – which provides both a unit of account for expressing the relative value of commodities, and a mechanism for releasing the debts with which we purchase different things. Exchange value is thus predicted relative worth of particular things, rights and services, and it can be expressed as a money figure.

This brings us to the first sense in which we might say that value 'moves' and can be traced through a transaction: if T misappropriates £10 held on trust for B and buys with it a bottle of wine, the exchange value of the trust right is somehow represented by the exchange value of title to the wine, so that B can trace and claim the latter.

Yet, quite how this works, and what exactly we mean by the statement that value 'moves' from one to the other, is not clear. To take a an extreme example, in 2006, in a story worthy of the Japanese legend of the 'Straw Millionaire', a 26 year

[25] Ibid.
[26] M. Dash, *Tulipomania: The Story of the World's Most Coveted Flower and the Extraordinary Passions it Aroused* (Phoenix 2010).

old Canadian man named Kyle MacDonald exchanged a paperclip, through a series of 14 trades, for a two-story farmhouse in Kipling, Saskatchewan.[27] The cases are clear that the vast divergence in the respective values of titles to the paperclip and farmhouse is no impediment to tracing from one to the other.

In *Jones v FC Jones* Mr Jones made a series of unauthorised transfers from his firm's account to his wife.[28] She multiplied those funds fivefold by speculating in potato futures, before transferring it to a deposit account with a bank, Raphaels. The Court of Appeal unanimously upheld the trustee in bankruptcy's proprietary claim to those (far more valuable) rights against Raphaels, concluding: 'There is now ample authority for the proposition that a person who can trace his property into its product, provided the product is identifiable as the product of his property, may lay legal claim to that property'.[29] Similarly, in *Foskett v McKeown* beneficiaries were held entitled to claim two fifths of an insurance payout from a policy obtained in part with funds misappropriated from a fund held on trust for them, even though the share of the proceeds recovered by the beneficiaries far exceeded that of the contributing trust funds.[30]

The substitute right might equally be worth less than the substituted right. If T misappropriates a £10 note title to which held on trust for B and buys a bottle of wine worth £1, B can still trace and claim title to the bottle of wine.[31] In Smith's words, 'there are good and bad bargains, and the invocation of 'value' as the object of the verb 'to trace' does not entail that an asset must have the same market value as the

[27] Kyle MacDonald, *One Red Paperclip: Or How an Ordinary Man Achieved His Dream with the Help of a Simple Office Supply* (1st edn, Three Rivers Press 2007).
[28] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.
[29] Ibid 171 (Millett LJ).
[30] *Foskett v McKeown* [2001] 1 AC 102.
[31] Birks, 'Mixing and Tracing: Property and Restitution' [1992] 45 CLP 69, 88.

asset used to acquire it'.[32] Indeed, there is no reason to think that either right need have any exchange value at all.

If this is correct, and it seems difficult to avoid the conclusion that it is, we are no closer to solving our problem: if T misappropriates a £10 note title to which is held on trust for B and buys with it a bottle of wine worth £100 (or 10p), how is it that value can be said to move from one right to the other?

**B. Wealth: Abstracted Exchange Value**

The sum of the immediate exchange value of an individual's assets, minus that individual's liabilities, produces a net amount that can be expressed as a money sum. This is often referred to as 'wealth'. This brings us to the second sense in which we might say that value 'moves' and can be traced through a transaction: if A has title to a scooter worth £20, and swaps it with B for title to a bicycle worth £10, the cumulative exchange value of the assets in B's hands is greater than it was prior to the transaction, and the cumulative exchange value of the assets in A's is less, so that £10 can be said to have "moved" from A to B.

If this is what we mean when we say that we trace value, there is no particular reason to tie it to the notion of an exchange of particular things or rights at all. After all, 'value may be received (and, more importantly, retained) by the defendant in a manner causally linked to the claimant without any transactional link between them'.[33] Accordingly, Evans argues that we ought to free parties seeking to trace from the obligation of proving a transactional link.[34] This must be correct. If we are interested in a transfer of wealth between individuals, there is no obvious reason to

[32] Smith, *The Law of Tracing* (OUP 1997) 17.
[33] Simon Evans, 'Rethinking tracing and the law of restitution' (1999) 115 LQR 469, 479.
[34] Ibid.

insist upon the presence of an exchange of rights. If, by contrast, we are interested in the exchange of particular rights, there is no obvious reason to insist upon a transfer of wealth between individuals.

It is abundantly clear, however, that Evans' solution is not that which has been adopted by our authorities. In *OJSC OIL Co Yugraneft v Abramovich* OJSC Oil Company Yugraneft ("Yugraneft"), which had a participation interest in LLC Oil Company Sibneft-Yugra ("Sibneft-Yugra"), claimed to have been the victim of a massive fraud perpetrated by Mr Abramovich, and sought to trace into the proceeds of sale of Sibneft to Gazprom on the basis that a part of the (increased) value of the shares in Sibneft represented the (decreased) value of its interest in Sibneft-Yugra.[35] The judge held that it could not, saying: 'At best there is a causal connection between the transfer and the increased value… when what is required is a transactional link by which a new asset is exchanged for, and acquired with, the old one'.[36] Although Abramovich was better of as a result of the breach of trust (and Yugraneft was worse off), his rights as a shareholder in Sibneft were not exchanged for Yugraneft's participation interests, which still existed at the time of the claim.[37]

By contrast, if the claimant *can* demonstrate that some right in the defendant's hands is the transactional product of a right originally held by or for the claimant, it is neither here nor there that the transaction leaves the defendant's balance sheet unaffected. In *Foskett* the defendants argued that the claimant could not trace from the premiums paid to the policy payout because:[38]

> Those premiums were not made in *exchange* for anything since they did not increase the value of the policy or policy moneys. The same

[35] *OJSC OIL Co Yugraneft v Abramovich* [2008] EWHC 2613
[36] Ibid, [365].
[37] Ibid.
[38] *Foskett v McKeown* [2001] 1 AC 102, 137.

> sum would have been paid out on M's death whether or not those premiums had been paid.[39]

Lord Millett dealt with that point swiftly:

> [T]he question is one of attribution not causation. The question is not whether the same death benefit would have been payable if the last premium or last few premiums had not been paid. It is whether the death benefit is attributable to all the premiums or only to some of them. The answer is that death benefit is attributable to all of them because it represents the proceeds of realising the policy, and the policy in turn represents the product of all the premiums.[40]

So, if A swaps title to a scooter for title to a bicycle, that B is better off as a result of the transaction is irrelevant: tracing simply connects A's prior title to the scooter with A's new title to the bicycle, and B's prior title to the bicycle with B's new title to the scooter, which it does on the basis of the exchange, not on the basis of the effect on the net worth of either A or B. What, therefore, does the term 'value' describe?

### C. Exchange Potential

One of the things that the holder of an assignable right can do is exchange it and by doing so obtain something in return. This does not tell us *what* he will receive in return: that must be determined by reference to the supply and demand of a particular market, in comparison with other assets within it. This will produce the 'exchange value' of that right, which, we have seen, is a prediction about what price the right will fetch. So, 'exchange potential' expresses the idea that 'I can exchange this right', whilst 'exchange value' expresses the idea that 'if I do I will be likely to receive *x*'.

[39] Ibid, 105.
[40] Ibid, 137.

Exchange value is subject to constant change.[41] Exchange potential is not:[42] even onerous assignable rights have exchange potential.

Control over the exchange potential of a thing is one of the incidents of title to it. This is the idea articulated by Hegel's statement that 'as full owner of the thing, I am owner both of its value and of its use'.[43] The 'ownership' of value is not, of course, ownership in the sense of 'best title'. Rather, it captures the idea that the person with best title to something is in the best position to exploit its exchange potential. Penner puts this clearly: 'the right regarding value which ownership gives us is the right to realise, to capture, the exchange value of our property. It is a right to *act* in a certain way, not a right *to something* that is somehow already there'.[44]

Because it is simply a description of what can be done with a right exchange potential cannot actually 'move' from one right to another any more than 'edible' can move from an apple to the person that eats it. The language of tracing value simply expresses the continuity that, on this view, is accounted for by the holder of the asset:

> The owner of the thing owns the value in the sense that ownership of the thing carries with it an entitlement to something equivalent when the thing is exchanged or injured. Value is thus the potentiality that is realised through a set of legal operations – exchange and liability – with respect to the things that one owns… The entitlement to value thus marks the continuity through the process of exchange.[45]

This, finally, is what we mean when we say that value moves from one right to another:

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[41] *Benedetti v Sawiris* [2013] UKSC 50, [2013] 3 WLR 351, [105] (Lord Reed).
[42] James Penner, 'Value, Property and Unjust Enrichment' in R. Chambers, J. Penner and C. Mitchell (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009) 309.
[43] G. W. F. Hegel, *Elements of the Philosophy of Right* (A. Wood ed, Cambridge University Press 1991) §63.
[44] Penner, 'Value, Property and Unjust Enrichment' in Chambers, Penner and Mitchell (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009) 309.
[45] E. Weinrib, 'Correctively Unjust Enrichment' in R. Chambers, C. Mitchell and J. Penner (eds), *The Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009) 34.

> If a £100 banknote is used to buy a painting, then the value inherent in ownership of the banknote is traceable into ownership of the painting. Ownership of the painting might be, or might become, worth £10 or £10,000. This does not change the conclusion that this asset was acquired with the other; the seller transferred ownership of the painting in exchange for receiving ownership of the banknote. This is what is meant by the notion that it is value which is traced from the first asset into the second.[46]

Of course, the same explanation is applied, as it must be, outside the context of title, to cases involving personal rights, so that it is not a feature of title, but of the capacity for exchange of any right, personal or proprietary.[47] For Birks, therefore, the 'key question' for tracing is simply 'whether the value inherent in the one asset has in whole or in part been used to acquire the other'.[48] In other words, has one right (with any, no or negative exchange value) been exchanged for another right (with any, no or negative exchange value)? Value is thus simply a 'reification' of exchange potential.[49]

So, if T, a trustee, misappropriates a £10 note, title to which is held on trust for B, and buys with it a bottle of wine worth £100, value can be said to move from the trust right to title to the bottle of wine because T exploited the exchange potential of the former in acquiring the latter.

**D. Improvements to the Value of Assets**

In *The Law of Tracing* Smith argues that improvements to the exchange value of an asset in the defendant's hands are sufficient for the tracing exercise to be conducted. In his words:

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[46] Smith, *The Law of Tracing* (OUP 1997) 16-17.
[47] Robert Chambers, 'Tracing and Unjust Enrichment' in J. Neyer, M. McInnes and S. Pitel (eds), *Understanding Unjust Enrichment* (OUP 2004) 265, 278.
[48] Birks, 'Overview: Tracing, Claiming and Defences' in Birks (ed), *Laundering and Tracing* (OUP 1995) 289.
[49] Smith, *The Law of Tracing* (OUP 1997) 157.

> Tracing shows that some value stands in the place of other value, because it was acquired with that value. This might be done either to show that some asset currently stands in the place of the plaintiff's value, or to show that something in particular was done with the plaintiff's value in the past.[50]

He continues:

> Sometimes services leave nothing behind… [But] other services do create continuing value. Ownership of a broken down car might be worth £500; after the performance of various services which make the car roadworthy, ownership of the car has doubled in value. The new value held by the owner is the traceable product of the services performed by the mechanic, because it was acquired via the application of those services. There was no exchange in the usual sense of the word… But it is perfectly clear where the extra £500 came from.[51]

Whether or not improvements to the market value of an asset are indeed enough to enable the claimant to trace was one of the questions considered by the Court of Appeal in *Re Diplock*.[52] In that case money had been paid mistakenly by the executors of the deceased's estate to certain charities, some of which was used to carry out improvements to land and buildings to which the charities had title. A series of claims were made against the charities. The proprietary claims were held to depend upon tracing into those improvements. Giving a joint judgment, Greene MR, Wrottesely and Evershed LJJ analysed the case as follows: at first, the charities had 'a negotiable instrument which in origin belonged to the residuary estate and in which the next-of-kin were, in the eyes of equity, interested;'[53] then it had a claim against the account, once the money was paid in;[54] but once that money was spent making the alterations and improvements, that claim disappeared.[55]

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[50] Ibid 240.
[51] Ibid.
[52] *Re Diplock* [1948] Ch 465.
[53] Ibid 522.
[54] Ibid 522-545 (although there was the separate problem that other funds also stood in the account, which a vast majority of the judgment is dedicated to discussing).
[55] Ibid 547-548.

According to Smith, they were incorrect to reject the possibility of tracing.[56] In Smith's words: 'If the value being traced goes into an improvement which raises the market value of an asset, then the value being traced is present in the enhanced asset. Where else did the increase in value come from?'[57] That even Smith should exemplify tracing in this manner demonstrates the substantive problems that ambiguous terminology can cause. Of course the value of the improved asset came from the work done (services) or money paid (*Re Diplock*). But the law of tracing that Smith describes throughout the rest of his monograph is not a law of causal increases in exchange value: it is a law of substitution, to which exchange value is irrelevant.[58] The employment of services or money to improve the condition of an existing asset manifestly is not an exchange of rights. In short, the decision in *Re Diplock* is, according to Smith's own account of tracing, absolutely correct.

**E. The Limits of Tracing Value: 'Tracing in Transit'**

Not one of our tracing cases actually involves the exchange of bank notes for bottles of wine. With only one or two exceptions,[59] they involve bank transfers. And the difficulty with using exchange potential to describe the link between two different bank accounts held by two different people is that the person who acquires the right into which the claimant seeks to trace is not the same person who gave up the original right. Smith labels such cases 'tracing in transit'.[60] He uses the following example:

> **Example 3.4:** A has a llama and he wants to give B a cow. C has a cow and wants a llama. So, A agrees with C that A will give the llama to C and C will give the cow to B.

[56] Smith, *The Law of Tracing* (OUP 1997) 241, 353.
[57] Ibid 241.
[58] *Foskett v McKeown* [2001] 1 AC 102.
[59] e.g. *Re Montagu's Settlement Trusts* [1987] Ch 264.
[60] Smith, *The Law of Tracing* (OUP 1997) Chapter 6.

Smith analyses this as follows: 'A's bargain with C is that A will give the llama to C, and in exchange C *will give the cow to B*. Thus, A never sees the cow; he gives the llama to C, who gives the cow to B'.[61] It is the same, he says, with bank transfers. If A instructs his bank, C, to pay £400 from A's account to that of B, 'The reason that the money received by B is traceably the money paid by A [is that] A 'bought' a payment from C; and this payment is the traceable proceeds of the value used to buy it'.[62]

But the difficulty with this is that the exchange potential account only explains tracing into whatever is acquired by the party who makes the exchange. In Smith's words, 'the *only connection* between the old and the new asset is the exchange; that is, the substitution of one for the other *by some person*'.[63] In his example it is B, not A, who gets the cow or the £400.

The way in which Smith deals with that problem with respect to **Example 3.4** is by employing principles of following. In his words 'if we were concerned with the value inherent in ownership of the llama, we could trace it through the substitution into the cow, and then follow the cow to B'.[64] But a bank transfer, as we have already seen, is simply a transaction involving a debit to one account and a credit to another. This explanation does not hold for his example of A's instruction to C to pay £400 from his account to that of B.

Judges have struggled to reconcile the notion of 'exchange' with the fact of a bank transfer. *Agip v Jackson* concerned a payment order that had been fraudulently altered to name Baker Oil as beneficiary. That order was executed by the claimant's bank, Banque du Sud, which debited their account with $518,822.92 and instructed Baker Oil's bank (Lloyds Bank) to credit Baker Oil's account in London with

[61] Ibid 244 (emphasis original).
[62] Ibid 252.
[63] Ibid 134 (emphasis added).
[64] Ibid 244.

$518,822.92, giving instructions to its correspondent bank in New York to reimburse Lloyds Bank with a similar amount. Lloyds Bank acted on those instructions. At the third defendant's behest, Lloyds Bank then transferred the sum to the account of the defendants' firm with the bank.

Millett J held that the claimants were unable to trace at common law for two reasons,[65] one of which was that it simply was not possible to show that the defendants' right was acquired in exchange for the claimant's right: all that had happened was that the claimants had lost a right and the defendants had acquired one.[66] Whilst the common law could trace rights through substitutions in the *same* set of hands, it could only follow *physical things* from one set of hands to another:

> In following the plaintiff's money into an asset purchased exclusively with it, no distinction is drawn between a chose in action such as the debt of a bank to its customer and any other asset... But *it can only follow a physical asset, such as a cheque or its proceeds, from one person to another*.[67]

Equity, on the other hand, could 'follow the chose in action through its transmutation as a direct result of forged instructions from a debt owed by the Banque du Sud to the plaintiffs in Tunis into a debt owed by Lloyds Bank to Baker Oil in London'.[68]

*Agip* is widely cited as authority is that it is possible to trace through bank accounts in Equity. In *Nimmo v Westpac* Blanchard J said:

> It is also said that common law tracing is defeated by a transmission of funds electronically, by a stream of electrons rather than by transfer of a physical asset… There was certainly no transfer of any physical asset. Equity could, of course, trace such transactions but at common law they cannot be traced.[69]

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[65] The second reason was that the payment through clearing meant that there was a mixed fund. That point is considered below.
[66] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 286.
[67] Ibid 285 (emphasis added).
[68] Ibid 1990.
[69] *Nimmo v Westpac Banking Corp* [1993] 3 NZLR 218 238.

But Millett J's statements were nothing to do with tracing: following was, said the judge, impossible at common law in the absence of a physical thing, but possible in Equity, which simply regarded it as the *same right*, transmuted. Tracing, on the other hand, was altogether impossible when seeking to connect two different people.

*Relfo v Varsani* concerned a claim brought by the liquidator of Relfo Ltd ("Relfo") against Mr Varsani to recover $878,479.35 that had been misappropriated by its former director, Mr Gorecia.[70] Mr Gorecia, in breach of fiduciary duty, caused Relfo to pay $890,050 to a company called Mirren Ltd ("Mirren"). The next day, another company, Intertrade Group LLC ("Intertrade"), paid $878,479.35 to Mr Varsani's bank account. Both the High Court and Court of Appeal held that the liquidator was entitled to trace the Relfo/Mirren payment into the Intertrade payment in Varsani's hands and that Varsani was obliged to account in knowing receipt for the full amount of the Intertrade payment. Arden LJ said, 'when funds are transmitted through the banking system, what matters is that there has been an exchange of the value of the claimant's property into the next product for which it is substituted and so on down the chain of substitutions'.[71]

'Exchange… into' is revealing. *Relfo* and *Agip* follow the same basic pattern: B misappropriates A's funds and transfers them to C. A cannot, in such a case, *follow* his right: when a bank transfer is made the transferee does not acquire the right that the transferor gave up.[72] But neither can he trace into C's right, if tracing is the exploitation of exchange potential: the appeal to value lies in explaining claims to whatever is acquired by the actor in exchange for the original right. The kind of value that moves from A to B is *wealth*, not exchange potential. The most that we can say

[70] *Relfo v Varsani* [2012] EWHC 2168
[71] *Relfo v Varsani* [2014] EWCA Civ 360 [60].
[72] *R v Preddy* [1996] AC 815 841; *Robb Evans of Robb Evans & Associates v European Bank Limited* [2004] NSWCA 82 [138].

about a case like *Relfo* or *Agip* is that there is a single transaction that links the parties.

## IV. 'Transactional Link'

That tracing involves proof of a transactional link or links is widely accepted.[73] In *OJSC OIL Co Yugraneft v Abramovich* Christopher Clarke J said:

> In order to be able successfully to trace property it is necessary for the claimant, firstly, to identify property of his, which has been unlawfully taken from him ("a proprietary base"); secondly, that that property has been used to acquire some other new identifiable property. The new property may then have been used to acquire another identifiable asset ("a series of transactional links"). Thirdly the chain of substitutes must be unbroken.[74]

But because we insist that the way in which we link two assets is by following a continuous stream of value from one to another, 'transactional link' has taken on an idiosyncratic meaning. Rather than looking to the intention of the parties to determine what legal result they intended to bring about,[75] we assume that we must map each step by which the transfer is executed. It follows that if we *cannot* produce such a list, or if producing such a list reveals a period of time in which there is no asset in existence, we cannot trace. Courts have thus concluded that the process of tracing is automatically thwarted if money is paid into an overdrawn bank account, because there is no asset into which we can trace,[76] or transferring through a clearing system, because its identity is lost.[77]

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[73] Oesterle, 'Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC §9-306' (1982) 68 Cornell L Rev 172, 174; *Foskett v McKeown* [2001] 1 AC 102 128 (Lord Millett); *Relfo v Varsani* [2014] EWCA Civ 360 [56]-[59] (Arden LJ); *Orb ARL v Ruhan* [2015] EWHC 262 [14] (Cooke J). Nb that the language tends to adopt the words chosen by Lord Millet in *Foskett*, in which his Lordship said that the relevant link was 'causal and transactional'. Later in his judgment he makes it clear that the requisite link is one of 'attribution not causation'.
[74] *OJSC OIL Co Yugraneft v Abramovich* [2008] EWHC 2613 (Comm), at [349].
[75] *In Re George Inglefield Ltd* [1933] Ch 1.
[76] *Conlan v Connolly* [2011] WASC 160; *Rea v Russell* [2012] NZCA 536.
[77] *Agip (Africa) Ltd v Jackson* [1990] Ch 265.

This approach to the process of determining a transactional link is altogether artificial. The existence and content of a transaction cannot be determined without reference to the intentions of the parties to it. And if those intentions reveal that multiple transactions are intended to operate together to achieve a particular outcome, the intermediate steps are typically ignored. This allows us to deal much more straightforwardly with the problems created by credit and clearing.

### A. Transactions and Intention

Although we use the term 'transaction' often, it is not easily defined without reference to a particular context. The etymology of the term does not help us to narrow its conceptual limits. Transaction comes from the Latin 'transigere'. 'Trans' means 'across or through' and 'agere', which also takes the form 'actus', means 'to do, drive, lead, or pass time'.[78] The only idea that appears in each use of 'transaction' is, accordingly, that there is some element of bilaterality of action or effect. So, 'transactional analysis' is an approach to psychological theory that developed from a study of human interaction by reference to individual developmental history; in computer science, 'transaction processing' is the unification of a sequence of information exchange.

'Transaction' in law contains this element of reciprocity, although it is not reciprocity of action or intention, but of legal effect. It is, as a consequence, broader than contract, which is our paradigm bilateral transaction: a gift is a transaction. If A gives B a bicycle there is an act – the physical movement by A of the bicycle – but there is also a 'transaction', because that act is both intended to and does change both

[78] Stevenson (ed) *Shorter Oxford English Dictionary on Historical Principles*, vol 2 (6th edn, OUP 2007).

parties' positions in law. Importantly, that change in the parties' rights and obligations arises out of the intention to change them: a car crash is not a transaction, nor does it become one if the driver intends to bring about the crash. This is so because the liability that arises from the wrong does not depend on the intention to create it.[79] So, a legal transaction is the performance of an act that is intended to and does in fact change the legal rights and obligations of two or more persons, precisely because that is what is intended.

**B. Characterising Transactions**

The ordinary approach to the characterisation of transactions is to look to the transactors' intentions to determine the content and type of transaction that they have created, deduced from consideration of the transaction as a whole. If this intention reveals that the parties intended several steps to operate as one, overarching, transaction, the intermediate steps are typically ignored.

In *In re George Inglefield* a furnishing company went into liquidation. A large proportion of its business consisted in letting out furniture on hire-purchase agreements, which it financed by virtue of a number of agreements with a discount company. At first instance Eve J held that these agreements amounted to a charge upon the future instalments payable under the hire-purchase agreement, which was void for non-registration. The Court of Appeal reversed that decision, holding that the agreements were 'out-and-out' sales. Lord Hanworth MR explained that the appropriate approach to characterisation was to 'see what are the rights and

[79] J. Hage, 'What is a Legal Transaction?' Academiaedu accessed 1st January 2014.

obligations of the parties to be derived from the consideration of the whole agreement' in order to 'ascertain the substance of the transaction'.[80]

In *Curtain Dream plc v Churchill Merchanting Ltd* Curtain Dream plc agreed to sell fabric under a finance agreement to a finance company ("CML") and to enter into a separate 'trading agreement' by which CML purported to resell the fabric to Curtain Dream plc, on terms reserving title in the fabric to CML. Knox J held that there was an 'indissoluble link between the various parts of the transaction',[81] so that it had to be regarded as a whole, and not as a series of independent transactions.[82] Viewed in this way, its effect was to produce an 'exact degree of mutuality' with regard to the passing of the title, conclusively indicative of a mortgage or charge.[83]

We take precisely the same approach in land law in order to determine whether the parties to a lease or licence have created the agreement indicated by the chosen label. In *Antoniades v Villiers* the landlord granted partners the right to occupy a small flat by separate but identical agreements, entered into contemporaneously.[84] The agreements were expressed to be 'licenses' and expressly stated that exclusive possession was not granted, and that the use of the rooms was 'in common with the licensor and such other licensees or invitees as [he] may permit from time to time to use the said rooms'. The House of Lords unanimously held that the two agreements were interdependent and must be read together because, 'There is an air of total unreality about these documents read as separate and individual licenses in the light of the circumstance that the appellants were together seeking a flat as a quasi-matrimonial home'.[85]

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[80] *In Re George Inglefield Ltd* [1933] Ch 1, 19 (Lord Hanworth MR).
[81] *Curtain Dream plc v Churchill Merchanting Ltd* [1990] BCC 341, 348.
[82] Ibid 352.
[83] Ibid 351.
[84] *AG Securities v Vaughan; Antoniades v Villiers* [1988] 3 WLR 1205.
[85] Ibid 467-8.

In tax law, individual transactions that appear to create a particular balance-sheet result, but which are designed to work as part of a network of transactions, will often be disregarded when the court determines the tax consequences of the wider transaction. In *Ramsay v IRC* the taxpayer company entered into a scheme known as the 'capital loss scheme' that was designed to create artificial capital losses on share transactions for the sole purpose of reducing the amount of the capital gains tax payable.[86] Lord Wilberforce said:

> It is the task of the court to ascertain the legal nature of any transactions to which it is sought to attach a tax or a tax consequence and if that emerges from a series or a combination of transactions, intended to operate as such, it is that series or combination which may be regarded.[87]

Concluding that it would be 'quite wrong, and a faulty analysis, to pick out, and stop at, the one step in the combination which produced the loss, that being entirely dependent upon, and merely, a reflection of the gain',[88] the House of Lords held that, viewed as a whole, the transaction produced neither gain nor loss.

So, in order to determine the existence, content and type of transaction the parties have created, the court will have reference to their intention, deduced from the agreement as a whole. If this intention, so deduced, reveals that several transactions are interdependent, the immediate steps will be ignored in determining the effect of the overall result.

[86] *Ramsay v IRC* [1982] AC 300 .
[87] Ibid, 323.
[88] Ibid, 328.

## C. Characterising Bank Transfers

The insistence that we must, as a matter of fact and without reference to intention,[89] trace a continuous stream of value through the multiple steps of modern payment mechanisms, has led us to preserve what the editors of *Goff and Jones* refer to as a 'tight focus on asset exchanges'.[90] Rather than looking to the parties' intentions to determine the existence and content of a transaction, we look instead to the precise legal mechanisms by which a particular result is achieved.

In *El Ajou v Dollar Land Holdings* the claimant was one of many victims of a massive share fraud carried out in Amsterdam by three Canadians between 1984 and 1985.[91] It had substantial funds and securities deposited with the First National Bank of Chicago in Geneva which were under the control of an investment manager. The manager misappropriated those funds, investing them in shares traded by two Dutch companies. Each time a sum was received by the Dutch companies, a corresponding amount was deducted from that account and credited to two accounts in Geneva. The fraudsters created three Panamanian companies in order to receive their individual shares in the profits. Those funds were then transferred, through an intermediary, into three more Panamanian companies, and then again into accounts in London, after which they were invested in a joint venture to carry out a property development project in Battersea in conjunction with the first defendant, Dollar Land Holdings plc ("DLH"). DLH argued that the claimant had not established that the money in the Geneva account used to secure an advance to finance the project represented the proceeds of the fraud remitted from Gibraltar to Panama.

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[89] Smith, *The Law of Tracing* (OUP 1997) 139; *Relfo v Varsani* [2014] EWCA Civ 360 [58].
[90] C. Mitchell, P. Mitchell and S. Watterson (eds), *Goff & Jones: The Law of Unjust Enrichment* (8th edn, Sweet & Maxwell 2010) 1176.
[91] *El Ajou v Dollar Land Holdings* [1993] 3 All ER 717.

At first instance Millett J held that although the claimant was 'unable by direct evidence' to demonstrate that the money received into the Geneva account represented money sent to Panama, the evidence that had been adduced was 'sufficient, though only just, to enable the inference to be drawn'.[92] One of the two sums received into the Geneva account was almost exactly the same as that sent from the Gibraltar account to the Panama account, and there was no evidence that the fraudsters had any significant sum available to them that did not represent proceeds of the fraud. In the judge's words, 'It is not much, but it is something; and there is nothing in the opposite scale'.[93]

What form might 'direct evidence' have taken? It could not have been evidence that the money in the Geneva account *was* the money that had been in the Panama account. Each debt was a different debt, owed by and to different people. The question for the judge was whether the two accounts were linked by the same transaction. *That* question could have been answered by direct evidence of an intention that the transactions should operate as a single whole. Or it could have been answered – as it was – by evidence that tipped the balance towards that conclusion.

That the inference is one of intention was clear at first instance in *Relfo v Varsani*.[94] In that case, despite the fact that the court had 'insufficient evidence to be able to map each step in the process'– in particular Relfo could not point to specific transactions passing between the Mirren and Intertrade accounts to show how the Relfo/Mirren payment was translated into the Intertrade payment which went to Varsani's account – Sales J held, at first instance, that the payments were so closely linked in time and amount that:

[92] Ibid 713 (Millett J).
[93] Ibid.
[94] *Relfo v Varsani* [2014] EWCA Civ 360.

> [I]t is a fair inference that the Intertrade payment was the product of a series of transactions between a number of entities and across a number of bank accounts *designed to produce the result that* funds paid in the Relfo/Mirren payment were (subject to the 1.3% deduction) paid on to Bhimji Varsani.[95]

On appeal Varsani argued that this reasoning was incorrect: 'Intention cannot make an exchange of property a case for tracing. It must still be shown by evidence or inference that there is a direct chain of substitutions whereby the claimant's property was exchanged for another asset'.[96] Arden LJ kept one foot firmly on either side of the fence, suggesting that the decision at first instance could only be explained on the basis that intention was not a 'major part of the evidence on which the judge based his inference'.[97] Other factors included 'the prior dealings between Mr Gorecia and the Varsani family, the prior dealings between Mr Gorecia and Ukrainian businessmen and between Mirren and Intertrade and the transactions between their accounts'.[98]

This cannot be correct. The only connection between the two accounts was the parties' intentions to bring about the result that funds would debited from Relfo's account and credited to Varsani's, through the medium of intermediate funds transfers. Evidence of prior dealings and other transactions contributed to the likelihood that the series of transactions was intended to operate together to bring about that result. That provided the link between the parties, and that is exactly what Sales J said.

In Hong Kong, a simpler approach can be detected. In *PBM (Hong Kong) Ltd v Tang Kam Lun & Ors* the first defendant ("AT") diverted funds due from a substantial customer of the claimant to his own bank accounts. A proprietary claim was brought against another defendant, Regent Trinity Investment Ltd ("RTIL") in

[95] Ibid [77] (emphasis added).
[96] Ibid [32].
[97] Ibid [58].
[98] Ibid.

respect of the proceeds of the sale of a substantial property owned by it.[99] The shares in RTIL were purchased and owned by AT and another defendant, before they were transferred to two more of the defendants. The share transfer was alleged to have been a sham.

Relying upon evidence such as the size of the transfers made, obvious collaboration with the other defendants, and the fact that AT was spending well above his ordinary means, the judge said 'I have no difficulty in drawing the obvious inference that these monies originated from funds misappropriated from PBM'.[100] That judgment was affirmed on appeal.[101]

Yeung suggests that this approach 'does not seem to have been based on what has been described as the transactional approach to tracing, which requires identification of each of the exchanges in an unbroken chain of substitutions'.[102] Properly understood however, the 'transactional approach' is no more or less than construing and characterising a transaction by which a particular legal objective is achieved. *PBM (Hong Kong) Ltd v Tang Kam Lun & Ors* is consistent with that approach, and a welcome departure from the insistence elsewhere that we are bound to itemise the legal mechanisms that contribute to that objective.

**D. Clearing**

The other reason for Millett J's conclusion that the claimant was unable to trace at common law in *Agip v Jackson*, considered above, was that the source of the payment could not be identified without going through the New York clearing system, 'where

[99] *PBM (Hong Kong) Ltd v Tang Kam Lun & Ors* [2002] HKCU 632; [2002] HKEC 646.
[100] Ibid 38.
[101] *PBM (Hong Kong) Ltd v Tang Kam Lun & Ors* [2003] HKCU 199.
[102] Clemence Yeung, *The Law of Unjust Enrichment in Hong Kong* (LexisNexis 2008) 121.

it must have been mixed with other money'.[103] Millett J's views on the clearing of electronic payments have been approved in several cases in the UK,[104] Canada,[105] Singapore,[106] and New Zealand,[107] creating doubt – whilst the distinction between common law and equitable tracing persists –[108] about the consequences for other payments mechanisms that involve some form of clearing, such as debt and credit cards.[109]

References to mixtures in the context of clearing are confusing. A 'mixed fund' ordinarily refers to a right than can be attributed to several sources.[110] So, in *Relfo* the judge at first instance held that tracing at common law was not possible where the intermediate accounts were not ring-fenced,[111] the assumption being that they would have been dealt with, so that it would be impossible to work out whether the right that represented each account at each stage was in fact the product of the right that represented the misappropriated funds. Clearing does not create this kind of problem. When the bank creates an obligation to a customer in execution of a payment order, the source of the right is simply the payment order, which may or may not be the product of another payment order.

Importantly, settlement and clearing are not identical: clearing is the process of exchanging payment orders between participating banks,[112] whilst settlement is

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[103] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 286.
[104] *El Ajou v Dollar Land Holdings* [1993] 3 All ER 717, 712; *Bank Tejarat v Hong Kong and Shanghai Banking Corp (CI) Ltd* [1995] 1 Lloyds Rep 239, 245; *Bank of America v Arnell* [1999] Lloyd's Rep Bank 399, 405; *London Allied Holdings v Lee* [2007] EWHC 2061 [89], [256].
[105] *Citadel General Assurance Co v Lloyds Bank Canada* [1997] 3 SCR 805 [57]; *BMP Global Distribution Inc v Bank of Nova Scotia* [2009] 1 SCR 504 [78]
[106] *Sumitomo Bank Ltd v Thahir Kartika Ratna* [1992] 3 SLR 638 [186].
[107] *Nimmo v Westpac Banking Corp* [1993] 3 NZLR 218, 238; *Equiticorp Industries Group Ltd v The Crown (No 47)* [1998] 2 NZLR 481, 698-699.
[108] See recently *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535 [44].
[109] Hare, 'Tracing Value and the Value of Tracing' (2013) 24 JBFLP 249, 256.
[110] *Foskett v McKeown* [2001] 1 AC 102, 129-131 (Lord Millett).
[111] *Relfo v Varsani* [2012] EWHC 2168 [75] (Sales J).
[112] E. P. Ellinger, E. Lomnicka and C. Hare, *Ellinger's Modern Banking Law* (5th edn, OUP 2011) 562

payment between the banks in settlement of their obligations *inter se*.[113] Settlement is irrelevant in tracing. In Smith's words, tracing through a payment order made by A to Bank A to pay B £400, which B does by instructing Bank B to credit B's account, 'does not require that when Bank A paid £400 to Bank B it was the same £400 A paid to Bank A, or even that it was its traceable proceeds. It would not matter if Bank A settled with Bank B by giving it £400 worth of kiwi fruit'.[114] Rather, the problem that *clearing* supposedly creates for the idea that we are tracing value through a series of exchanges is the necessity of identifying the precise series of payment orders that link A's right to B's.

In *Kwai Hung Realty Co Ltd v Yip Fung Sheung* the defendants sought to argue that it was impossible to connect two rights once the facts involved any kind of clearing – of a cheque or electronic payment.[115] The judge in the Hong Kong High Court addressed this with the words: 'The point is after all a simple one, namely whether the money received by Wing Lung under each cheque of the plaintiff is the money from the plaintiff and of the plaintiff. Any layman would have no hesitation in saying yes'.[116] This approach is considerably more consistent with treatment of transactions elsewhere in private law. What we must determine is whether A intends to credit B's account and debit his own account, and does in fact achieve the result of crediting B's account and debiting his own account. The intermediate steps by which that result is achieved are altogether irrelevant.

[113] Ibid 564. See also Hare, 'Tracing Value and the Value of Tracing' (2013) 24 JBFLP 249, 257.
[114] Smith, *The Law of Tracing* (OUP 1997), 255.
[115] *Kwai Hung Realty Co Ltd v Yip Fung Sheung* [1997] HKEC 683.
[116] Ibid.

## E. Credit

Linking a right acquired with a debt that is later repaid using another right is typically expressed as 'tracing into the payment of debt',[117] or 'backward tracing'.[118] One objection to this process is temporal, and was voiced by the defendants in *Foskett*:

> [T]he moneys used to pay the 1989 and 1990 premiums cannot be identified as being represented by the policy moneys since the policy was acquired prior to the payment of the premiums, and one cannot trace into an asset already acquired.[119]

This objection to credit can be dealt with easily. If T holds title to a plot of land on trust for B and agrees with X to exchange it for title to a house, it will make no difference to our conclusion about the nature of the transaction if X in fact transfers title to the house to T prior to T transferring title to the plot of land to X. As Arden LJ put it in *Relfo,* 'in order to trace money into substitutes it is not necessary that the payments should occur in any particular order, let alone chronological order'.[120]

The crux of the problem is this: if a buyer buys an asset on credit and pays for it with the claimant's money, 'The asset that the vendor accepted in return for agreeing to pass title in the goods to the purchaser was the benefit of the debt, not cash', so that even if the debt is later realised by payment of cash, 'that is satisfaction of the debt rather than payment of the consideration for which the asset was acquired'.[121] In other words, if B buys a bicycle from C for £10 on credit and A subsequently gives B £10, which B uses to meet the debt, however we look at it, A's rights have been substituted for the release of an obligation, and there is no immediate

[117] Smith, 'Tracing into the Payment of a Debt' (1995) 54 CLJ 290.
[118] *Bishopsgate Investment Management Ltd v Homan* [1995] Ch 211, 216.
[119] *Foskett v McKeown* [2001] 1 AC 102 [105].
[120] *Relfo v Varsani* [2014] EWCA Civ 360 [63].
[121] Conaglen, 'Difficulties with Tracing Backwards' (2011) 127 LQR 432 450.

product of that release. The product of the substitution of A's rights is in *C's* hands: C exchanged title to the bicycle for a right to £10, and then the right to £10 for £10.

In *Moffatt v Crawford* Heiner used proceeds of trust funds to pay for title to a piano previously bought on credit.[122] He gave the piano to his wife on Christmas Day, and she later gave it to her daughter. Lukin J held that title passed on delivery of the piano to Heiner and that the trust funds could not be followed in any case involving payment by credit.[123] That decision was affirmed on appeal.[124]

By contrast, there are several examples of cases in which the claimant was permitted to assert a claim in respect of a right acquired on credit, in which the presence of the debt is either acknowledged and dismissed as irrelevant, or ignored altogether.

In *Agricultural Credit Corp. of Saskatchewan v Pettyjohn* the claimant agreed to loan the defendants money to buy cattle.[125] The defendants bought the cattle before the loan was made, using an overdraft facility, which the defendants later repaid with funds advanced by the claimant. The Saskatchewan Court of Appeal held that that made no difference to the establishment of a 'close and substantial connection' between the claimant's funds and title to the cattle.[126]

In *Agip v Jackson*, considered above, Lloyds Bank in fact credited Baker Oil's account before Banque du Sud instructed its correspondent New York bank to reimburse Lloyds Bank's correspondent New York bank. At first instance Millett J

[122] *Moffatt v Crawford* [1924] St R Qd 241.
[123] Ibid 245-246.
[124] Ibid 248 (McCawley CJ).
[125] *Agricultural Credit Corp. of Saskatchewan v Pettyjohn* 1991 Carswell Sask 172.
[126] Ibid 60

held that this made no difference to the exercise of tracing,[127] and the judgment was affirmed on appeal without consideration of the point.[128]

Penner points out that in *Foskett v McKeown* the policy, which represented the right to future payment, was in fact acquired with a debt later discharged with the beneficiaries' funds.[129] Burrows argues that the substitute asset was the insurance pay-out, so that tracing can 'be seen as straightforwardly going forwards from the premiums paid to the pay-out'.[130] But the payout was not the direct product of the premiums, but of the policy, which constituted the 'right to payment of a debt payable on a future event'.[131] The premiums, paid following acquisition of that right, were paid to discharge the debt with which it was purchased.

In *Brazil v Durant* the claimants sought to trace the proceeds of a wide-scale fraud carried out in the late 1990s in connection with a major public works contract in Sao Paulo, Brazil. In order to do so they had to show that money paid into an account in the name "Chanani" at Safra International Bank in New York could be connected with an account in the name of Durant at Deutsche Bank, Jersey. At first instance, they were held able to do so. One of the issues the Jersey Court of Appeal had to consider was the status of two payments made into the Chanani account after the last of the payments out of it.

After considering the authorities, the court concluded that they did not lead to 'binary answers', so that the Jersey courts 'should not feel constrained either to adopt or reject any particular rules'.[132] James McNeill QC said:

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[127] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 280.
[128] *Agip (Africa) Ltd v Jackson* [1991] Ch 547.
[129] Penner, 'Value, Property and Unjust Enrichment' in Chambers, Penner and Mitchell (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009), 321.
[130] Andrew Burrows, *A Restatement of the English Law of Unjust Enrichment* (OUP 2012), 62.
[131] *Foskett v McKeown* [2001] 1 AC 102, 134.
[132] *Brazil v Durant* [2013] JCA 071 [62].

> [I]n a case such as this where an asset is acquired by making a transfer out of an account before trust money is paid into the account, the true question is whether the plaintiff can establish a sufficient link between the trust money of which he was originally deprived, and the asset which has now been acquired.[133]

On the facts, that link was clear, and the appeal against the tracing claim was dismissed.

According to Conaglen the result in *Moffatt* is correct, because to regard a right acquired with a debt that is later repaid with the claimant's right as the product of that right 'ignores the legal mechanism by which the trustee acquired the asset'.[134] But when it is juxtaposed with the approach that we adopt in determining the content and nature of a transaction everywhere else in private law, this looks odd indeed. If the transaction is intended to be one of sale and purchase, then the interposition of credit is neither here nor there: we ought simply to read two transactions involving (a) the acquisition of a right and assumption of an obligation to pay, and (b) the loss of a right and discharge of a debt, as (c) one transaction involving the loss and acquisition of a right. In the same way, if credit is simply the method by which participating banks execute a funds transfer, the transaction will be read as one transaction designed to reduce one person's bank balance and increase another's.

## V. Conclusion

In Birks' words, 'The exercise of plotting the path of an asset's value between two points in time either can be or cannot be done. In this respect… it is rather like finding keys. You either can find them or you cannot'.[135] Exchange, where it involves the physical substitution of one thing for another, can be entirely value neutral: fishermen who harvest the claws of brown crabs do so in the knowledge that a crab can, over a

[133] Ibid.
[134] Conaglen, 'Difficulties with Tracing Backwards' (2011) 127 LQR 432, 450.
[135] Birks, 'Overview: Tracing, Claiming and Defences' in Birks (ed), *Laundering and Tracing* (OUP 1995) 291.

period of months, generate new claws in their place; when my toothpaste runs out I replace the tube with another, a substitute for the empty tube. But the identification of a transactional link is not at all like finding keys, regenerating claws or replacing toothpaste. The existence and content of a transaction cannot be determined without reference to the intention of the actors involved.

This chapter has argued that the assumption that tracing involves the identification of a continuous stream of value has led us to overcomplicate analysis of facts that involve credit or clearing. It explains that the processes of identifying and characterising transactions that we apply everywhere else in private law provide a simple method for dealing with the problems created by the increasing complexity of modern payment mechanisms.

This, of course, leaves the crucial questions unanswered: B may well able to demonstrate that, as part of a single transaction, T acquired title to a bicycle by employing the credit represented by an account on trust for B, but that does not tell us whether or not B can claim it. Or A Co may well be able to demonstrate its director entered into a transaction by which company funds were misdirected in excess of authority to C. But that does not tell us whether or not A Co can assert a claim against C. These are the questions addressed in Part II of this thesis.

# Part II: Tracing and Claiming

# Introduction

The basis of contemporary tracing theory is this: if T, who holds title to a £10 note on trust for B, buys with it a bottle of wine without B's authority, B can show that T's title to the wine is the product of title to the note such that B's claim to the former is transmitted to the latter. This forms the foundation of current theory,[1] and application,[2] of the law of tracing across the entire common law world. Such accounts of liability stem from the decision in *Taylor v Plumer*, in which Lord Ellenborough explained the claim that arose to a right acquired by an agent in exchange for a right vested in him by the claimant on the basis that 'the product or substitute for the original thing still follows the nature of the thing itself, as long as it can be ascertained to be such'.[3]

This transmission of claims to the traceable proceeds of trust rights is explained either as part of the internal machinations of property,[4] or as 'non-consensual substitution, a species of unjust enrichment.[5] In this part it will be argued

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[1] See e.g. Smith, 'Tracing into the Payment of a Debt' (1995) 54 CLJ 290; Smith, *The Law of Tracing* (OUP 1997); Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997); Birks, 'On Taking Seriously the Difference between Tracing and Claiming' (1997) 11 TLI 2; Burrows, *The Law of Restitution* (3rd edn, OUP 2011); Mitchell, Mitchell and Watterson (eds), *Goff & Jones: The Law of Unjust Enrichment* (8th edn, Sweet & Maxwell 2010); Hare, 'Tracing Value and the Value of Tracing' (2013) 24 JBFLP 249.

[2] See e.g. *Kwai Hung Realty Co Ltd v Yip Fung Sheung* [1997] HKEC 683; *Foskett v McKeown* [2001] 1 AC 102; *Hillig v Darkinjung Pty Ltd* [2006] NSWSC 1217 ; *Waxman v Waxman* [2002] CarswellOnt 3047, [2002] OTC 443; *Grant v St. Marie* 2005 CarswellAlta 71, 2005 ABQB 35, [2005] AWLD 1355; *Pacific Electric Wire & Cable Co Ltd v Texan Management Ltd* [2008] 4 HKLRD 349; *CY Foundation Group v Cheng Chee Tock* [2012] 1 HKLRD 532; *Eaton v LDC Finance Limited* [2012] NZHC 1105; *Wee Chiaw Sek Anna v Ng Li-Ann Genevieve* [2013] SGCA 36; *Rushton v ANR Company, Inc. et al. (In re C.W. Mining Company)* 740 F3d 548 (10th Cir 2014).

[3] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721, 726.

[4] See e.g. Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co); Grantham and Rickett, 'Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?' [1997] New Zealand Law Review 668; Grantham and Rickett, 'Tracing and Property Rights: the Categorical Truth' (2000) 63 MLR 905; Rickett, 'Old and New in the Law of Tracing' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005); Graham Virgo, *The Principles of the Law of Restitution* (2nd edn, OUP 2012), 580; *Foskett v McKeown* [2001] 1 AC 102.

[5] Birks, 'Property, Unjust Enrichment and Tracing' (2001) 54 CLP 231, 253.

that the best explanation for the result in *Taylor v Plumer* does not depend centrally upon the existence of any proprietary claim at the start of the story, but rather upon the development, over the course of the eighteenth century, of the scope of the fiduciary's personal obligations to account.

Prior to 1726, no office that modern lawyers would recognise as 'fiduciary' existed in English law. A claimant had a claim in respect of rights acquired by his factor in execution of the agreement between them,[6] and that claim was enforced by Equity, idiosyncratically, as a trust. Subsequently, in order to prevent circuity of action, plaintiffs were permitted to proceed at law in *assumpsit*.[7] But such actions – whether in Equity or at law – depended entirely upon demonstrating that the factor was acting within his authority, in performance of the agreed task.

Throughout the eighteenth century, the scope of the factor's obligations changed. As a part of a broader response to instances of corruption in Chancery, Lord King held in *Keech v Sandford* that a trustee was accountable for any right and any profit acquired by virtue of his office, irrespective of any authority on the part of the beneficiary, and irrespective of any loss that the latter might have suffered.[8] The invocation of *Keech* in the context of claims against solicitors, agents, bailees and guardians, and 'all those who are a-kin to a trust by any connection of character or office',[9] and the development in parallel of actions to set aside agreements, allowed courts to delineate certain positions of confidence that, by the end of the eighteenth century, attracted the label 'fiduciary'.[10] An individual holding such a position was now not only under an obligation to perform an agreed task, but also under an

[6] *Burdett v Willett* (1708) 2 Vern 638, 23 ER 1017.
[7] *Scott v Surman* (1742) Willes 400, 125 ER 1235.
[8] *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223.
[9] *York Buildings Co v MacKenzie* (1795) 7 Bro PC 42, 3 ER 432 [66].
[10] *Attorney General v Foundling Hospital Governors* (1793) 2 Ves Jr 42, 30 ER 514.

obligation not to enter into a transaction with his principal,[11] and to account for any right and profit acquired in the course of executing the agreed task.[12]

This, it is argued, is the best explanation for the decision in *Taylor v Plumer*, that a trustee is liable for rights acquired without the authority of the beneficiary: in the period between 1708 and 1816 the content of the trustee's primary personal obligations altered. He was no longer accountable *in specie* simply for rights acquired in performance of the trust, but rather for any rights acquired within the sphere of fiduciary endeavour.

It will be argued that, far from providing a foundation for the assertion that a claimant can trace and claim at common law, the decision in *Lipkin Gorman v Karpnale* is an example of precisely the same phenomenon as that which occurred *Keech v Sandford*, of holding a fiduciary accountable *in specie* for a right acquired within the sphere of fiduciary endeavour. There is, therefore, no proper concern regarding either the 'geometric multiplication' of claims: the only claim that exists against a thief of some tangible thing, irrespective of any subsequent actions by that thief, is a claim in conversion.[13] The call to remove the fiduciary barrier to equitable claiming is thus altogether misplaced: the fiduciary relationship is thus at the heart of the justification for claims, in the nature of trusts, to new rights acquired by defendants.

[11] *York Buildings Co v MacKenzie* (1795) 7 Bro PC 42, 3 ER 432.
[12] *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223.
[13] Or, in a case where the thing is sold, an action for money had and received: *Young v Marshall* (1831) 8 Bingham 43, 131 ER 316.

# Chapter Four: Tracing and Proprietary Claims against Fiduciaries

## I. Introduction

The process of tracing value, explored in Part I, is generally thought to be at the heart of proprietary claims against trustees who act without authority. To return to the example with which Chapter Three began:

> **Example 4.1:** T, who holds title to a £10 note on trust for B, buys with it a bottle of wine without B's authority.

It is generally thought that such facts permit B to follow a continuous stream of value from T's right against the bank into title to the bottle of wine, by which his claim to the former is transmitted to the latter. The two alternative explanations offered for this phenomenon are: (i) that it is part of the combined effect of property and tracing;[1] and (ii) it is a 'non-consensual substitution', which is part of the law of unjust enrichment.[2]

In this chapter it is demonstrated that an important misstep was taken in 1816,[3] by which the theoretical prominence of the beneficiary's original proprietary claim was established. It argues that the best explanation for the extension of proprietary claims from trustees acting within their authority to those acting without it was the broadening, over the course of the eighteenth century, of the personal obligations of agents, solicitors and trustees. The rule then and now applicable to fiduciaries –

[1] See e.g. Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005); Grantham and Rickett, 'Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?' [1997] New Zealand Law Review 668; Rickett, 'Old and New in the Law of Tracing' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005); Virgo, *The Principles of the Law of Restitution* (2nd edn, OUP 2012).
[2] Birks, 'Property, Unjust Enrichment and Tracing' (2001) 54 CLP 231.
[3] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721.

trustees or otherwise – is that they are liable for any right acquired in the course of their office, irrespective of any loss that might have been suffered by the principal.[4]

## II. Claims against Agents Acting within the Scope of their Authority

### A. Equity

Actions against factors in respect of goods vested in them by their principal can be found all over the common law. They were brought in account,[5] debt,[6] and, later, assumpsit,[7] and actions on the case for conversion.[8] But none of these actions provided much assistance to a principal whose factor became insolvent prior to the action. Moreover, even if detinue could be brought against the assignee for such of the original goods as remained in the factor's hands,[9] a Jacobean bankruptcy statute had the effect of subjecting everything in a bankrupt's hands at the time of his bankruptcy to distribution to his creditors.[10]

The solution to these problems was provided by the courts of Chancery.[11] In *Burdett v Willett* Willett sold linen to the defendants on behalf of Burdett, in return for their promise to pay him £115.[12] Willett became bankrupt before that sum had been paid to him, but the court ordered that the money nevertheless be paid to Burdett,

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[4] *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223.
[5] *Perton v Tumby* YB 10 Edw II, Seldon Soc vol 54, p 109 (CP).
[6] *Core v May* KB 27/1097, m 33, Seldon Soc vol 94, p327.
[7] *Orwell v Mortoft* YB Mich 20 Hen VII, fo 8, pl 18, (1505) B & M 406
[8] *Halliday v Higges* BL MS Add 25203, fo 147v, YLS MS G R29 14, fo 15v, B & M 592.
[9] There is some disagreement over whether this was possible: *Anon* YBMich 41 EdwIII fo 31 pl 37 (CP).
[10] An Act for the further Description of a Bankrupt, and Relief of Creditors against such as shall become Bankrupts, and for inflicting of corporal Punishment upon the Bankrupts in some special Cases 21 Jac 1. Cap 19. 1623: 'be it enacted, that if at any time hereafter, any person or persons shall become bankrupt, and at such time as they shall so become bankrupt, shall by the consent and permission of the true owner and proprietary, have in their possession, order, and disposition, any goods or chattels, whereof they shall be reputed owners; and take upon themselves the sale, alteration, or disposition as owners, that in every such case such goods shall be liable to the bankrupt's debts, as if they had been the proper goods of the bankrupt.'
[11] *Copeman v Gallant* (1716) 1 P Wms 314, 24 ER 404.
[12] *Burdett v Willett* (1708) 2 Vern 638, 23 ER 1017.

discounting what was due to Willett as factor: even though Willett was entitled to the goods at law, in equity, said the court, he was a trustee of the right for which he had agreed to be accountable to Burdett.

Equity's practice of enforcing obligations to transfer rights *in specie* began in cases involving title to land. By the early eighteenth century, the trust had become so familiar to Chancery that every time it recognised a specifically enforceable obligation to convey title to land, the purchaser was considered to acquire a proprietary interest, which – irrespective of whether and when the purchase was complete at law – would form part of his estate on death.[13] In 1805 in *Beckford v Wade* Sir William Grant MR said: 'Upon what grounds is a Court of Equity ever called upon to direct one man to convey a real estate to another, except upon the ground of a trust, either actual or constructive?'[14] Applied indiscriminately to debts, the practice became a rule that every time Chancery recognised a non-gratuitous obligation to assign a right *in specie*, it recognised a trust.[15]

The rules that emerged from the sequence of authorities following *Burdett* were that if either the original goods could be distinguished,[16] or an identifiable asset was acquired in return for the goods exchanged by the factor in performance of the agreement between plaintiff and factor,[17] that asset was held on trust by the factor and continued to be held on trust by the assignees in bankruptcy. By contrast, if the

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[13] *Cotton v Iles* (1684) 1 Vernon's Cases in Chancery 271, 23 ER 464; *Mortimer v Capper* (1782) 1 Brown's Chancery Cases 156, 28 ER 1051; *Whittaker v Whittaker* (1792) 4 Bro CC 31, 29 ER 762. Note that this is not to *justify* such a result. For a persuasive account of why no such justification can be found, see William Swadling, 'The Vendor-Purchaser Constructive Trust' in S. Degeling and J. Edelman (eds), *Equity in Commercial Law* (The Lawbook Co 2005).
[14] *Beckford v Wade* (1805) 17 Ves Jun 87, 34 ER 1181, 96.
[15] *Burdett v Willett* (1708) 2 Vern 638, 23 ER 1017.
[16] *L'Apostre v Le Plaistrier* 1 P Wms 318, B R M (1708); *Godfrey v Furzo* (1733) 3 Peere Williams 185, 24 ER 1022; *Paul v Birch* (1743) 2 Atk 621, 26 ER 771; *Copeman v Gallant* (1716) 1 P Wms 314, 24 ER 404.
[17] *Dumas, Ex Parte* (1754) 1 Atk 232, 26 ER 149; *Hassal v Smithers* (1809) 2 Ves Jr 289, 34 ER 1098.

product of the original right in the factor's hands was money,[18] or some other thing that could not be distinguished from the rest of the factor's estate,[19] no trust arose and the plaintiff principal was forced to sue as a general creditor.

**B. The Common Law**

Three decades after *Burdett v Willett*, the absurdity of denying a claim at common law to a plaintiff who would succeed in a subsequent suit in Chancery drove the common law courts to reach a conclusion equivalent to that which was reached in *Burdett*: where Chancery would recognise a trust, the common law would order payment of a sum equivalent to the value of that trust right.

In *Scott v Surman* the plaintiffs consigned a quantity of tar to Scott as their factor.[20] The ship and goods arrived in the Thames from Carolina on the 22nd March 1739. The factor received the bill of lading and sold the tar to third parties in return for promissory notes payable four months post delivery. The factor subsequently committed an act of bankruptcy, and his assignees acquired the notes and received the money due on them. The defendants argued that as assignees they were entitled to keep that sum. The plaintiffs argued that it was received to the use of the plaintiffs. In order to avoid circuity of action, Willes J held that the assignees would be liable in respect of the sum received on the notes for money had and received at law:

> [W]herever the equity of the case is clearly with the plaintiff, I will always endeavour if I can, and if it be any ways consistent with the rules of law, to give him relief at law…. For I think it would be very absurd to say that any thing shall vest in the assignees for no other purpose but in order that there may be a bill in equity brought against them by which they will be obliged to refund and account and according to the case of *Burdett v Willett* will likewise have costs decreed against them, and so the effects of the bankrupt which ought

[18] *Whelpdale v Cookson* 27 ER 856; (1747) 1 Ves Sen 9.
[19] *Scott v Surman* (1742) Willes 400, 125 ER 1235.
[20] Ibid 404.

> to be applied to the discharge of his debts will be wasted to serve no purpose whatever.[21]

That the stated action in *Scott v Surman* was one for 'money had and received' tends to obscure analysis. In our contemporary categories, money had and received is generally thought to be an action in unjust enrichment.[22] But to suggest that all cases argued successfully with that count can be so described is to ascribe anachronistic uniformity to an emerging private law which contained no systematic theoretical or practical distinction between agreements, wrongs and unjust transactions.

The earliest assumpsit cases were those in which the plaintiff supplied the defendant with something on the faith of the defendant's promise to pay, but debt was not available. Subsequently, however, actions were successful in assumpsit where debt *would* have been available, and the plaintiff simply recovered the debt as damages. So long as there was some *quid pro quo*, it did not matter how the debt had arisen.[23]

The idea that assumpsit lay wherever debt lay enabled the action to be used also in those forms of debt that had replaced account: where, for example, A paid money to B to pay to C, where C paid B by mistake or under a void contract.[24] By 1616 the form of this remedy was established as *indebitatus assumpsit* 'for money had and received', and its foundation was the allegation that the defendant had received a

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[21] Ibid 404.

[22] See Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 290.

[23] D. Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP 2001) 141. The emerging divide between rights to things and pure obligations still contained no principled distinction between the different kinds of reason that there might be for a legal response. The development of tort law was slowed by a limitation to cases involving force. When trespass on the case emerged as a broader remedy for wrongs, several cases involving mis-performance and non-performance of informal contracts were brought in this action: ibid 89. In Ibbetson's words, '[U]ntil the very end of the fifteenth century, the courts maintained a spirited – if incoherent – defence of the rule that the trespassory remedy could not be used in cases of pure non-performance. As a result of this there was built into the Common law a strong cleavage between not performing agreements, provided with quintessentially contractual remedies, and performing agreements badly, provided with actions in tort.'
In the first half of the C16th, when assumpsit first appeared, pleadings were in the form of a wrong, even though the central allegation was that the defendant 'assumed and faithfully promised' the plaintiff to do something.

[24] Baker, *An Introduction to English Legal History* (4th edn, OUP 2002) 370.

sum of money to the use of the plaintiff, which sum the defendant had subsequently promised and refused to pay.[25]

The best-known summary of the action for money had and received is that of Lord Mansfield in *Moses v Macferlan*:

> This kind of equitable action, to recover back money, which ought not in justice to be kept, is very beneficial, and therefore much encouraged… it lies for money paid by mistake; or upon a consideration which happens to fail; or for money got through imposition, (express, or implied) or extortion; or oppression; or an undue advantage taken of the plaintiff's situation, contrary to laws made for the protection of persons under those circumstances. In one word, the gist of this kind of action is, that the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money.[26]

This passage provides the foundation for Birks' prescriptive claim about the theoretical unity of money had and received as an action in unjust enrichment.[27] Considering only this passage of Lord Mansfield's judgment, that claim looks persuasive indeed. But Lord Mansfield also explained that money had and received 'lay in numberless instances, for money the defendant has received from a third person, which he claims title to, in opposition to the plaintiff's right; and which he had, by law, authority to receive from such third person'.[28]

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[25] Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP 2001) 271. Later, theory would assert that these actions were based, not on implied promises (which they were), but on implied contracts (which they were not): see ibid 272.

[26] *Moses v Macferlan* (1760) 2 Burr 1005, 97 ER 676, 1012.

[27] Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 290.

[28] *Moses v Macferlan* (1760) 2 Burr 1005, 97 ER 676, 1009. See e.g. *Anon* Comb 341 (untr), B & M 508. Money had and received was even employed to assert claims that we would now consider to be damages for breach of contract. In *Dutch v Warren* the plaintiff paid money to the defendant on a promise to transfer stock to him. The defendant failed to do it. At the trial the doubt was whether the plaintiff could have an action in money had and received because, at the time the money was paid, the plaintiff never intended to have it back, and the promise to transfer the stock was a sufficient consideration for his parting with the money. The court awarded damages 'not for the whole money paid but the damages in not transferring the stock at that time, which was a loss to the plaintiff and an advantage to the defendant, who was a receiver of the difference money to the use of the plaintiff.' *Dutch v Warren* (1720) 1 Stra 406 (untr), B & M 511. It is probably the 'had' in 'money had and received' that causes confusion. Birks argues that there were two actions: (i) 'money had and received to the use of the plaintiff' and (ii) 'money paid to the use of the defendant'. He argues that these were separate: Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 287, but it does not appear that they were

Of course, Birks had an unjust enrichment explanation for these cases too.[29] But it is not necessary to consider the merits of that argument to demonstrate that this was not the basis for Willes J's decision in *Scott v Surman*. The action for money had and received lay for the realised value of a right that already belonged, in equity, to the plaintiffs. And the reason it already belonged, in equity, to the plaintiffs, was precisely the same reason as that which governed the decision in *Burdett*: equity would enforce specifically *the agreement* of the factor to sell the goods and hand over the price. The authority of the factor to act was central. To the defendants' attempt to distinguish the facts of *Scott* by arguing that they had acted outside their authority in selling the tar on credit, the judge replied:

> [C]onstant and daily experience shews that factors do sell upon credit without such a special authority. If it were otherwise, it would be the greatest prejudice to trade as it would be likewise if this notion should prevail that the owner must suffer by the factor's becoming bankrupt; and we ought always as much as we can and as far as is consistent with the rules of law to do every thing to promote the trade and commerce of the nation.[30]

So, Equity would enforce an agent's consensual obligation to pay his principal the price of goods sold on his behalf through the mechanism of a trust, and because Equity would enforce it, so would the common law, as an action for money had and received to the plaintiff's use. Thus, there was a remedy at law and in equity that allowed a plaintiff to recover goods from the estate of an insolvent factor or

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treated as such. In *Scott v Surman* the stated count was: 'Afterwards at Guildhall before Lord Chief Justice Parker, this case was cited and allowed to be law, because though it was agreed that payment by J. S. to Burwell and Mason with whom the contract was made would be a discharge to J. S. against the principal, yet the debt was not in law due to them, but to the person whose goods they were, and therefore it was not assigned to the defendant by a general assignment of their debts, but remained due to the plaintiff as before; and being paid to the defendant who had no right to have it, it must be considered in law as *paid for the use of him to whom it was due*, and so an action will lie as for *money had and received to his use*.' *Scott v Surman* (1742) Willes 400, 125 ER 1235, 406 (emphasis added). Throughout his judgment Willes J was content to describe the action both as 'money received to the use of the plaintiffs', and 'money had and received' ibid 404.

[29] He called it 'interceptive subtraction': Birks, *An Introduction to the Law of Restitution* (OUP 1985) 133. Cf M. McInnes, 'Interceptive Subtraction, Unjust Enrichment and Wrongs - A Reply to Professor Birks' [2003] CLJ 697.

[30] *Scott v Surman* (1742) Willes 400, 125 ER 1235, 407.

divert money, if it was in the form of a debt unpaid.[31] And it depended centrally upon the agreement between plaintiff and factor.

## III. Unauthorised Investments

This part of the history of claims against fiduciaries appears nowhere in modern cases and texts. The reason for this is another case, decided three quarters of a century later. In *Taylor v Plumer* Lord Ellenborough held that factors are *always* liable *in specie* for the identifiable product of a right, irrespective of their authority to act.[32] The plaintiff need prove only two things: (i) the principal's claim to the original right and (ii) that the agent exchanged it for some other right. This formed the foundation for a new line of authorities, and a theory of proprietary claims against trustees with tracing at its heart.

### A. Taylor v Plumer

In *Taylor v Plumer* Plumer gave his stockbroker, Walsh, a draft for £22,500 to buy Exchequer bills.[33] Instead of doing this, Walsh exchanged the draft for Bank of England notes with which he paid US government stock and Portugese gold coins. In the process of attempting to abscond to the United States, Walsh was apprehended by Plumer's agent, who took the stock and gold from him. Walsh's assignees in bankruptcy brought an action against Plumer in trover, arguing that Walsh's act of

[31] Khurshid and Matthews also point out that the court in both *Whitecomb v Jacob* (1710) 1 Salk 160, 91 ER 149 and *Scott v Surman* (1742) Willes 400, 125 ER 1235 recognised that if the agent had laid out the money received in acquiring specific goods, those goods could be claimed by the principal. The best understanding of this, they explain, is that 'the agent could specifically appropriate the proceeds to his principal, passing a property in them.' Khurshid and Matthews, 'Tracing Confusion' (1979) 95 LQR 78, 85.
[32] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721.
[33] Ibid.

fleeing London was an act of bankruptcy, so that the assignees had, at that point, acquired legal title.

Counsel for the plaintiffs conceded that a principal could recover specific goods in the possession of a bankrupt agent in the event of his agent's insolvency. He also conceded that the principal could recover the product of such goods, where it was acquired in pursuance of the trust.[34] The line, he argued, was at property that was *not* acquired in pursuance of the trust, but rather in fraud of it.[35]

In light of the discussion of *Burdett v Willett* and *Scott v Surman* above, and several other authorities prior to *Taylor v Plumer*,[36] he ought to have been on firm ground. Lord Ellenborough, however, considered that that argument was 'mischievous in principle, and supported by no authorities of law'.[37] Moreover, for the irrelevance of the fiduciary's authority to act, and the conclusion that 'an abuse of trust can confer no rights on the party abusing it, nor on those who claim in privity with him',[38] Lord Ellenborough relied entirely upon an isolated passage from Willes J's judgment in *Scott v Surman* itself:

> [W]hy are goods considered still as the owners? because they remain in specie, and so may be distinguished from the rest of the bankrupt's estate. But as money has no earmark, it cannot be distinguished. Otherwise to be sure in reason the thing produced ought to follow the nature of the thing out of which it is produced, if it can be distinguished.[39]

Lord Ellenborough continued:

> If the property in its original state and form was covered with a trust in favour of the principal, no change of that state and form can divest it of such trust, or give the factor, or those who represent him in right,

[34] Ibid 567.
[35] Ibid 567.
[36] *Perry v Phelips* (1790) 1 Ves Jr 251, 30 ER 327; *Cox v Bateman* (1715) 2 Ves Sen 19, 28 ER 13; *Gladstone v Hadwen* (1813) 1 M & S 517, 105 ER 193.
[37] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721, 725-726.
[38] Ibid 725-726.
[39] *Scott v Surman* (1742) Willes 400, 125 ER 1235, 404.

> any other more valid claim in respect to it, than they respectively had before such change…for the product of or substitute for the original thing still follows the nature of the thing itself, as long as it can be ascertained to be such…[40]

This demonstrates the importance of context. Willes J made it clear – as had the earlier cases upon which he relied –[41] that the presence of an identifiable right was a condition of the trust. But, again, the *justification* for liability in respect of that right, so identified, was the agreement between principal and factor. The assignees were liable in respect of the debt because the factor, once he had received the money, would have been liable for it to the plaintiffs, and the reason the factor would have been liable for it to the plaintiffs was because he had agreed to be accountable for it to the plaintiffs. Lord Ellenborough's judgment presents Willes J's conclusion – that the new right is held on trust – as the reason for liability.

**B. Fiduciary Liability for Unauthorised Investments**

*Taylor v Plumer* has been applied several times since 1816.[42] *Scott v Surman*, by contrast, has not. By the time *Re Hallett's Estate* was decided in 1878, Jessel MR considered it a firm principle of English law that a fiduciary who, with or without authority, acquires a right in exchange for another for which he is accountable to his principal holds it on trust:

> The modern doctrine of Equity as regards property disposed of by persons in a fiduciary position is a very clear and well-established doctrine. You can, if the sale was rightful, take the proceeds of the sale, if you can identify them. If the sale was wrongful, you can still take the proceeds of the sale, in a sense adopting the sale for the purpose of taking the proceeds, if you can identify them. There is no distinction, therefore, between a rightful and a wrongful disposition of

[40] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721, 726.
[41] *L'Apostre v Le Plaistrier* 1 P Wms 318, B R M (1708); *Whitecomb v Jacob* (1710) 1 Salk 160, 91 ER 149.
[42] *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551; *Frith v Cartland* (1865) 2 Hem & M 417, 71 ER 525; *Re Hallett's Estate* (1880) 13 Ch D 696; *Re Oatway* [1903] 2 Ch 356.

> the property, so far as regards the right of the beneficial owner to follow the proceeds.[43]

This draws a clear division between custodial and other fiduciary relationships, so that in 1985 Lord Lane CJ said:

> There is a clear and important difference between on the one hand a person misappropriating specific property with which he has been entrusted, and on the other hand a person in a fiduciary position who uses that position to make a secret profit for which he will be held accountable.[44]

As the trust recognised in *Taylor v Plumer* and the cases prior to it depends upon Equity's peculiar treatment of an obligation to account for a particular right,[45] the question considered in what follows is: what is the reason for a fiduciary's obligation to account *in specie* for a right acquired outside his authority? It is argued that the answer can be found, not in the proprietary nature of the relationship between beneficiary and trustee, but in the development, over the course of the eighteenth century, of the personal obligations owed by the trustee to the beneficiary.

## IV. Property

Some argue that the law of property permits the transmission of claims from substituted rights to their traceable proceeds, and provides a complete explanation of the beneficiary's acquisition of a claim to a new right in the hands of his trustee.[46] In the example with which this chapter began, B's claim to T's title to the bottle of wine is explained simply as part of the internal workings of property law:

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[43] *Re Hallett's Estate* (1880) 13 Ch D 696, 708-709.
[44] *Attorney General's Reference (No 1 of 1985)* [1986] 1 QB 491, 502 (Lord Lane CJ).
[45] The mechanics of that step have been challenged elsewhere, and are not considered here. See e.g William Swadling, 'Constructive Trusts and Breach of Fiduciary Duty' 18 Trusts & Trustees .
[46] Grantham and Rickett, 'Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?' [1997] New Zealand Law Review 668; Grantham and Rickett, 'Tracing and Property Rights: the Categorical Truth' (2000) 63 MLR 905; Rickett, 'Old and New in the Law of Tracing' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005); P. J. Millett, 'Restitution and Constructive Trusts' (1998) 114 LQR 399, 409; Virgo, *The Principles of the Law of Restitution* (2nd edn, OUP 2012) 580.

**Example 4.1:** T, who holds title to a £10 note on trust for B, buys with it a bottle of wine without B's authority.

It is argued in what follows that the simple proof of a transactional link between a right held on trust for the claimant and some new right acquired by the trustee cannot, either on its own or together with the law of property, justify the claimant's acquisition of a claim in respect of that new right.

## A. The Transmission of Claims

In *Foskett v McKeown* the House of Lords was given the opportunity to consider the basis of proprietary claims in respect of unauthorised substitutes. Their Lordships were unanimous in concluding that the explanation for such claims belonged to the law of property alone.

The case concerned the fraudulent activities of Murphy, who had been a trustee for the claimants. In 1988 a number of persons ("the purchasers") entrusted a total of £2.6m to Murphy for a property development scheme in Portugal on terms that within two years the developed plots would be conveyed to the purchasers or their money repaid with interest. The scheme was never carried out. Murphy, in breach of trust, used some £20,440 of the trust money to pay two annual premiums on a personal life insurance policy acquired in 1986. In 1989 he settled the policy on trust for his three children. In 1991 he committed suicide, and the insurers paid £1m to the trustees.

In 1994 the purchasers obtained a declaration that the land in Portugal and the shares in the company intended to develop it were held on trust for the purchasers. They also obtained £600,000 under a compromise with the bank from whose accounts

the money had been misappropriated. The purchasers then brought an action claiming the proceeds of the policy.

The judge at first instance held that they could also recover 53% of the proceeds, as representing the extent to which their money had contributed to the investment value of the policy. The Court of Appeal held that the use of the beneficiaries' money to pay the premiums could not give them an equitable interest in the death benefit, nor a share in the proceeds. Rather, they were limited to a restitutionary charge over the proceeds of the policy to the extent that their money could be traced into the premiums.[47]

On appeal, the House of Lords held that where a trustee wrongfully used trust money to provide part of the cost of acquiring an asset, the beneficiary was entitled either to claim a proportionate share of the asset or to enforce a lien upon it. Accordingly, since the purchasers could trace the trust money through the premiums into the policy money, and since the beneficiaries of the policy were volunteers and had not themselves contributed to the premiums, the purchasers were entitled to a share in the policy proceeds proportionate to the premiums paid out of the trust money.

Lord Millett explained that 'the plaintiffs have chosen at each stage to trace the money into its proceeds… Having completed this exercise, the plaintiffs claim a continuing beneficial interest in the insurance money'.[48] He continued: 'The transmission of a claimant's property rights from one asset to its traceable proceeds is part of our law of property, not of the law of unjust enrichment'.[49]

[47] *Foskett v McKeown* [1998] Ch 265.
[48] *Foskett v McKeown* [2001] 1 AC 102, 127.
[49] Ibid 127.

Virgo interprets the decision as follows, using it as a template for the 'proper method of analysis of proprietary restitutionary claims':

> (1) The claim was concerned with the vindication of the claimants' property rights and had nothing to do with whether the defendant was unjustly enriched.
> (2) The claimants had an initial proprietary interest in equity under an express trust. Consequently, the claimants had an equitable proprietary interest in the money which was taken from the trust fund.
> (3) The equitable tracing rules meant that the claimant's proprietary interest could be traced from the money taken from the trust fund into the payment of the premiums and finally into the death benefit.
> (4) It was then necessary to determine how the proprietary interest in the death benefit could be vindicated. It was held that this could be done by means of recognising a proportionate share in the money.
> (5) Finally, no defences were available to defeat or qualify the proprietary claim.[50]

This is, unarguably, an accurate description of the decision in *Foskett*. And such thinking is encouraged by expressing the relationship between the original right and the new right as one of 'tracing value':

> [W]e trace value: it is the only constant that exists before, through and after the substitution through which we trace. It exists in a different form after the substitution, and that is what can justify a claim to the new asset.[51]

But it is an incomplete justification for the result: we still need to know *why* the 'equitable tracing rules' permitted the beneficiaries to assert a proprietary interest in respect of the policy.

Significantly abridging three thorough papers,[52] Grantham and Rickett make the following argument: property rights are special because they relate to things; what

[50] Virgo, *The Principles of the Law of Restitution* (2nd edn, OUP 2012) 580.
[51] Smith, *The Law of Tracing* (OUP 1997) 119.
[52] Grantham and Rickett, 'Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity?' [1997] New Zealand Law Review 668; Grantham and Rickett, 'Tracing and Property

ties the duties in respect of them to the right-holder is that a personal obligation is owed by any person who breaches that duty, both at common law,[53] and in equity,[54] the purpose of which is to vindicate the claimant's property right; in equity property rights are inherently transmissible, so that vindicating the original right will often mean the imposition of an obligation in respect of that right in a location that is different from the original location.

The idea that tracing actually brings about the automatic transmission of rights, which mandates the conclusion that the beneficiaries' interest remains the same throughout,[55] is untenable. As Birks points out, the beneficiaries began with an absolute interest in respect of their trustee's rights against a bank, and ended with a two-fifths share in the proceeds of an insurance payout – 'a right in something which they never owned before and a right of a kind which they never had before – a co-ownership with outsiders'.[56] The beneficiary's claim is a new right. And if it is a new right, then there must be a reason for it.

**B. Property as a Reason for Liability**

Property is sometimes described as a causative event or 'reason' itself.[57] The idea is that a title-holder – whether at law or in equity – acquires an interest in a substitute thing because 'inherent in title' is the capacity to acquire interests in substitutes for the thing:[58]

> It is the law of property which deals with the creation, acquisition, disposal and transmission of property rights. It protects pre-existing

Rights: the Categorical Truth' (2000) 63 MLR 905; Rickett, 'Old and New in the Law of Tracing' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005).
[53] actions in conversion, or the self-help remedy of recaption.
[54] *Saunders v Vautier* (1841) EWHC Ch J82.
[55] Millett, 'Restitution and Constructive Trusts' (1998) 114 LQR 399, 409.
[56] Birks, 'Receipt' in Birks and Pretto (eds), *Breach of Trust* (Hart Publishing 2002) 217.
[57] Grantham and Rickett, 'Tracing and Property Rights: the Categorical Truth' (2000) 63 MLR 905.
[58] Craig Rotherham, *Proprietary Remedies in Context* (Hart 2002)

> rights of property. It tells us who owns disputed property. One of the rules of our law of property, common to both equity and the common law, is that the owner of a thing can claim ownership of its traceable proceeds.[59]

But property alone cannot provide a complete explanation of the creation, acquisition, disposal, transmission and protection of property rights. The claim can only possibly be that property makes up a part of the story for these responses. The transmission of the transferor's rights in a gift or contract occurs because of the parties' intentions that it should do. If it occurs in any case in which such intention is not present, we must explain why.[60]

Virgo argues that 'the principle could be rebranded into an event if it is necessary to do so. For example, the event could be that the defendant has interfered with the claimant's property rights in some way'.[61] Whether wrongdoing does indeed provide a justification for the beneficiary's acquisition of a claim to a substitute right acquired by a trustee acting without authority is considered below.

## V. Ratification

Some judges have considered fiduciary liability for substitute rights to depend upon ratification,[62] or a principle akin to it.[63] The ordinary logic of ratification is this: if

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[59] Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005) 314.

[60] Burrows exemplifies this as follows: 'There is a fundamental difference between, on the one hand, asserting that a person's ownership of a pig carries with it ownership of her piglets; and, on the other hand, asserting that a person's ownership of a pig carries with it ownership of the horse which a defendant has traceably substituted for the pig. The former assertion rests on a self-explanatory and true notion of "property"; the latter rests on a fictional use of "property".'A. Burrows, 'Proprietary restitution: unmasking unjust enrichment' (2001) 117 LQR 412. But even this example involves the application of some normative principle apart from property.

[61] Virgo, *The Principles of the Law of Restitution* (2nd edn, OUP 2012) 572. See also Graham Virgo, 'Unpacking Proprietary Restitutionary Claims' (1999) 3 Company Financial and Insolvency Law Review 119.

[62] *Sinclair v Brougham* [1914] AC 398, 441 (Lord Parker); *Re Diplock* [1948] Ch 465, 518.

[63] *Sinclair v Brougham* [1914] AC 398, 419 (Lord Haldane). Cf Lord Goff in *Lipkin Gorman v Karpnale* [1991] 2 AC 548, 573: "Tracing' or 'following' property into its product involves a decision by the owner of the original property to assert his title to the product in place of his original property. This is sometimes referred to as ratification. I myself would not so describe it.'

someone purports to act on another's behalf, it is open to that other to adopt the act as his own. The role of ratification is most important in the law of contract: if an agent purports to contract on his principal's behalf, the principal can enforce that contract irrespective of the agent's actual authority at the time of the transaction. So, ratification 'involves the idea that in certain circumstances a person can by expression of will adopt a transaction entered into by another on his behalf on which he is not liable or entitled so as to become liable and/or entitled as if he had made it at the time'.[64]

By contrast, in most cases in which a principal has been held entitled to claim a substitute right in the hands of their fiduciary, there is no suggestion that the fiduciary purported to act on his principal's behalf,[65] so that the principal could not ordinarily ratify.[66] If we nevertheless choose to call the process of asserting a claim to the new right 'ratification', we borrow a logic that has no force on the facts. In Smith's words:

> [T]he common law draws a line where the agent neither had any authority, nor was purporting to have authority, to act as an agent. In that case there can be no ratification. It would be fictional to use the consent-based concept of authority to regulate the effects of a transaction that had not a whiff of consent about it.[67]

Divorced from consent, ratification no more provides a complete explanation for liability than 'property' or 'tracing'. As Rotherham puts it, 'Even if it did provide a useful means of conceptualizing the manner in which the remedy operates, it begs the question: "why are plaintiffs allowed to ratify?"[68]

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[64] *Bowstead & Reynolds on Agency* (P. G. Watts ed, 19th edn, London: Sweet & Mawell 2010) [2-050].
[65] e.g. *Re Hallett's Estate* (1880) 13 Ch D 696; *Re Oatway* [1903] 2 Ch 356; *Foskett v McKeown* [2001] 1 AC 102.
[66] *Keighley Maxstead & Co v Durant* [1893] 1 QB 405 .
[67] Smith, 'Tracing' in Roger (ed), (OUP 2006) 133
[68] Rotherham, *Proprietary Remedies in Context* (Hart 2002)100.

Moreover, in *Taylor v Plumer* itself Lord Ellenborough considered that the actions of the claimant were inconsistent with an intention to ratify:

> If this case had rested on the part of the defendant on any supposed adoption and ratification on his part of the act of converting the produce of the draft or bank-notes of the defendant into these American certificates, we think, it could not have been well supported on that ground, inasmuch as the defendant, by taking a security by bond and judgment to indemnify himself against the pecuniary loss he had sustained by that very act, must be understood to have disapproved and disallowed that act instead of adopting and confirming it.[69]

In *United Australia Ltd v Barclays Bank* Lord Atkin considered the argument that a claimant who brought an action against a defendant for money had and received on facts that amounted to a conversion of something belonging to the claimant thereby elected to dismiss the tort and ratify the conversion. His Lordship said:

> If the plaintiff in truth treats the wrongdoer as having acted as his agent, overlooks the wrong, and by consent of both parties is content to receive the proceeds this will be a true waiver. It will arise necessarily where the plaintiff ratifies in the true sense an unauthorized act of an agent: in that case the lack of authority disappears, and the correct view is not that the tort is waived, but by retroaction of the ratification has never existed. But in the ordinary case the plaintiff has never the slightest intention of waiving, excusing or in any kind of way palliating the tort. If I find that a thief has stolen my securities and is in possession of the proceeds, when I sue him for them I am not excusing him. I am protesting violently that he is a thief and because of his theft I am suing him: indeed he may be in prison upon my prosecution…. I protest that a man cannot waive a wrong unless he either has a real intention to waive it, or can fairly have imputed to him such an intention, and in the cases which we have been considering there can be no such intention either actual or imputed. These fantastic resemblances of contracts invented in order to meet requirements of the law as to forms of action which have now disappeared should not in these days be allowed to affect actual rights. When these ghosts of the past stand in the path of justice clanking their mediæval chains the proper course for the judge is to pass through them undeterred.[70]

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[69] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721 [579]-[580].
[70] *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1, 28-29.

In *Agip v Jackson* Millett J considered Lord Atkin to have exposed the 'transparent nature of the fiction of ratification', and denounced continued reliance on it.[71] In short, there is neither actual nor apparent authority, nor anything in the nature of affirmation, there is nothing in the logic of ratification that explains a claim to a new right in the hands of a defendant.

## VI. Unjust Enrichment

One of the most popular explanations offered for claims against fiduciaries in respect of rights acquired in exchange for rights that are held on trust for the claimant is that the fiduciary is enriched unjustly at the claimant's expense by the unauthorised substitution.[72] In Birks' words:

> [I]f a person is alleged to have used the value of another's property to acquire another asset, the question whether that is what he has in fact done being determined by the exercise of tracing, the right which the law raises in the new asset is restitutionary. It is raised to effect restitution of unjust enrichment.[73]

Birks argued that the reason – the use of someone else's value to acquire a new asset – was 'non-consensual substitution':

> There is a non-consensual substitution where one person, without the consent of another, employs the value of an asset belonging to another, the original asset, to acquire another asset, the substitute asset… That causative event must be allocated to its correct genus, which can only be unjust enrichment.[74]

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[71] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 284

[72] Burrows, 'Proprietary restitution: unmasking unjust enrichment' (2001) 117 LQR 412; Birks, 'Property, Unjust Enrichment and Tracing' (2001) 54 CLP 231; A. Burrows, 'The Relationship between Unjust Enrichment and Property' in S. Degeling and J. Edelman (eds), *Unjust Enrichment in Commercial Law* (Lawbook Co 2008); Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 198-202; Burrows, *The Law of Restitution* (3rd edn, OUP 2011); Mitchell, Mitchell and Watterson (eds), *Goff & Jones: The Law of Unjust Enrichment* (8th edn, Sweet & Maxwell 2010) 8.20-8.30.

[73] Birks, 'Overview: Tracing, Claiming and Defences' in Birks (ed), *Laundering and Tracing* (OUP 1995) 318.

[74] Birks, 'Property, Unjust Enrichment and Tracing' (2001) 54 CLP 231, 253.

This has now been adopted as the orthodox approach by the authors of our unjust enrichment textbooks. In Burrows' words:

> [U]njust enrichment is the best explanation for the proprietary and personal rights conferred in the unauthorised substitution cases… The enrichment is the unauthorised substitute asset or its value; the substitution (ie the tracing) *along with title* satisfies the 'at the claimant's expense' element; and the injustice is normally the ignorance (or powerlessness) of the claimant or, if one agrees with Birks' approach to the unjust question, the absence of basis.[75]

It is not the purpose of this thesis to engage in a thorough analysis of the law of unjust enrichment, and such discussion as there is of its normative foundations occurs in Chapter Six. In this chapter the assertion of proprietary claims to new rights in the hands of trustees will simply be analysed by reference to the orthodox account of unjust enrichment, which insists that there must be: (i) enrichment by a defendant; (ii) at the claimant's expense; and (iii) injustice, in the form of an unjust factor.

It is argued that the problem with maintaining a persuasive unjust enrichment explanation of claims to rights acquired by fiduciaries acting outside their authority is the second of these elements: an unauthorised substitution will not have the effect of passing the claimant's (legal or equitable) title. There is not, therefore, loss sufficient to justify a claim to any right in the defendant's hands. And if that loss is manufactured by a claimant electing to renounce title, it is not unjust.

### A. At the Claimant's Expense

In *Foskett v McKeown* their Lordships rejected unjust enrichment as the basis for the claim. This was primarily because they thought that the result had been determined already by application of property principles, which argument was considered and

[75] Burrows, *The Law of Restitution* (3rd edn, OUP 2011) 119.

rejected above. But they also assumed that unjust enrichment required proof of a causal economic benefit. Lord Steyn said that 'the payment of the 1989 and 1990 premiums conferred no additional benefit on the children. They were not enriched by the payment of those premiums: they merely received their shares of the sum assured in accordance with their pre-existing entitlement'.[76] Lord Hope said that 'the law of unjust enrichment should not make them worse off as a result of those transactions than they would have been if those transactions had not happened'.[77] Lord Millett considered that, 'A plaintiff who brings an action in unjust enrichment must show that the defendant has been enriched at the plaintiff's expense, for he cannot have been unjustly enriched if he has not been enriched at all'.[78]

It is generally accepted that, even if a causal connection were enough to establish a claim to value in unjust enrichment,[79] a proprietary claim to a particular right depends upon proof of a different kind of link. The editors of *Goff and Jones: The Law of Unjust Enrichment* argue that:

> [W]here the claimant seeks a proprietary remedy, it is not enough for him to show that there was a transfer of value between the parties: he must also show either that he previously owned the property in which he now claims an ownership or security interest, or else that the defendant acquired this property in exchange for property that was previously owned by the claimant, or else that this property was formerly the subject matter of an interest that was discharged with property that was previously owned by the claimant.[80]

If 'ownership' is understood to include 'equitable ownership', the purchaser's claim in *Foskett* satisfies this test: when Murphy transferred funds from the account, their claim in respect of the original sum was extinguished. As part of that transaction

[76] *Foskett v McKeown* [2001] 1 AC 102, 112.
[77] Ibid 126.
[78] Ibid 130.
[79] This is not the orthodox approach, which is that something more direct is required – a 'transfer' – although it is not altogether clear precisely what 'transfer' means.
[80] Mitchell, Mitchell and Watterson (eds), *Goff & Jones: The Law of Unjust Enrichment* (8th edn, Sweet & Maxwell 2010) 169.

Murphy acquired the policy, through payment of the premiums. His enrichment was the proportion of the realised right that was referable to the trust account. In *The Law of Tracing*, Smith uses the following example.

> **Example 4.2**: A trustee holds title to land on trust for a beneficiary. In breach of trust, he sells it to a bona fide purchaser, and places the purchase price in an account.

Smith analyses this as follows:

> [Unjust enrichment] requires proof of an enrichment of the defendant, and a corresponding deprivation of the plaintiff. Here, the plaintiff beneficiary was deprived of the rights she held in the original estate and, through the same transaction, the trustee was enriched by receiving legal title to the purchase price.[81]

Thus, irrespective of comments to the contrary in the case itself, *Foskett* might indeed be analysed as involving a claim in unjust enrichment, as unjust enrichment is ordinarily understood: wherever the beneficiary's interest is destroyed as part of a transaction by which his trustee acquires a new right, the trustee is enriched unjustly at the beneficiary's expense.

The problem with this account is simple: destruction of the principal's original claim does not appear to be a pre-requisite of his claim to some new right acquired by his fiduciary. If this is so, it is difficult to see how, if the fiduciary's acquisition of a right is an enrichment, it is an enrichment acquired at the principal's expense.

In *Re Hallett's Estate* Hallett misappropriated trust funds and Russian bonds belonging to a client, Cotterill.[82] He sold them and credited the proceeds to his personal account. He died insolvent, and the trustees and Cotterill brought proprietary claims to his account in respect of the misappropriated investments. Their claims succeeded. Jessel MR stated explicitly that Hallett was a bailee of the bonds, with

[81] Smith, *The Law of Tracing* (OUP 1997) 300.
[82] *Re Hallett's Estate* (1880) 13 Ch D 696.

authority only to receive dividends as agent on Cotterill's behalf. The result of that characterisation is that Hallett's fraudulent sale would not have had the effect of passing title.[83]

Similarly, the sale of trust assets for some purpose not permitted by the terms of the trust does not have the effect of subordinating the beneficiary's claim to that of the purchaser, unless the purchaser can raise the defence of *bona fide* purchase. Where a trustee makes an authorised substitution of trust assets, two things happen: (i) the beneficiary acquires a claim to the new right, which is then held on the same terms as the original trust right;[84] and (ii) the beneficiary's claim to the original right (if it still exists) is subordinated to the interest of a third party acquiring that right.[85] The former is often referred to as a 'secondary effect' of overreaching,[86] and their combination as the 'transmission' or 'transposition'[87] of interests.[88] However, the two changes occur for different reasons, and do not always coincide. Without the trustee's ability to give a third party a title free from the beneficiary's claim, he could not deal with the trust fund. So, as a 'necessary corollary of the trustee's powers of disposition over the trust fund', the beneficiary's interest, although it is not destroyed altogether,[89] is subordinated to the third party's claim. This effect, which is called 'overreaching', occurs irrespective of the acquisition of any rights by the trustee.[90] It follows that

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[83] There is no dicussion in the case of whether the bonds were negotiable. If they were, of course, title would have passed to the bona fide purchaser from Hallett. The fact that the point is not discussed must be taken to mean that the court did not consider the point determinative of the claims that arose in respect of Hallett's account.
[84] *Re Brown* (1886) 32 ChD 597.
[85] Charles Harpum, 'Overreaching, Trustees' Powers and the Reform of the 1925 Legislation' (1990) 49 CLJ 277, 282.
[86] D. Fox, 'Overreaching' in P. Birks and A. Pretto (eds), *Breach of Trust* (Hart Publishing 2002); *Snell's Equity* (J. McGhee ed, 32nd Revised edn, Sweet & Maxwell 2012) 4-013.
[87] Fox, 'Overreaching' in Birks and Pretto (eds), *Breach of Trust* (Hart Publishing 2002) 95.
[88] Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005) 315: 'On an unauthorised sale of a trust investment, the beneficiaries' proprietary interests are overreached; that is to say, they are automatically transferred from the investment which is sold to the proceeds of sale and any new investment acquired with them.'
[89] *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195.
[90] Fox, *Property Rights in Money* (OUP 2008) 95; *State Bank of India v Sood* [1997] Ch 276

where a trustee makes a substitution that is *ultra vires*,[91] the beneficiary's interest in respect of it is *not* subordinated, but binds any recipient taking the legal interest gratuitously or with knowledge, and any purchaser of an equitable interest.[92]

The problem that this creates for an unjust enrichment account of claims to substitute rights is explained by Smith as follows:

> If an asset is held in trust and it is used to purchase other assets, even though such purchase be unlawful and unauthorised, the purchased assets are themselves held in trust, if the trust beneficiaries so elect….These proprietary outcomes – the trust over the proceeds – have often been ascribed to the law of unjust enrichment…There are, however, problems with this approach. One is that in unjust enrichment, it is generally essential that the plaintiff suffer a deprivation, not merely that her assets have been misused. In these cases, however, B is allowed to take the proceeds without having to establish that she lost her rights in the original property.[93]

In short, the presence or absence of any claim to the original right does not appear to be determinative of the beneficiary's claim to the substitute asset.[94] If this is so, the claim cannot be explained by reference to an orthodox account of unjust enrichment, which insists that the gain be made at the claimant's expense.

Whether or not a claimant who retains title can assert a claim in unjust enrichment has been the subject of much academic debate. Swadling argues that a case involving theft of goods involves neither enrichment nor loss, because the thief acquires a new, relative, title that does not come from the claimant.[95] Burrows, by contrast, argues that such a case is a clear example of enrichment at the claimant's

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[91] assuming that the substitution does not involve the destruction of the trust right, which it will if the transaction involves a bank transfer.

[92] *Pilcher v Rawlins* (1871-72) LR 7 Ch App 259; Fox, 'Overreaching' in Birks and Pretto (eds), *Breach of Trust* (Hart Publishing 2002) 96. Of course, on the facts of *Taylor v Plumer* itself the defence of *bona fide* purchase may well have been available, but there is no mention of it in the case, nor any suggestion that the result depended in any way upon the state of mind of the recipient of the notes.

[93] Lionel Smith, 'Philosophical Foundations of Proprietary Remedies' in R. Chambers, C. Mitchell and J. Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009) 298.

[94] The point is not discussed in either *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721 or *Re Hallett's Estate* (1880) 13 Ch D 696.

[95] W. Swadling, 'Ignorance and Unjust Enrichment: The Problem of Title' (2008) 28 OJLS 627, 628.

expense, because 'enrichment in the law of unjust enrichment is assessed factually and not in terms of legal entitlement:'[96]

> If the defendant has property belonging to the claimant but is treating it as his own and is not intended to return it, we say that, factually, the defendant has been benefited by the capital value of the property. Say, for example, the defendant is given a £100 banknote by the claimant by mistake as to identity, or the defendant steals the claimant's £100 banknote. It is clear that, factually, the defendant is enriched by £100 even though the banknote still belongs to the claimant.[97]

These interpretations of loss and gain in the law of unjust enrichment are not necessarily mutually exclusive. Chambers and Lodder argue that the law of unjust enrichment has never been concerned solely with the location of rights, nor solely with transfers of value, but with both.[98] Lodder points to cases of economic benefit that do not involve the acquisition of any right,[99] and cases involving the acquisition of a right that do not involve economic benefit.[100] Sometimes, he argues, loss is assessed factually (as economic benefit);[101] sometimes in terms of legal entitlement.[102]

Since the sole justification for restitution of an unjust enrichment is the imbalance between claimant and defendant, the remedy should, logically, do nothing other than redress it. If it is enough to support an action in unjust enrichment,[103] proof that the claimant has suffered economically by the loss of immediate control or the ability to obtain and transfer control, and that the defendant has benefitted economically by the same unjust event, the appropriate remedy is a claim that

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[96] Burrows, 'The Relationship between Unjust Enrichment and Property: some Unresolved Issues' in Edelman and Degeling (eds), *Unjust Enrichment in Commercial Law* (Thomson, Sydney 2008) 335.
[97] Burrows, *The Law of Restitution* (3rd edn, OUP) 195.
[98] Robert Chambers, 'Two Kinds of Enrichment' in R. Chambers, C. Mitchell and J. Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009); A. V. M. Lodder, *Enrichment in the Law of Unjust Enrichment and Restitution* (Hart Publishing 2012).
[99] *Benedetti v Sawiris* [2013] UKSC 50, [2013] 3 WLR 351; *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156.
[100] *Craven Ellis v Canons Ltd* [1936] 2 KB 403, [1936] 2 All ER 1066 .
[101] *Cobbe v Yeoman's Row* [2008] UKHL 55, [2008] 1 WLR 1752.
[102] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.
[103] This is doubted in Chapter Six.

removes both gain and loss. And since this is achieved best by an economic award, rather than by a claim to any identifiable right, this a personal claim, not a trust.[104]

So, the better explanation of a case involving the theft of goods or unauthorised substitution by a fiduciary is that if economic loss and enrichment are enough for the purposes of a claim in unjust enrichment, without a transactional link between claimant and defendant,[105] they are not enough for the purposes of a claim in unjust enrichment *to a right*.

Of course, not everyone considers that unjust enrichment requires symmetric loss of this nature. For Birks, an enrichment received by B could be regarded as being at A's expense if it 'came from' A,[106] and a right acquired by B could be treated as coming from A if it was acquired by 'intercepting opportunities' inherent in A's rights. In his words, 'the opportunities inherent in any item of property belong to its owner, so that to enrich oneself by usurping those opportunities is to intercept that which the law already attributes to the owner'.[107] For this approach to liability, Birks relied upon two cases: *Trustee of FC Jones v Jones*,[108] and *Edwards v Lee's Administrator*.[109]

In the first case Mr Jones drew three cheques in favour of his wife on a joint partnership account after the partnership had committed an act of bankruptcy. She credited her account with them, transferred those funds to commodity brokers and speculated in potato futures, multiplying the value of her account fivefold. The Court of Appeal held that the trustee in bankruptcy was entitled to trace the money in the firm's account into the cheques and the account with the commodity brokers, and

[104] Chambers, 'Two Kinds of Enrichment' in Chambers, Mitchell and Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009).
[105] This is considered further in Chapter Six.
[106] Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 82.
[107] Birks, 'Receipt' in Birks and Pretto (eds), *Breach of Trust* (Hart Publishing 2002) 219, fn 23.
[108] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.
[109] *Edwards v Lee's Administrator* (1936) 96 SW 2d 1028.

could claim the whole sum. According to Birks this was because 'in speculating with the firm's money Mrs Jones intercepted the firm's earning opportunities'.[110]

In the second case Edwards started a tourist business, profiting from tours of a cave that extended as to one third onto Lee's land. Lee recovered a third of Edwards' profits. Though the case was actually argued and decided as a trespass case, Birks argues that it could just as well have been decided in unjust enrichment: 'Edwards earned that money from Lee's property and hence by interceptive subtraction from Lee',[111] so that 'the case is materially indistinguishable from the *Jones* case'.[112]

Aside from more general concerns about the scope of unjust enrichment in private law,[113] there are two problems with this account – one general and one connected to the specific case of a substitution by a trustee.[114]

First, *Edwards v Lee's Administrator* and *FC Jones v Jones* are not indistinguishable from one another. It is easy to see the former as involving profits made from the exploitation of something belonging to another, whether one thinks that falls within the law of unjust enrichment or not. It is not at all easy to understand the latter in the same way. Birks himself argues forcefully that Mrs Jones' rights against the firm of brokers, and then against Raphael's, were not the firm's original rights, but *new* rights.[115] But if this is so, then Mrs Jones did not make a profit by exploiting the firm's right. Rather, she made a profit from exploiting *her* right – one which did not come from the firm, and could only ever have been asserted by her – by employing *her* skill and effort.

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[110] Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 82.
[111] Ibid.
[112] Ibid 85.
[113] See Smith, 'Tracing' in Roger (ed), (OUP 2006).
[114] Birks, 'Property, Unjust Enrichment and Tracing' (2001) 54 CLP 231, 246, fn35.
[115] On the ground that otherwise, if Mrs Jones had withdrawn the sums and absconded, the brokers would have remained liable to the liquidator for the same sum: Birks, 'On Taking Seriously the Difference between Tracing and Claiming' (1997) 11 TLI 2, 7.

The difficulty with application of interceptive subtraction to the specific case of a substitution by an express trustee is precisely Birks' assertion that 'the opportunities inherent in any item of property belong to its owner'. The *trustee* is the person entitled to exploit the asset. Of course, he is supposed to exploit it according to the terms of the trust and in the beneficiary's interest, but the beneficiary's acquisition of a claim to a right acquired by exploiting the asset in some other way cannot be explained on the basis that the opportunities inherent in the beneficiary's right have been intercepted: they were never his in the first place. That claim can mean nothing other than that the fiduciary acted in breach of the duties owing to the beneficiary. Whether such a breach of duty is itself sufficient to justify the beneficiary's claim is considered below.

**B. Injustice**

The claimant might, of course, choose to abandon his interest in the original right, thereby creating loss of a kind that might explain a proprietary claim. In Birks' words:

> That is the choice which the claimant has in this kind of situation. He can insist on his title, in which case he will either bring a vindicatio or complain of wrongful interference, or he can renounce his title and claim the value of the asset as an unjust enrichment.[116]

According to Smith, *Marsh v Keating* is authority for the proposition that a principal can elect to divest themselves of their original claim, in order to assert a claim in respect of its proceeds.[117] He argues that one way of reconciling the case with the assertion that non-consensual substitution is an action in unjust enrichment is by the

[116] Birks, *Unjust Enrichment* (2nd edn, OUP 2005) 66.
[117] Smith, *The Law of Tracing* (OUP 1997) 380-383.

idea that 'any claim deriving from unjust enrichment can be supported by a retroactive election'.[118]

*Marsh v Keating* concerned some of the activities of a fraudulent banker, Fauntleroy, who was sentenced to death and hanged for fraud in late October, 1824. In 1819 Fauntleroy had forged a power of attorney and sold stock that was in Mrs Keating's name without her consent. The stock was transferred to a broker and the proceeds paid into an account in the bank's name. Fauntleroy ensured that it did not appear in the bank's books and withdrew a matching sum. Accepting that Mrs Keating had not been divested of the stock by the purported transfer, the House of Lords held that she was, nevertheless, 'at liberty to abandon and give up all claim' to the stock, to 'adopt the sale', and to assert a claim to the proceeds, which had been 'sufficiently traced into the hands of the Defendants'.[119] The action, against the assignees in bankruptcy of Marsh & Co, was a proprietary claim, to particular rights. Nevertheless, the court held that she was entitled to recover the proceeds, according to the principle that:

> If the goods of A are wrongfully taken and sold, it is not disputed that the owner may bring trover against the wrongdoer, or may elect to consider him as his agent, may adopt the sale, and maintain an action for the price.[120]

In 2006 Smith pointed out the difficulty with his 1997 assertion that an action in unjust enrichment could be supported by a retroactive election:

> [T]he enrichment occurs later, by the claimant's elective choice; but this in turn arguably extinguishes the injustice. How can the claimant simultaneously relinquish his title, and make a claim that the defendant has been unjustly enriched by the acquisition of that title?[121]

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[118] Ibid 382, fn 15.
[119] *Marsh v Keating* (1834) 2 Cl & Fin 250, 6 ER 1149, 285.
[120] Ibid.
[121] L. Smith, 'Tracing', ch. 7 in A.Burrows, A. Rodger (eds), *Mapping the Law: Essays in Memory of Peter Birks* (OUP 2006) 121.

In short, a claimant cannot very well maintain that a defendant has been enriched unjustly by acquisition of title transferred at his own election.

There is, in fact, an explanation for *Marsh v Keating* that is far simpler. We have seen that ratification provides no explanation for a claim in respect of a right acquired by a fiduciary who does not purport to transact on his principal's behalf. However, since Fauntleroy *did* purport to act on Mrs Keating's behalf, it was straightforwardly possible for Mrs Keating to ratify the transaction and claim the proceeds of it.[122] The case thus provides no support for the conclusion that a claimant is generally entitled to claim a substitute right by abandoning his claim to the right substituted.

**C. Scope of Liability**

We saw in Chapter Two that *Re Hallett's Estate* is thought to decide not just that a principal acquires a proprietary claim to a substitute right, but also that if any sums have been withdrawn from the account, the fiduciary suffers that loss in the first instance.[123] By contrast, in *Re Oatway* it was held that if the fiduciary makes a profitable investment with such an account, the principal can 'cherry-pick' – choosing either to assert a claim to the investment or the original account.[124] These decisions are usually presented as an addition to the mechanics of tracing, designed simply to resolve evidential difficulties by analogical application of the rules for dealing with physical mixtures of homogenous things. From the idea that we follow the path of value emerges the idea that we can locate it at the end of the story, and the 'rules of tracing' are thought to assist a claimant in doing that where the value of an account

[122] *Wilson v Tunman and Fretson* (1843) 6 M & G 236 242; *Bird v Brown* (1850) 4 Exch 786, 154 ER 1433 798; *Firth v Staines* [1897] 2 QB 70.
[123] *Re Hallett's Estate* (1880) 13 Ch D 696.
[124] *Re Oatway* [1903] 2 Ch 356.

has been constituted by several different sources – a so-called 'mixed fund'. In Birks' words:

> [T]he proof of a substitution or a chain of substitutions almost invariably encounters difficulties with which ordinary proof by evidence cannot cope. When money has been paid into an account (a substitution of money for a chose in action) it is usually not possible to show by evidence exactly when those particular units of value were withdrawn (a second substitution, inverting the first)…. The rules of tracing turn out on examination to be rules for breaking that kind of evidential impasse.[125]

The difficulty with this account of the decisions in *Re Hallett's Estate* and *Re Oatway* has already been explained: bank accounts are not pools of homogenous assets or 'units of value', but indivisible debts. The rules of tracing cannot be designed to enable us to fill gaps in the available evidence, because there are no gaps to fill: the effect of payment into an account is to replace one debt with another. So, the rules must be premised upon normative decisions about the scope of liability. Until now, the mixing metaphor has prevented any serious discussion about the conceptual foundation of the decisions in the cases that apply them. The question here is whether that foundation can be found in the logic of unjust enrichment.

> **Example 4.3:** F holds an account on trust for P. Its value is £100. F's personal current account stands at £100. F transfers £50 from the trust account into his personal account, without P's permission. F then withdraws £50, using it to purchase a painting, which turns out to be worth £2 million.

The effect of the first transfer is to replace the trust right with a right to £50, and F's own right with a right to £150. The new right is acquired at P's expense to the extent that its acquisition is referable to a loss suffered by P. So, if there is any claim to the account arising from unjust enrichment, it is – like the purchasers' claim in *Foskett v*

[125] Birks, 'On Taking Seriously the Difference between Tracing and Claiming' (1997) 11 TLI 2.

*McKeown* – a claim to a proportionate interest: F's right to £150 is held on trust for both P and F in the ratio 1:2.

When F subsequently withdraws £50, the right to £150 is replaced by: (i) a new right to £100; and (ii) title to the painting. Application of the same logic leads to the conclusion that the right to £100 and title to the painting are both held in the same ratio. If there is a basis for concluding, as *Re Oatway* dictates, that title to the painting is held on trust for P alone, it is not unjust enrichment. And if instead of investing the sum withdrawn in the purchase of a painting, F spends it on ice-cream, unjust enrichment dictates the conclusion that the right to £100 is held on trust in the ratio 1:2. It does not explain the result, dictated by the conclusion in *Re Hallett's Estate*, that the right to £100 is held on trust for P alone.

So, for so long as the principal's interest continues to exist in respect of the substituted right, he has suffered no loss sufficient to justify a claim to the new right in his fiduciary's hands. His subsequent choice to abandon his interest and assert a claim to that right cannot be explained on the basis of unjust enrichment, because it is not unjust. And the logic of unjust enrichment does not explain the effect of the decisions in *Re Hallett's Estate* and *Re Oatway*, that unauthorised dealings with an account held on trust both place the risk of loss upon the trustee and enable the beneficiary to claim any profit.

## VII. Wrongdoing

We might interpret Lord Ellenborough's statement that 'an abuse of trust can confer no rights on the party abusing it' in one of two different ways:[126] (i) the abuse of trust itself provides the reason for which the agent is accountable *in specie* for the new

[126] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721, 725-726.

right; or (ii) there is some other reason for liability, and the abuse of trust cannot be set up as a countervailing reason *against* liability. Each of these interpretations is considered in what follows.

It must be emphasised at the outset that if a wrongdoing fiduciary is liable *in specie* for a substitute right it must be because there is something special about the fiduciary relationship: nowhere else in private law is a defendant held specifically accountable for a right in respect of which there is no agreement between the parties. In fact, we will see, the root of the "fiduciary" is precisely the idea that there are some relationships that are peculiarly deserving of protection.

### A. Keech v Sandford

The history of the Chancellorship is a murky one. Francis Bacon was forced out of office in 1621, in part for accepting substantial bribes.[127] The next big scandal occurred almost exactly a century later. The establishment of the Bank of England in 1696 not only caused an explosion in the practice of deposit banking, but also allowed far quicker and far greater investment. The temptation to speculate with court funds in shares of the rapidly growing South Sea Company proved too great for Chancery masters under Lord Macclesfied. In Getzler's words:

> By the early 1700s, the Court of Chancery was acting as an investment conduit, a kind of semi-official fidelity fund and pension broker, channelling trust estates and fortunes into the informally approved funds of the new Bank of England and the other "monied" companies such as the East India Company.[128]

When the South Sea Bubble burst in 1720, Chancery's losses were catastrophic. In the spring of 1725, Lord Chancellor Macclesfield was accused of

[127] Joshua Getzler, 'An Interdiscplinary View of Fiduciary Law: "As If" Accountability and Counterfactual Trust' (2011) 91 Boston University Law Review 973, 982
[128] Ibid 982.

corruption, including allegations of abuse of trust, encouragement of risky investment with court funds by his subordinates, and orchestration of a cover-up when such investment led to embezzlement.[129]

The case for Macclesfield's impeachment was brought before the House of Lords, with King CJ presiding. The arguments focused upon the exploitative nature of Macclesfield's activities: the funds of widows, children and lunatics were held on trust by Chancery for the purposes of protecting those individuals. The fact that that protection had been manipulated into exploitation aggravated the offences in a manner that sparked moral outrage:

> He, who was the great guardian of infants and lunatics, will be found to have suffered an advantage to be taken of the weakness of the one, and the misery of the other, to render their helpless condition a means of their ruin, instead of their protection.[130]

The trial ended on 27th May 1725 with a unanimous vote: Macclesfield was guilty of 'taking from several of the Masters in Chancery very great and exorbitant Sums of Money, for their Admission into their respective Offices'[131] and allowing men to buy positions using suitors' assets held by their predecessors in office.[132] Macclesfield had become 'an emblem for greed, gambling and deceit',[133] and the

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[129] J. Rudolph, *Common Law and Enlightenment in England, 1689-1750 (Studies in Early Modern Cultural, Political and Social History)* (Boydell Press 2013) 203.
[130] T. B. Howell (ed) *A Complete Collection of State Trials and Proceedings for High Treason and other Crimes and Misdemeanors from the Earliest Period to the Year 1783*, vol XVI (London 1816) 818.
[131] T. Salmon (ed) *A New Abridgment and Critical Review of the State Trials* (Dublin 1737) 874.
[132] Rudolph, *Common Law and Enlightenment in England, 1689-1750 (Studies in Early Modern Cultural, Political and Social History)* (Boydell Press 2013) 204. The speech to the House of Commons following impeachment spared no drama: 'Gentlemen, you have maintained the Charge of the Commons, with that Force of Argument, Beauty of Expression and Strength of Reason, as would have gained you the highest Applause in the most flourishing of the Grecian Commonwealths… You have stopp'd the Cries of Orphans, and dried up the Tears of the Widow; even those who must ever be insensible of the Benefits they receive.'[132]
[133] Ibid 205.

justice system itself came under fire: the critique of Macclesfield was a critique of Equity, and of Chancery's authority.[134]

Lord King was active in the eighteenth century movement for moral reform. Getzler describes how, 'As a member of Parliament, King had long criticized tory and Crown officials for their corruption and incompetence in service to the public'.[135] When Macclesfield was impeached, King was the obvious candidate to restore confidence in Chancery. Under his leadership, the Bank of England became the custodian of suitors' money, and the processes for record-keeping were overhauled to ensure better transparency. King's influence was not only bureaucratic, and the decision for which he is most celebrated is one that, given the series of events, seems almost inevitable. In 1726, shortly after his appointment, King decided that the office of a trustee is one that permits no profit or conflict of interest.[136]

In *Keech v Sandford*, labelled contemporarily the 'Rumford Markets case', a trustee was granted a lease to hold on trust for an infant. When the trustee asked for a renewal of the term for the beneficiary, the lessor refused, apparently on the basis that the infant could not protect the lease sufficiently at law.[137] The trustee renewed the lease for himself. Lord King ordered him to assign the lease to the infant, considering him an immediate trustee of it, and also ordered him to account for all profits. He said:

> [T]hough I do not say there is a fraud in this case, yet he should rather have let run out, than to have had the lease to himself. This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the

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[134] Ibid 207-208.
[135] Getzler, 'An Interdiscplinary View of Fiduciary Law: "As If" Accountability and Counterfactual Trust' (2011) 91 Boston University Law Review 973, 983.
[136] Ibid.
[137] J. Getzler, 'Rumford Markets and the Genesis of Fiduciary Obligations' in A. Burrows and A. Roger (eds), *Mapping the Law: Essays in Memory of Peter Birks* (Oxford: OUP 2006).

consequence of letting trustees have the lease, on refusal to *cestui que use*.[138]

The decision in *Keech* was – and still is – striking. Lord King did not order that the lease be set aside, even though he explicitly said that the trustee ought never to have obtained it. Rather, he held that the lease ought to be conveyed to the infant, together with profits.[139]

**B. Development of the Fiduciary**

*Keech v Sandford* does not seem to have been considered particularly significant at the time that it was decided.[140] Getzler points to the Chancery case of *Rakestraw v Brewer*, in which Jekyll MR (and on appeal Lord King himself) did not cite *Keech*, but rather spoke generally of protecting the mortgagor's title from the mortgagee's attempt to take advantage by 'worming out and oppressing a poor mortgagor'.[141]

However, not five years later the Kings Bench nullified a conveyance, citing *Keech* for the rule that: 'the Court will never allow trustees to purchase an estate which they are intrusted with; if trustees do make such purchase, the Court will set it aside'.[142] *Keech* was applied as a 'strong case' in the issue of a life tenant renewing,[143] and in 1787 it was described as 'the first and most notorious case' on that subject.[144]

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[138] *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223, 62.
[139] Edelman and Swadling have both accused Lord King of employing a fiction to arrive at that result. Swadling, 'Constructive Trusts and Breach of Fiduciary Duty' 18 Trusts & Trustees 999, discussing a 1993 paper of Sir Peter Millett: Peter Millett, 'Bribes and Secret Commissions' (1993) 7 RLR; James Edelman, 'Two Fundamental Questions for the Law of Trusts' (2013) 129 LQR 66. In Edelman's words: 'The argument requires the fiduciary to be treated "as if" he had behaved legitimately…The words "as if", are the hallmarks of fictitious reasoning:' ibid 82. This accusation presupposes that the remedy has something to do either with authority or intention. It is, in fact, far more basic than that: Lord King simply decided that a principal can claim any gains the fiduciary acquires in the course of his duty.
[140] Getzler, 'Rumford Markets and the Genesis of Fiduciary Obligations' in Burrows and Roger (eds), *Mapping the Law: Essays in Memory of Peter Birks* (Oxford: OUP 2006).
[141] *Rakestraw v Brewer* (1728) 2 P Wms 511, 24 ER 839.
[142] *Mansel v Mansel* (1732) 2 Barn KB 187, 94 ER 438.
[143] *Owen v Williams* (1773) Ambler 734; 27 ER 474.
[144] *Stone v Theed* (1787) 2 Brown CC 243, 29 ER 135 .

In *Whelpdale v Cookson* Lord Hardwicke struck down a trustee's purchase of land that had been settled in trust for the payment of debts. His Lordship held that a trustee was not permitted, in any case, to derive a benefit from the purchase of trust property. It was not necessary to show that the fiduciary had taken advantage of the beneficiary, because, said the judge: 'I know the dangerous consequence, nor is it enough for the trustee to say, you cannot prove any fraud, as it is in his own power to conceal it'.[145] That case paved the way for a broader account of the emerging fiduciary doctrine, which would unify the office of agent, trustee, guardian and 'all who are a-kin to a trust by any connection of character or office'.[146]

In *York Building Co v MacKenzie* the appellants sought to set aside a compulsory sale of several of their estates by the Court of Session.[147] Three arguments were made for the appellants: (i) the respondent was disabled by law from purchasing the estates, being the common agent who conducted the proceedings; (ii) he had acted fraudulently in concealing the value of the estate, or not promulgating its advantages; and (iii) the respondent was guilty of a breach of duty as common agent, in not moving for a delay or adjournment, which would or might have given time for other bidders to appear.

The court held that, 'The sale in question was ipso jure void and null, because the respondent, from his office of common agent, was under a disability and incapacity, which precluded him from being the purchaser'.[148] The judgment presents a clear and full account of the new prophylaxis:

> This conflict of interest is the rock, for shunning which, the disability under consideration has obtained its force by making that person, who has the one part entrusted to him, incapable of acting on the other side,

[145] *Whelpdale v Cookson* 27 ER 856; (1747) 1 Ves Sen 9.
[146] *York Buildings Co v MacKenzie* (1795) 7 Bro PC 42, 3 ER 432, 67.
[147] Ibid.
[148] Ibid 63-64.

> that he may not be seduced by temptation and opportunity from the duty of his trust. And the true principle of the thing, rightly understood, necessarily concludes the respondent's case to fall within the rule of disability which Lord King and Lord Hardwicke hold up as never at all to be relaxed or departed from in any case to the nature and circumstances of which the rule applies. It is upon the same principle that the general doctrine of the law of Scotland stands with regard to all the acts of tutors and guardians, factors, trustees, and all who are a-kin to a trust by any connection of character or office.[149]

Still the term 'fiduciary' is not yet coined, but a stronger statement of fiduciary principles could hardly be imagined: to ensure that a fiduciary's own economic ends do not come into conflict with those of his principal, he will not be permitted to benefit from his position, irrespective of whether that benefit is made, in the particular instance, at his principal's expense. Thus, the principal can set aside a conveyance from him to his fiduciary, and can claim any right acquired by the fiduciary from a third party in the course of the fiduciary's office.

In *Ex parte James*, Lord Eldon cited both Chancellor King's judgment in *Keech* and Lord Hardwicke's judgment in *Whelpdale v Cookson* for the principle that

> This doctrine as to purchases by trustees, assignees, and persons having a confidential character, stands much more upon general principle than upon the circumstances of any individual case. It rests upon this; that the purchase is not permitted in any case, however honest the circumstances; the general interests of justice requiring it to be destroyed in every instance; as no Court is equal to the examination and ascertainment of the truth in much the greater number of cases.[150]

Thus, 'an assignee under a Commission of Bankruptcy cannot buy the property sold under it, unless he shakes off the character altogether'.[151]

In short, the emerging claims – rescission and profit-stripping – were designed to secure the absolute loyalty of the fiduciary to his principal by removing any possibility of economic advantage.

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[149] Ibid 63-67.
[150] *James, Ex parte* (1803) 8 Ves 337, 32 ER 385 345.
[151] Ibid

### C. Fiduciary Liability in the Twenty-First Century

These restrictions upon the ability of a fiduciary to act self-interestedly are now at the conceptual heart of the offices to which they apply. In Smith's words:

> [I]f we think of a person who held the legal powers that go with any of the traditional fiduciary categories—a trustee, an agent, a partner—and we imagine that that person was free to use those powers exactly as they wished, in their own interests, then it would be impossible to say that they were a fiduciary.[152]

Somewhere along the way, however, two elements of fiduciary discourse have changed. First, *Keech* and the authorities that followed it have come to be thought of as introducing duties of 'no-profit' or 'no-conflict',[153] even that they are duties that support another overarching duty of loyalty.[154] In *Bristol & West Building Society v Mothew* Millett LJ said:

> The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single- minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal.[155]

The problem with such an account of *Keech* is that the result makes no sense as a response to an obligation not to do something. Remedies for wrongs typically return parties to the positions in which they were prior to the wrongful event.[156] Before the trustee in *Keech* acquired the lease neither the beneficiary nor the trustee had it. Putting the parties in the positions in which they were prior to acquisition of

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[152] Lionel Smith, 'Fiduciary relationships: ensuring the loyal exercise of judgement on behalf of another' (2014) 130 LQR 608, 609.
[153] Matthew Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Reprinted edn, Hart 2011).
[154] *Bristol and West Building Society v Mothew* [1998] Ch 1, 18.
[155] Ibid, 18.
[156] *East v Maurer* [1991] 1 WLR 461.

the lease would have involved setting aside the contract, not assigning it to the beneficiary. In Worthington's words, 'any disloyal gains must be disgorged because the fiduciary must not have them, even though there is often no particular further and additional reason why the principal must have them'.[157] Again, *Keech* is a strong case because it decided, not that the lease should be set aside, but that it had to be conveyed to the beneficiary.

It should be clear from the discussion above of *Keech* and the cases that followed it that loyalty was never originally considered to be a positive concept in emerging fiduciary law. Rather, it was the absence of selfish economic acting, which the law secured straightforwardly by making it impossible for the fiduciary to act selfishly: a fiduciary *could not* come into financial conflict with his principal's interests, because any gain he acquired in the course of his position had to be given up immediately, and any transaction that he carried out with his principal could be struck down. 'No conflict' and 'no profit' do not describe two different but overlapping duties, but two distinct types of claim: (i) if he is party to it and does not give his free and full consent, the principal can set the transaction aside; and (ii) the principal can assert a claim in respect of a profit acquired by the fiduciary.

Second, the rule laid down in *Keech* has come to be thought of as connected to loss suffered by the principal. In *Sinclair v Versailles* Mr Cushnie, the director of Trading Partners Ltd ("TPL"), solicited investments in his capacity as director that were passed on to a trading subsidiary of a company of which Mr Cushnie was primary shareholder – Versailles Group pld ("VGL") – in order to inflate its share value artificially.[158] Mr Cushnie sold shares in VGL and used some of the profit to

[157] Sarah Worthington, 'Fiduciary duties and proprietary remedies: addressing the failure of equitable formulae' (2013) 72 CLJ 720, 731.
[158] *Sinclair v Versailles* [2011] EWCA Civ 347, [2012] Ch 453.

purchase a flat. An action for an account of profits was brought by TPL, through its assignee, against Mr Cushnie. The principal question at first instance and on appeal was whether Mr Cushnie held the profit made from sale of those shares on trust. Citing several academic works on restitution of unjust enrichment,[159] Lord Neuberger considered that a proprietary claim was justified only where 'the asset or money is or has been beneficially the property of the beneficiary or the trustee acquired the asset or money by taking advantage of an opportunity or right which was properly that of the beneficiary'.[160]

This principle has caused a great deal of confusion. Although it was applied by the Court of Appeal in *FHR v Mankarious,*[161] each of their Lordships held that the opportunity or right diverted from the beneficiary need not actually be capable of being owned or held on trust.[162] Nor, of course, need it amount to a right or opportunity that the beneficiary or principal could or would have taken advantage of.[163] It is very difficult to see how you can divert a right or opportunity away from someone who never owned it and could never have exercised it.

The better view is that whether or not the principal suffers any loss is altogether beside the point. In Lord Russell's words in *Regal Hastings v Gulliver*:

> The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no

[159] Birks, *An Introduction to the Law of Restitution* (OUP 1985); R. M. Goode, 'Ownership and Obligation in Commercial Transactions' (1987) 103 LQR 433; Roy Goode, 'Proprietary Restitutionary Claims' in William Cornish (ed), *Restitution- Past, Present and Future: Essays in Honour of Gareth Jones* (Hart Publishing 1998); Virgo, *The Principles of the Law of Restitution* (2nd edn, OUP 2012); Burrows, *The Law of Restitution* (3rd edn, OUP 2011); A. Tettenborn, *The Law of Restitution in England and Ireland* (3rd edn, Cavendish 2001); Peter Watts, 'Bribes and Constructive Trusts' (1994) 110 LQR 178; D. Crilley, 'A Case of Proprietary Overkill' [1994] RLR 57; G. McCormack, 'The Remedial Constructive Trust and Commercial Transactions' (1996) 17 Co Law 3.
[160] *Sinclair v Versailles* [2011] EWCA Civ 347, [2012] Ch 453 [88].
[161] *FHR European Ventures LLP v Mankarious* [2013] EWCA Civ 17, [2013] 3 All ER 29.
[162] Ibid [57] (Lewison LJ); [84]-[85] (Pill LJ); [84] (Etherton LJ). See further *Bhullar v Bhullar* [2003] EWCA Civ 424.
[163] *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223; *Boardman v Phipps* [1967] 2 AC 46, [1966] 3 WLR 1009.

> way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action ...The liability arises from the mere fact of a profit having, in the stated circumstances, been made.[164]

Some clarity has been restored by the Supreme Court in *FHR v Cedar Capital Partners*.[165] That case concerned the sale of Monte Carlo Grand Hotel to the claimants, an investor group. The claimants were advised by Cedar, who received a substantial commission from the sellers, Monte Carlo Grand Hotel Ltd. Holding that the claimant's claim to the commission was in the nature of a trust, Lord Neuberger explained the rule in *Keech* as follows:

> [A]t least in some cases where an agent acquires a benefit which came to his notice as a result of his fiduciary position, or pursuant to an opportunity which results from his fiduciary position, the equitable rule ("the Rule") is that he is to be treated as having acquired the benefit on behalf of his principal, so that it is beneficially owned by the principal. In such cases, the principal has a proprietary remedy in addition to his personal remedy against the agent, and the principal can elect between the two remedies.[166]

Importantly, his Lordship said, this rule has nothing to do with either the fiduciary's state of mind, or any breach of duty: 'The principal is…entitled to the entire benefit of the agent's acts in the course of his agency. This principle is wholly unaffected by the fact that the agent may have exceeded his authority'.[167]

In a note on the Court of Appeal's decision in that case Smith explains: 'The rule is not activated by wrongdoing (although wrongdoing there may be); it is a direct implication of the fact that a fiduciary acts, within a sphere of activity, for and on

[164] *Regal (Hastings) Ltd v Gulliver* [1942] 2 AC 134, 144-5 (Lord Russell).
[165] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535.
[166] Ibid [7].
[167] Ibid [33].

behalf of the principal'.[168] Neither, he explains, does it have anything to do with loss. It is enough that the fiduciary has accepted a role that requires him to act only in the interests of his principal in a particular area of activity. The implication of this is that 'whatever may be extracted from that sphere of activity is attributed, as between the fiduciary and the beneficiary, as a matter of primary right, to the beneficiary'.[169]

This, it is submitted, is the best explanation for the result in *Taylor v Plumer*: Walsh, who acquired the substitute rights by doing the very thing that he had been employed to do, was immediately accountable for the rights he acquired because of a century-old principle preventing him from acquiring them in any other capacity than as trustee. And the best interpretation of Lord Ellenborough's statement that 'an abuse of trust can confer no rights on the party abusing it' is that a fiduciary cannot set up his intention to defraud the trust as a reason for disapplication of that principle. Writing extra-judicially Lord Millett explains that, where a beneficiary asserts a claim in respect of an investment acquired by the trustee using trust property:

> The beneficiaries do not thereby ratify or authorise the trustee's conduct. They simply require the trustee to account for all his dealings with the trust property whether authorised or not; and then decide whether to falsify the account by disallowing the disposal of the trust investments (in which case the trustee must restore them or their value to the trust) or to let the account stand, in which case the new shares are treated as if they were an authorised investment made for the beneficiaries account. The trustee cannot resist the claim by saying: "You have got it wrong. I acted in breach of trust. I stole the trust property and used it to buy shares for myself."[170]

In Smith's words:

> If an asset held in trust has been used to purchase another asset, one can deploy the logic that the trustee is not in a position to say that he acted otherwise than as a trustee in so using it. This logic is sufficient

[168] Lionel Smith, 'Constructive Trusts and the No-Profit Rule' (2013) 72 CLJ 260, 261-262.
[169] Ibid.
[170] Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005) 315.

> to create a bilateral obligation in relation to the proceeds, and that obligation makes a trust.[171]

Thus, the proof of a transaction connecting the trust asset with the new asset was relevant in *Taylor v Plumer*, not because it established that Plumer had suffered a loss, but because it demonstrated that Walsh was acting within the scope of his role as fiduciary in executing the sale. And Walsh could not resist Plumer's claim by setting up his intention to defraud the trust.

> **Example 4.1:** T, who holds title to a £10 note on trust for B, buys with it a bottle of wine without B's authority.

To return to our example, B's claim to T's title to the wine arises because, in dealing with the trust assets T is performing the role that he was appointed to perform. The right that he acquires is thus within the sphere of fiduciary endeavour and caught by the rule in *Keech v Sandford*.

## VIII. Conclusion

If a fiduciary acquires a right within the scope of his fiduciary endeavour he is accountable *in specie* for it to his principal irrespective of his authority to act. This is not because the principal has suffered any loss, but because the fiduciary has accepted a role that requires him to prioritise the interests of his principal within a particular sphere of activity. If the fiduciary is a trustee, the proof of a transactional link between some right originally held on trust for the beneficiary and a new right acquired by the trustee goes, not to establishing that the beneficiary has suffered a loss, but to establishing that the right was acquired by the trustee within the scope of

[171] Smith, 'Philosophical Foundations of Proprietary Remedies' in Chambers, Mitchell and Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009) 304.

his fiduciary endeavour. This has nothing to do with value, tracing or unjust enrichment.

# Chapter Five: The Scope of Fiduciary Accountability

## I. Introduction

Five 'rules of tracing' are generally thought to shape a trustee's proprietary accountability for unauthorised gains: (i) the claims of innocent parties to an account into which trust funds have been paid without authority decline *pari passu*,[1] but (ii) if a trustee withdraws funds without authority from an account held on trust for both beneficiary and trustee, the trustee's claim is reduced in the first instance;[2] (iii) if the trustee makes some unauthorised purchase with an account into which trust funds have been paid without authority, the beneficiary can claim it, asserting that the trustee used 'the beneficiary's funds' to make the purchase;[3] (iv) the maximum sum that the beneficiary can claim is whatever is the lowest balance of the trust account between the date at which his claim arose and the date of judgment;[4] and (v) where the trust account has not suffered any loss, the trustee is entitled to redeem from it the amount of his own contribution (if any) to it.[5]

We have already seen that bank accounts are unitary debts, not pools of homogenous assets, and that these results cannot be explained simply as presumptions or rules that fill gaps in the available evidence. It is argued here they ought to be understood as follows: (i) a fiduciary is liable for any right that he acquires by exploiting an opportunity acquired within the scope of the fiduciary endeavour; and (ii) if the principal elects to take the right as part of the account the fiduciary is

[1] *Sinclair v Brougham* [1914] AC 398; *Re Diplock* [1948] Ch 465; *Barlow Clowes International Ltd v Vaughan* [1992] 4 All ER 22.
[2] *Re Hallett's Estate* (1880) 13 Ch D 696.
[3] *Re Oatway* [1903] 2 Ch 356.
[4] *James Roscoe (Bolton) Ltd v Winder* [1915] 1 Ch 62.
[5] *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551.

entitled to be indemnified for any loss that he suffers as a result, to the extent that exceeds any compensation owing by the fiduciary to the principal. This leaves no room for the so-called 'lowest intermediate balance' rule which, it is argued, has no foundation in logic or authority.

## II. The Scope of Fiduciary Accountability

The scope of the fiduciary's obligation to account is an area of continuing academic and judicial controversy, compounded by recent confirmation that the acquisition of an unauthorised commission can subject the fiduciary to the kind of obligation that takes priority over other creditors.[6] We saw in Chapter Four that the proprietary claim that arises in respect of rights acquired by fiduciaries does so, not because of any reason of principle or policy, but because of Equity's peculiar treatment of obligations to transfer rights. The question that will be considered in what follows is thus: when can a principal claim a right acquired by his fiduciary? That question will be answered by reference to two examples, and it will be argued that only the first gives rise to such a claim:

> **Example 5.1:** F is a director of P Co, which provides financial advice for its clients. The company is engaged to find a purchaser for a plot of land. F decides to invest in the plot on his own behalf.[7]
>
> **Example 5.2:** F is a director of P Co, which is a property development company. On his way to work he spots a sign that advertises a plot of land with planning permission for sale. F decides not to tell the company about it, and invests on his own behalf.[8]

### A. Causation and the Scope of Fiduciary Accountability

[6] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535.
[7] This example is based on the facts of *O'Donnell v Shanahan* [2008] EWHC 1973 , considered below.
[8] This example is based on the facts of *Bhullar v Bhullar* [2003] EWCA Civ 424, also considered below.

The cases that most obviously engage the rule in *Keech* are those in which a fiduciary derives a profit directly from the task that they were appointed to carry out. So, trustees dealing with trust assets,[9] directors dealing with company assets,[10] and agents acquiring commissions from purchasers that they were appointed to find,[11] have all been held accountable *in specie* for rights acquired whilst so doing. And in determining the scope of the fiduciary endeavour, the court will have regard not only to the agreement between the parties, but also to the tasks the fiduciary in fact carries out.[12]

We have already seen that the presence of a transactional link between some right originally held on trust for the claimant and a new right acquired by the trustee goes to establishing that the trustee was acting within the scope of his fiduciary endeavour. Insofar as we are concerned with the application of *Keech* there is, therefore, no difference between a trustee who deals with trust assets and a trustee who makes a profit by performance of some other aspect of his role. In *Sugden v Crossland* a trustee retired from his office in return for a payment of £75. John Stuart VC ordered that the sum be repaid and dealt with as part of the trust assets. He said:

> It is a well-settled principle that, if a trustee make a profit of his trusteeship, it shall enure to the benefit of his cestui que trusts…. [T]here does not seem to be any difference in principle whether the trustee derived the profit by means of the trust property, or from the office itself.[13]

[9] *Re Hallett's Estate* (1880) 13 Ch D 696.
[10] *Regal (Hastings) Ltd v Gulliver* [1942] 2 AC 134.
[11] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535.
[12] *Birtchnell v Equity Trustees, Executors and Agency Co. Ltd* (1929) 42 CLR 384, 408: 'The subject matter over which the fiduciary obligations extend is determined by the character of the venture or undertaking for which the partnership exists, and this is to be ascertained, not merely from the express agreement of the parties…but also from the course of dealing actually pursued by the firm' (Dixon J).
[13] *Sugden v Crossland* 65 ER 620; (1856) 3 Sm & G 192.

The best-known judicial discussion of the scope of fiduciary accountability is that of Viscount Sankey in *Regal Hastings Ltd v Gulliver*.[14] That case concerned an action brought by Regal against its former directors to recover some £7,000, being profits made by them upon the acquisition and sale by them of shares in a subsidiary company formed by Regal, known as Hastings Amalgamated Cinemas Ltd. Lord Russell considered that 'having obtained these shares by reason and only by reason of the fact that they were directors of Regal and in the course of the execution of that office', the directors were accountable for those profits.[15]

Worthington interprets Lord Russell's words as having the tenor of a causal test, which she rejects.[16] But this is to read only the first half of his sentence. Read as a whole the statement is entirely consistent with the view that if a fiduciary in fact makes a profit from the performance of some aspect of their fiduciary task, principles of causation are irrelevant. In *United Pan-Europe Communications NV v Deutsche Bank AG* Morritt LJ said:

> If there is a fiduciary duty of loyalty and if the conduct complained of falls within the scope of that fiduciary duty… then I see no justification for any further requirement that the profit shall have been obtained by the fiduciary by virtue of his position. Such a condition suggests an element of causation which neither principle nor the authorities require.[17]

In *Novoship (UK) Ltd v Mikhaylyuk* Longmore LJ similarly considered that 'A fiduciary's liability to account for a secret profit does not depend on any notion of causation. It is sufficient that the profit falls within the scope of his duty of loyalty to the beneficiary'.[18]

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[14] *Regal (Hastings) Ltd v Gulliver* [1942] 2 AC 134.
[15] Ibid, 149.
[16] Worthington, 'Fiduciary duties and proprietary remedies: addressing the failure of equitable formulae' (2013) 72 CLJ 720, 733.
[17] *United Pan-Europe Communications NV v Deutsche Bank AG* [2002] 2 BCLC 461.
[18] *Novoship (UK) Ltd v Mikhaylyuk* [2014] EWCA Civ 908 [96].

However, we also know that the rule is not only engaged by the direct acquisition of a profit from the activity that the fiduciary was appointed to perform, but also by the use of an opportunity that arises within the sphere of fiduciary endeavour. In *Boardman v Phipps*, a beneficiary under a will trust claimed an account of profits made as a result of purchasing shares in a company in which the trust had a substantial holding.[19] The defendant purchasers were a solicitor to the trustees of the will and a beneficiary of it. Together they made a successful bid for a controlling share of the company, making use of the information which they had received in their capacity as representatives of the trustees. A majority of the House of Lords held that the defendants were constructive trustees of the shares, and had to account for the profits made from them.

The best view is thus that a fiduciary is accountable for any profit made by exploiting an opportunity that arises from performance of the fiduciary task – whether that opportunity is the direct acquisition of money,[20] or the opportunity to invest –[21] but is not accountable for a profit that, but for his fiduciary position, he would not have made. There is, therefore, a distinction between **Example 5.1** and **Example 5.2**:

> **Example 5.1:** F is a director of P Co, which provides financial advice for its clients. The company is engaged to find a purchaser for a plot of land. F decides to invest in the plot on his own behalf.
>
> **Example 5.2:** F is a director of P Co, which is a property development company. On his way to work he spots a sign that advertises a plot of land with planning permission for sale. F decides not to tell the company about it, and invests on his own behalf.

In **Example 5.1** the opportunity to invest arises within the sphere of F's fiduciary endeavour. In **Example 5.2**, whilst F discovers the opportunity only because of his

[19] *Boardman v Phipps* [1967] 2 AC 46, [1966] 3 WLR 1009.
[20] E.g. *Attorney General of Hong Kong v Reid* [1994] 1 AC 324; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535.
[21] E.g. *Boardman v Phipps* [1967] 2 AC 46, [1966] 3 WLR 1009; *O'Donnell v Shanahan* [2008] EWHC 1973 .

fiduciary role, he does not do so through the performance of any aspect of that role. P Co can therefore assert a claim to the property in **Example 5.1**, but cannot do so in **Example 5.2**.

### B. Conflicts and Partnership

There have been some suggestions that the presence of a risk of conflict might render the fiduciary liable for a profit for which he would not otherwise have to account. In *Bhullar v Bhullar*, upon which **Example 5.2** is based, a director of a company acquired land situated adjacent to that belonging to the company.[22] Although the director did not discover the opportunity to purchase the land in his capacity as a director, but rather as a passer-by, Jonathan Parker LJ held that he was accountable for it on the basis that there was 'a real sensible possibility of conflict' between the director's personal interests and those of the company.[23]

By contrast, the absence of such a conflict is sometimes thought to take the activity outside the scope of the obligation to account. In *Aas v Benham*, Benham, one of the partners of a firm of stockbrokers, used information acquired whilst assisting in the formation of a joint-stock company to set up an independent company.[24] The court held that as the business of that new company did not compete with the partnership business, Benham was not accountable for the profits he had made from it. Lindley LJ said:

> [T]here is no principle or authority which entitles a firm to benefits derived by a partner from the use of information for purposes which are wholly without the scope of the firm's business…. Suppose a partner to become, in the course of carrying on his business, well acquainted with a particular branch of science or trade, and suppose him to write and publish a book on the subject, could the firm claim

[22] *Bhullar v Bhullar* [2003] EWCA Civ 424.
[23] Ibid [42].
[24] *Aas v Benham* [1891] 2 Ch 244.

> the profits thereby obtained? Obviously not, unless, by publishing the book, he in fact competed with the firm in their own line of business.[25]

The problem with placing actual or potential conflict at the heart of accountability is that it ignores a century and a half of authority concerning the scope of fiduciary liability. To repeat the words of Lord Eldon in *Ex parte James*:

> This doctrine as to purchases by trustees, assignees, and persons having a confidential character, stands much more upon general principle than upon the circumstances of any individual case. It rests upon this; that the purchase is not permitted in any case, however honest the circumstances; the general interests of justice requiring it to be destroyed in every instance; as no Court is equal to the examination and ascertainment of the truth in much the greater number of cases.[26]

The boundaries of fiduciary liability have not been shaped by the determination of actual conflict on the facts of the particular case, but by the general risk of selfish acting created by allowing fiduciaries to profit from their office.[27] In *Boardman v Phipps* Viscount Dilhorne emphasised that, since the active trustee had made clear his intention not to purchase the shares,[28] there was no risk of conflict, citing Lindley LJ's judgment in *Aas v Benham* in reaching his decision to allow the appeal. The majority, by contrast, held that the defendants were indeed accountable for their profit.

In fact, the ratio of *Aas v Benham* is not that the absence of any risk of conflict limits the scope of fiduciary accountability, but that the absence of any risk of conflict limits the scope of accountability of a *partner*.[29] Enshrined in section 30 of the Partnership Act 1980 is the rule that 'if a partner, without the consent of the other partners, carries on a business of the same nature as and competing with that of the firm, he must pay over to the firm all profits made by him in that business'. The rule

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[25] Ibid, 255-256.
[26] *James, Ex parte* (1803) 8 Ves 337, 32 ER 385, 345.
[27] See also *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223: 'it is very obvious what would be the consequence of letting trustees have the lease, on refusal to renew to cestui que use.'
[28] *Boardman v Phipps* [1967] 2 AC 46, [1966] 3 WLR 1009 [88].
[29] Ibid 108.

applicable to partners is thus that an individual partner cannot carry on for his own benefit an enterprise that is within the field in which the partnership operates. That is a principle peculiar to partnership law, and it cuts both ways: if, as in *Aas v Benham*, the partner makes use of information to carry on an enterprise that is outside that field, he is not accountable for the profits he makes from it.

In *O'Donnell v Shanahan*, upon which **Example 5.1** is based, a company had been engaged to find a purchaser for property.[30] When the purchaser identified by the directors decided to pull out, they decided to purchase the property themselves. It was argued on behalf of the directors that, since the company did not ordinarily engage in activities in the nature of estate agency, they were entitled to make the investment on their own behalf. Rimer LJ considered that:

> In my judgment, this was obviously a case in which, once that opportunity arose, the respondents could not properly make use of the information they had so obtained in deciding to take up the opportunity for their own benefit. That was because they had obtained the information in the course of acting as directors of the company, and the opportunity also came to them in such course.[31]

He continued:

> The point about *Aas v Benham* is that it concerned the fiduciary duties owed by a partner whose duties were circumscribed by the contract of partnership. The extent of Mr Benham's fiduciary duties was determined by the nature of the partnership business, which was expressly limited by the terms of the partnership agreement. The consequence was that if he used partnership information for any purpose that fell within the scope of the partnership business, he was required by the fiduciary obligations to which the contract subjected him to account to the firm for any profits so made; but his fiduciary obligations did not require him similarly to account to the firm for any profits made by the use of such information for a purpose that was beyond the scope of the business of the partnership…. By contrast with Mr Benham's position, directors of companies occupy what Lord

[30] *O'Donnell v Shanahan* [2008] EWHC 1973 .
[31] Ibid 54.

> Hodson in *Boardman v Phipps* called a 'general trusteeship or fiduciary position'.[32]

Since there was no sense in which the scope of the company's business could be regarded as having been circumscribed by its constitution,[33] the argument that the directors were entitled to exploit on their own behalf an opportunity that was not within the ordinary interests of the company was bound to fail.

So, unless there is an independent reason for holding that the director in *Bhullar v Bhullar* was unable to pursue opportunities on his own behalf,[34] that decision ought to be regarded as incorrectly decided. A fiduciary is not generally accountable for a profit acquired by exploiting an opportunity that comes to him in his personal capacity. By contrast, a partner is accountable for a profit acquired by exploiting an opportunity, whether or not it comes to him in his personal capacity, if exploiting that opportunity involves an activity that falls within section 30 of the Partnership Act 1890.

### C. 'Secondary Profits'

The term 'secondary profits' is a label that Worthington employs for 'profits generated from the successful investment of the initial disloyal fiduciary gains'.[35] Several cases have held that a proprietary claim to secondary profits can be founded upon the establishment of proprietary claim to the original profit, on the basis that the principal can trace from one right to the other. Indeed, these claims have formed the heart of explanations for liability in several cases, in which proprietary liability of

[32] Ibid [68]-[69].
[33] Ibid [69].
[34] It is, of course, possible to extend the sphere in which the fiduciary obligations operate by contract, so that if the director had agreed to act, like a partner, only on behalf of the company within a certain field of business, that might well have created a foundation for the operation of the rule.
[35] Worthington, 'Fiduciary duties and proprietary remedies: addressing the failure of equitable formulae' (2013) 72 CLJ 720, 729.

other fiduciaries is established by analogy with those in which a trustee deals with trust assets.[36] In what follows it will be argued that these cases fall within the rule that a fiduciary must account for any profit made by exploiting an opportunity that arises from performance of the fiduciary task.

In *Re Oatway*, considered in Chapter Two, Oatway was held liable for shares purchased using an account into which trust funds were paid on the basis that the shares represented the trust funds alone, despite the fact that Oatway's own contribution to the account exceeded the price of the shares.[37] Joyce J held that:

> Trust money may be followed into land or any other property in which it has been invested; and when a trustee has, in making any purchase or investment, applied trust money together with his own, the cestuis que trust are entitled to a charge on the property purchased for the amount of the trust money laid out in the purchase or investment…The investment by Oatway, in his own name, of the £2137 in Oceana shares no more got rid of the claim or charge of the trust upon the money so invested, than would have been the case if he had drawn a cheque for £2137 and simply placed and retained the amount in a drawer without further disposing of the money in any way.[38]

One of the best known 'secondary profit' cases is *Attorney General of Hong Kong v Reid*.[39] That case involved one Charles Warwick Reid, who pled guilty to the charge of accepting bribes to obstruct the prosecution of various defendants whilst in office as Attorney General of Hong Kong. He was sentenced at the High Court on 6 July 1990 to 8 years' imprisonment and ordered to give up some HK$12 million. Reid

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[36] This was at the heart of the assertion in *Sinclair v Versailles* [2011] EWCA Civ 347, [2012] Ch 453 that a fiduciary will only be subject to a proprietary liability if 'the asset or money is or has been beneficially the property of the beneficiary or the trustee acquired the asset or money by taking advantage of an opportunity or right which was properly that of the beneficiary.'

[37] *Re Oatway* [1903] 2 Ch 356.

[38] Ibid 359-361.

[39] He served 4 years and upon his arrival back to New Zealand, Reid was approached by an individual acting on behalf of the wife of an incarcerated businessman on trial in Hong Kong. According to Reid's subsequent account to the relevant witness, the individual offered Reid a substantial sum to sign an affidavit that would discredit the testimony of the Crown Counsel's principal witness. Reid accepted. No prosecution has resulted. Apparently, he now works as a lawyer: N. Fraser, 'Fury as corrupt ex-Hong Kong prosecutor Warwick Reid sets up new legal firm' South China Morning Post accessed 25th August 2014.

never paid that sum and the Attorney-General for Hong Kong lodged caveats in New Zealand against the titles to properties bought by Reid. He applied to the High Court of New Zealand to renew the caveats, but the judge refused, holding that the Crown had no equitable interest in the properties. The Court of Appeal of New Zealand dismissed the Attorney-General's appeal. On the Attorney-General's appeal to the Privy Council, it was held, applying *Keech* and departing from *Lister*, that Reid was indeed a trustee.

Lord Templeman clearly considered that the case before him involved tracing.[40] Despite citing Sir William Page Wood VC's statement in *Sugden v Crossland* that 'there does not seem to be any difference in principle whether the trustee derived the profit by means of the trust property, or from the office itself',[41] he held that it was significant that the original bribe was held on trust, and had been substituted for title to the properties:

> The authorities show that property acquired by a trustee innocently but in breach of trust and the property from time to time representing the same belong in equity to the cestui que trust and not to the trustee personally whether he is solvent or insolvent. Property acquired by a trustee as a result of a criminal breach of trust and the property from time to time representing the same must also belong in equity to his cestui que trust and not to the trustee whether he is solvent or insolvent.[42]

More recently, the Supreme Court in *FHR v Cedar Capital Partners* accepted FHR's argument that tracing might have been necessary in order to establish a link between the right acquired by the fiduciary and some other right now in his hands.[43] Indeed, since Cedar was solvent and, by the time the case reached the Court of

[40] *Attorney General of Hong Kong v Reid* [1994] 1 AC 324, 328-329.
[41] *Sugden v Crossland* 65 ER 620; (1856) 3 Sm & G 192.
[42] *Attorney General of Hong Kong v Reid* [1994] 1 AC 324, 331.
[43] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535 [44].

Appeal, had accepted that it was liable to account for the commission in Equity, that was the entire point of the case.

According to Worthington, fiduciary liability for secondary profits is explicable on the basis that a fiduciary who deals with such rights deals *as a fiduciary*:

> Where the original asset being traced is held by a fiduciary for the benefit of his principal, the principal is invariably entitled to adopt successful investments and insist that the fiduciary holds those too for the principal. This is justified because it is precisely what the fiduciary role demands: the fiduciary must selflessly use the principal's property solely for the benefit of the principal. If the fiduciary purports to use it for his own benefit, the principal can insist that the investment is held for him.[44]

In *Reid*, therefore, 'capture [of secondary profits] by proprietary means followed as a matter of course since the principal had a proprietary claim to the initial pre-investment fiduciary gain'.[45] But this is a conclusion, not a justification. What we need to know is *why* a fiduciary who makes a profit using a right acquired within the scope of his fiduciary endeavour is accountable *in specie* for the new profit.

The best explanation for the decisions in *Oatway* and *Reid* is that if the initial profit is derived from doing precisely the thing that the fiduciary was employed to do, then any additional rights acquired by exploiting those profits are rights acquired by exploiting an opportunity acquired within the sphere of fiduciary activity. Applying this logic to *FHR*, it was not necessary for FHR to pursue a proprietary claim in respect of the commission at all.

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[44] Worthington, 'Fiduciary duties and proprietary remedies: addressing the failure of equitable formulae' (2013) 72 CLJ 720, 741.
[45] Ibid 729.

## III. Preventing Liability from Arising

### A. Absence of Authority

Although Lord King was explicit in holding that there was no question of fraud in *Keech v Sandford*, almost all of our authorities that have applied that decision have involved some element of wrongdoing, of varying degrees of severity. This has led to the assumption that it is the fiduciary's wrongdoing that forms the foundation for such claims, and that a causal connection must be established between some breach of duty committed by the fiduciary and the profit claimed by the principal.[46]

Whether or not the fiduciary is performing a particular task in breach of duty or with the intention of defrauding the principal makes no difference to the determination of whether the activity falls within the scope of the fiduciary endeavour. In *FHR v Cedar Capital Partners* Lord Neuberger said:

> The principal is entitled to the benefit of the agent's unauthorised acts in the course of his agency, in just the same way as, at law, an employer is vicariously liable to bear the burden of an employee's unauthorised breaches of duty in the course of his employment.[47]

In fact, wrongdoing is relevant, not to establishing liability, but to negating it: it goes to the quite separate question of whether the fiduciary has obtained the principal's consent to profit from the activity. It is possible for the fiduciary to prevent any liability from arising from a transaction entered into within the scope of his fiduciary endeavour by acquiring the permission of the principal to carry out such a transaction on his own behalf. Such consent may be either explicit or implicit,[48] but it

[46] Virgo, *The Principles of Equity and Trusts* (OUP 2011) 603.
[47] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535 [33] (Lord Neuberger).
[48] *Kelly v Cooper* [1993] AC 205.

must in fact be obtained: it is not enough that the profit might still have been made had consent been acquired, if it has not been acquired.

In *Murad v Al-Saraj*, Al-Saraj had represented to the Murads that the purchase price for a hotel that they intended to buy would be £4.2 million, and that he would make his contribution of £500,000 to that sum.[49] In fact, that contribution was made by setting-off against it a commission due from the seller to Al Saraj. The trial judge found that, if Al-Saraj had disclosed the true purchase price and commission, the claimants would still have agreed to the venture. Nevertheless, a majority of the Court of Appeal held that Al-Saraj was accountable for the commission. Arden LJ said:

> [I]t is not enough for the wrongdoer to show that, if he had not been fraudulent, he could have got the consent of the party to whom he owed the fiduciary duty to allow him to retain the profit. The point is that the profit here was in fact wholly unauthorised at the time it was made and has so remained… It is only actual consent which obviates the liability to account.[50]

Virgo describes the case as 'difficult'. In his words, 'Surely, if the defendant would have made a profit anyway had there not been a breach of fiduciary duty, then the only profit that was caused by the breach must be the difference between the profit that was made and what would otherwise have been made?'.[51] But the question, said Jonathan Parker LJ, was simply whether the profit was acquired 'within the scope and ambit of the relevant fiduciary duty'.[52] The presence or absence of consent was relevant only to the question of whether the fiduciary had been permitted to deal on his own behalf in executing the transaction. As he had not been, the fact that such permission might have been obtained on similar terms was altogether beside the point.

[49] Virgo, *The Principles of Equity and Trusts* (OUP 2011) 603.
[50] *Murad v Al-Saraj* [2005] EWCA Civ 959, [71].
[51] Virgo, *The Principles of Equity and Trusts* (OUP 2011) 605.
[52] *Murad v Al-Saraj* [2005] EWCA Civ 959 [116].

**B. Excluding the Rule in Keech v Sandford**

We have already seen that the principal may permit the fiduciary to deal on his own behalf within the scope of the fiduciary endeavour, so as not to give rise to any liability at all. But the principal may also permit the fiduciary to deal on his own behalf with rights for which the latter would ordinarily be accountable *in specie* to the principal in such a manner as to engage only a personal liability to account, and no trust.

*Space Investments Ltd v Canadian Imperial Bank* concerned the effect of a trust deed that allowed the trustee bank to deposit funds with itself and deal with them on its own behalf.[53] Lord Templeman held that because the settlor had 'allowed M.B.T. to appropriate trust money and to treat the trust money as belonging absolutely and beneficially to M.B.T',[54] the beneficiaries were simply creditors.[55]

In *Nelson v Rye* the claimant musician had appointed the defendant as his manager with the arrangement that he should collect the fees and royalties due to the claimant and pay his expenses, and account to him annually for his net income after deducting his own commission.[56] The question was whether the account taken at the end of the relationship should be limited to the six years before the issue of the writ or whether it should extend over the whole period of the relationship. If it was held on trust, it was not caught by the Limitation Act 1980. Laddie J decided that whether or not it was held on trust, to allow the account to extend over the full period would cause the defendant substantial prejudice.

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[53] *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072. The case is best known for Lord Templeman's *obiter dicta* on the so-called 'swollen assets' theory of tracing,
[54] Ibid, 1076 (Lord Templeman).
[55] Ibid, 1075.
[56] *Nelson v Rye* [1996] 1 WLR 137.

Millett LJ considered the nature of the defendant's obligations in some detail in *Paragon Finance v DB Thakerar*. In his Lordship's words, the question was whether the defendant was 'not merely a fiduciary… but a trustee, that is to say, on 'whether he owed fiduciary duties *in relation to the money*'.[57] As to that he said:

> [T]he defendant was entitled to pay receipts into his own account, mix them with his own money, use them for his own cash flow, deduct his own commission, and account for the balance to the plaintiff only at the end of the year. It is fundamental to the existence of a trust that the trustee is bound to keep the trust property separate from his own and apply it exclusively for the benefit of his beneficiary. Any right on the part of the defendant to mix the money which he received with his own and use it for his own cash flow would be inconsistent with the existence of a trust…. .[58]

This must be correct: if the fiduciary is expressly permitted to acquire rights in the course of his fiduciary endeavour on his own behalf, to be accountable only for their value, the logic of the trust is absent.

## IV. Bank Accounts and the Rule in *Keech v Sandford*

The rule in *Keech v Sandford* depends upon the fiduciary's acquisition of a right, for which equity forces him to account *in specie*. Courts have tended to treat the acquisition of rights against banks in precisely the same way as the acquisition of other rights.[59] Thus far, it has been assumed that follows as a matter of necessity from the decision in *Keech*. In the final section of this chapter it is argued that this treatment of bank accounts is not in fact mandated by logic or authority.

In *Lister v Stubbs* the plaintiffs ran a business of silk-spinning, dying, and manufacturing. The defendant, Stubbs, was their foreman dyer. For some years, he

[57] *Paragon Finance plc v DB Thakerar & Co* [1999] 1 All ER 400
[58] Ibid.
[59] E.g. *Lister v Stubbs* (1890) 45 Ch D 1; *Sinclair v Versailles* [2011] EWCA Civ 347, [2012] Ch 453; *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535.

had been entrusted with the job of buying supplies for the business. One of the firms Stubbs dealt with regularly was Varley, drysalters of Leeds. In return for placing orders with them, Stubbs received a commission, which amounted, over the years, to a total of some £5000. Stubbs invested a large amount in land and in other investments, but, says the report, some of it 'was still in the shape of cash'.[60]

When the plaintiffs discovered what had been going on, they brought an action to recover the money and the investments, and they moved for an injunction to restrain the defendant from dealing with the investments or for an order directing him to bring the moneys and the investments into court. The court refused the order. Holding that the claim amounted to 'confounding ownership with obligation',[61] Lindley LJ said:

> The relation between them is that of debtor and creditor; it is not that of trustee and cestui que trust. We are asked to hold that it is—which would involve consequences which, I confess, startle me. One consequence, of course, would be that, if Stubbs were to become bankrupt, this property acquired by him with the money paid to him by Messrs. Varley would be withdrawn from the mass of his creditors and be handed over bodily to Lister & Co. Can that be right?[62]

That is, of course, precisely what *Keech* decides, and Equity's history of confounding ownership with obligation is long and well-established.[63] The decision to follow the line of authorities that includes *Keech* and *Reid* in *FHR v Cedar Capital Partners* lays to rest the debate surrounding departure from *Lister* in *Reid*, and explicit preference for the latter in *Daraydan Holdings*.[64] But *Lister* continues to shape both the reasoning and decisions of judges.

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[60] *Lister v Stubbs* (1890) 45 Ch D 1.
[61] Ibid 15.
[62] Ibid 15.
[63] See further Smith, 'Philosophical Foundations of Proprietary Remedies' in Chambers, Mitchell and Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009).
[64] *Daraydan Holdings Ltd v Solland International Ltd* [2005] Ch 119.

The fact that Lindley LJ did not distinguish the money claim from the claim to the freehold has led subsequent courts to frame the debate in a binary fashion: one either holds that there is a trust, in which case it applies to money, or one holds that there is not. In fact, there is an argument to be made that, even if one acknowledges that the conversion of personal obligations into trusts has been part of the mechanics of fiduciary liability since at least the early eighteenth century, that does not affect the characterisation of claims in respect of bank debts.

First, we have already seen that the acquisition of bank funds is only a novation at all at a particular level of abstraction. It is quite possible to view the effect of crediting an account as increasing the value of a pre-existing claim, to the sum total of the account at the relevant time. Since the constructive trusts doctrine depends upon the acquisition of a particular right, it would have no application to accounts, thus understood.

Second, the ordinary approach to specific performance is to consider whether damages would be an adequate remedy, specific performance being awarded only in cases in which they are not. This has been applied particularly strictly in the context of agreements to transfer particular rights, in which Equity's constructive trusts doctrine has been confined to unique rights, such as title to land,[65] and shares in private companies.[66]

In *Keech v Sandford* itself Lord King awarded a constructive trust of the lease and an account of profits. There is no suggestion that *the profits* were, themselves, held on trust. In *Boardman v Phipps* the declarations sought by the claimant were that Boardman and Phipps held 5/18ths of 21,986 ordinary shares in the company as

[65] *Lysaght v Edwards* (1876) 2 Ch D 499; *London and South Western Railway Company v Gomm* (1882) 20 Ch D 562.
[66] *Re Rose* [1949] Ch 78; *Oughtred v IRC* [1960] AC 206; *Neville v Wilson* [1997] Ch 144; *Pennington v Waine* [2002] EWCA Civ 227.

constructive trustee for the plaintiff, and, secondly, an account of the profits made by them from these holdings. In *Attorney General for Hong Kong v Reid* the Privy Council recognised a constructive trust of title to houses. The thing that each of these cases has in common is that they involved unique rights – in respect of land or a private company.

Agreements to pay money would seem to be a fairly obvious example of a case in which damages would be adequate. Nevertheless, in each of *Burdett v Willett* and *Scott v Surman* specific performance was awarded of an obligation to pay money. And in *Beswick v Beswick* Lord Hodson called 'untenable' the argument that specific performance was not available in respect of a contract to make a money payment,[67] although the majority considered damages to be inadequate on the different ground that, the promisee having suffered no loss, damages would be nominal.

If accounts did not fall within the rule in *Keech v Sandford* the only relevant questions would be: (i) did the fiduciary make the profit by exploiting an opportunity acquired from the fiduciary office? And if the answer is yes, (ii) is the fiduciary solvent?

## V. Indemnifying the Fiduciary

The facts are almost always more complex than the simple acquisition of a new right by a fiduciary: most often, he has contributed to the account which the principal claims. Indeed, it may be that the sum that gives rise to the proprietary claim is a fraction of the amount standing in the fiduciary's account.[68] In such a case, to permit the principal to collapse the trust and claim the full sum would work an obvious injustice. In what follows it is argued that, again, the answer to this problem has long

[67] *Beswick v Beswick* [1968] AC 58.
[68] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535.

been part of the mechanics of fiduciary law. Since the principal, in asserting a claim to a new right acquired by the fiduciary, is accepting the account as it is, he must allow any expenses of the fiduciary,[69] and indemnify him against his losses.[70]

### A. Pennell v Deffell

*Pennell v Deffell* concerned the estate of a Mr Green, who had been one of the official assignees of the Court of Bankruptcy, and who had died intestate.[71] Green had opened an account in his own name with the Bank of England, into which he paid all the monies he received, whether as assignee or in his private capacity. He continued to do so until required by statute to set apart the account he held as official assignee. However, as the Bank of England would not open an account with an individual as a trustee, or in any character qualifying his absolute title, Green was permitted to keep the account under his name. The executor of his estate referred the question of how to distribute Green's funds, to which the defendant took eleven exceptions, each allowed by the Master of the Rolls. The plaintiffs appealed, and the Court of Appeal upheld the initial report.

Knight Bruce LJ began with an analogy:

> [L]et me suppose that the several sums for which, as I have said, Mr. Green was accountable at the time of his death, had been (that is to say, that the very coins and the very notes received by him on account of the trusts respectively had been) placed by him together in a particular repository—such as a chest—mixed confusedly together as among themselves; but in a state of clear and distinct separation from everything else, and had so remained at his death. It is, I apprehend, certain, that after his death the coins and notes thus circumstanced would not have formed part of his general assets, would not have been permitted so to be used; but would have been specifically applicable to the purposes of the trusts on account of which he had received them.[72]

[69] *Ultraframe (UK) Ltd v Fielding (No. 2)* [2005] EWHC 1638 [1513].
[70] *Hardoon v Belilios* [1901] AC 118.
[71] *Pennell v Deffell* (1853) 4 De GM & G 372, 43 ER 551.
[72] Ibid 555.

He continued:

> Suppose the case that I have just suggested to be varied only by the fact, that in the same chest with these coins and notes Mr. Green had placed money of his own (in every sense his own), of a known amount—had never taken it out again—but had so mixed and blended it with the rest of the contents of the chest, that the particular coins or notes of which this money of his own consisted could not be pointed out—could not be identified. What difference would that make? None, as I apprehend, except (if it is an exception) that his executors would possibly be entitled to receive from the contents of the repository an amount equal to the ascertained amount of the money in every sense his own, so mixed by himself with the other money.[73]

This conclusion was applied in *Frith v Cartland*, for the same reason: 'if a man mixes trust funds with his own, the whole will be treated as the trust property, except so far as he may be able to distinguish what is his own'.[74]

Again, an account is not a mixture of divisible claims, but one claim. The best explanation for the conclusion that a trustee is entitled to recover from an account an amount equivalent to his contribution is that he is entitled to be indemnified for the loss that he suffers as a result of the account being allocated to the trust. In *Hardoon v Belilios* Lord Lindley said:

> The plainest principles of justice require that the cestui que trust who gets all the benefit of the property should bear its burden unless he can shew some good reason why his trustee should bear them himself….This is no new principle, but is as old as trusts themselves.[75]

In *CMS Dolphin Ltd v Simonet*, Lawrence Collins J held that the right to an indemnity is as much a right of a fiduciary acting without authority, where the principal chooses

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[73] Ibid 556.
[74] *Frith v Cartland* (1865) 2 Hem & M 417, 71 ER 525.
[75] *Hardoon v Belilios* [1901] AC 118, 123-124. See also *Re Grimthorpe* [1958] Ch 615, 623 (Danckwerts J): 'It is commonplace that persons who take the onerous and sometimes dangerous duty of being trustees are not expected to do any of the work at their own expense; they are entitled to be indemnified against the costs and expenses which they incur in the course of their office.… The general rule is quite plain; they are entitled to be paid back all that they have had to pay out.'

not to falsify, as it is that of a fiduciary acting within his authority.[76] This must be correct: where the principal opts to take the profits of the fiduciary as part of the account, he waives any breach of duty. Of course, the principal is not forced to indemnify: he can reject the right acquired by the fiduciary, and take the account without it,[77] in which case he will only be required to compensate the fiduciary to the extent that liabilities properly incurred by the fiduciary exceed the sum that he is required to restore to the account.[78] But if the beneficiary chooses to assert a claim to the right, he is accepting that the expenses of the fiduciary are properly incurred,[79] and must compensate the fiduciary for the expense he suffers by virtue of the principal's claim.

This provides an alternative explanation for *Foskett v McKeown*.[80] In that case, the House of Lords held that where a trustee wrongfully used trust money to provide part of the cost of acquiring an asset, the beneficiary was entitled either to claim a proportionate share of the asset or to enforce a lien upon it. An explanation for the result, and the many assertions in the judgments that the cause of action did not belong to the category 'unjust enrichment', is that the beneficiaries, in asserting a claim to the policy, had to indemnify those claiming through Murphy for his loss of the right to payment of the death benefits.

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[76] *CMS Dolphin Ltd v Simonet* [2002] BCC 600 [97].
[77] *Ultraframe (UK) Ltd v Fielding (No. 2)* [2005] EWHC 1638 [1513].
[78] *Re Grimthorpe* [1958] Ch 615, 623; *X v A* [2000] 1 All ER 490; See David Hayton, Paul Matthews and Charles Mitchell, *Underhill and Hayton: Law of Trusts and Trustees* (LexisNexis 2010) 81.1
[79] Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005) 315.
[80] *Foskett v McKeown* [2001] 1 AC 102.

**B. Re Hallett's Estate**

We have already seen that the decision in *Re Hallett's Estate* that the wrongdoer suffers any depletion to the account in the first instance is usually explained as a presumption that allows the court to overcome the problems of evidence created by mixing. In Smith's words, 'once the claimant's value is traced into a bank account, she has the option of asserting that her contribution subsists in the account even if subsequent withdrawals are made'.[81] We also saw that this cannot be correct, because an account is a single debt. Any withdrawal has the effect of replacing one right, in respect of which the beneficiary and trustee have a claim, with another. Therefore, if the amount that the trustee can recover from the account alters as a result of the withdrawal, it cannot be because of any presumption or rule of evidence. Rather, it must involve a normative decision about the scope of liability.

In *Foskett v McKeown*, Lord Millett considered that that the effect of the decision in *Re Hallett's Estate* was to recognise a charge or 'equitable lien', which secured the fiduciary's obligation to restore a falsified account:

> The simplest case is where a trustee wrongfully misappropriates trust A property and uses it exclusively to acquire other property for his own benefit. In such a case the beneficiary is entitled at his option either to assert his beneficial ownership of the proceeds or to bring a personal claim against the trustee for breach of trust and enforce an equitable lien or charge on the proceeds to secure restoration of the trust fund. He will normally exercise the option in the way most advantageous to himself. If the traceable proceeds have increased in value and are worth more than the original asset, he will assert his beneficial ownership and obtain the profit for himself.[82]

In *Re Hallett's Estate* itself, Jessel MR said:

> [A]ccording to the now well-established doctrine of Equity, the beneficial owner has a right to elect either to take the property

[81] Smith, *The Law of Tracing* (OUP 1997) 199.
[82] *Foskett v McKeown* [2001] 1 AC 102, 130.

> purchased, or to hold it as a security for the amount of the trust money laid out in the purchase; or, as we generally express it, he is entitled at his election either to take the property, or to have a charge on the property for the amount of the trust money.[83]

This aligns the explanation for the decision with that of *Indian Oil v Greestone Shipping*, considered in Chapter Two.[84] But it also creates a new problem. Hallett's actions gave Cotterill a choice: she could either accept the account and assert a proprietary claim to the new right, or she could falsify it and force Hallett to restore the deficit.[85] She could not do both. Since she chose the latter, said Lord Millett, she was entitled to a charge in respect of Hallett's right against his bank that secured Hallett's obligation to restore the deficit. But, since the only basis for Cotterill's claim to the new right represented by Hallett's account was the fact that it was acquired by virtue of a transaction carried out in the course of (mis)management of the fiduciary assets, if she falsified the account, there would have been nothing at all to connect that right to the fiduciary office.[86]

The better explanation for the decision in *Re Hallett's Estate* is that the right of a trustee acting in breach of a trust to be indemnified by the trust is limited to the extent to which the liabilities properly incurred exceed the compensation due from him to the trust.[87] If he acts without authority, a fiduciary who withdraws funds from an account after a claim has arisen in respect of it thereby commits a breach of trust. He thus becomes liable to restore that value, which can be set off against his own

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[83] *Re Hallett's Estate* (1880) 13 Ch D 696, 709.
[84] *Indian Oil Corporation Ltd v Greenstone Shipping SA (Panama)* [1988] QB 345.
[85] See e.g. *Ultraframe (UK) Ltd v Fielding (No. 2)* [2005] EWHC 1638 ; Millett, 'Proprietary Restitution' in Degeling and Edelman (eds), *Equity in Commercial Law* (Lawbook Co 2005).
[86] So if Cotterill struck from the account the transaction by which that right was acquired, the subsequent recognition of a security interest in respect of it achieves precisely what was eschewed in *Director of the Serious Fraud Office v Lexi Holdings plc* [2008] EWCA Crim 1443, [2009] QBD 376.
[87] *Re Knott* (1887) 56 LJ Ch 318; *Re Kidd* (1894) 70 LT 648; *Re Evans* (1887) 34 Ch D 597, 601; *RWG Management Ltd v Corporate Affairs Comr* [1985] VR 385. See Hayton, Matthews and Mitchell, *Underhill and Hayton: Law of Trusts and Trustees* (LexisNexis 2010) 81.1.

right of indemnity.[88] The effect is that the value of the fiduciary's claim is reduced in the first instance.

### C. James Roscoe (Bolton) Ltd v Winder

The so-called 'lowest intermediate balance' rule, discussed in Chapter Two, has been applied by many authorities across the common law world.[89] In *James Roscoe (Bolton) Ltd v Winder* the judge considered that:

> Certainly, after having heard *In re Hallett's Estate* stated over and over again I should have thought that the general view of that decision was that it only applied to such an amount of the balance ultimately standing to the credit of the trustee as did not exceed the lowest balance of the account during the intervening period.[90]

The rule is an inevitable consequence of the view that an account is a pool of homogenous assets, in which particular units of value can be identified as a matter of fact: *Re Hallett's Estate* allows the beneficiary only to say that value withdrawn from the account was that of the trustee, not to say that value paid into the account derives – against the evidence – from the funds initially misappropriated. In Smith's words, 'The law allows evidential difficulties, and thus impossibilities, to be resolved against the wrongdoer; but it does not allow findings contrary to the evidence'.[91]

This stands in direct contrast with the effect of the decision in *Re Hallett's Estate*, that a fiduciary is only entitled to recover what remains owing to him after he has restored to the trust any losses improperly incurred. And it demonstrates the

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[88] *Re Evans* (1887) 34 Ch D 597, 601.
[89] *Transvaal and Delegoa Bay Investment Co v Atkinson* [1944] 1 All ER 579; *Re Diplock* [1948] Ch 465; *Re Norman Estate* [1951] OR 752; [1952] DLR 174 (CA); *Bishopsgate Investment Management Ltd v Homan* [1995] Ch 211; *Dewar v Nu Stock Pastoral Co Pty Ltd* (1994) 10 SR (WA) 1; *Nimmo v Westpac Banking Corp* [1993] 3 NZLR 218; *Re Global Finance Group Pty Ltd (In Liq) (Supervisor Appointed)* [2002] WASC 63; (2002) 26 WAR 385 [129]; *Williams v Peters* [2009] QCA 180, [2010] 1 Qd R 475.
[90] *James Roscoe (Bolton) Ltd v Winder* [1915] 1 Ch 62, 69.
[91] Smith, *The Law of Tracing* (OUP 1997) 202. {goff & Jones), 180.

practical problems created by the metaphorical premise. We have already seen that it is not possible, or not possible without fiction, to locate 'the beneficiary's value' within the account. There are no problems of evidence that might be solved by the application of presumptions. And if it is not possible to locate the beneficiary's value, as a matter of fact and with or without the help of presumptions, then it is not possible to point to facts that disable the beneficiary from locating his value. If the beneficiary has a proprietary claim to his trustee's account, and some wrongful act of the trustee caused that account to be worth less than it is at the time of trial, the beneficiary can claim the balance, subject to payment of any loss rightfully incurred by the trustee. In short, the trustee will only ever recover the net product of accounting for any compensation due from him to the trust.

Support for the 'lowest intermediate balance' rule has not been universal. In *Law Society of Upper Canada v Toronto-Dominion Bank*, Upshall, a solicitor, misappropriated over $900,000 from a trust account at the Toronto-Dominion Bank.[92] Although Upshall's final misappropriation left a balance of $66,242, the following day the bank deposited $173,000 to the account as a mortgage advance to a client of the solicitor. It then unilaterally withdrew the $173,000 and advanced it to another solicitor to complete the mortgage. The bank agreed to have the account treated as if it had not made that withdrawal, so that the question before the Court of Appeal was whether the claims of Upshall's clients were limited by the lowest intermediate balance rule to a total of $66,242, the balance before the bank's deposit.

Blair J held that, as a descendent of the rule in *Clayton's Case*, the lowest intermediate balance rule was based upon a fiction. He held that 'a more just, convenient, and equitable approach' involved:

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[92] *Law Society of Upper Canada v Toronto Dominion Bank* (1998) 169 DLR (4th) 353, 42 OR (3d) 257

> [A] simple rateable sharing of the remaining funds based upon establishing the total quantum of the assets available and sharing them on a proportionate basis among all the investors who contributed to the acquisition of those assets, ignoring the dates on which they made their investments.[93]

That decision was applied in *Re Graphicshoppe Ltd*.[94] In that case the employees of Graphicshoppe Limited ("Graphicshoppe") had contributed to a pension plan. Graphicshoppe failed to remit the amount of the employees' contributions between February 2003 and Graphicshoppe's bankruptcy on November 20, 2003 to the plan administrator. The employees filed a proof of claim in the bankruptcy and argued that their pension contributions were impressed with a trust and therefore excluded from the pool of funds available for distribution to creditors. The trustee in bankruptcy considered that, since the closing balance of the account came from four wire transfers from another company, the employees were unsecured creditors.

On appeal from that decision, the Registrar in Bankruptcy agreed with the employees' position. The trustee in bankruptcy appealed against the Registrar's decision. Considering that 'the LIBR principle, as well as other rules of equitable tracing, such as the rule in Clayton's Case, are legal fictions, and can work manifest unfairness dependent on a fortuitous accident of timing',[95] Lax J held that the court was 'bound to search for the method of allocating the loss which is the more just, convenient and equitable in the circumstances'.[96] Since the contest was between wronged trust beneficiaries and creditors of the bankrupt, Lax J held that it would be 'unjust and inequitable to apply the LIBR rule in these circumstances to deprive the

[93] Ibid.
[94] *Re Graphicshoppe Ltd* [2004] OJ No 5169.
[95] Ibid.
[96] Ibid [34].

employees of their own property and correspondingly benefit the creditors of the bankrupt's estate at their expense'.[97]

In Australia, following the decisions in *Law Society of Upper Canada v Toronto-Dominion Bank* and *Re Graphicshoppe Ltd*, the lowest intermediate balance rule has been held to be too complex and expensive to apply.[98] The time is now ripe for English law to take the same step, and remove from our private law a rule that, as a matter of substantive law, is manifestly arbitrary.

## VI. Conclusion

If we depart from the decision in *James (Roscoe) v Winder*, we have a coherent pattern of fiduciary liability: a fiduciary is accountable for any profit and *in specie* for any right acquired by exploiting an opportunity acquired during the course of his fiduciary endeavour. If the principal opts to take the right as part of the account, he must indemnify the fiduciary in respect of any loss properly suffered by him as a result of so doing. This blueprint for fiduciary liability has both theoretical and practical appeal: it treats bank accounts as what they are, rather than as metaphorical mixtures; it does not shape liability in a way that, once the fictional premise is removed, is revealed to be altogether irrational, and – because it contains only elements of fiduciary law with which we are already familiar – is simple to apply.

[97] Ibid [34].
[98] *Re Magarey Farlam Lawyers Trust Accounts (No 3)* (2007) 96 SASR 337 [140].

# Chapter Six: Claims against Non-Fiduciaries

## I. Introduction

Thus far, Part II of this thesis has argued that proprietary claims to new rights acquired by trustees and other fiduciaries are best explained without reference to the notion of transmitting claims from one right to its traceable proceeds. This chapter deals with those claims against non-fiduciaries that are considered to involve principles of tracing. In particular, it considers the idea that it is possible to trace and claim 'at common law', which forms the foundation for arguments for a unitary law of tracing, and it considers the role of tracing in the context of proprietary and personal claims against those who transact with fiduciaries. It will be argued that the language of tracing value, and the conclusion drawn from it that a claimant can cause a claim to be transmitted automatically from one right to its traceable proceeds, has lent the appearance of unity to dissimilar fact patterns, obfuscating the need for an explanation in cases in which the right acquired by the defendant is not one formerly held by or for the claimant.

The first part of this chapter analyses the decisions in *Lipkin Gorman v Karpnale*,[1] and *Trustee of FC Jones v Jones*,[2] which are at the heart of modern accounts of common law tracing. It is argued that far from creating an arbitrary practical obstacle for claimants, the existing differences between fiduciary and non-fiduciary cases are rational and principled. It is argued that those differences do not go to the problem of so-called 'mixed funds', but rather to the question of whether there is a normative foundation for a claim to a new rights in the hands of a defendant. In this regard, the decision in *Lipkin Gorman*, which involved the acquisition and

[1] *Lipkin Gorman v Karpnale* [1991] 2 AC 548.
[2] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.

transfer of a right by a fiduciary, is distinguished from that in *Trustee of FC Jones v Jones*, which did not. It is argued that the decisions in *BCCI v Akindele* and *Relfo v Varsani*, can be explained as an orthodox application of principles of unjust enrichment, but that those principles do not explain or justify the result in *Trustee of FC Jones v Jones*.

The second part of this chapter considers the decisions in *Re Montagu*,[3] *Independent Trustee Services v GP Noble Trustees*,[4] and *Williams v Central Bank of Nigeria*,[5] which together provide a representative picture of the orthodox principles of equitable tracing. It is argued that, whilst the result in *Re Montagu* can be explained according to the idea that the defendant has received a trust asset in breach of trust, the results in *ITS v GP Noble Trustees* and *Williams v Central Bank of Nigeria* – each of which involved bank transfers – cannot. If there is an explanation for proprietary and personal claims against non-fiduciary payees it is disguised, not revealed, by the assumption that by tracing it is possible to transmit a claim from one right to its traceable proceeds.

The conclusion to be drawn from the above is that so-called 'common law' and 'equitable tracing' in fact describe several different kinds of claim, not one of which depends upon tracing and transmitting claims. As such, the chapter is unavoidably long and complex. However, it is hoped that by the end of this chapter it will be manifest that: (i) there is no barrier to actions in money had and received that is properly described as involving 'mixed funds'; but (ii) there is a fundamental distinction between cases involving fiduciary relationships and those that do not; and (iii) the reason for and parameters of liability in knowing receipt have not yet been

[3] *Re Montagu's Settlement Trusts* [1987] Ch 264.
[4] *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195.
[5] *Williams v Central Bank of Nigeria* [2014] UKSC 10, [2014] 2 WLR 355.

articulated in a manner that accounts for the differences between the transfer of an independent asset, and a bank payment from trustee to defendant.

## III. Common Law Claims and Tracing

Common law tracing is thought to be possible only where the facts do not involve so-called 'mixed funds'.[6] In Burrows' words:

> At common law the traditional approach has been that tracing to a substitute is possible provided there has been a 'clean substitution'. Examples of clean substitutions are the exchange of a car for a boat, or a cow for a goat, or £1,000 in cash for a picture. No special rules are here required for plainly the boat, the goat and the picture are, respectively, substitutes for the original assets. The common law has had no difficulty with simple clean substitutions.[7]

The foundation for the rule that the common law cannot trace through a mixed fund is the judgment of Lord Ellenborough in *Taylor v Plumer*:

> [T]he product of or substitute for the original thing still follows the nature of the thing itself, as long as it can be ascertained to be such, and the right only ceases when the means of ascertainment fail, which is the case when the subject is turned into money, and mixed and confounded in a general mass of the same description.[8]

In *Banque Belge pour l'Etranger v Hambrouck* that passage was considered to stand for the proposition that the processes of tracing at law and in equity are conducted differently: equitable tracing permits a claimant to trace through a bank account into which funds have been paid from multiple sources, whilst common law tracing does not.[9] That distinction was reiterated by Millett J in *Agip (Africa) Ltd v Jackson*,[10] and

[6] *Agip (Africa) Ltd v Jackson* [1991] Ch 547, 285.
[7] Burrows, *The Law of Restitution* (3rd edn, OUP 2011) 123.
[8] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721, 575.
[9] *Banque Belge pour l'Etranger v Hambrouck* [1921] 1 KB 321, 327-328 (Bankes LJ). Cf Scrutton LJ, who considered the claim to involve equitable principles of tracing (330).
[10] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 283, 289-290.

more recently by Rimer J in *Shalson v Russo*,[11] and Etherton J in *London Allied Holdings v Lee*.[12]

For Birks, the distinction was a logical absurdity. If tracing was simply a process of locating value, 'neutral as to rights', then it could not be conducted differently according to whether the claimant sought to claim at law or in equity:

> An exercise of identification either can or cannot be conducted. It would be absurd to suppose that it could be conducted vigorously and resourcefully only on Mondays and Thursdays, and it is *prima facie* no less absurd to assert that it can be so conducted only by a plaintiff who has managed to attract the attention of equity. 'Equity' is not a reason. The *prima facie* absurdity can only be displaced by finding a convincing reason why some plaintiffs, but not others, should be allowed to overcome evidential difficulties.[13]

These criticisms were echoed by Lord Millett in *Foskett v McKeown*:

> Given its nature, there is nothing inherently legal or equitable about the exercise. There is thus no sense in maintaining different rules for tracing at law and in equity. One set of tracing rules is enough… There is certainly no logical justification for allowing any distinction between them to produce capricious results in cases of mixed substitutions by insisting on the existence of a fiduciary relationship as a precondition for applying equity's tracing rules.[14]

Whether so-called 'mixed funds' do indeed present a theoretical or practical obstacle to claimants seeking to assert a claim against a non-fiduciary is considered below.[15] However, logically prior to the question of whether a claimant ought to be entitled to trace at law where the value of the right he claims was derived from multiple sources, is the question of whether a claimant can trace and claim at law *at all*. Two kinds of case can be distinguished. The first involves a substitution by a non-

[11] *Shalson v Russo* [2005] Ch 281 [102]-[105].
[12] *London Allied Holdings v Lee* [2007] EWHC 2061 [256].
[13] Birks, 'The Necessity of a Unitary Law of Tracing' in Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP 1997) 243.
[14] *Foskett v McKeown* [2001] 1 AC 102, 128.
[15] The text accompanying fn 46-67.

fiduciary in circumstances that are thought to give rise to a proprietary claim against the wrongdoer to the substitute:

**Example 6.1:** C steals a pig from A and swaps it for title to a cow.

Such facts are thought to give A three claims against C at law: (i) a claim in conversion; (ii) a claim in money had and received;[16] and (iii) a proprietary claim – either title,[17] or by way of a trust.[18] Tracing, in such a case, thus appears to give rise to the opposite problem to that thought to be created by the presence of a 'mixed fund'. In Smith's words:

> If a thief steals my car, and swaps it for a boat, it could be that I become the owner of the boat. On the other hand, the normal rule is that my ownership of the car survives the transfer of possession to the one who acquired it. Do I then own both the car and the boat?[19]

Birks called this the problem of 'multiplication of ownerships'.[20]

In what follows it is argued that A does not have a proprietary claim – either at law or in equity – to the substitute right. A fiduciary relationship is at the heart of the justification for a claim to a new right in the hands of someone else, and that claim is in the nature of a trust.

The second type of case typically considered to be an example of common law tracing involves a bank transfer from claimant to defendant:

> **Example 6.2:** A, who is P Co's accountant, alters the name of the payee on payments orders signed by P Co's signatory, causing P Co's bank to debit P Co's account and credit X's account with £100,000.

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[16] Young v Marshall (1831) 8 Bingham 43, 131 ER 316.
[17] See e.g. *Banque Belge pour l'Etranger v Hambrouck* [1921] 1 KB 321; *Lipkin Gorman v Karpnale* [1991] 2 AC 548.
[18] Smith, 'Simplifying Claims to Traceable Proceeds' 125 LQR 338.
[19] Smith, *The Law of Tracing* (OUP 1997) 322. See also Birks, *An Introduction to the Law of Restitution* (OUP 1985) 394.
[20] Birks, 'Mixing and Tracing: Property and Restitution' [1992] 45 CLP 69, 95.

We know that the right X acquires is a different right from that lost by P Co.[21] P Co cannot, therefore, follow any asset from its account to that of X. Nevertheless, if A is not a fiduciary, P Co is thought to be able to trace its money and assert a claim in money had and received against X if, and only if, the facts do not also involve an element of 'mixing'.[22] Much, therefore, is thought to turn on the manner in the which the payment is executed. If, for example, the parties do not have a common correspondent, so that the payment goes through clearing, or if X's account is actually credited before P Co's account is debited, the claimant seeking to trace and claim at common law will, it is thought, struggle to identify a series of 'clean' substitutions.[23]

In what follows it is argued that A has an action in money had and received against B irrespective of the manner in which the payment happens to be executed. The facts involve a payment by P Co to X without its consent,[24] and the effects of that payment can be reversed.

### A. 'Common Law Tracing' and Proprietary Claims against Non-fiduciaries

In what follows the first of our examples will be considered:

**Example 6.1:** C steals a pig from A and swaps it for title to a cow.

The authority most often cited for the proposition that, in such circumstances, A has a proprietary claim at law to title to the note is *Lipkin Gorman v Karpnale*.[25] In this section it is argued that that any such claim is in the nature of a trust, and that *Lipkin Gorman v Karpnale*, which involved the acquisition of title by a fiduciary, provides limited support for such a claim.

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[21] *R v Preddy* [1996] AC 815.
[22] *Agip (Africa) Ltd v Jackson* [1990] Ch 265.
[23] Ibid.
[24] The processes of identifying and characterising transactions are considered in depth in Chapter Three. See in particular the text accompanying fn 73-134.
[25] *Lipkin Gorman v Karpnale* [1991] 2 AC 548.

In *Lipkin Gorman v Karpnale* Cass, one of the partners of a firm of solicitors, obtained funds from a client account by withdrawing cash by cheque, and by causing funds to be transferred to building society accounts in his name, from which he withdrew cash. He used that cash to gamble in the defendant casino.[26] The court ordered the casino to pay the firm a sum equivalent to that which it had received from Cass, reduced by any sums that it had spent in reliance on receipt. Lord Goff explained the claim as follows:

> The first ground is concerned with the solicitors' title to the money received by Cass (through Chapman) from the bank. It is to be observed that the present action, like the action in *Clarke v Shee and Johnson*, is concerned with a common law claim to money, where the money in question has not been paid by the appellant directly to the respondents [but rather] to the respondents by a third party, Cass; and in such a case the appellant has to establish a basis on which he is entitled to the money. This (at least, as a general rule) he does by showing that the money is his legal property, as appears from Lord Mansfield's judgment in *Clarke v Shee and Johnson*. If he can do so, he may be entitled to succeed in a claim against the third party for money had and received to his use, though not if the third party has received the money in good faith and for a valuable consideration.[27]

His Lordship recognised explicitly that the original funds were in the nature of a debt owing to the firm. Nevertheless, citing the decisions in *Marsh v Keating* and *Taylor v Plumer*, Lord Goff concluded:

> There is in my opinion no reason why the solicitors should not be able to trace their property at common law in that chose in action, or in any part of it, into its product i.e. cash drawn by Cass from their client account at the bank. Such a claim is consistent with their assertion that the money so obtained by Cass was their property at common law.[28]

*Taylor v Plumer* dictates that the firm's claim in *Lipkin Gorman* was equitable, not legal.[29] That case, discussed at length in Chapter Four, involved the

[26] Ibid.
[27] Ibid 572.
[28] Ibid 574.
[29] Smith, 'Simplifying Claims to Traceable Proceeds' 125 LQR 338.

unauthorised purchase by an agent of stock and gold coins. The agent subsequently committed an act of bankruptcy and the question for the court was whether the principal, Plumer, was properly entitled to the assets purchased. In *Banque Belge pour l'Etranger v Hambrouck*, that case was considered to stand for the proposition that the principal in such a case could assert legal title to the stock and coins.[30] But it cannot be so interpreted. A Jacobean statute had the effect of subjecting everything in the bankrupt's hands at the time of bankruptcy to distribution to his creditors.[31] At law, therefore, Plumer's action would have been unsuccessful. However, a series of authorities had concluded that the statute had no application where the agent held the goods on trust for his principal.[32] In order to avoid circuity of action, Willes J thus decided in *Scott v Surman* that a claimant who would succeed if an action was brought by the claimant subsequently in Chancery would succeed at law,[33] so that by the time *Taylor v Plumer* was decided it was clear law that 'trust property in the possession of a factor… does not pass to his assignees under the Stat Jac 1, upon his becoming a bankrupt'.[34] The most that *Taylor v Plumer* decides, therefore, is that the agent is a trustee of the substitute right.

This is crucial. The misinterpretation of *Taylor v Plumer* has led to the conclusion that not only is the claimant able to expropriate a defendant unilaterally in a case involving title to a physical thing, but so too in a case involving a debt, so that a debtor may be indebted to someone of whose existence he may not even be aware.

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[30] *Banque Belge pour l'Etranger v Hambrouck* [1921] 1 KB 321, 327-328 (Bankes LJ). Cf Scrutton LJ, who considered the claim to involve equitable principles of tracing (330).
[31] An Act for the further Description of a Bankrupt, and Relief of Creditors against such as shall become Bankrupts, and for inflicting of corporal Punishment upon the Bankrupts in some special Cases 21 Jac 1. Cap 19. 1623.
[32] *Copeman v Gallant* (1716) 1 P Wms 314, 24 ER 404; *Godfrey v Furzo* (1733) 3 Peere Williams 185, 24 ER 1022; *Scott v Surman* (1742) Willes 400, 125 ER 1235.
[33] *Scott v Surman* (1742) Willes 400, 125 ER 1235.
[34] *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721

In *Trustee of FC Jones v Jones* Mr Jones had drawn cheques on his firm after the partners had committed an act of bankruptcy, handing them to his wife who used the funds to speculate successfully in potato futures.[35] It was argued for the trustee in bankruptcy of the firm that, 'under section 37 of the Bankruptcy Act 1914, the money in the partners' joint account vested in the trustee, his title relating back to the date of the act of bankruptcy'.[36] That argument succeeded. Millett LJ said:

> [A]s from the date of the act of bankruptcy the money in the bankrupts' joint account at Midland Bank belonged to the trustee. The account holders had no title to it at law or in equity. The cheques which they drew in favour of the defendant were not "void" or "voidable" but, in the events which happened, they were incapable of passing any legal or equitable title. They were not, however, without legal effect, for the bank honoured them. The result was to affect the identity of the debtor but not the creditor and to put the defendant in possession of funds to which she had no title.[37]

The difficulty with this is clear. The effect of Mrs Jones' investment was to vest in her a claim against the bank to a sum of money, which debt could only ever have been owed to her. We have strict rules governing the assignment of debts at law, which ensure that the debtor is never in any doubt as to the person from whom he can receive a good discharge. The idea that on the facts of *Trustee of FC Jones v Jones* the trustee in bankruptcy could bypass those rules – indeed, that the debt was *always* owing throughout to a creditor unknown to the bank – is 'extraordinary'.[38]

Millett LJ described the trustee in bankruptcy's claim as 'exclusively proprietary. He claims the money because it belongs to him at law or represents profits made by the use of money which belonged to him at law'.[39] The best explanation for such a characterisation is that Mrs Jones was accountable for the right

[35] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.
[36] Ibid 162.
[37] Ibid 166-167.
[38] Smith, 'Simplifying Claims to Traceable Proceeds' 125 LQR 338
[39] *Jones v Trustee of FC Jones & Sons* [1997] Ch 159, 168.

that she acquired with partnership funds as a trustee,[40] not on the basis of any unilateral expropriation.[41]

So, if in *Lipkin Gorman* the firm had a claim to title in Cass' hands, it was a proprietary claim in the nature of a trust, not legal title. But we have not yet explained why such a claim existed. In *Banque Belge pour l'Etranger v Hambrouck Taylor v Plumer* was applied – as indeed it was reasoned –[42] as if the simple fact of a substitution *itself* transmitted title from one right to another. But this cannot be correct,[43] and it is, we have seen, an implausible interpretation of the decisions that preceded *Taylor v Plumer*.[44]

Lord Goff relied upon two cases, one of which was *Marsh v Keating*.[45] In that case Fauntleroy had forged a power of attorney and sold stock that was in Mrs Keating's name without her consent. He ensured that it did not appear in the bank's books and withdrew the proceeds. Accepting that Mrs Keating had not been divested of the stock by the purported transfer, the House of Lords held that she was, nevertheless, 'at liberty to abandon and give up all claim' to the stock, to 'adopt the sale', and to assert a claim to the proceeds, which had been 'sufficiently traced into the hands of the Defendants'.[46] That decision, we have already seen, involves a straightforward application of the rule that a claimant may adopt a transaction entered into on his behalf, whether or not the agent had actual authority.[47] In *Lipkin Gorman*, by contrast, Cass did not purport to act on the firm's behalf, so that there is no

[40] Smith, 'Simplifying Claims to Traceable Proceeds' 125 LQR 338, 347,
[41] Smith, *The Law of Tracing* (OUP 1997), 328-331.
[42] This was considered in Chapter Four, in the text accompanying fn 33-41.
[43] The reasons for this are considered in Chapter Four, in the text accompanying fn 46-71.
[44] See Chapter Four, the text accompanying fn 33-41.
[45] *Marsh v Keating* (1834) 2 Cl & Fin 250, 6 ER 1149.
[46] Ibid, 1162.
[47] Chapter Four. See the text accompanying fn 118-122.

foundation for the conclusion that the firm was entitled to ratify the transaction and assert a claim to title to the cash.[48]

The other case upon which Lord Goff relied was *Taylor v Plumer*. The result in that case, we have seen,[49] is best understood as an application of the rule, which originated in *Keech v Sandford*, that an individual who accepts a fiduciary role is specifically accountable for any right acquired by exploiting an opportunity that arises in the course of his fiduciary endeavour. It will be argued in what follows that the decision in *Lipkin Gorman* falls squarely within that rule.

For the purposes of partners, the rule in *Keech v Sandford* is now enshrined in section 29(1) of the Partnership Act 1890:

> Every partner must account to the firm for any benefit derived by the partner without the consent of the other partners from any transaction concerning the partnership, or for any use by the partner of the partnership property, name, or business connexion.

Several cases have recognised that that rule has the effect of subjecting the partner to the kind of obligation to account that forms the foundation of a proprietary claim.[50] In *Barber v Rasco International Ltd* a partnership had been set up for a single venture of providing services to BP in Azerbaijan and Georgia.[51] The partners agreed that those services would be provided by the first defendant, Rasco International Ltd ("Rasco"), in its own name, as it was anticipated that BP wished to contract with a company based in Azerbaijan. Rasco secured the contract and the partners provided the relevant services. That relationship broke down, and one of the partners sought a court order for dissolution. It was argued that the contract was an asset of the partnership and that any profits from it were held by Rasco on trust until the partnership was dissolved.

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[48] Lord Goff in fact expressly rejected such analysis: *Lipkin Gorman v Karpnale* [1991] 2 AC 548 573.
[49] See Chapter Four.
[50] See e.g. *Don King Productions Inc v Warren* [1998] 2 All ER 608.
[51] *Barber v Rasco International Ltd* [2012] EWHC 269 .

Considering section 29(1) to be 'based on the line of equity cases starting with one of the great equity cases, *Keech v Sandford*',[52] Anthony Thornton QC held that 'the BP contract is… an asset of the Partnership property and all benefits derived from it must be held exclusively for the purposes of and on trust for the Partnership'.[53]

The best explanation of the decision, if not the reasoning, in *Lipkin Gorman v Karpnale*, is thus that Cass was accountable for title to the cash as a fiduciary. Several cases have recognised that the beneficiary's interest under a trust persists unless and until the right to which it relates is received by a bona fide purchaser.[54] In the same manner and for the same reason as the claim in *Taylor v Plumer*, the action for money had and received therefore gave effect, at law, to the firm's continuing proprietary claim in equity.

*Lipkin Gorman v Karpnale* ought thus to be regarded as a weak authority for the proposition that in the following example A had a proprietary claim at law against C and can therefore assert a claim against B:

**Example 6.1:** C steals a pig from A and swaps it title to a cow.

A can assert a claim in conversion or an action in money had and received against C.[55] As C is not also his fiduciary, he cannot assert a claim to title to the cow.[56]

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[52] Ibid.
[53] Ibid [90].
[54] *Pilcher v Rawlins* (1871-72) LR 7 Ch App 259; *Attorney General of Hong Kong v Reid* [1994] 1 AC 324; *Foskett v McKeown* [2001] 1 AC 102, 127.
[55] See e.g. *Young v Marshall* (1831) 8 Bingham 43, 131 ER 316.
[56] This does not, of course, do away with *Banque Belge pour l'Etranger v Hambrouck* [1921] 1 KB 321. The reasoning in that case – which depended upon the assumption that tracing permits one, without more, to claim the product of a substitution – was manifestly deficient, and exemplifies the difficulties that the terminology of tracing has created for those attempting to explain the claims that result.

## B. 'Common Law Tracing' and Agency

The second kind of case thought to fall within the principles of tracing at common law is as follows:

> **Example 6.2:** A, who is P Co's accountant, alters the name of the payee on payments orders signed by P Co's signatory, causing P Co's bank to debit P Co's account and credit X's account with £100,000.

In such a case it is thought that A can assert a claim in money had and received against C, by tracing through the substitution and into B's right against his bank.[57] Those substitutions must, it is thought, be 'clean', so that if the parties do not have a common correspondent (so that the process of clearing is engaged), A cannot trace and claim at law.[58] In what follows it is argued that if C's intention is to debit A's account and credit that of B, the transaction is a single transaction. Because that transaction is entered into by C on A's behalf, the parties to it are A and B. And if A can assert an action in money had and received for money he transfers by mistake, he ought also to be able to assert such a claim for money transferred absolutely without consent.

At the heart of relationships of agency is the idea that, within a particular sphere and for particular purposes, another person has the capacity to make decisions and carry out acts that shape one's entitlements and obligations. Such relationships manifest in different ways. The agent may have the power to alter the principal's rights and obligations as to some future performance, or may have the power to alter the principal's existing entitlements. It is well established that if an agent purports to act on his principal's behalf in entering into an agreement for the provision of

[57] *Agip (Africa) Ltd v Jackson* [1990] Ch 265.
[58] Ibid.

services, but has no actual or apparent authority to do so, the principal (unless he ratifies) cannot sue or be sued on the contract.[59] Similarly, if the agent purports to transfer title to goods on behalf of the principal, but without actual authority to do so, title will not – subject to certain exceptions – pass.[60] In each of these circumstances the purported change in legal relations occurs without the principal's consent, and does not have the effect of changing his legal position. But often an agent will have the power to change the legal position of his principal, whether consent is present or absent. If, for example, the subject matter of the purported transfer is shares or a security interest in shares, pursuant to which the name of the purported transferee is entered on the register of members, the principal may apply under section 125 of the Companies Act 2006 to rectify the register.[61]

Such a result is explicable on the basis that the change in legal relations that the agent effects on behalf of his principal but without the latter's authority is unjustified because of the want of consent. Although the terminology ordinarily used is that of 'transfers of value', these actions are often considered to involve restitution in circumstances that amount to enrichment of the defendant at the claimant's expense. The proper ambit and operation of the law of unjust enrichment is outside the scope of this project. It suffices here to agree with the many writers who have argued that if an action lies for money transferred by mistake,[62] it ought also to lie in circumstances that amount to a total lack of consent on the part of the transferor.[63] And although they are ordinarily considered under the heading 'knowing receipt', it is

[59] *Bowstead & Reynolds on Agency* (Watts ed, 19th edn, London: Sweet & Mawell 2010), 8-001.
[60] Sale of Goods Act 1979 s21(1); Factors Act s2.
[61] See J. L. Yap, 'Knowing Receipt and Apparent Authority' (2011) 127 LQR 350, 350. *Thanakharn v Akai Holdings Ltd* [2010] HKEC 1692 (CFA (HK)).
[62] *Kelly v Solari* (1841) 9 M & W 54, 152 ER 24.
[63] See e.g. Mitchell, Mitchell and Watterson (eds), *Goff & Jones: The Law of Unjust Enrichment* (8th edn, Sweet & Maxwell), Chapter 8.

argued in what follows that the decisions in *BCCI v Akindele* and *Relfo v Varsani* exemplify precisely this phenomenon.[64]

*Relfo v Varsani* concerned a claim brought by the liquidator of Relfo Ltd ("Relfo") against Mr Varsani to recover $878,479.35 that had been misappropriated by its former director, Mr Gorecia.[65] Mr Gorecia, in breach of fiduciary duty, caused Relfo to pay $890,050 to a company called Mirren Ltd ("Mirren"). The next day, another company, Intertrade Group LLC ("Intertrade"), paid $878,479.35 to Mr Varsani's bank account. Both the High Court and Court of Appeal held that Varsani was accountable for that sum to the liquidator.[66]

In *BCCI v Akindele* the defendant, Akindele, entered into an agreement with ICIC Ltd, a company controlled by the BCCI group, to pay $10 million for shares in another company in the same group.[67] Under the agreement the defendant was guaranteed a return of 15 per cent if he decided to sell his shares after two years, which he did. Payment was made by BCCI Overseas, which was subsequently reimbursed by ICIC Ltd. The reason for the arrangement was to boost BCCI's apparent capital. The liquidator sought to hold the defendant liable for knowing receipt. Nourse LJ considered that the claimant could establish a disposal of his assets in breach of fiduciary duty, and the receipt by the defendant of assets that could be traced to those of the claimant. The claimant's claim failed at the third stage, for lack of knowledge.

Conaglen and Nolan have claimed that one of the primary obstacles to understanding liability in knowing receipt has been the 'failure to pay sufficient

[64] *BCCI v Akindele* [2001] Ch 437; *Relfo v Varsani* [2014] EWCA Civ 360.
[65] *Relfo v Varsani* [2012] EWHC 2168
[66] *Relfo v Varsani* [2014] EWCA Civ 360 [60].
[67] *BCCI v Akindele* [2001] Ch 437.

attention to whether the contract was made by a trustee or by an agent'.[68] In their words, 'despite the superficial similarity between trustees, who act "on behalf of the trust", and true agents, such as company directors, these two categories of legal actors enter into contracts in fundamentally different capacities'.[69] For Conaglen and Nolan that distinction goes to the question of whether a transfer of property made pursuant to the contract has been made in breach of duty.[70] In what follows it is argued that the distinction is indeed crucial, but that the reason for this goes not to the issue of breach, but to whether the facts raise questions that are appropriately considered under the head of liability known as 'knowing receipt' at all.

Directors do not hold company accounts on trust. Rather, the account is in the nature of a debt owing to the company at law.[71] Neither *BCCI* nor *Relfo* can therefore be explained on the basis that the defendant had received or dealt with any assets held on trust for the company, because there was no trust: the company was a creditor, not a beneficiary. The better view is that, because the agent in each case purported to effect the transaction on behalf of his principal, it was the principal who was party to the transaction,[72] and if lack of consent is a sufficient foundation for an action in unjust enrichment, each was a claim in unjust enrichment, to undo the effects of a transaction that was defective for a want of consent.[73]

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[68] Matthew Conaglen and Richard Nolan, 'Contracts and knowing receipt: principles and application' (2013) 129 LQR 359, 359.
[69] Ibid.
[70] Ibid.
[71] *Agip (Africa) Ltd v Jackson* [1991] Ch 547; *El Ajou v Dollar Land Holdings plc* (1995) 69 P & CR D25; *BCCI v Akindele* [2001] Ch 437; *Shalson v Russo* [2005] Ch 281; *Relfo v Varsani* [2014] EWCA Civ 360. See Robert Stevens, 'The Non-Existence of Unjustified Enrichment' (Sixth Biennial Conference on the Law of Obligations: Challenging Orthodoxy, London (Ontario), July 17th - 20th 2012).
[72] Ratification is altogether beside the point if the transaction has, as a matter of fact, changed the legal position of the company.
[73] In order for such an action to succeed, there must be something wrong with the transaction itself, or some independent reason for undoing it. The allegation in each of *BCCI v Akindele* and *Relfo v Varsani* ought to have been that the relevant directors were acting outside the ambit of their authority in entering into the transaction.

Of course, in *Relfo v Varsani* the process by which the payment was effected was particularly convoluted. Arden LJ considered it necessary to demonstrate that there had been 'an exchange of the value of the claimant's property into the next product for which it is substituted and so on down the chain of substitutions',[74] and was adamant that such a process could be conducted as a matter of fact, without reliance upon the intention of the parties.[75] Her Ladyship said:

> The judge [at first instance] inferred that there was a series of transactions between a number of entities and across a number of different accounts. He referred to a "journey" of the funds, and to a succession of choses in action, or obligations, assumed by one entity to another to pay on the funds (judgment, [77]). That is at the heart of the process.[76]

She analysed the facts as follows:

> At the start of the chain of transactions, Relfo had money on deposit with its bank, i.e. it had the benefit of a debt owed to it by its bank. It exchanged this right for a debt owed to it by Mirren. The value of this debt lay in the credit balance on this account. Mirren agrees to transfer this balance to another person or persons at some future date in exchange for Intertrade making the Intertrade payment.[77]

It is this kind of analysis that has led to the conclusion that the presence of a 'mixed fund' makes it impossible to trace at common law. In 1995 Birks described as 'absurd' the search for a 'string of clean substitutions'.[78] He continued:

> The best way forward will be to assert as a matter of law… what everyone already understands as a matter of fact, namely that a payment by A to Z made through the banking system is indeed a payment by A to Z.[79]

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[74] *Relfo v Varsani* [2014] EWCA Civ 360 [60].
[75] Ibid [58].
[76] Ibid [44].
[77] Ibid [61].
[78] Paul Birks, 'Tracing misused (Bank Tejarat v Hong Kong and Shanghai Banking Corp)' (1995) 9 Trust Law International 91, 92.
[79] Ibid.

We saw in Chapter Three that the terminology of 'tracing value' has led us to interpret the process of demonstrating that the parties are linked transactionally in a manner that is wholly artificial.[80] It is this idea that has led to the continued attempt, a decade after Birks' note on *Bank Tejarat v Hong Kong and Shanghai Banking Corp (CI) Ltd* was written, to show that there are a series of direct exchanges connecting two accounts. Identifying a transactional link is a normative process, and the intention of the parties is at its heart. What is necessary is not a series of transactional links, but a single transaction, which is demonstrated by proof of the intention to bring about a particular change in legal relations – whether by multiple steps or one single step. Determining whether claimant and defendant are indeed connected as part of the same transaction in such a case depends in the ordinary way upon whether an assessment of the parties' intentions reveals that multiple steps are intended to operate as one.[81]

**Example 6.2** ought, therefore, to be explicable as an ordinary two-party action in unjust enrichment:

> **Example 6.2:** A, who is P Co's accountant, alters the name of the payee on payments orders signed by P Co's signatory, causing P Co's bank to debit P Co's account and credit X's account with £100,000.

Importantly, it makes absolutely no difference to the result whether or not the parties happen to have a common correspondent, or whether or not the payment is accomplished by the use of multiple accounts, not one of which stands at £0. If the intention and result of the transaction is a payment from P Co to X, then it is a payment no matter how it is effected.

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[80] Chapter Three. See in particular the text accompanying fn 73-134.
[81] See for example *Curtain Dream plc v Churchill Merchanting Ltd* [1990] BCC 341; *AG Securities v Vaughan; Antoniades v Villiers* [1988] 3 WLR 1205.

## C. Proprietary Restitution

The decision in *Trustee of FC Jones v Jones* was considered above, in the context of characterisation of the claim in *Lipkin Gorman v Karpnale*.[82] It was argued that if any claim arose on the facts of either case, it was in the nature of a trust. But unlike the decision in *Lipkin Gorman*, the right claimed was not acquired by and did not come from a fiduciary. This section considers and rejects an unjust enrichment explanation for that claim.

In *Chase Manhattan Bank v Israel British Bank* the claimant bank paid some $2 million by mistake to a second bank in New York, to be paid to the defendant bank which carried on business in London.[83] Prior to the claimant's action for the recovery of that money the defendant bank obtained a winding up order, and the question at trial was whether the claimant was nevertheless 'entitled in equity to trace the mistaken payment and to recover what now properly represented the money'.[84] Goulding J held that 'a person who pays money to another under a factual mistake retains an equitable property in it and the conscience of that other is subjected to a fiduciary duty to respect his proprietary right'.[85] Since there was no trust prior to the payment,[86] that decision can only be understood as recognising a new proprietary claim as a result of the mistaken transfer.

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[82] The text accompanying fn 31-36.
[83] *Chase Manhattan v Israel-British Bank* [1981] Ch 105.
[84] Ibid 106.
[85] Ibid 119.
[86] This was made clear by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 2 WLR 802, [1996] AC 669, 706: A person solely entitled to the full beneficial ownership of money or property, both at law and in equity, does not enjoy an equitable interest in that property. The legal title carries with it all rights. Unless and until there is a separation of the legal and equitable estates, there is no separate equitable title. Therefore to talk about the bank "retaining" its equitable interest is meaningless. The only question is whether the circumstances under which the money was paid were such as, in equity, to impose a trust on the local authority. If so, an equitable interest arose for the first time under that trust.'

That decision has proven exceedingly controversial, and the debate is generally phrased in the following way: 'does unjust enrichment create proprietary rights to restitution?'.[87] We saw in Chapters Four and Five that the conversion in equity of claims to rights from personal obligations into proprietary claims is largely an accident of history.[88] Yet there are multifarious examples of situations in which an immediate,[89] future,[90] or conditional,[91] obligation to transfer a right is treated in equity as a trust. The question is thus not, 'does it make sense to award a proprietary claim?' but rather, 'does it make sense to award a claim to a particular right?'.[92] That question will be answered by reference to the following examples:

> **Example 6.3:** A mistakenly gives B a painting.
>
> **Example 6.2:** A, who is P Co's accountant, alters the name of the payee on payments orders signed by P Co's signatory, causing P Co's bank to debit P Co's account and credit X's account with £100,000.

It will be argued that that a claim to a right is an appropriate mechanism for effecting restitution in **Example 6.3** but is not in **Example 6.2.**

It is sometimes possible without additional help from equity for the claimant to restore the parties to the positions in which they were prior to a transaction. In *Load v Green* a bankrupt, Bannister, was found to have acquired title to handkerchiefs by fraud. The defendants, Bannister's assignees in bankruptcy, took possession of the handkerchiefs. The plaintiffs argued that the assignees were liable in trover. Entering a verdict for them, Baron Parke said:

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[87] See e.g. William Swadling, 'Policy Arguments for Proprietary Restitution' (2008) 28 Legal Studies 506.
[88] See the text accompanying fn 11-15.
[89] E.g. *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223.
[90] E.g. *Lysaght v Edwards* (1876) 2 Ch D 499.
[91] E.g. *Re Rose* [1949] Ch 78; *Pennington v Waine* [2002] EWCA Civ 227; *Zeital v Kaye* [2010] EWCA Civ 159, [2010] 2 BCLC 1; *Curtis v Pulbrook* [2011] EWHC 167, [2011] 1 BCLC 638.
[92] See further Smith, 'Philosophical Foundations of Proprietary Remedies' in Chambers, Mitchell and Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP).

> As the goods were obtained by a fraudulent purchase, the plaintiffs had a right to disaffirm it, to revest the property in them, and recover their value in an action of trover against the bankrupt; and as the assignees take, by virtue of the assignment, such interest only as the bankrupt has, the plaintiffs had a right to recover the value of the goods in the hands of the assignees, in the same form of action, on a conversion by them…[93]

*Load v Green* is ordinarily understood to be controversial because it decides that title to goods transferred under a contract that is subsequently rescinded for fraud automatically revests upon rescission.[94] It is in fact controversial because it decides that title passes at all. During the eighteenth century title to any goods transferred under a contract procured by fraud was considered to remain with the plaintiff.[95] *Load v Green* established, for the first time, that title to goods obtained under a contract induced by fraud passes, but defeasibly.

In *Car & Universal Finance Ltd v Caldwell* Caldwell had advertised his Jaguar for sale. Two men persuaded him to sell it to them in return for a cheque and another car as security. The former was dishonoured and the latter turned out to have been stolen. Caldwell immediately informed the police and the Automobile Association. One of the fraudsters then sold the car to Motobella Ltd, who sold it to G & C Finance Ltd, who sold it to a dealer, who sold it, in turn, to Car & Universal Finance. In interpleader proceedings, the question at first instance and on appeal was whether Caldwell's act of informing the police and the Automobile Association of his

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[93] *Load v Green* (1846) 15 M & W 216, 135 ER 828 [221].

[94] Swadling attacks the decision on that basis: William Swadling, 'Rescission, property, and the common law' (2005) 121 LQR 123. His attack is really concerned, however, with the rule that title passes by virtue of the agreement, rather than by delivery, which is the foundation for the idea that it can be revested by virtue of recognising that the agreement is void, rather than by redelivery. That rule arose to satisfy the concerns that an action in detinue could not be brought where the plaintiff could not show a prior right to the thing claimed. Swadling argues that it is not only by virtue of the transaction that title passes, but also by delivery. This does not really advance the debate, since title only passes by delivery if that is what the claimant intends. If his intention is defective, then we might just as well conclude that title has not, after all, passed.

[95] *Anon* (1704) 6 Mod 114, 87 ER 872; *Miller v de Metz* 1 M & Rob 479; *Ex parte Carlow* 2 Mont & Ayr 39; *Earl of Bristol v Wilsmore* (1823) 1 B&C 514, 107 ER 190, 192; *Ferguson v Carrington-Adams* 7 Taunt 54.

intention to rescind the contract of sale had the effect of revesting title in him. Both held that it did, which meant that the onward sale of the car was ineffective to pass title.

In each of these cases, the claimant was entitled to set the contract aside, which itself had the effect of returning the parties to the positions in which they were prior to it. Often, however, it will not be possible for the claimant to revest title unilaterally in this way. In *Blacklocks v JB Developments* the claimant contracted to sell part of their land to a purchaser, Godden.[96] The plan included a parcel of land that neither party intended to transfer. Subsequently Godden sold his land to the defendants who became registered owners of the whole of the land, including the disputed land. The judge held that the defendants were trustees of title to the disputed portion of land, pending rectification of the register.

The purpose of a restitutionary action is to restore the parties to the positions in which they were prior to the transaction. If the transaction takes the form of a transfer of a particular right, the best way of effecting restitution is to require the defendant to retransfer that right. So, in *Blacklocks* the claimant acquired a power to revest title, the purpose of which was to restore the parties to their pre-transactional holdings. And a claim to a right is, we have seen, treated in equity as a trust.[97] Similarly, the following example, A's claim to title to the painting is a proprietary claim in the nature of a trust:

**Example 6.3:** A mistakenly gives B a painting.

Such cases are, however, few and far between. More often, the transaction that the claimant seeks to reverse does not involve the transfer of an identifiable right, but

[96] *Blacklocks v JB Developments* [1982] Ch 183.
[97] See above, the text accompanying fn 84-87, and Chapter Three, the text accompanying fn 11-15.

rather a debit to one account and credit to another. In some such cases it has been held that a trust arises in respect of the credited account, on the basis that this – in the same way as the trust in *Blacklocks* – permits the restoration of title to the claimant. These explanations, explored in what follows, are fundamentally flawed, for the simple reason that an account does not involve the transfer of anything to which it is possible to vest or revest title.

One of the claims in *Shalson v Russo* involved title to a yacht, which had been acquired with loan payments from the eighth defendant, Mimran.[98] In 1999 Shalson and the eighth defendant had set up a company, W, to be the vehicle for joint ventures between them. Between 1999 and 2000 Mimran made four loan payments to W totaling US$7.5 million, the money being paid into the sixth defendant's account with P. Russo fraudulently represented that the moneys were to be used in joint venture property transactions, while in fact Russo used the funds for his own purposes, including making loan payments to E towards the acquisition of a yacht, the 'Mosaique'. Mimran sought to assert a proprietary claim to title to that yacht. Rimer J said:

> If Mr Mimran can establish a proprietary interest in the Mosaique, it can only be because money in which he had a proprietary interest was applied in its acquisition. If he had no proprietary interest in any of the money so applied, then he can have acquired no proprietary interest in the Mosaique: as Lear advised Cordelia in the opening scene of his tragedy, nothing will come of nothing.[99]

He continued, echoing the words of Millet J in *Lonrho plv v Fayed (No. 2)*.[100]:

> [U]pon rescission of a contract for fraudulent misrepresentation, the beneficial title which passed to the representor under the contract

[98] *Shalson v Russo* [2005] Ch 281.
[99] Ibid [122].
[100] *Lonrho Plc v Al-Fayed (No.2)* [1992] 1 WLR 1 'It may well be that if the representee elects to avoid the contract and set aside a transfer of property made pursuant to it the beneficial interest in the property will be treated as having remained vested in him throughout, at least to the extent necessary to support any tracing claim.' [12].

> revests in the representee. The representee then enjoys a sufficient proprietary title to enable him to trace, follow and recover what, by virtue of such revesting, can be regarded as having always been in equity his own property.[101]

The judge concluded that whilst it was in principle possible for Mimran to establish a claim both to the account and title to the yacht, the fact that the account into which the funds had been paid was overdrawn prevented Mimran from being able to trace through it, to title to the yacht.

In *London Allied Holdings v Lee* London Allied Holdings paid £1 million to Lee pursuant to negotiations and as part of an agreement between London Allied Holdings and Lee for the sale by Lee of the Ritz Hotel to London Allied Holdings.[102] Lee represented that he had access to a contract to purchase the Ritz at a price of £200 million. That representation was false, and London Allied Holdings brought an action to rescind the contract and claim what remained of the £1 million and a car Lee had bought with it. Etherton J held that the claimant was entitled to rescind the contract, and could claim both the money and title to the car.

> There is no doubt that a transaction induced by fraud is voidable and, subject to equitable considerations, may be rescinded. The effect is to restore retrospectively to the claimant the equitable title to the property, at least to the extent necessary to support an equitable tracing claim.[103]

There are two reasons why the judge's characterisation of the effect of rescission in each case cannot be correct: (i) setting aside the contract could not have had the effect of retransferring the funds, because the funds were transferred by virtue of the payment instruction, not the contract; and (ii) unlike the facts of *Load v Green* and *Car & Universal Finance v Caldwell* there was no thing transferred to which it

[101] *Shalson v Russo* [2005] Ch 281.
[102] *London Allied Holdings v Lee* [2007] EWHC 2061.
[103] Ibid [276].

was possible to revest title.[104] If a proprietary claim arose on the facts of either case, it cannot be because title in some sense 'revested' in the claimant.

That the discussion of restitution is usually framed in the language of 'tracing' and 'trusts' has prevented both the logic and operation of such claims from attaining any level of clear articulation.[105] Importantly, where the characterisation of claims consequent on rescission has been raised for discussion, it is not because establishing a proprietary claim to the defendant's account will allow the claimant to recover more than he might with a personal claim, but rather for the purposes of asserting a claim to some asset acquired by the defendant as a consequence of his fraud – title to a yacht in *Shalson*, and title to car in *London Allied Holdings*.

We have already seen that the presence of a prior proprietary claim to the defendant's account is neither an explanation nor a pre-requisite for a claim that arises in respect of a new right acquired with it.[106] It would, however, be surprising indeed if the effect of fraud was to import into the relationship between wrongdoer and wronged party the rule in *Keech v Sandford*.[107] That rule is premised on the prior assumption of a fiduciary role, the loyal performance of which it secures. According to the authors of *The Law of Rescission*, any proprietary claim that arises on facts that involve fraud does so, not to effect restitution in the ordinary way, but rather for

[104] 'Unlike the situation where property is transferred or cash paid over, in this situation no interest in any *res* is transferred. There is simply a correspondence between a debit to the payer's account and a credit to the payee's. The only property in respect of which a proprietary interest can arise is the chose in action represented by the new or increased credit balance in the payee's bank account' Dominic O'Sullivan, Steven Elliott and Rafal Zakrzewski, *The Law of Rescission* (OUP 2007) 16.42.

[105] In discussing the liability of a thief in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 2 WLR 802, [1996] AC 669 Lord Browne-Wilkinson used 'constructive trustee' to refer to the claimant's proprietary claim, and not to the establishment of additional fiduciary obligations (715-716). See now *Shalson v Russo* [2005] Ch 281 317 (Rimer J) and *Armstrong DLW GmbH v Winnington Networks Ltd* [2013] Ch 156

[106] Chapter Four. See in particular the text accompanying fn 127-172.

[107] In *Lonrho Plc v Al-Fayed (No.2)* [1992] 1 WLR 1 Millett J considered that 'Even after the representee has elected to avoid the contract and reclaim the property, the obligations of the representor would in my judgment be analogous to those of a vendor of property contracted to be sold, and would not extend beyond the property actually obtained by the contract and liable to be returned' (11-12). Compare *Bank Tejarat v Hong Kong and Shanghai Banking Corp (CI) Ltd* [1995] 1 Lloyds Rep 239, 248; *Estate Properties Ltd v Wignall* [1992] 2 NZLR 615, 633.

reasons that are peculiar to fraud: 'cases involving fraud… are to be regarded as exceptional, and justified by policy considerations that do not apply to the other grounds for rescission'.[108] If this is true, and there are suggestions in our cases that there is a 'flexibility' in the equitable jurisdiction to cope with fraud, those policy considerations have yet to be articulated and examined.[109]

Our highest court has, in fact, rejected the possibility of proprietary restitution, at least on by virtue of an institutional trust and in circumstances that do not amount to the acquisition of knowledge of the relevant injustice.[110] In *Westdeutsche Landesbank Girozentrale Respondent v Islington London Borough Council* money had been paid by the claimant under an interest-rate swap agreement that was subsequently held to be ultra vires the defendant council.[111] At first instance and on appeal the council was held liable to make restitution and the only question before the House of Lords was whether the council also had to pay compound interest. A majority of the House held that it did not. One of the claims concerned whether the bank held the funds on trust for the council. Lord Browne-Wilkinson considered that the only appropriate basis upon which to develop proprietary claims in such circumstances was by reference to the remedial constructive trust.[112] His Lordship said:

> I do not think it right to make an unprincipled alteration to the law of property (i.e. the law of trusts) so as to produce in the law of unjust enrichment the injustices to third parties which I have mentioned and the consequential commercial uncertainty which any extension of proprietary interests in personal property is bound to produce.[113]

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[108] O'Sullivan, Elliott and Zakrzewski, *The Law of Rescission* (OUP 2007) [16.54].
[109] *Lonrho Plc v Al-Fayed (No.2)* [1992] 1 WLR 1 9.
[110] The role of knowledge in cases involving unauthorised bank transfers is considered below.
[111] *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 2 WLR 802, [1996] AC 669.
[112] Ibid 714.
[113] Ibid 709.

Smith argues that, 'in the case of the mistaken payment… there can only be a trust if the obligation of the defendant can be understood as an obligation to re-transfer *the very money* that was mistakenly paid'.[114] He continues:

> The intuitive outcome in a case of payment by mistake, or any transfer that is unjustified from the outset, is that the primary obligation of the defendant should be to restore the very substance of what was unjustly received. That is the most perfect way to make restitution, since it most perfectly restores the *status quo ante*.[115]

But there are two reasons why, as a matter of principle, the decision in *Westdeutsche* might be considered welcome. First, perfect restitution of this kind is never possible in the context of a bank transfer: the right that the defendant acquires is a different right from that lost by the claimant. A trust does therefore not bring about perfect restitution, because that cannot be done. Second, what might be thought to operate as substitutive restitution in fact achieves perfect restitution: if the claimant transfers £10 to the defendant, reducing his balance from £100 to £90, and increasing the defendant's balance from £100 to £110, if the defendant is required to pay the claimant £10, the claimant's balance becomes £100 and the defendant's £100. So, the *best* way of reversing an unjust bank transfer is for the defendant to retransfer an equivalent sum. That is not an obligation to account *in specie* for any particular right. Thus it is a personal remedy, not a trust. Writing extra-judicially, Edelman J argues:

> If A mistakenly instructs his bank (Bank A) to pay money into B's account with another bank (Bank B), the best way of reversing the transfer of value from A to B is for an order that B make restitution to A of the value received. This would generally occur by a cheque from B which would be paid back into A's initial account, restoring the situation before the mistake. In contrast, an attempt to make restitution of the rights received by B, by recognition of a trust of B's rights against his bank, would not reverse the transfer. Far from it. A started

[114] Smith, 'Philosophical Foundations of Proprietary Remedies' in Chambers, Mitchell and Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (OUP 2009) 293.
[115] Ibid 294.

> with rights, subject to particular terms and conditions, against Bank A. A concludes with the benefit of a trust of different rights, subject to different terms and conditions, against Bank B.[116]

So, the better view is that reversal of a transaction entered into without consent, or with defective consent, ought not to involve a proprietary claim where the transaction sought to be reversed is a bank transfer. We are now able to distinguish **Example 6.2** from **Example 6.3**:

> **Example 6.3:** A mistakenly gives B a painting.
>
> **Example 6.2:** A, who is P Co's accountant, alters the name of the payee on payments orders signed by P Co's signatory, causing P Co's bank to debit P Co's account and credit X's account with £100,000.

In **Example 6.3** the best way of reversing the transaction is to award A a claim to title to the painting. In **6.2** the best way of reversing the transfer is to award P Co a personal claim against X to £100. The decision in *Trustee of FC Jones v Jones*, which amounts to recognition of a proprietary claim against an innocent non-fiduciary, to a right that was acquired under a transaction independent of that entered into by the partner,[117] is exceedingly difficult to defend as a matter of authority or principle.

## III. Equitable Claims and Tracing

We have seen that the ordinary explanation for a claim to a new right in the hands of a trustee is that the beneficiary can trace from the original trust right to its product. In Smith's words:

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[116] James Edelman, 'Restitution of (Property) Rights' (University of Melbourne Colloquium on Proprietary Rights, Melbourne, 5-7 December 2012) 14.

[117] We cannot have it both ways: either a bank transfer is a transaction, that has the effect of changing the legal positions of the parties to it, or it is not. The right that Mrs Jones acquired in respect of the profits after her dealings cannot be the same right as that which she initially acquired by paying the funds into her account. If dealings with bank accounts do not have the effect of changing the account holder's legal position, the decisions in *Keech v Sandford* (1726) Sel Cas Ch 61, 25 ER 223 and *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] 3 WLR 535 are indefensible.

> Tracing identifies a new thing as the potential subject matter of a claim, on the basis that it is the substitute for an original thing which was itself the subject matter of a claim. The new thing, as a substitute, stands in the place of the old thing, and therefore can be subject to the same claims.[118]

If the trustee then transfers that right to a third party, the explanation for the claim against that third party is then considered simply to be a matter for following:

> Suppose that a thief steals my computer and swaps it for a stereo, which he then gives to his brother… If I am to assert a claim against the thief's brother, I have to trace through the substitution of the stereo for the computer. Then I have to follow the stereo to its receipt by the brother.[119]

So, in the following example, B can, it is thought, trace into title to the wine, follow it to X's hands, and either claim it, or assert a personal claim against X in knowing receipt:

> **Example 6.4**: T holds title to a £10 note on trust for B. Without B's authority he buys a bottle of wine with the note and then gives the bottle to X, who knows about the trust.

That explanation is applied wholesale to the following example:

> **Example 6.5:** T holds an account on trust for B. He debits the trust account and credits his own account. He then credits X's account with an equivalent sum. X knows about the trust and T's lack of authority.

In each case the claimant can, it is thought, demonstrate that the right in the defendant's hands is the product of the claimant's right, such that his claim is transmitted to the substitute. Whether it involves a bank transfer or transfer of a right from claimant to defendant, a claim in knowing receipt is thus 'concerned with the person who receives for his own benefit trust property transferred to him in breach of trust'.[120]

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[118] Smith, *The Law of Tracing* (OUP 1997), 6.
[119] Ibid 8.
[120] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 291.

In what follows it is argued that the language of tracing has lent the appearance of conceptual unity to two discrete claims. A beneficiary can assert a continuing proprietary claim to a trust right in the hands of a third party if the third party cannot raise the defence of bona fide purchase.[121] But a transaction involving a debit to one account and credit to another is not such a case. In these cases, if liability arises it cannot be on the basis that the beneficiary's claim persists. Nor are we aided by the idea that the beneficiary's claim is automatically 'transmitted' from one account to another: if it is transmitted, we must explain why. And if liability arises on some basis other than by virtue of an equitable claim to payee's account, as a wrong committed against the beneficiary, we have not yet articulated the scope and content of that wrong.

## A. Persisting Equitable Interests

The beneficiary of an express trust can collapse it, imposing upon the trustee an obligation to transfer to him whatever right was vested in the trustee by the settlor.[122] Prior to a demand, that claim is in the nature of a power, not an immediate right.[123] Importantly, it is a proprietary interest: no matter into whose hands the trust right comes, and irrespective of additional duties that may be or become owing,[124] the

[121] *Pilcher v Rawlins* (1871-72) LR 7 Ch App 259.
[122] *Saunders v Vautier* (1841) EWHC Ch J82.
[123] See *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53; (2005) 224 CLR 98; Cutts, 'The Nature of Equitable Property: a Functional Analysis' (2012) 6 Journal of Equity 44.
[124] Sometimes the term 'trust' is used to describe only the beneficiary's proprietary claim e.g. *Boscawen v Bajwa* [1996] 1 WLR 328, 334-335. Often it is used to mean 'fiduciary relationship' e.g. *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 2 WLR 802, [1996] AC 669707. Mitchell and Watterson are correct to point out that much of the disagreement in this regard is semantic: Charles Mitchell and Stephen Watterson, 'Remedies for Knowing Receipt' in C. Mitchell (ed), *Constructive and Resulting Trusts* (Hart Publishing 2010) 117. See also *R v Chester and North Wales Legal Aid Area Office, ex parte Floods of Queensferry Ltd* [1998] 1 WLR 1496 , 1500 (Millett LJ).

beneficiary can, by notifying that person, impose upon them an obligation to restore the trust right to the trust.[125] As Lord Millett held in *Foskett v McKeown*:

> A beneficiary of a trust is entitled to a continuing beneficial interest not merely in the trust property but in its traceable proceeds also, and his interest binds every one who takes the property or its traceable proceeds except a bona fide purchaser without notice.[126]

Unlike the title-holder at law, the beneficiary does, accordingly, have something in the nature of a true *vindicatio*. As Birks put it:

> A claim which asserts "I say that you have come under an obligation to pay me damages for misappropriating my Cézanne!" does, in the loosest lay sense, vindicate my property right, but it is not properly speaking a *vindicatio* and it should never be referred to as such. It asserts the proprietary right obliquely or indirectly. There is no vindication of chattels at common law. However, in equity there is. A claimant can ask a court to declare that the defendant holds the Cézanne on trust for him. In effect he is then directly asserting that the painting is his in equity. He is asking the court to uphold that proposition and to declare it to be true.[127]

The reason why the trust arises does not affect the question of whether or not it binds third parties. In *Attorney General for Hong Kong v Reid* Reid, whilst Attorney General for Hong Kong, had accepted substantial bribes to obstruct the prosecution of certain alleged criminals.[128] He used those funds to purchase properties in New Zealand, which he subsequently transferred to his wife and solicitor. The Attorney General for Hong Kong was permitted by the Privy Council to renew the caveats on the basis that the solicitor and wife held title to the properties on trust. We saw in Chapter Four that the claim that arises in such a case does so because the fiduciary

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[125] *Pilcher v Rawlins* (1871-72) LR 7 Ch App 259; *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 2 WLR 802, [1996] AC 669, 705 (Lord Browne-Wilkinson).
[126] *Foskett v McKeown* [2001] 1 AC 102.
[127] Birks, 'Receipt' in Birks and Pretto (eds), *Breach of Trust* (Hart Publishing 2002) 215-216.
[128] *Attorney General of Hong Kong v Reid* [1994] 1 AC 324. This case is considered in Chapter Five, in the text accompanying fn 38-42.

acquires the new right within the scope his fiduciary endeavour.[129] Once that claim has arisen, it can be asserted wherever its subject matter happens to reside, unless that place is in the hands of a bona fide purchaser.

So in the following example, B can assert a continuing equitable claim to title to the vase:

> **Example 6.4**: T holds title to a £10 note on trust for B. Without B's authority he buys a bottle of wine with the note and then gives the bottle to X, who knows about the trust.

T acquires the right by (mis)managing the trust. The claim that arises in respect of that right can be asserted against X.

More difficult, however, are attempts to apply this analysis to bank accounts. In *ITS v GP Noble Trustees* Mr Anthony Morris was wrongfully credited with £4,890,000 from various pension schemes.[130] He paid £1,480,000 to his former wife, Mrs Morris, to satisfy his liability under a consent order. She was initially a *bona fide* purchaser: she gave value in the form of agreeing not to pursue any further claims for ancillary relief in return for the sum paid under the consent order. However, she later succeeded in having the consent order set aside, on the basis that Mr Morris' disclosure in the ancillary relief proceedings had been deliberately and materially deficient. By the time a new order was made, she had notice of the funds' provenance. ITS was held to be able to 'trace the £1.481m into the hands of Mrs Morris on the basis of a subsisting beneficial interest', and could recover the entire sum.[131]

More recently, in *Credit Agricole Corporation and Investment Bank v Papadimitrou*, the court considered an action for the recovery of some US$10.3 million, constituting the proceeds of sale of a collection of art deco furniture which

[129] See the text accompanying fn126-171
[130] *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195 [101].
[131] Ibid [67], [101]

had been deposited in a bank in Gibraltar.[132] It was common ground that the defendant bank still had the proceeds of sale, and the only question was whether the bank could show that it was a bona fide purchaser. Delivering judgment for the Privy Council, Lord Clarke held that it was not: the bank ought to have made inquiries that would have revealed the claimant's pre-existing proprietary right in the funds received.

The problem with such accounts was explored in Chapters Two and Three. The recipient's claim against his bank is a debt owing to the recipient at law, and it is an entirely different right from that which the claimant can assert against his own bank. No independent asset is transmitted.[133] In Yap's words

> [W]hen the benefit received takes the form of a funds transfer into a bank account… there is no transfer of property rights from one account to another; instead, there is merely a corresponding but separate adjustment of the choses in action (as represented by the bank accounts) of the payer and payee against their own respective banks.[134]

Often, the terminology of 'tracing value' is used to describe the process of linking some right originally held on trust with a right now in the hands of the defendant, so as to explain the transmission of the beneficiary's equitable claim from the former to the latter.[135] As we saw in Chapter Three, the most that we can say about the process of linking the parties to a funds transfer is that it is a process of identifying and characterising a transaction by which one account is debited and another credited. That process does not permit us to say that the right in the defendant's hands *is*, in some metaphysical sense, the original right. Nor does it explain, without more, any claim that might arise against the payee.

The following two examples are not, therefore, identical:

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[132] *Credit Agricole Corporation and Investment Bank v Papadimitriou* [2015] UKPC 13.
[133] *R v Preddy* [1996] AC 815.
[134] Yap, 'Knowing Receipt and Apparent Authority' (2011) 127 LQR 350, 351.
[135] Smith, *The Law of Tracing* (OUP 1997) 253.

> **Example 6.4**: T holds title to a £10 note on trust for B. Without B's authority he buys a bottle of wine with the note and then gives the bottle to X, who knows about the trust.

In this example, B's claim to title arose because the right was acquired by T in within the sphere of his fiduciary endeavour. That title still exists, and can be asserted against X.

> **Example 6.5:** T holds an account on trust for B. He debits the trust account and credits his own account. He then credits X's account with an equivalent sum. X knows about the trust and T's lack of authority.

In this example there is no sense in which the right acquired by X can be regarded as having come from T. It is an entirely different right. The explanation for the result in *ITS v GP Noble* trustees cannot therefore be that B's claim somehow 'persists'.[136]

### B. Persisting Equitable Interests and 'Knowing Receipt'

If the recipient of a trust right knows about the trust, the beneficiary may also be able bring an action in knowing receipt, subjecting the recipient to a personal liability to account 'as a constructive trustee' for the right or rights received.[137] In *El Ajou v Dollar Land Holdings* Hoffmann LJ laid down the following formula for liability in knowing receipt:

> The plaintiff must show, first, a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty.[138]

The application of this formula to the context of trust rights that are actually transferred from the trustee to the defendant is the easiest case. The only area of

[136] Whether it can be explained on the basis of an action in knowing receipt is considered below, in the text accompanying fn 156-158.
[137] *Re Montagu's Settlement Trusts* [1987] Ch 264.
[138] *El Ajou v Dollar Land Holdings plc* (1995) 69 P & CR D25 154 (Hoffmann LJ).

significant controversy surrounds the idea that once these criteria are met, the defendant is liable 'as a constructive trustee'.

*Re Montagu's Settlement Trusts* involved the improper release by trustees of trust assets to the beneficiary, the tenth Duke of Manchester.[139] In 1923 the future tenth Duke of Manchester assigned to trustees 'all articles of furniture, plates, pictures and other chattels' to which he was absolutely entitled in remainder after the death of the ninth Duke. The trustees were to make an inventory of such chattels as they considered suitable for inclusion in the settlement, and were to hold the residue in trust for the future tenth Duke. The ninth Duke died in 1947. Although the trustees released the chattels to the tenth Duke without making the agreed inventory, the Duke's solicitor informed the Duke that he was free to sell the items released. The Duke disposed of a number of items during his lifetime. After his death in 1977, the eleventh Duke brought an action for inquiries as to the proceeds of items sold, alleging that the tenth Duke held the chattels as a constructive trustee, as a knowing recipient of trust assets released in breach of trust.

Sir Robert Megarry VC considered two questions, one of which was 'whether the tenth Duke received any or all of the settled chattels with sufficient knowledge that the trustees were in breach of duty in allowing him to treat them as his own absolute property so as to make him a constructive trustee of them'.[140] He concluded that since he was entirely innocent of the facts giving rise to the breach of trust, the Duke could not be held accountable in knowing receipt.[141]

[139] *Re Montagu's Settlement Trusts* [1987] Ch 264.
[140] Ibid 268.
[141] Ibid 271-272.

According to Mitchell and Watterson, when courts say that a knowing recipient is liable to account as a trustee 'they mean exactly what they say'.[142] That is, they claim that because the asset 'continues to be owned by the beneficiaries in equity, '[143] 'equity fixes [the recipients] with custodial duties which are the same as some of the duties which are voluntarily assumed by express trustees'.[144] It is not altogether clear how or why, on this account, such fixing occurs.[145] Nevertheless, the primary obligation that they identify is the obligation to restore the trust right to the trust:

> A knowing recipient's core duty, and generally his only duty of practical significance, is to restore the misapplied trust property. His duty is to restore the property immediately, rather than to restore it on demand. In this respect his position can be contrasted with that of an express bare trustee, who holds the trust property to the order of the beneficiary while the trust subsists, and whose continuing retention of this property is authorised, and therefore legitimate, until the beneficiary gives contrary instructions.[146]

By contrast, in *Paragon Finance v DB Thakerar*, in a passage recently cited by the Supreme Court,[147] Millett LJ drew a firm distinction between cases in which a recipient receives a right in circumstances that make it 'unconscionable' for him to deny the equitable interest of another', in which 'the constructive trustee really is a trustee', and cases in which 'the defendant is implicated in a fraud':

> Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case he is traditionally though I think unfortunately described as a

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[142] Mitchell and Watterson, 'Remedies for Knowing Receipt' in Mitchell (ed), *Constructive and Resulting Trusts* (Hart Publishing 2010) 115-116.
[143] Ibid 115-116.
[144] Ibid 130.
[145] Later in that chapter, they suggest that fiduciary obligations might arise on the basis that retention of trust rights amounts to an acceptance of responsibility: ibid 144. This does not seem to be much different – in the absence of manifestation of acceptance – from the mere conclusion that such duties are 'fixed'.
[146] Ibid 132. Precisely why it is that knowledge is not only necessary but also sufficient for such a duty is not altogether clear.
[147] *Williams v Central Bank of Nigeria* [2014] UKSC 10, [2014] 2 WLR 355.

> constructive trustee and said to be "liable to account as constructive trustee." Such a person is not in fact a trustee at all, even though he may be liable to account as if he were. He never assumes the position of a trustee, and if he receives the trust property at all it is adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff. In such a case the expressions "constructive trust" and "constructive trustee" are misleading, for there is no trust and usually no possibility of a proprietary remedy; they are "nothing more than a formula for equitable relief".[148]

This distinction was recently reiterated in *Williams v Central Bank of Nigeria*.[149] That case concerned the application of the Limitation Act 1980 to a claim in knowing receipt. In 1986 the claimant had participated in a transaction under which it was alleged that he had been defrauded of some $6.5 million. The claimant alleged that in May 1986 an English solicitor, who had held that sum in his client account in trust for the claimant on terms that he would only release it when certain sums had been paid in Nigeria, had, in breach of that trust, paid $6,020,190 into an account maintained by the defendant in England, who was party to the fraud.

The important question was whether, having brought his claim 14 years after it accrued, the claimant's action was time-barred. Section 21(3) of the Limitation Act prescribes a six-year period for any 'action by a beneficiary to recover trust property or in respect of any breach of trust' not otherwise covered by the Act. However, section 21(1)(a) of the 1980 Act provides that

> No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy.

One of the arguments advanced for the claimant was that a knowing recipient could be regarded as a 'trustee' for the purposes of section 21(1)(a). A majority of the

[148] See also *Selangor United Rubber Estates Ltd v Craddock (No. 3)* [1968] 2 All ER 1073, 1582 (Ungoed-Thomas J), and *Dubai Aluminium Co Ltd v Salaam* [2002] UKHL 48.
[149] *Williams v Central Bank of Nigeria* [2014] UKSC 10, [2014] 2 WLR 355.

Supreme Court held that it could not.[150] Reiterating Millett's LJ's distinction between 'true' constructive trustees and strangers, Lord Sumption said:

> The essence of a liability to account on the footing of knowing receipt is that the defendant has accepted trust assets knowing that they were transferred to him in breach of trust and that he had no right to receive them. His possession is therefore at all times wrongful and adverse to the rights of both the true trustees and the beneficiaries. No trust has been reposed to him. He does not have the powers or duties of a trustee, for example with regard to investment or management. His sole obligation of any practical significance is to restore the assets immediately. It is true that he may be accountable for any profit that would have been made or any loss that would have been avoided if the assets had remained in the hands of the true trustees and been dealt with according to the trust. There may also, in some circumstances, be a proprietary claim. But all this is simply the measure of the remedy. It does not make him a trustee or bring him within the provisions of the Limitation Act 1980 relating to trustees.[151]

It is clear that Lord Sumption considered that the beneficiaries' claim in such a case persisted, and that the recipient was subject to an obligation to restore the assets to the trust. He simply held that it was not an action, for the purpose of the Limitation Act, *against a trustee*.

According to Lord Sumption, the reason why the clock does not run in an action against a trustee in respect of the misapplication of trust assets is that a trustee's liability does not depend upon proof of any breach. Rather, 'if the trustee misapplied the assets, equity would ignore the misapplication and simply hold him to account for the assets as if he had acted in accordance with his trust'.[152] By contrast, strangers to the trust who receive trust assets misappropriated in breach of duty would

[150] See James Lee, 'Constructing and limiting liability in equity' (2015) 131 LQR 39.
[151] *Williams v Central Bank of Nigeria* [2014] UKSC 10, [2014] 2 WLR 355 [31].
[152] Ibid [13].

be liable because 'their dealings with the assets were at all times adverse to the beneficiaries, and indeed to the true trustees holding the legal interest'.[153]

Each of the accounts of knowing receipt considered in this part accordingly depends upon the idea that the beneficiary has a continuing claim in respect of the right received. The difference between Mitchell and Watterson's characterisation of liability and that of Lord Sumption goes to the reason why the beneficiary can not only obtain back the trust right, but also sue for compensation or disgorgement of any profit acquired by the recipient. For the former, it is because the recipient is a trustee in the full sense. For the latter, it is because acquisition of the trust right with knowledge of its provenance either amounts to or is dependent upon a wrong.

Recall now **Example 6.4:**

> **Example 6.4**: T holds title to a £10 note on trust for B. Without B's authority he buys a bottle of wine with the note and then gives the bottle to X, who knows about the trust.

In this example, B can assert a proprietary claim against X, or – if X no longer has it – a personal claim in knowing receipt.

The difficulty lies in reconciling either account of knowing receipt with the fact pattern most commonly present, and which was present in *Williams*. Recall, also, **Example 6.5**:

> **Example 6.5:** T holds an account on trust for B. He debits the trust account and credits his own account. He then credits X's account with an equivalent sum. X knows about the trust and T's lack of authority.

In such a case the most that we can say is that T and X enter into a transaction that has the effect of changing T, B and X's legal positions. We have *not* explained how it is that X's right against his bank is held in a manner that can be regarded as

[153] Ibid.

adverse to B's claim. According to Davies, although liability in knowing receipt depends upon proof of an initial breach of trust, it arises because of an independent wrong, which 'lies in the realm of property' – 'parasitic on the claimant's property rights, rather than a primary wrongdoer's breach of duty'.[154] But if liability really does depend upon a wrong, it must be broader than the simple receipt and/or wrongful retention of trust rights.[155] It must also include participation in a transaction in which a trust right is destroyed.[156] If, by contrast, the wrong goes, not to the initial participation, but to some act that is inconsistent with B's claim to X's account,[157] we have not yet explained, and must, why that claim exists.[158]

This will have important practical consequences, exemplified by the distinction between the following two examples:

> **Example 6.6:** T holds title to a painting on trust for B. Without B's authority he transfers title to X as a gift. X is initially innocent but subsequently finds out about the trust and T's lack of authority. X deliberately destroys the painting.
>
> **Example 6.7:** T holds a bank account on trust for B. Without B's authority and by fraudulent misrepresentation he induces X to sell him title to a jaguar at half price, paying X £100,000 from the trust

[154] Paul S. Davies, *Accessory Liability* (Hart Publishing), 92, where he quotes the Privy Council in *Arthur v Attorney General of the Turks and Caicos Islands* [2012] UKPC 30 [38] (Sir Terence Etherton).

[155] Birks called it the 'equitable version of the wrong of misappropriation': Birks, 'Receipt' in Birks and Pretto (eds), *Breach of Trust* (Hart Publishing 2002) 225. Importantly, the wrong of misappropriation, or 'conversion', encompasses circumstances broader than the mere receipt of assets. It includes anything that amounts to an interference with a thing, such as to exclude a person better entitled, without their consent. See e.g. Simon Douglas and Ben McFarlane, 'Defining Property Rights' in J. Penner and H. Smith (eds), *Philosophical Foundations of Property Law* (Oxford: OUP 2013).

[156] Of course, if the circumstances also amount to an interference with the fiduciary relationship, the defendant will be liable in dishonest assistance, which is considered in the section that follows.

[157] In *Arthur v Attorney General of the Turks and Caicos Islands* [2012] UKPC 30 it was described as 'parasitic' on the claimant's property rights: [38]. See further Davies, *Accessory Liability* (Hart Publishing), 92.

[158] A possibility would be unjust enrichment, although compare the discussion of proprietary restitution above, in the text accompanying fn 69-96. It would be inconsistent with the arguments for a dual wrongs/ unjust enrichment regime in claims against payees. See e.g. Birks, 'Receipt' in Birks and Pretto (eds), *Breach of Trust* (Hart Publishing); Lord Nicholls, 'Knowing Receipt: the Need for a New Landmark' in W. Cornish and others (eds), *Restitution: Past, Present and Future: Essays in Honour of Gareth Jones* (Hart Publishing); *Criterion Properties Plc v Stratford UK Properties LLC* [2004] UKHL 28, [2004] 1 WLR 1846 [4].

> account. X rescinds the contract, and T and X make a new agreement for sale at full price. Prior to signing that agreement X finds out about the trust provenance of the funds.[159]

If liability in knowing receipt based upon some sort of wrongful interference with the trust right, then B can assert a claim in **Example 6.6**. The time of receipt and the time of interference need not be one and the same. In *Baden, Delvaux and Lecuit v Société Generale pour Favoriser le Développement du Commerce et de l'Industrie en France SA* Peter Gibson LJ said:

> It is clear that a stranger to a trust may make himself accountable to the beneficiaries under the trust in certain circumstances. The two main categories of circumstances have been given the convenient labels in *Snell's Principles of Equity* (28th ed.) pp. 194, 195, 'knowing receipt or dealing' and 'knowing assistance'. The first category of 'knowing receipt or dealing' is described in Snell, op cit. at p. 194 as follows: 'A person receiving property which is subject to a trust… becomes a constructive trustee if he falls within either of two heads, namely: (i) that he received trust property with actual or constructive notice that it was trust property and that the transfer to him was a breach of trust; or (ii) that although he received it without notice of the trust, he was not a bona fide purchaser for value without notice of the trust, and yet, after he had subsequently acquired notice of the trust, he dealt with the property in a manner inconsistent with the trust.' I admit to doubt as to whether the bounds of this category might not be drawn too narrowly in *Snell*. For example, why should a person who, having received trust property knowing it to be such but without notice of a breach of trust because there was none, subsequently deals with the property in a manner inconsistent with the trust not be a constructive trustee within the 'knowing receipt or dealing' category?[160]

X destroys the painting following the acquisition of knowledge. The cause of action is thus complete at that stage, and B can sue X under the cause of action that we call 'knowing receipt'.

In **Example 6.7**, by contrast, the interference occurs at the time of the initial bank transfer. X, at that time, is innocent and – if the gist of the cause of action is

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[159] This example is based on the facts of *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195.

[160] *Baden v Societe Generale pour Favoriser le Developpement du Commerce et de l'Industrie en France SA* [1993] 1 WLR 509, [1992] 4 All ER 161, 403.

interference – cannot be made liable to B by his subsequent acquisition of knowledge.[161]

The reliance upon tracing principles has made it too easy to assume that a bank payment and a gift by a trustee are identical in effect. They are not. If the beneficiary has a proprietary or personal claim against a knowing payee, that reason must be articulated clearly, and without reference to the notion of automatic transmission of equitable proprietary rights.

### C. Distinguishing Dishonest Assistance from Knowing Receipt

That a trusteeship is both custodial and fiduciary can make it difficult to identify the type of action appropriate to protect a beneficiary whose trustee acts without authority. Lord Hoffmann has argued extra-judicially that 'knowing participation' is the 'equitable counterpart' of the common law tort of inducing a breach of contract.[162] Lord Nicholls has also argued extra-judicially that, 'Dishonest receipt and dishonest assistance are two instances of similarly wrongful conduct: dishonest participation by third parties in a breach of trust. Both cases concern personal liability for participation by a third party in a breach of trust'.[163] According to Lord Nicholls 'receipt of property is incidental, in that it is merely the form which the dishonest participation takes'.[164]

This approach has received limited judicial approval. In *Consul Development Pty Ltd v DPC Estates Pty Ltd* Gibbs J said, 'a person who knowingly participates in a breach of fiduciary duty is liable to account to the person to whom the duty was owed

[161] Cf *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195.
[162] Sir Leonard Hoffmann, 'The Redundancy of Knowing Assistance' in P. Birks (ed), *The Fronteirs of Liability*, vol 1 (Oxford: OUP 1994) 29.
[163] Nicholls, 'Knowing Receipt: the Need for a New Landmark' in Cornish and others (eds), *Restitution: Past, Present and Future: Essays in Honour of Gareth Jones* (Hart Publishing 1998) 243.
[164] Ibid 244.

for any benefit he has received as a result of such participation'.[165] It has been said that that approach is 'too wide to be accepted in England'.[166] Nevertheless, that passage from *Consul Developments* was cited with approval in *Fyffes Group Ltd v Templeman*.[167]

In that case Templeman had negotiated a contract on behalf of the Fyffes Group Ltd ("Fyffes") for weekly shipments of Fyffes' bananas from South America and the Caribbean to Europe. Templeman received secret commissions for four years amounting to $1.4 million. Fyffes sought to recover that sum. Holding that it could, Toulson J considered that Templeman was liable for dishonest participation in a breach of fiduciary duty. The judge explicitly rejected the proposed distinction between knowing receipt and dishonest assistance.[168]

The difficulty with this approach lies in reconciling the absence of any requirement that the defendant act so as to bring about a breach of fiduciary with the requirement at common law that liability depends upon proof that some act of the defendant had a 'sufficient causal connection with the breach by the contracting party'.[169] The better view is that, in England at least, there is a distinction between liability that arises for some wrong that is connected to the beneficiary's proprietary claim, and actions against those who induce a breach of fiduciary duty.[170] If a fiduciary, in the course of their office, makes a profit and refuses to account for it to

[165] *Consul Development Pty Ltd v DPC Estates Pty Ltd* [1975] 132 CLR 373, 397.
[166] *Ultraframe (UK) Ltd v Fielding (No. 2)* [2005] EWHC 1638 1483.
[167] *Fyffes Group Ltd v Templeman* [2000] 2 Lloyds Rep 643.
[168] Ibid 668-672.
[169] *OBG Ltd v Allan* [2008] 1 AC 1 [36].
[170] See recently Davies, *Accessory Liability* (Hart Publishing), 92.

his principal,[171] any third party who aids that breach of duty is accountable to the principal on the basis of an interference with the fiduciary relationship.

Since the law guards fiduciary relationships particularly jealously, if disgorgement of profits has any place in third party liability it is here. In the words of McTiernan J in *Consul Development v DPC Estates*, 'If the maintenance of a very high standard of conduct on the part of fiduciaries is the purpose of the rule it would seem equally necessary to deter other persons from knowingly assisting those in a fiduciary position to violate their duties'.[172]

## V. Conclusion

Where the claimant cannot point to a fiduciary relationship at the start of the story, he cannot assert a claim to a new right in the hands of the defendant. The problem of 'geometric multiplication' is illusory, not because the claim that arises is in the nature of a power, but because the following example only gives rise to two claims against C, neither of which is proprietary:

**Example 6.1:** C steals a pig from A and swaps it for title to a cow.

A neither owns the cow, nor can he assert an equitable title to it.

The language of 'tracing value' does more than make the task of construing a transaction unnecessarily complicated. It also leads to claims that have no sound normative foundation, or at least, a foundation that has not yet been articulated clearly.[173] In this chapter it has been argued that there is no process of tracing and claiming at common law, that a defendant to whom bank funds have been transferred

[171] In *Novoship (UK) Ltd v Mikhaylyuk* [2014] EWCA Civ 908 Longmore LJ explained that 'the core duty of the fiduciary is single minded loyalty to his beneficiary. Thus the breach of duty does not consist in the making of a profit by the fiduciary, but in the keeping of it for himself' [104].
[172] *Consul Development Pty Ltd v DPC Estates Pty Ltd* [1975] 132 CLR 373 [16] (McTiernan J).
[173] *Banque Belge pour l'Etranger v Hambrouck* [1921] 1 KB 321; *Jones v Trustee of FC Jones & Sons* [1997] Ch 159; *Independent Trustee Services v GP Noble Trustees* [2012] EWCA Civ 195.

by a trustee is not accountable on the basis of some pre-existing equitable title, and that the insistence that a claimant point to a fiduciary relationship in order to claim a new right in the defendant's hands is not 'capricious', but crucial.

# Chapter Seven: Conclusion

## I. Introduction

In *Shalson v Russo* Rimer J described tracing as 'the process by which a claimant seeks to show that an interest he had in an asset has become represented by an interest in a different asset'.[1] Although its historical foundation is less than robust,[2] this idea – that by tracing from one right to another a claimant's claim is somehow transmitted from the original right into its product – is the central tenet of much of the law that has developed to cope with unauthorised acts by fiduciaries. The concepts upon which it is built were described in Chapter One: (i) following and tracing are distinct exercises, one involving the physical location of tangible things, and the other involving the substitution of rights; (ii) the object of tracing is the value inherent in rights, and (iii) by tracing that value from one right to another the claimant can move his claim from the original to its substitute. With the benefit of the six intermediate chapters, it is to these concepts that we now return.

## II. Foundational Concepts

One of the first and most influential claims made by Lionel Smith in *The Law of Tracing* was that following and tracing are independent processes – one concerned with the physical location of things, the other with substitution.[3] In Chapter Two it was demonstrated that following not only involves the physical location of tangible things, but also involves the application of legal rules to determine the location of rights. Further, much of what we consider to belong to the exercise of following in

[1] *Shalson v Russo* [2005] Ch 281 [103].
[2] We saw in Chapter Four that the conceptual gap filled by tracing was created by Lord Ellenborough's misinterpretation in *Taylor v Plumer* (1816) 3 M & S 562, 105 ER 721 of the earlier decision in *Scott v Surman* (1742) Willes 400, 125 ER 1235.
[3] Smith, *The Law of Tracing* (OUP 1997) 6.

fact involves the allocation and destruction of claims, so that insofar a following is described as a 'factual' or 'physical' exercise of 'practical investigation',[4] this refers only to the smallest and least interesting aspect of the cases explored by Smith in his monograph.

We saw in Chapter One that the central difference between following and tracing is generally thought to be the object of the exercise: we follow things from place to place, and trace value from right to right. Beyond this, however, there is much that the exercises appear to share: although the process of tracing cannot be limited to the physical, is generally also thought to be a factual process, aided in situations of evidential difficulty by rules that reflect those applicable to physical mixtures. In Chapter Three it was demonstrated that the language of 'tracing value' has led us to clothe the process of identifying and construing a transaction with a meaning that it bears nowhere else in private law. We saw that the supposed problems created by clearing and credit are a product of the idea that tracing can be conducted as a matter of pure fact. The existence and content of a transaction can, we have seen, only be determined with reference to the parties' intentions. If those intentions reveal that multiple steps are intended to operate together to bring about a single result, the transaction is characterised accordingly.

But the biggest problem caused by the choice of terminology is not in the reconciliation of substitution with modern payment mechanisms, but in the assumption that where the claimant can trace, he can claim. If a claimant can establish that Right 2 in some sense *is* or represents Right 1, held by or for the claimant, because inherent in Right 2 is the value that formerly resided within Right 1, it seems to follow as a matter of course that the claimant can now, absent defences, claim

[4] Ibid 68-69.

Right 2. This achieves precisely the opposite end to that which Smith sought to reach, which was to demonstrate that if a claimant can assert a claim to a new right in the defendant's hands there must be a new reason for such a claim.[5]

The object of Part II of this thesis was to attempt to identify the reason for that claim. It was argued that the best explanation for the decision in *Taylor v Plumer* is that a principal can claim as a matter of primary right any right acquired by their fiduciary by exploiting an opportunity that arose within the scope of their fiduciary endeavour. It was argued that claims against those who do not owe fiduciary duties to the claimant, typically grouped under the headings 'common law' and 'equitable' tracing, are in fact a collection of disparate claims. There are actions at law and in equity to protect title, and actions to reverse defective transactions entered into directly by the claimant, or by an agent of the claimant. Not one of these claims is an example of the phenomenon with which this chapter began, of demonstrating that a right in the defendant's hands is the product of a right originally held by or for the claimant.

The following three examples demonstrate the cumulative effect of the arguments presented in Parts II and III, and the reasons why it has been argued that calls to align fiduciary and non-fiduciary cases are misplaced:

> **Example 7.1:** T is a trustee of title to a painting for B. He gifts it without authority to A, who exchanges it for title to a vase.
>
> **Example 7.2:** D is a director of B Co. Without authority he transfers £1 million from B's account to A, who buys a house.
>
> **Example 7.3:** A is a director of B Co. Without authority he transfers £1 million from B's account to his own, and buys a house.

[5] Ibid 7-8.

In **Examples 7.1** and **7.2** B cannot assert a proprietary claim against A. In **Example 7.3** he can. In the latter A has agreed to perform a particular kind of role that is defined by the confidence reposed in him. Equity secures the loyal performance of that role by allowing B to claim any right acquired by A by exploiting an opportunity that arises within the scope of his fiduciary endeavour.

## III. Conclusion

There is much work still to be done to create a robust account of the circumstances in which defendants are liable for the receipt of intangible money. The scope and content of fiduciary liability deserves a thesis of its own, and a profound analysis of the proper parameters of unjust enrichment lies outside the scope of this project. This thesis has simply attempted to give an account of certain aspects of fiduciary and non-fiduciary liability that lays the foundation for important questions to be asked and answered.

Some of those questions have been raised in this thesis. For example, what is the proper scope of fiduciary accountability, and if a fiduciary is accountable *in specie* for rights acquired within the scope of the fiduciary endeavour, does that liability extend properly to bank accounts? Is a proprietary claim ever an appropriate method of effecting restitution of bank funds? Is a claimant from whom funds are fraudulently misappropriated able to strip from the fraudster any profit made by him, and if so is that claim ever in the nature of a trust? If it is not on the basis of some pre-existing title, why is a knowing payee accountable to a beneficiary? Some have not yet been raised. For example, if actions to undo bank payments are actions to reverse defective transactions, does unjust enrichment also include actions in respect of unjust value transfers? And if knowing receipt is a wrong that includes interference with a trust

right, and not just receipt, what does that mean for existing characterisations of equitable claims? A full answer to any of these questions would require much more work than it has been possible to carry out in this thesis, the scope of which has been more closely circumscribed by the need to remove from private law discourse metaphors and labels that obscure the need for such work to be conducted.

The purpose of this thesis has thus been twofold: it has sought to demonstrate that there is no independent law of tracing concerned with the process of following and identifying value, and that the work necessary to determine the appropriate scope and content of liability is much easier to see and execute without starting from the premise that there is.

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