COMPENSATION CLAIMS AGAINST TRUSTEES

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Abstract

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The thesis examines the claims that may be brought against express trustees for pecuniary compensation. It contends that a difference of principle divides this conventional category in two. Some compensation claims complain that the trustee has breached one of his duties and seek to charge him with reparation for whatever ensuing loss has been suffered by the beneficial interests. These claims resemble claims for damages founded upon a tort or breach of contract. Other compensation claims overlook whatever breach there may have been and demand that the trustee account and perform the trusts, in money where this cannot be done in specie. This second type of claim resembles a claim for the specific performance of a contract, bearing in mind that specific performance may be given with compensation where the defendant cannot deliver what he has promised. The claims are cumulative subject to the principle of full satisfaction.

To the memory of my father,
Dr William George Murray Elliott,
who died before the end.

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INTRODUCTION

CHAPTER I

INTRODUCTION

Chapter I

Pick up any of the standard texts on English equity or trusts and turn to the chapter dealing with compensation claims against trustees and other fiduciaries. You will most likely find a passage similar to this one from *Snell's Equity*:

> "The obligation of a defaulting trustee is essentially that of effecting a restitution to the trust estate." It has been said that the liability is to account, not to pay damages. But where appropriate the court can order equitable compensation which is equivalent to the common law remedy of damages.[1]

The author makes no serious attempt in the ensuing pages to explain the differences between these liabilities nor to distinguish the circumstances in which they arise. The difficulties lawyers have encountered in labelling the liabilities arising out of the abuse of fiduciary relationships reflect more rudimentary uncertainties or disagreements about the structure of the subject. These structural uncertainties manifest themselves in questions about the measure of recovery, the applicability of causal and remoteness criteria, the availability of defences, correct pleadings and procedure, statutory limitations, the incidence of burdens of proof and of strict liability, the principles on which trustee's are held liable for the misconduct of others, the calculation of interest and a number of other matters.

At bottom the problem is one of classification. This study asserts that the illuminating ordering principle does not depend upon the basis of the right enforced, including whether it is personal or proprietary, nor the nature of the wrong remedied, nor the character of the remedy granted, nor the historical contrast between the common law and equity. Each of these is an important element of the subject but none has the

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[1] J McGhee, *Snell's Equity* (30th edn, 2000) Ch 13 para 3. The excerpt is from *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 543, there referring to *Re Dawson* [1966] 2 NSWR 211.

explanatory force to make sense of the more fundamental puzzles thrown up by the cases. The analysis in this thesis demonstrates that in order to understand these puzzles it is necessary to begin with a classificatory scheme organised according to the nature of the claims that may be brought.

The object of this study is accordingly to explain the different compensation claims that may be brought against misconducting trustees. The central argument is that these claims are of two fundamentally different types. Each type seeks compensation but in different senses of that noun. The first type resembles a claim for damages at law. These are claims to charge the fiduciary with compensation for whatever loss has resulted from his breach of trust. The second type contrasts with damages claims. These are claims that the defaulting fiduciary discharge himself by accounting to his beneficiary and paying over any balance found to be outstanding. The argument will be that a beneficiary seeking an account and payment does not demand compensation for a loss he has suffered but rather insists that his fiduciary perform his trust, in money if it cannot be done *in specie*. The compensation the beneficiary claims is a substitute for the property to which he is entitled rather than reparation for a loss he has suffered.

This chapter introduces some of the central arguments, distinctions and themes that will be developed at greater length in subsequent chapters. The objects are to orient the reader and to fix the boundaries of the study.

1. The Defendants

This thesis concentrates on compensation claims against conventional express trustees. This might appear to be an unusual choice of topic. Lord Millett observes that cases involving express trusts are nowadays uncommon.[2] This is largely because of the efficacy of modern trust exclusion clauses. A spate of recent cases shows that compensation claims against trustees are not altogether unknown, but the real significance of the topic derives from the central position trustees occupy in equity

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[2]Sir Peter Millett, 'Equity–The Road Ahead' (1995) 9 TLI 35, 36.

jurisprudence. Our conception of the claims available against conventional trustees conditions our understanding of the equitable claims available against company directors, pension trustees, constructive trustees of different varieties and many others. This thesis concentrates on the archetype but the argument should explain *mutatis mutandis* compensation claims against a larger class of fiduciaries of which these are all members. Some mention of claims against directors and constructive trustees and others will be made in passing but full analysis will have to wait for further work

Lord Mustill said in *Re Goldcorp Exchange Ltd* that 'To describe someone as a fiduciary, without more, is meaningless.'[3] Fiduciary nomenclature is variously used to describe a range of relations and rules. This thesis treats claims against trustees in their capacity as custodial fiduciaries.[4] Custodial fiduciaries are people who control property that they are bound in equity to apply for the benefit of another. In this sense a trustee is a fiduciary, and so is the executor of a deceased estate, a company director, certain commercial agents, certain guardians, certain constructive trustees, and a number of others. In this connection the term fiduciary duty refers to any duty imposed on the fiduciary in his custodial office. The word fiduciary and its derivatives will be used in this sense except where otherwise indicated.

Custodial fiduciary relations must be distinguished from a number of other relations that are sometimes said to be fiduciary. Most prominent amongst these is the fiduciary relation of trust and confidence that obtains where one person is required to act with an undivided loyalty towards another. In this connection the term fiduciary duty only encompasses emanations of the core duty of loyalty.[5] The fiduciary relation of trust and confidence frequently overlaps with the custodial fiduciary relation but the two are analytically distinct and each can be found without the other. Claims depending upon the fiduciary relation of trust and confidence receive some attention in this thesis but

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[3] *Re Goldcorp Exchange Ltd* [1995] 1 AC 74 (PC) 98.

[4] This concept is explained at greater length in Chapter II Part 1.

[5] This usage is now associated with the decision in *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA).

they are not its primary concern.

Claims depending upon other supposed types of fiduciary relation will not be discussed in this thesis. Most notably, this thesis does not treat claims arising out of the relation that supports a claim in undue influence, which is sometimes analysed as a species of fiduciary relation.[6] Claims arising out of the misuse of information imparted in confidence do not depend upon a fiduciary relation of any sort though fiduciary nomenclature is occasionally used.[7]

2. Equitable Compensation

Part of the motivation for this study lies in the development of what has been called equitable compensation.[8] Equitable compensation, by that name at least, was virtually unknown to English law only a decade ago. Its availability as a remedy for fiduciary misconduct has since been recognised by the courts on several occasions.[9] It is generally understood to be a compensatory money remedy for the violation of equitable rights. The author of *Modern Equity* writes that the principles of equitable compensation 'have not yet been fully worked out'.[10]

Early analyses of equitable compensation presented it as a remedy for misconduct sounding in equity but committed by persons who do not hold property in a

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[6]For example *Mahoney v Purnell* [1996] 3 All ER 61; PD Finn, *Fiduciary Obligations* (1977) Ch 15; LA Sheridan, *Fraud in Equity* (1956) 107.

[7]Compare *Attorney-General v Blake* [1998] Ch 439 (CA) 454 with *Indata Equipment Supplies Ltd v ACL Ltd* [1998] FSR 248 (CA) 256. See J Glover, 'Is breach of confidence a fiduciary wrong? Preserving the reach of judge-made law' (2001) 21 LS 594.

[8]Some of the considerable literature on equitable compensation is collected together by CEF Rickett in 'Compensating for Loss in Equity: Choosing the Right Horse for the Course' in PBH Birks & F Rose (eds), *Restitution and Equity, Resulting Trusts and Equitable Compensation* (2000) Vol 1 Ch 10 n 1.

[9]See especially *Target Holdings Ltd v Redferns* [1996] AC 421, 439; *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 17; *Swindle v Harrison* [1997] 4 All ER 705 (CA); *Longstaff v Birtles* [2001] EWCA Civ 1219, [2002] 1 WLR 470.

[10]J Martin, *Modern Equity* (16th edn, 2001) 652.

custodial capacity.[11] Many of the cases involve partial advice given by solicitors or financial advisors who are either personally interested or doubly employed. In cases of that sort equitable compensation appeared to be a novel form of relief, though it found an important antecedent in *Nocton v Lord Ashburton*.[12]

The development of equitable compensation as a remedy against non-custodial fiduciaries has been driven by a perception on the part of claimants that equitable relief carries a number of significant advantages over damages at law. The advantages contended for have included a more generous measure of recovery; more claimant-friendly causation and remoteness criteria or none at all; greater difficulty in defending on the basis of the claimant's own fault or the entire exclusion of those defences; extended limitation periods or none at all; compound interest at higher rates; and assistance curing defective pleadings as was given in *Nocton v Lord Ashburton* itself. The game for claimants seeking one or other of these perceived advantages has been to put their claims on a fiduciary basis. This has focussed attention on the nature of equitable compensatory relief as well as on the relationships that support claims for this form of relief.

While English courts have recognised that equitable compensation is a legitimate and distinct head of relief, there are very few cases in which claimants have actually obtained an advantage they would not have taken had they sued on a comparable common law cause of action.[13] The course of authority suggests that where carelessness is the gravamen of the complaint relief will be given on similar principles to those that would apply in a negligence claim at law, and where dishonesty or intentional disloyalty is shown relief will be given on a similar basis to damages for

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[11]IE Davidson, 'The Equitable Remedy of Compensation' (1981-82) 13 MULR 349 is the locus classicus.

[12]*Nocton v Lord Ashburton* [1914] AC 952.

[13]See especially *Companhia de Seguros Imperio v Heath (REBX) Ltd* [2001] 1 WLR 112 (CA); *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA); *Swindle v Harrison* [1997] 4 All ER 705 (CA); *Ata v American Express Ltd* (CA, The Times 26 June 1998); *Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA).

deceit.[14] The courts have disappointed some early expectations that by putting his claim on an equitable footing a claimant would automatically gain the advantages equity is sometimes thought to afford a beneficiary suing his trustee.

These developments have not, however, been redundant because there are circumstances disclosing an equitable claim but no claim at law,[15] and there are also circumstances in which the only available legal claim does not yield a just measure of relief. The principal example of the latter arises where a solicitor or other fiduciary advisor intentionally fails to disclose a fact to one client where disclosure might prejudice himself or another client. The first client may have a claim for breach of contract or tortious negligence against the advisor, but because there has been no positive misrepresentation he cannot take advantage of the more generous measure of recovery a claim in deceit would offer.[16] In point of moral turpitude the advisor's misconduct is at least equivalent to actual fraud and so it seems right that the claimant should be able to obtain an equivalent measure of recovery by suing on the non-disclosure as a breach of fiduciary duty. This is the central message of fiduciary advisor cases such as *Swindle v Harrison* and *Hodgkinson v Simms*.[17]

This thesis is not directly concerned with claims against fiduciaries other than those who control property in a custodial capacity and only a few more words will be said about them. That line of cases does, however, have some bearing on the present topic. The reason is that since the House of Lords's decision in *Target Holdings Ltd v Redferns* it has been widely understood that equitable compensation is also the characteristic money remedy for breach of trust, although Lord Browne-Wilkinson emphasised that in particular circumstances another remedy which he called restitution

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[14]See cases cited in the preceding note and *Nationwide Building Society v Balmer Radmore* [1999] Lloyd's Rep PN 241, 281. See further Chapter VIII Part 3.

[15]For example *Longstaff v Birtles* [2001] EWCA Civ 1219, [2002] 1 WLR 470 and *Medforth v Blake* [2000] Ch 86 (CA).

[16]See *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254, 264-265.

[17]*Swindle v Harrison* [1997] 4 All ER 705 (CA); *Hodgkinson v Simms* [1994] 3 SCR 377; see also *Huff v Price* (1990) 76 DLR (4th) 138 (BCCA) 149, leave refused (1991) 56 BCLR (2d) xxxviii.

to the trust estate is available.[18] His Lordship referred with approval to passages from McLachlin J's judgment in *Canson Enterprises Ltd v Boughton & Co*, which is the leading Commonwealth authority on equitable compensatory relief against fiduciary advisors.[19]

Equitable compensation is a troubled concept. The trouble is that it pulls in two directions. One strand of thought holds that equitable compensation is equity's counterpart to common law damages. A competing strand holds that equitable compensation contrasts with damages. Neither idea can be said to be dominant. One argument in Chapter III will be that the term equitable compensation as it has been expounded by the courts invites confusion of thought and should be excised from legal usage.[20]

3. Accountability

One idea that appears to have been lost in the literature and case law on equitable compensation is that a custodial fiduciary is accountable for the property committed to him.[21] This is a surprising oversight. The obligation to account has been said to be a defining characteristic of trustees and other fiduciaries to whom property has been committed.[22] An explanation of the personal claims that may be brought against custodial fiduciaries that makes no reference to accountability is an incomplete explanation.

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[18] *Target Holdings Ltd v Redferns* [1996] AC 421.

[19] *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534.

[20] Chapter III Part 3.

[21] This omission was first noticed by PBH Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 UWALR 1, 46. His observation has been taken up by Sir Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 225; AJ Oakley, *Parker and Mellows, The Modern Law of Trusts* (1998) 679-683; and C Nugee, 'Suing for Losses to a Pension Scheme–Some Issues' (2001) 15 TLI 83, 84. See also *Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712, [2001] 2 BCLC 531. This study owes a considerable debt to Professor Birks' insight.

[22] *Smith v Anderson* (1880) 15 ChD 247 (CA) 275; *Soar v Ashwell* [1893] 2 QB 390 (CA) 394; HAJ Ford & WA Lee, *Principles of the Law of Trusts* (3rd edn, 1996) 3; D Waters, *Law of Trusts in Canada* (2nd edn, 1984) 32.

The accounting relation has always served as one of the law's primary instruments for disciplining people entrusted with the stewardship of property for the benefit of others. Although it came to be associated with equity, the accounting relation's provenance lies in the common law, ecclesiastical and manorial courts of the middle ages.[23] At common law, account was the principal action the lord of a manor had if his bailiff refused to do his duty. The bailiff would be brought before auditors who would examine all aspects of his administration of the manor. If it transpired that the bailiff was in default then the auditors would strike a balance which the lord could collect as a debt. The special purpose of the action was to reduce the bailiff's primary obligation to make over the actual money or property he received into an obligation to pay an equivalent sum of money as a debt.

The form of liability enforced in the action of account has been passed down through the ages into our modern law of fiduciary relations. A fiduciary is accountable in precisely the same way a bailiff was at law: if he fails to make over the actual property as he should, he can be made to pay over a money equivalent. The accounting serves to convert the obligation to make over the property into an obligation to pay an equivalent sum as a debt or, as James and Baggally LJJ put it in *Ex p Adamson*, 'an equitable debt or liability in the nature of a debt'.[24] The detailed rules by which the account is taken have as their common purpose the identification of this pecuniary substitute.

The accounting relation is no longer as well understood as its prevalence and great age warrant. The subject has no modern text of its own, and so pieces must be collected together from general books on trusts and estates, books on their accounts, as well as from books on agency, companies, receivers, restitution, limitations, and pleading and procedure. Fiduciary accountability has fallen into such a state of neglect

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[23]See SJ Stoljar, 'The Transformations of Account' (1964) 80 LQR 203; R Helmholz, 'Trusts in the English Ecclesiastical Courts 1300-1640' (1998) 19 Comparative Continental and Anglo-American Legal History 153, 165-166; TFT Plucknett, *The Medieval Bailiff* (1954) 23; and HS Bennett, *Life on the English Manor* (1948) 151.

[24]*Ex p Adamson* (1878) 8 ChD 807 (CA) 819.

that many lawyers intuitively equate it with claims for the disgorgement of unauthorised profits.[25] An account of profits is, however, only one type of account. Notwithstanding the prominence it has achieved by the growth of scholarly interest in the law of restitution, the overwhelming majority of accounting relations found in the world are voluntarily assumed rather than imposed in order to strip unauthorised gains.

Pleading and procedure texts and cases are especially important sources in this area because the accounting relation takes its structure from the procedural form by which it was traditionally enforced, namely the old Chancery bill for an account. The substantive liabilities of accounting parties find expression in the technical rules governing the progress of that bill and the taking of accounts. The bill for an account, and in earlier times the action of account, may be thought of as the 'form of action' of modern claims for trustee maladministration. If the accounting relation is less well understood now than it formerly was then part of the blame must rest with the Judicature reforms. Those reforms allowed claims against accounting parties to be prosecuted without reference to the procedure in which these claims are conceptually embedded.[26] This thesis recovers and restates the principles of fiduciary accountability in modern form.

4. The Claims

The object of this thesis is to explain certain of the claims that may lie against a misconducting fiduciary. The claims in question are commonly grouped together as claims seeking compensation for abuse of a trust. The argument will be that a fundamental difference of theory divides that conventional category of claims down the middle. Some compensation claims against misconducting custodial fiduciaries are claims for the performance of the trust in money whereas others are claims for the reparation of loss occasioned by the breach of trust.

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[25]For example RB Grantham & CEF Rickett, *Enrichment & Restitution in New Zealand* (2000) Ch 20; J Eichengrun, 'Remedying the Remedy of Account' (1985) 60 Indiana LR 463.

[26]See Chapter IV Part 1.

The contrast between these two types of claim is neither distinct to equity nor distinctively equitable.[27] It is rooted in the basic structure of English private law. Reflecting its Germanic roots, English private law has always recognised a distinction between two types of claim. One is a claim asserting a right and demanding that it be vindicated; the other is a claim complaining of a wrong and seeking satisfaction. The organising principle depends upon the nature of the claim that is made rather than the basis of the right relied upon. Each type of claim is a genus with several species. One species of vindication claim asserts a duty owed by the defendant and demands that it be performed. One species of satisfaction claim complains that the defendant has violated the claimant's rights and seeks reparation for the injury suffered. These will be called performance claims and reparation claims.

A performance claim demands that the fiduciary execute his trust. If the fiduciary no longer has the actual property and so cannot specifically perform a duty to make it over, the claim will be that he perform by payment of a monetary equivalent. Mishandling of the property is put right in the accounting by which the equivalent is ascertained. Claims of this type are sometimes styled breach of trust claims, but this must be understood in the same sense in which a claim for specific performance of a contract is a breach of contract claim. Non-performance motivates the court to interfere but the claim overlooks the breach in its wrongful aspect. The basis of the claim, Bacon V-C explained in a case of misapplied company property, 'cannot be called a tort'.[28] The Vice-Chancellor then significantly added, 'nor is this an action for damages.'[29] The claim does not rest upon an allegation of loss in the sense of detriment or injury, and for this reason considerations of causation, remoteness, mitigation and contributory fault are inapposite. The award may be described as compensation but it is compensation of the substitutive variety. The beneficiaries' claim for performance of an obligation to make over trust property *in specie* or by payment of substitutive compensation thus resembles the claim in the classical action of detinue, though in detinue the defendant could choose

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[27]See further Chapter II Part 2.

[28]*Re Exchange Banking Ltd (Flintcroft's Case)* (1882) 21 ChD 519 (CA) 527.

[29]Ibid.

whether to deliver the goods or their value.

A reparation claim complains of a breach of trust and seeks reparative compensation for loss attributable to it. A central example is a claim for reparation of the loss occasioned by a trustee having pursued an authorised but negligent investment policy. In order to make out this second type of claim the beneficiaries must prove the breach of a duty and they must prove a sufficient causal connection between that breach and the loss for which reparative compensation is sought. While the authorities demand careful study, there is no conceptual difficulty with arguments that reparable loss should be cut back because it is too remote or because the claimant has either contributed to the loss or neglected to take reasonable steps to mitigate it. Any breach of trust resulting in loss may potentially found a reparation claim and so there are circumstances in which the beneficiaries are entitled to claim either or both performance of the trustee's primary obligation and reparation for any loss suffered. A successful performance claim may, however, reduce or extinguish the beneficiaries' reparable loss.

Plainly a beneficiary's reparation claim resembles a claim for damages on the basis of a common law tort or breach of contract. All of these claims are based upon alleged breach of duty and seek compensation for the loss attributable to that breach. There is nonetheless an element of truth in the traditional doctrine that damages cannot be given for a breach of trust. A successful damages claimant is entitled to an order directing the defendant to pay him a sum of money. By contrast, a beneficiary's reparation claim is formally a claim to charge the fiduciary in his account in the amount of the loss. If the beneficiary's interest is in possession then he may be immediately entitled to a further order directing the trustee to pay the sum over, in which case there may for practical purposes be no distinction with damages relief. Where, on the other hand, the beneficiary is not immediately entitled to have his interest distributed then the sum will be subject to the ongoing trusts and the fiduciary may be directed to apply it accordingly.

The purpose of this study is to highlight the contrast between these two types of claim. That contrast has always been immanent both in the substantive and procedural

law by which the courts enforce trusts and other fiduciary relations. The difference between the two is no longer, however, as well understood as it has been at some points in the past, for which reason the threads have become entangled in places. Some modern judges and commentators contend that all compensation claims against misconducting custodial fiduciaries are restitutionary in nature. Street J's judgment in *Re Dawson* is frequently referred to in this connection.[30] This suggests, in the terms adopted in this thesis, that all compensation claims are essentially claims for substitutive performance. Other judges and commentators go to the opposite extreme by contending that all compensation claims are essentially akin to damages claims at common law. The idea here, again in the terms adopted in this thesis, is that all of these claims are for reparation. This view finds its fullest expression in Lord Browne-Wilkinson's speech in *Target Holdings Ltd v Redferns*, which is examined in close detail in Chapter VI.[31] This thesis endeavours to show that the authorities do not support either of these extreme positions. The topic can only be made sense of if one recognises that there are two entirely different types of claim for what is called compensation.

As noted above, this thesis is not concerned with claims against non-custodial fiduciaries of the sort pressed in *Canson Enterprises Ltd v Boughton & Co*, *Swindle v Harrison*, *Longstaff v Birtles* and several other recent cases.[32] Nonetheless, any reader familiar with that line of authority will see that the argument has important implications for our understanding of those claims. The defendants in those cases did not hold the claimants' property in a custodial capacity other than incidently, and so the cases could not have involved claims for the performance of a primary obligation in respect of any property. They were instead reparation claims founded upon supposed equitable wrongs. Chapter III briefly explains that some of the complications that have arisen in those cases have resulted from misconceived attempts to treat what are essentially

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[30] *Re Dawson* [1966] 2 NSWR 211. The argument in Chapter VI Part 2(b) will be that this is a misreading.

[31] *Target Holdings Ltd v Redferns* [1996] AC 421.

[32] *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534; *Swindle v Harrison* [1997] 4 All ER 705 (CA); *Longstaff v Birtles* [2001] EWCA Civ 1219, [2002] 1 WLR 470.

reparation claims as if they were performance claims.[33]

Certain cognate claims will not be discussed. Notably, this thesis does not treat claims to unauthorised profits a fiduciary has made in the course of his engagement other than for the purposes of segregation, nor does it treat claims against third party constructive trustees. Moreover, this study is confined to beneficiaries' claims against their fiduciaries. It does not consider contribution claims between co-trustees or between trustees and third parties,[34] nor does it consider claims brought by trustees on behalf of their beneficiaries against third parties. Finally, while some of the claims to be discussed function indirectly to protect a proprietary title, claims for the specific transfer or vesting of property will not be treated even where the property in question is cash or a sum of money manifest in some other form.

5. Plan of the Work

The argument will be developed in eight further chapters. The first two are grouped together under the heading Foundations. Chapter II considers the nature of the fiduciary relation abuse of which may attract the claims in question, and then moves on to explain in a general way the two types of claim and the contrast between them. Chapter III analyses the principal concepts by which these claims and allied relief are cast. These concepts are compensation, restitution, equitable compensation and damages.

The second group of chapters is headed Performance Claims and examines the first type of claim, namely claims for the specific or substitutive performance of a trust. Chapter IV discusses the administration and accounting procedure by which performance claims are prosecuted. Chapter V considers the rules and principles that govern the taking of trust accounts. Chapter VI confronts the House of Lords decision in *Target Holdings Ltd v Redferns* and the idea that all compensation claims against

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[33]Chapter III Part 3.

[34]See C Mitchell, 'Apportioning Liability for Trust Losses' in PBH Birks & F Rose (eds), *Equity and Restitution, Resulting Trusts and Equitable Compensation* (2000) Vol 2 Ch 12.

trustees are reparative in nature.[35]

The third group of chapters is headed Reparation Claims and discusses the second type of claim, namely claims for reparation of loss occasioned by a breach of trust. Chapter VII discusses the availability of reparation claims and the relation between these and performance claims. Chapter VIII considers the relief these claims provoke and the role of causal criteria in conditioning recovery. Chapter IX treats pre-judgment equitable interest charges.

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[35] *Target Holdings Ltd v Redferns* [1996] AC 421.

FOUNDATIONS

FIDUCIARIES AND CLAIMS

CHAPTER II

FIDUCIARIES AND CLAIMS

Chapter II

This chapter and the next set out the doctrinal foundation of the thesis and examine a number of related conceptual issues. Part 1 of this chapter explains the type of fiduciary relation that attracts the two types of claim, namely the custodial fiduciary relation, and discusses the duties under which a custodial fiduciary labours. Part 2 is concerned to identify and explain the differences between the two types of claim that are considered in subsequent chapters.

1. The Custodial Fiduciary Relation

This thesis is principally concerned with certain claims against express trustees. These claims lie against express trustees by virtue of their membership in the larger class of custodial fiduciaries and so it will help to explain the more general legal relation.

(a) Distinction with the Relation of Trust and Confidence

The custodial fiduciary relation must first be distinguished from the overlapping fiduciary relation of trust and confidence.[1] The two relations imply correspondingly different conceptions of fiduciary duty. These are not the only two ways in which fiduciary nomenclature is used but they are the most important strands and the only two material to this study.[2]

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[1]The distinction drawn in this section was first suggested in SB Elliott, 'Fiduciary Liability for Client Mortgage Frauds' (1999) 13 TLI 74, 79. It resembles the distinction LS Sealy draws between his category I and II fiduciaries: 'Fiduciary Relationships' [1962] CLJ 69; see also 'Some Principles of Fiduciary Obligation' [1963] CLJ 119. Sealy's proposition that trusts are not a species of either type of fiduciary relation does not, however, correspond with ordinary and proper usage: *Plowright v Lambert* (1885) 52 LT 646, 652. The opposite is true, for express trustees are a paradigm of each type.

[2]This thesis is not concerned with relations of influence or confidential relations in respect of information: see Chapter I Part 1.

A custodial fiduciary may be tentatively defined as any person who receives property in circumstances binding him in equity to apply it for the benefit of another.[3] All of the duties he owes in connection with his custodial office are, in this sense, said to be fiduciary duties. Waters, for instance, defines fiduciary duty as 'the duty to account to another, the person with the right of enjoyment over the property in question, for all that one does with the property and in the office of trustee.'[4] This usage extends beyond express private trustees to encompass agents who control property belonging to their principals, as well as to executors, guardians and company directors.[5] This usage also encompasses certain constructive trustees such as third parties who improperly receive misapplied trust property.[6]

A second sense concentrates attention on the loyalty the fiduciary owes to his principal. This sense is now associated with the Court of Appeal's decision in *Bristol and West Building Society v Mothew*.[7] In that case Millett LJ defined a fiduciary as 'someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relation of trust and confidence.'[8] In this second sense the hallmark of a fiduciary relation is trust and confidence rather than the receipt of property to be applied for the benefit of another. This second sense implies a corresponding understanding of the term fiduciary duty. Millett LJ began by noting La

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[3]Etymologically this appears to be the dominant sense. 'In Rom. Law. *fiducia* denoted the transfer of a right to a person subject to the obligation to transfer it again at some future time or on some condition being fulfilled.' JA Simpson & ESC Weiner, *The Oxford English Dictionary* (2nd end, 1989) 878. See further Part 2(b) below.

[4]D Waters, *The Law of Trusts in Canada* (2nd edn, 1984) 32, but compare 33 where he slips into a different usage.

[5]See *Burdick v Garrick* (1870) LR 5 Ch App 233; *Re West of England and South Wales District Bank* (1879) 11 ChD 772, 778; *Re Hallett's Estate* (1880) 13 ChD 696 (CA) 708-711; *Soar v Ashwell* [1893] 2 QB 390 (CA) 394; *Commissioner of Stamp Duties (Queensland) v Livingstone* [1965] AC 694 (PC) 707; *Selangor United Rubber Estates Ltd v Craddock (No 3)* [1968] 1 WLR 1555, 1575.

[6]*John v Dodwell and Company* [1918] AC 563 (PC) 569.

[7]*Bristol and West Building Society v Mothew* [1998] Ch 1 (CA); approved on these points in *Arklow Investment Ltd v Maclean* [2000] 2 NZLR 1 (PC) 5-6. See in Australia *Breen v Williams* (1996) 186 CLR 71.

[8]*Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 18.

Forest J's remark in the *LAC Minerals* case that 'not every legal claim arising out of a relationship with fiduciary incidents will give rise to a claim for breach of fiduciary duty.'[9] Fiduciary obligation, Millett LJ explained, only encompasses the emanations of the duty of loyalty that characterise the relation of trust and confidence. These include the duty to act in good faith, the duty not to make a profit out of one's trust, and the duty not to place oneself in a conflict position, to give a few of his examples. It does not include any duty of skill and care the defendant may owe to his beneficiary even if that duty finds its jurisdictional provenance in equity.[10] Millett LJ said that 'The various obligations of a fiduciary merely reflect different aspects of his core duties of loyalty and fidelity. Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere incompetence is not enough.'[11] For the same reasons a fiduciary's obligations in this second sense do not include any other equitable duty a person may owe in handling property committed to him in a custodial capacity, such as a duty to transfer the property to a particular person or to invest it in a particular way. There can only be a breach of fiduciary duty in this second sense where fidelity is at stake.

The second sense is in different respects both wider and narrower than the first, custodial sense. The second sense is wider in that it may apply whether or not there is trust property. Fiduciary loyalty binds anyone who undertakes to selflessly promote his principal's interests. Solicitors and financial advisors are fiduciaries in this sense irrespective of whether they handle their client's money. The second sense is narrower than the first in that the custodial sense embraces the duty of loyalty as well as all other obligations incurred on receipt of trust property.

A person may therefore be another's fiduciary in the sense that he must act with the utmost selflessness, but nevertheless not be accountable for property received in the

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[9] *LAC Minerals Ltd v International Corona Resources Ltd* [1989] 2 SCR 574, 647. The sentence is strictly nonsense but the point is clear. See also *Giradet v Crease & Co* (1987) 11 BCLR (2d) 361, 362 and *Permanent Building Society v Wheeler* (1994) 14 ACSR 109, 157.

[10] See also *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 205 (Lord Browne-Wilkinson).

[11] *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 18.

course of his engagement. Agents always owe their principals duties of loyalty,[12] but this does not mean that all of the property received while carrying out their duties is received in a fiduciary capacity.[13] In many cases the agent will receive property for his own benefit subject to an obligation to pay his principal an equivalent sum as a debt.[14] The duty to keep property separate that accountability entails would often constitute an undesirable constraint on the agent's commercial activity. Though the agent is a fiduciary in the sense that he owes a duty of loyalty he is not a custodian of the property.

The converse is also true, for it is possible to be a fiduciary in the sense of being accountable for property but not owe a duty of undivided loyalty.[15] Certain types of constructive trustee incur custodial obligations by imposition of law but never undertake to act with an undivided loyalty towards the equitable title-holder. One example is a stranger who receives misapplied trust property with sufficient awareness of its provenance. The trust is imposed for no other reason than to compel him to return the property or to account for its value. There is no warrant for imposing an obligation of the utmost selflessness on a person who does not assume it, may have no connection with the claimant, and who himself asserts a title adverse to that of the claimant.

The differences between these two overlapping senses of the terms fiduciary and fiduciary duty have been a source of constant friction in the law. It is important to insist on a strict conceptual separation between the two types of fiduciary relation because rules and principles developed in connection with the one are not always apposite to the other. The root of the problem lies in the common label, but there is no obviously

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[12]FMB Reynolds, *Bowstead and Reynolds on Agency* (17th edn, 2001) Ch 6 para 36.

[13]LS Sealy, 'Fiduciary Relationships' [1962] CLJ 69, 79.

[14]*Paragon Finance v DB Thakerar & Co* [1999] 1 All ER 400 (CA); *Neste Oy v Lloyds Bank plc* [1983] 2 Lloyd's Rep 658; *Henry v Hammond* [1913] 2 KB 515; *Walker v Corboy* (1990) 19 NSWLR 383 (CA).

[15]*Lohnro plc v Fayed (No 2)* [1992] 1 WLR 1, 12; Sir Peter Millett, 'Restitution and Constructive Trusts', in WR Cornish et al, *Restitution: Past Present and Future* (1998) Ch 13, 204-207; L Smith, 'Constructive Fiduciaries?' in PBH Birks (ed), *Privacy and Loyalty* (1997) 249, 263-264; American Law Institute, *Restatement of the Law of Restitution, Quasi-Contracts and Constructive Trusts* (1937) para 160 comment a.

preferable nomenclature.[16] Jessel MR identified the custodial relation as a trust in *Re Hallett's Estate*,[17] but that is unsatisfactory because the trust concept imports the idea that there has been a separation of legal and equitable title.[18] The Master of the Rolls himself recognised in that case that this condition is not a necessary feature of the type of fiduciary relation with which he was concerned.[19] Company directors are a clear example of a fiduciary of the custodial type who does not enjoy any title to the property other than incidently. The nineteenth century quasi-trust concept, which seems to have been used to indicate these differences, is intentionally obscure. The language of trusts will not do.[20]

Millett LJ suggested in the *Mothew* case that fiduciary language should only be used in connection with the relation of trust and confidence, and a number of scholars applaud that proposal.[21] As attractive as that proposal is in theory it is probably unworkable in practice. The custodial sense is too deeply ingrained in our usage and in the cases, and there is no other vocabulary readily at hand that could do its work. Millett LJ has himself been unable to resist slipping back into using fiduciary language in the custodial sense.[22] The important thing is to keep the distinction between the two senses firmly before one's mind and to always be clear which sense is being used. This

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[16]LS Sealy called fiduciaries in something close to these two senses category I and II fiduciaries for lack of descriptive labels: 'Fiduciary Relationships' [1962] CLJ 69.

[17]*Re Hallett's Estate* (1880) 13 ChD 696 (CA) 709-710. Of directors see for example *Re Exchange Banking Ltd (Flintcroft's Case)* (1882) 21 ChD 519, 525.

[18]*Smith v Anderson* (1880) 15 ChD 247 (CA) 275; *Hardoon v Belilios* [1901] AC 118 (PC) 123. As to whether separation of title is sufficient to constitute a trust see Lord Browne-Wilkinson's controversial remarks in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 706-707.

[19]*Re Hallett's Estate* (1880) 13 ChD 696 (CA) 710.

[20]See Lord Westbury's caution in *Knox v Gye* (1872) LR 5 HL 656, 672.

[21]Amongst others DJ Hayton, 'Fiduciaries in Context: An Overview' in PBH Birks (ed), *Privacy and Loyalty* (1997) Ch 11, 286-290 and S Worthington, 'Fiduciaries and Self-Denial' [1999] CLJ 500, 501-503.

[22]See *Paragon Finance v DB Thakerar & Co* [1999] 1 All ER 400 (CA) 416: an agent's liability to account without statutory limitation depends 'on whether he was, not merely a fiduciary (for every agent owes fiduciary duties to his principal), but a trustee, that is to say, on whether he owed fiduciary duties *in relation to the money*.' (author's italics)

thesis is principally concerned with fiduciary relations of the custodial type and so the word and its derivatives will generally be used in that sense. The second type of fiduciary relation will generally be referred to as the relation of trust and confidence and its characteristic manifestation will be called the duty of loyalty.

(b) The Nature of the Custodial Fiduciary Relation

Most custodial fiduciaries undertake that office voluntarily. This class comprises express trustees, company directors, executors, guardians, appointed agents of various types, appointed receivers, trustees and agents of their own wrong, and miscellaneous others. Lord MacNaghten put his finger on the significance of the fiduciary's undertaking in *Lyell v Kennedy*, a case concerning the accountability of an agent of his own wrong:

> Nor do I think it can make any difference whether the duty arises from contract or is connected with some previous request, or whether it is self-imposed and undertaken without any authority whatsoever. If it be established that the duty has in fact been undertaken and that property has been received by the person assuming to act in a fiduciary character, the same consequences must, I think, in every case follow.[23]

A custodial fiduciary's undertaking is ascertained objectively for the relation will arise even though the recipient secretly intends to apply the property to his own purposes.[24]

There is another class of custodial fiduciary whose liabilities are imposed by law. This class includes constructive trustees of various types but it does not include what are now called dishonest assistants. That is because a dishonest assistant does not receive property into his control other than incidentally,[25] nor is he charged with the property held by the trustee whom he assists. Receipt is an essential feature of any

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[23] *Lyell v Kennedy* (1889) 14 App Cas 437, 463.

[24] *Twinsectra Limited v Yardley* [1999] Lloyd's Rep Bank 439 (CA) 490; *Re Fleet Disposal Services Limited* [1995] 1 BCLC 345, 349.

[25] 'Liability as an accessory is not dependent upon receipt of trust property.' *Royal Brunei Airlines v Tan* [1995] 2 AC 378 (PC) 382.

custodial fiduciary relation,[26] constructive or otherwise, for which reason it is widely thought that dishonest assistants should no longer be classified as a species of constructive trustee.[27]

The custodial fiduciary relation has the same formal nature whether the office is undertaken voluntarily or imposed by law. This may be expressed in two necessary propositions. The first is that a custodial fiduciary is a person who has received property into his control in circumstances sufficient to bind him to apply it in specific ways for the benefit of another. The second proposition is that the duties incurred on receipt of the property must be enforceable in a particular manner that is encapsulated by saying the fiduciary is accountable in equity.[28]

The language of accountability is freely used by equity lawyers to mean a number of different things. To say that someone is accountable can mean he is a responsible actor and it can mean that he is liable to answer for his responsibilities or conduct. A person may also be accountable in the sense that he is obliged to keep proper records and accounts and to make them available for inspection when a proper request is made. That a person is accountable may also mean that he is liable to have his accounts audited in a particular way, for example before a master of the Chancery Division.[29]

Custodial fiduciaries are variously accountable in these different senses but none is definitive of that relation. The definitive sense in which custodial fiduciaries are accountable is more technical and fundamental. Fiduciary accountability stands for the

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[26]*Re Barney* [1892] 2 Ch 265, 273.

[27]This view is so widespread that only the best-known exception bears mentioning. That is Lord Browne-Wilkinson's speech in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 705. His remark was made in passing only.

[28]*Soar v Ashwell* [1893] 2 QB 390 (CA) 394; *Smith v Anderson* (1880) 15 ChD 247 (CA) 275; HAJ Ford & WA Lee, *Principles of the Law of Trusts* (3rd edn, 1996) 3; D Waters, *Law of Trusts in Canada* (2nd edn, 1984) 32.

[29]See *Attorney-General v Cocke* [1988] Ch 414.

idea that the fiduciary's duties may be enforced by equitable claims of the same type as the claims that lie against an express trustee, however else they may be enforced. That is the sense of Fry J's famous definition: 'What is a fiduciary relationship? It is one in respect of which if a wrong arise the same remedy exists against the wrong-doer as would exist against a trustee on behalf of the *cestui que trust*.'[30] Fry J spoke of remedies rather than claims but that only looks at the topic from the opposite end. Westbury LC similarly said in *Rolfe v Gregory* that the expression constructive trustee is 'used for the purpose of describing the nature and extent of the remedy against him, and denotes that the parties entitled beneficially have the same rights and remedies against him as they would be entitled to against an express trustee'.[31] The reason a custodial fiduciary is said to be *accountable* is that both of the characteristic types of claim by which his duties are enforced are mediated by the fiduciary's account. As will be explained in Part 2 below, the definitive claims are claims for performance of the fiduciary's duties and claims to charge him with the loss resulting from the neglect of those duties.

Precisely how the account mediates these two types of claim will be explained in the course of this thesis. For present purposes it may be observed that the fact a claim is mediated by the account does not mean that it can only be given effect by having an account taken. The point is rather that the fiduciary's account is essential to the formal structure of the claim and the relief it evokes. Company directors, for example, are custodial fiduciaries of the company's property and liable to claims of the same types trustees are. Directors are not liable to have their accounts taken in court as trustees are but their liability nonetheless rests on the same underlying principles.[32] Bacon V-C put the point well in *Flintcroft's Case*:

> A man going abroad says to another person: "You take charge, possession, and management of all my property and account to me for it when I come back." What do subscribers to a joint stock company say? "We select you as

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[30] *Re West of England and South Wales District Bank* (1879) 11 ChD 772, 778; approved in *Re Hallett's Estate* (1880) 13 ChD 696 (CA).

[31] *Rolfe v Gregory* (1865) 4 De GJ & S 576, 579, 46 ER 1042.

[32] LS Sealy, 'The Director as Trustee' [1967] CLJ 83, 86 & 90-91.

> directors; we entrust you with all our moneys now paid, and all that we are liable to pay hereafter, and with the management of all our interests, and we look upon you to account to us for them;" and they do account at their general meetings, and by their balance sheets, and so on.[33]

The Vice-Chancellor gave this as his reason why directors are trustees. His meaning was that directors' duties are enforceable by claims of the same type as the claims available to enforce trustees' duties. The *Re Windsor Steam Coal Company* case is also instructive.[34] That case concerned a liquidator who had wrongfully compromised a claim against the company. Liquidators were assumed for the purposes of the case to be liable as trustees are. Companies legislation had, however, created a comprehensive procedural scheme for adjudicating creditors' claims against liquidators which did not involve a formal accounting. Lawrence LJ carefully explained that in order to understand those claims and consequent relief it remained necessary to consider how the events that had occurred impacted upon the liquidator's account.[35]

(c) Fiduciary Duties

It remains to discuss the duties a custodial fiduciary may owe his beneficiary. Because this thesis concentrates on the position of conventional express trustees this section is confined to their duties, but parts of the analysis apply mutatis mutandis to fiduciaries of other types.

i. Administrative Duties

Duties may be imposed by the trust instrument or by parole undertaking or by statute or by the general law. A trustee may, to give a few examples, be required to get in and secure the trust property, to make it productive by investing it, to keep and render accounts, to supervise agents and co-trustees, to maintain an even hand between the

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[33] *Re Exchange Banking Ltd (Flintcroft's Case)* (1882) 21 ChD 519, 525, see also Cotton LJ at 535-536.

[34] *Re Windsor Steam Coal Company (1901), Limited* [1929] 1 Ch 151 (CA).

[35] Ibid 166-167.

beneficiaries, to consider exercising discretionary powers, and eventually to distribute the property to the beneficiaries.

Some duties may only be performed in one way and any deviation will be a breach of trust. A trustee who pays the wrong person, for example, will be liable even though he acted faultlessly.[36] Other duties may be performed in more than one way and the trustee must exercise his judgment. The duty to invest the fund productively is one example and the duty to get in and secure the estate property is another. The discretion a trustee exercises in these cases is not absolute nor is honesty enough. One issue in *Re Brogden* was whether the trustees had failed to take sufficiently vigorous steps to collect debts owing to the estate, the debtor having since become bankrupt.[37] Fry LJ explained the limitations on the trustee's discretion in these terms:

> A trustee undoubtedly has a discretion as to the mode and manner, and very often as to the time in which and at which he shall carry his duty into effect. But his discretion is never an absolute one; it is always limited by the duty–the dominant duty, the guiding duty–of recovering, securing, and duly applying the trust fund. And no trustee can claim any right of discretion which does not agree with that paramount obligation.[38]

The Australian High Court expanded upon this in *Elder's Trustee and Executor Co Ltd v Higgins*.[39] The court was faced with an argument that a trustee who had failed to exercise a valuable option to purchase land for the estate was protected from liability by the fact it had considered acting and bona fide decided not to do so. The court rejected this argument observing that the trustee's choice whether to exercise the option did not fall within an absolute *Gisborne v Gisborne* discretion, subject only to a requirement that it be exercised in good faith.[40] It was instead subject to the trustee's overriding duty to administer the trust with due skill and care. The trustee had been negligent and was

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[36] *Eaves v Hickson* (1861) 30 Beav 136, 54 ER 840.

[37] *Re Brogden* (1888) 38 ChD 546 (CA).

[38] Ibid 571.

[39] *Elder's Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426, 448-449.

[40] *Gisborne v Gisborne* (1877) 2 App Cas 300.

held liable on that basis. Moreover, as Megarry J explained in *Cowan v Scargill*, the standard is objective so that a trustee will not be negligent because he acted for untenable reasons if a prudent trustee could have made the same decision in the circumstances.[41]

The duty of skill and care has been largely developed in cases involving the exercise of investment powers, though it has many other applications. The leading statement is that of Jessel MR in *Speight v Gaunt*:

> It seems to me that on general principles a trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee.[42]

This formulation was generally approved in the House of Lords, but Lord Blackburn noted the important exception that 'a trustee must not choose investments other than those which the terms of his trust permit, though they may be ones that an ordinary prudent man of business would select for his own money'.[43] Every trustee is bound to keep within his powers and any act that exceeds them is necessarily a breach of trust. Jessel MR's statement has been further explained on a number of occasions. In *Re Whiteley* Lindley LJ said that:

> The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.[44]

More recently, Brightman J held in *Bartlett v Barclays Bank Trust Co Ltd* that a paid professional trustee who holds himself out as having special skills and knowledge

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[41] *Cowan v Scargill* [1985] Ch 270, 287; approved by Dillon LJ in *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1270.

[42] *Speight v Gaunt* (1882) 22 ChD 727 (CA) 739.

[43] *Speight v Gaunt* (1883) 9 App Cas 1, 19.

[44] *Learoyd v Whiteley* (1886) 33 ChD 347 (CA) 355, aff'd (1887) 12 App Cas 727.

is bound by a higher duty of skill than a lay trustee.[45] The professional trustee is obliged to exercise the special skill that he professes to have. The duty of skill and care imposed by the general law is now supplemented in most areas by sections 1 and 2 of the Trustee Act 2000, which require the trustee to exercise such skill and care as is 'reasonable in the circumstances' and which enshrine the principle that a professional trustee must meet a higher standard of skill.[46] Finally, it must be said that in exercising his investment powers a trustee must maintain a fair balance between the conflicting interests of capital and income beneficiaries and in striking that balance he may take into account their personal financial circumstances.[47]

ii. The Duty of Loyalty

Most custodial fiduciaries also stand in a relation of trust and confidence to their beneficiaries. The theory of this relation was the subject of a conceptual realignment over the course of the twentieth century which is not widely appreciated. What follows first outlines the modern theory of the relation, then describes the traditional theory and contrasts the two, and finally indicates a few areas in which consequences are still being worked out.

The relation of trust and confidence is nowadays usually thought to consist in a cluster of duties emanating from the core requirement of loyalty.[48] It has been said that the duties the relation of trust and confidence entails are proscriptive rather than prescriptive: equity 'tells the fiduciary what he must not do. It does not tell him what he

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[45] *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515, 534; *Re Harman's Will Trust* [1952] 2 All ER 1054, 1055; and see Law Reform Committee, *The Powers and Duties of Trustees* (23rd rpt, 1982, Cmmd 8733) Ch 2 paras 12-15.

[46] See discussion in C Whitehouse & N Hassell, *Trusts of Land, Trustee Delegation and the Trustee Act 2000* (2nd edn, 2001) Ch 10.

[47] *Nestle v National Westminster Bank plc* (1996) 10 TLI 113, 115-116, aff'd [1993] 1 WLR 1260 (CA) especially 1279; *Re Mulligan* [1998] 1 NZLR 481, 501; *Re Pauling's Settlement Trusts (No 2)* [1963] Ch 576, 586.

[48] For example *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 17-18.

ought to do.'[49] Finn has influentially analysed the relation as consisting in two proscriptive rules:

> A fiduciary -
>
> (a) cannot misuse his position, or knowledge or opportunity resulting from it, to his own or to a third party's possible advantage; or
>
> (b) cannot, in any matter falling within the scope of his service, have a personal interest or an inconsistent engagement with a third party
>
> unless this is freely and informedly consented to by his beneficiary or is authorised by law.[50]

These are colloquially known as the no-profits rule and the no-conflicts rule.[51] Some commentators contend that the two rules can be usefully reduced to one, which Birks formulates as a duty not to pursue any interest which conflicts or might conflict with the fiduciary's duty to his beneficiary.[52] Whether a one-rule or two-rule theory gives a sharper picture of the relation, it is observable that these formulations are expressed at a high level of abstraction. Each formulation contains a number of subordinate rules and principles and must be worked down to that subordinate level if the formulation is to provide meaningful and practical guidance in deciding cases. Moreover, though the rules are often said to be unbending, their application in particular cases may be shaped and even relaxed by the trust or contract framing the relation

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[49] *Attorney-General v Blake* [1998] Ch 439 (CA) 455, not discussed on appeal [2001] 1 AC 268. See also *Breen v Williams* (1996) 186 CLR 71, 95, 113, 137; *Pilmer v Duke Group Ltd (in liq)* (2001) 180 ALR 249 (Aus HC) 270-271; and R Nolan, 'A Fiduciary Duty to Disclose?' (1997) 113 LQR 220.

[50] PD Finn, 'Fiduciary Law and the Modern Commercial World' in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (1992) Ch 1, 9. See also PD Finn, 'The Fiduciary Principle' in TG Youdan (ed), *Equity, Fiduciaries and Trusts* (1989) Ch 1, 27 and RP Austin, 'Moulding the Content of Fiduciary Duties', in AJ Oakley (ed), *Trends in Contemporary Trust Law* (1996) 153.

[51] The distinction between these two rules was accepted in *Don King Productions Inc v Warren* [1999] 3 WLR 276 (CA) 320-321, approving a passage in *Chan v Zacharia* (1984) 154 CLR 178, 198-199 (Deane J). See also *Warman International Ltd v Dwyer* (1995) 182 CLR 544, 557.

[52] PBH Birks, 'The content of fiduciary obligation' (2002) 16 TLI 34, 37.

between the parties.[53]

It is a small and natural step from the assertion that a fiduciary has breached his duty of loyalty to the conclusion that he must make good whatever loss the beneficiary has suffered as a consequence. Because the step is small and natural some commentators find it perplexing that the courts have only taken it in earnest in the past fifteen years, though the House of Lords's 1914 decision in *Nocton v Lord Ashburton* has been identified as a precursor.[54] To an earlier generation of lawyers abuse of a relation of trust and confidence could lead to rescission of a contract, accountability for profits or the imposition of a constructive trust but there was no equivalent to common law damages. This traditional view has recently been expressed by both Waller and Hobhouse LJJ.[55]

The perplexity rests upon a false premiss. The language of duty exercises a powerful hold over legal thought but fails to capture the nature of the relation of trust and confidence as it was traditionally conceived. The relation was instead understood as being composed of a cluster of disabilities. That is how it was analysed in Hill's seminal treatise and that is how it has been treated in *Halsbury's Laws of England* up to the present.[56] Unless the disability is lifted a fiduciary cannot acquire profits in the scope of his engagement beneficially but will be deemed to have received them for his

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[53]*Kelly v Cooper* [1993] AC 205 (PC); *Hospital Products Ltd v US Surgical Corporation* (1984) 156 CLR 41, 97; *Sargeant v National Westminster Bank plc* (1990) 61 P & CR 518.

[54]*Nocton v Lord Ashburton* [1914] AC 932.

[55]*Companhia de Seguros Imperio v Heath (REBX) Ltd* [2001] 1 WLR 112 (CA) 117-118; *Swindle v Harrison* [1997] 4 All ER 705 (CA).

[56]J Hill, *The Law Relating to Trustees* (1845) 554-561; Lord Mackay of Clashfern (ed), *Halsbury's Laws of England* (4th edn, 2000 reissue) Vol 48 paras 818-839. The analysis in *Halsbury's* was endorsed by Megarry J in *Tito v Waddell (No 2)* [1977] Ch 106, 248. See also *Movietex Ltd v Bulfield* [1988] BCLC 104; T Lewin, *The Law of Trusts and Trustees* (1837) 376 and succeeding editions (but compare J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 44 para 52); E Vinter, *The History and Law of Fiduciary Relationship and Resulting Trust* (3rd edn, 1955) especially Ch 1; LS Sealy, 'Directors' Duties Revisited' (2001) 22 The Company Lawyer 79; LS Sealy, 'Fiduciary Obligations, Forty Years On' (1995) 9 JCL 37, 51-52.

principal.[57] Likewise, unless the disability is lifted a fiduciary cannot acquire trust property for himself or contract conclusively with his beneficiary.

It does not necessarily follow from the fact that one person is disabled from contracting with another that the first will be liable to make good whatever loss the other sustains in a transaction subject to the disability. A contract between a husband and his wife may be set aside if she habitually reposed confidence in him but it is a misuse of words to say that he owes her a positive duty not to contract with her or a positive duty to see that the disability is lifted by having her take independent advice.[58] If he did owe her these duties it would easily follow that the husband would be liable to make good whatever loss his wife suffered in the transaction but that is not the law.[59] This appears to be how the entire relation of trust and confidence was traditionally understood. Logically disabilities cannot found claims for the reparation of loss and so a beneficiary seeking reparative compensation would have to find a positive contract, tort or trust duty on which to hang his claim.[60]

Recent years have seen a fitful and awkward translation of the relation of trust and confidence from one composed of negative disabilities to one composed of positive duties. Certain subordinate rules that make sense on the traditional understanding seem peculiar or perverse when the relation is recast in positive obligatory terms. Mistranslation lies at the heart of many problems the courts have confronted. A contract between a disabled fiduciary and his beneficiary may be set aside irrespective of

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[57]There is high authority for the proposition that a trustee's accountability for profits is not founded on any breach of trust or other wrong: *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 153 (1942); *Scott v Scott* (1963) 109 CLR 649. The same idea is reflected in para 203 of the *Restatement of Trusts 2d* (1959) which provides that trustees are accountable for any profit made through or arising out of the administration of the trust even though they may have committed no breach of trust. See RD Niles, 'Trustee Accountability in the Absence of Breach of Trust' (1960) 60 Columbia LR 141.

[58]See *Agnew v Länsförsäkringsbolagens* [2001] AC 223, 264.

[59]Contra L Ho, 'Undue Influence and Equitable Compensation' in PBH Birks & F Rose (eds), *Restitution and Equity, Resulting Trusts and Equitable Compensation* (2000) Vol 1 Ch 11.

[60]*Cockburn v Edwards* (1881) 18 ChD 449 (CA) repays careful study. S Worthington is a modern advocate of something like this position: 'Fiduciaries: When is Self-Denial Obligatory?' [1999] CLJ 500, 507.

whether the same contract would have been made if the disability had been lifted.[61] Similarly a fiduciary is accountable for profits gained in the course of his engagement even though those profits would have been authorised if he had asked permission and made a proper disclosure of his interest.[62] Can it be inferred that the beneficiary can recover whatever losses he has suffered as a result of entering the transaction even though he would have acted in the same way if the fiduciary had made full disclosure? The controversial *Brickenden* case has suggested to some commentators that the answer is yes.[63]

A further translation problem that the courts have not come fully to grips with lies in the specification of the positive duties the relation of trust and confidence entails. The prevailing view mentioned above that these duties are proscriptive and not prescriptive aspires to honour the older conception of the relation but is difficult to sustain without semantic contortions.[64] The defendant solicitor in the recent case of *Longstaff v Birtles* conducted a disastrous business venture with his unadvised clients.[65] At one point Mummery LJ described the solicitor's breach as failing to cause the clients to obtain independent advice and at another point as continuing to deal with his unadvised clients[66] It is difficult to see that a duty to make disclosure or to cause a client to take independent advice is proscriptive.[67] Once it is accepted that the relation of trust and confidence entails duties rather than or in addition to disabilities, it must also be allowed that these include prescriptive as well as proscriptive duties.[68]

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[61] *Maguire v Makaronis* (1997) 188 CLR 449; *UCB Corporate Services Ltd v Williams* [2002] EWCA Civ 555.

[62] *Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1 (PC) 15.

[63] *Brickenden v London Loan & Savings Co* [1934] 3 DLR 465 (PC). See Chapter VIII Part 2(c).

[64] Authorities stating the view that fiduciary duties are proscriptive and not prescriptive are cited in note 49 above.

[65] *Longstaff v Birtles* [2001] EWCA Civ 219, [2002] 1 WLR 470.

[66] Ibid paras 1 & 35.

[67] Compare A Dugdale (ed), *Clerk & Lindsall on Torts* (18th edn, 2000) Ch 28 para 8.

[68] See MDJ Conaglen, 'Fiduciary Liability and Contribution to Loss' [2001] CLJ 480, 482.

Precise specification of the positive duty of loyalty is important because the cases suggest that suing for reparation of loss on a breach of the duty of loyalty attracts certain advantages to the claimant. For present purposes there is no need to enter further into this question beyond making one observation. An important distinction has emerged in the English cases decided over the past five years between intentional disloyalty and other fiduciary misconduct.[69] The idea is that whatever special advantages there may be only obtain where the fiduciary has intentionally preferred other interests over those of his beneficiary. This Millett LJ has called a breach of the fiduciary duty of good faith.[70] He said that the defendant does not need to have been dishonest but that the preference must have been intentional. It follows that whenever a custodial fiduciary who also occupies a position of trust and confidence breaches any of his duties with an intention to prefer other interests over those of his beneficiary he will also breach the duty of good faith and must take whatever consequences follow from that.

iii. Breach of Trust

By breach of trust is meant a violation by the trustee of any duty which as trustee he owes to the beneficiary.[71] According to this definition it is not a breach of trust for the trustee to breach an obligation to a third party even if that obligation arises in the course of administering the trust. Moreover, it is not a breach of trust for the trustee to breach an obligation to the beneficiary that he owes in some other capacity, for example a duty under a contract or mortgage between them or a duty of care the trustee owes while

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[69] *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA); *Swindle v Harrison* [1997] 4 All ER 705 (CA) (Evans LJ); *Nationwide Building Society v Balmer Radmore* [1999] Lloyd's Rep PN 241; *Companhia de Seguros Imperio v Heath (REBX) Ltd* [2001] 1 WLR 112 (CA). See also A Dugdale (ed), *Clerk & Lindsall on Torts* (18th edn, 2000) Ch 28 paras 23-25.

[70] *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 19.

[71] This is the definition in the American Law Institute, *Restatement of Trusts 2d* (1959) para 201. Not every custodial fiduciary is a trustee in the strict sense, but consistently with ordinary usage breach of duty by any custodial fiduciary will be called a breach of trust.

driving the beneficiary.[72] The definition includes, however, both administrative duties and the fiduciary duty of loyalty.[73]

2. Performance and Reparation Claims

The central contention of this thesis is that money claims against defaulting custodial fiduciaries are of two types. Some claims demand that the fiduciary perform his trust by the payment of a money equivalent to the property he is obliged to make over while others complain of a breach of trust and seek pecuniary satisfaction. This part explains the contrast between these types of claim in a general way using examples drawn from the law of contracts.

(a) Groundwork

English private law has always recognised a rudimentary difference between claims asserting a right and demanding that it be vindicated and claims complaining of a wrong and praying for satisfaction.[74] The division is a Germanic one between the nature of the claims rather than a Roman division according to the basis of the underlying rights.[75]

The difference between vindication claims and satisfaction claims was immanent in the scheme of classification of original writs out of which the modern common law developed.[76] The form of action for making a demand for the vindication of a right was

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[72]Pomeroy's definition of breach of trust in *Equity Jurisprudence* (3rd edn, 1905) Vol 3 para 1079, which includes 'every violation by a trustee of a duty which equity lays upon him . . .' sweeps in duties imposed by equity but that do not relate to the trust. The definition in J McGee, *Snell's Equity* (30th edn, 2000) Ch 13 para 1 is altogether too wide: 'A trustee is guilty of a breach of trust if he fails to do what his duty requires, or if he does what he is not entitled to do.'

[73]Compare *Tito v Waddell (No 2)* [1977] Ch 106, 247-248.

[74]SFC Milsom, *Historical Foundations of the Common Law* (2nd edn, 1981) 243: 'The modern law of obligations . . . is the result of a continuing interplay between two simple ideas from which the common law started. It, and the earlier jurisdictions from which the common law sprang, knew two kinds of legal claim: the demand for a right and the complaint of a wrong.'

[75]F Pollock & FW Maitland, *The History of English Law* (2nd edn, 1968) Vol 2, 571.

[76]JH Baker, *An Introduction to English Legal History* (3rd edn, 1990) 67.

by *praecipe* writ. Characteristic demands were that the defendant put the demandant back into possession of his land (writ of right), restore chattels (detinue), or a certain sum of money (debt), perform a covenant, or render an accounting. There were both positive and negative formulas depending upon whether the right required action or acquiescence.[77] Baker writes that:

> All *praecipe* actions have this is common, that they look not to compensation for misconduct but to the restoration of some right; they are prospective rather than retrospective, in the subjunctive mood rather than the active, and in the present tense rather than the past. Where possible they resulted in the recovery of the right, enforced by a writ to hand over the thing in demand or to do what was asked.[78]

By contrast, a claimant who originated action by way of plaint–a plaintiff–sued on the violation of his rights for damages. The most fruitful writs of this variety were the writs of trespass. The claimant in trespass did not ask for the prospective enforcement of duties or the protection of rights but for redress of past infringements.

The ossification and decline of the *praecipe* actions and the corresponding rise of trespass had the effect of dramatically reducing the range of circumstances in which the common law courts would be called upon to entertain claims for the vindication of rights. The triumph of trespass was, however, qualified in two ways. The first was that older ideas about the substance of liability haphazardly survived transplantation into the framework of trespass. The claim for payment of an agreed sum is a simple example. The *praecipe* writ of debt was supplanted by the trespassory writ of *indebitatus assumpsit*, but the underlying idea that the claim is for payment rather than satisfaction was not so easily displaced.[79] Today claims for an agreed sum are generally thought to

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[77]These were *praecipe quod reddat* and *praecipe quod permittat.*

[78]Ibid 69. Likewise, SFC Milsom, *Historical Foundations of the Common Law* (2nd edn, 1981) 315: 'The *praecipe* writs were about enforcing the primary obligation and no more. Any harm other than mere non-performance of a covenant or non-payment of a debt was outside the ambit of those writs, and therefore properly remediable, if at all, in a trepassory action.'

[79]See DJ Ibbetson, 'Assumpsit and Debt in the Early Sixteenth Century: The Origins of the Indebitatus Count' [1982] CLJ 142.

be for the enforcement of the primary obligation to pay the money.[80] The second qualification is that alongside developments in the common law courts, the Lord Chancellors were increasingly willing to entertain claims for the vindication of rights. The bill for an account is a straightforward example for Chancery simply picked up cases of account where the common law left off.[81] The powers to grant specific performance of contracts and injunctions are of greater modern significance.[82] Claims for relief of these types are directed towards the prospective enforcement or protection of rights rather than retrospective satisfaction for violations.

Volumes have been written exploring the interplay between claiming vindication of a right and claiming satisfaction for a wrong in the historical development of English private law and nothing further needs to be said here.[83] The present concern is with the end product. The line between these two types of claim remains one of the rudimentary ordering principles of modern English private law. It cuts across the historical boundary between the jurisdictions of the common law courts and Chancery, though in modern times equity has been more closely associated with vindication claims and the common law more closely associated with satisfaction claims.[84]

Each type of claim is a genus with several species representing the different ways in which rights may be vindicated or wrongs satisfied. This thesis is only concerned with one species of each genus, but a brief and oversimplified sketch of the larger scheme will clarify the situation of each in relation to the other. Important species

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[80] *Jervis v Harris* [1996] Ch 195 (CA) 202-203; *Re Park Air Services plc* [2000] 2 AC 172, 187; HG Beale (ed), *Chitty on Contracts* (28th edn, 1999) Ch 27 para 8; GH Treitel, *The Law of Contract* (10th edn, 1999) 943: 'It is a claim for the *specific* enforcement of the defendant's primary obligation to perform what he has promised'.

[81] See discussion in SJ Stoljar, 'The Transformations of Account' (1964) 80 LQR 203.

[82] WT Barbour concludes that petitions for the specific performance of contracts were comparatively common by the fifteenth century: *The History of Contract in Early English Equity* (1914) 122.

[83] This interplay is the central theme of both SFC Milsom, *Historical Foundations of the Common Law* (2nd edn, 1981) and DJ Ibbetson, *A Historical Introduction to the Law of Obligations* (1999).

[84] Compare J Story, *Commentaries on Equity Jurisprudence* (3rd English edn, 1920) para 30.

of vindication claim are claims that the defendant perform a positive duty (performance claims); claims that he comply with a negative duty to respect the claimant's rights (prohibition claims); and claims that a right be authoritatively recognised (declaration claims). Similarly, important species of satisfaction claim are claims that the defendant make reparation for the injury suffered (reparation claims); claims that the defendant be punished (punishment claims); and claims that the wrong be authoritatively acknowledged (another type of declaration claim). There are certainly other species but for present purposes there is no need to be exhaustive. The classification is represented in the following diagram:

Private Law Claims

Vindication Claims — Satisfaction Claims

Performance Prohibition Declaration — Reparation Punishment Declaration

Note that the line between vindication and satisfaction claims corresponds to the distinction Lord Diplock introduced into English contract law between primary and secondary obligations.[85] In relation to contract a primary obligation is one to render the performance required such as the obligation to convey title under a contract for the sale of land. A secondary obligation is one that may arise by imposition of law on failure to perform a primary obligation such as the obligation to pay damages if title is not conveyed. Vindication claims enforce primary obligations whereas satisfaction claims enforce secondary obligations.

The scheme of classification outlined above divides claims according to the nature of the claim advanced rather than the form of relief sought, but it is nonetheless true that most remedies are designed to give effect to one type of claim or another. A

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[85]In *Lep Air Services Ltd v Rolloswin Investments Ltd* [1973] AC 331, 350 and *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827, 848-849 amongst others.

prohibitive injunction is a remedy given in response to a prohibition claim; nominal damages is a remedy given in response to a declaration claim; and punitive damages is a remedy given in response to a punishment claim. There is, however, no necessary correspondence between any particular type of claim and a single form of relief, and in practice certain types of claim may elicit different forms of relief depending on the circumstances. Damages is the most familiar form of relief given in response to a successful reparation claim but in some circumstances the correct remedy may be to allow a proof in bankruptcy in the amount of the loss or, it will be argued, to charge the defendant in his account. Similarly an order for specific performance of a contract is the most familiar remedy given in response to a successful performance claim but in other circumstances the correct remedy may be a mandatory injunction or, it will be argued, a pecuniary award calculated as a substitute for the defendant's performance.

A topical question with peripheral relevance to this thesis is how a claim seeking the disgorgement of profits earned by the defendant fits into the scheme of classification outlined above. There are at least two possibilities. The first is that a claim for the disgorgement of profits is a species of satisfaction claim founded upon the complaint of a wrong and sitting alongside claims for the reparation of loss, claims that the defendant be punished, etc. On this view the obligation to give up the profits is a secondary obligation arising on the violation of a primary duty such as the fiduciary duty of loyalty. This analysis has been forcefully advocated by Birks and other scholars who, following his lead, situate these claims within a field called restitution (or disgorgement) for wrongs.[86] The second possibility is that these are a species of vindication claim seeking performance of a primary obligation to make over the profits. The idea here is that the defendant's obligation to disgorge his profits arises by operation of a disability that prevents him from taking the profits beneficially. The events generating the defendant's obligation may have included something that could be characterised as a breach of duty but that is only incidental.[87] It is of course possible that there is no single

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[86]PBH Birks, *An Introduction to the Law of Restitution* (Rev ed, 1989) Ch 10.

[87]*Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 153 (1942); *Scott v Scott* (1963) 109 CLR 649.

solution and that some disgorgement claims are for satisfaction and others for vindication. The position assumed in this thesis is that claims to the profits acquired by a custodial fiduciary through use of the trust property are essentially claims to vindicate the beneficiary's right to have the profits made over. That is thought to accord with the dominant course of authority as well as the basic structure of the custodial fiduciary relation, but to prove this assumption would require a further thesis.

The central contention of this thesis is that compensation claims against defaulting custodial fiduciaries must be understood in light of the contrast between performance and reparation claims. The next section examines three basic differences between performance and reparation claims, illustrating those differences by examples drawn from the law of contract. The following section considers claims to performance of an obligation to transfer property by payment of a monetary substitute.

(b) Three Basic Differences

The first basic difference between performance and reparation claims is that, whereas the defendant's breach of a primary obligation is a necessary element of a reparation claim, it is not essential to a performance claim. Williams writes of the power to order specific performance of a contract for the sale of land that:

> The court pronounces that the agreement ought to be, and shall be, carried out as intended. The cause of action, therefore, is not a breach of the contract, such as alone gives rise to an action at law for damages, but is the duty considered in equity to be incumbent on the defendant of actually doing what he promised by the contract to perform. It follows that a breach of contract by one party thereto is not necessarily a condition precedent to the other party's obtaining an order for its specific performance; though a breach of the contract is usually requisite to induce the court to interfere.[88]

For this reason the purchaser of land in *Hasham v Zenab* was held entitled to claim specific performance on a writ issued before the date of completion where the vendor

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[88]TC Williams, *Contract for the Sale of Land* (1930) 132.

had declared his intention not to perform.[89] The expectation that the vendor would breach was sufficient to motivate the court to order performance. When performance relief is claimed the basic question is not whether the defendant has breached his primary obligation but whether the court should intervene to enforce it.[90]

The second basic difference is that, whereas the claimant having suffered loss is a necessary element of any claim for reparative relief, neither past nor prospective loss is essential to his title to performance relief. All the claimant must prove to obtain performance relief is the defendant's outstanding primary obligation and, if necessary, circumstances calling for the court to intervene. Claims for payment of a debt provide a simple example. Millett LJ expressed the orthodox view in *Jervis v Harris*: 'The plaintiff who claims payment of a debt need not prove anything beyond the occurrence of the condition on the occurrence of which the debt became due. He need prove no loss . . .'[91]

The third basic difference is closely related to the second. Whereas the relief sought by a reparation claim is crafted by reference to the position of the claimant, performance relief is crafted by reference to the defendant's duty that is being enforced. The relief given in response to a reparation claim is measured by the loss the claimant has sustained by the defendant's breach. For this reason a causal relation must be shown between the breach and deterioration in the claimant's prior or expected position. There is also room for arguments that the claimant's recoverable loss should be cut back for one reason or other, such as that it is too remote or that the claimant's own conduct has contributed to or failed to prevent the loss. The precise application of these criteria differs depending on the cause of action and other factors. Performance relief, by contrast, is not directed to the consequences of the breach, if there has been a breach,

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[89] *Hasham v Zenab* [1960] AC 316 (PC). See also *Roy v Kloepfer Wholesale Hardware and Automotive Corp* [1952] 2 SCR 465; *Zucker v Tyndall Holdings plc* [1992] 1 WLR 1127 (CA); RE Megarry, Note (1960) 76 LQR 200.

[90] Similarly, a quia timet prohibitive injunction may be granted on proof of a sufficiently imminent risk: for example *Earl of Ripon v Hobart* (1834) 3 My & K 169, 176, 40 ER 65.

[91] *Jervis v Harris* [1996] Ch 195 (CA) 202-203.

and the claimant's conduct does not affect the shape of his relief. In drawing a performance order the court is characteristically concerned only with the nature of the defendant's obligation that is being enforced. Considerations of causation, remoteness, contributory fault and mitigation have no purchase.

These last two differences are illustrated by the Supreme Court of Canada's decision in *Semelhago v Paramadevan*.[92] The vendor of a residential property under construction refused to complete and the property then appreciated in value by some C$120, 000 as the market improved. Because the vendor did not complete, the purchaser did not sell his existing house which also then appreciated by some C$110, 000. The purchaser sued for damages in lieu of specific performance under Lord Cairns's Act and the question in the case was how those damages should be assessed.[93] The vendor argued that because the purchaser would have sold his existing house had the vendor completed, the purchaser's loss (in the sense of net profits he had foregone) as a result of the breach was only C$10, 000. The court nonetheless awarded the purchaser C$120, 000 subject to miscellaneous deductions. Sopinka J explained:

> If the respondent had received a decree of specific performance, he would have had the property contracted for and retained the amount of the rise in value of his own property. Damages are to be substituted for the decree of specific performance. I see no basis for deductions that are not related to the value of the property which was the subject of the contract. To make such deductions would depart from the principle that damages are to be a true equivalent of specific performance.[94]

Sopinka J gave as authority for this award Megarry J's decision in *Wroth v Tyler*, which he observed had not been overruled by the House of Lords in *Johnson v Agnew*.[95] It is

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[92]*Semelhago v Paramadevan* [1996] 2 SCR 415, affirming the law stated by the Ontario Court of Appeal 17 years earlier in *306793 Ontario Ltd v Rimes* (1979) 25 OR (2d) 79 leave refused [1979] 2 SCR xi.

[93]The Chancery Amendment Act 1858.

[94]*Semelhago v Paramadevan* [1996] 2 SCR 415, 427-428.

[95]*Wroth v Tyler* [1974] 1 Ch 30, 58-59; *Johnson v Agnew* [1980] AC 367.

an interesting question whether an English court would interpret *Johnson v Agnew* in the same way.[96]

Sopinka J accepted that his award would leave the purchaser with a windfall of C$110, 000 because he would benefit from the simultaneous market appreciation of both properties. This the judge did not take to be a criticism because the windfall was the natural consequence of the purchaser's title to specific performance. Sopinka J's analysis suggests that he would have made the same award if the purchaser's existing property had appreciated to the same extent as the vendor's property so that the purchaser would have been suffering no loss whatsoever, or indeed if the purchaser's property had appreciated to a greater extent than the vendor's property so that he had already benefited from non-performance of the contract. The order in *Semelhago v Paramadevan* essentially directed monetary or substitutive performance of the vendor's obligation to convey the land rather than payment of reparation for the purchaser's loss.

While it is arguable whether an English court would assess damages in lieu of specific performance on the same basis as the Supreme Court of Canada did, the underlying point about specific performance is beyond question. Where specific performance is otherwise appropriate it will not be refused because it would give the purchaser a windfall.[97] Title to specific performance of a contract does not depend upon the claimant having suffered a loss and the relief granted is not calibrated to reflect the extent of any loss he may have suffered. The reason is that specific performance gives effect to a performance claim rather than a reparation claim. If *Semelhago v Paramadevan* reflects the law in England then the same is true of damages in lieu of specific performance.

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[96]Compare Lord Nicholls's perplexing remarks in *Attorney-General v Blake* [2001] 1 AC 268, 281-283 with T Ingham, 'Damages in Equity–A Step in the Wrong Direction' [1994] Conv 110.

[97]That the claimant will gain a windfall may be a factor to consider in deciding whether an order for specific performance would cause hardship to the defendant: compare *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1, 15. Nonetheless, the mere fact the claimant will gain a windfall does not show the defendant will suffer hardship by the order.

In sum, a reparation claim depends upon the defendant having breached his primary obligations thereby causing loss to the claimant and the relief it seeks is measured by that loss. By contrast, a performance claim is for the enforcement of the defendant's primary obligations. Whether the claimant will suffer loss if the obligation is not performed is not an element of a performance claim and the extent of any such loss does not bear on the shape of the remedy that may be given to effect that claim.

(c) Substitutive Performance of Duties to Transfer Property

It is frequently impossible to order even substantial performance of a duty to transfer property. Amongst other possibilities the obligor may no longer have the property or the property he has may not conform to the contractual description. Frequently the court will deny the performance claim and leave the claimant to what other relief he may be entitled to.

The impossibility of exact performance does not always defeat a performance claim for the transfer of property. In a range of circumstances the court will order a party to transfer what property he has and pay a sum of money to make up the deficiency. If the vendor of land can convey substantially what the purchaser bought then performance may be ordered at his instance with compensation for small and immaterial defects.[98] The purchaser has a larger right, for he is entitled to take what he can get with compensation for the deficiency.[99] Harpum divides the decided cases into those where the vendor has misdescribed the property, those where he has failed to disclose the existence of a latent or irremovable encumbrance affecting the land, and those in which he is unable to give vacant possession.[100] Where the property is deficient in one of these respects, compensation is considered in Alexander LCB's words to be

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[98] *Rutherford v Acton-Adams* [1915] AC 866 (PC) 869-870.

[99] *Mortlock v Buller* (1804) 10 Ves Jun 292, 315-316, 32 ER 857; *Thames Guarantee Ltd v Campbell* [1985] QB 210, 235.

[100] C Harpum, 'Specific Performance with Compensation as a Purchaser's Remedy–A Study in Contract and Equity' [1981] CLJ 47, 47-48.

'incidentally necessary to effectuate decrees for specific performance.'[101] The compensation is usually given by way of an abatement of the purchase price.[102]

There is an elementary distinction between compensation as an element of specific performance and damages for breach of contract. In the leading case of *Todd v Gee* Eldon LC went so far as to say that damages have 'no resemblance to compensation.'[103] He illustrated the distinction by the case of a contract to sell land, part of which is falsely described as tithe-free, where the purchaser has contracted to sell the land on under the same description. In a purchaser's suit for specific performance with compensation the purchaser would be entitled to the land with compensation for so much as was not tithe-free, but he would not recover in respect of the damage he sustained in not being able to complete the subsequent contract. The implication is that if the claimant wished to recover his loss of bargain or any further or incidental losses, his remedy would be damages for breach of contract rather than compensation.[104]

The difference between compensation and damages can also be seen where the vendor has delayed completion and the purchaser has suffered injury as a consequence. The vendor in *King v Poggioli*, a decision of the High Court of Australia, failed to deliver possession of grazing land at the proper time.[105] The purchaser was unable to obtain sufficient pasture elsewhere and his cattle starved. The value of the lost cattle, the majority of the judges held, should not be taken into account in computing

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[101] *Newham v May* (1824) 13 Price 749, 752, 147 ER 1142.

[102] *Grant v Dawkins* [1973] 1 WLR 1406. In exceptional cases the vendor's performance may be perfected by directing that the purchaser take an indemnity against the vendor, which Fry says is a species of compensation because it is given in place of the thing contracted for: *Specific Performance* (6th edn, 1921) para 1224.

[103] *Todd v Gee* (1810) 17 Ves Jun 273, 278, 34 ER 106.

[104] There were doubts as to scope of Chancery's jurisdiction to award damages for breach of contract before the passage of The Chancery Amendment Act 1858: see PM McDermott, 'Jurisdiction of the Court of Chancery to Awards Damages' (1992) 108 LQR 652. Since that time it has always been possible to claim both specific performance (with or without compensation) and damages in addition for any residual loss in the same proceeding: for example *Grant v Dawkins* [1973] 1 WLR 1406; see also *Neylon v Dickens* [1987] 1 NZLR 402 (CA).

[105] *King v Poggioli* (1923) 32 CLR 222.

compensation. Starke J explained that 'compensation is given for some diminution or deterioration in the value of the property contracted to be sold: the purchaser "has not got the whole of what he contracted to buy"'.[106] He went on to say that 'a claim for loss due to delay in not giving possession is not, in my opinion, a claim in the nature of compensation'.[107] That loss would only be recoverable as damages, which in the special circumstances of the case could not be given. The English case *Re Wilsons and Stevens' Contract* is to like effect notwithstanding that it was decided under the Vendor and Purchaser Act 1874.[108]

The distinction between compensation and damages is grounded in unquestionable authority and judges have rarely had difficulty applying it. Notwithstanding this, doubts have been raised by a number of academic commentators about the cogency of the principle on which it rests.[109] The position taken here is that the distinction is sound for it rests upon the principle separating performance claims from reparation claims. Damages for breach of contract are essentially reparative, calculated as an equivalent to the loss the claimant has suffered. Compensation with specific performance, by contrast, is measured as an equivalent to the deficiency in the

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[106]Ibid 246, quoting Kay LJ in *Clarke v Ramuz* [1891] 2 QB 456 (CA) 461.

[107]Ibid.

[108]*Re Wilsons and Stevens' Contract* [1894] 3 Ch 546, 552. *Royal Bristol Permanent Building Society v Bomash* (1887) 35 ChD 390 must be regarded as a case, like *Jaques v Millar* (1877) 6 ChD 153, in which damages were given in addition to specific performance.

[109]Most forcefully by C Harpum, 'Specific Performance with Compensation as a Purchaser's Remedy–A Study in Contract and Equity' [1981] CLJ 47, 67-76. G Jones & W Goodhart, *Specific Performance* (2nd edn, 1996) 298 accept Harpum's contention. PM McDermott, *Equitable Damages* (1994) 225 writes that the relationship between the remedies of compensation and damages 'is not easy to deduce from the cases' but goes on to say the two are distinct.

property.[110] The only question in the assessment is one of valuation.[111] Fry aptly remarked that by compensation 'something else is given in place of the very thing contracted for'.[112] Compensation effectively cures the deficiency in the property, thereby perfecting the performance the vendor is ordered to make. The award in *Semelhago v Paramadevan* may be understood as compensation taken one step further in that it was given as a substitute for the entire property the vendor had been bound to convey rather than for a defect in that property. Granting relief of this sort is not inconsistent with the rule that a purchaser is entitled to take what he can get with compensation for the remainder.

Compensation as an element or in lieu of specific performance is not the only type of substitutive performance.[113] The claimant in the old action of detinue sued for the return of property detained by the defendant or for payment in lieu, the choice being for the defendant. The optional pecuniary sum would be measured by the market value of the property and the claimant would not be recompensed for any additional damage he had suffered.[114] Detinue was essentially a performance claim and the sum was awarded by way of substitutive performance. By contrast, a claimant in conversion, which was a species of trespass on the case, sued on the wrongful interference with his

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[110]A distinction will be drawn in Chapter III Part 1 between compensation (using that word substantively) in a substitutive and in a reparative sense. Compensation with specific performance is compensatory in the substutitive sense whereas damages for breach of contract are compensatory in the reparative sense. For this reason Harpum is wrong to say that compensation with specific performance should be assimilated to damages. The other reasons he gives for this assimilation fall away once it is understood that the two remedies follow different principles.

[111]In some cases this will be the cost of rectifying the defect and in other cases it will be the difference between the market value of the property or the contract price and the value of the property subject to the defect: compare amongst others *Re Chifferiel* (1888) 49 ChD 45 with *Topfell Ltd v Galley Properties Ltd* [1979] 1 WLR 446. It is not difficult to imagine cases in which a deficiency should be valued on some other basis.

[112]E Fry, *Specific Performance* (6th edn, 1921) para 1224.

[113]The compensation that may be given in the course of working out the rescission of a transaction where the property cannot be returned in its original condition may be another example of substitutive performance (or substitutive unperformance): consider *Newbigging v Adam* (1886) 34 ChD 582 (CA) and *Whittington v Seale-Hayne* (1900) 82 LT 49. This suggestion is too large to be developed here.

[114]DJ Ibbetson, *A Historical Introduction to the Law of Obligations* (1999) 89 & 111 (in the fifteenth and sixteenth centuries).

property. Damages were at large and had to be assessed by the jury, which could award more or less than the market value of the property depending on the extent of the claimant's actual suffering.

In conclusion, in appropriate cases the law allows a sum of money to stand in the place of property which the defendant is obliged to make over to the claimant for the purpose of giving effect to his performance claim. These sums are awarded by way of substitutive performance and must be distinguished from damages, which are awarded in response to a reparation claim. Substitutive performance awards reflect the difference between the property the claimant is entitled to receive and the property, if any, that he is given. Any loss the claimant may have suffered is not material to this calculation.

(d) Conclusion

The contrast between performance and reparation claims has been illustrated by examples drawn from the law of contract because there are fundamental similarities between the claims that lie to enforce contractual relations and custodial fiduciary relations. Claims for the enforcement of a custodial fiduciary's primary duties are not treated in the books on specific performance but certain of those duties are amenable to specific performance just as certain contractual duties are.[115] A trustee, for example, may be compelled to exercise an imperative power, or to consider exercising a discretionary power,[116] or to render an account, or to distribute the property to an equitable title-holder whose interest has fallen into possession. The only reason Fry could give for excluding trusts from his landmark study of specific performance was that trusts trace their historical provenance to Chancery whereas contracts depend on rights that were recognised at law.[117] In a sense trusts have a stronger claim to inclusion for while the specific performance of contracts has always been regarded as exceptional,

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[115]The identity of these claims is reflected in the language of the orders that are used to compel performance: see Chapter IV Part 1.

[116]*Re Hay's Settlement Trusts* [1982] 1 WLR 202.

[117]E Fry, *Specific Performance* (6th edn, 1921) para 40.

claims for the performance of trusts are usually allowed on proof of the primary obligation.[118] Substitutive performance claims against custodial fiduciaries will be considered in Chapters IV, V and VI.

Similarly, books on claims for damages have traditionally excluded claims founded upon equitable rights. This exclusion has either been justified on the basis that abuse of a fiduciary relation does not found relief comparable to common law damages or,[119] less robustly, on the basis that even though breach of trust may call for relief akin to damages, trusts form a separate department of the law.[120] The position taken in this thesis is that neither point of distinction is persuasive insofar as one type of available claim is concerned. Reparation claims against custodial fiduciaries will be considered in Chapter VII, VIII and IX.

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[118]Compare AW Scott & FW Fratcher, *The Law of Trusts* (4th edn, 1989) para 199.1.

[119]PH Winfield, *The Province of the Law of Tort* (1932) 112; H McGregor, *McGregor on Damages* (16th edn, 1997 as supplemented) Ch 1 paras 5 & 5A.

[120]G Williams & BA Hepple, *Foundations of the Law of Tort* (1976) 18.

FOUNDATIONS

REMEDIAL CONCEPTS

CHAPTER III

REMEDIAL CONCEPTS

Chapter III

Analysis of equitable compensatory relief has been complicated by the failure of judges and commentators to agree on a stable terminology. This chapter sets about the task of clarifying and settling our vocabulary by examining four terms that have given particular trouble: compensation, restitution, equitable compensation and damages. These terms are each used to identify the object of a money claim against a custodial fiduciary with differing degrees of frequency. Equitable compensation and damages are ordinarily used to identify the formal object, the remedy, while compensation and restitution are often used to identify the substance of that formal object.

Both equitable compensation and damages are contested concepts when used in connection with claims against custodial fiduciaries. This part explains that the contest lies between those who implicitly contend that all compensation claims against custodial fiduciaries are performance claims, those who implicitly contend that all compensation claims are for reparation, and those who take an intermediate position. A common failure to appreciate that the claims may be of one or the other type lies at the root of many of the difficulties that have bedevilled this branch of the law.

1. Compensation

This thesis is concerned with claims for compensation. That word has a number of legal and non-legal meanings but the present concern is with its use in connection with judicial relief founded upon equitable rights. Compensation is used in relation to equitable relief in two distinct senses that are explained and contrasted in this part. Both carry the idea of an equivalent.[1] In its dominant sense compensation consists in a

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[1] JA Simpson & ESC Weiner, *Oxford English Dictionary* (2nd edn, 1989) Vol 3, 601 sense 2a; J Burke, *Jowitt's Dictionary of English Law* (2nd edn, 1977) Vol 1, 400.

money equivalent to the injury or loss a person has suffered.[2] This may be called reparative compensation because it is calculated to repair the loss. In its second sense compensation consists in a money equivalent to property of which a person has been deprived or denied. This may be called substitutive compensation because it is calculated to provide a substitute for the property. The two concepts are elucidated and contrasted in what follows.

Reparative compensation is the typical object of an award of damages in tort or contract. There is a generic formula that guides the calculation of compensable loss. This formula was most famously articulated by Lord Blackburn in *Livingstone v Rawyards Coal Co*:

> . . . where an injury is to be compensated by damages, in settling the sum of money to be given for reparation of damages you should as nearly as possible get at that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation.[3]

Lord Blackburn's formula applies somewhat differently in breach of contract cases from its application in tort cases. In tort the claimant is entitled to be put in the position he would have occupied if the tort had not been committed.[4] In contract the claimant is entitled to be put in the position he would have occupied if the agreement had been performed according to its terms.[5]

Lord Blackburn's formula mandates a counterfactual comparison of the claimant's present position with the position he would have occupied if the tort had not been committed or if the agreement had been performed. This hypothetical comparison

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[2]See A Burrows, 'Judicial Remedies', in PBH Birks, *English Private Law* (2000) Vol 2 Ch 18 para 16.

[3]*Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39.

[4]*Liesbosch Dredger v SS Edison* [1933] AC 449, 459.

[5]*Robinson v Harman* (1848) 1 Ex 850, 855, 154 ER 363.

is drawn pursuant to a causal inquiry linking the defendant's misconduct with deterioration in the claimant's position. Reparative compensation matches injury *caused* by the defendant's misconduct. Sums awarded in excess of this amount are not compensatory in this first sense and must be attributed to another object, sometimes punishment or deterrence. The word compensation is occasionally used in a larger sense that encompasses punitive and other sums awarded to a successful claimant,[6] but this is irregular and imperfect usage.[7]

Reparative compensation needs to be distinguished from substitutive compensation. This second concept of compensation consists in providing a money equivalent to property of which a person has been deprived or denied. The distinction between the two senses was drawn by the United States Supreme Court in the famous case *Monogahela Navigation Co v United States*.[8] The court was called upon to construe a clause in the United States Constitution mandating 'just compensation' for expropriated property, in that case a lock and dam on the Monogahela river in Pennsylvania. The court held that compensation under the clause 'must be a full and perfect equivalent for the property taken.'[9] This sense of compensation was contrasted with the sense in which the term is used in connection with damages, 'being the equivalent for the injury done'. The court went on to explain the significance of the distinction. In calculating compensation for property taken one should not take 'into account as an element in the compensation any supposed benefit that the owner may receive in common with all from the public uses to which his private property is appropriated'.[10] In other words, the government was not entitled to argue for a reduction of the award on the basis that the claimant's subjective injury was less than the objective

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[6]For example *Riches v News Group Newspapers Ltd* [1986] QB 256 (CA) 268.

[7]*Lancashire County Council v Municipal Mutual Insurance Ltd* [1996] 3 All ER 545 (CA) 556; *Monogahela Navigation Co v United States*, 148 US 312, 326 (1893).

[8]*Monogahela Navigation Co v United States,* 148 US 312, 326 (1893).

[9]Ibid 326. Similarly, the Supreme Court of India defined compensation in the expropriation case *State of West Bengal v Bela Banerjee* AIR 1954 SC 170, 172 as 'a just equivalent of what the owner has been deprived of.'

[10]*Monogahela Navigation Co v United States,* 148 US 312, 326 (1893).

value of the property; equally it might be said that the award should not be augmented because the government's subjective gain exceeds that objective value.[11] Causal connection between the claimant's injury and the defendant's act is not to the point where compensation is used in this second sense because the compensation is an equivalent to the property and not whatever injury there may be.

These two concepts of compensation imply correspondingly different concepts of loss. Reparative compensation responds to loss in the figurative sense of injury or damage.[12] Loss in this sense is subjective in that it is concerned with injury or damage to a particular claimant. It is harm to the claimant's interests such that his position is comparatively worse than it would have been if he had not suffered the wrong or if his contract had been performed. This idea includes foregone gains as well as consequential losses. It is always a question for further investigation which features of the claimant's position may be considered in the comparison. The measurement of compensation is subject to an important caveat, which is that the claimant is to be made whole only so far as it can be done in money.[13] Loss of this sort will be called reparable loss.

Compensation of the second type, by contrast, meets the loss of property to the claimant, whether by deprivation or denial. Substitutive compensation is measured by the property's objective value or by the objective value of some deterioration or diminution. How the property is to be valued is always a question for decision. Even where there is a ready market, a valuation date needs to be selected. It may be necessary to decide which potential uses should be taken into account or whether the property is to

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[11]Compare the controversial Canadian expropriation case *Fraser v The Queen* (1963) 40 DLR (2d) 707 (SCC).

[12]The word loss in this sense is used interchangeably by English lawyers with the words injury and damage: H McGregor, *McGregor on Damages* (16th edn, 1997) Ch 1 para 9.

[13]In its nature non-pecuniary loss has no equivalent in money, but English law proceeds on the fiction that it is possible to compensate non-pecuniary loss in money: *Lancashire County Council v Municipal Mutual Insurance Ltd* [1996] 3 All ER 545 (CA) 556; *Wright v British Railways Board* [1983] AC 773, 777; *British Transport Commission v Gourley* [1956] AC 185, 197; see also American Law Institute, *Restatement of Torts 2d* (1979) para 903.

be valued independently or as part of a larger parcel or concern. Whether the claimant's overall financial position or personal well-being is diminished or improved by the deprivation of the property is not a material consideration to that valuation. Consequential loss is likewise conceptually inapposite to compensation of the substitutive variety.

The distinction between reparative and substitutive compensation has been overlooked by modern equity lawyers but is implicit in their usage. If the distinction is not recognised it is easy to unwittingly slide between the two senses. It has already been suggested that the difference between these types of compensation separates damages for breach of contract from the compensation that is given as an element of specific performance.[14] The argument will similarly be that where the beneficiary of a custodial fiduciary relation asserts a reparation claim, his claim must be understood as one for reparative compensation; but where he asserts a performance claim and literal performance is impossible, the compensation he takes in lieu is substitutive in nature. It is a pecuniary substitute for the property the fiduciary was bound to convey.

2. Restitution

Street J said in *Re Dawson* that 'The obligation of a defaulting trustee is essentially one of effecting a restitution to the estate.'[15] That was a case in which the trustee had lost trust money by improperly committing it to an agent who then absconded. The term restitution was only occasionally used to describe the object of a claim against a misconducting custodial fiduciary in earlier cases, but since *Re Dawson* was decided in 1966 this usage has entered into orthodoxy.[16] Most cases and texts now characterise the liability of a defaulting custodial or non-custodial fiduciary to pay compensation as

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[14]Chapter II Part 2(c).

[15]*Re Dawson* [1966] NSWR 211, 214.

[16]Street J's analysis achieved prominence by inclusion in the 13th edition of DJ Hayton, *Underhill's Law Relating to Trusts and Trustees* (1979) 702. That reference was then picked up in *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 543 and by Wilson J in *Guerin v The Queen* [1984] 2 SCR 335, 360-62.

being restitutionary.[17] Section 14 of the Pensions Act 1995, which provides a statutory basis for claims against pension trustees along apparently similar lines to the common law, is headed 'Restitution'. The questions this part addresses are, first, in what sense these claims may be said to be for restitution and,[18] second, how these claims relate to what is known as the law of restitution.

(a) Analysis of Restitution

The proposition that a claim against a custodial fiduciary is a claim for restitution is just as ambivalent as the proposition that it is for compensation because restitution is also used in connection with equitable pecuniary relief in two different senses.[19] By an unhappy coincidence these two senses correspond to the two senses in which the claims are said to be for compensation. This coincidence systematically obscures the fundamental differences between the two types of claim these words are used to describe.

In its first sense restitution means 'reparation to one for loss or injury previously inflicted'.[20] This is the sense in which La Forest J used the term in *Hodgkinson v Simms*, a case involving a non-custodial fiduciary investment advisor. La Forest J said

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[17]For example J Martin, *Modern Equity* (16th edn, 2001) 652; DJ Hayton, *Underhill and Hayton Law Relating to Trusts and Trustees* (15th edn, 1995) 829; J McGhee, *Snell's Equity* (30th edn, 2000) Ch 13 para 3; RP Meagher, WMC Gummow & JRF Lehane, *Equity Doctrines and Remedies* (3rd edn, 1992) Ch 23 para 3; J Glover, *Commercial Equity–Fiduciary Relationships* (1995) Ch 6 para 118.

[18]The word restore and its variants are used interchangeably with restitution and its variants. The two words are so similar in their relevant meanings that dictionaries often define each in terms of the other. Recent attempts to differentiate restitutionary relief from restorative relief are unhelpful and probably unworkable for this reason: for example RB Grantham & CEF Rickett, *Enrichment and Restitution in New Zealand* (2000) 19-20 and AD Little, 'Restoration for Breach of Confidence' [2000] LMCLQ 142.

[19]There is a third sense in which restitution means the restoration of a thing or institution to its former state or of a person to a former status or position: JA Simpson & ESC Weiner, *The Oxford English Dictionary* (2nd edn, 1989) Vol XIII 753 senses 4a & 5a. This sense is also occasionally used in the connection with the reconstitution of trust funds: the fund is restored to a state sufficient to satisfy the claims of the beneficiaries.

[20]JA Simpson & ESC Weiner, *The Oxford English Dictionary* (2nd edn, 1989) Vol XIII 753 sense 1a. 'Restore' carries a parallel sense of 'to compensate, to make good (loss or damages)', though the editors add that this usage is now rare or obscure: Vol XIII 755 sense 2a.

that 'the proper approach to damages for breach of a fiduciary duty is restitutionary. On this approach, the appellant is entitled to be put in as good a position as he would have been in had the breach not occurred.'[21] These words echo Lord Blackburn's classical formulation of the reparative compensation principle in *Livingstone v Rawyards Coal Co*,[22] for when used in this sense restitution is not distinct from reparative compensation. The principle governing reparative compensation is itself sometimes identified by the Latin tag 'restitutio in integrum'.[23]

In its second sense restitution means 'the restoration of something lost or stolen to its proper owner'.[24] To lost and stolen one might add withheld. This is the dominant meaning of the word in the usage of English private lawyers. It is the sense in which James and Baggallay LJJ used the term in *Ex p Adamson*:

> The Court of Chancery never entertained a suit for damages occasioned by fraudulent conduct or for breach of trust. The suit was always for an equitable debt or liability in the nature of a debt. It was a suit for the restitution of the actual money or thing, or value of the thing, of which the cheated party had been cheated.[25]

This second sense is non-reparative as it makes no reference to any reparable loss suffered by the claimant. The concern is instead with the claimant's entitlement to a thing of which he has been deprived or denied. This concept of restitution presupposes that there has been money or other property come into the defendant's hands to which the claimant's entitlement can attach. It is a misuse of words to speak of non-reparative

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[21] *Hodgkinson v Simms* [1994] 3 SCR 377, 440. In England see amongst others *Swindle v Harrison* [1997] 4 All ER 705 (CA) 733 and *Nationwide Building Society v Balmer Radmore* [1999] Lloyd's Rep PN 241, 270.

[22] *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39.

[23] The Latin term means 'restoration to the whole (ie uninjured) state'. Restitutio in integrum is now used to mean 'restoration of an injured party to the situation which would have prevailed had no injury been sustained.' J Pearsall, *The Concise Oxford Dictionary* (10th edn, 1999) 1220.

[24] J Pearsall, *The Concise Oxford Dictionary* (10th edn, 1999) 1220 sense 1. 'Restore' carries a parallel sense of 'to give back, to make return or restitution of (anything previously taken away or lost).' JA Simpson & ESC Weiner, *The Oxford English Dictionary* (2nd edn, 1989) Vol XIII 755 sense 1.

[25] *Ex p Adamson* (1878) 8 Ch App 807, 819.

restitution where this condition does not obtain.

This second concept of restitution is not identical to substitutive compensation but the two are logically connected. The dictionary definition set out above superficially confined the concept to specific restitution, restitution of the actual thing. On reflection, however, that limitation is not required by ordinary or legal usage. Where specific restitution is impossible or inappropriate restitution may be made by payment of a sum of money representing the thing that has been lost, stolen or withheld.[26] The old action of detinue, for instance, was an action for restitution either by the return of the chattels or by payment of a pecuniary equivalent. Similarly, as the excerpt from *Ex p Adamson* suggests, restitution of trust property may be effected by delivery of the actual property or by payment of an equivalent sum. As Street J said in *Re Dawson*, the obligation of a defaulting trustee to pay money where he no longer has the actual asset is 'tantamount to an obligation to effect restitution *in specie*'.[27] Where restitution is to be effected by payment of a pecuniary equivalent the award is one of substitutive compensation.

Several scholars contend that Street J and those coming after him have been guilty of misusing words. Rickett refers to *Re Dawson* and writes that 'the language of restitution is unfortunate, and it should not be allowed to hide the fact that what is being effected in a monetary award "restoring" the trust fund is compensation.'[28] Of course restitution carries a sense that is perfectly apt to describing an award of reparative compensation, but Street J was not speaking of reparative restitution. The position taken here is that Street J was not misusing words because the type of claim with which he was concerned is for restitution in the dominant, non-reparative sense of that word. At the same time, certain of his successors are mistaken to infer that all compensation claims against misconducting trustees and other custodial fiduciaries have this character.

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[26]See PBH Birks, *An Introduction to the Law of Restitution* (Rev ed, 1989) 12-13.

[27]*Re Dawson* [1966] NSWR 211, 216.

[28]CEF Rickett, 'Compensating for Loss in Equity–Choosing the Right Horse for the Course' in PBH Birks & F Rose (eds), *Restitution and Equity* (2000) Vol 1 Ch 10, 176. Rickett was of course speaking of reparative compensation. See also A Burrows, 'Judicial Remedies' in PBH Birks (ed), *English Private Law* (2000) Ch 18 para 142.

Two examples will help to make the point. A fiduciary holds gold for his beneficiary absolutely which he refuses to deliver when the beneficiary calls for it. The beneficiary's claim is for performance of the fiduciary's duty to deliver the gold and the order he seeks is for restitution.[29] This is restitution in the non-reparative sense: the fiduciary must render the thing he has been withholding. If the fiduciary no longer has the gold then specific restitution will be impossible. Unless he can offer an exculpatory explanation of what became of the gold, the fiduciary may be required to pay a money equivalent. This order is also for restitution in the non-reparative sense: the fiduciary must pay money as a substitute for the gold he cannot deliver. *Re Dawson* was a case of this sort. The trustee had taken money from the fund for his own purposes and was now being made to pay back an equivalent sum. The claimant's argument, which Street J agreed with, was expressly restricted to cases in which 'a defaulting trustee is required to make good to a trust estate moneys or assets which he has wrongfully extracted from it'.[30]

Now take a different type of case. A trustee misconceives his investment duties and invests the fund over a period of time in fixed income securities rather than diversifying into equities. The result is that the real value of the trust capital is steadily eroded by inflation. The trustee may be in breach both of his duty to invest the fund prudently and of his duty to maintain an even hand between the capital and income beneficiaries. If held liable he will be charged with a sum calculated to put the fund or the capital interests in the financial position it or they would have occupied if he had made proper investments. The trustee's obligation in these circumstances has been said by a New Zealand judge to be 'one of effecting a restitution to the estate',[31] but there is nothing to put back and so this can only be restitution in the non-reparative sense. *Bartlett v Barclays Bank Trust Co Ltd* also involved claims against a trustee alleged to

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[29]Note that not all performance claims are restitutionary. A claim demanding that trustees exercise a power, for example, is for performance of a duty but not for restitution. The contention here is that all performance claims for the transfer of withheld or misapplied property may be properly described as restitutionary.

[30]*Re Dawson* [1966] NSWR 211, 214.

[31]*Re Mulligan* [1998] 1 NZLR 481, 507.

have mismanaged the trust investments.[32] Brightman LJ remarked that 'the claims in this case are not and cannot be for restitution in the strictest sense', which he explained in these words:

> The so-called restitution which the defendant must now make to the plaintiffs, and to the settled shares, is in reality compensation for loss suffered by the plaintiffs and the settled shares, not readily distinguishable from damages except with the aid of a powerful legal microscope.[33]

The claims were in reality for reparative compensation.

These two examples show that the word restitution is used in two ways in connection with compensation claims against defaulting fiduciaries. They express fundamentally different ideas. The first describes the object of a performance claim for the transfer of property. This first concept is connected with substitutive compensation. The second describes the object of a reparation claim. This concept is identical to reparative compensation. Both uses of the word are cogent and apt to describe the object of the type of claim to which they pertain, but there is an obvious danger in using the same word to mean different things in such close quarters. The problem is overuse rather than misuse of words. The dominant sense of restitution as it is used by English private lawyers is non-reparative. For this reason restitution should only be used to identify the object of a performance claim for the transfer of money or other property. Confining its usage in this way would represent a significant advance in clarity.[34]

(b) Relation with the Law of Restitution

The next question is whether the two types of claim for restitution just identified fall within the area of law now generally known as the law of restitution. This question is

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[32] *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515.

[33] Ibid 545. One argument in Chapter VIII Part 4 is that Brightman LJ misunderstood the significance of this insight.

[34] See further SB Elliott, 'Restitutionary Compensatory Damages for Breach of Fiduciary Duty?' [1998] RLR 135.

complicated by the fact that there seem to be as many views on the boundaries of the law of restitution as there are teachers of it. For present purposes we may put to one side some of the more idiosyncratic positions and concentrate on what Burrows calls the conventional picture sketched in the foundational texts.[35]

According to the foundational texts, the law of restitution does not encompass all claims that might by the ordinary use of words be described as claims for restitution. Nor does it encompass all claims that are usually described by lawyers as claims for restitution. For these reasons Birks concedes that the choice of name for this area of the law 'is not perfectly appropriate.'[36] Goff and Jones identify the limiting criterion: 'The law of restitution is the law relating to all claims . . . which are founded upon the principle of unjust enrichment.'[37] Birks's central contribution has been to suggest that the subject has two parts, namely unjust enrichment by subtraction and unjust enrichment by wrongdoing.[38] The relation between unjust enrichment and property law has been especially problematic. The conventional view is that claims depending upon pre-existing property rights (which Goff and Jones call 'pure proprietary claims') are not part of the subject while claims depending upon property rights that arise by operation of the principle against unjust enrichment ('restitutionary proprietary claims') are part of the subject. A pure proprietary claim to be put back into possession of the claimant's own land is a good example of a claim that is restitutionary on any view but does not fall within the conventional bounds of the law of restitution.

Reparation claims against custodial fiduciaries plainly do not fall within the law of restitution because they are concerned with harm to the claimant and not enrichment

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[35]A Burrows, 'Quadrating Restitution and Unjust Enrichment: A Matter of Principle?' [2000] RLR 257. The foundational texts are Lord Goff of Chieveley & G Jones, *The Law of Restitution* (5th edn, 1998); PBH Birks, *An Introduction to the Law of Restitution* (Rev edn, 1989)(though he has since recanted central propositions); and The American Law Institute, *Restatement of Restitution* (1937).

[36]PBH Birks, *An Introduction to the Law of Restitution* (Rev edn, 1989) 14.

[37]Lord Goff of Chieveley & G Jones, *The Law of Restitution* (5th edn, 1998) 3.

[38]Birks himself now contends that the wrongdoing cases are not founded upon unjust enrichment and belong instead in the law of civil wrongs along with other tort claims: 'Misnomer' in WR Cornish et al (eds), *Restitution: Past, Present and Future* (1998) 1.

to the defendant. The performance claims for the transfer of property that may be pressed against custodial fiduciaries are only slightly more problematic. The category of performance claims is defined according to the nature of the claim, these being claims that the defendant perform a primary duty. The category of claims falling within the law of restitution is defined according to the basis of the right, these being claims enforcing rights that arise out of the unjust enrichment of the defendant. These are not parallel contrasting categories. On the contrary, it may be that unjust enrichment claims are best understood as a species of performance claim. The claimant demands that the defendant perform his duty by making restitution of the thing he has received or its value. Whether that is a satisfactory analysis depends on large and contested issues that do not need to be considered here.[39]

The reason the beneficiary's claim for restitution of the actual gold in the example given above does not fall within the law of restitution is that it is not based on rights arising to prevent the defendant from being unjustly enriched. One reason is that the duty the beneficiary seeks to enforce–the duty to transfer the property–was voluntarily undertaken. It is axiomatic that a duty to make restitution for unjust enrichment arises by imposition of law rather than the consent or promise of the defendant. Another reason that might be given is that the beneficiary's claim is based upon a property right that did not arise by operation of the unjust enrichment principle. Pure proprietary claims, it has been noted, are conventionally excluded from the law of restitution. Whichever of these reasons is correct, the claim is not based upon unjust enrichment and so does not fall within the law of restitution.

There is no need to decide whether these or parasitic reasons also mean that the beneficiary's alternative claim for payment of the value of the gold where the gold itself is not forthcoming falls outside of the law of restitution because there is a simpler reason. That reason is that the substitutive claim lies irrespective of whether the fiduciary has been enriched by the events that have foreclosed a specific claim. For

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[39]Most legal academics working in this area would object to the notion that a claim for the disgorgement of profits gained in breach of the defendant's duty can or should be analysed as a performance claim: see Chapter II Part 2(a).

instance, a fiduciary will be bound to make pecuniary restitution even though he has mistakenly donated the property to the wrong person,[40] which plainly does not enrich the fiduciary.

The argument in this section has been that all reparation claims fall outside of the law of restitution. Performance claims for the transfer of property or its monetary equivalent brought against consensual fiduciaries also fall outside its ambit, even though these claims are for restitution in the same sense of that word, because they do not depend on the unjust enrichment principle. There are much more difficult questions about claims against constructive trustees but they do not concern us here.

3. Equitable Compensation

Part of the motivation for this study lies in the development of what has been called equitable compensation.[41] Equitable compensation, by that name at least, was largely unknown to English law only a decade ago. Its availability as a remedy for fiduciary misconduct has since been recognised by the courts on a number of occasions.[42] Early treatments of equitable compensation presented it as a remedy for misconduct sounding in equity but committed by persons who do not hold property in a custodial capacity.[43] Many of the cases involve advice given by solicitors or financial advisors who are either personally interested or doubly employed and who have not made sufficient disclosure of the conflict. In cases of that sort equitable compensation appeared to be a novel form

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[40]For example *Eaves v Hickson* (1861) 30 Beav 136, 54 ER 840 and *Bishopsgate Investment Management Limited (in liq) v Maxwell (No 2)* [1994] 1 All ER 261 (CA) 265 & 269 (company director).

[41]Some of the considerable literature on equitable compensation is collected together by CEF Rickett in 'Compensating for Loss in Equity: Choosing the Right Horse for the Course' in PBH Birks & F Rose (eds), *Restitution and Equity, Resulting Trusts and Equitable Compensation* (2000) Vol 1 Ch 10 n 1.

[42]See especially *Target Holdings Ltd v Redferns* [1996] AC 421, 439; *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 17; *Swindle v Harrison* [1997] 4 All ER 705 (CA); *Longstaff v Birtles* [2001] EWCA Civ 1219, [2002] 1 WLR 470.

[43]IE Davidson, 'The Equitable Remedy of Compensation' (1981-82) 13 MULR 349 is the locus classicus.

of relief, although it found an important antecedent in *Nocton v Lord Ashburton*.[44] Since the House of Lords's decision in *Target Holdings Ltd v Redferns* it has been thought that equitable compensation is also a characteristic money remedy for breach of trust.

Numerous cases in England and elsewhere in the Commonwealth have considered the character of equitable compensation but difficult questions remain to be answered. It is possible to distill two competing theories, which may be called the restitution theory and the damages theory.[45] Neither has been fully developed in the literature and they are frequently run together. The two theories nonetheless represent identifiable strands of thought that are usefully contrasted. The two differ according to the relationship they postulate between equitable compensation and common law damages.

Proponents of the restitution theory begin with the idea that equitable compensation is somehow different from common law damages. On their view equitable compensation has a distinctive character emanating from the nature of the trust. The restitution theory finds fullest expression in McLachlin J's influential concurring judgment in *Canson Enterprises Ltd v Boughton & Co*:

> . . . we start from the traditional obligation of a defaulting trustee, which is to effect restitution to the estate. But restitution *in specie* may not always be possible. So equity awards compensation in place of restitution *in specie*, by analogy for breach of fiduciary duty with the ideal of restoring to the estate that which was lost through the breach.[46]

Canson enterprises was itself a case of non-disclosure by a doubly employed solicitor. The solicitor failed to notify his purchaser client of facts that would have indicated that his vendor client was perpetrating a fraud. Because there was no trust estate the so-

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[44]*Nocton v Lord Ashburton* [1914] AC 952.

[45]Compare WMC Gummow, 'Compensation for Breach of Fiduciary Duty' in TG Youdan (ed), *Equity, Fiduciaries and Trusts* (1989) Ch 2.

[46]*Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534, 547.

called restitution was only possible by analogy. McLachlin J's idea was elaborated by the English Court of Appeal in *Swindle v Harrison*, which was also a case of non-disclosure by a solicitor in a conflict position.[47] Evans LJ explained that whereas common law damages ordinarily aim to put the claimant in the position he would have occupied if the breach had not occurred, equitable compensation given on a restitutionary basis aims to put him in the position he had occupied before the wrong occurred.[48] Speaking of equitable compensation, Mummery LJ said that 'Foreseeability and remoteness of damages are, in general, irrelevant to restitutionary remedies for breach of trust or breach of fiduciary duty.'[49]

Proponents of the damages theory dispute the analogy with restitution of trust property and say that equitable compensation (or one type of equitable compensation) is essentially akin to common law damages. As with common law damages, equitable compensation is on this view a money remedy calculated to make good a loss sustained by the claimant by reason of the defendant's wrongful act. The damages theory was propounded by La Forest J speaking for the plurality of judges in *Canson Enterprises*:

> In the case of a trust relationship, the trustee's obligation is to hold the *res* or object of the trust for his *cestui que trust*, and on breach the concern of equity is that it be restored to the *cestui que trust* or if that cannot be done to afford compensation for what the object would be worth. In the case of a mere breach of duty, the concern of equity is to ascertain the loss resulting from the breach of the particular duty.[50]

La Forest J took these to be two types of equitable compensation. The former he contrasted with common law damages, but he said that in a case of the latter sort not involving the restoration of property 'the difference in practical result between compensation and damages is by no means as clear.'[51] He concluded that the correct

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[47] *Swindle v Harrison* [1997] 4 All ER 705 (CA).

[48] Ibid 713-718.

[49] Ibid 733.

[50] *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534, 578.

[51] Ibid 577.

measure of recovery in a case of non-disclosure by a solicitor is the same as the measure of damages in deceit. It may be noted that the contrast La Forest J drew in the excerpt is the contrast between substitutive and reparative compensation.

Treating money awards for fiduciary misconduct under the label equitable compensation and then describing these awards as a species of restitution has been the source of considerable trouble because both terms elide ideas that clear thinking requires be kept apart. Judges and commentators slide back and forth between using the word compensation in its reparative and substitutive senses just as they slide back and forth between using the word restitution in its two corresponding senses. The result is a confusion of ideas.

The problem manifests itself in the difficulties the judges in the *Canson Enterprises* case, which is the leading Commonwealth authority, encountered in describing the distinctive character of equitable compensatory relief.[52] McLachlin J explained in the excerpt above that equitable compensation for misconduct by a non-custodial fiduciary is given by analogy with trust principles. She recognised that specific restitution is impossible because there is no trust property, but said that in a case of this sort 'the court may award compensation in lieu of restitution. This is a pragmatic distinction in the form of the remedy which must not obscure the fact that the measure of compensation remains restitutionary or "trust-like" in both cases.'[53] McLachlin J later summarised her conclusions in these words:

> By analogy with restitution, [equitable compensation] attempts to restore to the plaintiff what has been lost as a result of the breach; i.e., the plaintiff's lost opportunity. The plaintiff's actual loss as a consequence of the breach is to be assessed with the full benefit of hindsight. Foreseeability is not a concern in assessing compensation, but it is essential that the losses made good are only those which, on a common sense view of causation, were caused by the

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[52]There are seeds of this confusion in Viscount Haldane's speech in *Nocton v Lord Ashburton* [1914] AC 932, 952 & 956-958.

[53]*Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534, 547.

breach.[54]

The reasoning in these passages runs reparative and substitutive thinking together. In effect, McLachlin J wished to distinguish equitable compensation from common law damages on the basis that it is substitutive rather than reparative, but she was unable to make the analogy with restitution of trust property work because she could not convincingly describe the object of the substitution. Her Ladyship inevitably ended with a reparative model confusingly clothed in substitutive language.

La Forest J's analysis, excerpted above, is preferable to that of McLachlin J because he plainly recognised the rudimentary difference between a claim for restitution of property or substitutive compensation in lieu and a claim for reparative equitable compensation in cases involving 'a mere breach of duty'.[55] La Forest J's achievement is limited, however, by the fact that he insisted in that case and subsequently in *Hodgkinson v Simms* on characterising each type as both compensation and restitution, but failed to recognise that he was using each of these words in two different ways.[56] Stevenson J expressed general agreement in the *Canson Enterprises* case with La Forest J but on this point he differed, saying that 'restitutionary concepts do not fit.'[57]

Millett LJ's judgment in *Bristol and West Building Society v Mothew* suggests a better understanding of the problem.[58] He distinguished in that case between equitable compensation for breach of a duty of skill and care, which he said resembles common law damages in that it is awarded to the claimant by way of compensation for his loss; and equitable compensation for breach of fiduciary duty, which he said may be awarded in lieu of recission or specific restitution. The distinction between these two types of

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[54]Ibid 556.

[55]Ibid 578.

[56]Ibid 577; *Hodgkinson v Simms* [1994] 3 SCR 377, 440.

[57]*Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534, 590.

[58]*Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 17. See also *Companhia de Seguros Imperio v Heath (REBX) Ltd* [2001] 1 WLR 112 (CA) 125.

equitable compensation implicitly depends upon the distinction between reparative and substitutive compensation. Having recognised the principled difference between these two forms of relief it is difficult to see why Millett LJ nonetheless insisted on identifying both by the same label, equitable compensation. Perhaps for this reason his distinction was lost on the judges who subsequently heard the appeal in *Swindle v Harrison*.[59] The judgments of Evans and Mummery LJJ represent further attempts to perform the logically impossible feat of stating a theory of equitable compensation that is at once reparative and substitutive.

This thesis is only concerned with claims against custodial fiduciaries, and so claims such as those raised in *Canson Enterprises* fall outside of its scope. *Canson Enterprises* is nonetheless relevant to this study because the analysis developed by McLachlin J has, in *Target Holdings Ltd v Redferns*, been applied to the liability of a custodial fiduciary.[60] That case involved a misapplication of money held by a solicitor in his client account. Lord Browne-Wilkinson said that the claimant's only available remedy was equitable compensation and that he could not have it because on the assumed facts of the case there was no causal nexus between the solicitor's breach and the client's loss. Lord Browne-Wilkinson referred to McLachlin J's judgment and concluded from it that 'Equitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests: to make good a loss suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach.'[61] In other words, on Lord Browne-Wilkinson's view equitable compensation for breach of trust is reparative in nature.[62]

This is a peculiar conclusion to draw from McLachlin J's judgment. Whereas Lord Browne-Wilkinson analysed equitable compensation in straightforwardly

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[59]*Swindle v Harrison* [1997] 4 All ER 705 (CA). See further my comments on the case in 'Restitutionary Compensatory Damages for Breach of Fiduciary Duty?' [1998] RLR 135.

[60]*Target Holdings Ltd v Redferns* [1996] AC 421.

[61]Ibid 439.

[62]See further Chapter VI Part 1.

reparative terms, McLachlin J had been at pains to argue that equitable compensation is substitutive in nature: and for this she took as her model the remedy against a trustee who misapplies trust property. Nor does Lord Browne-Wilkinson's position accord with that of the majority in *Canson Enterprises*, for La Forest J expressly distinguished equitable compensation where the claim does not relate to specific property from equitable compensation against a trustee who has mishandled property. La Forest J said the former is concerned with making good loss whereas he analysed the latter in substitutive terms. In short, both the majority and the concurring judges in *Canson Enterprises* began with the idea that equitable compensation in a case of misapplied trust property is substitutive in nature, but differed in their characterisation of equitable compensation in a case that does not involve trust property. It is for this reason an irony of Lord Browne-Wilkinson's speech in *Target Holdings Ltd v Redferns* that he took *Canson Enterprises* as his authority for the proposition that equitable compensation in a case of misapplied trust property is reparative in nature.

The remedial label equitable compensation is deeply problematic. It is presently used to classify together forms of relief that are fundamentally different. The common label conceals the basic question whether the underlying claim is for reparative or substitutive compensation. Logically a claim cannot be for both but the label invites judges to run the two concepts together in order to distinguish equitable compensation, conceived as a single remedy, from damages at law. The potential for confusion has been compounded by ambivalent usage of restitutionary language. For these reasons the label equitable compensation should be avoided altogether.

4. Damages

McGregor defines damages in these terms:

> Damages are the pecuniary compensation, obtainable by success in an action, for a wrong which is either a tort or a breach of contract, the compensation being in the form of a lump sum awarded at one time, unconditionally and

> generally, but not necessarily, expressed in English currency.[63]

This definition contains two controversial features material to present purposes. The first is McGregor's contention that damages are necessarily compensatory (in the reparative sense). The second is his contention that damages may only be awarded in respect of torts and breaches of contract. The argument will be that McGregor is right in saying that damages are necessarily compensatory but mistaken in saying that damages cannot be awarded in response to misconduct sounding in equity. A non-controversial feature of McGregor's definition that should be noticed is that damages consist in a pecuniary award.

(a) Damages and Reparative Compensation

Damages is ordinarily used to denote a compensatory award responding to loss in the sense of injury to the claimant.[64] Compensation is, according to Lord Wright in a case of maritime collision, the 'dominant rule' of the law of damages.[65] Lord Wilberforce similarly said in a contract case that compensation is the 'general principle for the assessment of damages'.[66] There are, however, several types of money award conventionally known as damages that are not compensatory. The best known are nominal damages, contemptuous and vindictive damages, punitive damages and liquidated damages. According to the Law Commission money awards measured by the defendant's unauthorised profit should be called restitutionary damages,[67] but that term

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[63]H McGregor, *McGregor on Damages* (16th edn, 1997 as supplemented) para 1; approved by Hailsham LC in *Broome v Cassell & Co Ltd* [1972] AC 1027, 1070; compare with Lord Hailsham (ed), *Halsbury's Laws of England* (4th edn, 1975) Vol 12 para 1102.

[64]*Lancashire County Council v Municipal Mutual Insurance Ltd* [1996] 3 All ER 545 (CA) 556.

[65]*Liesbosch Dredger v SS Edison* [1933] AC 449, 463.

[66]*Johnson v Agnew* [1980] AC 367, 400. See also *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673, 689; *Surrey County Council v Bredero Homes Ltd* [1993] 1 WLR 1361 (CA) 1364, 1368 & 1371.

[67]Law Commission, *Aggravated, Restitutionary and Exemplary Damages* (Law Com No 247, 1997) paras 3.82-3.84. See also amongst others PBH Birks, *Civil Wrongs–A New World* (1991) 94-98 and J Edelman's more refined use of the term in 'Restitutionary Damages and Disgorgement Damages for Breach of Contract' [2000] RLR 129.

has not found general acceptance and has been sharply criticised in the House of Lords.[68]

The existence of these non-compensatory types of damages relief has led some commentators to define damages in a large sense that is divorced from any particular object or measure. Mayne defined damages as 'the pecuniary satisfaction which a plaintiff may obtain by success in an action'.[69] This wide definition sweeps in not only other recognized types of damages but also orders for the payment of debts and other liquidated obligations. Mayne's definition has been described as unusual for this reason.[70] Birks more cautiously proposes that we use damages to mean 'a money award for a wrong'.[71] This formulation avoids catching debts, actions for the price of goods, dividends in bankruptcy and other awards that are not made in respect of a wrong. The principal advantage of this formulation is its taxonomic elegance. On Birks's view damages is a genus which may then be subdivided into a number of species of which compensatory damages is only one.

Birks's proposal would have considerable attractions in a neater world. In the world we live in it seems unrealistic to hope to uproot the popular, ancient and etymologically correct association between damages and injury.[72] The term compensatory damages sounds redundant to most lawyers. The nominate types of

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[68]The term was criticised by Lord Nicholls in *Attorney-General v Blake* [2001] 1 AC 268, 284 and see 291 (Lord Steyn). It has been subsequently used by Lord Scott in *Kuddus v Chief Constable of Leicestershire* [2001] UKHL 29 para 109, [2001] 2 WLR 1789. See further criticisms in S Doyle & D Wright, 'Restitutionary Damages–The Unnecessary Remedy?' (2001) 25 MULR 1, 13-20 and H McGregor, 'Restitutionary Damages' in PBH Birks (ed), *Wrongs and Remedies in the Twentieth Century* (1996) 203, 203.

[69]JD Mayne, *A Treatise on the Law of Damages* (1856) 1.

[70]*Jabbour v Custodian of Absentee Israeli Property* [1954] 1 WLR 139, 144-145; see WG Earengey, *Mayne's Treatise on Damages* (11th edn, 1946) 1 n (a).

[71]PBH Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 UWALR 1, 27-29; and see American Law Institute, *Restatement of Torts 2d* (1979) para 902.

[72]CT Onions, *The Oxford Dictionary of English Etymology* (1966) 242. W Blackstone defined damages 'as a compensation and satisfaction for some injury sustained.' *Commentaries on the Law of England* (1766) Vol 2, 438. See also *Leeds Industrial Co-operative Society v Slack* [1924] AC 851, 868-869 and *Bowen v Massachusetts*, 487 US 879 (1988) 897.

damages are conventionally recognised as being exceptional and for this reason they are always qualified by an adjective. For these reasons alone we should accept McGregor's equation of unqualified damages with reparative compensation.

(b) Damages and Purely Equitable Rights

McGregor's definition of damages restricts its ambit to money awards responding to common law torts and breaches of contract.[73] This view is widely shared. La Forest J said in the *Canson Enterprises* case that damages 'are a monetary payment awarded for the invasion of a right at common law.'[74] Jolowicz elaborates on the point:

> It is the characteristic of a cause of action at common law that the plaintiff's typical if not exclusive remedy is an award of damages; it is, or was, characteristic of a cause of action in equity that, whatever the remedy available to the plaintiff, he cannot have damages. To this the combined administration of law and equity makes no difference: all it means is that both kinds of remedy, where appropriate, are available in a single action in a single court.[75]

Rights that would not have been enforced in a common law court before the Judicature reforms may be called purely equitable rights. The central example are rights arising out of trusts. Hardwick LC said that 'a trust is where there is such a confidence between parties, that no action at law will lie, but is merely a case for consideration of this court'.[76]

The proposition that damages may not be awarded on the basis of purely equitable rights has come under pressure over the past two decades. In the last section we saw that there have been numerous cases in England and elsewhere in the

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[73]See especially H McGregor, *McGregor on Damages* (16th edn, 1997 as supplemented) Ch 1 paras 5 & 5A.

[74]*Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534, 577, but compare with 589 and with *Hodgkinson v Simms* [1994] 3 SCR 377, 440 where La Forest J identifies the equitable remedy as 'damages'. See also *Mertens v Hewitt Associates*, 124 L Ed 2d 161, 169-170, 113 S Ct 2063 (1993).

[75]JA Jolowicz, 'Damages in Equity–A Study of Lord Cairns' Act' [1975] CLJ 224, 227-228.

[76]*Sturt v Mellish* (1743) 2 Atk 610, 612, 26 ER 765; similarly E Coke, *Institutes of the Laws of England* (1628) section 272b.

Commonwealth in which fiduciaries have been required to pay not damages by that name but rather equitable compensation. This terminological discrimination has been said to mark a 'difference without a distinction' in many cases.[77] The term damages is itself frequently used.[78] If nothing else these tokens evidence an intuitive correspondence between damages and certain money awards that have been issued on the basis of purely equitable rights. The question whether damages are available in respect of such rights has provoked strong opinions on either side.[79]

Historically one reason damages were associated with common law causes of action was that until sometime in the nineteenth century damages were conceived as jury relief and Chancery judges did not sit with juries. This connection was drawn by both Coke and Blackstone,[80] amongst others, though the idea was never universal.[81] Story speculated that the doctrine that damages cannot be given for a breach of trust might be rooted in the view that a judge sitting alone could not properly assess the damages.[82] Neither the association of damages with jury relief nor the view that a judge

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[77] *Day v Mead* [1987] 2 NZLR 443 (CA) 451.

[78] For example *Companhia de Seguros Imperio v Heath (REBX) Ltd* [2001] 1 WLR 112 (CA) 125 ('described as a claim for damages because that is what, in truth, it is.'); *Walsh v Deloitte & Touche Inc* [2001] UKPC 37 para 7; *Personal Representatives of Tang Man Sit v Capacious Investments Ltd* [1996] AC 514 (PC) 520; *Alsop Wilkinson v Neary* [1996] 1 WLR 1220, 1224; *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 3 All ER 75 (PC) 76; *Re Tankard* [1941] 1 Ch 69, 73; *Ahmed Angullia bin Hadjee Mohamed Salleh Angullia v Estate and Trust Agencies (1927) Limited* [1938] AC 624 (PC) 637; *Nocton v Lord Ashburton* [1914] AC 932, 958; *Brickenden v London Loan & Savings Co* [1934] 3 DLR 465 (PC) 469-470; *Re Lake* [1903] 1 KB 439, 443. The term is used in innumerable older authorities, for example *Cardinal Beaufort's Case* (1453) reproduced in JH Baker & SFC Milsom, *Sources of English Legal History Private Law to 1750* (1986) 95; and see J Fonblanque, *A Treatise of Equity* (1794) Vol 2, 423-447, principal text conventionally attributed to H Ballow (1737).

[79] Compare especially Sir Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 225; DJ Hayton, *Law Relating to Trusts and Trustees* (15th edn, 1995) 826-827; Meagher, RP, Gummow, WMC, & Lehane, JRF, *Equity Doctrines and Remedies* (3rd edn, 1992) Ch 23 paras 1 & 4; and PBH Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 UWALR 1, 27-29.

[80] E Coke, *Institutes of the Laws of England* (1628) section 257a; W Blackstone, *Commentaries on the Law of England* (1766) Vol 2, 438.

[81] Innumerable examples could be given. See for instance the ambivalent usage in the report of *Harris and Bakers Case* (1586 or 1588) 1 Leon 302, 3 Leon 192, 74 ER 275, 74 ER 626.

[82] J Story, *Commentaries on Equity Jurisprudence* (13th edn, 1886) Vol 2 para 794a.

is not fit to assess damages forms a part of modern English law.[83]

The idea that damages may be given for the violation of a duty arising out of a custodial fiduciary relationship has been said to entail a fusion fallacy.[84] A fusion fallacy is the supposed error of thinking that the procedural fusion wrought by the Judicature Acts 1873 and 1875 resulted in a substantive fusion of common law and equity principles such that common law remedies may now be awarded on the strength of purely equitable rights. But if a remedy that has always been given on the strength of purely equitable rights shares the analytic characteristics of damages relief then we should call a spade a spade.[85] It behoves us in a fused system of judicial administration to articulate legal and equitable doctrine in terms of shared principles and to employ a terminology that groups like ideas together regardless of which side of the jurisdictional divide they grew up on.[86] Insisting on separatist terminology in the face of shared characteristics perpetuates needless complexity and courts error. Terminological distinctions should reflect basic differences of principle rather than jurisdictional provenance.

Once these arguments are cleared away it is difficult to see any *a priori* objection to the idea that equity grants damages relief, whether for the violation of a right arising out of a custodial fiduciary relation or otherwise. The question is ultimately empirical and may only be answered by comparing the relief that may be issued on the strength of purely equitable rights with a formal definition of damages that makes no reference to

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[83]Damages are sometimes still associated with jury relief in the United States: compare *Kann v Kann*, 690 A2d 509 (Md Ct App, 1997) with *Levinson v Citizen's National Bank*, 644 NE 2d 1264 (Ind CA, 1994).

[84]J Martin, 'Fusion, Fallacy and Confusion: A Comparative Study' [1994] Conv 13, 15-22; RP Meagher, WMC Gummow & JRF Lehane, *Equity: Doctrines and Remedies* (3rd edn, 1992) Ch 2 para 20 & Ch 31 para 1; see also DJ Hayton, *Underhill and Hayton, Law Relating to Trusts and Trustees* (15th edn, 1995) 826-827.

[85]There is a slight risk that applying the term damages to awards premised on purely equitable rights will lead to confusion with the remedy commonly called equitable damages, which are damages awarded under Lord Cairns's Act. Equitable damages are peculiar in that they may be awarded in respect of prospective as well as retrospective loss. See generally PM McDermott, *Equitable Damages* (1994).

[86]See generally A Burrows, 'We do this at Common Law but that in Equity' (2002) 22 OJLS (forthcoming) and further materials referenced therein.

the historical division between the law and equity.

(c) Conclusion

The core of ordinary legal usage may be encapsulated with some over-simplification in the following definition of damages:

> An unliquidated money award payable to the claimant, responding to the breach of a lawful duty by the defendant, and calculated to compensate the claimant for the reparable loss he has sustained by reason of that breach.

The award may be made by any tribunal; may be ascertained by judge or by jury; and an award may be a damages award notwithstanding the jurisdictional provenance of the rights on which it is based.

Damages are a form of reparative relief but they are not the only form of relief that may be given in response to a reparation claim. The claimant may instead seek to prove in the defendant's insolvency or he may seek to charge the defendant in his account, the proof or the charge being in the amount of the loss suffered. Allowing a proof or imposing a charge is not the same thing as awarding the claimant an order for the payment of money. One argument in Chapter VII will be that a reparation claim against a defaulting custodial fiduciary asks the court to impose a charge against the defendant in his account in the amount of the loss. Once that sum has been apportioned between the beneficial interests the court may go on to direct the fiduciary to distribute the balance owing on the account. That payment order is, however, consequential for the breach of trust is remedied when the charge is imposed. But though this remedy is not damages in the conventional sense the two share important similarities in that they both rectify loss caused by the defendant's breach of duty. It is important not to lose sight of either the difference or the similarities between them. Conventional legal usage strikes the right balance: damages are *awarded to* a tort or contract claimant whereas

they are *charged against* a defaulting custodial fiduciary.[87]

[87]That is for example how Lord Romer expressed himself in *Ahmed Angullia bin Hadjee Mohamed Salleh Angullia v Estate and Trust Agencies (1927) Ltd* [1938] AC 624 (PC) 637.

PERFORMANCE CLAIMS

JUDICIAL EXECUTION

CHAPTER IV

JUDICIAL EXECUTION

Chapter IV

This chapter examines the procedural channels by which money claims against custodial fiduciaries who have withheld or misapplied trust property are conventionally prosecuted. These channels describe the character of the claims embedded in them, just as the forms of action used to describe the character of common law claims. The conclusion that emerges from this study is that money claims concerning withheld or misapplied trust property are typically claims for performance of the defendant's duties.[1] The first part examines proceedings for the judicial execution (sometimes called administration) of trusts.[2] The second part narrows the focus to account proceedings, which are the phase of judicial execution in which money claims are conventionally adjudicated.

1. Judicial Execution Proceedings

Judicial execution is a proceeding in which the court assumes responsibility for directing the entire execution of a trust. The High Court's authority to execute trusts descends from the inherent jurisdiction of the Court of Chancery.

Execution proceedings are now uncommon but before the Judicature reforms most questions and claims relating to trusts could only be raised in the course of a suit

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[1]A cumulative reparation claim will generally be available on the same facts: see Chapter VII Part 2.

[2]The term administration claim is used in the Civil Procedure Rules to include a claim for the execution of a trust under the direction of the court: CPR Sched 1, RSC Ord 85 r1. The word 'execution' is used in this connection to mean performance or fulfilment. In this sense, Hardwicke LC said in *Bagshaw v Spencer* (1748) 1 Ves Sen 142, 152, 27 ER 944 that 'All trusts in notion of law are executory, and to be carried into execution here by *subpeona* according to the old books.' The distinction drawn in, for example, *Austen v Taylor* (1759) 1 Eden 366, 368, 28 ER 725 between trusts under which the limitations of the equitable interest are complete and final (an executed trust) and those under which the limitations are intended to serve merely as minutes or instructions for perfecting the settlement (an executory trust) is not material to the present discussion.

for execution.[3] These included questions and claims arising out of a trustee's alleged misconduct. Haddan wrote in 1862 that an administrative practice 'seems to flow, at once and of necessity, from any assumption at all by the Court, of a power to establish or enforce the fiduciary obligation.'[4] One of the changes wrought by the Judicature reforms was to break this connection by allowing relief of various sorts to be sought in a discrete action brought for that purpose without the need to commit the trust to judicial control.[5] As a practical matter full execution proceedings are no longer the only way to enforce a trust, but fundamental principles were unaffected by the Judicature reforms. One argument in this chapter is that hostile claims against trustees must still be understood in light of the principles of judicial execution.

The first section treats proceedings for the full execution of a trust,[6] and the second section considers the proceedings for partial execution that were made possible by the Judicature reforms.

(a) Judicial Execution

Judicial execution proceedings are directed towards the same object as execution by the trustees, namely the performance of the trust according to its terms. By an order for execution the court takes responsibility for the trust in order to 'ascertain, secure, and

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[3]*Re Wilson* (1885) 28 ChD 457, 460; *Atkin's Court Forms* (2nd edn, 2000 issue) Vol 41 para 8. Administration suits were later called administration actions and are now called administration claims: CPR Sched 1, RSC Ord 85 r1.

[4]TH Haddan, *The Administrative Jurisdiction of the Court of Chancery* (1862) 5, and at 4: 'the jurisdiction of the Court of Chancery over trusts has always, both in principle and in fact, implied, and been accompanied by, an administrative practice and procedure.' Haddan's unjustly forgotten book contains the only sustained analysis of the administrative jurisdiction in the literature.

[5]The Rules of the Supreme Court, 1883, Ord LV r3; see now CPR Sched 1, RSC Ord 85 r2. Execution of trusts was not affected by the Rules of Court, 1875, and was largely untouched by the Woolf reforms of 1998.

[6]Although proceedings may still be brought for the full execution of a trust, they are now uncommon and as a consequence most of the learning on the topic pre-dates Judicature. Execution procedures were considerably elaborated and rationalised during Lord Eldon's chancellorship and so references to execution proceedings before Judicature are references to the law during the earlier part of the nineteenth century.

apply the property for the benefit of its rightful owner'.[7] That this is the governing object of these proceedings is clear from the form of the order, which begins with a direction that the trust 'be performed and carried into execution'.[8] These pivotal words have been used continuously since at least the eighteenth century.[9] It is worth observing that this form of order is virtually identical to the form of order for specific performance of a contract.[10]

Execution orders were granted before 24 October 1883 as a matter of course on the application of any of the trustees or beneficiaries.[11] All that was required was proof of the fiduciary relation and of the claimant's standing to have it enforced.[12] Since Judicature it has also been necessary to show that there are questions or disputes that cannot be properly resolved except by means of a general administration.[13] Misconduct on the part of the trustee has never been a precondition of an order for execution of a trust,[14] though since Judicature it may be a factor that motivates the court to make the order.[15]

Typically either the beneficiaries have lost confidence in their trustees or the trustees are unsure of their duties. Judicial execution protects the property for the

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[7]TH Haddan, *The Administrative Jurisdiction of the Court of Chancery* (1862) 1.

[8]*Atkin's Court Forms* (2nd edn, 2000 issue) Vol 41 paras 118, 119 & 249.

[9]See for example *Gibson v Styles* (1741) and *Lang v Griffiths* (1859) reproduced in *Seton's Forms of Decrees in Equity* (3rd edn, 1862) Vol 1, 224 & 500; *Daniell's Forms and Precedents of Pleadings and Proceedings in the High Court of Chancery* (2nd edn, 1871) 870-871.

[10]The form of order in contract requires that the contract be 'specifically performed and carried into execution': *Atkin's Court Forms* (2nd edn, 1995 issue) Vol 37 form 64.

[11]*Re Blake* (1885) 29 ChD 913 (CA) 918.

[12]TH Haddan, *The Administrative Jurisdiction of the Court of Chancery* (1862) 202, 36 & 183.

[13]RSC 1883, Ord LV r10; now CPR Sched 1, RSC Ord 85 r5(1); *Re Blake* (1885) 29 ChD 913 (CA) 919.

[14]*Re Wilson* (1885) 28 ChD 457, 461; *Attorney-General v Cocke* [1988] Ch 414, 420.

[15]Under CPR Sched 1, RSC Ord 85 r5(1). The court in its discretion may decline to make an execution order even though misconduct is shown: *Campbell v Gillespie* [1900] 1 Ch 225.

beneficiaries and protects the trustees from personal liability for actions taken under the direction of the court.[16] Once the order for execution has been made the trustees' powers are suspended and they cannot take any further step except with the approval of the court.[17] The trustees may remain in possession of the property or they may be required to transfer it into court. If the property has been transferred into court the trustees remain charged with it even though they have surrendered legal title.[18] That is to say, the trustees remain in that office notwithstanding that their powers have been suspended and they have given up possession of and title to the property. The court directs the execution of the trust: it does not assume the trusteeship.

The administrative jurisdiction was initially conceived for the execution of private family trusts, but in time its scope was extended to include other relations that were not trusts in the classical sense but were analogous and could be enforced according to like principles. Charitable trusts and constructive trusts were both from the beginning enforced *mutatis mutandis* by execution proceedings. Perhaps the most important analogous relation is that of an executor and the claimants on the deceased's estate. Testamentary and intestate estates were originally administered in the ecclesiastical courts, but were attracted to Chancery during the Elizabethan period by its superior procedures.[19] Lord Redesdale underlined the ensuing doctrinal integration in *Adair v Shaw*, writing that the whole jurisdiction of the court in administering estates 'is founded on the principle, that it is the duty of the court to enforce the execution of

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[16]But only if the trustee has made full disclosure to the court of relevant circumstances: *Marley v Mutual Security Merchant Bank & Trust Co Ltd* [1991] 3 All ER 198 (PC).

[17]*Minors v Battison* (1876) 1 App Cas 428; *Re Viscount Furness (deceased)* [1943] Ch 415; *Bethnell v Abraham* (1873) LR 17 Eq 24. See also *Re Gadd* (1883) 23 ChD 134 (CA). The topic is discussed in J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 36 paras 80-83.

[18]*Thompson v Tomkins* (1862) 2 Dr & Sm 8, 21, 62 ER 524. Legal title vests in the officer who receives the property, traditionally the Accountant-General, but he holds that title on behalf of the court and not in the capacity of a trustee: *Thorndike v Hunt* (1859) 3 De G & J 563, 44 ER 1386. By contrast, payment into court of trust property under section 63 of the Trustee Act 1925 discharges the trustees: see *Re William's Settlement* (1858) 4 K & J 87, 70 ER 37.

[19]G Spence, *The Equitable Jurisdiction of the Court of Chancery* (1846) Vol 1, 578-580; J Story, *Commentaries on Equity Jurisprudence* (2nd English edn, 1892) paras 530-543.

trusts'.[20] Administration of the assets of a deceased's estate is distinct as executors are responsible both to the legatees and to the estate creditors where trustees are only responsible to the beneficiaries. From this follows numerous detailed differences between the execution of trusts and the administration of estates.[21] Notwithstanding these differences, many of the rules governing the accountability of trustees and other custodial fiduciaries were developed in cases involving executors.

In view of the spectrum of fiduciary relations that may be the subject of judicial execution or administration, it is not surprising that execution proceedings are plastic and easily moulded to the special circumstances of particular cases. It is nonetheless possible to distinguish four analytic steps, though they are sometimes run together in practice. The first step is to decide whether execution should be ordered. There must be a trust, the claimant must have standing to enforce it and, since Judicature, there must be good cause for interfering with the trustees.[22] The second step is to ascertain the trust property. Accounts and inquiries are usually directed to this end. The third step is to secure and manage the property while the trusts remain on foot. For its security the property may need to be taken into the possession of the court, especially where the trustees have been guilty of misconduct.[23] The management of the trust may take years, with many applications for different purposes, and the proceeding may at times lie dormant. The fourth step is to resolve competing claims and distribute the property. Completion of this final step discharges the trustees and ends the proceeding.

One reason beneficiaries may wish to put a trust into judicial execution is in the

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[20] *Adair v Shaw* (1803) 1 Sch & Le 243, 262. See also *Re Thomas* [1912] 2 Ch 348 (CA) and the discussion in J Story, *Commentaries on Equity Jurisprudence* (3rd English edn, 1920) para 532.

[21] On these differences see JHG Sunnucks (ed), *Williams, Mortimer and Sunnucks on Executors, Administrators and Probate* (18th edn, 2000) and TH Haddan, *The Administrative Jurisdiction of the Court of Chancery* (1862) 20-21.

[22] CPR Sched 1, Ord 85 r5(1).

[23] See generally J Mowbray et al, *Lewin on Trusts* (2000) Ch 38 paras 14-20; J Story, *Commentaries on Equity Jurisprudence* (2nd English edn, 1892) paras 827-842; *Daniell's Chancery Practice* (5th edn, 1871) Vol 2, 1607-1645; *Freeman v Fairlie* (1817) 3 Mer 29, 29, 26 ER 12; *Wilton v Hill* (1852) 2 De G M & G 807, 809, 42 ER 1088; *Strange v Harris* (1791) 3 Bro CC 365, 29 ER 586.

hope of obtaining an order holding the trustee personally liable to pay a sum of money.[24] It is important to understand how maladministration is addressed in execution proceedings, for that tells us something about the character of equity's response to a breach of trust. The prosecution of misconduct in the course of execution proceedings is considered in detail in Part 2 below and so a simple illustration will suffice for present purposes.

Take the case of a trustee who pays money to a person whom the beneficiaries say is not entitled. The question whether the payment was authorised will be considered at the second stage of the proceeding, as part of the process of ascertaining the trust property. Typically accounts and inquiries will be ordered at the initial hearing; the trustee will put forward accounts which include the impugned payment as an entry on the outgoings side; and the beneficiaries will challenge the account by falsifying that entry. If the adjudicator concludes that the payee was not entitled to the money then that payment will be disallowed and the sum will remain to the trustee's debit in the account. In effect it is a sum for which the trustee is personally liable by reason of his breach of trust, but in principle the money is treated as if it never left his hands.[25] The trust fund is deemed to include both whatever property actually continues to be held by the trustee and the misapplied sum.

Once the trust property has been ascertained the court will have to decide what should be done with it. In a simple case, where the beneficial interests are in possession, there is no need to reconstitute the fund. The court will skip the third step, that of securing and managing the property, and direct the trustee to distribute the property to the beneficiaries. This means that he must pay the balance showing in his account, out of his own pocket if necessary. On the other hand, if the trusts are still on foot then the fund will need to be reconstituted under the control of the court. To this end the court will generally require the trustee to pay into court the balance showing on

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[24]Compare *Re Weal* (1889) 37 WR 779: 'this is not really an action for administration of a trust, but an action commenced and brought to trial for the purpose of challenging the claim of the trustees to charge particular items of expenditure against the trust estate.'

[25]See Part 2(c) below.

his account, whether it represents money actually held on trust or money that he must take from his own pocket.[26] That is an interim measure only which, in itself, does not terminate his trusteeship unless he is also being replaced.[27] Eventually, once the beneficial interests fall into possession, that fund will be distributed to the beneficiaries and the trustee will be discharged.

The process by which a trustee is made to pay money in respect of misapplied trust property occurs in the course of judicial execution. The overriding object of judicial execution is to enforce the performance of the trust and that is what the court does when it settles a trustee's account and orders him to distribute the balance. The court ascertains what property the defendant should be treated as holding on trust and it then obliges him to carry out his duties under that trust by making the property over to the beneficiaries. The nature and purpose of the proceeding is for this reason distinct from, for example, a common law trial for damages caused by a tort or a breach of contract. A beneficiary alleging misapplication of trust property does not come to court complaining of an injury he has suffered and asking for reparation; rather, he comes to court demanding that the trust be performed.[28]

(b) Execution After Judicature

The procedural complications associated with the full execution of a trust or estate imposed unnecessary costs and complexity on simple matters. Discrete questions or points of dispute could not be resolved without recourse to a procedure designed for the full and formal execution of a trust. For these reasons, execution proceedings were poorly suited to reaching expeditious determinations between hostile contentions.

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[26]See for example the order in *Sculthorpe v Tipper* (1871) reproduced in *Seton's Forms of Decrees, Judgments, and Orders* (4th edn, 1877) Vol 1, 468-469. See also *Ingle v Partridge* (1863) 32 Beav 661, 55 ER 260; *Wiglesworth v Wiglesworth* (1852) 16 Beav 269, 51 ER 782; *Bourne v Mole* (1845) 8 Beav 177, 50 ER 70; *Score v Ford* (1844) 7 Beav 333, 49 ER 1093; *Collis v Collis* (1828) 2 Sim 365, 57 ER 825; *Vigrass v Binfield* (1818) 3 Madd 62, 56 ER 432; *Beaumont v Meredith* (1814) 3 Ves & Beam 180, 35 ER 447.

[27]*Thompson v Tomkins* (1862) 2 Dr & Sm 8, 21, 62 ER 524.

[28]See *Atkin's Court Forms* (2nd edn, 2000 issue) Vol 41 para 246.

Counsel made the best of a bad job. The practice developed, Fry LJ tells us, of 'commencing an administration suit, raising the particular point by the pleadings, getting an inquiry and directions upon that point, and then staying further proceedings in the suit.'[29] The costs of the proceeding were generally borne by the estate.[30] The wastefulness of administration proceedings was excoriated by Lindley LJ as 'one of the greatest scandals of the profession.'[31]

The Judicature reforms were intended to end routine execution and administration proceedings and to simplify these proceedings where they are necessary. 'The object of the orders is to prevent general administration of the estate when the questions in controversy can otherwise be properly determined.'[32] The reforms did not abolish judicial execution,[33] but it would no longer be granted as a matter of course.[34] Applications for unnecessary executions would be discouraged by costs.[35] The Judiciature reforms also made special provision for commencing uncomplicated administrations by an originating summons directed to a judge in chambers.[36]

As a result of these changes judicial execution is now only claimed in unusual cases. A full execution may still be necessary where recurrent difficulties make it

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[29]*Re Medland* (1889) 41 ChD 476 (CA) 492.

[30]*Re Blake* (1885) 29 ChD 913 (CA) 918. Costs could be awarded against a party obstinately insisting on an unwarranted proceeding: *Taylor v Glanville* (1818) 3 Madd 176, 56 ER 475; *Bluett v Jessop* (1821) Jacob 240, 37 ER 840; *King v Bryant* (1841) 4 Beav 460, 49 ER 417; *Ottley v Gilbey* (1845) 8 Beav 602, 50 ER 237; *Attorney-General v Gibbs* (1847) 1 De G & S 156, 63 ER 1013; *White v Jackson* (1852) 15 Beav 191, 51 ER 510; *Fuller v Green* (1857) 24 Beav 217, 53 ER 341.

[31]*Re Blake* (1885) 29 ChD 913 (CA) 918. Lindley LJ may have had in mind Charles Dickens's satire of administrative procedure in *Bleak House* (1853).

[32]Ibid 919. See also *Conway v Fenton* (1888) 40 ChD 512, 515.

[33]The present Rules nowhere state that an order for a general execution may be granted, but this is implied by CPR Sched 1, RSC Ord 85 rr2 & 5 which discourage the granting of these orders.

[34]Now CPR Sched 1, RSC Ord 85 r5(1). See *Re Wilson* (1885) 28 ChD 457, 460-461 and *Re Blake* (1885) 29 ChD 913 (CA) 919.

[35]RSC 1883, Ord LXV r1.

[36]RSC 1883, Ord LV r4. A similar process was already available for the administration of simple testamentary estates: Chancery Reform Act 1852, s 45.

expeditious to keep the trust before the court so that it may deal with problems as they arise.[37] In most cases where the management of a trust has truly broken down the trustees should instead be replaced or else a judicial trustee should be appointed.[38] A judicial trustee is bound to act under the supervision and direction of the court, but this is still more efficient than having the trust administered under the direct control of the court.[39] In those unusual cases where the court does order the judicial execution of a trust, however, the matter will proceed in much the same way as it might have before the Judicature reforms. If trustee misconduct comes to light in the course of judicial execution then full relief may be granted within that proceeding.

Most matters relating to trusts should now instead be raised in a claim brought for that purpose without any need to commit the trust to the full control of the court.[40] The governing Order 85 r2(1) currently states:

> A claim may be issued for the determination of any question or for any remedy which could be determined or granted, as the case may be, in an administration claim and a claim need not be made for the administration or execution under the direction of the court of the estate or trust in connection with which the question arises or the remedy is sought.[41]

Numerous examples are given which illustrate the breadth of this Rule.[42] These examples include claims for an order that the trustee furnish and, if necessary, verify accounts as well as claims for an order that the trustee pay into court money held in his official capacity. All hostile money claims against trustees fall within the ample scope

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[37] *Atkin's Court Forms* (2nd edn, 2000 issue) Vol 41 para 30; *Civil Procedure* (2001) Vol 1, 1305.

[38] Judicial Trustees Act 1896.

[39] *Re Ridsdel* [1947] Ch 597, 605.

[40] Though it is still the practice to ask for execution of the trusts generally 'if and so far as may be necessary', in order to remove any doubts as to the jurisdiction of the court should executory relief prove necessary: J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 27 para 4.

[41] CPR Sched 1, RSC Ord 85 r2(1). A like provision was contained in the 1883 Rules. See also the earlier Law of Property and Trustee Relief Amendment Act 1859, s 30.

[42] CPR Sched 1, RSC Ord 85 rr2(2) & 2(3).

of the Rule and so should typically be brought by a claim issued for that purpose.[43] If the claimant's only object is payment of discrete sums then an accounting of the trustee's entire administration will often be wasteful and unproductive.[44] The dispute may be resolved by a judge at trial and if necessary specific accounts and inquiries may be directed towards the disputed aspect of the trustee's administration.[45]

The philosophy of the Judicature reforms was to rationalise procedure while leaving substantive rights largely intact.[46] Consistently with this philosophy, though execution under the direction of the court is now discouraged by the Rules, the same principles continue to govern all claims relating to trusts. That was Kekewich J's starting point in *Conway v Fenton*:

> I take it that, for all purposes, or for most purposes, the Court is in precisely the same position on the hearing of an originating summons as if there were really an administration action properly constituted, and that I have precisely the same jurisdiction under an originating summons as I should have in an administration action–neither more nor less. Therefore I proceed as if I had an administration action now before me.[47]

That is the correct approach where the claim relates to maladministration on the part of the trustee. The power the court now exercises to grant a remedy against a trustee absent execution proceedings is expressly confined by Ord 85 r2 to remedies of a sort that may be granted in the course of judicial execution. In *Re Blake* Fry LJ tellingly described an order giving relief against maladministration in circumstances where full

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[43]The current procedural steps are outlined by D Goodman & C Bell, 'Action by Disgruntled Beneficiaries' in O Clutton & S Jennings (eds), *Tolley's Administration of Trusts* (December 2000 issue) Ch H 15-23. Contentious allegations of trustee misconduct should be brought by issuance of a Part 7 claim form: *Civil Procedure* (2001) Vol 1, 1305. See also *Re Sir Lindsay Parkinson & Co Ltd Settlement Trusts* [1965] 1 WLR 372 and *Re 462 Green Lane* [1971] 1 WLR 138 (both decided under the RSC 1965).

[44]*Re Gyhon* (1885) 29 ChD 834 (CA).

[45]In the United States breach of trust claims are sometimes tried before juries, though some judges deprecate that practice: compare *Levinson v Citizen's National Bank*, 644 NE2d 1264, 1267 (Ind Ct App 1994) with *Kann v Kann*, 690 A2d 509 (Md Ct App, 1997).

[46]FW Maitland, *Lectures on Equity* (2nd edn, 1936) 148.

[47]*Conway v Fenton* (1888) 40 ChD 512, 516.

judicial execution was not appropriate as an order for a 'limited administration'.[48]

There is a risk that the true nature of the beneficiary's claim and remedy will be overlooked where the claim is brought outside of full execution proceedings. Haldane LC warned against this danger in *British American Elevator Co v Bank of British North America*, a Privy Council appeal from Canada.[49] The claimants were grain merchants, and their local agent held their money on trust in an account with the defendant bank for the purpose of acquiring grain for the claimants from local farmers. In breach of this trust, and with the bank's knowledge, the agent transferred some C$13, 500 into his personal account in order to reduce his overdraft. The claimants sued the bank for the return of this money on the basis of what we would call knowing receipt.

The claimants put evidence of the misapplied sums before the judge, and he gave judgment in their favour. Other evidence indicated that the agent had sometimes paid for the claimants' grain with his own money, sometimes allowed farmers to set the purchase price off against debts owed to his own firm, and that he had made payments of his own money into the claimants' grain account. The claimants admitted before the Court of Appeal that the total amount due from the agent was something less than the amount misapplied, and for this reason the majority of the justices overturned the trial judgment and directed an inquiry to ascertain what loss the claimants had suffered. On further appeal the claimants complained that owing to the complexity of the agent's dealings this cast a burden on them that they could not discharge.

The Privy Council restored the trial judgment on the basis that damage to the claimants was not an element of their cause of action. Haldane LC said that:

> The majority of the learned judges in the Court of Appeal appear to have treated the action as one which must be regarded as brought simply for damages for a breach of agreement, in which the burden lay on the plaintiffs to prove the quantum of damage suffered by them. This view is quite inadequate.

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[48] *Re Blake* (1885) 29 ChD 913 (CA) 920.

[49] *British American Elevator Co v Bank of British North America* [1919] AC 658 (PC).

> . . . The Court of Appeal should have treated the claim as one for replacement of trust funds, and not for damages.[50]

If the bank had wished to have the agent's repayments offset against its own liability then that was a matter it should have raised and in respect of which it would have carried the burden of proof. Haldane LC explained that the source of the problem seemed to lie in the procedure adopted at trial:

> Possibly the learned judges in the Court of Appeal were led to hold as they did by the fact that, instead of asking for a general declaration of liability on the ground of breach of trust, and for an account to be taken of all the sums so received, in which case the result of the account, after any proper deductions had been claimed and established on the initiative of the respondents, would have been followed by a judgment on further consideration for the balance found due, a different course was followed at trial.[51]

British American Elevator involved a claim against a knowing recipient of trust money, but the Lord Chancellor's remarks are equally applicable to cases involving trustees and other custodial fiduciaries who have assumed that office. Haldane LC's criticisms of the courts below express a concern that the more flexible procedures introduced by the Judicature reforms must not obscure the principles governing the underlying claim. The governing principles are those that apply where a claim is brought for the execution of a trust and in particular the principles regulating the account of the trustee's administration.

2. Account Proceedings

This part considers the principles governing proceedings for a general account of a trustee's administration and consequent relief, whether or not the account is sought in the course of a larger proceeding for the execution of a trust.[52] Claims for general

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[50]Ibid at 663-664, 666.

[51]Ibid at 663-664.

[52]The principles governing accounts on the footing of wilful default are treated in Chapter VII.

accounts may be divided into three analytic stages.[53] The first concerns the claimant's right to an account; the second involves the taking of the account, which ends in a settlement covering the accounting period; and the third concerns consequent relief such as an order for payment. The principles governing these claims will be examined in that order following a discussion of the structure of a trust account.

(a) The Structure of an Account

'The main object of trust accounts is to demonstrate that the trust funds, including the income thereof, have been applied in accordance with the provisions of the trust instrument.'[54] The account forms a record of the administration of money and non-monetary assets received in an accountable capacity. The statement of this account tells the reader, amongst other things, which assets were committed to the fund, what transformations the fund has undergone as investments have been bought and sold, what administrative disbursements have been made, and ultimately how the fund has been distributed.

The account consists of two classes of items, namely items of charge and items of discharge.[55] Charges are items debited against the accounting party on the incomings side and discharges are items credited in his favour on the outgoings side. What is a good charge and what a good discharge is a large subject that will be treated in greater depth in ensuing chapters, but the following shows its outlines.[56]

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[53] *Atkin's Court Forms* (2nd edn, 1992) Vol 1, 606.

[54] The Institute of Chartered Accountants of England and Wales, *Trust Accounts: Accounting Recommendations* (1986) para 1.

[55] The categories of charge and discharge reflect the rudimentary structure of a trust account, and are not meant to match the actual format in which it is drawn up for the purposes of an audit. Written accounts may be prepared in a variety of ways. Many actual trust accounts are complicated by the necessity of separate income and capital accounting. Texts on the minutiae of trust accounting with sample accounts include S Jennings, 'Trust Accounts' in O Clutton & S Jennings, *Tolley's Administration of Trusts* (December 2000 issue) Ch J and M Sladen & T Sherring, *Executorship Law, Trusts and Accounts* (24th edn, 1996). A sample form of account where the accounts are taken in court may be found at *Atkin's Court Forms* (2nd edn, 1992) Vol 1, 647.

[56] See generally the American text GG Bogert & GT Bogert, *The Law of Trusts and Trustees* (Rev 2nd edn, 1983) sections 971 & 972.

There are two types of charge. First, an accountable party must charge himself on the incomings side of his account with any property he has actually received in his official capacity, whether personally or through an agent, as well as its fruits and exchange-product as the fund is invested and re-invested. Where a trustee has improperly alienated trust property the beneficiary may be entitled to elect whether to insist that he remain charged with the misapplied asset or instead that he be charged with the proceeds. Second, some accountable parties must charge themselves on the incomings side of the account with what they ought to have received but did not by reason of their wilful default. For example, a trustee will be charged where he neglects to collect a recoverable debt or where he fails to invest money productively. The argument in Chapter VII is that this second type of charge is in reality imposed in respect of reparable loss.

Once the receipts have been tallied up the next question is whether the accountable party is entitled to a discharge in respect of some or all of it. Discharge operates in an accounting to extinguish the accountable party's responsibility for his receipts. An accountable fiduciary is discharged on the credit side of the account with all payments and transfers necessary to carry out any of the duties and powers he is invested with.[57] What discharges may be claimed under this head depends on the mandate of the particular accountable party. There are three types. First, an accountable party is entitled to discharges for proper payments to the beneficiary or at his command.[58] Second, an accountable party is entitled to discharges for proper administrative outlays, which are collectively known as just allowances. He is entitled to credit for payments made either with trust money or out of his own pocket. Third, an accountable party is entitled to a discharge for property lost or stolen through no fault of his own. An accountable party will not be entitled to a discharge in respect of an unauthorised transfer of property unless the beneficiary elects to ratify it, and so the fiduciary will stand charged with the property until it is restored.

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[57] *Worral v Harford* (1802) 8 Ves 4, 8, 32 ER 250.

[58] Executors are also entitled to discharges in respect of payment to the creditors of the estate.

An account balances when the sum of the receipts equals the sum of the discharges and property still on hand. If an account does not balance then, subject to defences, the difference represents a sum the accountable party is liable to make good out of his own pocket.

(b) The Right to an Account

'Before a party can be ordered to account, liability to account must be established.'[59] The first stage of the claim is concerned with whether the defendant has a duty to account and whether the court should specifically enforce that duty. These issues will typically be ventilated at an initial hearing convened for that purpose.[60] The order directing the account should contain detailed directions as to its scope and the manner in which it is to be taken.[61] This chapter is only concerned with common accounts, which are accounts of what the defendant has received and what has become of it.[62]

The duty to render an account arises immediately out of the defendant's receipt of property in an accountable capacity. Harman J expressed this in *Attorney-General v Cocke* by saying the 'basis of the duty to account is the fiduciary relationship.'[63] The onus of proving the fiduciary relation falls on the claimant.[64] The claimant must show that the defendant has received property into his control in circumstances sufficient to import an equitable obligation to handle the property for the benefit of another. If the

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[59] *Associated Alloys Ltd v ACN 001 452 106 Pty Ltd* (2000) 171 ALR 568 (Aus HC) 585. Contrary to the view taken by the High Court of Australia it may be appropriate to direct preliminary accounts and inquiries for the limited purpose of ascertaining whether the defendant is liable to account: *Coope v Carter* (1852) 2 De G M & G 292, 298; *Batthyany v Walford* (1887) 36 ChD 269 (CA) 276-277.

[60] *Sharer v Wallace* [1950] WN 370.

[61] CPR 40PD-002 & Sched 1, RSC Ord 43 r3 & Ord 44 r3. A typical order may be found at *Atkin's Court Forms* (2nd edn, 2000 issue) Vol 41 para 255. If the accounts and inquires are required pursuant to an order for the execution of the trusts then they will typically be directed at the same time that order is made: para 248.

[62] Wilful default accounts are treated in Chapter VII.

[63] *Attorney-General v Cocke* [1988] Ch 414, 420; *Butler v Axco Trustees Ltd* [1997] JLR N-17.

[64] *Associated Alloys Ltd v ACN 001 452 106 Pty Ltd* (2000) 171 ALR 568 (Aus HC) 585.

account is sought pursuant to a general order for execution then the right to have the account taken coincides with the right to the execution.

There is no issue at this stage of the accountable party's entitlement to a discharge in respect of some or all of his receipts. The duty to render an account does not depend on the defendant having mishandled the property or otherwise breached his trust.[65] For this reason limitations defences in respect of specific misapplications do not affect the claimant's anterior right to have the account taken.[66] A limitation defence is instead given effect when the account is taken by allowing the accounting party wrongful payments and transfers made before the limitation date.[67] For the same reason a claimant suing for an account will not usually be required to give particulars of any complaints he intends to make.[68] If he wishes, however, the claimant may prove specific irregularities at the initial hearing, and if he succeeds then the order will direct that the accounts be taken in light of the court's findings.[69]

It is a good defence for the trustee to prove that he has been released from his duty to account by a settlement.[70] If the accounts have been settled then the claim will be defeated unless the beneficiary can show that the settlement was obtained by fraud or imposition,[71] or that it contains sufficient errors of sufficient magnitude to warrant

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[65] *Dowse v Gorton* [1891] AC 190, 204; *Partington v Reynolds* (1858) 4 Drew 253, 255-256, 62 ER 98 ('it is sufficient that the Defendant holds the office'); *Hodson v Ball* (1842) 12 LJ Ch 80.

[66] *Attorney-General v Cocke* [1988] Ch 414. Actions for accounts in which misconduct was not alleged were sometimes time-barred by the old Trustee Act 1888, s 8: *How v Earl Winterton* [1896] 2 Ch 626 (CA); *Re Blow* [1914] 1 Ch 233 (CA); *Re Richardson* [1920] 1 Ch 423 (CA).

[67] See the form of order in *Atkin's Court Forms* (2nd edn, 2000 issue) Vol 41, 349, adapted from the order made in *How v Earl Winterton* [1896] 2 Ch 626 (CA).

[68] *Re Wells* [1962] 1 WLR 874 (CA); *Sharer v Wallace* [1950] WN 370.

[69] For example *Knott v Cottee* (1852) 16 Beav 77, 79-80, 51 ER 705. The order is reproduced in *Seton's Forms of Judgments and Orders* (7th edn, 1912) Vol 2, 1096-1097.

[70] *Re Webb* [1894] 1 Ch 73 (CA) 80.

[71] *Vernon v Vawdry* (1740) 2 Atk 119, 26 ER 474; *Allfrey v Allfrey* (1849) 1 M & G 87, 93, 41 ER 1195; *Coleman v Mellersh* (1850) 2 Mac & G 309, 314, 42 ER 119; *Re Webb* [1894] 1 Ch 73 (CA) 80.

setting it aside and taking the accounts from the beginning.[72] If the claimant can only prove errors of a lesser number or magnitude then he will be granted liberty to surcharge and falsify.[73] By this order the master is only directed to rectify specific errors in the settled account, and the onus of proof falls on the claimant. Settlement of accounts will be treated in greater depth below.[74]

Before the Judicature reforms the court did not have a discretion whether to order a common account once the duty to account had been established. One consequence of those reforms is that the court is no longer bound to make the order if the issues between the parties can be properly determined in some other way.[75] The claimant in *Campbell v Gillespie* was the residual beneficiary of a trust for the payment of debts.[76] After the debts had been paid the claimant was shown certain records and had seemed satisfied, but there was no formal settlement extinguishing the trustee's duty to account. Two years later the trustee destroyed the account records and shortly after that the claimant sued for an accounting. The trustee admitted that there had been three irregularities in his administration and offered to pay these amounts but he resisted the claim for a general accounting. Cozens-Hardy J accepted that the accounts had been honestly and properly kept and that the records had been destroyed in good faith. In these circumstances he declined to order a general accounting because to do so 'would be to enable the plaintiff to blackmail the defendant.'[77]

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[72]*Williamson v Barbour* (1877) 9 ChD 529.

[73]*Dawson v Dawson* (1737) West 171, 1 Atk 1, 25 ER 879, 26 ER 1; *Pit v Cholmondeley* (1754) 2 Ves Sen 565, 28 ER 360; *Gething v Keighley* (1878) 9 ChD 547.

[74]See Part 2(d) below.

[75]CPR Sched 1, RSC Ord 85 r5(1).

[76]*Campbell v Gillespie* [1900] 1 Ch 225.

[77]Ibid 229.

(c) Taking Accounts

The second stage of the claim involves the taking of the account itself.[78] This is ordinarily done before a master.[79] The master's role is an adjudicative one. He adjudicates contested questions of fact and also of law, for a true accounting depends upon the rights of the parties. Whether an accounting party is entitled to allowances for outlays of diverse sorts is as much a question for the master as whether the accounting party has effected the outlays in question. Hearings may be directed in the course of the accounting to resolve issues that arise.[80] The master makes authoritative findings concerning the state of the fund and what transformations it has undergone during the accounting period.

The accounting party first submits his verified accounts and supporting vouchers, and the beneficiary may then raise any specific objections he may have.[81] Objections to an account presented in court as complete are either by way of surcharge or falsification.[82] The beneficiary surcharges the account when he contends that the accounting party should have charged himself on the incoming side of his account with more than he has admitted. The beneficiary falsifies the account when he challenges an item of discharge entered into the outgoings side of the account.

The beneficiary carries the burden of proving surcharges and the accounting party carries the burden of proving his discharge.[83] The accounts of the deceased executrix in *Davenport v Stafford* showed that she had sold out £5, 400 in stock and not

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[78]This section is only concerned with the nature of the exercise. The detailed rules governing how items should be treated in the accounts will be considered in subsequent chapters.

[79]CPR 40PD-010.

[80]CPR 40PD-006.

[81]CPR 40PD-003 & 004.

[82]*Pit v Cholmondeley* (1754) 2 Ves Sen 565, 566, 28 ER 360.

[83]*Ahmed Angullia bin Hadjee Mohamed Salleh Angullia v Estate and Trust Agencies (1927) Limited* [1938] AC 624 (PC) 637; *Bacon v Clarke* (1837) 3 My & Cr 294, 297, 40 ER 938; *Jevon v Bush* (1685) 1 Vern 342, 343, 23 ER 508.

accounted for the proceeds.[84] Neither her executors nor the legatee entitled to that share of the estate could give any evidence whether she had replaced the stock or paid the legatee. Romilly MR ordered her estate to pay this sum as well as the lost dividends at the conclusion of a common accounting. Accordingly, an accounting party must be prepared to document each item.[85] If he has not kept proper records, or if he has destroyed the records, then presumptions may be made against him.[86] The court will lean against a professional who has kept inadequate accounts or any person who has destroyed records in bad faith.[87] The agent in *Gray v Haig* destroyed the records relating to his commission in the course of his own litigation, and Romilly MR said he was compelled to 'presume everything most unfavourable to him, which is consistent with the rest of the facts which are admitted or proved.'[88] At the other extreme, a non-professional fiduciary who has acted in good faith may be granted fair and reasonable allowances despite having neglected to keep proper accounts.[89]

The object of the exercise is to ascertain the trust property, but a trust account is not necessarily an account of what the trustee has actually done and of what property is actually on hand. The account instead shows the fund as it should have been administered. Subject to defences, deficiencies in the trustee's administration that come to light before the master are rectified in the statement of the account. *Lewin on Trusts* states 'A trustee who has once had trust funds in his possession is treated by a court of

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[84] *Davenport v Stafford* (1851) 14 Beav 319, 335, 51 ER 309, aff'd 2 De G M & G 901, 42 ER 1125.

[85] 'It is the first duty of an accounting party, whether an agent, a trustee, a receiver, or an executor . . . to be constantly ready with his accounts.' *Pearse v Green* (1819) 1 Jac & W 135, 140, 37 ER 327; *Kemp v Burn* (1863) 4 Giff 348, 349, 66 ER 740.

[86] *Fellows v Mitchell* (1705) 1 P Wms 81, 24 ER 302.

[87] *Jenkins v Gould* (1827) 3 Russ 385, 393, 38 ER 620.

[88] *Gray v Haig* (1855) 20 Beav 219, 226, 52 ER 587.

[89] *Barnes v Ross* [1896] AC 625 (HL(Sc)) 644 (guardian); see also *Countess of Bective v Federal Commissioner of Taxation* (1932) 47 CLR 417, 420-421.

equity as still having them in his possession until he has properly discharged himself'.[90] Actual outlays may be struck from the account because of their invalidity and interest may be added though it was not actually earned. If the resulting statement shows items of property other than money which the trustee no longer holds then those items will have to be assigned a monetary value with which the trustee will stand charged.[91]

The rectification of deficiencies in an account may be illustrated by cases in which the trustee has laid out money in an unauthorised investment. If the beneficiaries repudiate the investment, as they are entitled to do, it is accounted for as if the disposition did not occur. The unauthorised investment in *Knott v Cottee* was treated on the basis that it 'had been made for [the trustee's] own benefit out of his own monies, and that he had at the same time retained monies of the testator in his hands.'[92] The order declared the investment to be improper and directed that 'in taking the accounts . . . regard is to be had to the foregoing declaration.'[93] Likewise, Kekewich J is reported to have said this in *Re Bennison*: 'You were trustee of a certain particular sum of stock for this legatee, and that trust money still remains in your hands. It has never been taken out. Some other sum has been taken out, but this sum must be treated as in your hands, and you have not discharged yourself of that particular trust.'[94] It is on this basis that the fiduciary may be required to pay interest on a principal sum which has been misapplied.[95] The interest represents foregone revenue from money the fiduciary is

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[90]J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 39 para 106. This proposition is also illustrated by a number of cases decided under the Debtors Act 1869: *Middleton v Chichester* (1871) LR 6 Ch App 152, 157; *Marris v Ingram* (1879) 13 ChD 388; *Re Knowles* (1883) 52 LJ Ch 685; *Re Smith* [1893] 2 Ch 1 (CA).

[91]There have been cases in which the defendants have instead been charged with the actual misapplied property and ordered to purchase a replacement for the trust. This type of order is discussed below in Part 2(e).

[92]*Knott v Cottee* (1852) 16 Beav 77, 79-80, 51 ER 705. Romilly MR said the case might equally be treated as if the investment had not been made at all, which would amount to the same thing.

[93]The order is reproduced in *Seton's Forms of Judgments and Orders* (7th edn, 1912) Vol 2, 1096-1097.

[94]*Re Bennison* (1889) 60 LT 859. See also *Re Salmon* (1889) 42 ChD 351 (CA) 357.

[95]*Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) 397; *Attorney-General v Köhler* (1861) 9 HLC 654, 11 ER 885; *Re Hulkes* (1886) 33 ChD 552.

deemed to have been holding idle in his hands.[96]

A trustee who misapplies trust property necessarily breaches his trust but a beneficiary does not need to plead or prove the breach in order to falsify outgoings in the account or to obtain relief based upon the resulting balance.[97] In *Ahmed Angullia bin Hadjee Mohamed Salleh Angullia v Estate and Trust Agencies (1927) Ltd*, a Privy Council appeal from Singapore, the common accounts of an executor had been taken and certain payments had been disallowed.[98] The executor objected to these disallowances on the ground that breach of trust had not been pleaded. Although the executor's appeal was allowed for other reasons, Lord Romer did not accede to this particular objection:

> In taking the account the appellant could not, of course, be charged with damages occasioned to the estate by a breach of trust. But it was incumbent upon him to justify his payments, and those he could not justify would necessarily have been disallowed.[99]

Similarly, *Bacon v Clarke* involved a claim by the residual beneficiaries of a trust against the estate of the trustee Fairlie.[100] Fairlie had received in a fiduciary capacity some 145, 000 sicca rupees as the proceeds of sale of certain trust properties, which he had then deposited into a trust account with a Calcutta trading house of which he was then a partner. Eventually Fairlie left the partnership and he then died. Some years later the residual beneficiaries called for the money to be remitted to them in England. The trading house drew a bill payable by a firm in London but before the bill arrived both the trading house and the London firm failed.

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[96]See further Chapter IX.

[97]In addition to the cases discussed in this paragraph and the next see the constructive trusts case *Green v Weatherill* [1929] 2 Ch 213, 222-223 and *Re Windsor Steam Coal Company (1901), Limited* [1929] 1 Ch 151 (CA) 167: 'there would be no question of wilful default', that term being synonymous with breach of trust.

[98]*Ahmed Angullia bin Hadjee Mohamed Salleh Angullia v Estate and Trust Agencies (1927) Ltd* [1938] AC 624 (PC).

[99]Ibid 637. See also *Re Stevens* [1898] 1 Ch 162 (CA).

[100]*Bacon v Clarke* (1837) 2 My & Cr 294, 40 ER 938.

Fairlie's estate defended a claim for payment of the trust money on the basis that Fairlie had not been guilty of any breach of trust. This point, Cottenham LC said, 'does not appear to me to be very important, because, whether a breach of trust was committed or not, as W. Fairlie received the proceeds of the property out of which the [money] was to be paid, his estate must remain liable to pay what is due in respect of that sum, unless payment or a sufficient excuse for non-payment can be shown'.[101] Fairlie could not show a sufficient excuse because deposit of the property with the trading house of which he was a partner would either be treated as his own possession, in which case he remained charged notwithstanding the insolvency of the house, or it was an unauthorised loan in which case he equally remained charged. Lending the money to the trading house would have been a breach of trust but the breach was not an element of the claim. Breach of trust operates, rather, to bar the fiduciary from claiming to be discharged by virtue of an improper application of the property.

A trustee who misapplies trust property exposes himself to two cumulative claims.[102] One is a claim to charge him with whatever reparable loss is attributable to the misapplication in its wrongful aspect.[103] The other is a claim for performance of the trust, if necessary by payment of a pecuniary substitute for the misapplied property. This latter type of claim seeks enforcement of the defendant's primary duties under the trust rather than reparative compensation for the breach of those duties. The sole purpose of accounts in common form is to ascertain the property for which the trustee is responsible so that he may then be directed to apply it to the purposes of the trust. Where property has been misapplied there will have been a breach of trust but a claimant seeking performance does not need to plead or prove it because the breach is not an element of his claim. This reflects one of the basic differences between performance and reparation claims identified in Chapter II.[104]

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[101]Ibid 298-299.

[102]See Chapter VII Part 2.

[103]See Chapters VII and VIII.

[104]See Chapter II Part 2(b).

(d) A Note on Settled Accounts

Strachan defines a settled trust account as 'a statement of accounts between fiduciary and beneficiary, as to some, or all of the items of which, both parties have agreed to accept, or are estopped from disputing as correct.'[105] A settled account is sometimes known as a stated account. Accounts may either be settled by the court or by a private accounting between the parties.[106]

Settlement of accounts had two important consequences. Consistently with Strachan's definition, the first of these consequences is that the account binds the parties to the settlement.[107] A settled account forms an authoritative statement of the history of the trustee's administration and thereby fixes the parties' liabilities and entitlements over that period. It operates as a release of claims falling within the scope of the account; a separate release is extraneous.[108] Moreover, the settlement discharges the trustee's duty to account in respect of the transactions to which it pertains. The limited circumstances in which settled accounts may be reopened have already been described.[109]

The second consequence of settlement is that it transforms the legal relation of the parties in respect of any sum of money shown in the accounts to be unconditionally payable. Sums that are not yet payable continue to be held in a fiduciary capacity after settlement. This may be because the trusts are still on foot, or because the defendant has

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[105]W Strachan, *Law of Trust Accounts* (1911) para 122.

[106]A private accounting will only assist the defendant if it resulted in a settlement: *Sumner v Thorpe* (1736) West 11, 2 Atk 1, 25 ER 793, 26 ER 398; *Kinsman v Barker* (1808) 14 Ves Jun 579, 33 ER 643. See also RM Jackson, *The History of Quasi-Contract in English Law* (1936) 27. If instead of ascertaining an exact balance the parties agree to accept a gross sum then there is settlement by compromise: *McKellar v Wallace* (1853) 8 Moo PC 378, 402, 14 ER 144.

[107]The duty to account is owed to the beneficiaries and cannot be satisfied by a settlement between co-trustees: *Re Fish* [1893] 2 Ch 413 (CA).

[108]*Re Webb* [1894] 1 Ch 73 (CA) 85.

[109]At page 92 above.

a right to be given a receipt acknowledging payment,[110] or for some other reason. The defendant's fiduciary obligations in respect of sums immediately payable, however, are extinguished by the settlement and from then on he owes the money as a debt.[111] Pollock CB said in *Bartlett v Dimond* that, where money had been held on trust,

> If that trust was ended, and the [defendant] had stated an account, or, in other words, had admitted himself to the plaintiff that he held any sum of money in his hands payable to him absolutely, he would, with respect to that sum, be a debtor, not properly a trustee . . .[112]

For this reason before Judicature the beneficiary could recover the balance owing on the settlement of a trust account by a claim at law for money had and received though no such claim lay against the trustee before the settlement.[113] If the accounts are settled in court then the beneficiary will not usually be required to bring a separate claim for the balance because the court will typically go on to make a payment order. All of this explains why the sum a defaulting trustee must pay is said to be 'in the nature of a debt';[114] but it is only a debt once the fiduciary relation has been dissolved by settlement of the account.[115]

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[110]*Bond v Nourse* (1847) 10 QB 244, 116 ER 95.

[111]It is said that this transformation does not prejudice the beneficiary in the trustee's insolvency: AW Scott & WF Fratcher, *The Law of Trusts* (4th edn, 1988) para 198.1. The point does not appear to have been tested in the courts.

[112]*Bartlett v Dimond* (1845) 14 M & W 49, 46, 153 ER 385; see also *Edwards v Lowndes* (1852) 1 El & Bl 81, 89, 118 ER 367: 'the character of the relation between the parties is changed; and the trustee does not hold it as a trustee properly so called, but as a receiver for the plaintiff's use'.

[113]*Hart v Minors* (1834) 2 C & M 700, 709, 149 ER 944: 'the character of executor is shifted off'; *Roper v Holland* (1835) 3 Ad & E 99, 111 ER 351; *Pardoe v Price* (1847) 16 M & W 451, 153 ER 1266; *Howard v Brownhill* (1853) 23 LJQB (NS) 23; *Topham v Morecroft* (1858) 8 El & Bl 972, 120 ER 361.

[114]*Ex p Adamson* (1878) 8 Ch App 807 (CA) 819.

[115]A trustee who has misappropriated trust money is not the debtor of his beneficiary or his co-trustee before this point: *Ex p Taylor* (1886) 18 QBD 295 (CA); *Re Hutchinson* (1887) 35 WR 264; *New Prance and Garrard's Trustee v Hunting* [1897] 1 QB 607; *Mocha Investments Ltd v Day, Michel, Crill and Cusher* [1990] JLR N-10 (Jersey CA). Halsbury LC's aberrant obiter dictum in *Sharpe v Jackson* [1899] AC 419, 426 was made without argument on the point and was subsequently doubted in *Re Lake* [1901] 1 KB 710 (CA).

This second consequence of settlement is illustrated by a bank failure case dating from before the advent of deposit insurance. One defining difference between accountability and debt is that, whereas a debtor is strictly liable to pay the sum, an accountable party such as a trustee is entitled to be discharged if property is faultlessly lost or stolen.[116] Accordingly, it has been settled since *Knight v Plymouth* that an accountable party is entitled to a discharge for money lost in a bank failure if he was not careless in selecting the bank and if there were good reasons for making the deposit.[117] The trustees in *Wilkinson v Bewick* had justifiably deposited £1, 041 with a bank which subsequently failed and the question was whether they should bear the loss.[118] The complication was that their accounts had been passed earlier that year before the Chief Clerk, and certain sums had by that accounting become payable to the beneficiaries. The £1, 041 in the bank when it failed was partly money subject to the earlier accounting and partly money subsequently received on trust. The trustees were held responsible for that portion of the money that had been subject to the accounting, for in respect of that sum they were debtors, but they were not held responsible for the money that had been subsequently received. The subsequent receipts were still held in an accountable capacity when the bank failed and as such the trustees were entitled to be discharged.

(e) Consequential Relief

A general accounting is occasionally sought without any claim for consequential relief,[119] but more often the claimant's purpose is to gain something more than information or a settlement of the account. What relief he is entitled to is the topic of

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[116] *Morley v Morley* (1678) 2 Ch Cas 2, 22 ER 817.

[117] *Knight v Earl of Plymouth* (1747) Dick 120, 3 Atk 480, 21 ER 214, 26 ER 1076.

[118] *Wilkinson v Bewick* (1858) 4 Jur (NS) 1010. Compare *Surratt v State*, 167 Md 357, 173 A 573, 175 A 191, 100 ALR 1116 (CA Md, 1934).

[119] For example *Attorney-General v Cocke* [1988] Ch 414.

the third stage of the proceeding.[120] This section is only concerned with orders for the payment of money. The correct order depends upon the trustee's duty in respect of the sums subject to the accounting, bearing in mind that a single statement of account may show items of different sorts.

There are three types of case. The simplest occurs where the beneficial interests in respect of sums shown in the account have crystallised such that the holders have an immediate right to be paid. The trustee's duty in such a case is to distribute the money to the beneficiaries and the court will make whatever orders are necessary to ensure that he does so. There is no need to actually reconstitute the trust fund for as concerns these sums the trust is at an end.[121] If the trustee is not holding sufficient trust funds to satisfy the beneficial interests then he will have to satisfy them out of his own pocket.

A second type of case occurs where the trusts are still on foot but the person against whom the order is being made is not the current trustee, either because he has retired or died or been removed from that office.[122] In a case of this sort it would be inappropriate to order payment to the beneficiaries because they are not yet entitled to be paid. The defendant's duty is to pay the current trustee.

The third type of case is more complicated. It occurs where the trusts are still on foot and the defendant remains the trustee. Where this is so, the governing duty cannot be a duty to pay either the beneficiaries or anyone else. *Hillsdown plc v Pensions Ombudsman* was such a case, and Knox J said this: 'Where there is a continuing trust the remedy of a beneficiary under the trust which has payments made out of it in breach

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[120]In former times the master would produce a Report or Certificate which would be referred back to the court for further consideration and a payment order might then be made by the judge. If the accounting would end the dispute, the initial order directing the account might itself mandate payment of the balance found due. Master's Certificates are no longer used: SI 1982/1111. The master should now make the payment order himself unless he deems further consideration by the court to be necessary: CPR Sched 1, RSC Ord 44 r11. Further consideration will typically be necessary where the trust has been put into execution under the direction of the court.

[121]*Target Holdings Ltd v Redferns* [1996] AC 421, 435.

[122]Another example occurs where the defendant is charged as a knowing recipient of misapplied trust property. His duty is to pay a money equivalent to the property to the current trustee.

of trust is to have the trust fund restored.'[123] The correct order, he added, is one that the assets improperly taken out 'should be put back.'[124]

The idea that the misapplied assets should be restored or put back perhaps suggests that the trustee's duty is to make a payment to the trust, but that is difficult to make sense of because the trustee's duty would be to pay himself. In practice the trustee is often ordered to pay the money into court,[125] but that does not explain the nature of the duty that is being enforced. The order for payment into court does not enforce a duty to pay the beneficiaries for they are not yet entitled. Likewise, the case cannot be analysed as one in which the trustee is being replaced and so comes under a duty to transfer the property to the new trustee in the person of the court. The reason is that the defendant remains trustee of funds after they have been paid into court.[126] In principle paying money into court is no different from the trustee paying himself.

For these reasons the duty to reconstitute a trust cannot be understood as a duty to pay the money to another person. Rather, the trustee is deemed to continue holding all of the sums subject to the accounting and his duty is to see that they are properly segregated and invested for the protection and benefit of the beneficiaries.[127] Where the trusts are still on foot, 'the right of each beneficiary is to have the whole fund vested in the trustees so as to be available to satisfy his equitable interest when, and if, it falls into possession.'[128] Thus in the old case of *Hancom v Allen*, for example, the trustees were ordered to account for the money and then to put it into a proper state of investment.[129]

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[123]*Hillsdown plc v Pensions Ombudsman* [1997] 1 All ER 862, 897, referring to *Target Holdings Ltd v Redferns* [1996] AC 421, 434.

[124]*Hillsdown plc v Pensions Ombudsman* [1997] 1 All ER 862, 897.

[125]See for example the form of order set out at *Atkin's Court Forms* (2nd edn, 2000 issue) Vol 41 para 119, adapted from *Re Whiteley* (1886) 33 ChD 347 (CA). See generally J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 39 paras 14-20.

[126]*Thompson v Tomkins* (1862) 2 Dr & Sm 8, 21, 62 ER 524.

[127]See J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 44 para 20.

[128]*Target Holdings Ltd v Redferns* [1996] AC 421, 434.

[129]*Hancom v Allen* (1774) 2 Dick 498, 21 ER 363.

Where the trustee has been guilty of a breach of trust the court will more frequently ensure that the fund is properly segregated and invested by ordering that it be paid into court, but that is an interim measure only pending directions as to how the fund should be applied. The trustee will remain accountable for the reconstituted fund.

The foregoing analysis shows that the various orders for the payment of money that may be made against a trustee at the conclusion of an accounting are not granted in order to enforce secondary duties to make good the breach of trust as a damages award is. These orders instead either enforce primary duties the trustee incurred when he undertook the trust, such as the duty to distribute the fund, or the duty to segregate and protect the fund, or else they enforce the primary duty he incurred when he was removed from office to transfer the fund to the new trustee. The orders in the first and second types of case direct the trustee to make restitution of the trust property (which may be by payment of a pecuniary substitute) to the beneficiaries or the current trustee. By contrast, the order in the third type of case directing the reconstitution of a trust of which the defendant remains trustee is not restitutionary. The defendant is not required to transfer the property into proper hands but rather to segregate and invest it in his own hands.

A final matter requires comment. It is sometimes said that a trustee who has misapplied property other than money may either be required to pay a money equivalent or to purchase an actual replacement for the beneficiaries.[130] Actual replacement is less common now than it once was, though pleadings are still occasionally expressed in this language.[131] Actual replacement is usually only ordered where the property consists in

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[130] J Hill, *Law Relating to Trustees* (1845) 540. See also *Re Dawson* [1966] 2 NSWR 211, 216 and AW Scott & WF Fratcher, *The Law of Trusts* (4th edn, 1988) para 208.4.

[131] *Ivie v Ivie* (1738) 1 Atk 429, 430, 26 ER 274; *Earl Powlet v Herbert* (1791) 1 Ves Jun 297, 30 ER 352; *French v Hobson* (1803) 9 Ves Jun 103, 32 ER 540; *Byrchall v Bradford* (1822) 6 Madd 235, 56 ER 1081; *Kellaway v Johnson* (1842) 5 Beav 319, 49 ER 601; *Re Massingberd's Settlement* (1890) 59 LJ Ch 107, 108, affirmed (1890) 63 LT 296 (CA); and see the orders reproduced in *Seton's Forms of Judgments and Orders* (5th edn, 1893) Vol 2, 974 & 957. See also the form of pleading in *Atkin's Court Forms* (2nd edn, 1991) Vol 41, 100.

fungible securities such that an identical replacement can be obtained in the market.[132] Ordering a trustee to purchase an actual replacement serves two purposes. The first is to fix the amount of money the trustee must pay at a level ensuring full restoration. A secondary purpose is to ensure the money is properly invested. For this reason whether the defendant is made to pay money or purchase an actual replacement probably depends upon considerations of administrative convenience.[133] In most cases the trustee's duty to restore the property is enforced by an order for the payment of money though this is expressed in terms of replacement.[134] The trustees in *Phillipson v Gatty*, for example, had wrongfully sold certain securities.[135] Wigram V-C said 'Then comes a material question–are the trustees to replace the stock, or the money produced by the sale? . . . My opinion is, that the trustees must replace the stock.'[136] Crucially, by his order the Vice-Chancellor directed the trustees to pay into court sufficient funds to purchase the replacement.[137]

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[132]In *Mansell v Mansell* (1732) 2 P Wms 678, 24 ER 913 the judges said that trustees to preserve contingent remainders who allowed the land to be transferred to a bona fide purchaser without notice would be ordered to purchase land of equivalent value for the beneficiaries.

[133]There do not appear to be any authorities touching on this point. This lack of comment supports the hypothesis propounded in the text.

[134]*Davenport v Stafford* (1851) 14 Beav 314, 335, 51 ER 309.

[135]*Phillipson v Gatty* (1848) 7 Hare 516, 68 ER 213.

[136]Ibid 528.

[137]Ibid 531. See also *Re Walker* (1890) 62 LT (NS) 449, 452: 'I see no reason to direct the trustees to repurchase the bonds.'

PERFORMANCE CLAIMS

TAKING ACCOUNTS

CHAPTER V

TAKING ACCOUNTS

Chapter V

The object of taking accounts is to ascertain the property and sums the fiduciary is deemed to hold in his fiduciary capacity.[1] The rules and principles that govern the account have this as their common purpose. These rules and principles are the topic of this chapter. The first two parts consider legitimate charges and discharges and the following three parts consider how unauthorised dispositions and transactions are treated in the account. This chapter does not cover accounts taken on the footing of wilful default, which will be discussed in Chapter VII.

The account comprises individual items of charge and discharge, which represent property received and property alienated.[2] In taking the account, an entry representing particular property must sometimes be reduced to money but the sum always stands for the value of the particular property. The entries in the account are not conceptualised in terms of abstractions such as gain and loss or enrichment and disenrichment. Unless this is kept in mind it is difficult to understand the workings of the account and the liabilities it regulates.

1. Charges

A custodial fiduciary is charged with all of the property he receives in his official capacity. Receipt may either be personal or through an intermediary such as an agent.[3] Accordingly, the order for a common account is usually expressed to require an account to be taken of the property received by the fiduciary or any person by his order or for his

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[1]The role of the accounting in mediating claims against misconducting trustees is examined in Chapter IV.

[2]The structure of an account is analysed in Chapter IV Part 2.

[3]*Partington v Reynolds* (1858) 4 Drew 253, 257, 62 ER 98; *Doyle v Blake* (1804) 2 Sch & Lef 229, 246.

use.[4]

The Control Test

Control is the criterion of receipt. The essential requirement is that the fiduciary becomes capable of disposing of the estate as he chooses. Kekewich J put the test in these terms in *Re Barney*: 'I apprehend that when the law says that a man is responsible as a trustee for money under his control, it means money which he can, if he will, put into his pocket or pay away as he pleases to someone else.'[5] The decisive moment is that of receipt for a person may remain accountable even though the property subsequently shifts out of his control.

A fiduciary may acquire control over property even though he does not take it into his possession or personal custody and even though legal title remains with someone else. A company director, for instance, is accountable for his handling of the company's property even though he likely never has possession, custody or title.[6] Likewise, a trustee who has been appointed but to whom the trust property has not yet been conveyed has sufficient control if he has the right to call for it.[7] The trustees of a marriage settlement in *Westmoreland v Holland* were, for instance, held accountable where they had signed a receipt for £1, 400 but allowed the money to remain in the hands of the settlor, the woman's guardian, who continued to use it in his business.[8] By contrast, it is not enough that the alleged recipient has only been able to prevent another person from using the property in a particular way, as where an account holder cannot draw funds without the cheque being counter-signed by another.[9] The question in every

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[4]For example *Blakely v Blakely* (1855) 1 Jur (NS) 368; *Atkin's Court Forms* (2nd edn, 2000 issue) para 122.

[5]*Re Barney* [1892] 2 Ch 265, 276.

[6]LS Sealy, 'The Director as Trustee' [1967] CLJ 83, 86-87.

[7]*Re Barney* [1892] 2 Ch 265, 272.

[8]*Westmoreland v Holland* (1871) 23 LT 797, aff'd [1871] WN 124 (CA).

[9]*Re Barney* [1892] 2 Ch 265.

case is whether the person is able to apply the property for authorised as well as unauthorised purposes.

Fruits and Lawful Substitutions

A trustee must account for any fruits produced by property in his charge, such as interest or dividends. If he carries on an authorised business for the trust then he must account for its gross profits and he is entitled to an allowance for the expenses of the business.[10] A trustee who validly exercises a power to sell, exchange or invest trust property will be charged with the proceeds or investment in place of the property used to acquire it.[11]

Joint Receipts

Trustees may receive jointly in which case each will be charged. Land conveyed into their several names is received jointly, as is money deposited to a joint bank account or delivered to them when they are assembled together.[12] The difficult question is in what circumstances one trustee will be charged with property actually received into the exclusive custody of another. There is an ancient principle that the receipts of one trustee are not vicariously imputed to another.[13] Between 1859 and 2001 this principle rested on a statutory footing,[14] but with the commencement of the Trustee Act 2000 it has fallen back onto the common law. Notwithstanding this principle a trustee may be charged with property actually received into the custody of another in two situations.

In order to understand the first of these situations it is necessary to take two steps back. For the protection of the beneficiaries trust property should ordinarily be held

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[10] *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319.

[11] *Re Salmon* (1889) 42 ChD 351 (CA) 368.

[12] *Re Flower* (1884) 27 ChD 592, 599.

[13] *Townley v Sherborne* (1633) J Bridge 35, 123 ER 1181.

[14] Trustee Act 1925, s 30(1) and its predecessors.

under the joint control of the trustees.[15] That being so, a person making money or other property over to the trustees will want to insist on obtaining written receipts from each of them.[16] It sometimes happens that for one reason or another the payment is in fact made to one trustee alone and the others join in giving written receipts for what is called conformity. A trustee who joins for conformity only and does not actually receive will not ordinarily be charged with the property,[17] though the onus falls on him to prove that the property acknowledged to be received by all was in fact only received by the other or others.[18] Lord Redesdale explained that 'The true consideration in a question of this kind is, whether the executor who merely joins in the receipt had a control; and his joining in the receipt is evidence of that control, although the money was actually received by the other.'[19]

While joining in a receipt for conformity in itself will not charge a trustee, he will be charged if by doing so he unnecessarily allows his fellow to take the property into his exclusive control.[20] Allowing a co-trustee to take property into his exclusive control is unnecessary where it is done without sufficient reason, in other words if it is something an ordinary prudent man of business would not do in the conduct of his own affairs.[21] In applying this test the security afforded by joint custody must be balanced by the impracticality of requiring the trustees to act in concert. Permitting one trustee to receive alone may be justified for limited administrative purposes such as paying

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[15]*Re Flower* (1884) 27 ChD 592, 596.

[16]Ibid.

[17]*Re Fryer* (1857) 3 K & J 317, 69 ER 1129; *Shipinbrook v Hinchinbrook* (1805) 11 Ves Jun 254, 32 ER 1085; *Brice v Stokes* (1805) 11 Ves 319, 32 ER 1111; *Harden v Parsons* (1758) 1 Eden 144, 28 ER 639.

[18]*Brice v Stokes* (1805) 11 Ves 319, 32 ER 1111.

[19]*Doyle v Blake* (1804) 2 Sch & Lef 229, 242. But while joining in a receipt is presumptive evidence of control against a trustee, it is conclusive evidence against an executor: Ibid; *Brice v Stokes* (1805) 11 Ves Jun 319, 32 ER 1111; *Chambers v Minchin* (1801) 7 Ves Jun 185, 32 ER 76. This unstable distinction is difficult to justify: compare *Westley v Clarke* (1759) 1 Eden 357, 1 Dick 329, 28 ER 723, 21 ER 295 and *Churchill v Hobson* (1713) 1 P Wms 240, 24 ER 370.

[20]*Re Flower* (1884) 27 ChD 592. See further Part 3 below.

[21]*Lowe v Shields* [1902] 1 IR 320 (CA).

creditors or converting assets where that is the best way of proceeding.[22] Where no sufficient reason can be given for failing to act jointly, however, the trustee will be charged. Two cases describe this as 'constructive receipt' but that is an unnecessary obfuscation.[23] The natural explanation is that at the point where his written receipt was needed the trustee had a control which he then used to enable his co-trustee to acquire the property. As control rather than possession or custody is the criterion of receipt, the trustee is in the same position as if he had physically received the property and then made it over to his co-trustee without good reason.[24] That is why he may be charged with the sum in a common accounting without the need to establish wilful default.

The second exception to the general rule that one trustee is not charged with the receipts of another occurs where one trustee appoints a co-trustee to receive as his agent.[25] The three executors in *Toplis v Hurrell* appointed one of their number to manage a farm owned by the estate.[26] The appointed executor deposited the earnings from this enterprise into a bank account which he later overdrew for his own purposes and then became insolvent. The legatees sued the other two for an account of those earnings. Romilly MR said that the earnings should not be accounted for as the receipts of the one executor alone for he had received as agent for the others. Accordingly, 'the accounts must be taken, against these executors, exactly in the same manner . . . as if they had employed a stranger as their agent'.[27] On general principles a fiduciary is charged with the receipts of his agent. In *Re Fryer*, by contrast, money was received by

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[22]For example *Re Gasquione* [1894] 1 Ch 470 (CA); *Ex p Griffin* (1826) 2 Gl & J 114; *Blakely v Blakely* (1855) 1 Jur (NS) 368; *Townley v Sherbourne* (1633) J Bridge 35, 123 ER 1181.

[23]*Terrell v Matthews* (1841) 1 Mac & G 433, 41 ER 1333; *Blakely v Blakely* (1855) 1 Jur (NS) 368.

[24]*Candler v Tillett* (1855) 22 Beav 257, 52 ER 1106; *Townsend v Barber* (1763) 1 Dick 356, 21 ER 307.

[25]*Home v Pringle* (1841) 8 Cl & F 264 (HL) 288, 8 ER 103. See generally Trustee Act 2000, ss 11(1) & 12(1) and *Re Flower* (1884) 27 ChD 592.

[26]*Toplis v Hurrell* (1854) 19 Beav 423, 52 ER 415.

[27]Ibid 428.

one trustee alone who was also solicitor for the trust.[28] Page Wood V-C declined to charge the other trustees on agency principles because the recipient did not take the money in his capacity as solicitor, 'it being no part of his duty in that capacity to receive it'.[29]

2. Discharges

Once the charges have been tallied up, the question becomes whether the fiduciary is entitled to a discharge in respect of some or all of it. Discharges may be claimed for all authorised outgoings but may not be claimed if the trustees have applied the property beyond their authority. There are three major types of legitimate discharge.

Distribution

Most obviously, an accounting party is entitled to discharges for proper payments or transfers to the beneficiary or at his command.[30] If the beneficiary of a trust cannot be found then the trustees may obtain a discharge by paying the money into court.[31]

Just Allowances

Accounting parties are entitled to claim allowances for all payments and liabilities incurred in carrying out their duties and powers.[32] This principle of the general law is reinforced by section 31 of the Trustee Act 2000.

It is impossible to give an exhaustive or definite list of what may be claimed as a

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[28] *Re Fryer* (1857) 3 K & J 317, 69 ER 1129.

[29] Ibid 318.

[30] *Nightingale v Lawson* (1784) 1 Cox 23, 29 ER 1045.

[31] AJ Oakley, *Parker and Mellows, The Modern Law of Trusts* (7th edn, 1998) 506.

[32] *Worral v Harford* (1802) 8 Ves Jun 4, 8, 32 ER 250; *Forshaw v Higginson* (1857) 8 De G M & G 827 (CA) 834, 44 ER 609.

just allowance because the entitlement of each fiduciary will differ with his individual mandate.[33] A few of the major heads will suffice for illustrative purposes. Trustees are entitled to be indemnified out of the trust property for their costs and administrative expenses in executing the trust.[34] Under the same principle they are entitled to be indemnified for costs and liabilities incurred while properly carrying on a trade or business in their official capacity.[35] Trustees are likewise entitled to their costs of defending or prosecuting proper litigation on behalf of the trust.[36] If a trustee is entitled to remuneration then this may be the subject of an allowance, but if he pays himself a salary without authority then he will be made to refund the money.[37] Trustees are similarly not entitled to be indemnified for costs or liabilities they incur in unauthorised transactions.[38] They are also not entitled to be reimbursed for the costs of litigation occasioned by their own negligence or litigation brought or defended for their own purposes.[39] Payment of these costs may be disallowed in a common accounting.[40]

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[33]Examples of just allowances may be found in W Strachan, *The Law of Trust Accounts* (2nd edn, 1937) 197-198 and SE Williams, *The Law of Account* (1899) 30-34, 185-194. The topics mentioned in this paragraph are treated in greater detail in J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Chs 20 & 21.

[34]*Re Grimthorpe* [1958] 1 Ch 615, 628.

[35]See *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 324-328.

[36]*Amand v Bradburne* (1682) 2 Ch Cas 138, 22 ER 884; *Courtney v Rumley* (1871) 6 Ir R Eq 99.

[37]*Re Bedingfield* (1887) 57 LT 332.

[38]*Leedham v Chawner* (1858) 4 K & J 458, 70 ER 191; *Ecclesiastical Commissioners v Pinney* [1900] 2 Ch 736 (CA). If the trustee acts in good faith and the transaction benefits the estate then he may be entitled to an indemnity to the extent of the benefit: *Vyse v Foster* (1872) 8 Ch App 309, 336-337; *Conway v Fenton* (1888) 40 ChD 512, 518.

[39]*Caffrey v Darby* (1801) 6 Ves Jun 488, 497, 31 ER 1159; *Peers v Ceeley* (1852) 15 Beav 209, 51 ER 517; *Leedham v Chawner* (1858) 4 K & J 458, 70 ER 191; *Hosegood v Pedler* (1896) 66 LJQB 18, 21.

[40]*Smith v Chambers* (1847) 2 Ph 226, 41 ER 926.

Accidental Loss

Trustees and other custodial fiduciaries are entitled to be discharged of property accidentally lost. The two chief causes of accidental loss are theft and insolvency. Thus a trustee will be discharged of property stolen from his own house or from an agent to whom he has properly entrusted it,[41] and he will be discharged of property misappropriated by such an agent or by a co-trustee.[42] Likewise, a trustee will be discharged for property lost in the failure of a banker or broker or co-trustee or anyone else to whom it has been properly committed.[43]

A trustee will be answerable, however, for property accidentally lost where he has acted improperly. This proposition has two aspects reflecting the two different types of claim that may be brought against a trustee. The first aspect is that a trustee will not be discharged if he has previously misapplied the property. For instance, if a trustee improperly surrenders control of property to a co-trustee or an agent he guarantees it from then until it is restored into proper hands.[44] That is the sense of Grant MR's statement in *Caffrey v Darby*, 'if they have been already guilty of negligence, they must be responsible for any loss in any way to the property'.[45] The second aspect is that a trustee who fails to take sufficient care of the property exposes himself to a reparation claim for any ensuing loss. In order to recover reparation the beneficiaries will need to

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[41] *Morley v Morley* (1678) 2 Ch Cas 2, 22 ER 817.

[42] *Re Gasquoine* [1894] 1 Ch 470 (CA); *Jobson v Palmer* [1893] 1 Ch 71; *Ex p Griffin* (1826) 2 Gl & J 114; *Jones v Lewis* (1750-51) 2 Ves Sen 240, 38 ER 155.

[43] *Job v Job* (1877) 6 ChD 562; *Wilkinson v Bewick* (1858) 4 Jur (NS) 1010; *Lunham v Blundell* (1857) 27 LJ Ch (NS) 179; *Ex p Belchier* (1754) Amb 218, 27 ER 144.

[44] *Re Dawson* [1966] 2 NSWR 211; *Salway v Salway* (1831) 2 Russ & M 215, 218, 39 ER 376; aff'd *sub nom White v Baugh* (1835) 9 Bligh NS 181, 3 Cl & Fin 44, 5 ER 1261, 6 ER 1354 (HL); *Clough v Bond* (1837) 3 My & Cr 490, 496, 40 ER 1016; *Lowe v Shields* [1902] 1 IR 320 (CA); *Townsend v Barber* (1763) 1 Dick 356, 21 ER 307; *Cowell v Gatcombe* (1859) 27 Beav 568, 54 ER 225; *Candler v Tillett* (1855) 22 Beav 257, 52 ER 1106.

[45] *Caffrey v Darby* (1801) 6 Ves Jun 488, 495, 31 ER 1159.

mount a positive case showing a breach of duty causing the particular loss.[46]

3. Unauthorised Dispositions

The remaining parts of this chapter consider how unauthorised dispositions and transactions are accounted for. These questions must be approached in three stages. The first stage is to ascertain whether there has been a misapplication of trust property (this part).[47] The second is to ascertain whether the accounting party should stand charged with the misapplied property itself or with any proceeds there may have been from unauthorised dealings (Part 4). Where the accounting party retains whichever of these items he stands charged with then he will continue to hold it subject to the trusts and will be accountable on that basis. Where, however, he no longer has the actual property then he will instead be charged with a monetary substitute. This substitute is ascertained at the third stage (Part 5).

A trustee who has misapplied trust property may rectify the account by paying an equivalent sum out of his own pocket.[48] Repayment rectifies the account from that date so that if the misapplied property subsequently appreciates in value he will not be responsible for that appreciation.[49] If the sum is paid by someone else, whether voluntarily or by legal compulsion, that will discharge the trustee pro tanto.[50] Where trustees or third parties are jointly and severally liable payment by one will discharge the

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[46]*Jobson v Palmer* [1893] 1 Ch 71; *Re Brier* (1884) 26 ChD 238 (CA); *Styles v Guy* (1848) 1 Mac & G 422, 41 ER 1328; *Re Fryer* (1857) 3 K & J 317, 69 ER 1129.

[47]Once it is shown that property has been received in an accountable capacity the burden shifts to the fiduciary to show that he has applied the property in accordance with the trusts and his powers: *Re Stevens* [1898] 1 Ch 162 (CA) 172; *Jevon v Bush* (1685) 1 Vern 342, 343, 23 ER 508; *Davenport v Stafford* (1851) 14 Beav 319, 335, 51 ER 309, aff'd 2 De G M & G 901, 42 ER 1125. See Chapter IV Part 2(c).

[48]*Hagan v Waterhouse* (1991) 34 NSWLR 308, 347.

[49]Ibid.

[50]*Bacon v Clarke* (1837) 3 My & Cr 294, 40 ER 938; *Trustor v Smallbone* (9 May 2000, unreported CA) paras 63-68.

others, but those others may be obliged to contribute to the payor.[51] If the misapplied property has appreciated in value then the trustee may also rectify the account by replacing the actual property or a substitute purchased in the market. Likewise the trustee may rectify the account by recovering the property from a third party to whom it has passed. Where, however, the property is now worth less than it had been at the time of misapplication then the trustee may not in every case unilaterally discharge his liability by restoring or recovering the actual property or a replacement.[52] If the misapplication was productive then the beneficiaries may elect to charge the trustee with what proceeds there have been in lieu of the original property.[53] Moreover, if the trustee has misappropriated trust property to his own purposes then the beneficiaries may charge him at values ruling on the date of the misapplication on the theory that he then profited to that extent.[54]

Every custodial fiduciary is authorised to apply the trust property to a more or less extensive range of objects. A private trustee may have very broad powers to invest and manage the property as well as to make discretionary advances and to pay beneficiaries whom he appoints. By contrast, a constructive trustee's only authority is typically to make the property over into proper hands. A trustee misapplies property if he disposes of it other than within and by a proper exercise of his authority. Rudimentary instances occur where the fiduciary consumes, discards or destroys trust property, if he 'were to throw the coin into the sea, or burn the banknotes'.[55] Likewise no discharge will be allowed for transfers to the fiduciary's mistress or any other person

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[51]Civil Liability (Contribution) Act 1978, ss 2(1) & 6(1). See generally C Mitchell, 'Apportioning Liability for Trust Losses' in PBH Birks and F Rose (eds), *Equity and Restitution* (2000) Vol 2, Ch 12.

[52]*Scott v Scott* (1963) 109 CLR 649, 662-663; *Nant-y-glo and Blaina Ironworks Company v Grave* (1878) 12 ChD 738, 748.

[53]See further Part 4(a) below.

[54]*Pearson's Case* (1877) 5 ChD 336 (CA) 341; *Nant-y-glo and Blaina Ironworks Company v Grave* (1878) 12 ChD 738, 748; *Lord Hardwick v Vernon* (1798-99) 4 Ves Jun 411, 31 ER 209. See further Part 4(b) below.

[55]*Blount v O'Connor* (1886) 17 LR Ir 620, 630.

who is not entitled.[56] An executor who has paid debts in the wrong order to the detriment of a creditor is liable to have the payments disallowed on the same principle.[57]

The accounting rule governing payment to the wrong person entails strict liability in that the fiduciary will remain charged even absent fault on his part.[58] Intentional misapplications will obviously be disallowed,[59] as will be transfers owing to a mistake which the fiduciary was negligent in making.[60] A trustee or executor who pays the wrong person will also be liable even though he acted on a mistaken but honest and reasonable interpretation of an obscure instrument.[61] It is also no excuse that the trustee has been induced to pay by a forgery.[62] The trustees in *Eaves v Hickson* were induced by a forged marriage certificate to pay illegitimate children.[63] Romilly MR did not fault the trustees for failing to detect the forgery but he nonetheless held them liable to replace the money. Moreover, it is no defence that the trustee acted on professional advice if that advice was itself erroneous. The trustee in *National Trustees Company of Australasia v General Finance Company of Australia* was required to restore money it

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[56]*Re Hulkes* (1886) 33 ChD 552, 557.

[57]*Re Stevens* [1898] 1 Ch 162 (CA) 169; see also *Re Stuart* (1896) 74 LT 546, 547.

[58]See generally A Scott & WF Fratcher, *The Law of Trusts* (4th edn, 1989) paras 201 & 226. See also *Bishopsgate Investment Management Limited (in liq) v Maxwell (No 2)* [1994] 1 All ER 261 (CA) 265 & 269 (company director).

[59]*Barratt v Wyatt* (1862) 30 Beav 442, 54 ER 960; *Cresswell v Dewell* (1863) 4 Giff 460, 66 ER 787.

[60]*Re Windsor Steam Company (1901) Limited* [1929] 1 Ch 151 (CA).

[61]*Hilliard v Fulford* (1876) 4 ChD 389; *Palmer v Wakefield* (1840) 3 Beav 227, 49 ER 88.

[62]As to frauds, see *Bostock v Floyer* (1865) LR 1 Eq 26 and *Davis v Hutchings* [1907] 1 Ch 356. Those were cases in which the fraud was perpetrated by the trustees' solicitor, to which cases Trustee Act 2000, s 23 now applies.

[63]*Eaves v Hickson* (1861) 30 Beav 136, 54 ER 840. See also *Ashby v Blackwell* (1765) 2 Eden 299, 28 ER 913 and authorities referred to in the note to that case. But see *Re Smith* (1902) 46 Sol J 358; critically noted (1901-02) 15 Harvard LR 753.

had paid to persons whom it mistakenly believed were entitled beneficiaries.[64] The trustee had acted honestly and reasonably on the advice of a reputable firm of solicitors which had failed to notice that a particular statute had not been in force at the material time.

The remainder of this part discusses other major types of misapplication.

Misappropriation

It is plainly a misapplication for a trustee to appropriate property to his own purposes unless there is some specific authority.[65] Purported purchases of property from the trust by the trustee himself or by his nominee are likewise unauthorised even if the trustee has a power of sale and full value is given.[66]

Unauthorised Investments

The standard of liability is similarly strict where a trustee purchases an unauthorised investment. Porter MR explained in *Blount v O'Connor* that making an unauthorised investment is analogous to destroying the trust property and may be accounted for in the same manner.[67] The beneficiary is entitled to falsify the purchase and hold the fiduciary charged with the purchase money.[68] The purchase of an unauthorised investment is necessarily improper, and so it is no excuse that the trustee has acted honestly and reasonably.[69] In the Irish case *Rochfort v Seaton*, for example, the trustees were held

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[64]*National Trustees Company of Australasia v General Finance Company of Australia* [1905] AC 373 (PC). See also *Doyle v Blake* (1804) 2 Sch & Lef 231; *Peers v Ceeley* (1852) 15 Beav 209, 51 ER 517; *Re Knight's Trusts* (1859) 27 Beav 49, 54 ER 18; *Re Jackson* (1881) 44 LT 467.

[65]*Re Stuart* (1896) 74 LT 546, 547; *Re Dawson* [1966] 2 NSWR 211.

[66]*Farrar v Farrar's Limited* (1888) 40 ChD 395 (CA) 409. See further Part 4(b) below.

[67]*Blount v O'Connor* (1886) 17 LR Ir 620, 630.

[68]AJ Oakley, *Parker and Mellows, The Modern Law of Trusts* (7th edn, 1998) 683.

[69]*Re Salmon* (1889) 42 ChD 351 (CA) 367; *Speight v Gaunt* (1884) 9 App Cas 1, 19.

liable for investing on the advice of their solicitors in certain judgments where they were only authorised to invest in real securities, since in making the purchase they were acting beyond their powers.[70]

Unauthorised investment cases must be contrasted with cases in which the trustees have laid out money in an investment of an authorised type but have selected the investment without due skill and care, or failed to realise it when they should have, or otherwise mismanaged the portfolio. In these circumstances the purchase is within the trustee's authority and cannot be struck out of the account. Accordingly, Cotton LJ said in *Re Salmon* that 'The money was invested according to the terms of the trust, though without due care, and the mortgage was from the first a part of the trust estate.'[71] The mortgage in that case had been of a proper type but the trustees had imprudently lent too much in view of the nature and value of the underlying land. If the beneficiaries wish to fix their trustee with any losses occasioned by underperformance of an authorised investment or the inadequacy of an authorised security they must bring a reparation claim on the footing of negligent breach of trust.

Re Chapman illustrates the difference between claims in respect of authorised and unauthorised investments.[72] The trustees of a deceased estate had continued holding the testator's mortgages over agricultural lands in a collapsing market. The beneficiaries contended that the mortgages had been speculative and should have been sold as soon as the trustees took control of them. In approaching the issue Lindley LJ said that 'everything turns upon' the fact the mortgaged were authorised investments.[73] If the mortgages had been unauthorised then the trustees would have been bound to sell them immediately and would now be liable to replace what could have been earned through that sale with interest. By contrast,

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[70] *Rochfort v Seaton* [1896] 1 IR 18.

[71] *Re Salmon* (1889) 42 ChD 351 (CA) 368.

[72] *Re Chapman* [1896] 2 Ch 763 (CA).

[73] Ibid 775.

> There is no rule of law which compels the Court to hold that an honest trustee is liable to make good loss sustained by retaining an authorized security in a falling market, if he did so honestly and prudently, in the belief it was the best course to take in the interest of all parties. Trustees acting honestly, with ordinary prudence and within the limits of their trust, are not liable for mere errors of judgment.[74]

The Lord Justices held there had been no breach of trust because at the time when the beneficiaries said the mortgages should have been sold the extent of the subsequent market decline had been unforeseeable and there had been no reason to doubt the amplitude of the securities.

What is an authorised and what an unauthorised investment may be specified in the trust deed, failing which the general law supplies its own rules. The categories of unauthorised investment supplied by the general law include those investments deemed by prevailing thinking to be necessarily imprudent for the purposes of a trust. In the nineteenth century trustees were confined to English government debt and mortgages over English land. There has since been a fitful expansion in trustee investment powers reaching maturity with the passage of the Trustee Act 2000. Subject to a few qualifications this legislation empowers trustees to make any kind of investment they could if they were absolutely entitled to the assets of the trust.[75] Similarly broad powers were granted to pension trustees in 1995 and have been routinely written into trust deeds for many years.[76] As a consequence the rules governing unauthorised investments are no longer as important in practice as they once were. Today most claims to fix trustees with investment losses are reparation claims founded upon allegations of negligence.[77]

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[74]Ibid 776.

[75]Trustee Act 2000, s 3(1).

[76]Pensions Act 1995, s 34; Law Commission & Scottish Law Commission, *Trustees' Powers and Duties* (Law Com 260, 1999) para 2.17.

[77]Familiar examples include *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 and *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA).

Failure to Earmark

All custodial fiduciaries are bound to keep the property earmarked and separate from other property in their possession and to apply that particular property to the purposes for which it was received. A fiduciary who mixes trust property with other property is treated as if he has taken it for his own use, whether he meant to or not.[78] For this reason where trust money must be deposited with a bank it should be put in a separate trust account. A number of cases from before the advent of deposit insurance held that if a fiduciary pays trust money into his own bank account mixing it with other money and the bank fails he will remain charged even though his choice of the bank could not be impugned.[79] The reason is that the money is considered to have been misapplied when the deposit was made.

Improper Surrender of Control

Trusteeship is a joint office and so a trustee misapplies the property if he improperly surrenders control of it to one or more co-trustees. Kay J said this in *Re Flower*:

> The theory of every trust is that the trustees shall not allow the trust moneys to get into the hands of any one of them, but that they all shall exercise control over them. They must take care that they are in the hands of all, or invested in their names, or placed in a proper bank in their joint names.[80]

Keeping trust property under joint control protects it from misappropriation by or the insolvency of an individual trustee. A trustee or executor who unnecessarily allows property to get into the sole hands of a co-fiduciary will be liable if it is embezzled or

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[78]*Massey v Banner* (1819) 4 Madd 413, 56 ER 757, aff'd (1820) 1 Jac & Walk 241, 37 ER 367.

[79]Ibid. See also *Wren v Kirton* (1805) 11 Ves Jun 377, 32 ER 1133 (receiver); *Fletcher v Walker* (1818) 3 Madd 73, 56 ER 436 (executor); *Robinson v Ward* (1825) Ry & Mood 274, 171 ER 1019 (solicitor).

[80]*Re Flower* (1884) 27 ChD 592, 596.

lost in his insolvency or in some other way.[81] He may not deliver control to his co-fiduciary nor may he create a situation where the co-fiduciary can seize control for himself.[82]

This prohibition is subject to the important qualification that a trustee may surrender control of property to a co-fiduciary if that is necessary for the expeditious administration of the fund.[83] The requirement that the surrender be necessary was at one time interpreted fairly strictly, but there was a softening in the late nineteenth century as trust administration became more complex and the requirement correspondingly more burdensome. Speaking at the dawn of the twentieth century, the Irish judge Fitz Gibbons LJ framed the law in these terms in *Lowe v Shields*: 'When money is lost of which he had control he must show a sufficient reason for having parted with it.' The defendant in that case had allowed his co-trustee to receive the proceeds of sale of estate assets in circumstances where they might have been received jointly, and the proceeds were later lost when his bank to which he had deposited it stopped payment. The Lord Justice explained the standard of sufficient reasonableness as follows:

> The true measure of the duty of an executor who has become jointly responsible for the control of assets, as to passing that control exclusively to his co-executor, is, I think, to be found in what an ordinary prudent man of business would do with his own property under similar circumstances.[84]

In short, the trustee's conduct must meet the usual standard of care required of a trustee.[85] Fitz Gibbons LJ acknowledged that there are a range of situations in which it

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[81] *French v Hobson* (1803) 9 Ves Jun 103, 32 ER 540; *Langford v Gascoyne* (1805) 11 Ves Jun 333, 32 ER 1106; *Clough v Bond* (1837) 3 My & Cr 490, 496, 40 ER 1016; *Candler v Tillett* (1855) 22 Beav 257, 52 ER 1106; *Cowell v Gatcombe* (1859) 27 Beav 568, 54 ER 225; *Townsend v Barber* (1763) 1 Dick 356, 21 ER 307; *Lowe v Shields* [1902] 1 IR 320 (CA).

[82] For example *Clough v Bond* (1837) 3 My & Cr 490, 496, 40 ER 1016.

[83] Necessity is traditionally divided into legal and moral necessity: *Ex p Belchier* (1754) Amb 218, 27 ER 144.

[84] *Lowe v Shields* [1902] 1 IR 320 (CA) 324.

[85] *Speight v Gaunt* (1882) 22 ChD 727 (CA) 739. See also *Re Gasquoine* [1894] 1 Ch 470 (CA). Today the correct formulation is to be found in the first section of the Trustee Act 2000 if the activity falls within the first schedule to that Act. See generally Chapter II Part 1(c)(i).

would be impractical for co-fiduciaries to act in concert. In these situations the ordinary course of business may be for one person to take control of the property for the purpose of carrying out some administrative task.[86] What these situations are is to be decided by application of the general standard of care.

In theory it has long been possible to appoint one trustee as agent for the others to receive or hold or apply property for different purposes, but in practice before the Trustee Act 2000 this ran up against the theory that trustees should control the property and act jointly. Sections 11(1) and 12(1) of the new legislation largely clear away any objections to the practice. Together these provisions empower trustees to appoint one or more of their number as agents to carry out delegable functions of the trust. The concept of a delegable function is given a broad meaning and it is implicit that handling trust property may be ancillary to the agent's role.[87] One important qualification is that if the trustees wish to authorise one or more of their number to exercise asset management functions then section 15 requires that the authority be granted by agreement in or evidenced by writing. Where control of property is committed to one or more trustees as agents for the others within the limits of section 11 and 15 it will not be a misapplication of the property. This is true even where the committing trustees are negligent, though that may found a reparation claim for breach of trust.

Unless a trustee who has committed trust property to the control of a co-trustee can bring himself within one of the exceptions explored in the last two paragraphs, he will be treated as having misapplied the property. By consequence he becomes a guarantor of the fund and will remain liable to restore it if the property is later lost for any reason, even a reason unconnected with the initial misapplication.[88] He also exposes himself to a reparation claim founded on his negligent breach of trust, but from

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[86]For example *Re Gasquione* [1894] 1 Ch 470 (CA); *Ex p Griffin* (1826) 2 Gl & J 114; *Blakely v Blakely* (1855) 1 Jur (NS) 368; *Townley v Sherbourne* (1633) J Bridge 35, 123 ER 1181.

[87]Trustee Act 2000, s 11(2).

[88]See especially *Salway v Salway* (1831) 2 Russ & M 215, 218, 39 ER 376; aff'd *sub nom White v Baugh* (1835) 9 Bligh NS 181, 3 Cl & Fin 44, 5 ER 1261, 6 ER 1354 (HL) and *Clough v Bond* (1837) 3 My & Cr 490, 496, 40 ER 1016.

his point of view remaining charged with the property is often a worse consequence.

The common law principles governing surrender of control to solicitors, brokers and other agents were much the same as those governing surrender to a co-trustee but proved inadequate to the needs of modern trust administration and for this reason were largely overtaken by legislation in 1926.[89] The Trustee Act 2000 now accords trustees a broad power to delegate their functions to agents and also authorises most trustees to deposit trust assets with a custodian.[90] If trustees are negligent in selecting or supervising their agent or custodian they will of course be liable to pay reparation for any loss,[91] but it will now be a rare case in which they are treated as having misapplied the trust property. There is one important exception, which is that if the trustees appoint an agent to exercise asset management functions the appointment will be invalid unless done by agreement in or evidenced by writing.[92] Permitting the agent to receive trust assets under an invalid authority will amount to misapplication unless it can be justified on common law principles.

Improper Purposes

A disposition of trust property within the express terms of the trust will be invalid if it is made for an improper purpose.[93] An application of the property for the trustee's own purposes is an obvious example,[94] as is the sale of property to facilitate an improper

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[89]Trustee Act 1925, especially s 23(1).

[90]Trustee Act 2000, ss 11(1) & 17.

[91]Amongst many others *Re Brier* (1884) 26 ChD 238 (CA) and *Speight v Gaunt* (1884) 9 App Cas 1.

[92]Trustee Act 2000, s 15(1).

[93]*Hayim v Citibank NA* [1987] AC 730 (PC) 746; *Edge v Pensions Ombudsman* [1999] Ch 512, 535, aff'd [2000] Ch 602 (CA). The proper purposes doctrine is applied more frequently in connection with dispositions by company directors: see especially *Howard Smith Ltd v Ampol Ltd* [1974] AC 821 (PC). The company law cases will undoubtedly influence further refinement of the doctrine as it applies to trusts.

[94]*Hagan v Waterhouse* (1991) 34 NSWLR 308, 345.

distribution of the proceeds.[95] Likewise, an advance of money held on a married woman's trust to the woman so that she can pay her husband's debts will be disallowed.[96] Although the woman receives the payment, the real object of facilitating a benefit to the husband is foreign to the trust. By contrast it is no objection that a disposition made entirely with a view to the well-being of the beneficiary incidentally benefits others, such as her children.[97]

The proper purposes doctrine is striking illustrated by cases in which a trustee sells property over which he has a power of sale in order to use the proceeds in an unauthorised manner. Under the rule in *Phillipson v Gatty* and *Re Massingbird* the initial sale is itself considered to be unauthorised.[98] The trustees in the latter case sold out consols in 1875 and improperly invested the proceeds in a contributory mortgage without obtaining the consent of the life tenant. The mortgage proved sufficient but the consols rose dramatically in value. The beneficiaries refused to adopt the mortgage and successfully sued to have the consols or their present value replaced in 1887.

Invalid Exercise of a Discretionary Power

The exercise of a discretionary dispositive power, such as a power of advancement, will be vitiated if the discretion is exercised improperly. Unless a discretion has been surrendered to the court it will not substitute its view as to how the trustees should have decided, but it will scrutinise their decision-making. Truro LC famously said in *Re Beloved Wilkes' Charity* that,

> . . . it is to the discretion of the Trustees that the execution of the trust is confided, that discretion being exercised with an entire absence of indirect

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[95] *Re Bell's Indenture* [1980] 1 WLR 1217, 1231.

[96] *Talbot v Marshfield* (1868) 3 Ch App 622; *Byam v Byam* (1854) 19 Beav 58, 52 ER 270.

[97] *Pilkinton v IRC* [1964] AC 612, 636.

[98] *Phillipson v Gatty* (1848) 7 Hare 516, 68 ER 213; *Re Massingberd's Settlement* (1890) 63 LT 296 (CA). *Re Massingbird* is criticised as unjust but accepted as according with authority and general principles by W Strachan, 'Compensation for Breach of Trust' (1918) 34 LQR 168, 169.

> motive, with honesty of intention, and with a fair consideration of the subject. The duty of supervision on the part of this Court will thus be confined to the question of the honesty, integrity and fairness with which the deliberation has been conducted, and will not be extended to the accuracy of the conclusion arrived at, except in particular cases.[99]

At the limit a discretionary disposition will be invalid if the trustees have acted perversely by taking a decision that no reasonable body of trustees could arrive at.[100] The other grounds on which the purported exercise of a discretionary power may be set aside are well-known.[101]

4. Unauthorised Transactions

If a trustee misapplies trust property unproductively then he will remain charged with it and the account will be taken on that basis. More often trust property is misapplied in a productive transaction. Where this has happened it becomes necessary to decide whether the trustee should stand charged with the misapplied property itself or with its proceeds. In order to understand this topic it is necessary to consider the impact of unauthorised transactions on the beneficiaries' property rights. Unauthorised transactions with third parties will be discussed first and transactions with the trust and the beneficiaries second.

(a) Transactions with Third Parties

As a general rule, when a trustee improperly exchanges trust property with a third party the beneficiary may choose between holding him accountable for the property that has been alienated or instead accepting the exchange-product as a substitute and holding the

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[99] *Re Beloved Wilkes' Charity* (1851) 3 Mac & G 440, 448, 42 ER 330.

[100] *Edge v Pensions Ombudsman* [1999] Ch 512, 534 & 536, aff'd [2000] Ch 602 (CA); *Harris v Lord Shuttleworth* [1995] OPLR 79 (CA) 86-87.

[101] See generally G Thomas, *Thomas on Powers* (1998) Ch 6.

trustee accountable on that basis.[102] This is so whether the transaction was dishonest and undertaken with a view to misappropriating the proceeds or either mistakenly or judiciously undertaken with a view to benefiting the trust.

The beneficiary is entitled to the more advantageous of the two options. As most transactions involve the purchase or sale of some marketable investment for money, this means that the beneficiary may hold the trustee accountable for the investment if it has outperformed the standard rate of interest and the money with interest if it has not. The effect is that the beneficiary cannot lose so long as his trustee is solvent.

i. Insisting on Replacement

Whenever trust property is alienated in an unauthorised transaction with a third party the beneficiaries may disavow the transaction and hold the trustee accountable for the item. Where the third party did not take the property as a bona fide purchaser for value then the trustee may be able to erase his personal liability by recovering the property for the trust.

If the fiduciary holds an item of property into which the beneficiary can trace the value misapplied then that property will be impressed with an equitable charge from the moment at which it was acquired.[103] By virtue of this charge the beneficiary holds a power of sale over the secured property and the right to have the proceeds applied to the purposes of the trust. In contrast with equitable title, an equitable charge does not

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[102] *Foskett v McKeown* [2001] 1 AC 102, 130; *Harrison v Harrison* (1740) 2 Atk 121, 26 ER 476; *Bostock v Blakeney* (1789) 2 Bro CC 654, 656, 29 ER 362; *Pocock v Redington* (1801) 5 Ves Jun 794, 800, 31 ER 862; *Heathcote v Hulme* (1819) 1 Jac & W 122, 37 ER 322; *Re Hallett's Estate* (1880) 13 ChD 696 (CA) 709; *Scott v Scott* (1963) 109 CLR 649, 660; *Re Tilley's Will Trusts* [1967] Ch 1179, 1189; *Boscawen v Bajwa* [1996] 1 WLR 328 (CA) 341-342; see also *Personal Representatives of Tang Man Sit v Capacious Investments Ltd* [1996] AC 514 (PC) and American Law Institute, *Restatement of Trusts 2d* (1959) para 205.

[103] *Re Salmon* (1889) 42 ChD 351 (CA) 357. If the trustee wrongfully alienates a trust asset and later reacquires it for himself the beneficiary may alternatively assert equitable title in the reacquired asset even though it was intermediately laundered through the hands of a bona fide purchaser for value: *Gordon v Holland* (1913) 10 DLR 734 (PC) 743; *Re Stapleford Colliery Company* (1879) 14 ChD 432 (CA) 445.

entitle the holder to participate in any appreciation in the market value of the charged asset, though appreciation may improve the charge's desirability as collateral. The charge is limited to the cost of replacing the misapplied item and the charge-holder has no further interest in the asset once replacement has been effected.

ii. Taking the Proceeds Instead

Were a trustee who misapplied trust money only liable to restore the money with interest then he could speculate by investing it for his own benefit and pocketing whatever difference there might be between the returns on this investment and the sum he later had to restore. He would take the risk that his chosen investment underperformed, but he would have good reason to take this risk because misapplied trust money is usually repayable with simple interest at a low rate only.[104] Higher returns than this can ordinarily be had in the market and so he would likely be a gainer. A trustee in this position would have a powerful incentive to take good investment opportunities for himself rather than for the trust.

In order to align the trustee's interests with the beneficiary's interests the courts give the beneficiary the option of holding the trustee accountable for whatever proceeds he may have acquired in exchange for the misapplied property as well as any fruits. It is sometimes said that the beneficiary may elect to claim disgorgement of the profits. The rule and its rationale were stated in *Bostock v Blakeney*: 'When stock is sold by a trustee, contrary to the trust, the *cestui que trust* has a right to elect to have the stock restored, or the produce of it paid, as the trustee shall never make the advantage, when he could replace the stock at a less price than that at which he sold it.'[105] The same principle is thought to explain why in an appropriate case the beneficiary may assert equitable title in the traceable substitute of misapplied trust property. Lord Millett,

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[104] *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) 397. Interest is discussed in Chapter IX. The same is true if the trust asset in question is something other than money. As trust funds are typically invested conservatively, the trustee would stand a good chance of obtaining a better return on the market so that he could subsequently restore the misapplied asset to the trust and pocket any difference.

[105] *Bostock v Blakeney* (1789) 2 Bro CC 654, 656, 29 ER 362; see also *Bate v Scales* (1806) 12 Ves Jun 402, 405, 33 ER 152.

speaking for the majority in *Foskett v McKeown*, approved a statement by Williston that the reason why a beneficiary may claim the traceable substitute of misapplied property 'is that the trustee cannot be allowed to make a profit from the use of the trust money, and if the property which he wrongfully purchased were held subject only to a lien for the amount invested, any appreciation in value would go only to the trustee.'[106] The beneficiary may assert a proportional title if the trust money was invested in assets purchased partly with the beneficiary's money and partly with the trustee's own money or money belonging to a different trust.[107]

A beneficiary who for some reason cannot trace the misapplied property into a substitute now in the trustee's hands is not debarred from holding the trustee accountable for the value of the proceeds.[108] A beneficiary who opts to do so may also be entitled to choose the basis on which the proceeds and their fruits are to be assessed. He may either ask for an account to be taken of the profits that have actually been made or he may ask for the money with interest at a rate reflecting what is presumed to have been made. These options are discussed in Chapter IX.[109]

iii. The Choice Between Them

A trustee who misapplies trust property productively immediately becomes personally liable to replace the misapplied item. This is true whether he acted intentionally and for his own benefit or in the mistaken belief that he was purchasing an authorised investment for the trust. He holds the substitute without distinction between legal and equitable title, though it is impressed with a charge securing the beneficiary's rights. This being the initial position as between the fiduciary and his beneficiary, the

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[106] *Foskett v McKeown* [2001] 1 AC 102, 130-131. The quoted passage is from S Williston, 'The Right to Follow Trust Property when Confused with Other Property' (1880) 2 Harvard LR 28, 29.

[107] *Foskett v McKeown* [2001] 1 AC 102; *Hagan v Waterhouse* (1991) 34 NSWLR 308, 355-356; *Re Tilley's Will Trusts* [1967] Ch 1179, 1189; *Scott v Scott* (1963) 109 CLR 649, 663-664; *Lord Provost of Edinburgh v Lord Advocate* (1879) 4 App Cas 823 (Sc).

[108] *Bate v Scales* (1806) 12 Ves Jun 402, 33 ER 152; *Scott v Scott* (1963) 109 CLR 649, 661-663.

[109] Chapter IX Part 1(b).

beneficiary may then enforce both his right to have the misapplied property replaced and his rights as charge-holder, or he may choose to take the substitute property instead.[110] The beneficiary will not be able to choose to take the substitute unless he is competent and, if there is more than one beneficiary, they are unanimous.[111] As it is his own property, the trustee can give good title to a purchaser with notice of the trust at any time before the beneficiary chooses to take it for the trust.[112] If the beneficiary instead wishes to realise his security then he must first give the trustee the opportunity to pay up and keep the substitute. If the beneficiary or his new trustee controls the substitute and simply realises it without granting this opportunity then he will be deemed to have chosen to adopt it for the trust.[113] Once the beneficiary chooses to adopt the substitute he loses his right to have the misapplied property replaced as well as his charge.[114] He does not, however, lose his right to sue for reparation on the breach of trust if the wrongful transaction has resulted in any further loss.[115] There has never been an equitable equivalent to the exploded common law doctrine of waiver of tort.[116]

(b) Self-dealing Transactions

The most frequent self-dealing transactions involve attempts to purchase trust property. Other possibilities include attempted sales of the trustee's own property to the trust as well as attempted loans and leases either to the trust or to the trustee. The same general

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[110] *Thornton v Stokill* (1855) 1 Jur (NS) 751; *Re Salmon* (1889) 42 ChD 351 (CA).

[111] *Re Jenkin's and Randall's Contract* [1903] 2 Ch 362; *Power v Banks* [1901] 2 Ch 487; *Wright v Morgan* [1926] AC 788 (PC).

[112] See cases cited in preceding note. These cases involved mistaken trustees–quaere whether the same rule applies if the purchaser is aware the trustee is acting dishonestly. A trustee cannot profit by selling the substitute asset at this point advantageously and then restoring the initial money to the trust thereby making good his breach of trust. He will be accountable for the difference: *Scott v Scott* (1963) 109 CLR 649, 662-663.

[113] *Re Salmon* (1889) 42 ChD 351 (CA) 357-358.

[114] *Scott v Scott* (1963) 109 CLR 649, 660; *Re Tilley's Will Trusts* [1967] Ch 1179, 1189; L Smith, *The Law of Tracing* (1997) 378.

[115] *Re Lake* [1903] 1 KB 439. This alternative is discussed in Chapter VII Part 2.

[116] Exploded in *United Australia, Limited v Barclays Bank, Limited* [1941] AC 1.

principles apply and so for expository purposes this section concentrates on attempts to purchase trust property.

Attempted purchases of the trust property may be governed by the self-dealing rule or the fair-dealing rule.[117] Both rules are designed to protect the beneficiaries against conflicts of interest but they operate in different ways and on different types of transaction. Attempts by a trustee to purchase the trust property from the trust are prohibited by the self-dealing rule. This rule was said in *Tito v Waddell* to be that 'if a trustee purchases trust property from himself any beneficiary may have the sale set aside ex debito justitiae, however fair the transaction.'[118] Attempts to purchase the beneficial interests from the beneficiaries are regulated by the fair-dealing rule: 'if a trustee purchases his beneficiary's beneficial interest, the beneficiary may have the sale set aside unless the trustee can establish the propriety of the transaction'.[119] The two rules and their implications for the trustee's account will be treated in turn.

i. The Self-dealing Rule

There are several reasons why an attempted purchase of trust property by a trustee may be ineffective. One is that every contract requires at least two parties so that a contract with one's self is a nullity.[120] By extension a trustee may not contract with himself through an agent.[121] The requirement that there be discrete contracting parties is easily

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[117]BH McPherson, 'Self-Dealing Trustees' in AJ Oakley (ed), *Trends in Contemporary Trust Law* (1996) Ch 6, 148. This section builds on McPherson's analysis. See also *Clay v Clay* [2001] WTLR 393 (Aus HC) 414-415; R Nolan, 'Directors' Self-Dealings: Liabilities and Remedies' [1999] CifLR 235; and AJ Oakley, *Constructive Trusts* (3rd edn, 1997) 138-149.

[118]*Tito v Waddell (No 2)* [1977] 1 Ch 106, 224-225, see also 247-249.

[119]Ibid.

[120]*Lewis v Hillman* (1852) 3 HLC 607, 629, 10 ER 239; *Denton v Donner* (1856) 23 Beav 285, 290, 53 ER 112; *Henderson v Astwood* [1894] AC 150 (PC) 158; *Ellis v Kerr* [1910] 1 Ch 529, 534; *Rye v Rye* [1962] AC 496; *Kildrummy (Jersey) Ltd v IRC* [1990] STC 657 (CS) 662 & 670; *Ingram v IRC* [1997] 4 All ER 395 (CA).

[121]*Ingram v IRC* [1997] 4 All ER 395 (CA) 423-424. Nor can two agents of the same principal contract with each other in that capacity: *Grey v Ellison* (1856) 1 Giff 438, 65 ER 990.

circumvented, however, for a trustee may contract with his nominee or an accomplice.[122] By virtue of section 82 of the Law of Property Act 1925 a trustee may also contract with himself and another. An attempted purchase may also fall foul of conveyancing restrictions, though the effect of the 1925 reforms was to abrogate the common law rule that a person cannot convey to himself so that the remaining restrictions are also easily circumvented.[123]

A trustee who circumvents these technical barriers and effects an otherwise valid contract and conveyance to himself or his nominee or accomplice must still reckon with the limits of his authority. Trustees and other custodial fiduciaries ordinarily lack authority to sell trust property to themselves or related parties. The first part of this proposition was clearly expressed by Lindley LJ in *Farrar v Farrar's Limited*: 'a power of sale does not authorise the donee of the power to take the property subject to it at a price fixed by himself, even although such price be the full value of the property.'[124] To this Millett LJ added in *Ingram v IRC* that 'A trustee's power of sale does not authorise the trustee to sell the trust property except to someone with whom he can deal at arm's length. A sale to his nominee, being unauthorised, is incapable of overreaching the interests of the beneficiaries.'[125] These propositions constitute the self-dealing rule, which is distinct from the contracting and conveyancing barriers mentioned in the preceding paragraph.[126] Its rationale was captured by the New Zealand judge Salmond J in these words:

> The rule is not based on any technical considerations relative to any difficulty, real or supposed, in the way of a person transferring property to himself. It is based on considerations of public policy, with intent to protect the beneficiaries

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[122]*Ingram v IRC* [1997] 4 All ER 395 (CA) 417-427, dissenting but approved on appeal [2000] 1 AC 293, 305 & 310.

[123]See the Law of Property Act 1925, s 72 and *Rye v Rye* [1962] AC 496.

[124]*Farrar v Farrar's Limited* (1888) 40 ChD 395 (CA) 409.

[125]*Ingram v IRC* [1997] 4 All ER 395 (CA) 425, dissenting but approved on appeal [2000] 1 AC 293, 305 & 310.

[126]Contrast *Clay v Clay* [2001] WTLR 393 (Aus HC) 414, where the court suggests that 'This "rule" may represent the conflation of several principles.'

> of a trust by precluding the trustee from placing himself in a position where his interests conflict with his duty.[127]

A fiduciary's authority may be enlarged to permit self-dealing transactions by the nature or terms of the trust or by statute.

The effect of an attempted self-dealing purchase on the beneficial title is uncertain on present authorities. A dominant line of cases holds that the purchase is voidable at the option of the beneficiaries,[128] but McPherson (writing extra-judicially) points to a parallel line suggesting that it is in fact void because the trustee cannot unilaterally extinguish the beneficial interests.[129] In principle McPherson's view seems right. There can be no doubt that a simple transfer of property held in the name of the trust to the trustee personally without the informed consent of the beneficiaries has no effect upon their beneficial title.[130] It is difficult to see that the position is any different if at the same time the trustee deposits a sum of his own money to the trust account; or dresses the transfer up as a formal sale; or purchases from himself at a public auction. Even if a valid contract or conveyance can be effected, the purported sale in each of these cases should be void because the trustee's power of sale does not authorise a sale to himself or his nominee. The idea that the sale is voidable and can be set aside may have been used in some of the cases consistently with McPherson's view to mean nothing more than that the property may be recovered; or to mean that the beneficiaries

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[127] *Robertson v Robertson* [1924] NZLR 552, 553. See also *Re Thompson's Settlement* [1986] Ch 99, 115; *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461 (HL) 471; *Wright v Morgan* [1926] AC 788 (PC) 797-798.

[128] *Ingram v IRC* [1997] 4 All ER 395 (CA) 424; *Holder v Holder* [1968] 1 Ch 353 (CA) 398; *Re Sherman* [1954] Ch 653; *Campbell v Walker* (1800) 5 Ves Jun 678, 680, 31 ER 801; *Re Daly* (1907) 39 SCR 122; J McGhee, *Snell's Equity* (30th edn, 2000) Ch 11 para 77; see also *Guiness plc v Saunders* [1990] 2 AC 663, 697-698. J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 20 para 60 recognises that these authorities are dominant but questions them. The issue was discussed in passing by the High Court of Australia in *Clay v Clay* [2001] WTLR 393 (Aus HC) 414. The court said the transaction was voidable but does not appear to have considered the matter closed.

[129] BH McPherson, 'Self-Dealing Trustees' in AJ Oakley (ed), *Trends in Contemporary Trust Law* (1996) Ch 6, referring in particular to *Franks v Bolans* (1868) 3 Ch App 717, 718-719; *Denton v Donner* (1856) 23 Beav 285, 290, 53 ER 112 and *Williams v Scott* [1900] AC 499 (PC), to which may be added *Morse v Royal* (1806) 12 Ves Jun 355, 372, 33 ER 134.

[130] *Glennon v Federal Commissioner of Taxation* (1972) 127 CLR 503, 511-513.

may elect whether to treat the purported sale as void or to affirm the sale and keep the proceeds.

Assuming that McPherson is right, the effect of the self-dealing rule is to invoke the ordinary principles applicable to an unauthorised disposition of trust property. Because the attempted dealing is unauthorised it involves a misapplication of the property in favour of the trustee.[131] The self-dealing rule accordingly consists both in a disability and in a duty. The disability imposed by the rule prevents a trustee from extinguishing the beneficial interests without the consent of the beneficiaries.[132] Even where a trustee manages to effect a valid contract and conveyance to himself or his nominee, equitable title will remain with the beneficiaries. That title may only be cut off if the property reaches the hands of a bona fide purchaser for value or if the trustee acquires it from the beneficiaries. The duty imposed by the self-dealing rule consists in the general duty incumbent on custodial fiduciaries not to misapply the property, here by taking it for their own purposes. A fiduciary who misapplies trust property is necessarily guilty of a breach of trust and relief may be claimed on that basis.[133] For these reasons Megarry V-C's contention obiter in *Tito v Waddell (No 2)* that the self-dealing rule consists in a disability but not a duty stands in need of revision.[134]

The present question concerns how self-dealing transactions are treated in the account. One implication of the self-dealing rule *qua* disability is that the trustee is unable to discharge himself of property purportedly sold to himself or a related party. He remains accountable for the property as well as for any income that accrues from it

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[131]BH McPherson, 'Self-Dealing Trustees' in AJ Oakley (ed), *Trends in Contemporary Trust Law* (1996) Ch 6, 151: 'What needs to be firmly kept in mind is that self-dealing involves a misappropriation or misapplication of the trust property.'

[132]*Franks v Bolans* (1868) 3 Ch App 717, 719; *Denton v Donner* (1856) 23 Beav 285, 290, 53 ER 112.

[133]*Clay v Clay* [2001] WTLR 393 (Aus HC) 415.

[134]*Tito v Waddell (No 2)* [1977] 1 Ch 106, 248.

and the beneficiaries may claim on this basis.[135] Accordingly the beneficiaries may insist that the property be restored into proper hands and dealt with in accordance with the terms of the trust, or in certain cases that it be sold and the proceeds held on the trusts,[136] subject always to allowing the trustee to take back the consideration he had provided and other fiscal adjustments. If the trustee cannot restore the actual property because he has sold it on then the beneficiaries may hold him accountable for its present value and insist that he perform by payment of a pecuniary substitute,[137] or else they may ratify that sale and insist that its proceeds be brought into account.[138] Consistently with the general principles outlined in the last section, the availability of this latter type of claim ensures that the trustee cannot profit from his improper dealings.

Alternately, if the property has declined in value since the initial sale then the beneficiaries may elect to adopt the ineffective transaction and take the consideration the trustee had provided while surrendering the original property to him.[139] The beneficiaries may be assisted in making their choice by a conditional order that the property be resold with a reserve price matching the price purportedly paid by the trustee.[140] If the reserve is not met then the trustee will be held to his purchase but if the sale is advantageous then the difference will accrue to the trust. Moreover, if the initial purchase was at an undervalue then the trustee will be accountable for the difference as

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[135]Likewise, where a trustee sells his own property to the trust he remains accountable for the purchase money just as if he had made an unauthorised investment: *Re Duckwari (No 1)* [1999] Ch 253 (CA); *National Trust Company Limited v Osadchuk* [1943] SCR 89.

[136]*Holder v Holder* [1968] Ch 353 (CA) 370-373. See generally J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 20 paras 97-98.

[137]*Re Bulmer* [1937] Ch 499 (CA) 511, recognising also an exception if the trustee did not know when he sold the property on that it was subject to the trusts, in which case he is only accountable for the proceeds of that sale; *Re Caerphilly Colliery Company (Pearson's Case)* (1877) 5 ChD 336 (CA) 341. See also AW Scott & WF Fratcher, *The Law of Trusts* (4th edn, 1988) para 206 and the influential New York Court of Appeals case *Estate of Rothko*, 43 NY 2d 305, 372 NE 2d 291 (1977).

[138]*Lord Hardwick v Vernon* (1798-99) 4 Ves Jun 411, 31 ER 209; *Ex p Reynolds* (1800) 5 Ves Jun 707, 31 ER 816; *Re Daly* (1907) 39 SCR 122.

[139]J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 20 para 57.

[140]*Holder v Holder* [1968] Ch 353 (CA) 371, 373-374, 389; *Ex p Reynolds* (1800) 5 Ves Jun 707, 31 ER 816; *Tennant v Trenchard* (1869) 4 Ch App 537, 546.

a profit made at that time in abuse of the relation of trust and confidence, notwithstanding that he did not realise that profit by selling while values remained high.[141]

ii. The Fair-dealing Rule

The fair-dealing rule governs attempts by a fiduciary to purchase a beneficiary's estate from him. As Megarry J explained in *Tito v Waddell*, the fair dealing rule belongs to the general part of equity governing all relations of trust and confidence, for the same rule governs transactions between fiduciaries and their principals irrespective of whether the subject is trust property.[142] Where the subject is the beneficiary's interest under a trust the transaction extinguishes the trusts and the purchasing trustee's interest in the property becomes absolute by union of the legal and equitable title.

Like the self-dealing rule, the fair-dealing rule ensures that the fiduciary does not take advantage of his position. The fair-dealing rule operates differently, however, because the transactions it governs do not involve the servile interest in trust property. Whereas the self-dealing rule operates to invalidate the attempted disposition of the servile interest held by the trustee, the fair-dealing rule merely renders unfair dispositions of the equitable estate voidable at the beneficiary's option. The burden of upholding the transaction falls on the fiduciary, who must show 'that he has taken no advantage of his position and has made full disclosure to the beneficiary, and that the transaction is fair and reasonable.'[143]

Logically one effect of a dealing between a trustee and his beneficiary is to discharge the trustee of the subject property. If at some later time the transaction is successfully impugned and restitutio in integrum remains possible then the transaction

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[141] *Lord Hardwick v Vernon* (1798-99) 4 Ves Jun 411, 31 ER 209; *Re Daly* (1907) 39 SCR 122.

[142] *Tito v Waddell (No 2)* [1977] 1 Ch 106, 249.

[143] Ibid 240-241. The best-known authorities supporting this proposition are referred to in J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 20 para 127.

may be set aside and the beneficial interest reconstituted. If restitutio in integrum is no longer possible, typically because the property has passed into the hands of a protected third party, the fiduciary may nonetheless be held accountable for any profits he has made. These profits typically take one of two forms. First, if the fiduciary has sold the property advantageously then he may be charged with the proceeds of that sale.[144] Second, if the initial sale was at an undervalue then the fiduciary may be charged with the difference as a profit he then made, notwithstanding that he did not realise that profit because the property subsequently declined in value.[145] This difference may also be recoverable as damages for misprepresentation or breach of the duty of loyalty, as may any further loss the beneficiary has suffered.[146]

5. Valuation

Recall that in considering how misapplied property should be accounted for, the first and second stages involve ascertaining whether there has been a misapplication and, if so, what property the fiduciary should be held accountable for. Where the conclusion is that the fiduciary should stand charged with property he actually possesses then that property along with its fruits will remain subject to the trusts. Where the conclusion is, however, that the trustee should stand charged with property which he no longer possesses then it will need to be reduced to a monetary value which will stand in place of the property in the account. The topic will be treated first in relation to misapplied money and then in relation to property of other types.

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[144] *Fox v Mackreth* (1788) 2 Bro CC 400, 29 ER 224, aff'd (1791) 4 Bro PC 258 (HL); *Whichcote v Lawrence* (1798) 3 Ves Jun 739, 30 ER 1248; *Price Waterhouse v MacCulloch* (1986) 25 DLR (4th) 126 (NSSC-AD).

[145] *Fox v Mackreth* (1788) 2 Bro CC 400, 420-421, 29 ER 224, aff'd (1791) 4 Bro PC 258 (HL). Similarly, where a fiduciary acquires trust property for himself without providing any consideration he may be required to account for it at values then ruling even though it is now worth less: *Pearson's Case* (1877) 5 ChD 336 (CA) 341; *Nant-y-glo and Blaina Ironworks Company v Grave* (1878) 12 ChD 738, 748.

[146] *Hollinger v Heichel* [1941] 1 WWR 97; *Efstratiou Glantschnig* [1972] 1 NLZR 594 (CA) 599.

(a) Money

If the misapplied property is money then the trustee will be deemed to have retained the sum on trust and he will be charged with interest from the date of misapplication.[147]

There is no difficulty with holding a trustee accountable for money in a foreign currency where that is the currency in which the obligation accrued. This can be necessary to protect the parties from the effect of fluctuations in the values of currencies on international markets. In *Re Dawson*, for example, money was abstracted from a New Zealand trust and when the case was heard some years later in Australia Street J held that the defaulting trustee had been liable to restore New Zealand pounds.[148] There is also no difficulty with ordering a defaulting trustee to replace the money in a foreign currency.[149] In the *Guardian Ocean* case, for example, Hirst J awarded US$600, 000 as money for which the defendant bank was accountable under a *Quistclose* trust.[150] The parties had transacted in American currency and the money had been held in New York. The selection of the currency presumably follows the same principles as apply in cases involving liquidated contractual obligations,[151] and so it should be sufficient to ask where the trust fund ought to have been held and in what currency.

The calculation of interest and the basis on which it is charged are topics that will be treated in depth in Chapter IX. Where obligations accrue in a foreign currency interest should be charged at the rates prevailing in that jurisdiction in order to prevent

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[147]See Chapter IV Part 2(c).

[148]*Re Dawson* [1966] 2 NSWR 211. Street J's assumption in that case that judgment had to be awarded in Australian pounds is now out of date both in England and in Australia.

[149]See generally *Miliangos v George Frank (Textiles) Ltd* [1976] AC 443; *The Despina R* [1979] AC 685. See also *Halsbury's Laws of England* (4th edn reissue, 1998) Vol 12(1) para 1139. Compare *Re Chesterman's Trusts* [1923] 2 Ch 466 (CA).

[150]*Guardian Ocean Cargoes Ltd v Banco do Brasil SA* [1991] 2 Lloyd's Rep 68, 87.

[151]These principles are discussed in H McGregor, *McGregor on Damages* (16th edn, 1997) para 719.

either under or over-compensation of the claimant.[152]

(b) Property of Other Types

If the fiduciary is accountable for something other than money then it will need to be reduced to a monetary value with which the fiduciary will stand charged.[153] In order to value the property the court must adopt a measure by which values are to be taken as well as a valuation date.

The usual valuation measure is market price. Most of the cases involve readily marketable land or securities. In particular circumstances the property may be worth more to the trust than it would sell for on the open market. For instance, it may consist in sufficient shares to constitute a majority holding or in a plot of land worth more in combination with other land held by the trust.[154] In circumstances such as these it may be necessary to value misapplied property above its discrete market price in order to capture its true value to the trust.[155]

Misapplied property is usually monetised at present values.[156] Street J explained in *Re Dawson* that 'The obligation to restore to the estate the assets of which he

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[152]In *Guardian Ocean Cargoes Ltd v Banco do Brasil SA (No 3)* [1992] 2 Lloyd's Rep 193, 199 interest was given at 1% above the New York prime rate. See SM Waddams, *The Law of Damages* (3rd edn, 1996) para 7.840.

[153]As to whether the beneficiaries can instead insist that the fiduciary replace the property *in specie* by purchasing a substitute for the trust, see Chapter IV Part 2(e).

[154]Compare *Elder's Trustee and Executor Company Limited v Higgins* (1963) 113 CLR 426, 472; *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 543.

[155]Valuations problems of this sort arise more frequently in company law cases, to which reference should be made.

[156]*Townsend v Barber* (1763) 1 Dick 356, 21 ER 307; *Ex parte Shakeshaft* (1791) 3 Bro CC 197, 29 ER 487; *Phillipson v Gatty* (1838) 7 Hare 516, 68 ER 213; *Davenport v Stafford* (1851) 14 Beav 319, 335, 51 ER 309, aff'd 2 De G M & G 901, 42 ER 1125; *Re Walker* (1890) 62 LT (NS) 449; *Re Massingberd's Settlement* (1890) 59 LJ Ch 107 (CA); *MacDonald v Hauer* (1976) 72 DLR (3d) 110 (Sask CA). See also *Estate of Rothko*, 43 NY2d 305, 372 NE2d 291 (NYCA, 1977), discussed on this point in RV Wellman, 'Punitive Surcharges Against Disloyal Fiduciaries–Is *Rothko* Right?' (1978) 77 Mich L Rev 95, 101. Compare *Re Bell's Indenture* [1980] 1 WLR 1217, 1232-1233.

deprived it necessarily connotes that, where a monetary compensation is to be paid in lieu of restoring assets, that compensation is to be assessed by reference to the value of the assets at the date of restoration and not at the date of deprivation.'[157] The reason, Street J explained, is that 'the obligation is a continuing one'.[158] Accordingly, the trustee must also account for dividends, rents, or other income that would have accrued in the interval.[159] The present value rule is reflected in cases where trustees have been required to purchase an actual replacement of the misapplied property for the trust,[160] for the effect of that order is to reconstitute the fund at present values. Either way, the fund gains the benefit of any appreciation after the date on which the property was misapplied. In litigation present value is taken to be value at the date of judgment rather than the date on which the claim was issued.[161]

There is an obvious and instructive parallel to be drawn with the date of valuation in the classical action of detinue, which was also the date of judgment. Diplock LJ explained in the *Cook Cars* case that values are assessed in detinue at the date of judgment because detinue 'is a continuing cause of action which accrues at the date of the wrongful refusal to deliver up the goods and continues until delivery up of the goods or judgment in the action for detinue.'[162] It is no coincidence that this echoes Street J's explanation for the present value rule in trusts cases. The reason why values are normally assessed at the date of judgment both in detinue and where trust property is being replaced is that both orders direct substitutive performance of an ongoing primary

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[157]*Re Dawson* [1966] 2 NSWR 211, 216.

[158]Ibid.

[159]*Davenport v Stafford* (1851) 14 Beav 319, 335, 51 ER 309, aff'd 2 De G M & G 901, 42 ER 1125: 'the necessity of replacing the stock clearly involves the necessity of replacing the dividends upon it.'

[160]*Ivie v Ivie* (1738) 1 Atk 429, 430, 26 ER 274; *Earl Powlet v Herbert* (1791) 1 Ves Jun 297, 30 ER 352; *French v Hobson* (1803) 9 Ves Jun 103, 32 ER 540; *Byrchall v Bradford* (1822) 6 Madd 235, 56 ER 1081; *Kellaway v Johnson* (1842) 5 Beav 319, 49 ER 601.

[161]*Re Bell's Indenture* [1980] 1 WLR 1217, 1233; AW Scott & WF Fratcher, *The Law of Trusts* (4th edn, 1988) para 208.3.

[162]*General and Finance Facilities Ltd v Cook Cars (Romford) Ltd* [1963] 1 WLR 644 (CA) 650-651.

obligation to deliver the property or otherwise to apply it to the owner's purposes.[163]

[163]See discussion in Chapter II Part 2(b).

PERFORMANCE CLAIMS

TARGET HOLDINGS LTD v REDFERNS

CHAPTER VI

TARGET HOLDINGS LTD v REDFERNS

Chapter VI

Target Holdings Ltd v Redferns raised an issue that goes to the heart of the argument advanced in this thesis.[1] Stated over-broadly the issue was whether a trustee can be made to replace misapplied funds where the misapplication did not put the beneficiary in a net financial position he would not have ended up in if the trust had been duly performed. The House of Lords ruled that the beneficiary could not recover because his loss had not been factually caused by the solicitor's breach of duty. As we shall see, their Lordships based this ruling on the proposition that all compensation claims against defaulting trustees are in the nature of reparation claims. If that is correct then the central distinction drawn in this thesis between reparation claims and substitutive performance claims against custodial fiduciaries collapses.

The result in *Target Holdings* has been widely approved but the analysis has proven controversial. A number of commentators welcome the decision for articulating the principles governing compensation for breach of trust in terms that transcend the historic division between the law and equity.[2] These commentators commend the analysis for highlighting the supposed similarity between a compensation claim and a common law claim for damages. Others contend that the analysis in *Target Holdings* overlooks the crucial significance of the accounting relation that obtains between trustee

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[1] *Target Holdings Ltd v Redferns* [1996] AC 421.

[2] CEF Rickett, 'Equitable Compensation: The Giant Stirs' (1996) 112 LQR 27; S Moriarty, 'Fiduciaries and Discretion' (1998) 114 LQR 9; D Capper, 'Compensation for Breach of Trust' [1997] Conv 14; J Ulph, 'Harmony in the Law: Hitting the Target' (1995) 9 TLI 89; R Nolan, 'A Targeted Degree of Liability' [1996] LMCLQ 161; R Davern, 'The Problem with Bare Trusts in Contractual Contexts: A Simple and Orthodox Solution' (1997-98) 8 KCLJ 86. The Court of Appeal's opposite decision had been criticised for converse reasons: D Heydon, 'Causal Relationships Between a Fiduciary's Default and the Principal's Loss' (1994) 110 LQR 328.

and beneficiary.[3] The controversy concerns more than legal history, for the Court of Appeal has recently refused in the company law case *Bairstow v Queen's Moat Houses plc* to accede to an argument founded on *Target Holdings*.[4] The defendant directors were held liable to replace funds improperly paid away as dividends even though the payment may not have been ultimately causative of any loss. Robert Walker LJ distinguished *Target Holdings* on the basis that here the directors were known to have acted fraudulently,[5] but he also indicated that the court may in future reconsider the entire analysis in *Target Holdings* in light of the criticisms that have been raised.

The argument in this chapter is that the analysis in *Target Holdings* is inconsistent with important authorities, most of which were not cited to the House of Lords. In order to make sense of these authorities it is necessary to recognise that the claims with which they were concerned were for substitutive performance rather than reparation. Causal connection and related criteria of reparative relief are inapposite to a performance claim. This is not to say that the beneficiary of misapplied property's only claim is for substitutive performance. The beneficiary also has a claim for reparation of any loss he has suffered.[6] The performance claim is, however, the dominant of the two because it is usually more advantageous to the beneficiary and most of the cases involve performance claims. Reparation claims will be discussed in Chapters VII, VIII and IX.

The argument will be developed in three parts. The first part contains an exposition of the facts and reasoning in the *Target Holdings* case. The second part sets out the ordinary understanding of the claim that is typically brought where trust property

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[3]PBH Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 UWALR 1, 45-48; Sir Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 224-227; AJ Oakley, *Parker and Mellows, The Modern Law of Trusts* (7th edn, 1998) 680-683. None of the three offer any authority supporting their position.

[4]*Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712, [2001] 2 BCLC 531. See also *Allied Carpets Group plc v Nethercott* [2001] BCC 81.

[5]*Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712 para 54, [2001] 2 BCLC 531. In distinguishing *Target Holdings* on this basis the Court of Appeal appears to have overlooked *Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA).

[6]The relation between these two claims is discussed in Chapter VII Part 2.

has been misapplied and argues that causal criteria play no role in the analysis of that claim. The final part considers whether the holding in *Target Holdings* can stand with the law as it has developed and asks whether and how the law needs to be modified.

1. *Target Holdings Ltd v Redferns*

The *Target Holdings* litigation arose out of a classic mortgage fraud perpetrated against Target Holdings Ltd, a lender. Redferns was a firm of solicitors acting for the fraudsters and, as the transaction progressed, for Target. The fraudsters applied to Target for mortgage finance of, in round figures, £1.7 million towards the purchase of certain properties in Birmingham. The fraudsters wrote in their loan applications that the total purchase price of the properties was £2 million but in fact it was much lower, in the order of £800, 000. The illusion of a £2 million purchase price was created by flipping the properties through a chain of paper companies. Target's valuers accepted the inflated £2 million figure out of carelessness or for some other reason. Target approved the loans and advanced money towards the purchase of the properties. The fraudsters absconded with the difference between the sum advanced by Target and the purchase price of the Birmingham properties. Target was left holding its security over the Birmingham properties, which were eventually sold for some £500, 000.

Target sued Redferns for the shortfall. As might be expected, Target claimed that Redferns had been negligent in failing to alert it to the suspicious circumstances of the loan. The present interest is in the alternative plea of breach of trust. Target's lawyers found an irregularity in Redferns's execution of the transaction which, they argued, permitted Target to by-pass the trial process and take summary judgment. As with most mortgage loans Target had instructed Redferns, the borrowers' solicitor, to act for it as well. Target paid the mortgage money into Redferns's client account to be held on trust pending completion. Redferns had implied authority to pay this money out once the properties had been conveyed to the purchaser and Target's security was in place. Before these steps had been taken Redferns paid the mortgage money out of its client account to various companies involved in the sham transaction. This was an

admitted breach of trust.[7] Some of these funds were used to make the initial purchase; without early access to Target's money the fraudsters may not have been able to set their plan in motion. The rest of the mortgage money was spirited away by the fraudsters. At this point Redferns advised Target that the purchase had been made and that its security was in place, but in fact the paperwork was done several days later and backdated.

Target's application for summary judgment was premised upon the submission that Redferns's unauthorised early payments had put it under an immediate duty to reconstitute the trust. Subsequent events could not absolve Redferns of this liability, although Target accepted that it should give credit for the £500, 000 realised on the eventual sale of the properties. Redferns sought leave to defend on the basis that its breach was merely technical. According to Redferns the early payments caused no loss because Target got the security it had desired a few days later. This is the issue that found its way up to the House of Lords. Because contested facts are assumed in favour of the defendant on a summary judgment application, the issue was treated as if alternative finance would have been found to set the fraudulent scheme in motion even if Target's money had not been wrongfully disbursed. That is to say, the case proceeded on the footing that Target would have ended up in the very same financial position even if Redferns had complied with its instructions.

The Court of Appeal allowed Target's application for summary judgment but this decision was reversed by the House of Lords. Lord Browne-Wilkinson was the only equity lawyer sitting on the appeal and he gave the only speech. He framed the issue as being whether a defaulting trustee can be held liable to make good losses to his beneficiaries absent *any* causal link between his breach of trust and those losses. Lord Browne-Wilkinson rejected the view, variously favoured by each of the judges below, that Target's loss might have been caused by Redferns's unauthorised payment despite the fact that Target's security was put into place a few days later. Only full-blooded 'but

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[7]This admission has been criticised by Sir Peter Millett, 'Equity–The Road Ahead' (1995) 6 KCLJ 1, 7 and by DJ Hayton, 'Fiduciaries in Context: An Overview' in PBH Birks (ed), *Privacy and Loyalty* (1997) Ch 11, 287-288, both contending that the breach of trust consisted in the failure to obtain the security rather than the payment itself.

for' causation would suffice. Lord Browne-Wilkinson explained that 'In any ordinary use of words, the breach of trust by Redferns cannot be said to have caused the actual loss ultimately suffered by Target unless it can be shown that, but for the breach of trust, the transaction would not have gone through'.[8] That the transaction would have gone through regardless was, as noted above, an assumed fact for the purposes of the summary judgment application. It followed that Target could only succeed in its application if Redferns's liability did not depend on proof of causation as if it were a liability sounding in tort. The House decided this issue in favour of Redferns.

Lord Browne-Wilkinson approached the legal question by stating a broad principle and then by considering how it applies in three different types of case. This statement needs to be excerpted in full:

> At common law there are two principles fundamental to the award of damages. First, that the defendant's wrongful act must cause the damage complained of. Second, that the plaintiff is to be put "in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation:" *Livingstone v. Rawyards Coal Co.* (1880) 5 App. Cas. 25, 39, *per* Lord Blackburn. Although, as will appear, in many ways equity approaches liability for making good a breach of trust from a different starting point, in my judgment those two principles are applicable as much in equity as at common law. *Under both systems liability is fault-based: the defendant is only liable for the consequences of the legal wrong he has done to the plaintiff and to make good the damage caused by such wrong. He is not responsible for damage not caused by his wrong or to pay by way of compensation more than the loss suffered from such wrong.* The detailed rules of equity as to causation and the quantification of loss differ, at least ostensibly, from those applicable at common law. But the principles underlying both systems are the same.[9]

Lord Browne-Wilkinson's words earlier in the judgment suggest that the requirement that a causal relation obtain between breach and loss applies whether the breach was

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[8]*Target Holdings Ltd v Redferns* [1996] AC 421, 431.

[9]Ibid 432 (my emphasis). It should be noted that when Lord Browne-Wilkinson said that liability for breach of trust is fault-based he was only further stipulating the necessity of a causal connection between a trustee's breach and recoverable loss. It is plain from the paragraph immediately prior that he did not intend to erase the venerable rule that a trustee who makes an unauthorised disposition of trust property is liable even absent negligence and whatever his mental state. See for example *Speight v Gaunt* (1883) 9 App Cas 1, 19; *Eaves v Hickson* (1861) 30 Beav 136, 54 ER 840; AW Scott & FW Fratcher, *The Law of Trusts* (4th edn, 1988) para 201.

innocent, negligent or fraudulent.[10]

Lord Browne-Wilkinson's broad statement of principle did not end the matter. He was evidently troubled by Target's submission that Redferns's duty was to reconstitute the trust rather than to pay compensation. Lord Browne-Wilkinson answered this submission by explaining that whether the beneficiaries are entitled to have the trust reconstituted rather than an order for payment of compensation to themselves directly depends upon what type of trust they are claiming under. A distinction falls between subsisting traditional trusts and bare trusts. Subsisting traditional trusts are trusts with indeterminate or contingent interests, whereas bare trusts are trusts under which the beneficiaries are entitled absolutely.[11] Lord Browne-Wilkinson further divided bare trusts into exhausted traditional trusts and bare commercial trusts.[12]

The beneficiaries of a depleted subsisting traditional trust are entitled to have it reconstituted. Lord Browne-Wilkinson said that the basic right of each beneficiary of a subsisting trust is to have the trust administered and to have the fund vested in the trustee 'so as to be available to satisfy his equitable interest when, and if, it falls into possession.'[13] The only way to protect the interests of all the beneficiaries is for the defaulting trustee to reconstitute the trust by restoring what ought to be there. 'The obligation to reconstitute the trust fund applicable in the case of traditional trusts', his

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[10]*Target Holdings Ltd v Redferns* [1996] AC 421, 432. The requirement was applied to deny recovery where the defendant's breach had been fraudulent in *Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA), clarifying Evan LJ's analysis in *Swindle v Harrison* [1997] 4 All ER 705 (CA) 715-718. *Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712, [2001] 2 BCLC 531 appears to have been decided without the benefit of *Collins v Brebner*.

[11]*Target Holdings Ltd v Redferns* [1996] AC 421, 434-436.

[12]Most commentators who mention this point find it perplexing: J Martin, *Modern Equity* (16th edn, 2001) 654; Sir Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 224; D Capper, 'Compensation for Breach of Trust' [1997] Conv 14, 22. Compare R Nolan, 'A Targeted Degree of Liability' [1996] LMCLQ 161 and DJ Hayton, 'Fiduciaries in Context: An Overview' in PBH Birks, *Privacy and Loyalty* (1997) Ch 11, 287-288 (criticised in note 15 below.) See also *Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712 para 53, [2001] 2 BCLC 531. The true significance of the distinction is explained in Chapter VIII Part 4(a).

[13]*Target Holdings Ltd v Redferns* [1996] AC 421, 434.

Lordship explained, 'reflects the fact that no one beneficiary is entitled to the trust property and the need to compensate all the beneficiaries for the breach.'[14] By contrast, reconstitution is not generally appropriate in cases involving bare trusts because the beneficiaries enjoy individual and immediate rights to call for their share of the property. The correct remedy is usually an order for payment of compensation directly to the individual beneficiaries rather than to the present trustee. Lord Browne-Wilkinson did not exclude the possibility that reconstitution of a bare trust might be appropriate in special cases, for example where the trust was an incident of an incomplete commercial transaction. The trust in issue in the *Target Holdings* case itself was a bare commercial trust relating to a completed conveyancing transaction and so Target's only right was to be paid compensation for whatever loss it may have suffered.

Lord Browne-Wilkinson was at pains to emphasise the distinction between those cases in which reconstitution is appropriate and those cases in which the correct remedy is an order for payment of compensation to the beneficiaries personally. It is, however, difficult to understand what significance he attributed to it. His Lordship took the broad principle excerpted above to apply in both types of case.[15] Where the correct remedy is reconstitution of the trust (as it usually is under a subsisting traditional trust), he said the basic rule is that the trustee must restore or pay to the estate either the actual assets that have been lost or 'sufficient compensation to the trust estate to put it back to what to what it would have been had the breach not been committed'.[16] There must, he said, be a 'causal connection between the breach of trust and the loss to the trust estate for which compensation is recoverable'.[17] Where the correct remedy is the payment of compensation directly to the beneficiary (as it usually is under a bare trust), the 'measure

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[14]Ibid 436.

[15]For this reason it is difficult to accept Hayton's interpretation of the case, which is that the ratio depended upon the distinction between traditional trusts and bare commercial trusts: DJ Hayton, 'Fiduciaries in Context: An Overview' in PBH Birks, *Privacy and Loyalty* (1997) Ch 11, 287-288; DJ Hayton, *Underhill and Hayton The Law Relating to Trusts and Trustees* (15th edn, 1995) 834 n 6. Lord Browne-Wilkinson's analysis shows that he would have decided the appeal the same way whatever type the trust had been.

[16]Ibid 434.

[17]Ibid.

of compensation is the same, i.e. the difference between what the beneficiary has in fact received and the amount he would have received but for the breach of trust.'[18]

For these reasons it is tempting to conclude that the distinction Lord Browne-Wilkinson elaborated between relief under subsisting traditional trusts and relief under bare trusts only relates to the consequential question of whom the money should be paid to. Knox J took the distinction to have a deeper significance in the subsequent case of *Hillsdown Holdings plc v Pensions Ombudsman*.[19] The trustees of a pension fund had wrongfully abstracted money and then wound up the fund. The judge held that the trusts on which the money had been held had been continuing so that the defendants' liability was to restore the abstracted funds rather than pay compensation to the individual pensioners. He thought ordering that the funds be 'put back' might yield a higher or lower award than ordering compensation be paid to the individual pensioners because in assessing this compensation 'each complainant would have to establish the individual quantum of injustice which he or she would have suffered'.[20] Knox J said that a claim for individual compensation of this latter type is 'in effect a claim for damages.'[21]

Knox J's interpretation has the considerable attraction that it accords a role to the distinction between reconstitution and direct compensation that is consonant with the importance Lord Browne-Wilkinson plainly attributed to it. It remains, however, to explain the contrasting nature of reconstitution to a trust, for Lord Browne-Wilkinson also took this remedy to have a reparative object. If reconstitution were not a species of reparative relief then proof of a causal connection between breach and loss would not necessarily be a condition of recovery. The explanation appears to be that a claim for

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[18]Ibid 435. That remark was made in connection with exhausted traditional trusts. Lord Browne-Wilkinson later said at 436C that the same 'basic principle of equity' applies where compensation is awarded for breach of a bare commercial trust.

[19]*Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862.

[20]Ibid 897. See also *McConnell v Boyd* [1997] OPLR 53, 58 where Vinelott J contrasted compensation for the loss of trust property and compensation for the actual loss the beneficiary has suffered.

[21]*Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862, 897.

reconstitution of a trust is a claim that the defendant pay compensation to the present trustee for loss suffered by the estate. If the idea of a fund which lacks separate personality suffering loss seems odd then it might be said that the loss is suffered by the beneficiaries collectively by deterioration in the value of their interests. By contrast, compensation under a bare trust is paid to each individual beneficiary in respect of loss he alone has suffered.[22] On Lord Browne-Wilkinson's analysis causation of loss conditions recovery either way and so Target's appeal would have failed whichever of the two remedies was thought to be appropriate.

Lord Browne-Wilkinson further explained the causal connection requirement later in his speech. The Court of Appeal had held that where trust money has been paid away without authority the claimant sustains an immediate loss that cannot be cured by subsequent events.[23] Peter Gibson LJ said that in these circumstances the causal connection is obvious.[24] Lord Browne-Wilkinson disagreed, stating that the measure of recovery should be assessed at the date of judgement 'using hindsight and common sense'.[25] He agreed that if proceedings had been taken immediately after the breach then Redferns would have been ordered to make good the fund in full. This did not, however, mean that Target's recoverable loss could not be diminished by events subsequent to the breach. His Lordship said 'the fact that there is an accrued cause of action as soon as the breach is committed does not in my judgment mean that the quantum of the compensation payable is ultimately fixed as at the date when the breach occurred.'[26] Fixing quantum at the date of the breach might, Lord Browne-Wilkinson thought, 'lead to compensating the trust estate or the beneficiary for a loss which, on the facts known at trial, it has not suffered.'[27]

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[22]One argument in Chapter VIII Part 4 is that this distinction depends upon the scope of the trustee's duties.

[23]*Target Holdings Ltd v Redferns* [1994] 1 WLR 1089 (CA) 1102.

[24]Ibid.

[25]*Target Holdings plc v Redferns* [1996] AC 421, 439.

[26]Ibid 437.

[27]Ibid.

It should be clear that Lord Browne-Wilkinson's analysis is founded upon the contention that a beneficiary's compensation claim against a trustee who has misapplied trust property is in every case reparative in nature. This contention is implicit in his statement of broad principle as well as in the ensuing discussion of that principle's application. On this view the claim in *Target Holdings* was essentially akin to a damages claim founded on the conversion of property.[28] This view having been taken, Target's claim was destined to fail because reparation claims are claims for recovery of causally-related loss. The next part is devoted to refuting the premiss that Target's claim was for reparation.

2. Causation and Remoteness of Loss

The argument in this part is that the beneficiary of misapplied trust property has a compensation claim against his fiduciary that is not conditioned by a requirement that he has suffered causally-related loss nor by related limiting factors. This argument vitally undermines the theory that these claims are reparative in nature but is consistent with the proposition that they are instead claims for substitutive performance of the fiduciary's primary duties. That a custodial fiduciary's personal liability is not constrained by causal criteria does not mean it is unlimited. The sum he must pay by way of substitutive performance cannot exceed the value of the property.[29]

(a) Factual Causation of Loss

The argument in this thesis is that a beneficiary whose custodial fiduciary has misapplied trust property may sue for performance of the fiduciary's primary duty to make over the property into proper hands or to put it into a proper state of investment or

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[28]Compare *Hiort v The London and North Western Railway Company* (1879) 4 ExD 188 (CA), in which nominal damages were given.

[29]The claimant may also be entitled to charge the defendant with the value of whatever investment opportunity has been lost, perhaps by way of an interest charge. That type of charge is imposed to repair losses and will be discussed in Chapters VII, VIII and IX.

to apply it in some other way depending on the circumstances of the case.[30] If the actual misapplied property is irrecoverable then the beneficiary may demand performance by payment of a monetary substitute taken from the fiduciary's pocket. The monetary sum stands in place of the actual property and is not given as reparation for any loss the beneficiary may have suffered. The misapplication will also have been a breach of trust, for which reason the beneficiary may have a cumulative claim for reparation.[31] If the beneficiary sues on the breach of trust for reparation then a causal relation between the breach and alleged loss will need to be made out,[32] but no causal relation needs to be shown to the entitle the claimant to substitutive performance. The only question is one of valuing the property that is the subject of the defendant's duty.[33]

The proposition that a beneficiary seeking substitutive performance relief in respect of a misapplication of trust property does not complain of a breach of trust causing loss may be broken down into three constituent propositions. The first is that the claim does not assert or depend upon a breach of trust. The second is that the concept of reparable loss has no application. The third is that no causal relation between breach and loss needs to be made out. The first of these propositions was defended in Chapter IV.[34] The second and third will be discussed here in turn. This section is only concerned with rudimentary factual causation, that being the requirement that the breach was a necessary condition of the loss occurring.

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[30]See Chapter IV Part 2(e).

[31]See Chapter VII Part 2.

[32]See Chapter VIII Part 1.

[33]See Chapter V Part 5.

[34]See Chapter IV Part 2(c).

Immateriality of Reparable Loss

It is a basic feature of a claim for performance or substitutive performance that the claim does not seek relief against reparable loss.[35] Where property that is the object of a custodial fiduciary's performance obligation has been misapplied, that misapplication will be accounted for as if the fiduciary had disposed of his own assets all the while keeping the trust property in his hands.[36] The trustee is not held liable on the basis that by mishandling the property he has brought about a loss either to the beneficiaries or the fund. He is rather held liable on the basis that he has received property subject to an obligation which he has not yet discharged. Reparable loss has no role to play in the analysis. This last proposition was the ratio of the decision of a unanimous division of the Court of Appeal in *Re Windsor Steam Coal Company (1901), Limited*.[37]

The defendant was liquidator of a company and for material purposes he was assumed to be in the position of a trustee. He honestly compromised a claim against the company and pursuant to this compromise he paid out £15, 000. The claim had been invalid and the payment was made in breach of trust. The liquidator was sued by a contributory for repayment of the money to the company. The liquidator raised a number of defences, the interesting one being that he was protected from liability by section 30(1) of the Trustee Act 1925. That provision stated that trustees should not be liable for various things, and the words relied on were 'nor for any other loss, unless the same happens through his wilful default.' Wilful default had not been alleged and so the liquidator contended that he could not be held liable 'for any other loss' resulting from his wrongful payment.[38]

The Court of Appeal refused this defence for the reason that loss is not a

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[35]See Chapter II Part 2(b).

[36]See Chapter IV Part 2(c).

[37]*Re Windsor Steam Coal Company (1901), Limited* [1929] 1 Ch 151 (CA).

[38]The liquidator's argument might equally have been defeated on the basis that the words 'any other loss' are construed *ejusdem generis*: *Re Vickery* [1931] 1 Ch 572, 582.

criterion of relief where a wrongful payment is concerned. Hanworth MR said 'Here the fund was not lost. The liquidator received it, and having received it paid it away to the wrong person.'[39] Lawrence LJ gave more elaborate reasons. He observed that no question of 'other loss' arose where the breach of trust consisted in paying trust money to the wrong person. The only question is whether the trustee can discharge himself in his account. Lawrence LJ said this:

> If s 215 of the Companies (Consolidation) Act, 1908, had not existed and an action had been brought for an account against the liquidator on the footing of his being [as was assumed] a trustee, an ordinary account would have been directed of his receipts and payments, and every payment which could not be vouched as having been properly made under the trust would be disallowed, and he would be treated as still having in his hands the balance found due from him. There would be no loss and there would be no question of wilful default.[40]

Loss is only apposite where the trustee is sued not on his receipts, but beyond his receipts on the basis of wilful default. The argument in Chapter VII will be that this should be understood to mean that loss would only be apposite if the claimant had instead brought a reparation claim founded upon the liquidator's breach of duty.

The same principle had been applied some forty years earlier by a division of the Court of Appeal consisting of Halsbury LC and Cotton and Bowen LJJ in *Magnus v Queensland National Bank.*[41] This case is of considerable significance but, like the *Windsor Steam Coal* case, it has been almost entirely overlooked in recent texts and discussions. Three trustees had jointly held railway debenture stock the value of which they had resolved to reinvest in a different form of security. To this end the three transferred the stock to the defendant bank so that it could carry out the sale. Two mistakes were then made, the first by the bank and the second by two of the trustees who were the claimants in the case. The third trustee was a stockbroker named Goldsmid. He was a regular client of the bank and had instigated this transaction. At

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[39]Ibid 156, 161.

[40]Ibid 166-167.

[41]*Magnus v Queensland National Bank* (1888) 37 ChD 466 (CA).

his request, once the railway stocks had been sold the bank paid the purchase money to him alone. This was the first mistake. The Court of Appeal held that the bank had had no authority to pay Goldsmid alone and should rather have paid the money to the three trustees jointly. Having received the money, Goldsmid did reinvest it as planned but he did so in his own name. The second mistake was that the two other trustees, learning of this, did not insist that Goldsmid transfer the new security into their joint names. Goldsmid subsequently sold the security, secretly misappropriated the proceeds, and later absconded. The question in the case was whether the bank or the two trustees should recoup the trust.

The judges were unanimous in holding the bank responsible for the money. The bank had received the stock in an accountable capacity and then held the proceeds in the same capacity. Cotton LJ said that 'the bank was accountable to the trustees for the purchase-money. The only defence they could set up was that they had paid the money to, or allowed it to be received by, a person authorized on behalf of the trustees to receive and give a good discharge for it.'[42] The bank could not establish this defence as it had not been authorised to pay one of the trustees alone. The payment to Goldsmid had been a misapplication of the money and as such could be falsified in the bank's account. The bank remained accountable for the money and was ordered to pay over an equivalent sum.

If the claim against the bank had been in damages then it seems the bank would have been entitled to plead contributory negligence or failure to mitigate as a defence. Cotton LJ accepted that the claimant trustees had been negligent in failing to ensure that the replacement stock was transferred from Goldsmid into their joint names. If they had done so then Goldsmid would have been unable to perpetrate his fraud. The bank contended that 'the negligence of the trustees was the real cause of the loss to the trust'.[43] Cotton LJ considered this argument to be misconceived:

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[42]Ibid 474.

[43]Ibid 477.

> . . . if the bank having this stock, in respect of which . . . they were accountable to the trustees, paid the money arising from that property, not to the trustees, nor to any person authorized by the trustees to give a good receipt for it, they, in my opinion, must be held answerable to the trustees just as if the money was still in their hands.[44]

The unauthorised payment had been a nullity and so the bank's account would stand as if the payment had not been made. So far as the claim against the bank was concerned, there was no 'loss' for which the trustees might be responsible by reason of their subsequent negligence.[45] Bowen LJ expanded on this point, saying that the bank's argument rested on a misleading use of the phrase 'loss caused by the conduct of the bank'. In saying that the bank's wrongful payment did not cause the loss to the trust, counsel for the bank 'was using the term in a popular and non-legal sense, and one which is not sufficient to support his proposition. When was the property of the trust lost? At the time when it first passed into unauthorized hands.'[46] To say that the 'loss' had been caused by the claimant trustees' negligence created an 'ocular illusion'.[47] The only question in Bowen LJ's view was whether the bank had had authority to pay Goldsmid alone, and the answer was that the bank had lacked this authority. Halsbury LC agreed with this analysis in separate reasons.

The analysis relied upon by the judges in the *Magnus* case shows that where a custodial fiduciary is sued for the value of property which he has previously misapplied, the claim does not depend upon loss in the sense of damage or injury. The only material loss consisted in the fact that the property was no longer there. This appears to be the idea relied upon by Peter Gibson LJ, speaking for the majority of the Court of Appeal in *Target Holdings Ltd v Redferns*.[48] The Lord Justice contrasted cases involving wrongful transfers with other breach of trust cases. In cases that do not involve a wrongful

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[44]Ibid.

[45]This is not to say that, had the trustees been unable to recover the money from the bank, the beneficiaries would not have had a reparation claim against the trustees.

[46]Ibid.

[47]Ibid 480.

[48]*Target Holdings Ltd v Redferns* [1994] 1 WLR 1089 (CA).

payment 'it makes sense to ask whether the loss would have happened but for the breach.'[49] Events occurring after the breach may show that in fact there has been no loss and so one 'waits to see whether and, if so, what loss will thereby be eventually sustained.'[50] By contrast, 'Where the breach consists in the wrongful paying away of trust moneys so that there is an immediate loss, no inquiry is necessary: the causal connection is obvious.'[51] It seems clear that Peter Gibson LJ was using the term loss in two different senses in these contrasting passages. The immediate loss to which he referred is best understood as the loss of the money in the sense that it is no longer there rather than loss in the sense of injury or damage.

Immateriality of Causation

The third proposition set out above was that no causal connection between breach and loss needs to be made out for the claimant to succeed in a claim for substitutive performance. This proposition follows analytically from the first two. If the claim is not founded upon breach nor directed towards reparation of loss then causal connection between the two must be beside the point.

The third proposition is implicit in the reasoning of the judges in the *Magnus* case and explicit in a passage from Halsbury LC's speech. One of the arguments made in that case was that the claimant trustees has reposed such confidence in Goldsmid that had the bank contacted them before paying over the money, they would have instructed it to pay Goldsmid alone so that the money would have been lost in any event. The Lord Chancellor referred to doubts he had entertained 'whether it could properly be alleged that the loss which is complained of . . . was consequent upon the breach of duty

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[49]Ibid 1102.

[50]Ibid.

[51]Ibid. Compare *Re Anglo-French Co-operative Society (Pelly's Case)* (1882) 21 ChD 492 (CA) 506 per Brett LJ: 'The moment you have paid away a person's money wrongfully he is damaged to the extent of that payment. Nothing can lessen the extent of that damage unless the money has been, before the supposed action has been brought, paid back into the hands of the person from whom it was taken as free to him as it was before.'

by the bank.'[52] He overcame those doubts for the reason that,

> . . .when once the fact is established that money belonging to this trust has got into the hands of one of the three trustees without the consent of the others, and that by the default of the bank, we are not at liberty to speculate whether the same result might not have followed whether the bank had been guilty of that default or not.[53]

In the circumstances there would have been no need to speculate, for Halsbury LC later said he had little doubt that Goldsmid might have defrauded the trust in some other way. This passage suggests that the Lord Chancellor thought a custodial fiduciary should be liable notwithstanding that the same consequences would have followed even if he had done his duty. The reasoning may be explained on the simple basis that the payment was to an unauthorised recipient so that the bank remained charged with the money. The submission Halsbury LC rejected resembles the submission accepted by the House of Lords in *Target Holdings*, for in both cases the fraud would have been perpetrated even if the defendant had done his duty. Two other allied cases will be discussed here, namely *Cocker v Quale* and *Salway v Salway*.

Cocker v Quale involved a marriage settlement which authorised the trustees, with the wife's written consent, to lend money to the husband on the security of his bond alone.[54] At the wife's instance the trustees lent the husband money without obtaining a written consent and without taking a bond. The husband became insolvent and the trust money was lost. The trustees argued that there was no causal connection between the wrongful loan and the loss sustained in the husband's insolvency. Acting properly they would have obtained the wife's written consent and the husband's bond. In the insolvency the bond would have ranked as a specialty debt. Crucially, a specially debt would have been equally irrecoverable. The trustees said that 'the fund, therefore, had sustained no loss which it would not have suffered equally if the trust had been

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[52]*Magnus v Queensland National Bank* (1888) 37 ChD 466 (CA) 471-472.

[53]Ibid 472. Compare *Bishopsgate Investment Management Ltd v Maxwell (No 2)* [1994] 1 All ER 261 (CA) 265-266.

[54]*Cocker v Quale* (1830) 1 Russ & M 535, 39 ER 206.

executed in the strictest manner.'[55] The claimants replied that:

> . . . the moment the trustees lent the money to the husband, in a manner not warranted by the marriage settlement, they became answerable for the amount; and this liability could not be removed from them by any subsequent event. It could not be denied that they were liable the hour before the bankruptcy of the husband: how could this bankruptcy place them in a better situation?[56]

Leach MR agreed with the claimants: 'The trustees cannot be excused from a breach of trust in lending the money without the security of the husband's bond, by reason of the subsequent event of the husband's bankruptcy.'[57] In reaching this conclusion, the Master of the Rolls implicitly rejected the trustees' contention that 'A trustee . . . could not be made answerable, unless actual loss had been sustained in consequence of his breach of trust.'[58]

Cocker v Quale is explicable on the basis that an unsecured loan is treated just as if the trustee had burnt the banknotes, or thrown the coin into the sea.[59] The trustees remained charged with the money, for the transaction would be accounted for as if they had made the unauthorised loan with their own money and retained the trust money in their hands.[60] If the debtor in *Cocker v Quale* had not become insolvent then the trustees might have reduced or eliminated their personal liability by collecting the debt and restoring the money to the trust, but that would have been their good fortune.

The operation of factual causation in cases involving improper dealings with

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[55]Ibid 536.

[56]Ibid 537.

[57]Ibid 538.

[58]Ibid 535.

[59]*Blount v O'Connor* (1886) 17 LR Ir 620, 630; *Adye v Feuilleteau* (1783) 2 Cox 24, 3 Swans 90, 36 ER 784, 72 ER 886; *Wilkes v Steward* (1801) G Coop 6, 35 ER 457; *Walker v Symonds* (1818) 3 Swans 1, 36 ER 751.

[60]*Knott v Cottee* (1852) 16 Beav 77, 81, 51 ER 705.

property was addressed by the House of Lords in *Salway v Salway*.[61] That case involved a receiver, but for material purposes receivers are accountable just as trustees are and *Salway v Salway* has been referred to in cases involving trustees.[62] In the nineteenth century receivers (and trustees) were entitled and often required to deposit funds received in a bank for safekeeping notwithstanding the fact that the deposit was in effect an unsecured loan. Receivers would ordinarily be discharged for deposits lost on the failure of a bank if they had had no reason to doubt its solvency.[63] The receiver White had lost deposits in two bank failures, and his choice of the banks was not impugned. White had, however, fallen short of the mark in parting with exclusive control of the fund. His sureties had insisted for their own protection that the money be deposited on condition that White could only withdraw it with their agent's participation. Brougham LC thought this was a dangerous arrangement. White would have been dependent on the availability and consent of the sureties if there had been a sudden run on the bank and the deposit had to be withdrawn immediately.[64] For this reason White had acted improperly in giving up sole control of the money.

White contended that however improper it may have been, the account arrangement had not in the circumstances caused the money to be lost. There had been no warnings of the bank failures, and so the deposits would have been lost whatever the terms of the accounts. Brougham LC accepted this, but thought it did not relieve White of his liability to account for the funds:

> . . . the receiver shall be answerable for what has happened to the fund which he has so dealt with, not merely in a case where the peril can be sworn to be the cause of the loss, but where he has not so rightly conducted himself as to exonerate him from the loss–where he has not so conducted himself as a

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[61] *Salway v Salway* (1831) 2 Russ & M 215, 39 ER 376; aff'd *sub nom White v Baugh* (1835) 9 Bligh NS 181, 3 Cl & Fin 44, 5 ER 1261, 6 ER 1354 (HL).

[62] *Re Dawson* [1966] 2 NSWR 211, 215.

[63] *Knight v Earl of Plymouth* (1747) Dick 120, 3 Atk 480, 21 ER 214, 26 ER 1076.

[64] *Salway v Salway* (1831) 2 Russ & M 215, 219-220, 39 ER 376.

> prudent person would have.[65]

The House of Lords confirmed Brougham LC's decree. The Lord Chancellor himself spoke in favour of his disposition of the case, and the erstwhile Lord Chancellor, Lord Lyndhurst, spoke in support of him:

> But then it was pressed in argument that the loss did not arise from that circumstance. That, however, appears to me a point altogether immaterial. The party who is paid for the discharge of his duty comes to be relieved from his liability. The Court says, "You cannot be relieved from your liability unless your conduct has been strictly regular, whether the loss has been occasioned by the irregularity of your conduct or not."[66]

None of the other Lords is reported to have commented on the case. The true analysis of *Salway v Salway* is that it had been improper of White to part with exclusive control of the money just as in *Cocker v Quale* it had been improper to lend the money without taking security. The fact that it subsequently became irrecoverable without White's fault was 'altogether immaterial'. White would only have been discharged of the money if he had acted properly in giving the sureties shared control over the account. Causation of loss did not enter the equation.

Cocker v Quale and *Salway v Salway* are both cases in which the defendant was held responsible where the money would have been lost even if he had strictly complied with the terms on which he held it. They show that a factual causal connection between breach and loss does not need to be shown to hold the fiduciary charged with a misapplied sum. Regrettably, neither of these cases nor any of the others discussed above was pressed upon the House of Lords in the *Target Holdings* case.

There are obvious similarities between *Target Holdings* and *Cocker v Quale* in particular. Both cases involved a wrongful payment and a subsequent event, the effect of which was to break the causal connection between the breach of trust and the

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[65]Ibid 220.

[66]*White v Baugh* (1835) 9 Bligh NS 181, 3 Cl & Fin 44, 65-66, 5 ER 1261, 6 ER 1354.

reparable loss suffered by the estate. Lord Browne-Wilkinson said in *Target Holdings* that there was no warrant for 'stopping the clock' and fixing the quantum of compensation payable as at the date on which the payment was made,[67] but in *Cocker v Quale* Leach MR rejected the argument that the husband's subsequent bankruptcy could relieve the trustees of their liability to replace the money. Leach MR's decision accords with the conventional understanding of the trustee's liability, which is to perform his trust on the basis of a true accounting. There is no question of stopping the clock because the claim to enforce this liability is not concerned with reparable loss. The only question is whether the fiduciary can establish his right to a discharge in respect of the item. Failing that he will remain charged and bound to perform down until the time of judgment.

(b) Remoteness of Loss

Bare factual causation is a necessary condition for recovery of an item of loss by a reparation claim but it is almost never considered to be a sufficient condition. By the doctrine of remoteness of loss the law excludes from recovery those causally-related consequences that occurred in an unexpected or unusual manner for which the wrongdoer should not be responsible. The criteria by which recoverable loss is cut back differ from wrong to wrong. The dominant criteria applicable in tort are variously whether the loss was of a foreseeable type, whether it is property attributed to an intervening cause, and whether it was the direct consequence of the defendant's wrongful act.[68]

Remoteness arguments have rarely been raised directly in cases involving misapplied trust property. Cottenham LC commented on the bearing of foreseeability on a custodial fiduciary's accountability for misapplied property in *Clough v Bond*.[69] The defendant in that case had given his co-administrator absolute control of a bank

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[67] *Target Holdings Ltd v Redferns* [1996] AC 421, 437.

[68] See further Chapter VIII Part 3.

[69] *Clough v Bond* (1838) 3 My & Cr 490, 40 ER 1016.

account containing £1, 348 belonging to the estate. This had not been necessary for the due administration of the estate. The co-administrator later withdrew the money and absconded. The Lord Chancellor said that 'the *devastavit* consisted in the improper deposit . . . the money lost was part of the estate which came into the hands of the [defendant], and from which nothing has taken place that can discharge him.'[70] The defendant complained that it was hard to hold him liable when he had acted honestly and the co-administrator's misappropriation had been wholly unexpected. Cottenham LC explained that a trustee or executor who makes an unauthorised investment or unnecessarily puts property in the control of another is responsible 'however unexpected the result, however little likely to arise from the course adopted, and however free such conduct may have been from any improper motive.'[71] Langdale MR made similar remarks in connection with unauthorised investments in *Fyler v Fyler*: 'The trustees having, without authority, procured and accepted in lieu of so much stock, an unauthorised but ample security for so much money, became responsible for any future loss traceable to that first error.'[72]

There is a well-known obiter dictum in the earlier case *Caffrey v Darby* to the same effect.[73] The trustees of a marriage settlement had sold trust property, a public house, to the husband taking security for his promise to pay the purchase price in annual instalments. The business did not prosper and the husband fell behind in his payments. Confident in their security, the trustees did not take possession of the property for fear of ruining the family. The husband became insolvent and absconded, at which time the trustees discovered that their security was invalid.[74] The trustees argued that the court decision pronouncing their security invalid was legally doubtful and therefore

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[70]Ibid 498.

[71]Ibid 496.

[72]*Fyler v Fyler* (1841) 3 Beav 550, 558, 49 ER 216, and see 567: the transaction 'being unauthorised and a subsequent loss (which would not have occurred but for the first deviation from the trust) having happened, the principals may be liable.'

[73]*Caffrey v Darby* (1805) 6 Ves Jun 488, 31 ER 1159.

[74]*Darby v Smith* (1798) 8 TR 82, 101 ER 1278.

unforeseeable. Grant MR did not think the decision was doubtful or unforeseeable, but commented on the position had it been so:

> . . . if they have been already guilty of negligence, they must be responsible for any loss in any way to that property: for whatever may be the immediate cause, the property would not have been in a situation to sustain that loss, if it had not been for their negligence. . . . If the loss had happened by fire, lightning, or any other accident, that would not be an excuse for them, if guilty of previous negligence.[75]

In order to understand this passage it is necessary to pay special attention to the character of the breach of trust in question. The breach consisted in selling the property to the husband without taking proper security for his promise to pay the purchase price. Grant MR's analysis is expressed in terms of negligence but he was not using that term in the technical sense in which we use it today. In reality the case was one in which the trustees had unwittingly made an unauthorised disposition of trust property by not taking good security for the husband's payment obligation. This is clear from the same judge's decision in *Wilkes v Steward* four years earlier, where he said that lending money on a personal security exceeds an executor's powers.[76] Grant MR's statement accords with the rule applicable in misapplication cases as it was later stated in *Clough v Bond* and *Fyler v Fyler*.[77]

Re Dawson is the leading modern case.[78] The analysis in this Australian first instance decision was adopted wholesale in the 13th edition of *Underhill and Hayton*,[79]

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[75] *Caffrey v Darby* (1805) 6 Ves Jun 488, 496, 31 ER 1159.

[76] *Wilkes v Steward* (1801) G Coop 6, 35 ER 457. The proposition also applies to private trustees.

[77] *Clough v Bond* (1838) 3 My & Cr 490, 496, 40 ER 1016; *Fyler v Fyler* (1841) 3 Beav 550, 49 ER 216. *Caffrey v Darby* was read as a misapplication case in *Re Dawson* [1966] 2 NSWR 211, 214.

[78] *Re Dawson* [1966] 2 NSWR 211.

[79] DJ Hayton, *Underhill's Law Relating to Trusts and Trustees* (13th edn, 1979) 702.

and has gone on from that to have a remarkably influential career.[80] One of the trustees and executors of a deceased estate in New Zealand conceived a scheme to use trust funds for his own business venture in Australia. In order to evade currency controls he entrusted an agent with NZ£4, 700 to be smuggled out of the country, but the agent absconded and the sum was lost. Placing the money in the agent's hands was an admitted breach of trust. The misconducting trustee was now dead, but his estate was ordered to pay the money back. One of the issues in the case arose out of the circumstances that the money taken had been New Zealand currency but that the case was being tried many years later in New South Wales and judgment had to be given in Australian currency. The relative values of New Zealand and Australian currency had changed dramatically in the intervening years and so it was a question whether for the purposes of giving judgment the currency should be converted according to values ruling at the date on which the money was misappropriated or at the date of judgment. The prevailing rule in contract and tort was that conversion should be effected according to values at the date on which the loss was suffered on the theory that losses owing to currency fluctuations are too remote.[81]

Street J's judgment is less interesting for his conclusion that conversion should take place according to values at the date of judgment than for his wider discussion of the principles applicable to a claim against a defaulting trustee. Though that discussion has been referred to in connection with all sorts of equitable liabilities to pay money, Street J himself began by restricting the discussion to cases in which a trustee has misapplied trust property. The obligation of a defaulting trustee, Street J said, 'is

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[80]Approved by Wilson J in the Supreme Court of Canada in *Guerin v The Queen* [1984] 2 SCR 335, 360-362 and by the House of Lords in *Target Holdings Ltd v Redferns* [1996] AC 421, 434; adopted wholesale in DJ Hayton, *Underhill and Hayton, Law Relating to Trusts and Trustees* (15th edn, 1995) 829-830 and in RP Meagher, WMC Gummow & JRF Lehane, *Equity, Doctrines and Remedies* (3rd edn, 1992) Ch 23 para 3.

[81]*SS Celia v SS Volturno* [1921] 2 AC 544 and *Di Ferdinando v Simon Smits & Co Ltd* [1920] 3 KB 409 (CA), which concerned awards of damages in tort and breach of contract respectively. The common law has been modified in England since *Re Dawson* was decided in *The Despina R* [1979] AC 685. Nor would the issue arise today in Australia because most the courts in most states now have the power to award judgment in a foreign currency: E Sykes & M Pryles, *Australian Private International Law* (3rd edn, 1991) 634, 642-643.

essentially one of effecting a restitution to the trust estate.'[82] This obligation 'is of a more absolute nature than the obligation to pay damages for tort or breach of contract.'[83] One feature of an obligation to effect restitution is that it is not, the judge said, 'to be limited by common law principles governing remoteness of damage'.[84] This proposition has since been affirmed by the House of Lords and in the English Court of Appeal.[85]

It has been said that the liability of a trustee who has dissipated the property is not contained by remoteness criteria because of 'special policy reasons for deterring trustees from carelessness or abuse of their position . . . in safeguarding the trust property'.[86] It is difficult to make sense of this policy for the trustee may be liable even though he acted altogether innocently, in which case a deterrent response would be disproportionate.[87] The true reason why the trustee's liability is not contained by remoteness criteria concerns the nature of the claim advanced, as Street J appears to have recognised, rather than any special policy.

(c) Market Fluctuations

The principles discussed in the last section find their most important application in circumstances where the trustee has exceeded his powers in dealing with the trust property and there has since been a significant change in the market value of the property wrongfully alienated or acquired.

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[82] *Re Dawson* [1966] 2 NSWR 211, 214.

[83] Ibid 216.

[84] Ibid 214.

[85] *Target Holdings Ltd v Redferns* [1996] AC 421, 434; *Swindle v Harrison* [1997] 4 All ER 705 (CA) 733. See also *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213, 244-245, aff'd [1999] 1 NZLR 664 (CA) 687.

[86] *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213, 245. See also *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534, 546-547 (McLachlin J) and *Target Holdings Ltd v Redferns* [1994] 1 WLR 1089 (CA) 1106.

[87] See further Chapter VII Part 3(c).

This is most readily demonstrated in cases where the trustee acquires for the trust property which he should not, whether in the form of an unauthorised investment or by selling his own property to the trust or otherwise. So long as he does not delay in asserting his rights, the beneficiary is entitled to choose between holding the trustee accountable for the purchase money or taking the exchange-product. Thus the trustee may be required to recoup the trust even though the only loss that has been suffered resulted from market movements which were unexpected and over which the trustee had no control. Nourse LJ has recently described the effect of the authorities concerning improper purchases in these terms:

> If the unauthorised investment depreciates in value, the trustee is automatically liable for the amount of loss incurred on its realisation. No question of foreseeability or remoteness, in particular foreseeability of the depreciation in value of the investment, arises, as it would at common law.[88]

The trustee must account for the purchase money. Unless and until the beneficiaries elect to take the unauthorised exchange-product it is accounted for as if the trustee purchased it with his own money and for his own benefit and so the effect of any decline in its value is for him to bear.

By contrast, *Re Chapman* demonstrates that a trustee who bona fide holds an investment on a falling market will not be responsible if the investment was of an authorised type and the market decline was unforeseeable.[89] That is because the beneficiary cannot disavow the investment and so his only pecuniary claim is one for reparation of loss, which claim is foreclosed by the fact that the loss was of an unforeseeable type.[90]

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[88]*Re Duckwari plc (No 2)* [1999] Ch 268 (CA) 272; *Re Duckwari (No 1)* [1999] Ch 253 (CA). Of the earlier authorities see especially *Clough v Bond* (1838) 3 My & Cr 490, 40 ER 1016 and *Hancom v Allen* (1774) 2 Dick 498, 21 ER 363.

[89]*Re Chapman* [1896] 2 Ch 763 (CA). Discussed in Chapter V Part 3.

[90]See further Chapter VIII Part 3.

(d) Summary

A beneficiary suing for an account and performance of the trustee's primary duties in respect of the property does not complain of a breach of trust and does not seek reparation of any loss he has suffered. The courts have noted on a number of occasions that the concept of reparable loss is altogether inapposite to this type of claim. It follows from this that a beneficiary demanding performance does not need to show a causal connection between the trustee's breach and any deterioration in his position or that of the fund. For allied reasons liability cannot be cut back by considerations of remoteness of loss. This does not mean that liability is unlimited, for the trustee can only be held responsible for the value of the property.

3. Discussion

Lord Browne-Wilkinson set out in *Target Holdings* to restate the law relating to compensation claims against trustees from first principles. The 'basic equitable principle applicable to breach of trust' on which he founded his conclusions was that the beneficiary, or the fund where reconstitution is appropriate, 'is entitled to be compensated for any loss he would not have suffered but for the breach.'[91] The corollary is that the beneficiary should not recover as compensation more than his causally-related loss. It is implicit in this that a beneficiary's only compensation claim against a trustee who has misapplied trust property is reparative in nature. Lord Browne-Wilkinson seems to have considered this idea to be self-evident and he did not offer any authority for his broad statement of principle which depends upon it.[92]

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[91] *Target Holdings Ltd v Redferns* [1996] AC 421, 436.

[92] He did refer to two authorities in support of his proposition that there must be a 'causal connection between the breach of trust and the loss to the trust estate for which compensation is recoverable', namely *Re Miller's Deed Trusts* (1978) 75 LSG 454 and *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA), and he later referred to *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534 in support of the same idea. Each of these was a case where on conventional principles the only claim open to the beneficiary was for reparation of loss and so none decisively favours Lord Browne-Wilkinson's analysis.

We have seen that critical contrary decisions were neither pressed on the House nor mentioned in Lord Browne-Wilkinson's speech. These contrary decisions form a coherent body of principle that admits of no notable exceptions until *Target Holdings* itself and that has been variously endorsed by well-known Lord Chancellors, strong divisions of the Court of Appeal as well as the House of Lords itself. These decisions cannot be made sense of if they are treated as having involved reparation claims and nor can certain other elementary features of the law governing trustees' liabilities. Amongst others, it becomes difficult to explain the significance of the distinction between authorised and unauthorised investments; those cases in which breach of trust does not need to be pleaded or proved; the incidence of strict liability; the principles governing when a trustee will be responsible for the misconduct of another; the nature of an administration claim and the role of the account;[93] and the applicable procedural rules, including the distinction between common accounts and accounts on the footing of wilful default.

To a common lawyer the expression compensation for breach of trust is what linguists call a false friend. It conjures up a cluster of familiar ideas at the heart of which is the notion that the governing claim is reparative in nature. As Strachan observed in connection with trustee liability for making unauthorised investments, however, damages or loss is not always the basis of compensation for breach of trust as it is in contract or tort.[94] The word compensation is sometimes used in this connection in a different sense to indicate a sum of money that stands in the place of an item of property and is measured by its value rather than the reparable loss a person has suffered. A custodial fiduciary who has misapplied property may be ordered to pay the monetary value of the property by way of substitutive performance of his primary obligation to apply the property according to the terms on which it was received. There are such elementary differences between this type of claim and a claim for damages at law that the attempt to bring the two together is misconceived. Claims for substitutive

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[93]Compare G Vos, 'Linking Chains of Causation: An Examination of New Approaches to Causation in Equity and the Common Law' [2001] CLJ 337, 344-345.

[94]W Strachan, 'Compensation for Breach of Trust' (1918) 34 LQR 168. See also PH Winfield, *The Province of the Law of Tort* (1932) 112.

performance of a trustee's obligation are not, however, in a class of their own. They share principles with other types of performance claim, such as the claim for specific performance of a contract with compensation.

If the criticisms levelled at the analysis in *Target Holdings* in this chapter are valid then a difficult question presents itself. The question asks how the case is to be reconciled to the law as it had developed up until that point. On the one hand we may treat *Target Holdings* as having radically reshaped the law of trustee personal liabilities. The effect of the decision will have been that henceforth the beneficiary of misapplied trust property is restricted to claiming either reparation if there has been a loss or profits if there has been a gain. *Target Holdings* would be taken to have closed the door on substitutive performance claims. This reading would have far-reaching implications for our understanding of the trust and its enforcement, for which reason it is unsurprising that subsequent courts have tended to confine the principle in *Target Holdings* within narrow bounds where misapplied trust or company property is involved.[95]

If that approach is thought to be too disruptive of settled principles than we may, on the other hand, try to reconcile *Target Holdings* with those principles. The question is how this should be done. The case is especially hard to square with the prior law because we do not have the benefit of a range of speeches addressing the issues in different ways. Critics of the decision in *Target Holdings* have approached the problem in two ways.

Millett (writing extra-judicially) and Birks contend that Lord Browne-Wilkinson's analysis rests upon the fundamental misconception that Target's claim was akin to a claim for damages at law.[96] Instead they say that the claim should have been understood as one for an account and payment of the balance and that in taking the

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[95] *Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712, [2001] 2 BCLC 531; *Allied Carpets Group plc v Nethercott* [2001] BCC 81; *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862; *McConnell v Boyd* [1997] OPLR 53.

[96] Sir Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 224-227; PBH Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 UWALR 1, 45.

account Target was entitled to falsify Redferns' early payments. But while they say the analysis was flawed, Millett and Birks contend that the result can be upheld on conventional principles because of the fact that Redferns did obtain the mortgage Target had sought. It is trite law that a defalcating trustee may rectify his account by restoring to the fund what he has taken out of it.[97] Millett explains that 'the trustee's obligation to restore the trust property is not an obligation to restore it in the very same form in which he disbursed it, but an obligation to restore it in any form authorised by the trust.'[98] Millett's contention is that Target had wanted a mortgage over the Birmingham properties and so it could not object when Redferns recouped the trust by obtaining this mortgage for it. This argument is cogent but there does not appear to be any authority one way or the other.[99] It seems open to question whether a trustee who misapplies £1.7 million can erase his personal liability by restoring an asset only worth, as it transpired, £500, 000, particularly where he has not obtained the beneficiary's specific authority to recoup the fund other than in money.

Oakley analyses the case somewhat differently.[100] He accepts that had Target's claim been for an account then Millett's critique would be valid. Oakley contends, however, that *Target Holdings* must be understood as a case in which the beneficiary sued for equitable compensation to be assessed without the taking of an account. On this view the principles stated by Lord Browne-Wilkinson only apply where no account is sought. Broadly-speaking, in the terms used in this thesis Oakley's position is that Target could not complain that it was required to make out causally-related loss because it had sued for reparation rather than substitutive performance. This argument is open to the objection that Lord Browne-Wilkinson did not mention any such restriction in his reasons but spoke as if those reasons were intended to cover the entire field. Nonetheless, the argument has the considerable attraction that it confines the broad principle stated in *Target Holdings* to those cases in which it has always applied,

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[97]See Chapter V Part 3.

[98]Sir Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 227.

[99]Compare *Solloway v McLaughlin* [1938] AC 247 (PC).

[100]AJ Oakley, *Parker and Mellows, The Modern Law of Trusts* (7th edn, 1998) 680-683.

namely cases involving a reparation claim.

Evaluation and the Way Forward

The argument has been that Lord Browne-Wilkinson's analysis in *Target Holdings* cannot be reconciled with the law as it had developed to that point though this may not be true of his result. If we step back from the law, however, and consider the case by the light of nature it is possible to sympathise with his Lordship's impulse. The intuitive objection to holding Redferns liable is that Target had not suffered a loss as a result of Redferns's breach of duty and nor had Redferns made any gain. The Court of Appeal's award effectively shifted the disastrous consequences of Target's lending decision onto a party who on the assumed facts had only played an incidental role in the course of events. The deterrent policy that Peter Gibson LJ appealed to in support of his conclusion seems capricious for,[101] as Lord Browne-Wilkinson observed, the same principles apply where a defendant breaches his trust wholly innocently.[102]

'It is well recognised', Nourse LJ observed in the *Duckwari* case, 'that the basis on which a trustee is liable to make good a misapplication of trust moneys is strict and sometimes harsh'.[103] It is nonetheless important not to overstate the law's severity for it is mitigated in three ways. The first is that trustees or executors uncertain of their duties or powers are entitled to apply to the court for directions and will be protected if they obey its order.[104] The second is that trustee investment powers have been dramatically enlarged over the past century so that it is now uncommon for trustees to overstep the bounds of their authority in the course of routine investment activity.[105] The third and most significant is that a trustee or executor may apply under section 61 of the Trustee Act 1925 to be relieved of personal liability where he has acted honestly and reasonably

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[101]Ibid 1106.

[102]*Target Holdings Ltd v Redferns* [1996] AC 421, 432.

[103]*Re Duckwari plc (No 1)* [1999] Ch 253, 265.

[104]*Re Londonderry's Settlement* [1964] 1 Ch 918 (CA); *Finers v Miro* [1991] 1 WLR 35 (CA).

[105]See Chapter V Part 3.

and ought fairly to be excused.[106] Where the statute applies it does not take effect by justifying a discharge but rather by authorising the court to relieve the trustee of the burden of paying the outstanding balance on his account or some portion of it. Lord Browne-Wilkinson's innocent trustee would fall within this provision and it is noteworthy that Redferns did not pretend to.

It is also important not to exaggerate the significance of the fact that Redferns's breach was not causative of Target's loss. There are a range of circumstances in which the law grants relief of greater value to the claimant than any loss he may have suffered through the defendant's wrong. A contracting party's title to specific performance does not depend on his having suffered loss or the defendant having acquired a gain, and specific performance will not be refused because the effect of the order is to confer a windfall on the claimant.[107] The law of rescission permits a similar result. If a seller induces a purchaser to buy shares on the basis of a misrepresentation and the purchaser sues for damages when he learns of his rights, the shares having declined in value in the interim by the play of ordinary market forces, the purchaser will not recover the loss he suffered by the market decline.[108] His damages will be restricted to the difference between the contract price and the true open market value of the shares as at the date of the purchase. The reason is that the subsequent market loss was not causally attributable to the seller's default but rather to the combination of the market decline and the purchaser's decision not to sell.[109] Unless a bar has arisen the purchaser may, however, rescind the sale contract and recover the purchase money. The fact that the shares have declined in value does not prevent the purchaser from making full restitutio

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[106]Similarly Companies Act 1985, s 727(1).

[107]Compare *Semelhago v Paramadevan* [1996] 2 SCR 415, discussed in Chapter II Part 2(b).

[108]*Waddell v Blockey* (1879) 4 QBD 678 (CA); *Cemp Properties (UK) v Dentsply Research Corporation* [1991] 2 EGLR 197 (CA). Where the misrepresentation was fraudulent there are exceptional circumstances in which the purchaser will be entitled to recover the loss he suffered in the market decline, such as where the misrepresentation also induced him to hold onto the shares or where by the nature of the transaction the purchaser was locked into holding them: *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254.

[109]*South Australia Asset Managment Corporation v York Montague Ltd* [1997] AC 191, 221.

in integrum, though he must not delay in asserting his rights.[110] The effect of rescission is to shift the market loss onto the seller even though it must be regarded as the causal consequence of the purchaser's decision to retain the shares rather than the seller's misrepresentation.[111] This loss does not correspond to any gain the seller has made and so rescission leaves him in a net financial position that is worse than the position he occupied before the sale.

It remains true in spite of the considerations advanced in the last two paragraphs that the availability of substitutive performance claims against custodial fiduciaries can produce hard results. Section 61 of the Trustee Act 1925 softens the law by authorising the court to cure hard results where the defendant has acted honestly and reasonably and ought fairly to be excused, but it is possible to think that the statute does not go far enough. The *Target Holdings* case raises the possibility that there may be defendants who cannot bring themselves within the statute, but whose misconduct has not been so egregious as to warrant liability disproportionately greater than the reparable loss suffered by the claimant. Parliament is unlikely to intervene and so it is necessary to ask whether the general law contains within itself the resources to mitigate its own occasionally harsh consequences.

A satisfactory solution may lie in the recognition of a discretionary hardship defence. A claimant's bid for specific performance of a contract may be defeated where the order would work hardship on the defendant that is not outweighed by the hardship the claimant would suffer in being confined to damages relief.[112] The argument has

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[110] *Armstrong v Jackson* [1917] 2 KB 822; *William Sindall plc v Cambridgeshire County Council* [1994] 1 WLR 1016 (CA) 1038; *JAD International Pty Ltd v International Trucks Australia Limited* (1994) 50 FCR 378 (FCA). McGregor contradicts this proposition in *McGregor on Damages* (16th edn, 1997) para 2021, arguing that *Armstrong v Jackson* is only authority in fiduciary relations cases, though the judge's words suggest that he did not intend to qualify the proposition in the text. McGregor cites no relevant authority for his position.

[111] The disjunction between the effect of damages and rescission was acknowledged and accepted in *Waddell v Blockey* (1879) 4 QBD 678 (CA).

[112] See especially *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1, 15, and Millett LJ's judgment in the Court of Appeal at [1996] Ch 286, 304-305. McCardie J seems to have accepted in *Armstrong v Jackson* [1917] 2 KB 822, 830 that hardship may also be a discretionary defence to a claim for rescission of a contract, but not where the defendant has been dishonest.

been that the type of claim which produces the results under considerations is akin to a claim for specific performance of a contract.[113] It is not unreasonable to expect that the courts should take a consistent approach to deciding in what circumstances performance relief may be sought and in what circumstances the claimant may only sue for reparation of whatever loss he has suffered. Where a beneficiary effectively seeks to shift losses owing to his own misjudgment onto his fiduciary and the fiduciary has not profited in the transaction, as happened in the *Target Holdings* case, there is a prima facie case of hardship, though proof that the fiduciary has acted dishonestly would generally deprive him of this defence.[114]

At one time equity judges took a high-minded view of their jurisdiction over trusts which precluded the development of discretionary defences. Langdale MR's remarks in *Palmer v Wakefield* illustrate an attitude that was not uncommon in the first half of the nineteenth century: 'In cases of breach of trust the law must be rigidly applied, however hard it may press in individual cases.'[115] As that century wore on, however, a feeling developed that this rigidity could work injustice. The predecessor to section 61 was eventually enacted to remedy what Lindley LJ described as 'a very hard state of the law, and one which shocked one's sense of humanity and of fairness'. The courts in some American states lacking comparable legislation have achieved a similar result by the application of equitable principles,[116] and this finds some support in the *Restatement of Trusts 2d*.[117] If rough edges survive the enactment of section 61 then Parliament's intervention should be seen as pointing the way forward rather than foreclosing further development. *Target Holdings Ltd v Redferns* may be properly viewed as the harbinger of this development.

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[113]See especially Chapter II Part 2.

[114]*Blake v Mowatt* (1856) 21 Beav 603, 613, 52 ER 933.

[115]*Palmer v Wakefield* (1840) 3 Beav 227, 49 ER 88; see also *Fyler v Fyler* (1841) 3 Beav 550, 49 ER 216 and *Barratt v Wyatt* (1862) 30 Beav 441, 54 ER 960.

[116]*Re Guthrie's Estate*, 320 Pa 530, 182 Atl 248 (1936); *Morrissey v Curran*, 650 F 2d 1267, 1275 n 7 (2d Cir, 1981). To similar effect see *Vyse v Foster* (1872) 8 Ch App 309, 336-337.

[117]American Law Institute, *Restatement of Trusts 2d* (1959) para 204, comment g.

REPARATION CLAIMS

AVAILABILITY OF REPARATION CLAIMS

CHAPTER VII

AVAILABILITY OF REPARATION CLAIMS

Chapter VII

The last three chapters were concerned with the performance claims that may be brought against a trustee with a view to obtaining pecuniary relief. This chapter and the next two are concerned with the other type of money claim that may be brought against a defaulting trustee, namely a reparation claim. These chapters aim to chart the availability and salient features of these claims as well as the relief they provoke.

The idea that a reparation claim may be made against a defaulting trustee is controversial. Traditional doctrine holds that damages cannot be given for a breach of trust.[1] This doctrine may appear to exclude the possibility of a reparation claim, for damages is the most familiar remedy sought by such a claim. The proposition that damages are available for breach of trust is said to entail a fusion fallacy.[2] This supposed fallacy consists in reasoning from the procedural fusion wrought by the Judicature reforms to the conclusion that the common law remedy of damages may now be given on the strength of equitable rights. This fallacy falls away if it can be shown that a remedy equity has always given against defaulting trustees has the analytic characteristics of damages.[3]

The first part of this chapter shows that equity does allow reparation claims against defaulting trustees. Although equity has not traditionally given damages by that name, it has since the late seventeenth century at least allowed claims to surcharge a

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[1] *Corporation of Ludlow v Greenhouse* (1827) 1 Bligh (NS) 18, 57-58; *Leeds Industrial Co-operative Society v Slack* [1924] AC 851, 868; *Metall und Rohstoff AG v Donaldson Lufkin & Jenrette Inc* [1990] 1 QB 391 (CA) 473; *Ex p Adamson* (1878) 8 ChD 807 (CA) 819.

[2] J Martin, 'Fusion, Fallacy and Confusion: A Comparative Study' [1994] Conv 13, 15-22; RP Meagher, WMC Gummow & JRF Lehane, *Equity: Doctrines and Remedies* (3rd edn, 1992) Ch 2 para 20 & Ch 23 para 1; DJ Hayton, *Underhill and Hayton, Law Relating to Trusts and Trustees* (15th edn, 1995) 826-827.

[3] See Chapter III Part 4.

trustee's account on the basis of wilful default. Surcharging on this basis is one of equity's equivalents to a damages claim at law for in essence the surcharging party's claim is for reparation of loss attributable to the defendant's breach of duty. The term wilful default has give particular trouble. The argument will be that it is used in this connection interchangeably with breach of trust. The second part examines the relationship between reparation and performance claims in circumstances of potential overlap. The argument will be that the claims are cumulative subject to the principle of full satisfaction.

1. Surcharge on the Footing of Wilful Default

At one time a beneficiary wishing to hold his trustee financially responsible for the consequences of having mismanaged the fund could only do so by suing for an account. We have seen in earlier chapters that unlawful payments would be falsified in the account and so the trustee would stand charged with any property he had misapplied. In appropriate circumstances a trustee could also be surcharged with sums he had never actually received. The basis of these latter charges came in the seventeenth century to be known as wilful default.[4] Surcharges founded upon an allegation of wilful default must be distinguished from surcharges founded upon an allegation that the defendant has actually received more than he admits. This chapter is not concerned with surcharges of this latter variety.[5]

Palmer v Jones is one of the earliest reported cases discussing the circumstances in which trustees could be surcharged on the footing of wilful default.[6] It sets the stage for later developments. Dr Jones was trustee of land which he had covenanted to let out. He neglected to let the land for eight years, 'all things being left to a shepherd'. Palmer, the beneficiary, sued for an account, and Lord Nottingham ordered Dr Jones to

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[4]DEC Yale, *Lord Nottingham's Chancery Cases* (1961) Vol 2, 141.

[5]These surcharges were treated in Chapter IV Part 2(c).

[6]*Palmer v Jones* (1683) 1 Vern 144, 23 ER 376; (1678) 79 SS 649. See also *Hays v Zouch* (1675) 73 SS 162.

account for what he might have received without his wilful default. The case was reheard before North LK, who thought the decree was severe and 'declared he would never charge a trustee with imaginary values; but that he should be charged as a bailiff only.' Counsel for Palmer pressed on the Lord Keeper the practice of the court of charging a trustee with what might have been made without his wilful default (indeed, bailiffs were also subject to these charges).[7] North LK accepted that was the practice, but said that while 'very supine negligence might in some cases charge a trustee with more than he had received . . . the proof must be very strong.' The reason given was that the Lord Keeper 'thought it a great hardship, that a trustee was allowed nothing for his labour and pains.' The proceeding was aborted by a settlement between the parties.

The difference between Lord Nottingham and North LK in *Palmer v Jones* concerned the application of the law to the facts of the case.[8] There does not appear to have been any disagreement as to the nature or basis of the beneficiary's claim. Formally the claim was to charge the defendant in his account. In addition to being chargeable with property he had actually received, a trustee was liable to be surcharged with property he might have received. The basis on which a trustee would be surcharged with foregone receipts was wilful default.

The following sections consider first the basis of a surcharge claim and then the nature of such a claim in greater depth. The purpose of the discussion is to show that the conceptual and procedural complexities in this branch of the law belie the fact that the claims in question are for the reparation of loss occasioned by a breach of trust.

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[7]As regards bailiffs, see E Coke, *Commentary Upon Littleton* (1628) section 172a; H Rolle, *Un Abridgment des Plusieurs Cases et Resolutions del Common Law* (1668) Vol 1, 125 & 126; C Viner, *A General Abridgement of Law and Equity* (2nd edn, 1791) Vol 1, 162; *Barton v Sadock* (1609) 1 Buls 103, Yelv 202, 80 ER 800 & 133; *Wheeler v Horne* (1740) Willes 208, 210, 125 ER 113; *Knight v Lord Plymouth* (1747) 3 Atk 480, 26 ER 1076.

[8]DEC Yale (ed), *Lord Nottingham's 'Manual of Chancery Practice' and 'Prolegomena of Chancery and Equity'* (1965) 165-167, 196; DEC Yale, *Lord Nottingham's Chancery Cases* (1961) Vol 2, 142; contra J Getzler, 'The Trustee's Duty of Care' in PBH Birks & A Pretto, *Breach of Trust* (forthcoming 2002).

(a) Basis of a Surcharge Claim

From the seventeenth century onwards the basis of a trustee's liability to be surcharged beyond his actual receipts was wilful default. Wilful default is a contraction or variant of wilful neglect and default, which is also sometimes used. This section is concerned to identify the class of acts or omissions that may constitute wilful default.

The term wilful default suggests a standard of fault. It is semantically ambivalent and has been used to indicate a different standard in different branches of the law. It is sometimes used to mean deliberate misconduct,[9] and at other times the word wilful is used to mean only that the person 'is a free agent, and that what has been done arises from the spontaneous action of his will.'[10] Neither use is semantically inapt for the word wilful carries more than one meaning,[11] though most users of the language probably find the first use more natural in connection with the word default. It seems likely that the term wilful default was originally fixed upon in cases involving trustees to indicate fairly egregious fault, and even then the claimant in *Palmer v Jones* conceded that it was generally thought to be too demanding. In another case from the same period the term was used to indicate fraud,[12] but it is clear from *Palmer v Jones* that bad faith or dishonesty did not need to be shown to charge a trustee beyond his actual receipts.[13]

While wilful default remained the touchstone of a trustee's liability to be charged beyond his actual receipts right up until modern times, the standard which it

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[9]Most notably *Lewis v Great Western Railway* (1877) 3 QBD 195; *Re City Equitable Fire Insurance Company* [1925] Ch 407 (CA) 430-441; *Re Vickery* [1931] 1 Ch 572, 583.

[10]*Re Young and Harston's Contract* (1885) 31 ChD 168 (CA) 175, but compare Hannen MR at 173.

[11]Compare senses 4a and 5 of 'wilful' in JA Simpson & ESC Weiner, *The Oxford English Dictionary* (2nd edn, 1989) Vol 20, 339.

[12]*Davis v Drew* (1676) 73 SS 434, 435. See also DEC Yale (ed), *Lord Nottingham's 'Manual of Chancery Practice' and 'Prolegomena of Chancery and Equity'* (1965) 167, 'wilful neglect in the managing'.

[13]The reported cases suggest that the rule applicable to mortgagees in possession hovered in the same region: compare *Anonymous* (1682) 1 Vern 45, 23 ER 298 with *Anonymous* (1675) 1 Ch Cas 258, 22 ER 789.

marks has fluctuated with changing ideas about the scope of trustee responsibilities.[14] Fraud and deliberate misconduct have always been understood to fall within the term,[15] but from sometime in the late eighteenth century onwards its use was enlarged to embrace less turpitudinous misconduct. The word wilful may suggest that the defendant must have been aware that his act constituted a breach of duty, but by the beginning of the nineteenth century at the latest this was not required.[16]

In the course of the nineteenth century various trustee duties were collectively rationalised as emanations of a general duty of care that trustees owe in administering their trust. A failure to meet the applicable standard of care constituted wilful default. *Re Chapman* concerned a failure by the trustees to realise an authorised mortgage investment on a falling market.[17] Lindley LJ said this:

> Trustees acting honestly, with ordinary prudence and within the limits of their trust, are not liable for mere errors of judgment . . . To throw on the trustees the loss sustained by the fall in value of securities authorised by the trust, wilful default, which includes want of ordinary prudence on the part of the trustees, must be proved.[18]

Lopes LJ said in the same case that:

> The trustees might have brought an action on the covenants, they might have exercised the powers of sale contained in the mortgage deeds, or they might have foreclosed; and if any of these remedies could be shown to have been imprudently neglected by the trustees, and thereby loss to the estate caused, they would be liable for wilful default.[19]

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[14]DEC Yale, *Lord Nottingham's Chancery Cases* (1961) Vol 2, 142-143.

[15]For example *Knight v Lord Plymouth* (1747) 3 Atk 480, 26 ER 1076 and *Smith v Armitage* (1883) 24 ChD 727, 729.

[16]*Walker v Symonds* (1818) 3 Swan 1, 69, 36 ER 751.

[17]*Re Chapman* [1896] 2 Ch 763 (CA). See also G Jones 'Delegation by Trustees: A Reappraisal' (1959) 22 Modern LR 381, 385.

[18]*Re Chapman* [1896] 2 Ch 763 (CA) 776.

[19]Ibid 779-780.

In the event the Lord Justices concluded that the trustees had acted with sufficient care. *Speight v Gaunt* is one of the leading cases defining the standard of care a trustee must meet.[20] The question in that case was whether the trustee Gaunt should be liable where the property was stolen by a dishonest broker with whom Gaunt had deposited it. It is clear from Selborne LC's speech in the House of Lords that the question whether Gaunt had acted with due care in selecting and monitoring the broker was also the question whether he was guilty of wilful default.[21] The Court of Appeal recently confirmed in *Armitage v Nurse* that wilful default used in this connection encompasses want of due skill and care.[22]

The cases discussed in the preceding two paragraphs illustrate the reach of the concept but none of them contains a positive definition. Difficulty in positively defining wilful default is in one sense endemic to the subject-matter. Jessel MR remarked in *Re Owens* that 'There is no case which exactly defines what wilful neglect is in executors, any more than there is any case which defines what negligence is at law. You must have regard to all the circumstances of the case.'[23] *Re Owens* itself involved a claim by the residual beneficiaries under a will against the executors for having failed to take sufficiently vigorous steps to collect a debt owing to the estate. But while it would be impossible to enumerate all of the acts or omissions that may amount to wilful default, definition is possible at a higher level of abstraction. The speeches of the other Lord Justices in *Re Owens* are illuminating. Brett LJ said this:

> I think that those who first enunciated the doctrine of wilful neglect or default intended, by using the word "wilful," to show that they did not mean to say the mere omission to do a thing was a neglect or default which would make executors personally liable. What they meant to say was, that it must be a wrongful neglect or a wrongful default; that is to say, they deduced the

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[20] *Speight v Gaunt* (1883) 9 App Cas 1, aff'g (1882) 22 ChD 727 (CA). The trustee's duty of care is discussed in Chapter II Part 1(c)(i). For further analysis of its historical development see J Getzler, 'The Trustee's Duty of Care' in PBH Birks & A Pretto, *Breach of Trust* (forthcoming 2002).

[21] *Speight v Gaunt* (1883) 9 App Cas 1, 14.

[22] *Armitage v Nurse* [1998] Ch 241 (CA) 252; see also *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 546.

[23] *Re Owens* (1882) 47 LT 61 (CA) 63.

> proposition as if the word "negligence" or "wrongful"[24] had been used. If that be the true meaning of it, in order to decide whether a person has been negligent you must first of all consider what is the duty with regard to which he was not to be negligent.[25]

Cotton LJ advanced a positive definition:

> If they knowingly do that which it is their duty not to do, or omit to do that which it is their duty to do, that is wilful neglect or default; that is, knowingly doing what they ought not to do, or knowingly omitting to do what they ought to do.[26]

Consistently with this definition, Cotton LJ immediately asked 'What is their duty?' It appears that when Cotton LJ said the defendants must have acted or omitted to act knowingly he only meant that they must have been free agents. This is clear from his earlier qualification that 'it is not necessary to show that the executors intended to neglect anything which they recognised as their duty.'[27]

These passages from *Re Owens* indicate that a trustee will be guilty of wilful default if he has been guilty of breaching a duty imposed by his office. This was Stannard's conclusion: '. . . it is not really possible to express a single test of what will amount to "wilful default" by a party liable to account. All that can be said is that they have a number of duties to perform, failure to discharge which will make them liable for "wilful default."'[28] Stannard then gave a number of examples of duties that may be owed, and went on to conclude that '"Wilful default" is simply failure to carry out one of these many duties. As such like "negligence" it is a purely relative term and means no more than simply "default".[29] The duty breached may be prescriptive or proscriptive. It may be imposed by the general law or by statute or by a term in the trust instrument,

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[24]"Wrongful dismissal" in the original text, which appears to be a typographic error.

[25]*Re Owens* (1882) 47 LT 61 (CA) 63.

[26]Ibid 64.

[27]Ibid.

[28]JH Stannard, 'Wilful Default' [1979] Conv 345, 348.

[29]Ibid.

as the covenant to let the land in *Palmer v Jones* presumably was. What the duties of a particular fiduciary are depends upon his individual mandate.

It follows that wilful default does not itself describe a standard of fault when it is used to identify the basis of a trustee's liability to be charged beyond his receipts.[30] It is rather a compendious marker for the breach of a range of duties, many of which can be breached without any intention to do so. This is not a natural application of the term wilful default for that term does suggest fault. For this reason it has been said that wilful default is used in a technical sense in connection with accounts in equity.[31] Perhaps the reason wilful default largely fell out of use during the twentieth century was that it is semantically inapt for its allotted purpose. Wilful default is today only used in relation to a particular form of account proceeding which will be discussed in the next section.

It should be clear that wilful default and breach of trust are co-extensive concepts in this branch of the law. They were used more or less interchangeably before the twentieth century, and once wilful default fell into disuse breach of trust occupied the field entirely. The term breach of trust, however, is intrinsically no better suited to identifying the basis of a trustee's liability to be charged beyond his receipts than wilful default was. The reason is that it suggests disloyalty, and before the nineteenth century that is how it was sometimes understood. *Harden v Parsons*, for example, raised the question whether a trustee should be responsible where he loaned trust money on a personal security and the debtor became insolvent.[32] Lending on a personal security is obviously unwise, but Northington LK did not think it was sufficiently foolish to amount to a breach of duty. He said this:

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[30]By contrast, controversial authorities held that the use of wilful default in section 30(1) of the Trustee Act 1925 required deliberate misconduct: *Re Vickery* [1931] 1 Ch 38; *Armitage v Nurse* [1998] Ch 241 (CA) 252. This provision was abolished by the Trustee Act 2000.

[31]*Leeds City Brewery v Platts* [1925] Ch 532, 533.

[32]*Harden v Parsons* (1758) 1 Eden 144, 28 ER 639. The ruling was criticised by Lord Eldon in *Walker v Symons* (1818) 3 Swans 1, 63, 36 ER 751, describing the case as 'a curious document in the history of trusts'.

> No man can require, or with reason expect a trustee to manage his property with the same care and discretion that he would his own. Therefore the true touchstone by which such cases are to be tried is, whether the trustee has been guilty of a breach of trust or not. If he has been guilty of a gross negligence, it is as bad in its consequences as fraud, and is a breach of trust.[33]

Here we find an echo of the earlier idea that a trust is a gratuitous personal and confidential relation rather than a managerial relation. By the nineteenth century the requisite standard of care had been tightened and lending on a personal security had been strictly forbidden.[34] We now use breach of trust as a term of art meaning 'a violation by the trustee of any duty which as trustee he owes to the beneficiary',[35] but the usage in *Harden v Parsons* fits better with the ordinary meaning of the words.

The conclusion is that whether it is called wilful default or breach of trust or by any other name, the basis of a trustee's liability to be surcharged beyond his actual receipts is that he has breached a duty he owes by virtue of his office. There is no additional requirement that he has acted deliberately, or contrary to the interests of the beneficiaries, or grossly negligently. What a particular fiduciary's duties are is a question that always requires further investigation.

(b) Nature of a Surcharge Claim

The purpose of this section is to consider the nature of a surcharge claim on the basis of what is now called breach of trust. The argument will be that these are essentially claims calling on the defendant to make pecuniary reparation for loss occasioned by his misconduct. Treatment of this topic will be framed by a discussion of the forms of proceeding by which surcharge and contrasting claims are conventionally prosecuted. An incidental argument will be made that a form of proceeding still known as an

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[33] *Harden v Parsons* (1758) 1 Eden 144, 148, 28 ER 639.

[34] *Adye v Feuilletau* (1783) 1 Cox 24, 29 ER 1045; *Wilkes v Steward* (1801) G Coop 6, 35 ER 457. In the latter case lending on a personal bond was said to be outside of a trustee's powers.

[35] This is the definition given in the American Law Institute's *Restatement of Trusts 2d* (1959) para 201. See the discussion in *Tito v Waddell (No 2)* [1977] Ch 106, 247-248 and Chapter II Part 1(c)(iii).

account on the footing of wilful default has outlived its usefulness and should be abolished.

By the time of Lord Eldon's chancellorship at the end of the eighteenth century a major distinction had been established between two types of general accounting to which trustees and executors might by subjected in the course of administration.[36] These are a common account and an account on the footing of wilful default. Common accounts are accounts of items the trustee has received and of what has become of them. A wilful default account is a larger enquiry that covers the same ground as a common account but in which the trustee's account may also be surcharged with items he would have received but for his wilful default. Furthermore, it had become possible in the course of administration to bring a bill alleging a discrete breach of trust and praying for a declaration of liability and whatever inquiries and accounts were necessary to ascertain the sum with which the defendant should stand surcharged in respect of that individual breach. This type of proceeding may be understood as a restricted form of wilful default accounting. Broadly-speaking these remain the three procedural channels by which a trustee can be made to answer for maladministration, though as a consequence of the Judicature reforms each may now be invoked without committing the trust to administration under the direction of the court.[37]

The distinction between 'the usual administration order' for common accounts and 'an order founded on breach of trust' was said by Lord Macnaghten in *Dowse v Gorton* to be one of elementary principles.[38] As such the distinction survived the Judicature reforms and comes down into the present law. The different principles underlying these two types of order were explained by Kindersley V-C in *Partington v Reynolds*:

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[36]*Coope v Carter* (1852) 2 De G M & G 292, 297, 42 ER 884. DEC Yale (ed), *Lord Nottingham's 'Manual of Chancery Practice' and 'Prolegomena of Chancery and Equity'* (1965) 196 and Hardwicke LC's words in *Bulstrode v Bradley* (1747) 3 Atk 582, 26 ER 1136 suggest that these two types of accounting had not yet been separated in the middle of the eighteenth century.

[37]See Chapter IV Part 1(b).

[38]*Dowse v Gorton* [1891] AC 190, 202.

> There are two different modes of accounting . . . and accordingly there are two different forms of decree in use to compel [a fiduciary] to account. The one is a decree compelling him to account only for what he has received . . . the other is a decree compelling him to account, not only for what he has received, but also for what he might, without his wilful neglect or default, have received, although he has not received it. . . . They proceed on totally distinct grounds. *The one supposes no misconduct; the other is entirely grounded on misconduct.*[39]

The Vice-Chancellor referred to *Hodson v Ball*, in which Lyndhurst LC spoke to similar effect. He said that an account on the footing of wilful default is of 'quite a different nature and character [from a common account], founded on the wrongful conduct of the parties, calling upon them to account . . . for what they might have received had it not been for their wrongful default.'[40]

The three procedural channels by which a trustee may be held answerable for maladministration will be treated in turn. These are common account proceedings (mentioned here for the purposes of contrast only), surcharge proceedings in respect of discrete breaches of trust, and proceedings for a wilful default account. The object is to draw out the nature of the claims embedded in these channels as well as the contrasts between them.

i. Common Accounts

The principles governing common accounts have been treated in Chapters IV through VI.[41] In order to obtain this order the beneficiary only needs to prove the fiduciary relation. Breach of trust is not a precondition of the beneficiary's right to the account and the beneficiary may not allege breach of trust when the account is taken. The fact that positive allegations of breach of trust cannot be made in the course of taking a common account does not, however, mean that the accounting cannot end adversely to

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[39] *Partington v Reynolds* (1858) 4 Drew 253, 255-256, 62 ER 98 (italics supplied).

[40] *Hodson v Ball* (1842) 12 LJ Ch 80, 81.

[41] See in particular Chapter IV Part 2(b) & (c).

the accounting party. The *Ahmed Angullia* case has been mentioned in Chapter IV.[42] Recall that the common accounts of an executor had been taken and certain payments had been disallowed.[43] The executor objected to these disallowances on the basis that breach of trust had not been pleaded. Although the executor's appeal was allowed for other reasons, Lord Romer did not accede to this particular objection:

> In taking the account the appellant could not, of course, be charged with damages occasioned to the estate by a breach of trust. But it was incumbent upon him to justify his payments, and those he could not justify would necessarily have been disallowed.[44]

This case and others show that the claim prosecuted by means of a common account is not founded upon misconduct. Moreover, as was explained in Chapter VI, the claim is not concerned with reparable loss. The object of the accounting is simply to ascertain the property which the defendant is considered to hold in a fiduciary capacity with a view to the execution of the trust.

ii. Discrete Surcharge Claims

If a beneficiary wishes to charge his fiduciary with what Lord Romer called damages then the defendant's misconduct is an essential element of the claim. For this reason the beneficiary must plead and prove the breach of trust and he must make out a prima facie case of causally-related loss. If he succeeds in proving breach and prima facie loss at the hearing then he will typically be granted a declaration of breach of trust as well as an order directing whatever inquiries and accounts are necessary to quantify the sum with which the defendant will stand surcharged.[45]

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[42]See Chapter IV Part 2(c).

[43]*Ahmed Angullia bin Hadjee Mohamed Salleh Angullia v Estate and Trust Agencies (1927) Ltd* [1938] AC 624 (PC).

[44]Ibid 637.

[45]No inquiry will be directed if there is proof of breach but it appears no loss has been suffered: *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1276 & 1283.

The proposition that a claimant wishing to charge his fiduciary beyond his receipts must prove breach of trust formed the basis of the Court of Appeal's decision in *Re Stevens*.[46] Legatees sued executors alleging wilful default for, amongst other things, their seven year delay in taking probate. The estate had owed a bank money at 5% interest, a portion of which had been secured by a life insurance policy earning interest at only 1%. The insurance company could not pay the policy money to the bank until the executors took probate. Before probate the estate was therefore unnecessarily paying the difference of 4% interest on the secured portion of the debt. The legatees contended that the executors were chargeable with this sum on the basis of wilful default. At first instance North J accepted that delay in taking probate was an act of wilful default but dismissed the claim, saying 'The damage is too remote.'[47] The Court of Appeal upheld North J's order but for the anterior reason that the executors had not been under a duty to discharge the debt to the bank even though failing to do so might entail a loss to the estate. In the course of his reasons Lindley MR said this:

> A wrongful payment is one thing, and can be set right by disallowing it when the executor brings in his account. But if it is sought to charge him with loss attributable to some other breach of duty, call it wilful default or by any other name, such breach of duty must be proved . . . In the present case no evidence of any such breach of duty has been given, and the attempt to charge the executors with more than they have received has failed.[48]

This passage expresses the law with characteristic precision and insight. The Master of the Rolls confirmed that the claimant must prove the alleged breach, and he also recognised two further points essential to the structure of surcharge claims. The first is that the relief sought by a claim founded on breach of duty is a charge against the trustee. The second is that this charge is imposed in respect of loss attributable to the breach of duty. These two points will be considered in turn.

The proposition that the relief sought by a breach of trust claim is a charge

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[46] *Re Stevens* [1898] 1 Ch 162 (CA).

[47] *Re Stevens* [1897] 1 Ch 422, 433-434.

[48] *Re Stevens* [1898] 1 Ch 160 (CA) 170.

against the defendant in his account encapsulates part of the truth in the traditional doctrine that damages may not be given for a breach of trust. Damages consist in a money award payable to a successful claimant, but in trusts cases the claimant beneficiary may have no immediate right to payment of the sum because the trusts are still on foot. His only right is to surcharge the defendant's account and then insist that the sum be applied for the purposes of the trust so that it is available when and if his interest falls into possession.[49] The money may need to be invested or paid over to new trustees or put into the control of the court, to give three examples, and to do this the trustee will have to reach into his own pocket.[50] The important point is that whatever the trustee is made to do with the money is consequential: in principle the breach of trust is remedied when the defendant's account is surcharged.

The same holds true in principle even where the beneficial interests (or some of them) have fallen into possession so that the court may immediately go on to direct distribution of the portions.[51] One reason why it is worth insisting that relief is given in two stages is that the charged sum may need to be apportioned amongst the beneficial interests before the balance can be distributed. Another reason is that the balance the trustee must pay may be reduced where he has properly incurred expenses or liabilities for the benefit of the trust. Although a trustee may ultimately sue his beneficiary on his personal right of indemnity for expenses and liabilities, his primary right is to indemnify himself directly out of the fund before he distributes it.[52] That more secure right and its supporting lien will be lost if the trustee is made to pay the beneficiary without first balancing the account. This matters where the estate's liabilities exceed the value of the remaining assets.

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[49]See *Target Holdings Ltd v Redferns* [1996] AC 421, 434.

[50]See Chapter IV Part 2(e).

[51]*Elder's Trustee and Executor Company Limited v Higgins* (1963) 113 CLR 426, 447-448. Lord Browne-Wilkinson's proposition in *Target Holdings Ltd v Redferns* [1996] AC 421, 435 that where the beneficial interests have fallen into possession there may be no need to reconstitute the fund is properly understood as a point about the scope of the trustee's duty: see Chapter VIII Part 4.

[52]Trustee Act 2000 s 31(1). *Ex p James* (1832) 1 Deac & Ch 272; *Re Chennell* (1878) 8 ChD 492 (CA) 503; *Jennings v Mather* [1901] 1 QB 108, 113-114. See J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 21 paras 26 & 37.

The second point Lindley MR recognised in the statement excerpted above is that where breach of trust is made out the surcharge is imposed in respect of loss attributable to the breach of duty. The beneficiary ordinarily carries the burden of proving causally-related loss.[53] The need to prove a causal relation between breach and alleged loss applies irrespective of the defendant's level of fault and so in *Collins v Brebner* recovery was denied where no causal connection was made out even though the trustee had acted fraudulently.[54] A number of issues bearing on the proof and calculation of recoverable loss are discussed in Chapter VIII. Only one aspect of this topic will be treated here. This is the misconception that a surcharge on the basis of wilful default is a charge in respect of foregone receipts rather than losses. For the purposes of this discussion the old term wilful default will be used because this particular misconception is associated with it.

Surcharging a trustee on the basis of wilful default, whether discretely or in the course of a general wilful default accounting, is sometimes said to involve charging him with what he ought to have received. This idea is reflected in the technical language of the order directing the general accounting, which requires that the trustee account for property received by him as well as property 'which might without his wilful neglect or default have been so possessed or received'.[55] This has occasionally been taken to mean that the only type of item with which a trustee may be charged in wilful default proceedings is what may be called a failed receipt.[56] The failed receipt theory has an air of plausibility but is fundamentally mistaken. The governing concept is that of compensation for loss including loss consisting in foregone profits.[57] In its nature an account consists of an offsetting series of receipts and payments. In order to bring

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[53]For example *Re Miller's Trust Deeds* [1978] LS Gazette 454.

[54]*Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA).

[55]*Atkin's Court Forms* (2nd edn, 2000 reissue) Vol 41, para 122.

[56]See for example *Armitage v Nurse* [1998] Ch 241 (CA) 252; *Re Stevens* [1898] 1 ChD 160 (CA) per Chitty LJ at 172 and Vaughan Williams LJ at 175, but compare Lindley MR at 170 who seems to doubt the failed receipt theory.

[57]*Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1283.

losses due to maladministration into this conceptual *schema* these losses must be translated into accounting items. This is done by charging the defendant on the debit side of his ledger with sums beyond his actual receipts. The accountable party is charged in the amount of the loss *as if he had received more*.[58] This is simply an accounting technique. It is a mistake to infer from the fact that the loss is accounted for as if it had been a receipt that the surcharge represents a receipt that never materialised.

The failed receipt theory appears to arise from the fact that two historically dominant categories of wilful default surcharge do in some sense result in the accountable party not receiving an item of property. The first includes failures to make the fund optimally productive. The trustee might not invest the money,[59] or not let the land,[60] or let it at an undervalue,[61] or accept interest at a lower rate than the purchaser was bound to pay.[62] The result is that the trustee does not receive foregone income. While foregone profits may be analysed as property the trustee has failed to receive, they may equally be analysed as loss suffered by the fund that the trustee must make good. When a trustee neglects to collect rents or to invest money he puts the fund in a worse position than it would have occupied had he done his duty. Cotton LJ expressly recognised in *Noyes v Pollock* that a wilful default surcharge for foregone rents is imposed in respect of loss suffered.[63]

The second historically dominant category of wilful default surcharge includes neglect to realise wasting assets or to get in the estate. The most familiar example is a

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[58]Compare the apt language used in CPR PD40-004: '. . . the amount which it is contended that the accounting party should be treated as having received in addition to the amount he actually received . . .'

[59]*Hall v Hallett* (1784) 1 Cox 134, 137-138, 29 ER 1096.

[60]*Noyes v Pollock* (1886) 32 ChD 53 (CA) 61.

[61]Ibid.

[62]*Re Symons* (1882) 21 ChD 757, 760.

[63]*Noyes v Pollock* (1886) 32 ChD 53 (CA) 63.

trustee, or more frequently an executor, neglecting to collect a recoverable debt.[64] He does not receive the money. The idea of failed receipt only applies superficially to this central example. The reality is that the fiduciary has already received the asset, which is a chose-in-action against the debtor, but that he neglects to convert it into money by not collecting the debt. For this reason Porter MR defined wilful default in the testamentary context as 'an improper failure to realize assets' rather than a failed receipt.[65] North J plainly recognised in *Re Brogden* that the thrust of the beneficiaries' claims in cases of this sort is to have the trustee make good losses occasioned by his neglect.[66]

There is another category of wilful default surcharge in which the failed receipt theory has no purchase at all. If a trustee negligently invests funds on an authorised security then he was traditionally said to be liable on the basis of wilful default for any attributable loss.[67] It might be thought that the failure of receipt arises at the point at which the security is finally sold, for at that time less is received than might have been. This proposition is inconsistent, however, with *Re Salmon*.[68] The Court of Appeal held in that case that where a former trustee has made an authorised but imprudent investment the beneficiaries must accept the investment and sue him for the shortfall. At no point has the former trustee 'failed to receive' anything, for he was no longer authorised to receive trust property at the time when the security was realised by his successor trustees.

The theory is similarly unhelpful in cases involving trustee liability for the default of others. A trustee is not ordinarily charged with property received by a co-trustee, but if he foolishly stands by and allows his co-trustee to misapply that property or otherwise breach his trust then the defendant trustee may be charged with the loss on

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[64] *Blount v O'Connor* (1886) 17 LR Ir 620.

[65] Ibid 629.

[66] *Re Brogden* (1888) 38 ChD 536, 557.

[67] *Re Chapman* [1896] 2 Ch 763 (CA); *Rawsthorne v Rowley* [1909] 1 Ch 409n (CA).

[68] *Re Salmon* (1889) 42 ChD 351 (CA).

the basis of wilful default.[69] The same rule applies where the trustee deposits funds with a bank or agent. Once it has been shown that he acted properly in allowing the bank or agent to take possession of the property, he will only be responsible if wilful default can be made out.[70] Wilful default in these circumstances usually consists in a neglect to safeguard the fund by monitoring the other.[71] Selborne LC articulated claims of this sort in terms of loss caused by wilful default in *Re Brier*.[72]

The conclusion must be that the failed receipts theory is misconceived. A surcharge claim on the basis of what used to be called wilful default is not a claim to charge the trustee with what he ought to have received; rather, it is a claim to charge him as if he had received more. The governing concept is reparation of loss, and a beneficiary seeking to surcharge his trustee with losses owing to his breach of trust does not face the additional hurdle of showing that the breach resulted in the defendant not receiving some item of property he otherwise would have.

iii. Wilful Default Accounts

Although the term breach of trust has now largely displaced wilful default, wilful default is still used in connection with a form of general accounting. By an order for wilful default accounts the master is granted a roving commission to inquire into all aspects of the fiduciary's administration.[73] This is an exceptional example of an English

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[69] *Blakely v Blakely* (1855) 1 Jur (NS) 368. See Lord St Leonard's Act 1859, section 31, which enacted the existing law: *Re Brier* (1884) 26 ChD 238 (CA); *Dawson v Clarke* (1810) 18 Ves Jun 248, 254, 34 ER 311.

[70] *Re Brier* (1884) 26 ChD 238 (CA).

[71] *Brice v Stokes* (1805) 11 Ves Jun 319, 32 ER 1111; *Mucklow v Fuller* (1821) 1 Jac 198, 37 ER 824; *Hanbury v Kirkland* (1829) 3 Sim 265, 57 ER 998.

[72] See *Re Brier* (1884) 26 ChD 238 (CA) 243-244: it must be shown that 'loss happened through their own wilful default . . .', for the law throws 'the *onus probandi* on those who seek to charge an executor or trustee with a loss arising from the default of an agent'.

[73] *Re Stevens* [1897] 1 Ch 422, 432; *Coultard v Disco Mix Club Ltd* [2000] 1 WLR 707, 734.

adjudicator being assigned an inquisitorial role.[74] Misconduct may be investigated by the master that was neither pleaded nor mentioned at the hearing and he may charge the defendant accordingly. For these and other reasons a direction that accounts be taken on the footing of wilful default has been described as 'drastic' and 'a very strong' order to make.[75] The court exercises a discretion not to make the general order if it would be oppressive or wasteful.[76]

To obtain this order the beneficiaries must make out a special case by pleading and proving that the past conduct of the trustees raises a reasonable prima facie inference that other breaches not yet known to the claimant or the court have occurred.[77] It is sometimes thought that the burden can be discharged by proving one instance of breach of trust but that would have to be a very telling breach.[78] The court may also take into account evidence of bad faith as well as the trustees' conduct in the litigation.[79] If the admissions and proofs before the court are conflicting or raise only a weak suspicion then an inquiry may be directed in order to gather further evidence.[80] Where individual instances of breach of trust are proven but the evidence is not strong enough to support an order for a general accounting the court may give relief in respect of the proven breaches only.[81]

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[74]There are no reported authorities governing the conduct of a wilful default accounting. According to CPR PD40-002 the directing court should stipulate the manner in which the account is to be taken and verified.

[75]*Re Tebbs* [1976] 2 All ER 858, 864; *Re Stevens* [1897] 1 Ch 422, 432.

[76]*Re Tebbs* [1976] 2 All ER 858, 863; *Campbell v Gillespie* [1900] 1 Ch 225; CPR Sched 1, RSC Ord 85 r5(1).

[77]*Re Tebbs* [1976] 2 All ER 858, 863; *Re Stevens* [1898] 1 Ch 160 (CA) 170.

[78]*Coultard v Disco Mix Club Ltd* [2000] 1 WLR 707, 733; *Shepherd v Towgood* (1823) T & R 379, 388, 37 ER 1147; *Jones v Morrall* (1852) 2 Sims NS 241, 249-250, 61 ER 333; *Sleight v Lawson* (1857) 3 K & J 292, 69 ER 1119. *Re Stevens* [1897] 1 Ch 422, 432: 'Possibly one clear case might be enough; but it is desirable to have more.'

[79]*Re Tebbs* [1976] 2 All ER 858, 863-864.

[80]*Coope v Carter* (1852) 2 De GM & G 292, 298, 42 ER 884.

[81]*Re Tebbs* [1976] 2 All ER 858, 863; *Re Stevens* [1897] 1 Ch 422, 433.

Perhaps in order to narrow the availability of wilful default accountings, two restrictions have been introduced as to the type of breach of trust proof of which will suffice to ground the order. These have been introduced by restrictively defining (or redefining) wilful default. One restriction is that the breach must have consisted in a failure to receive some item of property. Reasons have been given above why this restriction is inconsistent with the dominant thread of authority, which defines wilful default without any such restriction.[82] A second restriction introduced in *Re Wrightson* and taken up more recently in *Bartlett v Barclays Bank Trust Co Ltd* is that the breach must have been passive, that is, 'an omission by a trustee to do something which, as a prudent trustee, he ought to have done–as distinct from an active breach of trust, that is to say, doing something which the trustee ought not to have done.'[83] This distinction is also inconsistent with dominant authorities, which accept that positive acts may constitute wilful default. For example, a trustee who imprudently invests funds on a loss-making but authorised security is chargeable on the basis of wilful default,[84] as is a trustee who lets property at less than fair market value.[85] With a different turn of phrase both acts can be characterised as omissions, but this trick does nothing to enhance the appeal of the distinction between passive and active breaches of trust. Cotton LJ stated the law correctly in *Re Owens*: if executors 'do that which it is their duty not to do, or omit to do that which it is their duty to do then that is wilful neglect and default'.[86]

Not only are these two refinements inconsistent with dominant authorities, but it is difficult to see how either can be reconciled with the purpose of directing an inquisitorial audit of a trustee's administration, which is to uncover instances of

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[82]See pages 192-195.

[83]*Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 546; *Re Wrightson* [1908] 1 Ch 789, 799; *Gava v Grljusich* [1999] WASC 13; *McLaughlan v Prince* [2001] WASC 43. The distinction between active and passive breaches of trust is taken by the author of *Snell's Equity* (30th edn, 2000) Ch 13 paras 4 & 5 to be central to a proper understanding of money claims against trustees.

[84]*Re Chapman* [1896] 2 Ch 763 (CA).

[85]*Noyes v Pollock* (1886) 32 ChD 53, 61. Letting property at an undervalue is very act that was held to be an instance of wilful default in *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515.

[86]*Re Owens* (1882) 47 LT 61 (CA).

misconduct unknown to the claimant. If evidence of particular breaches of trust supports an inference that there have been other breaches as yet unknown, it would be perverse to refuse to direct an inquisitorial audit because the proven breaches consisted in positive acts rather than omissions, or because they did not lead to a failure to receive some item of property. In principle any evidence that raises sufficiently strong suspicions should justify the order. Moreover, there is no reason why the master should ignore active breaches of trust, or breaches that did not result in a foregone receipt, once he has embarked upon a comprehensive review of the trustee's administration. The purpose of the proceeding is to uncover concealed misconduct or to sort out thoroughly mismanaged estates, and so any irregularities that come to light should be put right in the accounting.

There are good reasons to think that proceedings for a general wilful default accounting should be abolished. The first is that the master's inquisitorial mandate is procedurally anomalous and oppressive to the defendant. Wilful default account proceedings bring into issue misconduct that has neither been pleaded nor proven at the hearing. Thus a claimant who has pleaded only one instance of breach of trust may obtain relief from other previously unknown breaches when the accounts are taken without needing to amend his statement of claim or otherwise notify the defendant.[87] This conflicts with the policy underlying the rules governing statements and particulars of claim.[88] In practice the defendant is oppressively faced with preparing to defend the negative proposition that he has not committed any further breaches of trust. More generally, the overriding objective of the Civil Procedure Rules militates against permitting open-ended proceedings lacking defined issues because they must inevitably run up costs and delay resolution of the dispute.[89]

A second reason why wilful default accountings should be abolished is that they have outlived their usefulness. Wilful default accountings descend directly from the

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[87] *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 545.

[88] See *Re Wrightson* [1908] 1 Ch 789, 799.

[89] CPR Pt 1.

procedure invoked by the old common law action of account which assigned an overtly inquisitorial role to the auditors appointed by the court,[90] but that action made no provision for disclosure of documents or the exchange of witness statements. Moreover, accountable parties at law do not appear to have been subject to continuing obligations to disclose information about their activities to inquiring principals. Parts 31 and 32 of the modern Civil Procedure Rules as well as specific rules relating to trusts afford beneficiaries sufficient access to documentation and other information concerning the administration of their interests that they should be able to state and particularise their claims as any other litigant must.[91] If information pointing to as yet unknown breaches comes to light in the course of litigation, and the beneficiaries could not with reasonable diligence have obtained it earlier, then they may amend their statement of claim or bring fresh proceedings. There is no longer any need to exempt beneficiaries from the ordinary exigencies of civil litigation.

Although orders for a general accounting on the footing of wilful default are still sought from time to time, in view of the considerations advanced in the last two paragraphs it is unsurprising that there is only one modern case in which such an order has been granted.[92] In practise this form of proceeding is virtually obsolete and the clarity of the law would be advanced if it were formally abolished.

(c) Conclusion

The object of this part has been to show that in surcharge proceedings equity has long recognised a form of claim that is equivalent to a reparation claim for damages at law. A claim to surcharge a fiduciary's account on the basis of what used to be called wilful default is essentially a claim to charge the defendant with the loss attributable to his

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[90]DEC Yale (ed), *Lord Nottingham's 'Manual of Chancery Practice' and 'Prolegomena of Chancery and Equity'* (1965) 165-167.

[91]See generally J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 23 paras 3-15; Public Trustee Act 1906, s 13.

[92]*McLaughlan v Prince* [2001] WASC 43. A claim for a general accounting on the footing of wilful default was not struck out in *Coultard v Disco Mix Club Ltd* [2000] 1 WLR 707, 733-734.

breach of trust. An incidental argument has been made that the form of proceeding known as an account on the footing of wilful default is obsolete and should be formally abolished.

The conclusion that a surcharge claim is essentially reparative prompts the question whether it is correct or acceptable to characterise the claim as being for damages. This question was considered in Chapter III Part 4. Damages are usually understood to consist amongst other things in a money award directing payment to the successful claimant or a person he represents. A reparation claim against a custodial fiduciary does not seek damages in this conventional sense but rather seeks to charge the defendant in his account in the amount of the loss. In other respects, however, the claims are essentially similar. They both seek to hold the defendant liable to make good loss occasioned by his breach of duty. For practical purposes it is both satisfactory and helpful to say that whereas damages in tort or contract are awarded to the claimant, in a trusts case damages are charged against the defendant.

2. Overlapping Performance and Reparation Claims

This part examines the relation between reparation claims and performance claims in circumstances of potential overlap. There is a potential overlap where trust property has been misapplied.

Misapplication of trust property is necessarily a breach of trust and so there are two possible claims open to the beneficiary. One is a claim to charge him with whatever damage is attributable to the breach of trust. The other is a claim for an account and performance of the trust, if necessary by payment of a pecuniary substitute for the misapplied property. This latter type of claim enforces the defendant's primary duties under the trust rather than whatever secondary duties the breach may have created. These two claims are cumulative rather than alternative.[93] As Lord Nicholls explained

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[93]In addition to the cases discussed below, see the constructive trust case *Trustor AB v Smallbone* (unreported CA, 9 May 2000) para 85.

in *Tang Man Sit v Capacious Investments*, where claims are cumulative the claimant is not required to choose between them but may take both subject, first, to bringing forward his whole case against a defendant in one proceeding and, second, to the limitation imposed by the principle of full satisfaction.[94] The principle of full satisfaction prevents the claimant from recovering more by way of reparation than the loss that remains once other relief is taken into consideration. Accordingly, where the beneficiaries hold their trustee charged with misapplied property other than money or adopt its exchange-product, and the property they charge him with has appreciated, then the estate will usually be suffering no loss so that a reparation claim would fail.

A familiar example of cumulative claims occurs where a fiduciary misapplies money. The beneficiaries may, first, falsify the outlay and, second, charge him with interest on the notional balance. The defendant is liable for the principal on the basis that he has failed to make out a good discharge. He simply remains liable to apply the money in accordance with the trusts. The defendant is then charged with interest on the notional balance as compensation for his breach of trust in failing to invest the money for the benefit of the trust over the relevant period.[95] The claim to the principal and the claim to charge the defendant with interest are cumulative.

Re Lake also illustrates the proposition that performance and reparation claims are cumulative.[96] The trustee Lake had invested £5, 500 of trust funds on an unauthorised contributory mortgage which had deteriorated in value. Lake then became bankrupt and the question in the case was whether the beneficiaries could prove for the whole £5, 500 where they had already compromised with the mortgagor without consulting Lake's trustee in bankruptcy. Wright J held that because the beneficiaries had not given the trustee in bankruptcy the option to repay the misapplied sum and take the mortgage for the estate, the beneficiaries should be treated as if they had adopted the

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[94]See *Tang Man Sit v Capacious Investments* [1996] AC 514 (PC) 521-522. His Lordship spoke of cumulative remedies rather than claims but this only treats the topic from a different end.

[95]See Chapter IX.

[96]*Re Lake* [1903] 1 KB 439.

unauthorised mortgage. He could 'see no good reason, however, why a proper proof should not be made for the damages that the Howe trust has sustained by reason of the improper investment . . . the measure of damages will be the difference between the 5500*l.* and the assessed value of the document of compromise.'[97] This shows that there is no equitable equivalent to the exploded common law doctrine of waiver of tort.[98] By adopting an unauthorised investment the beneficiary does not waive the breach for he may also claim reparation for whatever loss remains. The case also shows that the beneficiary's performance and reparation claims are cumulative rather than alternative. Understood in this way, *Re Lake* does not conflict with the confusingly reported case of *Thornton v Stokill,* for the latter case did not involve any claim for reparation of loss.[99]

The same principle was applied in the Scottish case of *Whyte's Trustees v Burt*.[100] The defendant Burt had been trustee of a bankrupt estate. As trustee Burt had put lands comprising the estate up for auction in 1846. Burt wanted to buy the lands for himself and covertly sent his agent to bid for them. Burt's agent successfully bid £6, 700, the next bid being £6, 690. When the creditors discovered that Burt had been the real purchaser they had him removed from office, the sale set aside and the land returned.[101] The creditors must have thought property values were rising but in fact they were falling. By the time the land was next put up for sale in 1849 the highest bid was £5, 580. The Court of Session held that the creditors had acted reasonably in setting aside the self-dealing transaction and had not unduly delayed resale. Burt was held liable for the difference between the price the property would have been sold for in 1846

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[97]Ibid 443.

[98]See *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1.

[99]*Thornton v Stokill* (1855) 1 Jur (NS) 751. This case must be misreported because it is impossible to discern why Wood V-C said the houses if adopted would stand in place of the misapplied £400 when only £374 was invested in them. *Thornton v Stokill* is generally thought to conflict with *Re Lake*: J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 22 para 40 & Ch 39 para 28; J Martin, *Hanbury & Martin, Modern Equity* (16th edn, 2001) 655; AJ Oakley, *Parker & Mellow, The Modern Law of Trusts* (7th edn, 1998) 683; P Pettit, *Equity and the Law of Trusts* (9th edn, 2001) 502.

[100]*Whyte's Trustees v Burt* (1851) 13 SC 679. See also *Efstratiou v Glantschnig* [1972] 1 NZLR 594 (CA) 599 where the court stated the law in terms that accord with *Whyte's Trustees v Burt.*

[101]Reported as *Brown v Burt* (1848) 11 SC 338.

absent his wrong–£6, 690–and the lower price of £5, 580 it commanded in 1849. He was also ordered to pay various expenses including the costs of the 1849 auction. The essential point is that restitution of the trust property misapplied in the self-dealing purchase did not bar the creditors from also charging Burt with reparation for the loss. That is because the claims are cumulative.

Both *Re Lake* and *Whyte's Trustees v Burt* were cases in which the property had declined in value so recovery of the property or adoption and realisation of its exchange product left the estate still suffering a loss. These cases are factually unusual for in most cases where the misapplied property and its exchange product have depreciated the beneficiaries will simply charge the defendant with the reparable loss so that no question of cumulative claims arises.

REPARATION CLAIMS

DAMAGES

CHAPTER VIII

DAMAGES

Chapter VIII

This chapter discusses the damages with which a defaulting trustee may be charged. Breaches of trust are highly diverse and so this chapter concentrates on just a few general issues that have given particular trouble or show the shape of the remedy. These are the measure of damages, special presumptions supposed to assist the claimant in establishing loss, factors that may cut reparable loss back, and the idea that damages are measured by loss suffered by the estate rather than the beneficiaries personally.[1]

1. The Measure of Damages

The general measure of damage with which a defaulting trustee may be charged was stated by a strong High Court of Australia in these terms: 'The liability of a trustee committing a breach of trust is measured by the loss or depreciation which his act or omission has caused to the trust estate. He must make good any depreciation and damage which the estate has suffered.'[2] North J's statement in *Re Brogden* may be added to this: 'It is clear that the Court will not punish a trustee pecuniarily for his breach of trust except so far as loss has resulted therefrom to the trust estate.'[3]

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[1]These topics are complicated by that fact that there are a number of recent cases that, on the theory advanced in this thesis, should have been treated as involving claims for the substitutive performance of a trust but were in effect treated by the court as involving reparation claims: especially *Target Holdings Ltd v Redferns* [1996] AC 421; *Ata v American Express Bank plc* (CA, The Times 26 June 1998); *Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA); and *O'Halloran v RT Thomas & Family Pty Ltd* (1998) 45 NSWLR 262 (CA). For present purposes these cases will be treated as they were intended, as good authorities on the nature and measure of reparative relief.

[2]*Elder's Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426, 453. Similarly *Fales v Canada Permanent Trust Co* [1977] 2 SCR 302, 320.

[3]*Re Brogden* (1886) 38 ChD 546, 557. See also *Vyse v Foster* (1872) LR 8 Ch App 309, 333; aff'd (1874) LR 7 HL 318 and The Law Commission, *Aggravated, Exemplary and Restitutionary Damages* (Law Com No 247, 1997) Ch 5 paras 54-56. The prohibition on penal interest charges is discussed in Chapter IX Part 1. It is conceivable that English courts will reconsider their blanket unwillingness to allow punishment claims for breach of trust now that the cause of action test has been discredited: *Kuddus v Chief Constable of Leicestershire* [2001] UKHL 29, [2001] 2 WLR 1789. Compare Pensions Act 1995, s 10, which permits penalty fines to be imposed for the maladministration of

These statements must be qualified by the fact that a particular breach may impact on different classes of beneficial interest differently. If the trustee administers the trust unfairly between different classes of beneficial interest–for example, by investing only in fixed-interest securities to the detriment of the capital beneficiaries–then some of the beneficiaries will gain while others lose.[4] Here the loss is not suffered by the estate as a whole but by the capital interests. Any charged sum and interest on it would have to be apportioned to the interests that have been prejudiced.[5] Where a breach of trust has a potentially detrimental impact on contingent interests and they sue before their interests fall into possession the correct form of relief is not to charge the trustee in the extent of their loss because that loss has not yet been suffered, may never be suffered, and is at present unascertainable. The court will instead order the trustee to establish a sufficient fund out of which their losses can be made good if and when they occur.[6]

It is implicit in the general measure of damages stated above that in order to charge a defaulting custodial fiduciary with an item of loss a sufficient causal link must be established between that loss and his breach of duty. A corollary to this is that a fiduciary cannot be charged with more than the claimant's causally-related loss. Lord Browne-Wilkinson described these as basic principles of equity, but as his own reasoning makes clear there is nothing distinctively equitable about them.[7] The principles govern all reparation claims whether the rights find their provenance in equity or the common law.

In order to establish a sufficient causal connection it is necessary to show that the loss was caused by the breach and that it was not too remote. The requirement that a

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occupational pensions.

[4]*Re Mulligan* [1998] 1 NZLR 481.

[5]See *Jaffray v Marshall* [1993] 1 WLR 1285, 1293-1294.

[6]*Bennett v Colley* (1832) 5 Sim 181, 58 ER 305 aff'd (1833) 2 My & K 225, 39 ER 930; see also *Elder's Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426, 472-473.

[7]*Target Holdings Ltd v Redferns* [1996] AC 421, 436 & 432.

loss for which compensation is sought was caused by the breach may be further divided into two distinct requirements. The first is that the loss was factually caused by the defendant's breach of duty.[8] Irrelevant events are eliminated by asking whether the injurious consequence would have occurred 'but for' the breach. The factual causation requirement obtains whether the breach was innocent, negligent or fraudulent.[9] In appropriate circumstances compensation may be given for loss of a proven chance to obtain a benefit or avoid a detriment though no case illustrates this possibility.[10]

Even where the defendant's misconduct was a necessary condition of the loss occurring it may be appropriate to attribute the loss to the claimant's own act or the act of a third party or an extraordinary natural event. The second requirement, then, is that the loss is attributable to the defendant's breach of duty. Questions of attributive causation are essentially questions of law depending upon the reason for which the duty was imposed.[11] The cause (or causes) to which a consequence is attributable for the purpose of imposing liability is commonly called its effective cause. Effective causes which occur subsequently in time to the defendant's misconduct are commonly called intervening causes. Intervening causes will be treated in Part 3 below under the rubric of remoteness. The argument will be that an intervening cause prevents a defaulting fiduciary from being liable for losses of which his act was a necessary condition. The same considerations apply where the effective cause occurred before or contemporaneously with the defendant's misconduct. What other causes will suffice to deflect liability from the defendant is a question that always depends on the nature of the defendant's duty and the circumstances of the case. At a general level it may be said

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[8] *Target Holdings Ltd v Redferns* [1996] AC 421.

[9] *Target Holdings Ltd v Redferns* [1996] AC 421, 436; *Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA). An opposite conclusion was subsequently drawn in *Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712 para 54, [2001] 2 BCLC 531, which appears to have been decided without the benefit of *Collins v Brebner*.

[10] *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1269. See also *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (CA) 685-686.

[11] See *Environment Agency v Empress Car Co (Abertillery) Ltd* [1999] 2 AC 22 and Lord Hoffmann, 'Common Sense and Causing Loss' (unpublished lecture to the Chancery Bar Association, 15 June 1999).

that the other cause must have been coincidental and extraordinary.

2. Presumptions of Loss

A beneficiary seeking to charge his trustee with reparable loss usually carries the burden of proving the causal relation between that alleged loss and the trustee's breach of duty.[12] A number of cases suggest, however, that in particular circumstances a presumption will arise that a proven breach was the cause of a subsequent loss. The cases will be treated under three headings.

(a) *Re Brogden*

Re Brogden involved a claim against trustees who had failed to take sufficiently vigorous steps to collect a debt owing to the estate by the testator's partners.[13] Fry LJ said this in the course of holding the trustees liable in the full amount of the debt:

> When the *cestui que trust* has shown that the trustee has made default in the performance of his duty, and when the money which was the subject of the trust is not forthcoming, the *cestui que trust* has made out, in my judgment, a *primâ facie* case of liability upon the trustee, and if the trustee desire to repel that by saying that if he had done his duty no good would have flowed from it, the burden of sustaining that argument is plainly upon the trustee.[14]

Cotton LJ spoke to similar effect.[15] The difficulty in the case was that both parties had thought they could win outright at first instance and for this reason they had prevented North J from directing an inquiry to determine how much of the debt would have been recovered if proper steps had been taken. North J was certain there had been some loss

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[12]*Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1269, 1276 & 1283; *Re Brier* (1884) 26 ChD 238 (CA) 243. The successor to the statutory provision Selborne LC referred to in *Re Brier* is no longer in force but he was clear that the provision was declaratory of the general law which has now been reinstated by the Trustee Act 2000.

[13]*Re Brogden* (1888) 38 ChD 546 (CA). See also *Tebbs v Carpenter* (1816) 1 Madd 290, 298-299, 56 ER 107; *Stiles v Guy* (1848) 16 Sim 230, 231-232, 60 ER 861.

[14]Ibid 572-573.

[15]Ibid 567-568.

but said he did not know how to ascertain it.[16] While both Cotton and Fry LJJ thought the issue could be resolved by applying a presumption, they also both went on to say that they were satisfied the entire sum would have been recovered had the trustees pressed for payment so that it does not appear that the evidential presumption was actually relied upon.

Re Brogden was cited to the House of Lords eight years later in the Scottish case *Carruthers v Carruthers*.[17] The defendant trustees had neglected to supervise one of their number by insisting that he render annual accounts of money he was receiving as factor for the estate. As a consequence the factor was able to abscond with sums that would otherwise have been applied for the benefit of the trust. Lord Herschell said the onus shifts to a defendant trustee to absolve himself once the breach is made out and 'it might be reasonably concluded that the trust would not have suffered as it did if the duty had been observed'.[18] He went on to say that 'I do not think they are entitled to insist upon the Court speculating as to whether it is or is not possible that, even if the trustees had done their duty, the loss would equally have resulted.'[19] As in *Re Brogden*, however, it does not appear that Lord Herschell rested his decision upon this evidential presumption because he went on to affirm that the money would not have been lost if the trustees had complied with the trust direction to insist upon annual accounts.

These cases show that the presumption identified in *Re Brogden* only arises once a claimant has adduced evidence reasonably supporting the conclusion that the defendant's breach was the cause of an alleged loss. That being so, it is difficult to see what the evidential presumption then arising adds to the ordinary rule that the claimant only needs to prove his case on a balance of probabilities. To a modern lawyer North J's anxieties about quantifying loss seem fastidious, and the evidential presumption identified by the Lord Justices may be best understood as a product of a time when the

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[16] *Re Brogden* (1886) 38 ChD 546, 560.

[17] *Carruthers v Carruthers* [1896] AC 659.

[18] Ibid 665.

[19] Ibid.

courts were still coming to grips with their powers to quantify loss without recourse to a jury.

The only subsequent appeal to this presumption was unsuccessful. The defendants in *Re Miller's Deed Trusts* were trustees of certain shares in a family business.[20] They took no interest in the trusts and left them to be managed by the third trustee who was an accountant. The company flourished but then collapsed and the defendants were sued for over a quarter of a million pounds as damages for breach of trust. Oliver J held that the defendant trustees had breached their duty by failing to inquire into the trusts but that this had not been proven to be causative of the loss in value of the shareholdings. The accountant trustee had properly acted upon the recommendations of expert advisors called in by the company. The abbreviated report of Oliver J's judgment states:

> It was necessary to prove a causal connection between the breach of duty and the resulting loss. No principle could be extracted from the cases that once a breach of duty was shown the burden fell on the defaulting trustee to show that the loss did not result from the breach.[21]

(b) Most Favourable Use of Property

A number of cases suggest that where the assessment of loss depends upon the use that would have been made of trust property had the breach not occurred, the courts will presume that the property would have been invested or applied in what with hindsight can be seen to have been the most economically favourable manner. The twentieth century cases to this effect are *Jaffray v Marshall*,[22] the Supreme Court of Canada's decision in *McNeil v Fultz*,[23] and Wilson J's concurring minority reasons in the Supreme

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[20] *Re Miller's Trust Deeds* [1978] LS Gazette 454.

[21] Ibid.

[22] *Jaffray v Marshall* [1993] 1 WLR 1285, disapproved in *Target Holdings Ltd v Redferns* [1996] AC 421, 440.

[23] *McNeil v Fultz* (1908) 38 SCR 198, 205. Duff J's dictum has been 'quietly overlooked or ignored' in Canada: see D Waters, *The Law of Trusts in Canada* (2nd edn, 1984) 997 and *Claiborne Industries Ltd v National Bank of Canada* (1989) 59 DLR (4th) 533 (Ont CA) 567-572 .

Court of Canada case *Guerin v The Queen*.[24] There is no need to explore these cases because superior authority holds that the presumption variously relied upon in them forms no part of English law.[25] A claimant must specifically prove that property would have been applied in a particular way had the breach not occurred if he wishes to have loss assessed on that basis.

(c) The Rule in *Brickenden*

The supposed rule stated by Lord Thankerton in *Brickenden v London Loan & Savings Co* concerns the relation of trust and confidence rather than the custodial fiduciary relation but it has given considerable trouble and should be mentioned here for completeness.[26] Lord Thankerton expressed the rule in these terms:

> When a party, holding a fiduciary relationship, commits a breach of his duty by non-disclosure of material facts, which his constituent is entitled to know in connection with the transaction, he cannot be heard to maintain that disclosure would not have altered the decision to proceed with the transaction, because the constitutent's action would be solely determined by some other factor, such as the valuation by another party of the property proposed to be mortgaged. Once the Court has determined that the non-disclosed facts were material, speculation as to what course he, the constituent, on disclosure, would have taken is not relevant.[27]

Brickenden was general solicitor to the Savings Co and he also represented the mortgage borrowers Mr and Mrs Biggs. Brickenden had failed to disclose on the certificate of title that the borrowers owed him money personally under two securities

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[24] *Guerin v The Queen* [1984] 2 SCR 335. See on this point J Berryman, 'Equitable Compensation for Fact-Based Fiduciaries: Tentative Thoughts on Clarifying Remedial Goals' (1999) 37 Alta LR 95, 108-111. In *Re Mulligan* [1998] 1 NZLR 481, 508 Panckhurst J acknowledged the presumption stated by Wilson J and immediately ignored it. A nineteenth century line of cases beginning with *Hockley v Bantock* (1826) 1 Russ 141, 38 ER 55 applied the same presumption but was overruled by the Court of Appeal in *Robinson v Robinson* (1851) 1 De GM & G 247, 42 ER 547.

[25] *Target Holdings Ltd v Redferns* [1996] AC 421, 440; *Ata v American Express Ltd* (CA, The Times 26 June 1998); *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1268 (but compare Leggatt LJ's perplexing and tentative remarks at 1283-1284); *Robinson v Robinson* (1851) 1 De GM & G 247, 42 ER 547.

[26] *Brickenden v London Loan & Savings Co* [1934] 3 DLR 465 (PC).

[27] Ibid 469.

and that part of the mortgage money would be used to repay these loans. The Privy Council advised that Brickenden should make good the loss suffered by the Savings Co when the borrowers defaulted.

The submission to which the excerpted passage responded is nowhere clearly explained but may be pieced together from the reports of the lower court decisions. Brickenden gave no oral evidence but pointed to aspects of the documentary record showing that the Savings Co's managing director had cashed Brickenden's order from Mr Biggs and arranged for the Savings Co to assume Brickenden's mortgages, so that he had necessarily been aware of the undisclosed mortgages.[28] The trial judge thought the managing director as well as other officers might have been held liable for agreeing to grant the loan.[29] Brickenden's position thus seems to have been that formal disclosure of his two securities in the certificate of title would have made no difference because the Savings Co's officers put the loan through with full knowledge of the facts.

In order to invoke the *Brickenden* rule the claimant must show that he has entered a transaction in which his fiduciary has a conflicting interest or duty and that the fiduciary has failed to disclose (or misrepresented) a fact material to the claimant's decision. There are two versions, or interpretations, of the rule then thought to apply. The strong version is that the fiduciary will be liable to make good whatever losses the claimant suffered by entering the transaction irrespective of whether the claimant would have taken the same course if he had known the truth. The weak version is that the evidentiary onus then shifts to the fiduciary wishing to avoid liability to prove that knowledge of the true facts would not have influenced the claimant's course of action. According to the weak version what the court will not do is speculate in the fiduciary's favour once materiality is made out. The courts in Canada and New Zealand have authoritatively settled on the weak version of the *Brickenden* rule to the exclusion of the

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[28] *Biggs v The London Loan and Savings Company of Canada* [1933] SCR 257, 265.

[29] *Biggs v The London Loan and Savings Company of Canada* (1930) 39 Ont WN 126. The Ontario Court of Appeal's decision is reported at (1932) 41 Ont WN 48.

strong version.[30] The two rules are not mutually inconsistent, however, and it is necessary to consider the status of each in England in turn.

The weak version of the rule is undoubtedly law in England whether or not it reflects Lord Thankerton's intent.[31] That is because the weak version only extends to non-disclosure the ordinary rule applicable to misrepresentation. English law is clear that once a claimant seeking damages for misrepresentation shows that the misrepresented fact was material to his decision to embark upon a loss-making course of conduct, the evidentiary burden shifts to the defendant to show that this claimant would have done the same thing even if the misrepresentation had not been made.[32] Consistency requires that the same rule apply where a material fact is not disclosed rather than misrepresented.[33] The weak version of the *Brickenden* rule is for this reason neither exceptional nor peculiar to fiduciary law.

The important question is whether the strong version of the *Brickenden* rule is also law in England. The first point to notice about the strong version is that it corresponds perfectly to the rule conditioning a beneficiary's right to an account of his fiduciary's illegitimate profits where the profits were conferred by the beneficiary,[34] as well as the rule entitling a beneficiary to rescind a contract between them.[35] In both cases the beneficiary's title to relief depends on showing that the profits were made or

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[30]*Hodgkinson v Simms* [1994] 3 SCR 377; *Gilbert v Shanahan* [1998] 3 NZLR 528 (CA) 536-537; *Everist v McEvedy* [1996] 3 NZLR 349. The weak version of the rule was decisive in *Commerce Trust Co v Berk* (1989) 68 OR (2d) 257 (CA) and *Taylor v Schofield Peterson* [1999] 3 NZLR 434, 446

[31]Commentators favouring the weak version to the exclusion of the strong version include H Tijo & TM Yeo, 'Limited Liability for Breach of Fiduciary Duty' (1998) 114 LQR 181 and P Matthews 'Developments in the Law of Equitable Compensation' (1997) 3(6) Trusts & Trustees 6, 9.

[32]*Smith v Chadwick* (1884) 9 App Cas 187, 196; *Gould v Vaggelas* (1985) 157 CLR 215, 236 & 238.

[33]*Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501, 549.

[34]*Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1 (PC) 15. Two of the five Supreme Court of Canada judges who heard the *Brickenden* appeal would have only held Brickenden accountable for his profits: *Biggs v The London Loan and Savings Company of Canada* [1933] SCR 257.

[35]*Maguire v Makaronis* (1997) 188 CLR 449. See also *Hill v Rose* [1990] VR 129, which is best read as an example of pecuniary rescission.

the contract concluded without proper disclosure of the fiduciary's interest irrespective of whether the beneficiary has suffered a loss. The *Brickenden* case was argued on authorities concerning the right of a client to rescind a contract with his solicitor and what the judges seem to have done is to translate the rules governing title to rescind into the law governing reparation claims.[36] There is a considerable difference, however, between depriving someone of a benefit which he would have acquired in any event, thereby leaving him in the position he started in, and requiring him to make good losses that would have occurred in any event. The strong version permits the imposition of reparative liability where there can be shown to be no causal connection between the breach and the alleged loss for which reparation is sought. It is for this reason unsurprising that the *Brickenden* case has attracted sharp criticism.[37] It is worth observing that Brickenden's submission might equally have been disposed of on the more modest ground relied upon by Crocket J in the Supreme Court of Canada, who said that Brickenden 'cannot invoke the connivance or dereliction of others as an excuse for his own breach of duty. It only renders his own breach of duty the more indefensible.'[38]

If it were possible for a case to be overruled by distinction it would be tempting to say that has happened here.[39] There is only one English case in which the rule has been applied in something like its strong version and exceedingly few cases from elsewhere in the Commonwealth.[40] The English case is the first instance decision in

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[36]See *Biggs v The London Loan and Savings Company of Canada* [1933] SCR 257, 261-262. See further the discussion in Chapter II Part 1(c)(ii).

[37]See especially D Heydon, 'Causal Relationships Between a Fiduciary's Default and the Principal's Loss' (1994) 110 LQR 328.

[38]*Biggs v The London Loan and Savings Company of Canada* [1933] SCR 257, 265-266.

[39]See especially *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) and *Swindle v Harrison* [1997] 4 All ER 705 (CA). The status of the strong version of the *Brickenden* rule remains open in Australia after the High Court's decision in *Maguire v Makaronis* (1997) 188 CLR 449, 474 but compare Kirby J's endorsement. The rule has been subsequently distinguished in *Beach Petroleum NL v Kennedy* (1999) 48 NSWLR 1 (CA) 91-94 and in *Duke Group Limited (in liquidation) v Pilmer* (1999) 73 SASR 64 (Full Ct) 234-236.

[40]*Bristol and West Building Society v May May & Merrimans* [1996] 2 All ER 801, 825-827; *Commonwealth Bank of Australia v Smith* (1991) 102 ALR 453 (FCA Full Ct) 478-479; *Wan v McDonald* (1992) 105 ALR 473 (FCA) 501-502; *Farrington v Rowe McBride & Partners* [1985] 1

Bristol and West Building Society v May May & Merrimans. The rule Chadwick J applied is that a solicitor who makes a knowingly false warranty or representation to induce a lender to advance money to another client cannot defend on the basis that the lender would have advanced the money if the warranty or representation had not been made. More recently Blackburne J discussed *Brickenden* and its successors at length in *Nationwide Building Society v Balmer Radmore* and concluded 'that nothing in the authorities compels me to disregard any inference which, on the evidence, can properly be drawn as to what would have happened if the fiduciary had performed his duty.'[41] Blackburne J left open the possibility that a different rule might apply where the fiduciary has acted 'dishonestly or in bad faith (or its equivalent)'.[42]

If the strong version of the *Brickenden* rule is confined to cases in which the fiduciary has intentionally deceived his beneficiary then it loses most of its practical force. The fact that the fiduciary considered the deception to be necessary indicates that the beneficiary would probably have acted differently if he had known the true facts. But even confined in this way the rule still fits uneasily into the broader fabric of the law. For one thing it runs counter to the rule that a claimant seeking damages for fraudulent misrepresentation must show by evidence or inference that the misrepresented fact was an actual inducement to his act. Once an intention to induce has been made out it is only a small step to the conclusion that there has been actual inducement but it is nonetheless a step that must be taken.[43] It is difficult to see why a different rule should apply where the true facts are not disclosed rather than misrepresented or where the defendant occupied a position of trust and confidence.

The rule is also difficult to square with the basic principle confirmed in *Target Holdings* that a beneficiary can only recover compensation for losses that would not

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NZLR 83 (CA) 93, 99.

[41] *Nationwide Building Society v Balmer Radmore* [1999] Lloyd's Rep PN 241, 278.

[42] Ibid.

[43] *Claudius Ash Sons & Co v Invicta Manufacturing & Co* (1912) 29 RPC 465 (HL) 475; KR Handley, *Actionable Misrepresentation* (4th edn, 2000) para 129.

have occurred but for the breach.[44] The *Brickenden* rule was not discussed in that case and one commentator has argued that the rule survived on the basis that the relation of trust and confidence was not engaged in *Target Holdings*.[45] That argument has since been foreclosed by the Court of Appeal's decision in *Collins v Brebner* that the principle in *Target Holdings* applies with full force where the defendant trustee has acted fraudulently.[46] Fraudulent breach of trust is necessarily an abuse of the relation of trust and confidence.

The conclusion is that the weak version of the *Brickenden* rule is law in England as it is in Canada and New Zealand, but that even in a qualified form the strong version should not be regarded as part of English law.[47]

3. Remoteness of Loss

Remoteness of loss is an umbrella concept encompassing a heterogenous collection of factors all of which serve to cut back reparable loss.[48] This part considers whether compensation should be cut back because the loss was unforeseeable or because it is properly attributable to the intervening act of a third party.

Caution is required in extracting principles from the decided cases because there are relatively few breach of trust cases actually raising remoteness issues and so the leading statements of principle have been largely made in the course of deciding other issues. This problem is compounded by the fact that general statements about the applicable criteria are frequently made with a particular type of breach of trust in mind.

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[44] *Target Holdings Ltd v Redferns* [1996] AC 421. See D Capper, 'Compensation for Breach of Trust' [1997] Conv 14, 17-18.

[45] L Ho, 'Breach of Fiduciary Duty and Causal Responsibility' (1997) 11 TLI 72.

[46] *Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA).

[47] See also *Cavendish-Bentick v Fenn* (1887) 12 App Cas 652. Contrast J Martin, *Hanbury & Martin, Modern Equity* (16th edn, 2001) 654-655.

[48] See H McGregor, *McGregor on Damages* (16th edn, 1997) Ch 1 para 12.

Those criteria may be inappropriate to a breach of a different type.

The remoteness criteria applicable in a case founded upon equitable rights are frequently compared with the more familiar criteria applicable in tort and so this section will begin by outlining those criteria.[49] Since *The Wagon Mound* cases it has been understood that the defendant to a common law negligence claim is only liable for losses of a kind that were a foreseeable consequence of his careless act.[50] Foreseeability also contains recovery for breach of statutory duty,[51] public and private nuisance,[52] as well as strict liability under the rule in *Rylands v Fletcher*.[53] Foreseeability does not, however, contain liability for deceit nor is there authority that it contains liability for any of the other intentional torts.[54] An intentional tortfeasor is always responsible for the intended consequences of his act without remoteness limitation,[55] and he is also responsible for unintended consequences of which his act was the direct cause.[56] Direct consequences are those that are factually caused by the defendant's breach of duty excluding consequences properly attributable to another cause.[57] Thus an item of loss will be too remote if it is attributable to the intervening act of a third party or

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[49]There is a respectable argument that the rules applicable in contract rather than tort form a more appropriate point of comparison where the equitable obligation was assumed rather than imposed by law. There have not yet, however, been any cases in which the differences between these rules would have mattered and so this line of argument will not be pursued here. See *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (CA).

[50]*The Wagon Mound (No 1)* [1961] AC 388 (PC); *The Wagon Mound (No 2)* [1967] AC 617 (PC).

[51]*Galashiels Gas Co v Millar* [1949] AC 275.

[52]*The Wagon Mound (No 2)* [1967] 1 AC 617 (PC); *Cambridge Water Co v Eastern Counties Leather Co* [1994] 2 AC 264.

[53]*Rylands v Fletcher* (1866) LR 1 Ex 265; (1868) LR 3 HL 330; *Cambridge Water Co v Eastern Counties Leather Co* [1994] 2 AC 264.

[54]*Smith New Court Securities Ltd v Citibank NA* [1997] AC 254; A Dugdale (ed), *Clerk & Lindsell on Torts* (18th edn, 2000) Ch 2 para 63.

[55]*Quinn v Leatham* [1901] AC 495, 537.

[56]*Smith New Court Securities Ltd v Citibank NA* [1997] AC 254, 267 & 281.

[57]*Re Polemis* [1921] 3 KB 560 (CA) 577; *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191, 216. The distinction between direct damages (trespass) and consequential damages (trespass on the case) is not material.

intervening natural causes. It is only one step ahead of the decided cases to suggest that where intentionality is an element of the tort for which damages are being given the principal criterion of remoteness is directness and where intentionality is not an element of the tort the principal criterion is foreseeability.[58] This discrimation is sometimes thought to reflect considerations of deterrence and morality.[59]

Turning to equity we find a widely-held view that the compensation with which a defaulting trustee may be charged should not be cut back because the loss is of an unforeseeable type or because it is properly attributable to an intervening cause.[60] This proposition is forcefully expressed amongst others by the author of *Lewin on Trusts*.[61] The more moderate view is sometimes expressed that compensation for breach of trust is not contained by the *common law* rules of remoteness and causation, thereby inviting the development of tailored equitable rules fulfilling a similar function.[62] Lord Browne-Wilkinson's dictum in *Target Holdings Ltd v Redferns* accommodates both of these positions:

> Even if the immediate cause of the loss is the dishonesty or failure of a third party, the trustee is liable to make good the loss to the trust estate if, but for the breach, such loss would not have occurred . . . Thus the common law rules of

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[58]See *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254, 281 (Lord Steyn). A further logical step towards which Lord Steyn's remarks point would be to mark the division according to whether the tort was committed intentionally rather than whether intentionality is a formal element of the tort.

[59]Ibid 279-280.

[60]*Swindle v Harrison* [1997] 4 All ER 705 (CA) 733; *Re Mulligan* [1998] 1 NZLR 481, 509; *O'Halloran v RT Thomas & Family Pty Ltd* (1998) 45 NSWLR 262 (CA) 273-278; *Maguire v Makaronis* (1997) 188 CLR 449, 470; *West v Lazard Brothers & Co (Jersey) Limited* [1993] JLR 165, 324; *Hill v Rose* [1990] VLR 129, 144; *Bennett v Minister of Community Welfare* (1992) 176 CLR 408, 426-427; *Permanent Building Society (in liq) v Wheeler* (1994) 14 ACSR 109 (WASC) 162-167.

[61]J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 39 para 3: 'The compensation is not limited by common law principles of causation, foreseeability or remoteness. If a trustee has been guilty of misconduct, and loss follows that would not have occurred apart from the breach, the court does not acquit the trustee because it was more immediately caused by some event wholly beyond the trustee's control, even if the immediate cause of the loss is the dishonesty or failure of a third party. The trustee is liable for the whole loss, however unexpected the result, however little likely to arise from the course adopted, and however free such conduct may be from improper motive.'

[62]See especially McLachlin J's judgment in *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534.

> remoteness of damage and causation do not apply.[63]

This statement was made in connection with compensation under subsisting traditional trusts. Lord Browne-Wilkinson did not indicate whether the same applies where the appropriate remedy is compensation directly to the beneficiaries under a bare trust though he did say that the measure of compensation is the same.[64] It is worth observing that the excerpted statement was not critical to the disposition of the issue before the House of Lords.

The position taken here is that neither the strong nor the moderate position set out above is defensible and that remoteness criteria similar to those conditioning recovery of reparative compensation at law govern or should govern reparative compensation for breach of trust as well. In order to make sense of the topic as well as the decided cases it is necessary to attend carefully to the distinctions between the different types of claim that may be advanced and between the different types of breach of trust that may be committed.

(a) Different Types of Claim

The wholesale exclusion of remoteness considerations is usually justified by reference to Street J's judgment in *Re Dawson*.[65] There he said that the obligation to restore misapplied trust money is not 'to be limited by common law principles governing remoteness of damage', as well as a number of other things to similar effect.[66] *Re Dawson* was considered in detail in Chapter VI and only needs to be mentioned here to

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[63] *Target Holdings Ltd v Redferns* [1996] AC 421, 434, referring to *Re Dawson* [1996] 2 NSWR 211 as well as DJ Hayton, *Underhill and Hayton, Law Relating to Trusts and Trustees* (14th edn, 1987) 734-736 and *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515.

[64] *Target Holdings Ltd v Redferns* [1996] AC 421, 435.

[65] *Re Dawson* [1966] 2 NSWR 211. This was, for example, the root authority on which Lord Browne-Wilkinson rested his remarks in *Target Holdings Ltd v Redferns* [1996] AC 421, 434 excerpted above.

[66] *Re Dawson* [1966] 2 NSWR 211, 214.

clear the ground.[67] The important point is that the case did not involve a reparation claim and neither it nor the cases to which Street J referred can be treated as authorities governing reparative relief.[68] The claimant's argument, which Street J agreed with, was expressly restricted to cases in which 'a defaulting trustee is required to make good to a trust estate moneys or assets which he has wrongfully extracted from it'.[69] If Street J's remarks are confined as intended to misapplication cases then they accord with the conventional principles applicable to performance relief.[70] Remoteness of loss is not conceptually apposite to a claim for restitution of misapplied money because that type of claim is not concerned with reparable loss.

Where a claimant sues for reparation of loss rather than restitution or another form of performance relief it makes sense to ask whether compensation should be cut back because the loss occurred in an unusual or unanticipated way for which the defendant should not be responsible. It would be startling and anomalous if recovery were not conditioned by remoteness criteria of any sort for that would raise the spectre of unlimited liability.[71] Unsurprisingly the course of appellate authority since *Target Holdings* was decided has been towards imposing limits on recovery analogous to those limiting recovery for cognate common law wrongs.

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[67]See Chapter VI Part 2(b).

[68]*Caffrey v Darby* (1805) 6 Ves Jun 488, 31 ER 1159; *Clough v Bond* (1838) 3 My & Cr 490, 40 ER 1016; *Salway v Salway* (1831) 2 Russ & M 215, 39 ER 376; aff'd *sub nom White v Baugh* (1835) 9 Bligh NS 181, 3 Cl & Fin 44, 5 ER 1261, 6 ER 1354 (HL).

[69]Ibid 214.

[70]The New South Wales Court of Appeal's decision in *O'Halloran v RT Thomas & Family Pty Ltd* (1998) 45 NSWLR 262, which involved a misapplication of company property, should properly be understood on the same basis.

[71]Compare *Liesbosch Dredger v SS Edison* [1933] AC 449, 460.

(b) The Authorities

Millett LJ distinguished in *Bristol and West Building Society v Mothew* between the relief available for breach of the equitable duty of skill and care that custodial fiduciaries may labour under and the relief available for breach of the fiduciary duty of loyalty.[72] The remedy given for breach of the equitable duty of skill and care, he said, is equitable compensation rather than damages but he added that the distinction is historical only.[73] 'There is no reason in principle why the common law rules of causation, remoteness of damage and measure of damages should not be applied by analogy in such a case.'[74] Millett LJ contrasted this with equitable compensation for breach of fiduciary duty, which he said may be awarded in lieu of rescission or specific restitution. The Lord Justice's implication seems to have been that remoteness considerations do not limit recovery of equitable compensation of this second type because they are conceptually inapposite. Within the terms used in this thesis the idea is that the claim is not reparative in nature and the compensation it seeks is of the substitutive variety.

Millett LJ's analysis makes sense so far as it goes but raises two questions. The first question asks which common law rules are to be applied by analogy where the breach is of an equitable duty of skill and care. The second question asks which rules apply where the beneficiary sues for *reparative* compensation of loss caused by the breach of an equitable duty that is not a duty of skill and care. That reparative compensation is available for breach of the fiduciary duty of loyalty is clear from subsequent authorities.[75]

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[72] *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 16-18.

[73] See also *Henderson v Merrett Syndicates Ltd* [1995] AC 145, 205.

[74] *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 17. See also Sir Peter Millett, 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 226.

[75] *Swindle v Harrison* [1997] 4 All ER 705 (CA); *Nationwide Building Society v Balmer Radmore* [1999] Lloyd's Rep PN 241; *Companhia de Seguros Imperio v Heath (REBX) Ltd* [2001] 1 WLR 112 (CA); *Longstaff v Birtles* [2001] EWCA Civ 1219, [2002] 1 WLR 470.

Collins v Brebner is the most recent English appellate authority on these issues.[76] The defendant was a solicitor trustee who had paid out client money fraudulently and contrary to his instructions in the course of a share purchase transaction. The case resembled *Target Holdings* because in the circumstances no causal connection obtained between that wrongful payment and the loss the client eventually suffered. The client tried to distinguish *Target Holdings* on the basis that here the defendant's fraud had been proven, but the Court of Appeal held that no distinction between fraudulent, negligent and innocent breaches of trust is to be drawn in assessing damages and so refused to grant relief.[77] Tuckey LJ reviewed Lord Browne-Wilkinson's remarks about the inapplicability of common law rules of remoteness and causation as well as the judgments in the intervening case of *Swindle v Harrison* and concluded that the principles on which damages are assessed for breach of trust equate with the principles on which damages are assessed for the tort of deceit.[78] On this view a defaulting trustee may be liable for all of the direct consequences of his breach including consequences of an unforeseeable type. That there was no remoteness question before him may explain why Tuckey LJ did not consider the possibility that while the requirement to prove a factual causal connection obtains irrespective of the nature of the particular breach, the applicable remoteness criteria may differ.

The idea that different remoteness criteria apply depending on the nature of the breach was taken up by the New Zealand courts in *Bank of New Zealand v New Zealand Guardian Trust Co Ltd.*[79] The defendant Guardian was the trustee of a debenture security for the investors in a property development company that eventually collapsed in a general market decline. By virtue of a number of unsecured advances the property

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[76] *Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA).

[77] Ibid 589. But see *Bairstow v Queen's Moat Houses plc* [2001] EWCA Civ 712 para 54, [2001] 2 BCLC 531, which appears to have been decided without the benefit of *Collins v Brebner*.

[78] *Collins v Brebner* [2000] Lloyd's Rep PN 587 (CA) 590; *Swindle v Harrison* [1997] 4 All ER 705 (CA).

[79] *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (CA). The trial judgment reported at [1999] 1 NZLR 213 is more illuminating than the judgments given in the Court of Appeal.

company had been in default of its obligations to the investors. Guardian owed the investors an equitable duty of care to supervise the property company and report any defaults it became aware of. Guardian breached this duty by neglecting to notice unsecured advances which were reported in the company's financial statements. The evidence was that had Guardian discovered these advances and notified the claimant National Australia Bank then the Bank would have withdrawn its funds before the property company collapsed. Guardian's negligent failure to notify the Bank of the borrower's default therefore factually caused the Bank to be exposed to the collapse. The question was whether the loss sustained by the Bank in the borrower's insolvency was too remote a consequence of Guardian's breach.

In answering this question Fisher J distinguished between categories of case where a close nexus must be shown between breach and loss and categories where a distant nexus will suffice. This division was said to be 'fundamental to the whole topic of remoteness.'[80] Close nexus cases, Fisher J explained, import the usual remoteness apparatus as it variously applies in common law negligence cases. By contrast, he said that remoteness considerations do not generally limit liability in a distant nexus case, though a factual causal connection must be shown. Fisher J attributed the difference to a policy of deterring certain forms of misconduct. He said that a distant nexus rule applies where there is a 'breach of trust resulting in loss of trust property', abuse of a relation of fiduciary reliance, and in the case of certain intentional torts.[81] A close nexus rule applies to 'a non-restitutionary claim for negligent breach of trust'.[82] Fisher J said that recovery under this latter heading is limited by the requirements of reasonable foreseeability and substantial causation.[83]

Guardian had been negligent and there had been no loss of trust property. For this reason a close nexus was required between that breach and the Bank's loss.

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[80] *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213, 241.

[81] Ibid 243.

[82] Ibid 247.

[83] Ibid.

Applying what he took to be the usual remoteness criteria in a negligence case, Fisher J held that the Bank's loss was too remote for a collection of reasons. These included the fact that it was not of a foreseeable type, being the loss of an opportunity to exit the loan facility rather than loss due to the irrecoverability of advances, and the fact that Guardian's breach was not a substantial cause of the loss.[84] Fisher J's decision was unanimously upheld on appeal.[85] The Court of Appeal approved Fisher J's analysis but preferred to put its decision on the footing that the Bank's loss did not fall within the scope of Guardian's duty of care. That aspect of the case is discussed in Part 4 below.

(c) Discussion

Fisher J's approach in the *Guardian Trust* case implicitly proceeds from two attractive principles, both of which were endorsed by the New Zealand Court of Appeal. The first is that remoteness problems should not be treated differently depending on whether the rights in question find their historical provenance at law or in equity. This is necessary if like cases are to be treated alike. Gault J said this in the appeal from Fisher J's decision:

> Surely the stage has been reached in the development of the law where something more substantial than historical origin is needed to justify disparate treatment in the law of those in breach of the obligation to exercise reasonable case. The proper focus ought to be on the scope of the duty in the circumstances, with a consistent approach to compensating for breach. Only were good reasons exist is differentiation warranted.[86]

This first principle is consistent with Lord Browne-Wilkinson's analysis of equitable duties of care in *Henderson v Merrett Syndicates Ltd* as well as Millett LJ's statements in the *Mothew* case.[87]

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[84]Ibid 254-256.

[85]*Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (CA).

[86]Ibid 681 (Gault J) and 686-687 (Tipping J).

[87]*Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 205; *White v Jones* [1995] 2 AC 207, 270-272; *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 17. See also PBH Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 UWALR 1, 45-48 and G Vos, 'Linking Chains

The second principle is that different remoteness criteria may apply depending upon the character of the breach in question. This is consistent with the movement in tort law towards affording the victim of an intentional tort a wider net of recovery than the victim of negligence or other unintentional misconduct.[88] In a sense this second principle falls out of the first, for it is necessary in order to maintain parity across the jurisdictional frontier. Although Tuckey LJ indicated a different view in *Collins v Brebner*, the second principle broadly accords with Evans LJ's approach in *Swindle v Harrison*. There he distinguished between the remoteness criteria applicable to breaches of fiduciary duty that are and are not 'equivalent to fraud'.[89]

Building on the first principle, Fisher J was right to analyse remoteness problems arising out of the breach of an equitable duty in terms of concepts predominantly developed in the common law courts. The reason these concepts have been refined to a greater level of sophistication at law than in equity is that most reparation claims complain of wrongs that before Judicature were only actionable in the common law courts and so common law judges have had greater exposure to remoteness problems. To develop a parallel but distinctly equitable conceptual vocabulary to describe the same phenomena when they arise in fiduciary relations cases would be a retrograde semantic exercise. The Supreme Court of Canada has twice had occasion to consider this problem and has settled on the view that the remoteness concepts elucidated in cases involving common law rights should be borrowed by equity where appropriate.[90]

The conclusion in *Guardian Trust* that compensation for breach of an equitable

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of Causation: An Examination of New Approaches to Causation in Equity and the Common Law' [2001] CLJ 337, 344-345.

[88]See in particular A Dugdale (ed), *Clerk & Lindsell on Torts* (18th edn, 2000) Ch 2 para 63 and *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254, 281 (Lord Steyn).

[89]*Swindle v Harrison* [1997] 4 All ER 705 (CA) 717.

[90]*Hodgkinson v Simms* [1994] 3 SCR 377, 444; *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534. See also *Mouat v Clark Boyce* [1992] 2 NZLR 559 (CA) 568 (Cooke P)('more direct and natural').

duty of skill and care is limited by foreseeability and may be precluded by operation of intervening causes vindicates the two principles. Compelling reasons would be needed for applying different criteria to the recovery of compensation for equitable negligence than apply where recovery is founded on negligence sounding at law. It is difficult to see how the mere fact that a duty of skill and care arises out of an equitable relation raises special concerns calling for a deterrent or otherwise unusual response. The common law has settled on the idea that compensation for unintentional torts should be limited to losses of a foreseeable kind and there is no convincing reason why a different rule should condition recovery for unintentional misconduct sounding in equity. As Viscount Simonds observed in *The Wagon Mound (No 1)*, foreseeability is a peculiarly appropriate limitation on recoverable loss where foreseeability of loss is also an element of the defendant's liability,[91] as it is an element of equitable negligence.[92]

For parallel reasons there is good sense in allowing a wider net of recovery where the fiduciary has acted with patent disloyalty. The precise content of the duty or duties entailed by the relation of trust and confidence has not yet been fully worked out by the courts.[93] It is clear, however, that the relation requires the fiduciary to act in good faith in the interests of his beneficiary. The duty of good faith is broken if the fiduciary intentionally prefers his own interests or those of a third party over the interests of his beneficiary.[94] Thus any breach of trust committed intentionally and adversely to the interests of the beneficiaries will amount to a breach of the duty of good faith. The considerations of deterrence and morality that motivate the courts to allow a wider net of recovery against fraudsters apply with full force against faithless fiduciaries. There is also a special concern to protect the integrity of trusting relationships.[95] As noted above, Evans LJ distinguished in *Swindle v Harrison* between breaches of fiduciary duty that are and are not 'equivalent to fraud' and said that breaches that are equivalent to fraud

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[91] *The Wagon Mound (No 1)* [1961] AC 388 (PC) 423.

[92] *Re Chapman* [1896] 2 Ch 763 (CA) 774.

[93] See Chapter II Part 1(c)(ii).

[94] *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA) 19.

[95] See *Hodgkinson v Simms* [1994] 3 SCR 377, 452-453.

attract the more generous remoteness criteria applicable to a claim for deceit.[96]

There are other types of case that engage the fidelity principle but to which these considerations may not apply. A fiduciary may put himself in a conflict position without meaning to, in which case there is less justification for a deterrent or retributive measure of relief. *Re Bulmer* was such a case, for the defendant had not been aware that he was a fiduciary of the estate holding the equity of redemption in shares he purchased.[97] Moreover, not every intentional breach of trust engages the fidelity principle as a trustee may breach his duties judiciously with a view to benefiting the equitable interests. If instead a loss results he may be liable, but in the absence of authority it is reasonable to expect that the court would not apply the same wide remoteness criteria it would in a case of intentional disloyalty.

It is impossible to pretend that the decided cases give clear answers. Taken together, however, the import of Millett LJ's remarks in the *Mothew* case and Evans LJ's remarks in *Swindle v Harrison* appears to be that breach of a duty imposed by the relation of trust and confidence will only attract an unusually generous measure of recovery where the fiduciary has intentionally preferred other interests over those of his beneficiary.[98] That raises the question what remoteness criteria apply in cases of this sort. Fisher J said that reasonable foreseeability is not required but he did not think it would be enough to prove simple factual causation. He referred in this connection to the Supreme Court of Canada's decision in *Canson Enterprises Ltd v Boughton & Co.*[99] The defendant solicitor had failed to advise his purchaser client of facts indicating that his vendor client had flipped up the price of the property. If the purchaser had known this it would have withdrawn from the transaction. By reason of the subsequent negligence of an engineering firm the development of the property was a financial

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[96] *Swindle v Harrison* [1997] 4 All ER 705 (CA) 717.

[97] *Re Bulmer* [1937] Ch 499 (CA); see also *Boardman v Phipps* [1967] 2 AC 46. Neither case involved a reparation claim.

[98] See A Dugdale (ed), *Clerk & Lindsell on Tort* (18th edn, 2000) Ch 28 paras 22 & 25 and SB Elliott, 'Fiduciary Liability for Client Mortgage Fraud' (1999) 12 TLI 74.

[99] *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534.

disaster for the purchaser, who sued the solicitor when the engineering firm's insurance proved insufficient. Though the judges disagreed on how to characterise the governing doctrine, in effect they all agreed that the contractor's negligence was an intervening act that extinguished the causal efficacy of the solicitor's breach of fiduciary duty.

What emerges from these cases is that the remoteness test for intentional breach of the fiduciary duty of loyalty is broadly similar to the test conditioning recovery for the tort of deceit as described by the House of Lords in *Smith New Court Securities Ltd v Citibank NA*.[100] Losses of unforeseeable types are recoverable but there must be a direct causal link so that the defendant will not be liable for losses properly attributable to other causes. That accords with Tuckey LJ's remarks in *Collins v Brebner*, Evans LJ's analysis in *Swindle v Harrison*, as well as a number of Canadian decisions.[101] The concerns raised by fiduciary disloyalty are not precisely those raised by fraudulent misrepresentation but they are sufficiently similar to warrant a similar approach to remoteness problems.

Fisher J's analysis of breaches of trust involving the loss of trust property is more problematic. He included in this category not only dissipation of the corpus but any breach resulting in 'a diminution in the value of the property directly or constructively held on trust.'[102] This appears to cut across the categories of negligent and disloyal breach of duty Fisher J treated separately. His view seems to have been that those categories only include duties owed to the beneficiary personally, as the duty in the *Guardian Trust* case was said to be, and not duties relating to the trust estate itself. Following Lord Browne-Wilkinson's lead in the *Target Holdings* case,[103] Fisher J seems to have thought that a defaulting trustee is liable to make good without remoteness limitation all of the losses the estate itself would not have incurred if the

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[100] *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254.

[101] *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534; *Hodgkinson v Simms* [1994] 3 SCR 377; *Huff v Price* (1990) 76 DLR (4th) 138 (BCCA) 149, leave refused (1991) 56 BCLR (2d) xxxviii.

[102] *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213, 244.

[103] *Target Holdings Ltd v Redferns* [1996] AC 421, 434-435.

trust had been duly performed. He explained that this was because of 'special policy reasons for deterring trustees from carelessness or abuse of their position . . . in safeguarding the trust property.'[104]

It is not obvious what the special reasons Fisher J mentioned might be. Certainly by virtue of his control over the property a trustee has an opportunity to take advantage of the beneficiaries, but that does not raise different concerns from abuse of a position of trust and confidence by a non-trustee fiduciary such as a solicitor. It is also difficult to see why a trustee's careless or otherwise unintentional maladministration of the fund should attract a larger measure of reparative relief than the unintentional breach of any other equitable or common law duty one person owes in handling the affairs of another. Fisher J's analysis yields the anomaly that a negligent failure to safeguard trust property attracts a larger measure of relief than intentional disloyalty by a non-trustee fiduciary. There is nothing peculiar about the trust relation that justifies treating breaches of trust resulting in a diminution in the value of the property in a separate and higher category from breaches of duties arising out of other managerial relations. In setting this category of case apart Fisher J overlooked the two sensible principles underpinning the rest of his analysis. It is possible he did so in order to honour Lord Browne-Wilkinson's dictum in *Target Holdings*,[105] but that dictum must itself be regarded as premature.

(d) Conclusion

A number of conclusions may be drawn from this discussion. Plainly there is a need for the English courts to restate the remoteness criteria applicable to a reparation claim for breach of trust. The dicta in *Target Holdings* and *Collins v Brebner* as well as the statement in *Lewin on Trusts* provide an unsatisfactory basis for deciding future cases. In restating the law the courts should apply the two principles that underpinned Fisher

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[104] *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213, 245. Similarly *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534, 546-547 (McLachlin J).

[105] *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213, 243, and see also [1999] 1 NZLR 664 (CA) 679-680.

J's approach in the *Guardian Trust* case: they should tailor the applicable criteria to the different types of breach of trust that may be committed and they should develop those criteria harmoniously with the law as it applies to cognate common law wrongs. The progress of the law is towards treating breaches of trust in two broad compartments that correspond to the two major compartments discernable in tort law. The first includes unintentional and judicious breaches of trust; here the principal remoteness test should be reasonable foreseeability of the kind of loss. The second includes intentional disloyalty; here unforeseeable losses should be recoverable so long as they are the direct result of the breach.

4. Loss to the Trust Estate

The loss a defaulting trustee must make good is conventionally described as loss suffered by the trust estate.[106] The High Court of Australia, to give only one example, spoke in those terms in the *Higgins* case.[107] The court went on to describe the loss as 'a loss of corpus'.[108] The court plainly took these forms of words to be significant. The trial judge had ordered payment to the claimant beneficiaries in the amount of the loss they had suffered. The High Court said this was a remediable defect for the order should have been that 'any resulting loss be made good to the estate, not the beneficiaries.'[109] Hayton sums the conventional understanding up by saying that the '"cheated party" is really the trust personified'.[110]

The proposition that the loss to be made good is suffered by the trust estate is satisfactory for most practical purposes but cannot be strictly true for it is axiomatic that

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[106]Or, implicitly, loss suffered by some class of the beneficial interests.

[107]'The liability of a trustee committing a breach of trust is measured by the loss or depreciation which his act or omission has caused to the trust estate. He must make good any depreciation and damage which the estate has suffered.' *Elder's Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426, 453.

[108]Ibid.

[109]Ibid 447-448.

[110]DJ Hayton, *The Law of Trusts* (2nd edn, 1993) 23.

a trust is a relation between persons rather than a person itself. The loss must in some sense be that of the beneficiaries. The implicit idea, however, is that the measure of loss suffered by a trust estate may differ from that suffered by the beneficiaries personally.[111] This raises a nice theoretical problem that has received virtually no judicial or scholarly comment. The problem may be expressed in two questions. The first question asks on what basis a trustee may escape being charged with the full extent of the loss suffered by the beneficiaries personally where that is greater than the notional loss suffered by the estate. The second question asks on what basis a trustee may be charged with the full extent of the notional loss suffered by the trust estate where that exceeds the loss suffered by the beneficiaries personally. These questions will be taken in turn.

(a) The First Question

The answer to the first question lies in a rule that is not peculiar to equity or trusts but runs through the whole law relating to reparation claims. This rule is that a claimant is only entitled to recover losses falling within the scope of the defendant's duty. This is not a new limitation but it has recently been brought into prominence by Lord Hoffmann in *South Australia Asset Management Corp v York Montague Ltd.*[112] In order to apply the scope of duty limitation it is necessary to ascertain the purpose of the duty. This may involve interpreting a statute or divining the policy of the common law. The limitation is not unique to tort for a contracting party is likewise only responsible for the risks he undertook. Those risks are to be ascertained from the terms of the contract, read if necessary in light of the circumstances at the time the obligation was undertaken.[113]

The traditional theory appears to be that a trustee only undertakes to safeguard and administer the estate and to distribute the income and residue. He does not

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[111]This difference may be one of the reasons supporting the traditional doctrine that damages are not given for a breach of trust, for damages are usually measured by the claimant's subjective loss.

[112]*South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191.

[113]*Czarnikow (C) Ltd v Koufos* [1969] 1 AC 350, 414 (Lord Pearce).

undertake the risk of losses suffered by the beneficiaries personally through his maladministration. His liability is limited to losses suffered by the trust estate, then, because other losses fall outside of the scope of his duty. That is the reason Fisher J gave in the *Guardian Trust* case for saying that compensation for breach of trust is not 'a remedy for independent losses suffered personally by one or more of the beneficiaries.'[114] The Scottish writer Menzies puts it this way: 'The duty undertaken by the trustee is to account for the estate conveyed to the trustee in trust. He does not owe to the beneficiary any duty towards his estate. Therefore a breach of trust does not give rise to any question of damage to the estate of the beneficiary'.[115] It is important to be clear, however, that while the loss the trustee must make good is said to be that suffered by the estate, that expression is a shorthand because in fact and in principle the loss is suffered by the beneficiaries or some of them. The shorthand stands for the idea that the trustee is only responsible for losses the beneficiaries suffer by deterioration in the value of their interests under the trust.[116]

There are two exceptions to the scope of duty limitation on a trustee's liability. First, Lord Hoffmann recognised in the *South Australia* case that the limitation does not contain damages for fraudulent misrepresentation and it is generally assumed that it also does not contain damages for an equivalent equitable wrong.[117] If that assumption is right then a fiduciary who breaches his trust by intentionally preferring other interests over those of his beneficiary will be liable for the entire loss suffered by the beneficiary

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[114] *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213, 245 & 248.

[115] AJP Menzies, *The Law of Scotland Affecting Trustees* (2nd edn, 1913) 684-685.

[116] The same result would sometimes be achieved by applying the remoteness criteria discussed in Part 3 above. The loss a beneficiary suffers personally may have been of an unforeseeable type or it may be properly attributable to his own fault: *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213. See also the American cases *Re Trust under Will of Comstock*, 219 Minn 325, 339, 17 NW 2d 656 (1945) and *Wanamaker's Trust Estate*, 340 Pa 419, 17 A 2d 380, 382 (1941), aff'g 38 D & C 347 (1940).

[117] *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191, 215; A Dugdale (ed), *Clerk & Lindsell on Torts* (18th edn, 2000) Ch 28 para 26.

personally which is not too remote.[118]

Second, there are cases in which the scope of the trustee's duty may be broader than it is thought to be under a traditional trust. At this point one must heed Lord Browne-Wilkinson's caution in the *Target Holdings* case against applying specialist rules developed in connection with traditional family and testamentary trusts to trusts of a different kind.[119] The rule that a trustee does not undertake the risk of losses suffered by the beneficiaries personally is just such a specialist rule. Where the trust is instead a bare trust arising in a contractual context it may happen that the scope of the defendant's trust duties is co-extensive with the scope of his contractual duties.[120] That is how the New Zealand Court of Appeal analysed the scope of the debenture trustee's duties in the *Guardian Trust* case. Gault J said the commercial setting favoured 'treating this deed, though embodying a trust, in the same manner as the other documents making up the whole loan facility.'[121] A particular type of loss suffered by a beneficiary personally may still fall outside the scope of a bare commercial trustee's duties–the Bank's loss in the *Guardian Trust* case was in the event held to be outside the risk Guardian had assumed–but that depends upon the circumstances of the case including the purpose of the duty breached and the nature of the loss suffered.[122]

In addition to his discussion of bare trusts, Lord Browne-Wilkinson also mentioned the position of a traditional trust under which the beneficial interests have fallen into possession so that there is an immediate right to call for distribution.[123] He seems to have thought that in some cases where the interests are in possession a

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[118]This is implicit both in Fisher J's judgment and in the judgments given in the Court of Appeal in *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 213, aff'd [1999] 1 NZLR 664 (CA).

[119]*Target Holdings Ltd v Redferns* [1996] AC 421, 435.

[120]*Kelly v Cooper* [1993] AC 205 (PC).

[121]*Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (CA) 684.

[122]Ibid. See also Fisher J's remarks at 248.

[123]*Target Holdings Ltd v Redferns* [1996] AC 421, 435.

defaulting trustee must make good the loss suffered by the beneficiaries themselves.[124] Where this is so, Knox J has observed, 'each complainant would have to establish the individual quantum of injustice which he or she would have suffered'.[125] Lord Browne-Wilkinson said that in other cases where the interests have fallen into possession the trustee may be required to reconstitute the fund, by which he seems to have meant that the trustee must make good the loss suffered by the estate.[126] The *Higgins* case illustrates this second type of case.[127] The beneficiaries sued their trustee after their interests had fallen into possession for negligently mismanaging the trust property while their interests had remained contingent, and the High Court of Australia expressly held that the trustee's liability was to make good loss suffered by the estate rather than by the beneficiaries themselves.[128]

Lord Browne-Wilkinson did not say where the line falls between the two types of case in which the interests have already fallen into possession, but it is not difficult to ascertain. The difference between them depends upon the nature of the particular duty that is the subject of the claim. The administrative duties the trustee of a traditional trust owes are limited in scope to protecting the beneficiaries against deterioration in the value of their interests under the trust. As the *Higgins* case suggests, that scope cannot be enlarged by suing after the beneficial interests have fallen into possession. Once the beneficial interests fall into possession, however, the trustee incurs a further duty to distribute the portions. In its nature the scope of this duty is not limited to safeguarding the value of the fund and so a trustee who wrongfully withholds distribution may be liable for losses suffered by the beneficiary personally that are not too remote. That is why, as we shall see in Chapter IX, a withholding trustee may be charged with interest reflecting the loss the beneficiary has himself suffered by being kept out of his money.

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[124]Though he added that the loss may be quantified by reference to 'what the fund would have been but for the breach of trust': ibid.

[125]*Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862, 897.

[126]See exposition in Chapter VI Part 1.

[127]*Elder's Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426.

[128]Ibid 447-448 & 453.

(b) The Second Question

The second question asks on what basis a trustee may be charged with the full extent of the notional loss suffered by the trust estate where that exceeds the loss suffered by the beneficiaries personally. That a trustee may be charged beyond the loss suffered by the beneficiaries personally is indicated by Brightman LJ's disposition of the intermediate taxation liability point in *Bartlett v Barclays Bank Trust Co Ltd.*[129] He held that the *Gourley* principle has no application to a claim for breach of trust.[130] In that case the Revenue had indicated that it would not seek to tax any pecuniary recovery the beneficiaries might receive in the litigation even though the beneficiaries would have had to pay tax if they had received the same sum as distributions as they should have. Accordingly, a defaulting trustee's liability is not to be reduced by reason of the fact that the beneficiary will have to pay less tax on the sum paid to him under court order than he would have had to pay if the trust had been duly administered. The result is that the beneficiary ends up with what must regarded as a windfall. This result conflicts with the basic principle that a defaulting trustee may not be charged with reparative compensation in a sum greater than the causally-related loss suffered by the claimant.[131]

Brightman LJ accepted that his refusal to take intermediate fiscal liabilities into account produced an unfair result but thought that was required by 'the established principles upon which equitable relief is granted'.[132] He explained these principles in the following terms:

> My reasoning is this: the obligation of a trustee who is held liable for a breach of trust is fundamentally different from the obligation of a contractual or tortious wrongdoer. The trustee's obligation is to restore to the trust estate the assets of which he has deprived it. The tax liability of individual beneficiaries, who have claims qua beneficiaries to the capital and income of the trust estate, do not enter into the picture because they arise not at the point of restitution to

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[129] *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515.

[130] *British Transport Commission v Gourley* [1956] AC 185.

[131] *Target Holdings Ltd v Redferns* [1996] AC 421, 432.

[132] *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 545.

> the trust estate but at the point of distribution of capital and income out of the trust estate. These are different stages despite the fact that they coalesce in the draft minutes [of the order].[133]

Brightman LJ also referred to Vinelott's decision not to apply the *Gourley* principle in *Re Bell's Indenture*.[134] That, however, was a different kind of case. The trustees in *Re Bell's Indenture* had sold certain agricultural land and improperly distributed the proceeds. Vinelott J said the *Gourley* principle has no application to 'an action against a defendant who has misappropriated money or property to compel him to restore that which he has wrongfully taken or its value.'[135] That is thought to be perfectly correct, for the *Gourley* principle concerns the measurement of loss whereas the claim for restitution Vinelott J described is not founded upon loss.[136]

Bartlett's case involved a reparation claim alleging that the trustee Barclays Bank's neglect of certain shareholdings resulted in loss in the shape of a diminution in the value of the equitable interests. Vinelott J's reason for distinguishing the *Gourley* principle does not apply where the claim is for reparation of loss. Brightman LJ's premiss that a 'trustee's obligation is to restore to the trust estate the assets of which he has deprived it' was false for it did not describe the obligation being enforced against Barclays Bank. Brightman LJ himself seems to have recognised this, for he said earlier in his reasons that 'the claims in this case are not and cannot be for restitution in the strictest sense.'[137] He went on to explain that:

> The so-called restitution which the defendant must now make to the plaintiffs,

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[133]Ibid.

[134]*Re Bell's Indenture* [1980] 1 WLR 1217.

[135]Ibid 1236.

[136]In fact the claim in *Re Bell's Indenture* was against the partners of the solicitor who had facilitated the wrongful distribution, but Vinelott J could see no distinction between the liability of a trustee who misappropriates property and the liability of 'a solicitor acting for trustees who assists with knowledge in a misappropriation by the trustees': ibid 1236. This proposition is difficult to maintain in the face of *Royal Brunei Airlines v Tan* [1995] 2 AC 378 (PC).

[137]*Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 544. As to the use of the restitution concept in this passage see, further Chapter III Part 2.

> and to the settled shares, is in reality compensation for loss suffered by the plaintiffs and by the settled shares, not readily distinguishable from damages except with the aid of a powerful legal microscope.[138]

That is exactly why Brightman LJ's professed basis for distinguishing the *Gourley* case was misconceived, there being no such microscope.

It is possible to detect a second strand in Brightman LJ's reasoning. He emphasised that the individual beneficiaries claimed 'qua beneficiaries to the capital and income of the trust estate'. This suggests an inverse application of the scope of duty point explained above. The idea is that a trustee only undertakes the risk of loss suffered by the beneficiaries by deterioration in the value of their interests and so parity requires that he be responsible for the entire loss suffered by the beneficial interests without regard to the actual loss the beneficiaries suffer personally. This argument has an attractive symmetry but lacks substance because the beneficial interests do not have personality and so cannot suffer loss that is distinct from that suffered by the beneficiaries. The scope of duty limitation does not operate inversely: its only function is to explain why certain defendants should not be required to make good losses of which their breach of duty was a factual cause. Put differently, the argument fails to provide any reason at all for overriding the basic principle that a defaulting trustee should not be charged with reparative compensation in a sum greater than the causally-related loss suffered by the claimant.

Neither of these lines of argument justifies Brightman LJ's refusal to take intermediate fiscal liabilities into account in calculating the amount of compensation payable by Barclays Bank. That refusal may nonetheless be defensible on the pragmatic ground that doing so would involve the court in an exercise the complexity of which is not justified by its potential impact. Nicholls LJ took this line in *John v James*, a case involving an account of profits earned in relation to publishing and recording agreements, with the result that the claimant recovered more than the defendant's profits

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[138]Ibid 545.

net of tax.[139] The Court of Appeal, however, directed that income tax be taken into account when rescinding certain agreements in *O'Sullivan v Management Agency and Music Ltd.*[140] The boundaries of this pragmatic argument have yet to be worked out. In doing so the courts should aspire to achieve a consistent result across all categories of case whether the rights in question are legal or equitable.

(c) Conclusion

There is a credible argument that in certain cases the reparative liability of a defaulting trustee should be limited to the loss suffered by the estate, by which is understood the loss suffered by the beneficiaries by deterioration in the value of their equitable interests. The argument depends upon the scope of the duty undertaken by the trustee and it is subject to exceptions where the trustee has breached his duty of good faith and where in the circumstances the trustee undertook a larger duty than that conventionally assumed by the trustee of a traditional family trust. Logically the scope of duty argument has no inverse application and cannot justify charging a trustee with more than the loss suffered by the beneficiaries personally. The principle that a defaulting trustee cannot be required to pay by way of reparative compensation more than the loss suffered by the claimant requires that the trustee's liability be limited to the loss suffered by the beneficiaries personally where that is less than the notional loss suffered by the trust estate. Special reasons such as the pragmatic considerations relied upon by Nicholls LJ in *John v James* must be given for infringing this principle.

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[139] *John v James* [1986] STC 352.

[140] *O'Sullivan v Management Agency and Music Ltd* [1985] QB 428 (CA).

REPARATION CLAIMS

INTEREST

CHAPTER IX

INTEREST

Chapter IX

This chapter considers the pre-judgment equitable interest that may be charged against a custodial fiduciary.[1] Whereas interest on sums payable at law is only available by contract or by custom or by the grace of legislation, interest on claims that find their provenance in equity is available in the High Court's inherent jurisdiction.[2] Though the principles governing equitable interest are respectably old, important issues remain unsettled. Disagreement extends as far as the types of interest that may be given in respect of equitable claims.

1. Types of Equitable Interest

The starting point is to distinguish the types of equitable interest with which a fiduciary may be charged. There are only two, namely disgorgement interest and compensatory interest. The difference between them may be expressed in terms of the object they are calculated to achieve. Disgorgement interest is calculated to strip profits the fiduciary has made through use of the trust property.[3] Compensatory interest, by contrast, is calculated to repair losses a person or estate has suffered by being deprived of its money over time. A third type, penal interest, is not allowed in England.

This is straightforward enough, but the organisation of the subject has been complicated by frequent references to *Attorney-General v Alford*. In that case Cranworth LC gave this formulation of the circumstances in which a defaulting

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[1]Some of the material contained in this chapter has been published as SB Elliott, 'Rethinking Interest on Withheld and Misapplied Trust Money' [2001] Conv 313.

[2]*Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) 388, 397, 406; *Rama v Millar* [1996] 1 NZLR 257 (PC) 262; Supreme Court Act 1981, s 35A; Late Payment of Commercial Debts (Interest) Act 1998.

[3]The term restitution is sometimes used: for example *Kuwait Oil Tanker Company SAK v Al Bader* [2000] 2 All ER (Comm) 271 (CA) 344.

fiduciary may be charged with interest:

> What the Court ought to do, I think, is to charge him only with the interest which he has received, or which it is justly entitled to say he ought to have received, or which it is so fairly to be presumed that he did receive that he is estopped from saying that he did not receive it.[4]

These canonical words have meant all things to all people.

The true interpretation of *Attorney-General v Alford* is this. The Lord Chancellor identified three types of legitimate interest charge. First, if a fiduciary misapplies trust money and earns interest on it then the beneficiary is entitled to charge him with that interest. This is a species of disgorgement interest for the charge represents profits the fiduciary is known to have made. Sometimes, however, it is not easy to know what profits the fiduciary has made though it is plain that he has used trust money for his own purposes. In cases of this second variety the court presumes that the fiduciary has made a certain return and charges him with interest accordingly. This is a second species of disgorgement interest measured by presumed rather than known profits. What, then, of the third type, interest the fiduciary 'ought to have received'? Trustees and certain other fiduciaries are often required to invest the money productively, and if they fail to do so then they may be charged with the interest the fund would have earned if they had done their duty. Interest of this third type is given by way of compensation.

On analysis, then, Cranworth LC's formulation is reducible to the proposition that fiduciaries may be charged in an appropriate case either with disgorgement interest, of which there are two species, or with compensatory interest. Grant MR stated the law in simpler terms in *Rocke v Hart*: 'an executor is not charged with interest, except upon one of two grounds: either, that he has made use of the money himself, or that he has neglected to lay it out for the benefit of the estate.'[5] Disgorgement and compensatory

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[4] *Attorney-General v Alford* (1855) 4 De GM & G 843, 851, 43 ER 737.

[5] *Rocke v Hart* (1805) 11 Ves 58, 59-60, 32 ER 1009; see also *Inglis v Beaty* (1878) 10 AR 453 (Ont CA) 490.

interest will be treated in turn following a few remarks about penal interest.

(a) Penal Interest

Interest is given on a penal basis where the award is augmented beyond the level required to achieve either disgorgement or compensation, as the circumstances require, in order to punish the defendant's egregious misconduct. This may be done by fixing interest at a higher rate than would otherwise be payable or by compounding it in circumstances where simple interest would otherwise be appropriate. Several English text writers contend that penal interest may be given where a fiduciary has been guilty of fraud or serious misconduct.[6] This is either false or misleading, for English courts have refused to give penal interest since the middle of the nineteenth century.

The leading case of *Attorney-General v Alford* has already been mentioned.[7] Alford was an executor charged with distributing an estate to certain charities. He did not distribute the estate or notify the charities of the bequests, but nor did he use the money for his own purposes. Alford simply kept the money for twelve years uninvested in his hands. Stuart V-C thought Alford had behaved badly in not notifying the charities and by way of punishment directed him to pay 5% compound interest on the uninvested balances.[8] On appeal, however, Cranworth LC reduced this to the standard trustee rate of compensatory interest, which at that time was 4% without rests. The Lord Chancellor founded his decision on the proposition that misconduct is only material to the question of interest where it has benefited the fiduciary, which is to say where proof of the misconduct supports a fair inference that he has profited. The beneficiary is entitled to

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[6]For example Lord Hailsham (ed), *Halsbury's Laws of England* (4th edn reissue, 1995) Vol 48 para 966; J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 39 para 33; J Martin, *Hanbury & Martin, Modern Equity* (16th edn, 2001) 647-658; J McGee, *Snell's Equity* (30th edn, 2000) 326; AJ Oakley, *Parker & Mellows, The Modern Law of Trusts* (7th edn, 1998) 689-690. This chapter is not concerned with the supposed equitable jurisdiction to award compound interest on money obtained by fraud, on which see *Johnson v R* [1904] AC 817 and *Clef Aquitaine SARL v Laporte Materials (Barrow) Ltd* [2000] 3 WLR 1760 (CA) 1774-1777.

[7]*Attorney-General v Alford* (1855) 4 De GM & G 843, 43 ER 737.

[8]*Attorney-General v Alford* (1854) 2 Sm & Giff 488, 65 ER 494.

disgorgement interest in those circumstances. If there has not been any profiteering then the fiduciary is only liable to be charged with compensatory interest at the standard rate. The rate of interest cannot be adjusted in order to punish the fiduciary.

Attorney-General v Alford stands for the proposition that the court may not award penal interest against a misconducting fiduciary, and English courts have constantly adhered to this.[9] James LJ said in *Vyse v Foster* that Chancery is not a court 'of penal jurisdiction', and that 'A man squandering trust money with deliberate dishonesty in profligate extravagance would be answerable for it with 4 per cent. interest'. [10] In other words, he would be liable to restore the money with interest at the standard compensatory rate. The prohibition on penal interest is consonant with the observable resistance of English courts to punitive damages. It also accords with the refusal of English courts to give punitive interest where that award is not founded upon equitable rights.[11] Even if misconducting fiduciaries were thought to deserve civil punishment,[12] adjusting the rate of interest would be a capricious and indirect way of punishing them.

Suggestions that custodial fiduciaries may be charged with penal interest generally stem from a failure to distinguish between penal and disgorgement interest.[13] In the nature of things, disgorgement interest is usually given in cases where the fiduciary has fraudulently misused trust property for his own purposes, and the award in

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[9]For example *Burdick v Garrick* (1870) LR 5 Ch App 233, 241, 243; *Belmont Finance Corporation Ltd v Williams Furniture Ltd. (No 2)* [1980] 1 All ER 393 (CA) 419; *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) 388; *Miliangos v George Frank (Textiles) Ltd* [1977] QB 489, 495; *Guardian Ocean Cargoes Ltd v Banco do Brasil SA (No 3)* [1992] 2 Lloyd's Rep 193, 198. See also *Equiticorp Industries Group Ltd v The Crown (No 3)* [1996] 3 NZLR 690.

[10]*Vyse v Foster* (1872) LR 8 Ch App 309, 333; aff'd (1874) LR 7 HL 318.

[11]The cases are collected in F Rose, 'Interest' in PBH Birks & F Rose (eds), *Lessons of the Swaps Litigation* (2000) Ch 11 nn 105 & 106.

[12]See The Law Commission, *Aggravated, Exemplary and Restitutionary Damages* (Law Com No 247, 1997) Ch 5 paras 54-56.

[13]The very few cases occasionally cited in support of the supposed practice of awarding penal interest have either been misunderstood or antedate *Attorney-General v Alford*: see especially *Jones v Foxall* (1852) 15 Beav 388, 15 ER 588 and *Gordon v Gonda* [1955] 1 WLR 885 (CA) 896.

such a case may be thought to perform a punitive function. Hatherley LC explained, however, in *Burdick v Garrick* that this is not the court's object in awarding disgorgement interest:

> The court does not proceed against an accounting party by way of punishing him for making use of the plaintiff's money by directing rests, or payment of compound interest, but proceeds upon this principle, either that he has made, or has put himself into such a position as that he is to be presumed to have made, 5 per cent., or compound interest, as the case may be.[14]

The policy the court pursues in stripping fiduciaries of profits made in the course of their engagement cannot be punitive for it applies equally where the fiduciary has acted faultlessly. Moreover, disgorgement interest is calculated to approximate the defendant's illegitimate profits, whereas proportional punishment might require a higher award. On analysis, purportedly penal interest awards are often better explained as disgorgement interest.[15]

(b) Disgorgement Interest

In Chapter V we saw that if a custodial fiduciary misapplies money profitably, whether mistakenly or for his own benefit, the beneficiary may elect how he wishes to have the account taken.[16] His first option is to disallow the outlay and claim restoration of the misapplied sum with compensatory interest. His second option is to ratify the outlay and have the proceeds brought into the account. If the beneficiary exercises this second option then the fiduciary will be treated as if he had received the proceeds for the beneficiary and he may be compelled to apply it or its pecuniary substitute to the purposes of the trust. The claim by which the beneficiary demands that the proceeds be so applied may be best understood as a claim for performance of the trust attaching to

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[14] *Burdick v Garrick* (1870) LR 5 Ch App 233, 241.

[15] For example *Southern Cross Commodities v Ewing* (1987) 91 FLR 271 (SASC) 285.

[16] *Foskett v McKeown* [2001] AC 102, 130; *Boscawen v Bajwa* [1996] 1 WLR 328 (CA) 341-342; *Re Hallett's Estate* (1880) 13 ChD 696 (CA) 709; *Scott v Scott* (1963) 109 CLR 649. See Chapter V Part 4.

those proceeds.[17]

If the beneficiary elects an account of the profits then he is ordinarily entitled to further elect the basis on which those profits are to be assessed.[18] His first choice is to claim an account of the profits that have actually been made in which case whatever interest the fiduciary has earned must be brought into account. This may be called actual disgorgement interest. Taking these accounts can be tedious and costly because actual profits are often difficult to ascertain. Typically the money has been thoroughly mixed up with the working capital of the fiduciary's business. For this reason the law affords the beneficiary a more convenient alternative. The beneficiary's second choice is to claim an account of the misapplied money with interest at a standard rate reflecting what the fiduciary may fairly be presumed to have made.[19] This may be called presumed disgorgement interest. Presumed disgorgement interest is normally compounded if it is reasonable to presume the fiduciary has made compound returns. The standard rate of presumed disgorgement interest and the circumstances in which it may be compounded will be treated in detail below. An account of presumed profits is usually preferred whenever it is not easily demonstrable that the fiduciary's actual profits exceed the standard disgorgement rate of interest.

There are two restrictions on the beneficiary's otherwise free choice between these two modes of accounting for profits. The first is that he may not claim presumed profits unless he can prove that the fiduciary has actually used the money for his own financial benefit. The beneficiary does not need to establish the details of this use, but he does need to show that the fiduciary intended to retain the benefit for himself. A trustee who innocently but mistakenly invested trust money in an unauthorised instrument could be held accountable for the actual returns on the investment but not for interest at the standard disgorgement rate if that exceeds what was actually made. The

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[17]See discussion in Chapter II Part 2(a).

[18]*Docker v Somes* (1834) 2 My & K 655, 673, 39 ER 1095. Compare *Mathew v TH Sutton Ltd* [1994] 1 WLR 1455, 1463, in which Chadwick J seems to have mistakenly assumed that this choice lies in the discretion of the court.

[19]*Vyse v Foster* (1872) LR 8 Ch App 309, 329.

second restriction is that in cases of unusual complexity or where the documentary evidence is unreliable the court may refuse to allow an account of the actual profits and require the beneficiary to accept presumed profits, but this discretion is exercised sparingly.[20]

If the beneficiary opts for an account of the money with interest at the standard disgorgement rate, the fiduciary may not argue that the disgorgement interest should be calculated at a lower rate because less has in fact been made,[21] or because the profits have been taxed in the fiduciary's hands.[22] The reason seems to be that to allow arguments of this sort would undermine the policy behind allowing the claimant to elect between claiming an account of the fiduciary's actual profits or interest at the standard disgorgement rate. That policy is to simplify litigation by foreclosing complicated but unpromising disputes over quantum.

(c) Compensatory Interest

Compensatory interest is distinct from penal interest and disgorgement interest in that it is calculated to repair losses rather than punish misconduct or strip profits. Compensatory interest is often less generous than disgorgement interest, and for this reason beneficiaries generally prefer to claim disgorgement interest if they have the choice. As a consequence compensatory interest is sometimes overlooked. Lord Woolf has gone so far as to deny that equity ever awards compensatory interest,[23] and

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[20] *Docker v Somes* (1834) 2 My & K 655, 39 ER 1095.

[21] *Attorney-General v Alford* (1855) 4 De GM & G 843, 852, 43 ER 737; explained in *The Mayor of Berwick v Murray* (1857) 7 De GM & G 497, 519-520, 44 ER 194; *Robinson v Robinson* (1851) 1 De GM & G 247, 257, 42 ER 547; *Burdick v Garrick* (1870) LR 5 Ch App 233, 243-244; D Browne, *Ashburner's Principles of Equity* (2nd edn, 1933) 148.

[22] *John v James* [1986] STC 352, 363-364; and *Equiticorp v The Crown* [1996] 3 NZLR 690, 703-706. Compare *O'Sullivan v Management Agency and Music Ltd* [1985] QB 428 (CA) 460.

[23] *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, 724 & 730; see also *Duke Group Ltd (in liq) v Pilmer* (1999) 73 SASC 64 (Full Ct) 236; *Equiticorp v The Crown* [1996] 3 NZLR 690, 697.

according to one writer it is a heresy to think otherwise.[24] These opinions could not be more wrong, for compensatory interest has been available for as long as equity has been taking trust accounts.

There are four categories of case in which a fiduciary may be charged with compensatory interest. The first category includes cases in which the fiduciary has kept money idle in his hands which he ought to have invested for the benefit of his trust (non-investment cases). The second category includes cases in which the fiduciary has withheld money, failing to pay it over to the beneficiary when due (withholding cases). The third category includes cases in which the fiduciary has misapplied money (misapplication cases). The fourth category includes cases where by otherwise breaching his trust the fiduciary has incurred a liability to repair loss suffered by the trust estate with money taken from his own pocket (reparation cases). These four categories will be treated in turn.

The non-investment cases present few difficulties. If a fiduciary has held money in his hands which he ought to have invested then he may be charged with compensatory interest at a rate reflecting the return the money should have been earning.[25] Interest is charged in order to make good the loss the fund has suffered by the fiduciary's breach in having 'neglected to lay [the money] out for the benefit of the estate.'[26]

The category of withholding cases consists of those cases in which the fiduciary has failed to pay money over to the beneficiary when due. A duty to pay money over might arise, for example, because the date of distribution under a trust has arrived, or

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[24]JRL Davies, 'Interest as Compensation' in PD Finn (ed), *Essays on Damages* (1992) 134. See also F Rose, 'Interest' in PBH Birks & F Rose (eds), *Lessons of the Swaps Litigation* (2000) Ch 11, 308-309.

[25]There may be circumstances in which, for any number of reasons, the accountant was entitled to hold money for a time unproductively. Here the fund cannot be said to have foregone income in respect of that period and so it would be inappropriate to charge interest on the balances: for example *Re Hulkes* (1886) 33 ChD 552, 558.

[26]*Rocke v Hart* (1805) 11 Ves Jun 58, 59-60, 32 ER 1009.

because a proper demand has been made of an agent, or because a third party has received misapplied trust property with knowledge of the breach. A withholding fiduciary may be ordered to pay over the money with interest at a compensatory rate. In these circumstances the fiduciary's investment obligations, if any, will by definition have expired, and so it would be inappropriate to calculate compensation on the basis that the fund has lost the benefit of an investment opportunity.[27] It is the beneficiary himself who has lost the opportunity to use the money. The loss in a case of this sort is not a loss to the fund, but rather a loss the beneficiary suffers personally by being wrongfully kept out of his money.[28]

The category of misapplication cases includes cases both where the money is misapplied by mistake and where it is misapplied intentionally and for the fiduciary's own benefit. We have seen that where money has been profitably misapplied the beneficiary may elect to allow the outlay and have an account of those profits. Here we are concerned with the beneficiary's other choice, which is to disallow the payment and have the money restored. If the beneficiary chooses this course the misapplication will be treated in the account as if the fiduciary had dealt with his own money, all the while keeping the trust money in his hands, and he will be charged with compensatory interest on these notional balances.[29] It is important to appreciate that interest is not charged because the fiduciary has misapplied the money, for the account is taken as if the money has not been misapplied. Rather, interest is charged for one of two reasons, depending on what the fiduciary should have done with the money which he instead misapplied. Either the fiduciary is made to pay interest because he has not invested the notional balances for the benefit of the trust,[30] or he is made to pay interest because he failed to

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[27]Compare *Re Emmet's Estate* (1881) 17 ChD 142, discussed in Part 5 below.

[28]See discussion in Chapter VIII Part 4.

[29]*Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) 397; *Knott v Cottee* (1852) 16 Beav 77, 51 ER 705; *Re Hulkes* (1886) 33 ChD 552, 557-558; D Browne, *Ashburner's Principles of Equity* (2nd edn, 1933) 147.

[30]Interest may be awarded at the conclusion of a common accounting where the account shows uninvested balances notwithstanding the fact that it is an accounting of what the defendant has actually received only. This is a recognised exception to the general rule. The exception is justified by the fact that it would be wasteful to order a further wilful default account where uninvested balances have been

pay the money over to the beneficiary when it became due. In this way every misapplication case falls to be analysed, for the purposes of awarding compensatory interest, as either a non-investment case or a withholding case.

The fourth category of case occurs where by breaching his trust in some other way the fiduciary incurs a liability to make good losses suffered by the estate. His liability arises at the date on which the loss is suffered and he must pay compensatory interest on the sum from that date forward.[31] Interest is charged as if he had brought the sum into account at that time and so interest is again charged depending on whether it should have then been invested or paid over to the beneficiaries. As with misapplication cases, every reparation case falls to be analysed as either a non-investment case or a withholding case.

It should be clear that compensatory interest on withheld or misapplied money is routinely available in a number of situations. These situations reduce to two analytical types, namely non-investment cases and the withholding cases. The significance of this distinction will become clear in the next part, which is concerned with the question of measurement. It should also be clear that a claim for compensatory interest is a straightforward claim for reparative compensation founded on a breach of trust.

2. Measurement of Compensatory Interest

The measure of presumed disgorgement interest is simply the profits the fiduciary is presumed to have earned. The measure of compensatory interest raises more complicated questions. These questions are governed by the dominant object of all compensatory relief, which is to put the claimant in the position he would have occupied if the breach had not occurred. Different considerations apply in non-investment cases and in withholding cases. In non-investment cases the concern is to craft an award

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held for the reason that the defendant's liability to pay interest is obvious. See *Jones v Morall* (1852) 2 Sim (NS) 241, 61 ER 233; *Partington v Reynolds* (1858) 4 Drew 253, 258, 62 ER 98; and *Re Barclay* [1899] 1 Ch 674.

[31] *Elder's Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426 is a good example.

which places the fund in the position it would have occupied if the money had been properly invested. In withholding cases the concern is instead to place the beneficiary in the position he would have occupied if he had been paid on time.

(a) Non-investment Cases

In non-investment cases the court aims to fix the rate of compensatory interest to reflect the returns that would have been earned by the fund if the money had been properly invested. It follows that the first question to ask is how the money should have been invested. The answer to this question depends upon the individual mandate of the fiduciary who is to be charged. There are a number of possibilities worth considering.

If the money should have been kept in a particular income-earning investment, then there is no difficulty settling the rate of interest that should be applied. The correct rate is the rate of return that the particular investment would have yielded, for that is the measure of the loss sustained by the fund.[32] In *Mosely v Ward*, for instance, the money had been invested in securities yielding 5%.[33] The trustee wrongfully called in the money, and Eldon LC held him accountable for interest at 5% rather than the lower standard rate of compensatory interest.

If the defendant is a trustee then he will commonly have a power to select from a large menu of authorised investments. At one time it was thought by some judges that here the fiduciary should account for the money as if it had earned the returns obtainable on the best performing of the authorised investments.[34] This was believed to be an application of the maxim that everything is presumed against a wrongdoer. This theory was repudiated by the Lord Justices in *Robinson v Robinson*.[35] They ruled that where a

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[32]*Robinson v Robinson* (1851) 1 De GM & G 247, 256, 42 ER 547.

[33]*Mosely v* Ward (1805) 11 Ves Jun 581, 32 ER 1214; similarly *Jones v Foxall* (1852) 15 Beav 388, 15 ER 588.

[34]*Hockley v Bantock* (1826) 1 Russ 141, 38 ER 55 and its successors. There was a conflicting line of authority beginning with *Marsh v Hunter* (1822) 6 Madd 295, 56 ER 1103.

[35]*Robinson v Robinson* (1851) 1 De GM & G 247, 258-260, 42 ER 547.

trustee has a power to select investments which he fails to exercise, or exercises wrongly, then the beneficiaries are only entitled to charge him with the money at the standard trustee rate of interest. The trustee rate reflects the average return on authorised investments and for this reason is thought to represent a fair valuation of the investment opportunity the fund has lost.

It is easy to imagine other scenarios in which the fund would have to be compensated on some other basis. Consider, for example, an investment fund which may only be invested in equities of a particular type. The trustee rate would be inappropriate in a case involving a fund of this sort because it reflects the mean return on a wider range of investment types. The proper course would be to compensate the fund by reference to the average yield on a representative basket of the particular equities over the material period.[36]

(b) Withholding Cases

The withholding cases raise different questions. The problem here is how to measure the loss a beneficiary suffers directly by delayed payment of his money. In not being paid his money when he should have been a beneficiary loses the value of that money in the interval. What the value of the money is to him depends on what he would have done with it. There are three possibilities to canvas. The first is that he would have invested it, in which case his loss is the return that he might have earned. It should be observed that unlike trustees, beneficiaries are not obliged to invest their money in any particular way. The second possibility is that he would have used the money to pay down a debt, in which case his loss is the interest payments he would have saved. The third possibility is that he would have spent the money consumptively. Where this is so his loss is the cost of his delayed gratification. The best way to measure this delayed gratification is by assuming that the beneficiary has had to borrow money to finance his hypothetical consumption and to fix his loss at the price of that loan.

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[36]For guidance see *Re Mulligan* [1998] 1 NZLR 481; *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA); and *Wells v Wells* [1999] 1 AC 345. See also G Watt & M Stauch, 'Is There Liability for Imprudent Trustee Investment?' [1998] Conv 352.

Deciding in which of these three ways a particular beneficiary would have used his money must be, in many cases, a speculative exercise. Even if the answer could be known, it would then be difficult to ascertain precisely what returns this beneficiary would have obtained or what price this beneficiary would have had to pay for a loan. The hypotheses are so numerous and the band of realistic conclusions is so narrow that the exercise must often be arbitrary and wasteful. For this reason the courts generally refuse to enter into questions of this sort and instead simply award compensatory interest at a standard rate reflecting the value of money to a typical beneficiary.

Two cases illustrate current practice. In *Re Duckwari plc* the Court of Appeal awarded compensatory interest at the commercial rate and expressly refused to take into account the suggestion that the particular beneficiary, a small company, would only have been able to obtain credit at a higher cost.[37] This reflects a policy of foreclosing complicated and unpromising disputes about quantum. In the same year Rix J indicated in *Dubai Aluminium Co Ltd v Salaam* that the court will reluctantly enter into a more detailed consideration of the beneficiary's particular circumstances if the sums involved are very large or there are other reasons for believing that the matter is worth pursuing.[38] In that case the sums were large but the rate was only being selected in order to settle the defendants' respective liabilities to contribute and so Rix J opted for 'simplicity rather than perfect accuracy' and applied the commercial rate. The standard rates of compensatory interest in withholding cases as well as non-investment cases will be treated in the next Part.

3. Standard Rates

The principle that interest should be awarded at a rate effecting full and accurate disgorgement or compensation, as the case may be, is balanced by a public interest in

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[37] *Re Duckwari plc (No 2)* [1999] Ch 268 (CA) 273.

[38] *Dubai Aluminium Co Ltd v Salaam* [1999] 1 Lloyd's Rep 415, 464-465, varied without comment on this point [2001] QB 113 (CA). It is not clear whether Rix J viewed the award in that case as compensatory or disgorgement interest.

having uniform rules that facilitate the resolution of disputes.[39] The courts have often been willing to compromise justice in particular cases in favour of upholding a consistent and simple practice. In order to effect accurate disgorgement or compensation the courts would have to award interest at fluctuating rates tracking changes in the investment climate. From at least the eighteenth century through the middle of the twentieth century the courts generally refused to do so, preferring to award compensatory interest at a standard trustee rate of 4%. This was thought to represent the average return on government debt, which was the principal authorised trust investment.[40] Likewise, presumed disgorgement interest was generally given at the then commercial rate of 5%,[41] which was thought to represent the usual return on money invested in the market.[42] These standard rates had the virtue of being predictable and easy to apply.

The standard trustee rate was challenged in different historical periods as being either too low or too high. The claimant in *Rocke v Hart* argued at the beginning of the nineteenth century that a higher rate of 5% should be given as that had been the usual return on trustee investments for some twenty years. Grant MR refused to award any more than 4% because of the perceived importance of maintaining a simple rule:

> Complete indemnity is not obtained unless that interest is paid, which might have been made. But that is not the principle, upon which the Court proceeds. A rule has been laid down as to interest from which the Court does not depart without special reasons; not for the general reason, that more might have been made . . . for that exists in every possible case.[43]

By the end of that century the complaint was instead that the 4% rate was too high. For

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[39]See *Fraser v Perpetual Trustees Estate and Agency Co of New Zealand Ltd* [1978] 1 NZLR 620, 625-626.

[40]*Re Lambert* [1897] 2 Ch 169, 180.

[41]*Gordon v Gonda* [1955] 1 WLR 885 (CA); *Re Davis* [1902] 2 Ch 314. There were exceptions. In *Re Emmet's Estate* (1881) 17 ChD 142 at 151, for example, Hall V-C said there was no absolute rule and awarded disgorgement interest at 4%.

[42]*Re Roberts* (1880) 14 ChD 49 (CA) 52.

[43]*Rocke v Hart* (1805) 11 Ves Jun 58, 60, 32 ER 1009.

a short while interest was given at a rate of 3%,[44] but a rate of 4% had been reasserted by the 1920s.[45] The same questions were raised in Australian courts and in 1942 found their way to the High Court in *Re Tennant*.[46] The argument was that the standard rate of 4% had moved out of line with market returns, but the High Court refused to vary it. Dixon J articulated the traditional policy in strong terms: 'Experience of the marked fluctuations in interest rates has rather confirmed the policy of the court in fixing for its purposes a rate which over a long period represents a fair or mean rate of return for money.'[47] This brings to mind John Maynard Keynes's quip that in the long run we are all dead.

(a) Current rates

High and variable inflation in the 1970s and 1980s eventually forced this policy to bend. Since *Wallersteiner v Moir* in 1975 English courts have awarded equitable interest at fluctuating rates pegged to recognised scales.[48] Two scales have been used, yielding the trustee rate and the higher commercial rate. The trustee rate, which was formerly 4%, is now pegged to the rate of interest allowed from time to time on the court's special investment account.[49] This rate is periodically adjusted by the Lord Chancellor and approximates the return on National Investment instruments. The trustee rate has been applied in cases involving private trusts, both where the money should have been held on proper investments during the relevant time and where it should have been paid over

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[44]Beginning with *Re Goodenough* [1895] 2 Ch 537.

[45]See cases cited in D Browne, *Ashburner's Principles of Equity* (2nd edn, 1933) 148.

[46]*Re Tennant* (1942) 65 CLR 473.

[47]Ibid 507-508.

[48]*Wallersteiner v Moir (No 2)* [1975] QB 373 (CA).

[49]This is the account to which English funds lodged in court are deposited if they are to be invested pending payment out. See the Administration of Justice Act 1982, s 38(7) and the Court Funds Rules 1987, rr 26 & 27(1). The interest earned on money deposited to the special account is compounded semi-annually but this is not necessarily done where trust money is concerned.

to the beneficiaries.[50]

The commercial rate, which was formerly 5%, is now pegged to the prime lending rate of 1% over the base rate. That is the rate usually given in the Commercial Court. It reflects the price of money to a favoured borrower.[51] This is the standard rate of presumed disgorgement interest, and the Court of Appeal has now held in *Re Duckwari plc* that the commercial rate may also be given as a measure of compensatory interest in a withholding case where 'the entity which is out of pocket is not a private trust but a commercial concern.'[52] The claimant in the *Duckwari* case was a company whose directors wrongfully caused it to purchase real estate which then deteriorated in value. The idea seems to be that as a risk-taking venture it would have earned commercial returns had the money been available for its use. The commercial rate is also given as a measure of compensation in knowing receipt cases, both where the claimant is a commercial entity and where he is a natural person.[53]

The reason interest is given at a lower rate in non-investment cases involving private trusts is that most private trustees are bound to adopt a relatively risk-averse investment strategy in order to preserve the value of the trust capital. One determinant of the return on any investment is the degree of risk the investor is willing to accept, for higher risk investments yield higher average returns over the long run. It follows that if money is misapplied from a private trust, the fund will have lost the opportunity of making returns that are, on average, lower than might have been made by an unconstrained investor.

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[50]*Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] Ch 515, 547; *Jaffray v Marshall* [1993] 1 WLR 1285, 1293.

[51]Recall that the courts decline to take account of the fact that in any particular case money would only have been obtainable at a less favourable rate by reason of the size and prestige of the entity from which the money has been abstracted: *Re Duckwari plc (No 2)* [1999] Ch 268 (CA) 273.

[52]*Re Duckwari plc (No 2)* [1999] Ch 268 (CA) 273.

[53]*Belmont Finance v Williams Furniture* [1980] 1 All ER 393 (CA) 419 (company); *El Ajou v Dollar Land Holdings plc (No 2)* [1995] 2 All ER 213, 224 (natural person); *Dubai Aluminium Co Ltd v Salaam* [1999] 1 Lloyd's Rep 415, 464-465, varied [2001] QB 113 (CA) (company). It is not clear whether Rix J viewed the award in *Dubai Aluminium* as compensatory or disgorgement interest.

While a lower trustee rate is the appropriate measure of compensation for non-investment where private family trusts are concerned, it may not be appropriate where money has been misapplied from trusts of other sorts. Today many trusts are really elaborate vehicles deployed for purely commercial ends,[54] and ought to be treated as commercial concerns for the purpose of settling the appropriate rate of compensatory interest. The possibilities are so varied that perhaps the best that can be said is that the court must consider whether the rationale for awarding interest at the lower trustee rate applies in the circumstances of each case.

(b) Two Deficiencies

The modern practice governing the standard rates of compensatory interest remains deficient in two respects. The first deficiency relates to the discrepancy between the commercial rate and the more modest trustee rate. The trustee rate is at best equivalent to the base lending rate less 0.5%, and often fluctuates considerably lower than that.[55] The present trustee rate is therefore at least 1.5% lower than the commercial rate. We have seen that there is a good reason for having differential rates, namely that private trustees are bound to adopt relatively risk-averse investment strategies. The reason the trustee rate is pegged to approximate the return on National Investment instruments is that government debt was historically the usual trustee investment. Government debt carries a lower risk than commercial investment and the average rate of return is accordingly lower.

While some discrepancy is warranted, there is reason to think that the magnitude of the discrepancy between the modern trustee rate and the commercial rate is too great. The reason is that few trusts are nowadays dominantly invested in government debt. The trend of legislation has been towards liberalising trustee investment powers, reaching maturity with the commencement of the Trustee Act 2000. This legislation

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[54]See JH Langbein, 'The Secret Life of the Trust' (1997) 107 Yale LJ 165.

[55]*Re Duckwari plc (No 2)* [1999] Ch 268 (CA) 273; The Law Commission, *Report on Interest* (Law Com No 88, 1978) para 88; see also The Law Commission, *Interest* (Working Paper No 66, 1976) 84-85.

creates a default regime granting all trustees the wide investment powers that trustees of occupational pension schemes already had by virtue of the Pensions Act 1995.[56] These statutes follow rather than lead in that most trusts already specifically provide for very wide investment powers, which are designed to give trustees the freedom to diversify and to maximise returns.[57] Consistently with modern portfolio theory, most trustees invest in a range of commercial instruments selected to achieve a suitable balance between capital maintenance and economic return.[58] There does not appear to be any empirical evidence as to the average return on modern trust investments, but it is reasonable to assume that it is higher than the average return on government debt because this will usually be the most cautious investment in the portfolio.

For this reason it seems doubtful that in modern conditions there is a 1.5% difference between the average return on trust investments and on commercial investments generally. Pegging the trustee rate of compensatory interest to the return on National Investment instruments depends upon assumptions about the content of a typical trust portfolio that are now decades out of date. It is worth observing that in fact the trustee rate yields a lower return than money deposited in the court's special investment account, because money in that account is compounded semi-annually whereas on current authorities equitable compensatory interest is rarely compounded.[59] In the absence of empirical evidence it seems fair to conclude that the average return on modern trust investments is lower than the commercial rate but higher than the base rate minus 0.5%. Historically the difference between the trustee rate and the commercial rate was only 1%, and that difference is now probably too great in light of the more

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[56]Subject to minor qualifications, section 3 of the Trustee Act 2000 empowers a trustee to make 'any kind of investment that he could make if he were absolutely entitled to the assets of the trust.' Section 34(1) of the Pensions Act 1995 states that 'The trustees of a trust scheme have, subject to any restriction imposed by the scheme, the same power to make an investment of any kind as if they were absolutely entitled to the assets of the scheme.'

[57]The Law Commission, *Trustees' Powers and Duties* (Law Com No 260, 1999) Ch 2 paras 3 & 17.

[58]The importance of diversification is emphasised by the Trustee Act 2000, s 4(3)(b) and by the Pensions Act 1995, s 36(2)(a). See also *Nestle v National Westminster Bank plc* (1996) 10 TLI 112, 115.

[59]These authorities are discussed in Part 6 below.

diversified content of modern trust portfolios. In the nature of the exercise it is impossible to be exact, but all things considered it would be better to fix the trustee rate at the base rate plus 0.5%, which is one-half percent lower than the commercial rate. There is a respectable argument that interest should simply be given at the commercial rate across the board.

The second deficiency with the modern practice governing compensatory interest awards relates to the rate that should be applied where the money has been withheld from a beneficiary who is not a commercial entity. As was explained in Part 2, compensatory interest in a withholding case should reflect the loss the beneficiary has suffered by being kept out of his money. The Court of Appeal held in *Re Duckwari plc* that where money is withheld from a commercial concern interest should be given at the commercial rate.[60] The court also accepted *Bartlett v Barclays Bank Trust Co Ltd* as authority that where money is withheld from an individual, at least where a private trust is involved, it need only be paid with interest at the lower trustee rate.[61] The implicit basis for this difference is the doubtful and unattractive proposition that money is more valuable to a commercial entity than it is to a private person.

There are three reasons to believe that this solution is misconceived and that interest on money withheld from a beneficiary should be payable at the commercial rate irrespective of whether he is a commercial entity. The first reason is a negative one. This is that the trustee rate cannot be appropriate, at least without further argument, because it is pitched to take account of the fact that private trustees must adopt unusually risk averse investment strategies. Private investors labour under no such restraint and there is no reason to believe that they are, as a class, naturally as conservative as private trustees must be. The second reason is comparative. In awarding presumed disgorgement interest we assume that a defalcating fiduciary has

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[60] *Re Duckwari plc (No 2)* [1999] Ch 268 (CA) 273.

[61] Ibid; *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515, 547. But compare *El Ajou v Dollar Land Holdings plc (No 2)* [1995] 3 All ER 717, where the claimant was a natural person from whom money had been withheld by a knowing receiver.

made commercial returns whether he is a commercial entity or not.[62] It would be inconsistent to assume that a beneficiary would not have done the same if he had been paid on time. The most important reason, however, why interest on withheld trust money should be given at the commercial rate is that this represents the best approximation of the opportunity a typical beneficiary will have lost. In the modern world commercial investment opportunities are available to everyone as they were not always in the past. If the beneficiary had been paid when payment was due he would have been able to invest the money commercially. Likewise, if he has had to borrow money in the interim then he will have had to pay at least the commercial rate for it. On either hypothesis the commercial rate represents a fair measure of the beneficiary's loss. For these reasons the commercial rate is the preferable standard measure of compensatory interest in all cases of withheld trust money.

In summary, two standard rates are used in awarding compensatory equitable interest. The commercial rate of 1% over the base rate is the proper measure of compensatory interest where money has been withheld from a commercial concern. The lower trustee rate is the standard rate of compensatory interest in non-investment cases involving private trusts. This rate fluctuates around 0.5% less than the base rate and an argument has been made that it is too low. On current authorities the trustee rate also applies where money has been withheld from a beneficiary who is not a commercial concern, but an argument has been made that the commercial rate would be more appropriate in these cases.

4. Period over which Interest Runs

The usual rule is that interest runs from the date on which the cause of action accrued.[63] Where interest is given on misapplied or withheld money that is either the date on which

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[62] *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA).

[63] *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 717.

the money was misapplied or the date on which it was first withheld,[64] and where the underlying claim is for reparative compensation it is the date on which the loss was incurred.[65] Because the award of interest is discretionary, the usual rule may be abrogated in exceptional circumstances. In *BP Exploration Co v Hunt*, Robert Goff J identified three such circumstances: '(1) when the position of the defendant demands it, (2) when the conduct of the plaintiff does so, and (3) when it would be unjust in all of the circumstances to award interest from the date of loss.'[66]

Robert Goff J's first category includes cases in which the defendant neither knew nor could he be expected to know that there was likely to be a claim. The interest period in the *BP Exploration* case itself was held to run only from the date on which BP notified its intent to claim against Hunt. In the unusual circumstances of the case an earlier date was rejected even though Hunt had known the relevant facts because Hunt could not have been expected to anticipate that BP might claim. In the *Westdeutsche* case, however, interest on a sum of money repayable under a resulting trust was thought by the judges in the Court of Appeal to run from the date on which the trust arose notwithstanding the fact neither party knew that the defendant's receipt had been defective. Dillon LJ said the overriding factor was that the defendant had improperly enjoyed the benefit of the money from that date.[67] The first category must include few trust cases. Because the defendant has control of the money he will generally know the material facts, and the bare circumstance that the claimant's rights are uncertain or contested is not a proper reason for abridging the interest period. Moreover, the balance Robert Goff J struck between BP and Hunt, who were both sophisticated commercial actors operating at arm's length, would usually be inappropriate in a case where a

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[64] *General Tire & Rubber Co v Firestone Tyre & Rubber Co Ltd* [1975] 1 WLR 819, 836.

[65] *Jefford v Gee* [1970] 2 QB 130 (CA).

[66] *BP Exploration Co (Libya) Ltd v Hunt (No 2)* [1979] 1 WLR 783, 846. That case involved a common law restitution claim, but Robert Goff J's analysis is thought to apply equally where the claim depends upon equitable rights: *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1994] 4 All ER 890 (CA) 963, 970; *Equiticorp Industries Group Ltd v The Crown (No 3)* [1996] 3 NZLR 690, 693.

[67] *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1994] 4 All ER 890 (CA) 963, 971.

fiduciary relation obtained between claimant and defendant.

Robert Goff J's second and third categories do not raise particular problems so far as claims against misconducting fiduciaries are concerned. The second category includes cases in which the claimant has been guilty of unreasonable delay in prosecuting his claim. Subsequent cases show that such delay must be genuinely exceptional in order to warrant an abridgment of the interest period.[68] The third category includes cases in which the underlying liability is calculated in such a way that it is appropriate that interest run from a later date. Interest on the component of a personal injuries damages award reflecting the plaintiff's pain and suffering, for example, cannot run from the date of the accident because the damage does not occur at that moment but is spread into the future.[69] It is possible to imagine fiduciary relations cases where the underlying claim is for reparative compensation in which similar considerations apply. Where the award of equitable interest is given on the disgorgement basis, it would be inappropriate to delay the running of the interest period until such time as the claimant sustained a loss because the purpose of the charge is not to repair loss.[70]

5. Compounding

Common lawyers associate compound interest with equity because it is very rarely given at law,[71] but even in equity compound interest has always been treated as exceptional. This is odd, because in real life compound interest is entirely unexceptional. Compounding is the straightforward result of reinvesting income. As Hobhouse J wrote

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[68] *Corbett v Barking, Havering and Brentwood Health Authority* [1991] 2 QB 408 (CA); *Day v Mead* [1987] 2 NZLR 443; *Equiticorp Industries Group Ltd v The Crown (No 3)* [1996] 3 NZLR 690, 693 (knowing receipt claim).

[69] *Jefford v Gee* [1970] 2 QB 130 (CA) 147.

[70] *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1994] 4 All ER 890 (CA) 964F.

[71] The Supreme Court Act 1981, s 35A and the Late Payment of Commercial Debts (Interest) Act 1998 only authorise simple interest. By contrast, the Arbitration Act 1996, s 49 authorises arbitrators to award either simple or compound interest.

at first instance in the *Westdeutsche* case, 'Simple interest does not reflect the actual value of money. Anyone who lends or borrows money on a commercial basis receives or pays interest periodically and if that interest is not payed it is compounded'.[72] Over time the difference between simple and compound interest can be considerable. The fact that the courts award simple interest in the absence of special circumstances requires explanation. The position taken here is that the traditional explanations are not good ones,[73] and that both disgorgement and compensatory interest should be compounded as a matter of course.[74]

(a) Compound Interest as a Measure of Profits

It is well-recognised that compound interest may be given as a measure of a fiduciary's profits. If a beneficiary claims an account of his fiduciary's actual profits then he will be entitled to compound interest if compound interest has in fact been made.[75] If instead the beneficiary asks for the money with presumed disgorgement interest then the traditional position was that interest would only be compounded if the fiduciary had used the money in his trade or business, which was assumed to be more profitable than investment in securities or a professional practice.[76] Even then, compounding would not be appropriate if the money had been used in a joint venture which had also benefited

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[72] *Westdeutsche Girozentrale Landesbank v Islington London Borough Council* [1994] 4 All ER 890, 955. This proposition seems to have been generally accepted by the members of the House of Lords who heard the appeal from that case, though a majority felt unable to honour it.

[73] Note that the exceptionality of compound equitable interest has quite rightly never been justified by a policy against usury: see *Raphael v Boehm* (1805) 11 Ves Jun 92, 106, 32 ER 1023. The Law Commission's argument that compound interest is impractical because it is too difficult to calculate no longer has whatever force it may have had before computers became generally available: The Law Commission, *Report on Interest* (Law Com No 88, 1978) para 85.

[74] Interest is usually compounded annually: for example *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) and *El Ajou v Dollar Land Holdings plc* [1995] 2 All ER 213. Semi-annual rests were occasionally ordered in the past, but this is thought to be severe: for example *Re Emmet's Estate* (1881) 17 ChD 142.

[75] For example *Cruce v Cruce,* 81 Mo 676 (1884).

[76] *Burdick v Garrick* (1870) LR 5 Ch App 233, 241-242; *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA).

the claimant.[77]

Lord Browne-Wilkinson suggested in the *Westdeutsche* case that disgorgement interest should be compounded irrespective of the type of investment that has been made.[78] He did not give his reason, but it is presumably that the traditional distinction between investment in a trade or business and investments of other types does not mark a realistic difference in average returns. This suggestion was taken up in *Kuwait Oil Tanker Company SAK v Al Bader*.[79] The defendant fiduciary in that case was held accountable to the claimants for money extracted from them by fraud. Moore-Bick J reviewed the traditional law and then said this:

> Nowadays, of course, everyone knows that money can be placed on deposit with a bank so as to earn interest with periodic rests and that it is unnecessary to employ it in a business in order to obtain growth of that kind. If the principle is to be applied at all, therefore, it is difficult to see why the court should not award compound interest as a matter of routine in cases of this kind.

Interest was expressly given as a measure of the defendant's profits. The judge went on to say that routinely awarding compound interest followed 'from the application of established principles to modern conditions'. His decision on this point was upheld in the Court of Appeal.

(b) Compound Interest as a Measure of Compensation

There is a widely-shared view that compound interest cannot be given as a measure of compensation. This view was expressed by Lords Goff and Browne-Wilkinson in the

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[77]Compare *O'Sullivan v Management Agency and Music Ltd* [1985] QB 428 (CA) 461 & 473-474 with *John v James* [1986] STC 352, 355-357.

[78]*Westdeutsche Girozentrale Landesbank v Islington London Borough Council* [1996] AC 669, 702.

[79]*Kuwait Oil Tanker Company SAK v Al Bader* (unreported QBD, 21 December 1998), varied [2000] 2 All ER (Comm) 271 (CA).

Westdeutsche case as well as by Buckley and Scarman LJJ in *Wallersteiner v Moir.*[80] Lord Denning said in the latter case that compound interest should be available either as a measure of profits or as a measure of the loss a company may have suffered by being deprived of its money, but his was a dissenting voice.[81] In the face of such a strong body of opinion it may seem perverse to argue the contrary. On closer study it appears, however, that there are no tenable objections to giving compound interest on withheld or misapplied sums as a measure of compensation, and indeed that there are compelling reasons for doing so.

Taking the question first as a matter of economic commonsense, the reason for giving compound interest is that simple interest must always under-compensate. Compound interest represents the opportunity cost of being deprived of money over time. If the money had been available to the claimant then he would either have invested it or paid down a debt or he would have spent it non-productively. If the money had been invested then we must assume that it would have produced compound returns or their equivalent, for that is the opportunity that has been lost, and if a debt was paid down it will generally have carried compound interest. If the money would have been spent non-productively then we must assume that the claimant has had to borrow an equivalent sum in order to finance that consumption, in which case he will have had to pay compound rates. Either way, compound interest represents the true measure of the claimant's loss.[82] This is equally true whether it is a fund or a beneficiary personally that has been deprived of the use of the money.

There does not appear to be much dispute about the commonsense argument in

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[80] *Westdeutsche Girozentrale Landesbank v Islington LBC* [1996] AC 669, 693 & 701; *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) 397 & 406. See also *Kleinwort Benson Ltd v South Tyneside MBC* [1994] 4 All ER 972, 990-995; *John v James* [1986] STC 352, 355; *O'Sullivan v Management Agency Music Ltd* [1985] QB 428 (CA) 461 & 474; *Polish Steam Ship Co v Atlantic Maritime Co* [1985] 1 QB 41 (CA) 61; *Belmont Finance v Williams Furniture* [1980] 1 All ER 393 (CA) 419; *Miliangos v George Frank* [1977] QB 489, 494-495; and H McGregor, *McGregor on Damages* (16th edn, 1997) para 670.

[81] *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) 388.

[82] This argument is presented in greater detail in JRL Davies, 'Interest as Compensation' in PD Finn (ed), *Essays on Damages* (1992) 131-132.

favour of compound interest. The problem, as FA Mann has observed, is that English law is strangely resilient to commonsense arguments about compound interest, so let us turn to consider the authorities.[83] Here we find that the law is not as rigidly set against compensatory compound interest as the dicta referred to in the paragraph before last would suggest. In fact, equity routinely gives compound interest as a measure of compensation in one important class of cases. Before examining these cases we should pause to take a closer look at the dicta denying this power.

The first point to take is that none of the cited statements denying the court's power to award compensatory compound interest was made in a case itself concerned with that issue. Compensatory interest was not claimed in the *Westdeutsche* case, and Lords Goff and Browne-Wilkinsons' statements purporting to restrict the availability of compound interest to profits cases may have been influenced by the fact that counsel for the contending parties agreed in their submissions that compound interest cannot be given as a measure of compensation.[84] The case concerned the quite different question whether equity has an ancillary jurisdiction to award compound interest in respect of a common law money claim. Similarly, the dispute in *Wallersteiner v Moir* was whether, in the circumstances, disgorgement interest should be compounded.

Most modern statements confining equity's power to award compound interest to profits cases are referable to Hatherley LC's seminal remarks in *Burdick v Garrick*, but on examination they too provide no authority for the supposed restriction. The fiduciary in that case was a solicitor who had received money on behalf of his client for investment but had instead deposited the money into his firm's general account. Stuart V-C had charged the firm with compound interest as a measure of disgorgement on the basis that he presumed the firm to have made compound returns through its use. On appeal Hatherley LC and Giffard LJ decided the Vice-Chancellor had been wrong to do so. The reason was that they did not think investment in a solicitors' partnership was a

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[83]FA Mann, 'On Interest, Compound Interest and Damages' (1985) 101 LQR 30, 44-47.

[84]*Westdeutsche Girozentrale Landesbank v Islington London Borough Council* [1996] AC 669, 674 & 677.

type of investment that could be expected to yield compound returns. The important point is that the Lord Chancellor did not even purport to exclude compound interest as a measure of compensation. He expressly confined his remarks to cases in which the fiduciary has made unauthorised use of the money and interest is sought as a measure of his presumed profits.[85] It is a misreading to suppose Hatherley LC said anything at all about compensatory compound interest.

It follows that neither *Burdick v Garrick* nor any of the modern cases referred to above provides binding authority for the proposition that compound interest cannot be given as a measure of compensation. This brings us back to the cases in which this has actually been done. These are cases in which a defaulting trustee had been under a duty to accumulate the income pending later distribution.[86] The cases in this class are somewhat dusty but they are uncontradicted and their continued vitality is recognised in the leading texts as well as the *Restatement of Trusts 2d*.[87]

Gilroy v Stephens is only one example. The trustee in that case failed to reinvest the income as it accrued, instead allowing it to remain uninvested in the hands of her solicitor. Fry J gave the following reasons for charging her with compound interest:

> What was the reasonable and proper thing for her to have done? It was to direct the payment of the dividends to some banker, and to instruct him to invest the dividends in consols, as received, and also the income of such investments as it came in. In that way the funds would have been invested at three per cent at compound interest. There was no reason for not doing this, as

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[85] *Burdick v Garrick* (1870) LR 5 Ch App 233, 241, note the words " . . . for making use of the plaintiff's money . . ."

[86] *Raphael v Boehm* (1805) 11 Ves Jun 92, 32 ER 1023; *Dornford v Dornford* (1806) 12 Ves Jun 127, 33 ER 9; *Byrne v Norcott* (1851) 13 Beav 336, 51 ER 130; *Jones v Foxall* (1852) 15 Beav 388, 15 ER 588; *Knott v Cottee* (1852) 16 Beav 77, 51 ER 705; *Wilson v Peake* (1856) 3 Jur (NS) 155; *Re Emmet's Estate* (1881) 17 ChD 142; *Gilroy v Stephen* (1882) 30 WR 745; *Re Barclay* [1899] 1 Ch 674. See also *Harrison v Mathieson* (1916) 30 DLR 150 (Ont CA); *Moss v Moss* (1898) 19 NSWLR (Eq) 146; *Public Trustee v Merry* [1934] NZLR 934 (CA); and the American cases cited in AW Scott & WF Fratcher, *The Law of Trusts* (4th edn, 1988) para 207.2 n 5.

[87] J Mowbray et al, *Lewin on Trusts* (17th edn, 2000) Ch 39 para 24; J Martin, *Hanbury & Martin, Modern Equity* (16th edn, 2001) 658; AJ Oakley, *Parker & Mellows, The Modern Law of Trusts* (7th edn, 1998) 689; D Browne, *Ashburner's Principles of Equity* (2nd edn, 1933) 147; The American Law Institute, *Restatement of Trusts 2d* (1959) para 207.

> there was no maintenance to be paid, nor any other payments to be made. The estate had long been realized, and there was nothing to do but to keep the fund in hand until the plaintiff was entitled to payment of it.[88]

Simply put, Fry J thought interest should be compounded for the good reason that compound interest represented the loss sustained by the fund.

The real question is why interest is not compounded more often. Some insight into this question can be gained by considering the unique characteristic of a trust for accumulation that is deemed to warrant compounding. Trusts containing duties to accumulate income contrast with trusts whereby the trustee is obliged to make periodic distributions to income beneficiaries or other non-productive dispositions. Where there is a duty to accumulate, the trust should earn compounded returns as income is reinvested. For this reason compound interest is necessary if the award is to reflect the extent of the diminution in the value of the fund. By contrast, in cases where the trustee is bound to distribute income the fund cannot earn compound returns even if the trusts are properly performed. Compound interest represents interest on earlier interest and so it cannot be earned unless the earlier interest is reinvested. All of this suggests that the exceptionality of compound interest is due to the fact that the law of trusts was largely developed in connection with traditional family trusts with income beneficiaries.

This analysis helps to explain the incidence of compensatory compound interest but it also points to an anomaly. This can be illustrated by imagining two trusts, according to each of which the money is to be paid over at a fixed time. The only difference between them is that the first requires the trustee to accumulate the income whereas the second requires the trustee to distribute the income to the beneficiary as it accrues. As the law stands, if both trustees misapply the money and are called to account the first trustee will be required to replace it with compound interest and the second trustee will be required to replace it with simple interest only. It seems anomalous that the beneficiary of the first trust should end up better off than the beneficiary of the second trust. While the second trust would not have been earning

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[88] *Gilroy v Stephens* (1882) 30 WR 745, 746.

compound returns had the trustee done his duty, the beneficiary himself would have been in a position to invest the income he received at compound rates and he has now lost the opportunity to do so.

This anomaly came to a head in *Re Emmet's Estate*.[89] The defendant trustee held money on trust for the beneficiary during his minority with a direction to pay it over on his twenty-first birthday. The trustee was bound to make discretionary advances and to accumulate any surplus. Part of this surplus money was improperly invested or not invested at all, and the money was not paid over when the beneficiary turned twenty-one. As the trust required accumulation there was no doubt that the trustee was liable to pay compound interest on the mishandled money during the beneficiary's minority. The point taken was whether the trustee should also pay compound interest on the mishandled money after the beneficiary had turned twenty-one.

The trustee argued that the trust for accumulation expired when the beneficiary turned twenty-one and that his only remaining duty had been to distribute the money. On this view compound interest could not be awarded after that date because the trustee had no longer been under a duty to accumulate the fund. Hall V-C disagreed: 'In my opinion, if he does not hand it over when he ought to do, he must be taken to be holding it still on the same trust and subject to the same obligations as before.'[90] Accordingly 'accumulations should have gone on until the trustee transferred the fund.'[91] The trustee was required to account for the money with compound interest right up until it was actually distributed.

The Vice-Chancellor's reasoning in *Re Emmet's Estate* is impossible. He would have us accept that the trustee came under contradictory duties once the beneficiary turned twenty-one. The trustee was at the same time required to pay the money over and to accumulate it. But while the reasoning entails a contradiction, the result still seems

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[89] *Re Emmet's Estate* (1881) 17 ChD 142.

[90] Ibid 150.

[91] Ibid.

right. It would have been anomalous if the trustee had been liable to pay compound interest up until the date of distribution and only simple interest thereafter. Up until the date of distribution the fund was deprived of the opportunity to earn compound returns on the trust capital and after that time the beneficiary himself was deprived of this opportunity. To have held otherwise, Hall V-C would have had to rest his decision on the unappealing proposition that the money was worth more to the estate than it was to the beneficiary.

A further anomaly appears when one compares the cases in which disgorgement interest is compounded with the cases in which compensatory interest is given on withheld sums. If, as happened in *Wallersteiner v Moir*, a fiduciary misapplies money and uses it to make commercial investments then he will be made to account for the money with compound interest because he is presumed to have made as much.[92] But if, as happened in *Re Duckwari plc*, money is taken from a company and the defalcating fiduciary is ordered to restore it with compensatory interest then that interest will not be compounded.[93] It is not at all obvious why the director in *Wallersteiner v Moir* was presumed to have had the opportunity to make compound returns while the company in *Re Duckwari plc* was presumed not to have had the same opportunity.

The fundamental reason compensatory interest is so rarely compounded is the stubborn refusal of English equity to accept that compound interest represents the loss a person suffers by being deprived of his money. If this simple proposition were accepted then nothing would stand in the way of compounding all compensatory interest awards. The accumulation cases show that there is no technical objection to doing so where compounding truly represents the loss that is being made good. Indeed, as these awards are made in the court's inherent jurisdiction, it is difficult to think what sort of objection that might be. The bar that seemingly prevents the courts from giving full compensation in many cases is nothing more than an implicit assumption about the value of money

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[92] *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA).

[93] *Re Duckwari plc (No 2)* [1999] Ch 268 (CA). Nourse LJ simply said at 273 that 'no case has been made out for compound interest.'

which is demonstrably false and applied inconsistently.

The Canadian, South Australian and Jersey appellate courts have already taken the step of abandoning this false assumption and now compound both disgorgement and compensatory interest in cases involving withheld or misapplied trust money.[94] They have followed Lord Denning's lead in *Wallersteiner v Moir* rather than the views expressed by the other Lord Justices. The English courts should do likewise because the present authorities governing when compensatory interest may and may not be compounded cannot be reconciled on any defensible basis. There are indications that the courts are moving in this direction. Compensatory interest was compounded in *El Ajou v Dollar Land Holdings*, which involved a claim against a knowing receiver, though interest in the subsequent knowing receipt case *Dubai Aluminium* was not compounded.[95] More recently, in the *Kuwait Oil Tanker Company* case Nourse LJ noted the traditional view that compound interest is only given as a measure of profits, but then said that 'ensuring full compensation' 'is nonetheless an element which usually plays a part in the reasoning of the court when considering whether or not to make [an award of compound interest] in modern conditions.'[96]

Reforming current practice would not require a large step for equity already recognises that interest should be compounded where compounding represents the true measure of either the fiduciary's profits or the beneficiary's loss, as the case may be. According to Lord Woolf, 'If the case is one where there is jurisdiction to award equitable interest then whether compound or simple interest is recoverable depends upon the facts of the particular case.'[97] All that is needed is a more regular recognition

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[94] *Brock v Cole* (1983) 142 DLR (3d) 461 (Ont CA) is the leading Canadian case; *Duke Group Limited (in liq) v Pilmer* (1999) 73 SASR 64 (Full Ct) 239; *Cutner v Schofield* [1980] JJ 269 (JCA). See also *McLaughlan v Prince* [2001] WASC 43.

[95] *El Ajou v Dollar Land Holdings plc (No 2)* [1995] 2 All ER 213, 224; *Dubai Aluminium Co Ltd. v Salaam* [1999] 1 Lloyd's Rep 415, 464-465, varied [2001] QB 113 (CA).

[96] *Kuwait Oil Tanker Company SAK v Al Bader* [2000] 2 All ER (Comm) 271 (CA) 344.

[97] *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 724. See also *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) 406 and *President of India v La Pintada Compania Navagacion SA* [1985] AC 104, 116.

of the economic proposition that compound interest represents the value of money over time. The legal principles are correct; the problem is that current practice fails to honour them. The decision in the *Kuwait Oil Tanker Company* case indicates that English courts are prepared to bring their practice into line with modern financial conditions, at least insofar as equitable claims are concerned.[98] There is reason to expect they will follow the logic of that decision and award compound interest not only as a measure of disgorgement, but as a general measure of compensation as well. The Law Commission, which is presently considering the powers of the courts to give compound interest, may nonetheless choose to recommend legislative reform in order to erase the anomalous differences in the ways interest is calculated in respect of legal and equitable claims.[99]

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[98]*Kuwait Oil Tanker Company SAK v Al Bader* (unreported QBD, 21 December 1998), affirmed on this point [2000] 2 All ER (Comm) 271 (CA).

[99]The Law Commission, *Seventh Programme of Law Reform* (Law Com No 259, 1999) 11. See the proposals in F Rose, 'Interest' in PBH Birks & F Rose (eds), *Lessons of the Swaps Litigation* (2000) Ch 11, 327-328.