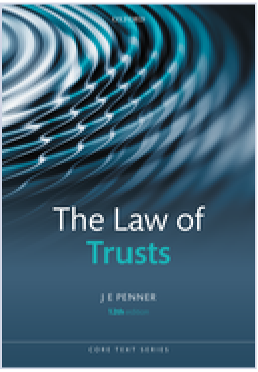

The Law of Trusts (12th edn)

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13. Breach of trust

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Abstract

Titles in the Core Text series take the reader straight to the heart of the subject, providing focused, concise, and reliable guides for students at all levels. This chapter discusses breach of trust. Breach of trust, as a wrong in private law, must be distinguished from other wrongs such as breach of contract and breach of fiduciary duty. The rules and principles that govern a trustee's liability for breach of trust are considered in detail, including with the trustee's liability to account and the performance interest in a trust; falsification and surcharging; equitable compensation; and personal claims where the account is not falsified. Following that, related issues concerning breach of trust are considered, including the liability of trustees inter se; beneficiaries' consent to a breach of trust; trustees' relief from liability under the Trustee Act 1925; trustee exemption clauses and ouster of trustee duties; de facto trusteeship; and a trustee's liability when breach is procured by a third party.

Keywords: breach of trust, account, performance interest, falsification, surcharging, equitable compensation, trustee exemption clauses, ouster of trustees' duties, trustee de son tort

Summary

Situating breach of trust

Breach of trust and breach of contract

13.1 In most undergraduate syllabi, the law of contract is taught before the law of trusts. Students may be forgiven, therefore, for having the initial impression that breach of trust is simply the trust law equivalent of breach of contract. The analogy is imperfect but useful. In exploring the key concerns of this chapter, this comparison will come to mind more than once.

p. 313 **13.2** One way in which the analogy holds (mostly) true is in the nature of the wrong. When a trustee misapplies trust property (ie takes property from the trust and deals with it in a way that is inconsistent with the trust terms), she breaches her trust. In this situation, she is *strictly* liable for breach of trust, in the same way that a contracting party is strictly liable for breach of contract. In general the law does not inquire into why, or with what mental state, you breached your contract—whether you did so intentionally, or negligently, or perfectly innocently, trying your best to perform your obligation. And the same is generally true of the trustee in breach. Regardless of her reasons or mental state, a court of equity will require her to return the misapplied property to the trust, ie hold it again as a trustee for the beneficiaries. Indeed, using a certain kind of terminology to which equity lawyers are occasionally prone (usually with poor results for the law's clarity and coherence) 'equity will not *hear* the trustee say that he misapplied trust property; it will treat him as if he never committed the misapplication, as if he held the property properly for the beneficiaries all along'. Where a trustee disposes of trust property in breach of trust so that the property is lost, or deals with the trust property in breach of trust so as to cause a loss to the trust fund, for example by making an unauthorised, losing investment, the trustee will be strictly *personally* liable to restore the trust.

13.3 Of course, there are situations where the trustee's state of mind coupled with what he does (in the sense of whether the trustee has been negligent, for example) does matter when determining if there has been a breach of trust. One such situation is where the alleged breach involves a breach of a duty of skill and care, such as the claim made in *Nestle* (**8.22** et seq). Likewise, the state of mind of a contracting party is relevant to determining whether there has been a breach of a contractual duty of care.

Personal and proprietary liability

13.4 This chapter deals with a trustee's personal liability for breach of trust. By far the most important question here is how to quantify this personal liability in various situations. Should the compensatory principle (**11.16**) (that is, money awards should only be given to compensate for loss actually caused by the commission of the wrongful act) govern breach of trust? Or should the court look first to a 'substitutive' award where it is possible to make one (**11.17**)? Following an examination in detail of the trustee's personal liability, we will look at the various ways in which a trustee may be relieved of liability, such as by the insertion in the trust terms of an exemption clause.

13.5 It is important to understand what *personal* liability means. There are no particular assets of the trustee that, prior to the trustee discharging this personal liability to restore the trust, are allocated to her doing so. The trustee in such a case has a 'money' award, like damages for breach of contract, ordered against her. Just as with the personal liability to pay a debt, the trustee may discharge the debt with any of the resources that she has, and indeed, with someone else's resources. She might get her brother to provide the required funds to reconstitute the trust, or secure a loan from a bank to do so. Because a debt or any other personal liability is
p. 314 not related to any particular assets of the trustee, if the trustee is insolvent by the time the breach is discovered, the claim that the beneficiaries have that the trustee restore the trust will be treated like any other debt the trustee owes—the beneficiaries will be unsecured creditors (**2.89** et seq).

13.6 In certain situations, the beneficiary may have *proprietary* claims, in particular where the beneficiary adopts the trustee's breach of trust, or where the trust property has been transferred in breach of trust but still exists in the hands of a third party. The latter situations we considered in detail in **Chapter 12**.

Breach of trust and breach of fiduciary requirements/company director's duties

13.7 Some of the cases that apply equity's principles for dealing with breach of trust occur in cases where there is not, strictly speaking, a breach of trust. The most common example is the case where a custodial fiduciary, whom we have already encountered (**12.4**–**12.5**). As a consequence, we will see cases that elaborate the principles of liability for breach of trust but which do not involve trustees at all but, rather, defaulting fiduciaries.

13.8 There is, however, an important difference between breach of trust and breach of fiduciary requirements. If you are able to grasp this difference and bear it in mind when you consider the cases, count yourself as an intellectual of the subject, because far too often judges and commentators make a mess of it (for a number of examples see Mitchell (2013, 2014)). A trustee is strictly liable for breaches of trust, and it does not matter *why* he misapplied the trust property or neglected to invest it properly, whether because he favoured his own interests over the beneficiaries, or because of his incompetence, or for any other reason. As you will recall (**3.28**–**3.30**) and as we shall examine in detail in **Chapter 14**, the fiduciary relationship is a very particular and precise relationship imposed upon people who have to use their discretion in making decisions for other people, and may have other duties as well to ensure they are acting in the best interests of their principals, such as the duty to be 'even-handed' between different beneficiaries in investing the trust property (**8.3** et seq). They breach the requirements of the fiduciary relationship when they fail to act entirely in the interest of their principal, in particular when they act in conflict with their own interests. The point is that if it were not for this fiduciary requirement, their actions would in many cases be perfectly correct. For example, a trustee may have the power to invest the trust property in shares. He does not breach the trust if he sells his own shares to the trust, because the trust terms allow him to invest in shares. What he breaches is the fiduciary requirement, because obviously he will be in a conflict of interest in trying to set a price for the shares—as a trustee he must try to get the shares at the lowest price possible, but as the owner of the shares himself he will try to sell them at the highest price possible. Notice, then, how the fiduciary requirement works—*it turns what would otherwise be a perfectly proper act of the trustee*, this investment in shares, *into an improper act*, because he undertakes it in conflict of interest.

p. 315 **13.9** There is, therefore, no point in referring to any fiduciary relationship if the act was a wrongful one in any event, as for example where the trustee in this case was not allowed to invest in shares at all. There is no *need*, and no *room*, for willy-nilly treating breaches of trust as breaches of fiduciary obligation where the breach is a breach of trust *simpliciter*. For example, if a trustee negligently invests the trust fund so that its value falls, the trustee will be liable for breach of trust, but this is not a breach of the fiduciary requirement, for negligence is not about favouring someone's interest at the expense of the beneficiaries' interests. Judges and commentators often confuse these different sorts of liabilities because, as trustees are always fiduciaries in the first meaning of 'fiduciary' (**3.28**), that is they do not hold the assets 'personally', ie for their own benefit, but for the benefit of the beneficiaries, they tend to use the words 'trustee' and 'fiduciary' interchangeably, and then go on to call any breach of trust a breach of a fiduciary obligation. As we shall see in **Chapter 14**, judges such as Lord Millett began to clamp down on this loose usage. NB: in **13.7** we saw that equity will treat cases where a custodial fiduciary transfers his principal's property wrongfully as cases of breach of trust; these cases do *not* turn on breaches of any fiduciary relationship. These, just as much as other cases of breach of trust, turn on the fiduciary doing something that is wrong anyway, for example a company director embezzling his company's funds. But on the rationale canvassed in **12.4**–**12.5**, **13.7**, equity will treat these wrongful exercises of the fiduciary's powers over the title to the principal's property as equivalent to breaches of trust.

The trustee's liability to account, the performance interest in a trust, and

personal claims against the trustee

13.10 Traditionally, the trustee's 'liability to account' is the starting point for understanding the beneficiary's remedies for breach of trust (see Conaglen (2016); Ho (2016); Mitchell (2013, 2014); Penner (2018a)). This liability flows from the very nature of the trust relationship. The principal task of the trustee is to keep the trust property separate from his own and dispose of it according to the terms of the trust.

13.11 This reflects what might be called the beneficiary's 'performance interest' in the trust (Penner (2018a)). The essence of a trust is that the trustee perform his obligations under the terms of the trust. Trusts are settled in order for the trust obligations to be performed. This is usually the one and only reason why trusts are created. This performance interest is protected by specific remedies, which require the trustee to do the very thing the trust terms require him to do, ie which grant the beneficiary the very performance due to him under the terms of the trust, and by 'substitutive remedies', by which the trustee is required to do something else, the next best thing, which comes closest to the intended performance. We examined the nature of both substitutive money awards and compensatory awards at **11.16**–**11.17**.

p. 316 **13.12** In the law of trusts, these specific and substitutive remedies are provided under the traditional 'accounting process'. In carrying out his trust obligations, the trustee must keep track of what he does with the trust property; this is called 'keeping the trust account(s)' and, as you would imagine, normally involves keeping the documents concerning transactions with the trust property in good order. When a beneficiary suspects that something has gone wrong with the administration of the trust, this is normally because he does not accept the trustee's account, ie his record of what he has done with the trust property, and the beneficiary's primary legal right is to bring the trustee to the Court of Chancery and have 'the account taken', ie reviewed. As Lord Millett NPJ explained in *Libertarian Investments v Hall* (2012):

> *[167] It is often said that the primary remedy for breach of trust or fiduciary duty is an order for an account, but this is an abbreviated and potentially misleading statement of the true position. In the first place an account is not a remedy for wrong. Trustees and most fiduciaries are accounting parties, and their beneficiaries or principals do not have to prove that there has been a breach of trust or fiduciary duty in order to obtain an order for account. Once the trust or fiduciary relationship is established or conceded the beneficiary or principal is entitled to an account as of right. Although like all equitable remedies an order for an account is discretionary, in making the order the court is not granting a remedy for wrong but enforcing performance of an obligation.*
>
> *[168] In the second place an order for an account does not in itself provide the plaintiff with a remedy; it is merely the first step in a process which enables him to identify and quantify any deficit in the trust fund and seek the appropriate means by which it may be made good. Once the plaintiff has been provided with an account he can falsify and surcharge it. If the account discloses an unauthorised disbursement the plaintiff may falsify it, that is to say ask for the disbursement to be disallowed. This will produce a deficit which the defendant must make good, either in specie or in money. Where the defendant is ordered to make good the deficit by the payment of money, the award is sometimes described as the payment of equitable compensation; but it is not compensation for loss but restitutionary or restorative. The amount of the award is measured by the objective value of the property lost determined at the date when the account is taken and with the full benefit of hindsight.*
>
> *[169] But the plaintiff is not bound to ask for the disbursement to be disallowed. He is entitled to ask for an inquiry to discover what the defendant did with the trust money which he misappropriated and whether he dissipated it or invested it, and if he invested it whether he did so at a profit or a loss. If he dissipated it or invested it at a loss, the plaintiff will naturally have the disbursement disallowed and disclaim any interest in the property in which it was invested by treating it as bought with the defendant's own money. If, however, the defendant invested the money at a profit, the plaintiff is not bound to ask for the disbursement to be disallowed. He can treat it as an authorised disbursement, treat the property in which it has been invested as acquired with trust money, and follow or trace the property and demand that it or its traceable proceeds be restored to the trust in specie.*
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> p. 317 ↵ *[170] If on the other hand the account is shown to be defective because it does not include property which the defendant in breach of his duty failed to obtain for the benefit of the trust, the plaintiff can surcharge the account by asking for it to be taken on the basis of 'wilful default', that is to say on the basis that the property should be treated as if the defendant had performed his duty and obtained it for the benefit of the trust. Since ex hypothesi the property has not been acquired, the defendant will be ordered to make good the deficiency by the payment of money, and in this case the payment of 'equitable compensation' is akin to the payment of damages as compensation for loss.*
>
> *[171] In an appropriate case the defendant will be charged, not merely with the value of the property at the date when it ought to have been acquired or at the date when the account is taken, but at its highest intermediate value. This is on the footing either that the defendant was a trustee with power to sell the property or that he was a fiduciary who ought to have kept his principal informed and sought his instructions.*

13.13 Before setting out how this passage shows that the process of taking the account and the making of orders in consequence thereof reflects the performance interest of the beneficiary under the trust, and the specific and substitutive remedies that protect and enforce it against the trustee, a few words must be said about a particular thing Lord Millett says. A beneficiary is entitled to an account as of right, and in pursuing the account, the beneficiary does not have to claim that the trustee has committed a breach of trust. But obviously, if the account can be falsified or surcharged, and the court provides a remedy in consequence of that, this will be a remedy for a breach of trust, ie for a failing by the trustee to fulfil his trust obligations. Not having to plead a wrong or a breach of trust when the beneficiary initiates the accounting process does not mean that the subsequent claim, to falsify or surcharge the account, doesn't reveal or express that a wrong has taken place. In all cases where the account is falsified or surcharged, it clearly does. What the process of taking the account and the court's subsequent orders *do* is to protect and enforce the performance by the trustee of her obligations under the trust, that is, give effect to the beneficiary's interest in the performance of the trust obligations by the trustee (Mitchell (2014)).

13.14 When a misapplication of trust property takes place, such as an unauthorised investment, a payment to a person who is not a proper object of the trust, or an excessive or fraudulent appointment (**3.43** et seq), the account is 'falsified' and the trustee must 'restore' the trust, which will require one of two things. If possible, the trustee will be required to restore the trust '*in specie*'; that is, he must return the very property misapplied, or the same kind of property, to the trust. Thus if the trustee has wrongfully transferred unique property out of the trust, such as land or a chattel such as a valuable painting, the trustee should first try to get that property back. As you can imagine, however, many breaches will involve the trustee's having wrongfully sold the trust property to a bona fide purchaser (**2.56**), and so it may be unlikely he can restore the trust *in specie*. In the cases of fungible property, such as shares, the trustee will most likely be unable to get back the very shares he wrongfully transferred, but he can go into the market and purchase a like number of the same
p. 318 shares, and if he does this he is regarded as restoring the trust *in specie*. Where the trustee cannot restore the trust *in specie*, he must restore the trust in money, obviously to the value of the misapplied trust property. An order to restore the trust by way of a money payment is a substitutive remedy.

13.15 A similar order is made where the beneficiary does not ask for the disbursement to be disallowed, but adopts the trustee's application of the money and claims the proceeds thereof as trust property. The trustee will be subject to an order, a specific remedy, to thereafter hold that very property on trust and bring it into the trust account.

13.16 In cases where the beneficiary surcharges the account, again, both specific performance and substitutive remedies can be awarded. Since it is sometimes not realised that a surcharging of the account can be met with an order for specific performance, we must consider the different sorts of occasion on which a claim to surcharge the account can arise.

13.17 As Lord Millett explains, a beneficiary surcharges the account when she maintains that the accounts fail to disclose trust assets which, under the terms of the trust and in fulfilment of the trustee's obligations, ought to form part of the trust fund. The right to surcharge the account can arise in a number of circumstances. First, upon taking up the office of trustee, a trustee's first obligation is to acquaint himself with the terms of the trust and 'get in' the trust property. In the case of a testamentary trust where the trustee is not also the deceased's executor, for example, the trustee must ensure that all the assets in the deceased's estate that are assets to be held on trust are transferred by the executor to him. If he fails to do so, the beneficiary can surcharge the account and the trustee will be ordered to get in those assets, by bringing an action against the executor if necessary. The same order for specific performance would be given where a successor trustee fails to get in the assets from his predecessor trustee. These orders to get in the trust property are all specific remedies.

13.18 Even so, substitutive remedies are much more likely to arise when the account is surcharged. A few examples suffice to illustrate. In the first place, a trustee must, of course, account for all the income that is due to the trust given the trust investments. A trustee who receives funds, say dividends on trust shares, but fails to bring them into the account, or worse, fails, for example, to collect rent on trust leases, will be required to account for their money value. A trustee would normally have a duty to insure against theft or destruction of valuable chattels which form part of the trust assets. Say he fails to do so and a trust chattel, a valuable painting for instance, is destroyed by fire. Obviously, there will be no insurance payment brought into account, for there was no insurance. By way of a substitutive remedy, the trustee will be required to pay money from his own pocket to make up for the missing insurance payment (minus the premiums that he would have paid and which would have appeared on the debit side of the account). Where a trustee has a power of investment with regard to the trust assets, he must comply with the relevant terms of the trust and invest with reasonable care (**8.8**). Where he fails to do so, and the trust assets suffer a fall in value as a consequence, the beneficiary can surcharge the account, and the trustee will again be subject to a substitutive order, to resort to his own resources to pay money into the trust fund to make up the deficiency.

p. 319 **13.19** There is one further feature of understanding the beneficiaries' remedy for breach of trust as invoking the trustee's liability to account: the only interest of the beneficiaries that the trustee's liability to account protects is their interest in the value of, or in the specific property in, the trust fund. It does not allow the beneficiaries any claim for *consequential loss* that they suffer which follows from the trust's being 'short of funds' owing to the breach. Take the following example: Because of the trustee's misapplication of the trust property, say making an unauthorised investment, Hazel, the income beneficiary, receives half the income in 2014 than she would have done if the authorised investment was retained. Let us also assume that Hazel can establish, on the standard 'but for' test of causation, that but for this reduction in her income she would have been able to make a profitable investment herself; instead, because of the reduced income, she could not afford it, and so can prove that the trustee's breach caused her a loss of profits. Has she any claim for this loss against the trustee? Not by way of account. By falsifying the trust account her only claim is to have the trust restored, and this will include an amount of money to ensure that she receives the missing income for 2014, plus interest. But can she 'go outside the account' and claim her consequential loss on some broader notion of the trustee's breach of trust? That would require founding a claim that would not be traditionally conceived of either as falsifying or surcharging the account, because the loss claimed is not a loss to the trust funds. No such claim has ever been argued for in any decided case (though see Glister (2014a) for a discussion about whether such a claim should be available; **13.48** et seq).

13.20 At first this might seem unjust, but it is submitted that it is not. Whilst a beneficiary is entitled to ensure that she receives all the distributions from the trust fund to which she is entitled, a trust fund which has all the property in it which it should, which is what the right to falsify and surcharge the account ensures,

she should not be entitled to recover any losses she suffers in her own personal affairs because she relied upon receiving such and such a distribution on a timely basis. If you have studied the law of torts, you will recognise the issue here as one about a wrongdoer's liability for consequential economic loss, or 'pure' economic loss as it is sometimes put. In general, tortfeasors are not liable to their victims for economic loss that does not directly follow from damage to the victim's person or to his tangible property. Why this is so, why a tortfeasor is not subjected to unlimited liability for all the economic losses his victim suffers that can be shown to flow from his wrong, is a controversial issue, but following Stevens (2007), chs 1–3, in the opinion of your author the most satisfactory rationale is this: the law does not protect your liberty to exploit economic opportunities for profit. It *indirectly* protects this liberty by prohibiting interferences to your person and property and, in this case, by allowing you to claim distributions under a trust to which you are entitled. But the law does not make anyone, including wrongdoers, *insurers* of your economic well-being, even if their wrongful actions alter to your detriment the economic context in which you operate. So the question in this case is whether a trustee owes his beneficiaries a duty (presumably a duty of care) to ensure that he makes distributions of the right amounts on time under the terms of the trust such that he is liable to them for any consequential losses that might eventuate if he does not (beyond any amounts of interest the beneficiaries
p. 320 will receive for late distributions). It is submitted that there is no good reason to impose such a duty, at least in the case of traditional trusts in which the benefits the beneficiary receives are by way of gift from the settlor; the trustee should not be liable for consequential losses you suffer because you receive the correct amount of a gift late (see Penner (2018a)).

13.21 As we have seen, the beneficiary need not falsify the account if the trustee enters into *a profitable* unauthorised transaction. About this Millett (Millett (1998a), 226) says:

> *If the unauthorised investment has appreciated in value, then the beneficiary will be content with it. He is not obliged to falsify the account which the trustee renders; he can always accept it. (It goes without saying that the trustee cannot simply 'borrow' the trust money to make a profitable investment for his own account and then rely on the fact that the investment was unauthorised to avoid bringing the transaction into account.) Where the beneficiary accepts the unauthorised investment, he is often said to affirm or adopt the transaction. That is not wholly accurate. The beneficiary has a right to elect, but it is really a right to decide whether to complain or not.*

13.22 The PC in *Tang Man Sit v Capacious Investments Ltd* (1996) reviewed the law governing a plaintiff's election of alternative remedies, and Lord Nicholls stated (at 521):

> *The basic principle governing when a plaintiff must make his choice is simple and clear. He is required to choose when, but not before, judgment is given in his favour and the judge is asked to make orders against the defendant ... In the ordinary course, by the time the trial is concluded the plaintiff will know which remedy is more advantageous to him ... Occasionally, this may not be so ... A plaintiff may not know how much money the defendant has made from the wrongful use of his property. It may be unreasonable to require the plaintiff to make his choice without further information. To meet this difficulty, the court may make discovery and other orders designed to give the plaintiff the information he needs, and which in fairness he ought to have, before deciding upon his remedy.*

13.23 The requirement of election is clearly to prevent the beneficiary from having it both ways—he cannot both 'adopt' the trustee's act that turns out to be profitable, and also claim damages for a loss on the footing that he wishes to disallow the transaction. Where he elects to falsify the account, the trustee must restore the trust to the position it would have been in, but for the breach, at the time the court gives its judgment (*Re Bell's Indenture* (1980)).

13.24 Each beneficiary is entitled to elect individually whether to falsify the account or adopt the unauthorised transaction in respect of the loss or gain to his own interest under the trust. (In the case of minor beneficiaries, their representative in the action, called a 'guardian *ad litem*' or 'litigation friend', elects for them.) For example, where an unauthorised transaction benefits the life tenant but harms the capital beneficiary, the capital beneficiary can choose to falsify the account and make the trustee liable for the loss to the value of the capital interest (*Dimes v Scott* (1828); **13.41**). However, beneficiaries have no individual right to p. 321 allow the trustee to *continue* keeping the property in a state that is in breach of trust, say in investments not allowed by the trust terms. The trustee's primary duty is to carry out the terms of the trust, and so when a breach comes to light, unless the beneficiaries are all *sui juris* and consent to the unauthorised investment, the trustee must 'realise' it, ie dispose of it and apply the money to an authorised investment (*Wright v Morgan* (1926); *Re Jenkins and Randall & Co's Contract* (1903)). Otherwise, as Swinfen-Eady J pointed out in *Re Jenkins*, a trustee could never remedy a breach of trust by disposing of an unauthorised asset and replacing it with an authorised one unless he got the consent of all the beneficiaries, and he could never do that where any were minors, for minors cannot give valid consent (**13.75** et seq).

13.25 It is important not to confuse the trustee's liability to account (and the process by which the account is taken) with the remedy known as an *account of profits*, which is a remedy that is available in respect of breach of fiduciary duty (**14.62**), and exceptionally, in cases of breach of contract and (very exceptionally) tortious wrongdoing. As Morgan J put it recently in *Vidya Bhushan Goyal v Florence Care Ltd* (2020):

> *[41] I consider that the type of account discussed by Lord Millett [in Libertarian Investments v Hall] is different from an order for an account of profits which is a true remedy for a breach of fiduciary duty. An account of profits was separately considered by Lord Millett at [169] where he described how a fiduciary may be called upon to restore to, or pay over to, the beneficiary of the fiduciary obligation the profits made by the fiduciary in breach of fiduciary duty.*

The personal liability of the trustee when the account is surcharged or falsified

13.26 As we have already seen (**13.4** et seq), it is vital to distinguish between a person's personal and proprietary liability; where a trust is surcharged or falsified, the trustee's liability is *personal*. It can be nothing else where the account is surcharged, because the trustee can have no property in his hands that the beneficiaries can claim as their own if the loss does not involve a misapplication of trust property. One typically surcharges the account where the trustee *failed* to do something, such as invest the trust funds with care, or insure the trust property, and this failure causes loss. The only way the trustee can make up the loss is by digging into his own funds or, for example, borrowing some money from someone else; he thus has a purely *personal* obligation to pay. But the same kind of liability arises when the account is falsified. The particular transfer of trust property is falsified, and the trustee has either a personal obligation to pay money or by some other means to get the trust property back in order to restore the trust *in specie*, or a personal obligation to pay money out of his own pocket to restore the money value of the misapplied property.

13.27 So in no case does surcharging or falsifying the account give rise to any proprietary liability against anyone. Only when the beneficiary 'adopts' the trustee's misapplication of the trust property in some form or p. 322 other does any proprietary liability arise, as we shall see (**13.37**). Moreover, this personal liability to account must be situated in the context of other claims that might be available to a beneficiary, which we have already seen. Recall that a trustee who 'excessively' exercises a power of appointment or one who commits a fraud on a power (**3.44**), in fact does nothing, in the sense that the 'exercise' of the power, going beyond the scope of the power, is invalid from the outset. In such a case when, pursuant to the invalid exercise of the power, the trustee distributes property to the purported object of the power, the trustee misapplies the trust property. A distribution on the invalid exercise of power is straightforwardly an unauthorised distribution, and the beneficiary can falsify the account. But we have also seen that a distribution under a valid exercise of a power of appointment is voidable, and can be set aside by the court (**3.56** et seq) if the trustee breached a duty in the exercise of a power, for example because the power was exercised on the basis of a sufficiently serious mistake as to its effect or consequence. This does not involve the falsification or the surcharging of the account. By setting aside the transaction, the trust is put into the position that it would have been in had the power not been exercised in the way that it was. This will give rise to a claim against the third-party recipients to recover trust property (or its traceable proceeds) wrongfully transferred to them. If this claim succeeds then the trustee will not be personally liable to restore the trust; if the property cannot be recovered, then the trustee will be personally liable to restore the trust.

'Equitable compensation' for breach of trust in contrast to equitable compensation for breach of a fiduciary duty

13.28 In certain cases, a trustee who commits a breach of trust is ordered to pay money directly to the beneficiaries because there is no point in reconstituting the trust fund itself. An example, which you will recall from **11.28**, is an SAT under which a solicitor holds funds prior to the completion of a purchase of land. Imagine such a solicitor pays those funds away in breach of trust. The beneficiary, the would-be purchaser whose money has not gone to buy the land as he intended, will obviously falsify the account. The solicitor will be liable to dig into his own pocket to replace the money paid away, but there is usually no point in his paying money back into his client trust account for the beneficiary, because at this stage the land purchase transaction will probably be irredeemably compromised by the solicitor's breach, and the beneficiary would be unlikely to want this solicitor to complete the land purchase in any event. The beneficiary will simply want the money paid to him directly.

13.29 A similar sort of case arises where the trustee, before misapplying the property, ought to have paid the entirety of the trust funds to the beneficiaries, if, for example, where the trust was for A for life and then to B, and A has died. The trustee would then hold the funds for B absolutely. Again, then, there is no point in the trustee's reconstituting the trust with a money payment; rather, he should pay B directly. In cases where a

trustee pays his beneficiaries directly to make up for his default, he has been said to make 'equitable
p. 323 compensation' to the beneficiaries. The idea is that the beneficiaries are compensated directly for the loss of their interest under the trust (see also Conaglen (2016), 146–150).

13.30 Similarly, in certain cases a fiduciary who has breached his fiduciary obligations will be liable directly to his principal for causing him loss (see, eg **14.62**), and is said to pay 'equitable compensation' for his breach of fiduciary duty. An example would be where a solicitor, in conflict of interest, advises his client to make an investment that falls in value. The solicitor will be made to compensate his client directly, and again, this is called equitable compensation. Nevertheless, it is important to understand that these cases are distinct. Though all cases where equity imposes a liability to pay an individual or individuals may be referred to as cases of 'equitable compensation', as Millett NPJ does at **13.12**, in the former case the trustee's liability is measured in exactly the same way as would be his liability to restore the trust under his liability to account. In the latter case, just as in the case of a tort, the fiduciary's liability is measured by the loss to the principal caused by the breach, and has nothing to do with any diminution in value of any trust fund he held for his principal.

13.31 Sometimes the former version of equitable compensation is correctly called 'substitutive' (the money award serves as a substitute for the misapplied asset) or 'restorative' or 'restitutionary' (as Millett NPJ does at **13.12**) compensation (the money award restores the trust fund) to distinguish it from the latter 'reparative' compensation (the money award repairs the loss to the beneficiary). You, however, should not worry overmuch about applying this terminology, so long as you understand that the liability 'to make equitable compensation' has different grounds in the two cases, but your author felt obliged to mention all of this so that you can make some sense of academic and judicial writings that bandy around the term 'equitable compensation' without telling you that it means different things in different contexts.

The measure of liability in cases where the account is surcharged

13.32 In *Bristol and West Building Society v Mothew* (1996), Millett LJ said (at 17, emphasis added):

> Equitable compensation for breach of the duty of skill and care resembles common law damages in that it is awarded by way of compensation to the plaintiff for his loss. 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. *It should not be confused with equitable compensation for breach of fiduciary duty which may be awarded in lieu of rescission [*ie instead of a contract being set aside for self dealing (**13.92** *et seq)] or specific restitution [*ie instead of an order to return specific property taken from the trust, where, for example, the property is no longer in existence*].*

13.33 Note the first two sentences of this quotation. In the case of a trustee's negligence, in principle he
p. 324 should be liable for the loss due to his negligence, in exactly the same way that any person committing the tort of negligence is liable for money 'damages' to his victim. There is no reason why any special 'equitable' rules of causation ought to apply, because the wrong is the same as the tort of negligence at common law. Negligence is negligence. But, as we shall see (**13.35** et seq), some very particular (and in certain cases,

arguably unjust) rules of causation, ie the rules that establish whether a particular loss should be attributed to the defendant's breach of duty, apply when the court determines a person's liability to restore the trust in cases of falsifying the account, and Millett LJ is rightly warning not to confuse the two situations.

13.34 Where an investment loss is caused by the trustee's negligence, the problem is to determine what the trust property would have been worth if it had not been for his negligence. In *Nestle* (**8.22** et seq), the plaintiff beneficiary failed to prove that the trust company's negligent misunderstanding of the trust instrument caused any loss; had she done so, however, Dillon LJ said *obiter* that the trustee would have to pay 'fair' compensation, ie an amount sufficient to restore the trust fund to a value it would have achieved if a proper investment policy had been followed, 'not just the minimum that might just have got by without challenge'.

The measure of liability where the account is falsified

13.35 Where trust money is misapplied in breach of trust, in principle the calculation of loss is easy, because the loss is simply the value of the trust property misapplied. If the trustee cannot restore the actual trust property *in specie*, what he must pay is simply the value of that property plus interest. The issue becomes much more complex and controversial, however, where a breach of trust happened sometime before the beneficiaries realised a breach had occurred and took action against the trustees. We can begin to approach this issue re-quoting the last two sentences from Lord Millett's discussion in *Libertarian Investments* (**13.12**):

> *[171] In an appropriate case the defendant will be charged, not merely with the value of the property at the date when it ought to have been acquired or at the date when the account is taken, but at its highest intermediate value. This is on the footing either that the defendant was a trustee with power to sell the property or that he was a fiduciary who ought to have kept his principal informed and sought his instructions.*

Lord Millett NPJ does not cite any authority for this proposition, but authority there most assuredly is.

13.36 In such cases the rules of causation appear to make the trustee liable for all risks that attend the ownership of the property involved in the unauthorised transaction. In *Clough v Bond* (1838), Cottenham LC put it this way (at 1018):

> *It will be found to be the result of all the best authorities on the subject, that, although a [trustee], acting strictly within the line of his duty, and exercising reasonable care and diligence, will not be responsible for the failure or depreciation of the fund ... yet if* p. 325 ↵ *that line of duty not be strictly pursued, and any part of the property be invested by such [trustee] in funds or upon securities not authorised, or be put within the control of persons who ought not to be instructed with it, and loss be thereby eventually sustained, such personal representative will be liable to make it good, 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.*

13.37 So, for example, if, in breach of trust, the trustee spends trust money on a painting, the beneficiaries can elect either to falsify the account or adopt the purchase of the painting. If the painting is stolen, then obviously they will falsify the account and demand that the trustee restore the money wrongfully spent on the painting. This makes perfect sense, because the trustee created the risk of the theft by purchasing a chattel that could be stolen.

13.38 But consider a case where, in breach of trust, the trustee sells one of a trust's collection of paintings and, shortly thereafter, all of the trust's paintings are stolen through no fault of the trustee. The loss of all these paintings will be a loss to the trust, but the trustee will not be liable for a loss that occurred through no fault of his. (Normally, of course, in a case like this the paintings would be insured against theft, but ignore that for the moment.) The beneficiaries now discover the breach. If the trustee has made a *good* bargain on the sale of the painting, they will of course adopt the transaction and require the trustee to hold the proceeds of the sale as trust money. But what if the trustee made a bad bargain, or the painting has risen in value, so that the present value of the painting is, say, £100,000, while the proceeds were only £50,000? The beneficiaries will falsify the account, impugning the trustee's sale of the trust painting, and demanding he restore its full value to the trust. (In 'accounting' terms, the £50,000 proceeds of sale will be treated as the trustee's own, and he will be required to pay £100,000 as the value of the painting; in practical terms, then, the trustee will have to add £50,000 in new money in addition to the £50,000 proceeds of the sale that he accounted for to the trust at the time of sale.) But notice that this falsification claim states, in theoretical or accounting terms, that the trustee never sold the painting: the beneficiaries 'falsify' the sale of the painting. So why, then, cannot the trustee, using the rules of causation that would normally apply at common law, argue that he need pay nothing in compensation, because had he continued to hold the painting on trust, it would have been stolen with all the others? In other words, if the beneficiaries choose to falsify the sale, must they then not accept all the logical consequences of that? In short, why should the trustee not argue that the trust lost nothing because of his breach; indeed the trust is £50,000 better off than it would have been, because the trust at least has the proceeds of the sale? Unfortunately, the cases do not all speak with one voice, but it is unlikely that this argument will be accepted. When the beneficiaries falsify the account, the court will regard the trustee as having the painting in his possession, which he must either restore *in specie* or pay the full value of; subsequent events such as the theft will not be taken into account to reduce his liability.

13.39 The principles under consideration here relate specifically to the risks and subsequent events
p. 326 concerning what happens to property and its value for the purpose of determining its 'replacement cost', ie the amount of money a trustee must pay to restore the trust when it is falsified. In other words, certain questions about what happens later, or the probability of things happening later, may in certain cases, such as in a case of a continuing breach, be relevant for determining the value of a substitutive award which adequately reflects the beneficiary's performance interest in the trust.

13.40 The nineteenth-century cases waver about what ought to be done where a trustee, instead of investing the trust property as he should, wrongly transfers the property to a third party on the terms of a loan, or holds onto property instead of investing it. In *Watts v Girdlestone* (1843) the trustees lent the money to a beneficiary instead of properly investing it in real property or government stock. The court held that they were liable to restore the trust as if they had invested the property in the most favourable investment they could have made. They therefore had to pay the difference between what they received back on the loan from the beneficiary and what they would have earned investing in government stock. By contrast, in *Shepard v Mouls* (1845) the trustees wrongfully allowed one trustee to personally take the trust funds on payment of interest. Some of the beneficiaries complained, and argued, as in *Watts*, that the trustees should be charged with the difference between the interest they were paid and what they would have earned if they had made the most favourable investment they were authorised to make. Here, however, the court decided against the beneficiaries, arguing that the trustees, having a discretion in how they might invest the funds, could not be charged with the returns they would have earned on any particular investment. One can see how allowing beneficiaries to charge the trustees in this way might be unfair in certain circumstances. It would not be fair to trustees who were allowed to invest in shares, but did not, to allow the beneficiaries to say, with the full benefit of hindsight, that they should have invested in shares of some company that had done spectacularly well in the meantime. On the other hand, it is a principle of the law that a wrongdoer should not benefit from uncertainties, whether of evidence or causation, ie of what might have been, which are due to his own wrongdoing (recall the discussion of this at **12.14**). Today, it is most likely that the courts would follow the approach stated by Dillon LJ in *Nestle* (**11.34**); the courts should try fairly to assess what the trustees might reasonably have earned by properly investing.

13.41 A different issue arose in *Dimes v Scott* (1828). The trustees, in breach of trust, held onto an unauthorised investment in an East India Company bond for ten years, which paid 10 per cent interest per annum on its face value, whereas they should have invested the money in 3 per cent Consols, government securities that paid 3 per cent interest per annum on their face value. At the end of the ten-year period the trustees did what they ought to have done in the first place, and sold the East India bond and purchased 3 per cent Consols. The trust was for one income beneficiary, and one capital beneficiary. The capital beneficiary falsified the account, because at first glance it seemed obvious that the income beneficiary had benefited from the breach at the capital beneficiary's expense, receiving a rate of 10 per cent interest on the unauthorised investment, whereas if the trust had been properly carried out, the income beneficiary would have received only 3 per cent interest
p. 327 on the authorised investment and, normally, this would have indicated that the East India bond was a poorer capital investment. The claim against the trustees, therefore, was that they should be liable to restore what the trustees had wrongly paid out to the income beneficiary, ie the difference between what she was actually paid in interest on the East India bond and what she would have received from the 3 per cent Consols. However, as it turned out, when the trustees actually converted the East India bond into Consols, albeit ten years late, the price of Consols was much lower than it was ten years earlier, and so they were able to buy more Consols with the same amount of money. Thus the unauthorised investment turned out to be good for all concerned: the income beneficiary benefited for ten years from the higher rate of interest payments, and the capital beneficiary ended up with more Consols as the capital of the trust than he would have done if the trustees had converted the investment at the outset. Nevertheless, when this was discovered, the capital beneficiary maintained his claim. He argued that the trustees should still be liable for the overpayments to the life tenant (had the investment been properly converted ten years earlier the life tenant would have received about £1,000 less), and should not be able to take any credit for the 'accidental' increase in value of the capital fund owing to their mistake. The trustees argued, quite reasonably, that the capital beneficiary could not have it both ways; he should not both 'adopt' the failure to convert in order to get the benefit of the mistake in terms of the increased capital value while at the same time falsify the account to recoup the overpayment to the life tenant. The Lord Chancellor Lord Lyndhurst decided in favour of the capital beneficiary, and the trustees were required to pay into the trust the £1,000 the income beneficiary was 'overpaid'. This case is generally regarded as harsh, and points out how the equitable rules of causation for loss arguably do not properly take into account the actual facts, or indeed, the logic of the beneficiaries' electing to falsify or adopt an unauthorised transaction.

13.42 A number of other cases, besides *Watts*, support the view that a trustee may be liable for the highest interim value of the trust property between the initial breach and the time when the account is taken (*Nant-y-glo and Blaina Ironworks Co v Grave* (1878); *McNeil* v *Fultz* (1906) (Supreme Court of Canada); *Re Dawson* (1966); *Guerin v The Queen* (1984) Supreme Court of Canada; see also *Michael v Hart* (1902), 488; cf *Shepard v Mouls* (1845); *Fales v Canada Permanent Trust Co* (1977) Supreme Court of Canada). Lord Millett says this is on the 'footing' that the trustee had a power to sell the property or that he was a fiduciary who ought to have kept his principal informed and sought his instructions. It is not clear that any of the cases turned on the latter consideration, but as regards the former, that the trustee had a power to sell the property, this is normally framed somewhat differently, in terms of the trustee having the opportunity to realise the value of the unauthorised asset through the period of continuing breach.

13.43 Furthermore, it seems that the traditional view is that so long as the trustee was in such a position, he is not entitled to avoid the liability to reconstitute the trust at the highest interim value by arguing that, but for the breach, the asset would not have been realised at that value in any case. Thus, a normal principle of 'but for' causation is denied to a trustee in the case of this valuation exercise. As the point was put by Nicholas Stewart QC in *Jaffray v Marshall* (1993):

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> ↵ *[1290H] … in cases of continuing breach of trust by a failure to restore trust property, it is not necessary for the plaintiff to establish by evidence what would have happened if there had been no breach of trust. In fact they go further. It is not, apparently, open to the defendant to adduce such evidence, either …*
>
> *[1293B–C] The underlying point of the authorities seems to be that the breach of trust has deprived the party who ought to have had the assets throughout the relevant period of the opportunity of realising them at any point he chose. Evidence may have to be considered to see whether that opportunity was there at all; … But if the opportunity was there at every point during the continuing breach of trust, the defaulting party must make compensation on the footing of the lost value of the opportunity at its highest point.*
>
> *[1293E] I do not see a distinction in principle between shares and other types of property. They are different in the sense that shares generally have no use to a trust except as a pure investment, whereas a house which provided a residence [in this case] fulfilled the basic purpose behind the trust and was in a sense only secondarily an investment. But each type of property is nevertheless a trust investment and the opportunity of selling it is normally there at any time.*

13.44 This reasoning is supported by the 'wrongdoer principle' (**13.40**), and this principle was clearly applied in the Canadian Supreme Court case of *McNeil v Fultz* (1906) to require a defendant treated as a trustee of securities to pay an award calculated on the assumption that he would have sold the securities at the highest price obtainable during the period of his continuing breach.

13.45 It is fair to say that the nineteenth-century authorities do not provide a consistent guide, and may not survive the reasoning of the HL in *Target Holdings Ltd v Redferns* (1996) and the UKSC in *AIB Group v Mark Redler & Co* (2014) (**13.47** et seq). In *Target*, Lord Browne-Wilkinson refused to follow *Jaffray* and the report says the case was 'over-ruled', but with respect, the judge in *Jaffray*, Nicholas Stewart QC, was unfairly characterised by Lord Browne-Wilkinson as having 'wrongly applied' 'the principles applicable in an action for an account of profits' 'to a claim for compensation for breach of trust'. He did no such thing. Lord Browne-Wilkinson also mischaracterised the claim in *Nant-y-glo* as a claim for an account of profits.

13.46 This is not to defend each of the rules set out by Nicholas Stewart QC, in particular the rule that the presumption that the investment would have been realised at its highest interim price is irrebuttable, ie that no evidence can be led by the trustee in order to rebut it. That was clearly the holding that sunk the trustee in *Jaffray*. The point is that, in the valuation exercise to determine the extent of the trustee's liability, the beneficiary has not been traditionally limited to his provable loss, nor to the trustee's provable gain, and this makes sense if the purpose of the valuation exercise is to determine the value of his performance interest under the trust. In these circumstances, it seems inevitable that in some cases some presumptions (rebuttable or not) will be necessary to ensure that a trustee restores the trust on a basis that is fair to the beneficiary.

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The new approach in *Target* and *AIB*

13.47 The facts, results and reasoning in *Target* and *AIB* have been analysed in detail in **Chapter 11** (**11.7** et seq). Recall that the results of both cases could have been reached by way of the traditional accounting rules that we have been discussing. However, that was not the reasoning of Lord Browne-Wilkinson in *Target*, nor the reasoning of Lords Toulson and Reed in *AIB*. Recall also the conclusion of our discussion of the ratio of *AIB* (**11.31**):

> *The resulting ratio decidendi seems to be the following: where the trust arises in a 'commercial context'—a 'commercial context' is not clearly specified—a beneficiary of a trust will be disentitled from falsifying the account—the unauthorised expenditure will be regarded as an expenditure of the beneficiary's funds for the beneficiary's purposes. However the trustee's breach in expending the funds on an unauthorised asset will, on the other hand, amount to a wrong sufficient to support a claim for a consequential loss, so that if the expenditure results in the beneficiary acquiring something of lower value than that which would have been obtained had the intended, authorised, expenditure been made, then the trustee will be liable for the difference.*

13.48 Does *AIB* represent the current state of English law on the remedies for breach of trust? As a prelude to this question, we turn briefly to some difficult terminology. The term 'consequential loss' is sometimes used confusingly in the literature. It can refer to *all* losses that are suffered as a result (but-for causation is usually the relevant standard of causation) of a wrong. These 'consequential losses' are then cut down by restrictions on recovery such as remoteness rules or the doctrine in *South Australia Asset Management Corporation (SAAMCO) v York Montague Ltd* (1997), which limits the defendant's liability in reference to the 'scope' of his duty to the claimant. Used in this sense, the term consequential loss is simply a shorthand for the kinds of losses that would be recoverable under the compensatory principle (**11.16**). This is the sense in which the term is used in the paragraph above. But there is another sense in which the term can be used. Used in this latter sense, the term consequential loss refers to losses which are caused by an initial loss. Therefore, if a contract breaker causes £100 of loss to the wronged party, and because of the lack of that £100 the wronged party has to pass up an investment opportunity that would have netted her £200, this £200 of foregone profit is sometimes also referred to as a 'consequential loss'.

13.49 This is important to understand, because this latter sense is partially what is meant when it is said that consequential loss is not recoverable for breach of trust. Recall the example of Hazel we discussed at **13.19**.

13.50 Hazel has no claim for the loss of profits she has suffered. The traditional accounting rules do not afford her any such claim: the law currently makes no provision for Hazel's attempt to 'tack on' her personal loss to the loss suffered by the trust fund. The question is whether the new compensatory approach under *AIB* would give her such a claim, especially given the focus on the loss suffered by the beneficiary, as opposed to the loss to the trust fund.

p. 330 **13.51** The ratio of that case, as discussed earlier (**11.31**, **13.41**) is at best unclear. There has been no further guidance from the Supreme Court since, but three subsequent Court of Appeal decisions are of value in discerning how *AIB* has been received. The first is *Main v Giambrone* (2018). Two Italian companies were in the business of building and selling beachfront apartments in Brancaleone, on the coast of Southern Italy. To maximise their returns, the companies decided to sell the apartments 'off plan', ie before they were built. Things fell apart, and very few of the units sold were actually completed and conveyed to purchasers. The entire development was subsequently seized by the Italian Financial Police due to suspected money laundering, and there were allegations that the whole project was a money laundering operation organised by the IRA and the Italian Mafia.

13.52 The disappointed purchasers of the apartments looked to their solicitors, a firm known as Giambrone, for their losses. The (modest) aim of the purchasers was to recover their lost deposits. To understand the crux of this case, it is important to understand the exact arrangements between the purchasers and Giambrone. The two developer companies reached an agreement with Giambrone, under which they were to refer prospective purchasers to Giambrone. Giambrone's role was to complete the necessary due diligence relating to the development, issue preliminary contracts, advise the purchasers as to the legal aspects of the purchase, and importantly, handle the deposits paid.

13.53 Upon signing preliminary contracts, the purchasers paid deposits to Giambrone ranging between £30,000 and £105,000. Giambrone had instructions to only release these deposits to the developer companies upon the issue of a bank loan guarantee in compliance with Italian Decree 122/05. This decree required a bank loan guarantee to be issued by a financial institution listed in art 107 of the Consolidated Law on Banking and Credit. The developers failed to procure such a guarantee, instead procuring non-compliant guarantees from financial institutions listed under art 106 and not art 107. These guarantees were also inferior in the sense that they lasted only for one year, as opposed to up to the date of completion of purchase. Unperturbed, Giambrone proceeded to release the deposits anyway.

13.54 The court of first instance found that Giambrone's release of the deposits without the receipt of the proper guarantees was a breach of trust, and this went unchallenged on appeal. Surprisingly, the events at Brancaleone did not amount to a 'crisis situation' which would have triggered the obligation of the guarantors to pay out. Therefore, *even if Giambrone had obtained compliant guarantees before paying out the deposits, the purchasers would be no better off. The guarantees, compliant or otherwise, did not affect their situation in any material sense.*

13.55 Jackson LJ (with Underhill and Moylan LJs concurring) set out the principles in *Target* and *AIB*, but thereafter effectively distinguished both authorities. According to Jackson LJ ([61]), the solicitors in *Target* were 'under a duty to take active steps to secure a charge over the property, before releasing the monies.' Likewise, in AIB, 'the solicitors were under a duty to take active steps to secure the removal of prior charges p. 331 before releasing the money'. In comparison, 'Giambrone's role was to receive whatever guarantees the developers provided and to check whether or not they complied with Decree 122' ([62]). If no compliant guarantees appeared, the solicitors were under a duty to 'act as custodians of the deposit monies indefinitely.' In other words, the duty in *Giambrone* was passive.

13.56 On this basis, the court held that the purchasers were entitled to their lost deposits by way of 'equitable compensation' (eg at [63]). The language of falsification was not used, but *in effect* the purchasers, as beneficiaries of the trust upon which the deposits were held, were allowed to falsify Giambrone's unauthorised disbursement of the money.

13.57 The distinction between active and passive duties is dubious. The duties in *Target* and *AIB* could be reframed as primarily passive duties—*not* to release the money until the specified conditions were met. Even if the distinction is maintained, what relevance should it have for a trustee's liability for breach? On one interpretation of Jackson LJ's judgment ([63]), it is relevant in establishing but-for causation between the breach of trust and the relevant loss: 'In *Target* the plaintiff's claim failed on the "but for" test. In the present case the claimants' claim passes the "but for" test.'

13.58 Can this be right? On the facts, the defendant's wrong was getting non-compliant guarantees, and paying out the money on the basis that they were compliant. But (**13.54**) it was clear that whether the guarantees were compliant or not was irrelevant to the loss the claimants suffered, so the wrong of getting non-compliant guarantees was not a but-for cause of the claimants loss. Perhaps the better explanation of the result in *Giambrone* is that, directly contradicting *AIB* and *Target*, the purchasers were allowed to falsify the disbursement of the deposits in breach of trust. As a matter of authority, it was not open to the Court of Appeal to directly contradict either *AIB* or *Target*, decisions of the Supreme Court and House of Lords respectively. Nevertheless, this seems to be the least problematic explanation of the result.

13.59 The second case is *ITC v Ferster* (2018). Jonathan Ferster was a director of the company ITC. In breach of fiduciary duty, he paid himself roughly £4.5m in unauthorised remuneration out of the company's funds. The judge at first instance ordered an assessment of equitable compensation. The CA was asked to consider the proper interpretation of the term 'equitable compensation'. In Richards LJ's view:

> *[16] ... Equitable compensation is apt to include a payment made to restore to a claimant the value of assets or funds removed without authority by a trustee or other fiduciary, such as a director. It may also include reparation for losses suffered by the claimant, such as in this case any tax penalties and interest resulting from the payment of the unauthorised remuneration. But, it is not restricted to reparation for losses, as the judge appears to have held by his adoption of Mr Thompson's binary distinction between loss-based and gains-based remedies.*

13.60 Richards LJ drew on Lord Millett NPJ's judgment in *Libertarian Investments v Hall* in support of the proposition that equitable compensation can involve both substitutive **a**nd reparative claims. No real discussion of *Target* or *AIB* was undertaken, except to say that the facts in *Ferster* bore no relation to those two cases.

p. 332 **13.61** *Ferster* is a difficult case. Arguably, it avoids the problem of directly contradicting Supreme Court authority (*AIB*) because its facts concern a breach of a custodial fiduciary duty by a company director with regard to the company's assets and not, strictly speaking, a breach of trust. But this is achieved only at the cost of raising a new problem—is there any good reason to disentitle a *beneficiary* from falsifying the account when a trustee is involved, but entitle the company, as a principal, to falsify the account when its director, a custodial fiduciary, misapplies the company's assets, especially in light of the traditional approach (**13.7**) under which equity treats the two as essentially identical?.

13.62 The final case is *Auden McKenzie v Patel* (2019), also a decision of David Richards LJ. Amit Patel and his sister were the only directors and shareholders of a pharmaceutical company, Auden McKenzie Ltd. In breach of fiduciary duty, Patel caused the company to pay out roughly £13.7m against sham invoices. Third parties engaged to generate the sham invoices kept a percentage of the sum, and the rest was paid to Patel. Auden McKenzie was sold to new owners. Under the direction of the new owners, the company sued Patel, claiming summary judgment on the misapplied sum plus interest. Patel argued that the company had suffered no loss as a result of the breach of fiduciary duty, for if the sum had not been paid out in breach, he and his sister (as the sole directors and shareholders of the company) would have caused the money to have been paid out as dividends or in some other lawful manner. This was rejected by the judge at first instance, who entered summary judgment in favour of the company. On appeal to the Court of Appeal, the issue was whether, as a matter of law, Patel's aforementioned argument was unsustainable such that it could be dealt with summarily instead of at a full trial.

13.63 Richards LJ (with Newey and Lewison LJs concurring) allowed the appeal, holding that although he was 'far from saying that Mr Patel has a defence that will succeed', he was not prepared to say that Patel's argument was unsustainable in law. In Richard LJ's view ([60]), *Target* and *AIB* 'demonstrate a willingness on the part of the courts to develop the equitable remedies for breach of trust and breach of fiduciary duty and, where required to do what is practically just, to entertain some departure from the strict obligation of trustees and fiduciaries to restore the fund under their control.' The characterisation of *AIB* as entertaining 'some departure' from the strict obligation of trustees and fiduciaries to restore the fund reveals that, in the eyes of the CA, the effect that *AIB* has had on the law of trusts is more muted than commonly believed. Richards LJ seems to have found a middle way in this case—neither fully endorsing the new compensatory approach, nor advocating a full return to the traditional accounting rules.

13.64 *Auden McKenzie* has received some criticism. Turner and Ho (2020) argue that the court in *Auden* has introduced uncertainty into a previously settled area of law—the liability of company directors for the misapplication of company assets. As they point out, no previous authority binding the Court of Appeal had allowed for any reduction of the defaulting director's liability by reference to hypothetical payments of lawful
p. 333 dividends or other benefits. In other words, falsification was the default remedy in such situations, not a compensatory loss-based approach. Turner and Ho also raise questions about whether an extension of *AIB*-

type reasoning from trusts law to company law is appropriate, given the different concerns in company law relating to the protection of company creditors and shareholders. The counter-argument to this is that this is how equity treats these wrongful exercises of the custodial fiduciary's powers over the title to the principal's property—as equivalent to breaches of trust (**13.7**).

13.65 In sum, *Main v Giambrone*, *ITC v Ferster* and *Auden McKenzie v Patel* have cast doubt on the extent to which *AIB* has changed the law on equitable compensation. Although none of these cases directly contradicted *AIB* in reasoning, none of them thought that *AIB* was directly applicable either. It may be that these narrow readings of *AIB* in the Court of Appeal indicate the direction of travel for the law on equitable compensation. We await further guidance from the UKSC.

Setting an unauthorised gain against an unauthorised loss

13.66 What should happen where a trustee enters into two different unauthorised transactions, one of which causes a loss, but the other creates a gain for the trust? Can the beneficiary falsify only the loss-causing transaction, and adopt the successful one? In general, the answer is yes, if the transactions are distinct (*Wiles v Gresham* (1854); *Dimes v Scott* (1828)). This seems right, because the trustee should not be exonerated of particular breaches because he can say, 'overall, the trust is in good shape'. However, where the losing and gaining unauthorised transactions form part of one composite transaction, the transactions must be falsified together or not at all (*Fletcher v Green* (1864)). For example, in *Bartlett* (**8.18**), the court held that the disastrous investment in one property development project was part of a larger investment policy favouring land development. In taking the account, then, this decision required the beneficiary to 'falsify' both the winning and losing projects as one invalid investment, with a resulting reduction in the amount of compensation. (Note: 'falsify' here is placed in quotation marks, as *Bartlett* was not a falsification case. Recall the facts in *Bartlett*. The trustee was liable for not preventing the company in which the trust held shares from embarking on property developments. Thus the case was one of negligence, and the beneficiaries surcharged the account. But the principles of causation for loss in falsification cases were relevant because the transactions the company entered into were essentially ones that, had the company been the trustee, would have been misapplications of trust property, and so it was appropriate to think in terms of falsification when assessing the loss to the trust.)

A personal claim where the account is not falsified

13.67 Where the beneficiaries choose not to falsify the account, the trustee must, of course, treat the property he holds as a result of the unauthorised transaction as trust property, and account for it to the trust. But as Millett LJ points out (**13.21**), a trustee cannot 'borrow' the trust funds but treat the profits he derives from the trust money as his own. If the trustee uses trust money in his own business, it will usually, however, be
p. 334 impossible to trace the money into any particular property the trustee holds that the beneficiaries could adopt as trust assets. Rather, the beneficiaries will usually be in the position of having to elect whether or not to adopt the trustee's 'loan' of the trust funds to himself. If they do so, they then have a further choice: they can elect either for an accounting of the trustee's business profits, which are attributable to the use of the beneficiaries' money, or for compound interest on the 'loan' (*Docker v Soames* (1834); *Westdeutsche Landesbank*

Girozentrale v Islington London Borough Council (1996)). Of course, the beneficiaries will falsify the account if the authorised transaction the trustee ought to have made would have been more profitable than his business profits or compound interest.

Confusions between cases of negligence, misapplication of trust property, and breach of fiduciary obligation

13.68 When you are looking at a case where a trustee commits a wrong, you must *always* ask yourself whether the wrong is: (1) negligence or a failure to act in some way, for which a beneficiary may surcharge the account; (2) a misapplication of trust property, for which the account can be falsified; or (3) a breach of fiduciary obligation. It is a failure of analysis simply to say the trustee committed a 'breach of trust' as if this term were precise enough to explain either what went wrong or what remedy is appropriate. Two cases where a precise analysis was necessary will show the importance of this.

13.69 *Bristol and West Building Society v Mothew* (1996) concerned a claim by a building society against a solicitor who had acted both for it and the borrower, holding the funds on trust prior to completion of the purchase of land, an SAT (**11.7**). The solicitor negligently failed to include facts pertinent to assessing the creditworthiness of the borrower in filling out a standard form report to the society prior to the release of the mortgage loan. Although he had been aware of the facts, he had forgotten or overlooked them when making the report. The lender claimed that the solicitor both breached the trust and breached his fiduciary obligation. Millett LJ, writing the opinion of the CA, carefully considered the nature of the solicitor's wrong, disapproving the indiscriminate use of the labels 'breach of trust' and 'breach of fiduciary obligation', in particular the latter. He held that while the solicitor's paying out the money for the purchase was certainly a payment of *trust* money (it was clearly held by him on trust), his action in paying it was not a misapplication of trust money, because the solicitor was at that time complying with his standing instructions as to how the trust money should be applied. Neither was there a breach of fiduciary duty for in paying the money away the solicitor was not acting in bad faith or in conflict of interest. Rather, the solicitor was guilty of negligence in failing to take care in the preparation of the report, which probably also constituted a breach of his contract with the lender.

13.70 The decision of the Australian High Court (the supreme appellate court in Australia) in *Alexander v Perpetual Trustees WA Ltd* (2004) shows, in contrast, a disappointing failure of analysis. In this case a solicitor acted under a bare trust with a contractual mandate to use the beneficiary's funds to make a certain kind of
p. 335 investment. The solicitor-trustee paid the money to purchase the investments, but failed to acquire certain documents that provided security for the investments. At the same time, the beneficiary was also careless in failing to take notice of the fact that these security documents were never acquired, and continued to invest more sums regardless. As a result, all the money invested was lost. The main issue was whether a *beneficiary* could be partly liable for a breach of trust. (Note: the issue is not about whether a beneficiary can consent to a breach of trust (**13.75**); consent to an act is not the same thing as committing that act oneself.) Now, if the case is one where the trust property is misapplied, then it would seem impossible for a beneficiary to be liable, because only a trustee can commit acts, such as a transfer of the property and so on, which misapply the trust property. As we shall see (**15.7** et seq), agents of the trustee such as his banker or his solicitor can participate in

a misapplication of trust property, and if they do so dishonestly they will be liable for the loss. But a beneficiary does not usually act as an agent of the trustee, and did not in this case; it was the trustee alone who carried out all the steps in the transactions with the trust money.

13.71 There may, however, be a case where the liability for a loss should be shared between a trustee and a beneficiary. Consider the case of a nomineeship. A nominee trustee essentially follows the directions of the beneficiary, and one can easily imagine a situation where both the beneficiary and the trustee carelessly contributed to a decision to make an authorised but losing investment. There would appear to be nothing in principle that would prevent the negligent trustee from claiming that the beneficiary was contributorily negligent, and should shoulder part of the loss. In *Alexander* itself, the trial judge said that if the case turned on negligence, the solicitor-trustee was 60 per cent liable and the beneficiary investor, 40 per cent liable, for the resulting loss. Unfortunately, none of the judges of the High Court specified what kind of breach of trust took place, that is whether the solicitor misapplied the trust funds in purchasing the investments without obtaining the security documents, for which the account could be falsified and the solicitor made strictly liable to restore all the funds paid away, or whether the money was properly paid under the mandate for the investments, but done negligently in the sense that the documents of security were never obtained. As Millett LJ made clear in *Mothew*, this is the crucial issue, because there is all the difference in the world between a trustee who carries out the trust terms by applying the money according to his mandate, but whose negligence gives rise to loss, and one who misapplies the money in breach of his mandate. What the court failed to analyse was whether the solicitor's purchase of the investment without acquiring the security documents was a misapplication of the trust money, akin to a solicitor's paying away a mortgage lender's money on completion of a house purchase without obtaining a charge on the property (the mortgage lender's mandate is to use its money to 'buy a charge' over the property), or whether the purchase of the investments was a perfectly proper application of the money according to the mandate, the failure to get the security documents being a collateral matter owing to the solicitor's, and, as the trial judge found, the beneficiary's, negligence. Having failed to analyse the facts and explicitly render a finding on this, it is no surprise that the High Court split 3:3 (see further Penner (2005)).

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Liability of trustees *inter se*

13.72 The general equitable rule is that individual trustees are only liable for their own breaches of trust, not for the breaches committed by their co-trustees. However, equity does not recognise a 'sleeping' or 'passive' trustee, ie a trustee who does not fully participate in the administration of a trust. As Cotton LJ stated in *Bahin v Hughes* (1886) at 396:

> *[I]t would be laying down a wrong rule that where one trustee acts honestly, though erroneously, the other trustee is to be held entitled to an indemnity who by doing nothing neglects his duty more than the acting trustee.*

On this basis a trustee would be liable for breaches of his co-trustees to the extent that he was negligent or fell below the standard of prudence in monitoring his co-trustees' behaviour.

13.73 Where two or more trustees are each liable for a breach of trust, they are jointly and severally liable. Between themselves trustees may rely upon the Civil Liability (Contribution) Act 1978, which gives the court a discretion to apportion the share of liability each defendant trustee will bear, according to their relative individual responsibilities for the loss. In certain cases a trustee, although himself liable for breach of trust, may demand that his co-trustee indemnify him for any compensation he must pay—the effect of this, where that co-trustee is solvent, is to make him alone pay for the loss. Two such circumstances were stated (at 396) in *Bahin v Hughes*. The first is:

> *[W]here one trustee has got the money into his own hands, and made use of it, he will be liable to his co-trustee to give him an indemnity.*

Secondly, a trustee may claim an indemnity against a co-trustee who is a solicitor if, but only if, that solicitor-trustee exercised a controlling influence over the conduct of a trust (*Head v Gould* (1898)). Thirdly, where a breaching co-trustee is also a beneficiary under the trust, special considerations apply because of this dual status (**13.79**).

13.74 These observations should be seen against another general principle—that in the absence of an express provision in the trust instrument, beneficiaries are entitled to require that the trustees act unanimously (*Re Thompson's Settlement* (1986)). This 'unanimity principle' was reconfirmed in *Fielden v Christie-Miller* (2015), where Sir William Blackburne referred to it as 'the principle that trustees must act unanimously except and to the extent that the trust instrument makes other provision.'

Beneficiaries' consent to a breach of trust

13.75 An adult beneficiary who freely consents to, or participates in, a breach of trust, may not sue the trustee to make good any loss caused by the breach. In *Re Pauling's Settlement Trusts* (1964), the trustee of a family
p. 337 settlement succumbed to the pressure of the father to make 'advancements' (**8.50** et seq) to his children, which in reality were not advancements at all: the money was not intended to benefit the individual children, but to defray the family's extravagant living expenses, including the cost of purchasing family homes. The children, although of full age, were not taken to have consented because, although they were aware of the true purposes of the advancements, the court held that their approval was procured by the undue influence of their father. The fact that several children received benefits to themselves from the advancements did not bar them from claiming against the trustee for breach of trust, although they did have to offset these benefits against their claim against the trustee to restore the trust fund.

13.76 To truly consent a beneficiary must be fully aware of the facts, although not necessarily of his legal rights. Wilberforce J described the court's general approach in *Re Pauling's Settlement Trusts* at 108:

> *[T]he court has to consider all the circumstances ... with a view to seeing whether it is fair and equitable that, having given his concurrence, he should afterwards turn round and sue the trustees ... it is not necessary that he should know that what he is concurring in is a breach of trust, provided that he fully understands what he is concurring in, and that it is not necessary that he should himself have directly benefited by the breach of trust.*

13.77 These principles were adopted in *Holder v Holder* (1968). The plaintiff sued to set aside the purchase of trust property by his brother who had technically acquired the status of an executor, for breach of the 'self dealing' rule (**14.33** et seq); the plaintiff was held to have acquiesced in the sale although unaware at the time of the legal position. He had subsequently received part of the purchase price as a beneficiary under the will, and throughout had full knowledge of all the facts concerning the sale. Besides considering these facts that go to determining actual consent, in *Holder* the 'fair and equitable' requirement for allowing the beneficiary now to 'turn round and sue' was applied. Although it was clear that the plaintiff did not know his legal rights to block or set aside the sale until afterwards, the court felt that his conduct throughout, which appeared to be motivated largely by animosity towards his brother, and the fact that he failed to discover the brother's technical breach (he and his brother stood on an equal footing as both were legally advised) made it inequitable for him now to have the sale set aside.

13.78 The court has an inherent power to 'impound' the beneficial interest of a beneficiary who has requested, instigated, or consented to a breach of trust. By 'impoundment' is meant that the beneficiary's interest will be applied, to the full extent of the interest, to compensating the trust for the loss incurred by the breach. The result of this is that a beneficiary whose interest is impounded is not only prevented from suing the trustee for the breach but is, in effect, made to indemnify the trustee for the latter's participation in it. It seems from *Chillingworth v Chambers* (1896) that where the beneficiary merely consents to a breach initiated by the trustee, ie in circumstances where the beneficiary has not instigated or requested the breach, his interest may only be impounded if he had consented in order to benefit from the breach himself. Section 62 of the Trustee Act 1925 now supplements the inherent jurisdiction, allowing the court to impound a beneficiary's interest if he consented to a breach irrespective of any benefit to himself, so long as his consent is made in writing.

p. 338 **13.79** Where the beneficiary is also a trustee, two rules come into operation. Normally a trustee may claim contribution from his co-trustees for a share of the compensation to be paid (**13.73**). In the case of a beneficiary-trustee, the rule in *Chillingworth v Chambers* applies: where a beneficiary-trustee and his co-trustee are liable for a breach of trust from which the beneficiary-trustee alone has benefited, then the beneficiary-trustee's beneficial interest is impounded to its full extent, and only if his interest is insufficient to cover the loss will he be able to claim contribution from his co-trustee. Under the rule in *Re Dacre* (1916), whether his interest is impounded or not, the trustee-beneficiary is not entitled to receive any part of his beneficial interest until his breach *qua* trustee is remedied, nor, somewhat surprisingly, is any assignee of his equitable interest, even if the assignment occurred before the breach; it is thus dangerous to take an assignment from a beneficiary who is also a trustee.

Trustees' relief from liability under Trustee Act 1925, s 61, trustee exemption clauses, and ouster of trustee duties

13.80 A trustee may be relieved of liability in a number of ways, one of which because the claim is barred by the Limitations Act 1980. We shall examine this at **15.62**.

13.81 Lord Cottenham LC once said that a person who accepted the office of trustee a second time was fit only for a lunatic asylum (Stebbings (2002), 26). This reflected the common nineteenth-century view that the office of trustee, which was at the time only rarely remunerated, was a burdensome and thankless task, and that the liability of trustees for breach of trust could seem very onerous, given the altruistic character of the office. It was at this time that legislative attempts were first made to empower the court to limit a trustee's liability in cases of breach. A second way to address the problem was for the settlor to include a clause in the trust instrument limiting a trustee's liability for breach of trust. Take note: these limitations on liability, whether statutory or in the trust instrument, do not authorise or validate breaches of trust—to the extent that a trustee can remedy a breach, say by restoring a misapplication of trust property *in specie*, he must do so. What these limitations on liability do is remove or reduce a trustee's *personal* liability to pay out of his pocket to compensate the trust for a loss. Finally, a settlor might exclude certain duties in the trust instrument that might be inclined to give rise to liability.

Trustee Act 1925, s 61

13.82 Section 61 of the Trustee Act 1925 relieves trustees of liability for breach of trust in certain circumstances. It reads:

> *If it appears to the court that a trustee, whether appointed by the court or otherwise, is or may be personally*
> p. 339 *liable for any breach of trust ... but has acted honestly and ↵ reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which he committed such breach, then the court may relieve him either wholly or partly from personal liability for the same.*

13.83 The court's exercise of the power is not governed by hard and fast rules. In *Re Pauling's Settlement Trusts* Upjohn LJ said (at 359):

> *Section 61 is purely discretionary, and its application necessarily depends on the particular facts of each case.*

13.84 Relief under s 61 was sought in three cases we have already considered. In *Re Pauling's Settlement Trusts* the sole trustee was a bank. Wilmer LJ opined (at 339) that:

> *Where a banker undertakes to act as a paid trustee of a settlement created by a customer, and so deliberately places itself in a position where its duty as trustee conflicts with its interest as a banker, we think that the court should be very slow to relieve a trustee under [s 61].*

13.85 Relief was refused with respect to an advancement that benefited the bank because it was used to reduce the mother's overdraft. This suggests that any breach carried out by a trustee acting in clear conflict of interest, although not in terms dishonest, cannot be reasonable. With respect to another transaction the court held that the bank's relying upon the consent of the children, although over 21, when clearly it was obtained by their father's undue influence, was unreasonable, and so relief under s 61 was unavailable. The court did afford the bank relief in respect of one advancement where the bank trustee's solicitors and the solicitor who separately advised the sons were largely at fault.

13.86 The trustees also sought relief under s 61 in *Bartlett* (**8.18**). Brightman J tersely dismissed the plea, although covering each of the three criteria of the section (at 357–358):

> *There is no doubt that the bank acted honestly. I do not think it acted reasonably. Nor do I think it would be fair to excuse the bank at the expense of the beneficiaries.*

13.87 In *Re Mulligan* (1998) (**8.4**), a trust company and the testator's widow were trustees of a testamentary trust of which the widow was also the life tenant. They invested in fixed-interest securities, which paid a high income to the widow but resulted in severe capital depreciation. Following the death of the widow the capital beneficiaries successfully sued the trust company and the widow's estate for the decline in the capital value arising from this breach of the even-handedness rule. Applying s 73 of the New Zealand Trustee Act 1956, which is in relevant respects identical to s 61, the court held that the trust company did not act reasonably because although it realised the danger of capital depreciation, it basically accepted the widow's insistence that they invest as she desired. As regards the widow: a person of some business acumen, she could not have claimed that she did not appreciate the significance of the course of investment; furthermore, she had failed as a trustee to exercise an independent judgement, clearly favouring her own interests above those of the other beneficiaries; she therefore had not acted reasonably as a trustee, and the personal representative of her estate was denied a claim for relief under the statute.

p. 340 **13.88** The section was successfully pleaded in *Re Evans* (1999) by a lay administrator of her deceased father's estate, who distributed the property to herself in the reasonable belief that her brother, whom she had not heard of in years, was dead; she took out a 'missing beneficiary' insurance policy, which when her brother later turned up, only partly compensated him for what he would have received. The court excused the daughter under s 61 from having to pay over the difference. (The brother was, of course, able to claim his full share in any of their father's property that she retained, in this case the father's house.)

13.89 In *Nationwide Building Society v Davison Solicitors* (2012) Morritt C in the CA held that: 'The section only requires [the defendant] to have acted reasonably. That does not, in my view, predicate that he has necessarily complied with best practice in all respects.' *Davison* also made clear that it was only the behaviour by the trustee that was connected to his liability for the loss caused to the claimant which was to be assessed for its honesty and reasonableness. In particular, showing a trustee's unreasonable failure to take due care in matters unrelated to the loss would not be relevant to the court's application of s 61.

13.90 In *Santander UK plc v RA Legal Solicitors* (2014), the CA, unanimously reversing the decision of the trial judge, denied relief under the section. First, the court held that the burden of proof lay upon the applicant under the section, here a solicitor who had in breach of trust transferred a lender's funds to a fraudulent solicitor under a fraudulent land transaction, to establish that he had acted honestly and reasonably; it was not for the claimant to have to prove otherwise, as if he were bringing an action against the trustee for professional negligence. Secondly, the court held that although the behaviour which must be assessed for its honesty and reasonableness must be connected to the loss suffered by the beneficiary, it is up to the trustee to show that any unreasonable behaviour of his did not materially contribute to the occurrence of the beneficiary's loss or the likelihood that it would come about. In this case, the solicitor's inadequate oversight of the transaction and failure properly to apply standard conveyancing practices were held to be unreasonable, and a ground for denying relief, even though the CA accepted as a matter of probability that even if the solicitor had acted properly throughout it was likely that the fraud would still have occurred. The fact that best practice in conveyancing procedures was encouraged in part to detect such frauds, plus the fact that here the solicitor's failures basically prevented either himself or the lender from acting quickly when fraud should have been suspected, meant that in relation to the lender's loss he had acted unreasonably, and his liability would not be excused under the section.

13.91 In *P&P Property v Owen White; Dreamvar UK v Mischon de Reya (a firm)* (2018), the law on the section developed further in a new (and dangerous) direction. It was held by the UKCA that despite acting honestly and reasonably, the question whether the trustee ought reasonably to be excused turned on the issue of insurance cover. In this case the trustee, a solicitor's firm, had liability insurance, unlike the beneficiary, in
p. 341 this case the purchaser of land who was defrauded, who did not. The court denied relief under the section for the reason that the trustee, given his insurance cover, could better bear the loss. The reason I say this is a dangerous path to take is that finding liability, or denying relief from liability, on the basis of insurance cover, has, first, a self-defeating element to it. If the law says you are liable if you have insurance, then the thing to do to avoid liability is not to take out insurance. Secondly, there is also a strong legal-moral objection—the fact that I have had the foresight to insure myself against liability should not be a factor in determining *what* my *liability* is under the law. It is in essence no different from the idea that the extent of my liability should be determined by how much money I have. That is why having insurance is not a reason, just on its own, to make you liable for a tort. Trustees, in general, are not required to take out insurance for breach of trust but solicitors are so required, whether they are acting as trustees or not.

Trustee exemption clauses

13.92 In *Armitage v Nurse* (1998) the CA held that an exemption clause in an instrument protecting the trustees from any loss or damage 'unless such loss or damage shall be caused by his own actual fraud' was valid. The effect of this is that trustees may be relieved of liability for any loss caused by their own negligence, even gross negligence. Millett LJ pointed out that such a clause does not purport to exclude, and does not exclude, a trustee's liability as a fiduciary in certain cases. Thus it would not prevent a beneficiary setting aside a sale of trust property to a trustee (a 'self dealing' transaction (**14.33**)), because that would not involve relieving a trustee for liability *for a loss*; neither, on such a view, would such a clause prevent a trustee from being stripped of an unauthorised profit. We will examine cases of this kind in **Chapter 14**.

13.93 Millett LJ accepted (at 253–254):

> *that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient ... [A] trustee who relied on the presence of a trustee exemption clause to justify what he proposed to do would thereby lose its protection: he would be acting recklessly in the proper sense of the term.*

13.94 In his opinion, therefore, there was no basis in authority for saying that an exemption clause that relieved a trustee of liability for his gross negligence was 'repugnant', ie conceptually inconsistent with there being a trust. In his focus on good faith and honesty Millett LJ went so far as to say that an exemption clause would relieve a trustee of liability even for a deliberate breach of trust if undertaken in the honest belief that it was for the best interests of the beneficiaries. This dictum was doubted by a subsequent CA in *Walker v Stones* (2001), which held that a solicitor-trustee could not rely upon an exemption clause where his 'perception of
p. 342 the interests of the beneficiaries was so unreasonable that no reasonable solicitor-trustee could have held such belief'. In *Bonham v Fishwick* (2008) it was held that trustees who reasonably relied upon a legal opinion could not be guilty of wilful wrongdoing, and thus were exempted from any liability by the trust's exemption clause.

13.95 Millett LJ examined the pleadings in *Armitage* and found that none clearly alleged dishonesty but, at most, negligence, and therefore the trustees were not liable. The trust arose as a variation of a previous trust under which both the plaintiff daughter and her mother were beneficiaries. Under the new trust, the plaintiff was the sole beneficiary. However, the trust largely consisted of a holding of farmland, and the trustees appointed a company controlled by her mother and grandmother to farm it, which also farmed the mother's own land. In essence the claim was that the trustees had managed the trust property with the interests of the family in mind, not the plaintiff, although the plaintiff was the only object of the trust. Millett LJ did not find in the pleadings sufficient particular allegations to sustain this charge, but allowed the plaintiff to re-amend her pleadings, adding (at 263):

> *I express no view on whether there is material which would justify counsel in advising such a course; and I would not wish to encourage it. They will no doubt bear in mind that at the material time the trustees of the settlement consisted of one professional man and two distant relatives; and that a charge of fraud against independent professional trustees is, in the absence of some financial or other incentive, inherently implausible.*

13.96 This narrow focus on fraud, however, seems to undercut Millett LJ's previous point that such a clause would not relieve the trustee of any breach of fiduciary duty. Consider in particular the duty of even-handedness. In *Nestle* (**8.22** et seq) the CA did not consider the trustee to have breached this duty by tailoring its investments to benefit the current life tenants, because the court's appreciation of the duty gave the trustee a very wide discretion, but one can imagine another court taking a somewhat narrower view. The trustee did not, apparently, give much thought to its duty of even-handedness, as the investments favouring the life tenant seemed to have been made simply in response to the hectoring of one of the life tenants. In any case, the duty of even-handedness must be regarded as one of the core trustee fiduciary obligations because only by being even-handed between the beneficiaries does a trustee meet his obligation to act in good faith and take into account the interests of *all* the beneficiaries. Indeed, the duty of even-handedness is just a specification of the duty of loyalty and good faith where there is more than one beneficiary. Therefore, an exemption clause cannot relieve a trustee from his liability to a beneficiary for failing to be even-handed towards him. If the plaintiff's claims were made out, *Armitage* is clearly *a fortiori* to *Nestle*, since the allegation was that the trustees were loyal to the interests of the plaintiff's mother, who was not a beneficiary at all.

13.97 Consider also *Re Pauling's Settlement Trusts*, where the trustee bank acted solely at the instigation of one beneficiary of the settlement, the father. It was apparently the forcefulness of his personality that largely led it to ignore the children's interests and make the advancements it did. In neither *Nestle* nor *Re Pauling's* p. 343 *Settlement Trusts* did the professional trustees stand to gain significantly from the alleged breaches of trust; they did so in the absence of any 'financial incentive' and it is not clear what 'other incentive' they had beyond making their lives easier in the administration of the trust (see also *Wilson v Turner*, **8.47**; *Re Mulligan*, **8.4**, **13.87**). So, although Millett J is right to suspect that any charge of actual fraud may be inherently implausible where the professional trustee gains no benefit by it, an allegation of a breach of the duty of even-handedness seems entirely plausible.

13.98 In *Armitage v Nurse*, Millett LJ suggested that statutory reform of the general law on the valid scope of exemption clauses was appropriate. The Law Commission of England and Wales (2002) took up the suggestion, producing a consultation paper on the question. (See also Matthews (1989) for the suggestion that clauses should be capable of excluding a trustee's liability for negligence, but not gross negligence;) No legislation has resulted.

13.99 We can categorise the way in which trustees may breach their duties according to different criteria:

(1) the way in which the breach displays the fault of the trustee, for example, whether a breach is committed intentionally, recklessly, or negligently;

(2) the particular sort of duty that is breached, in particular distinguishing breaches of trust duties, for example the duty to invest, the duty to keep the trust accounts, the duty to pay income as it arises in a timely fashion to the life tenant(s), etc, and breaches of fiduciary obligation (eg where a trustee invests the trust funds in a non-even-handed way).

13.100 As traditionally written, trustee exemption clauses seem clearly to relieve trustees of liability according to the fault the breach displays, that is according to the categorisation of breaches of trusts in (1). This seems to be the perspective Millett LJ takes in *Armitage*, and particularly in his characterisation of the 'irreducible core' of obligations without which a trust ceases to exist, ie an enforceable duty of good faith and honesty. If this is correct, then an exemption clause can relieve a trustee of liability for any breach of trust, from not only failing to invest the trust property properly or failing to manage the trust property well, as in

Armitage, to paying the trust property away to wrong beneficiaries, committing frauds on powers, to failing to maintain the trust accounts or failing to keep the property separate from his own or using the trust property for his own benefit, so long as the breach is not committed dishonestly.

13.101 With respect, it would seem that this perspective, whereby the usual envisaged breach is one of failing to manage the trust property well or invest it properly, loses much of its intuitive force when other sorts of breaches are envisaged. What if one examines the effect of trustee exemption clauses according to the type of breach as in (2)? An initial distinction within this category could be between administrative and dispositive breaches. It would seem that the perspective in (1) most appropriately applies to administrative breaches, such
p. 344 as the breach of a duty to invest or manage the trust property, rather than to dispositive breaches, such as paying away the money to non-beneficiaries, or to committing frauds on powers. It is submitted that from this type–duty perspective, one might arrive at a different set of 'core obligations' in the absence of which a trust cannot be said truly to exist.

13.102 For example, it seems that if there is no enforceable duty to keep the trust accounts and to keep the trust property separate from the trustee's own, there cannot be a trust purely on equitable property principles, because the trust can only attach to specific property kept separate as a fund, where the various substitutions of one item of property for another from time to time in the fund are properly kept track of or accounted for (**2.21** et seq). In other words, besides the core duties of good faith and honesty, there are core duties to keep the trust property separate and keep the trust accounts, which are just as much core duties in the absence of which there is simply no trust. A court might well not look favourably on an exemption clause employed to relieve trustees of liability for failure to keep the trust property separate from his own or for failure to keep the trust accounts. While at first glance it might be thought that such breaches would in every case reveal dishonesty or a lack of good faith as well, this is clearly not the case. Consider the case of a large corporate trustee, the property dealings and record keeping of which fall into disarray because of negligent management (eg the failure to properly train trust officers for example). It would not seem appropriate to allow an exemption clause to relieve the trustee of personal liability for this breach, because if the trust could not be restored by a proprietary claim against the trustee because, in the event, the property was untraceable, the entire value of the trust could be lost in such a way as to benefit the trustee or its creditors. The effect of a breach in such a case is, after all, essentially a taking of the beneficiaries' property by the trustee, and can be committed negligently. It would not seem at all just for an exemption clause in whatever terms to relieve the trustee of such a liability, because in such a case the relief from liability would not only save the trustee from having to restore the trust or to compensate the beneficiaries for their loss, but because of the nature of the breach would essentially sanction the trustee's inadvertent 'theft' (see Penner (2002)).

13.103 It might be contended that the trustee in such a case might be liable under two heads: first, to restore the trust or render equitable compensation to the beneficiaries but, secondly, under the law of restitution for unjust enrichment, to repay the value of the property it acquired by its mixing of the trust property with its own so as to make it untraceable, in order to prevent its unjust enrichment at the beneficiaries' expense. If so, then whilst a trustee exemption clause could afford the trustee relief from the first liability to restore or compensate the trust, it might arguably be regarded as ineffective against the second, restitutionary, claim. However, it would be unwise to think that a court would rely upon what might appear a rather scholastic distinction in the way a case might be framed, and might rather seek to modify or embroider upon Millett's 'core obligation' thesis to find an exemption clause ineffective to discharge the trustee of such a liability, on the basis that keeping the trust accounts and the trust property separate from one's own is one of the 'core' duties of the trustee.

13.104 As to breaches of fiduciary obligations, since the breach of fiduciary obligations can be framed as a
p. 345 breach of one of the core obligations Millett LJ recognises, to act in good faith in the best interests of the beneficiaries, at first glance it might seem that no exemption clause can relieve a trustee of liability for breach of fiduciary obligation. The problem is simply that fiduciary breaches can be committed innocently, without negligence, and in good faith with the best interests of beneficiaries in mind (**14.68** et seq). None of the defendants in *Nestle* or *Re Pauling's Settlement Trusts*, or *Re Mulligan* or *Armitage* were accused of acting in conscious bad faith (see also *Boardman v Phipps* (1967); **14.67** et seq). If the 'fault' test of (1) is applied, such non-fraudulent breaches would necessarily be relieved by any clause such as the one found in *Armitage*, and which Millett found valid. On the other hand, fiduciary obligations might well be regarded as 'core' trust obligations, and, thus once again, the decision in *Armitage* does not give certain guidance as to the effect of exemption clauses in these circumstances.

13.105 In *Barnsley v Noble* (2016), the Court of Appeal considered the proper interpretation of an exoneration clause to relieve trustees of a will trust of personal liability in respect of a breach of the fiduciary self dealing rule. Interpreting the phrases 'wilful wrongdoing' and 'wilful fraud', the court held that 'wilful' imports a requirement of conscious wrongdoing. The court found support for this proposition in Millett LJ's exposition of what 'wilful default' meant in *Armitage*—ie that it means a 'deliberate breach of trust' and that 'nothing less than conscious and wilful misconduct is sufficient'. The terms of a trust may allow a trustee to enter into a self-dealing transaction. But where it does not, then the court rightly pointed out that the exoneration clause merely removes the trustee's personal liability for any loss suffered by a beneficiary under such a transaction; it does not remove the beneficiary's right to have that transaction 'set aside' or rescinded.

The ouster of trustee duties

13.106 A settlor may, by a provision in the trust instrument, oust, ie remove, a duty that trustees would otherwise have under the general law of trusts (*Wilkins v Hogg* (1861) (duty to see to the application of money by co-trustee); *Hayim v Citibank* (1987) (duty to deal with a specific asset, a house lived in by the settlor's siblings, as a regular trust asset prior to their death)). For example, it is nowadays common for trustees to be relieved of the duty to monitor the affairs of a company in which the trust has a substantial shareholding, avoiding the general rule described in *Re Bartlett* (1980) (**8.19**). Fiduciary obligations can also be ousted, and where a trust instrument puts someone in a situation of conflict of interest this will serve to authorise good faith exercises of discretions or powers even though taken in a situation of conflict (*Sargeant v National Westminster Bank* (1990); *Re Z Trust* (1997)).

13.107 There is a possible problem with the ouster of duties, or the use of similar 'power-extending' clauses, which permit what would otherwise be denied by a general trust duty (eg a power 'to speculate freely with the trust assets as if the assets were entirely unneeded to provide for the beneficiaries in any way whatsoever such that the entire value of the fund might be lost with no adverse consequences to the beneficiaries whatsoever'). As Millett LJ made clear in *Armitage v Nurse* (**13.92** et seq) a trust requires a minimum of duties

owed by the trustee to the beneficiary and enforceable by them, otherwise there is no trust. If an ouster of a
p. 346 duty or duties is untoward or excessive, which can only be judged in the context of the particular trust, the 'trust' may not actually be valid as a trust, leading to the rather drastic result that either the 'trustee' is regarded as the beneficial owner of the property or the whole trust fails, as not being an effective disposition on trust (**5.74**).

13.108 The Law Commission (2002) in its consultation paper on trustee exemption clauses reasoned that the ouster of a particular duty does not *pro tanto* oust a general duty to take care, nor does the extension of a power, and neither would they *pro tanto* oust the fiduciary duties of loyalty to the beneficiaries. Thus, depending very much on the nature of the particular trust, such provisions in the trust instrument may not provide the protection from a failure to fulfil the overarching duties that is normally provided by an exemption clause. The Law Commission saw no sensible way of generally limiting the ability of trustees and settlors to oust duties and extend powers; whether an ouster or extension was judged to be effective could only be determined in the context of the particular trust, and the validity of such a provision could only be assessed in light of whether the action of the trustee taking advantage of the provision was consistent with the purposes of the trust and reasonable in the circumstances. In consequence the Law Commission proposed that the court should have the power to disapply such provisions where this was not the case. It is not clear whether such a statutory power is even needed, given the general background position of equity that powers may not be exercised for purposes for which they were not conferred (**3.43**) and that a minimum duty to the beneficiaries is a core requirement for a valid trust. It is unlikely that a court would treat a clause ousting entirely any duty to take care in the administration of a trust as an effective provision of a valid trust.

13.109 Take note: it must always be remembered that it is one thing to relieve a trustee of liability for the breach of a trust duty, and quite another to remove a duty altogether. Whatever the trustee's liability for breach, where there is a duty a prospective or ongoing breach of it can be enjoined by a beneficiary taking the trustee to court, so that, for example, a dangerously risky investment can be prevented. Similarly, a co-trustee can make reference to such a duty in thwarting the injudicious proposals of his co-trustees. And where there is a duty, there can be an advertent or reckless breach of a duty, which an exemption clause cannot protect against. Finally, whether there is exemption clause relief or not, a breach of trust may be grounds for removal of a trustee. By contrast, where a trustee is entirely relieved of a duty, there can be no breach of it, and so no possible liability for breach. Ouster and extension clauses should be regarded as bespoke provisions providing the right latitude for action for a trustee given the general purposes and features of the particular trust. They are not equivalent, much less ideal substitutes for, valid exemption clauses.

De facto trusteeship, or trusteeship *de son tort*

13.110 Where an individual who is not a trustee 'intermeddles' with the trust affairs, although innocently, he may become liable as a trustee for any misapplication of trust property or other loss caused to the trust (*Mara*
p. 347 *v Browne* (1896)); such a person is known as a trustee *de son tort* (a trustee 'by his own wrong'), although Lord Millett (*Dubai Aluminium v Salaam* (2003)) would put it otherwise (at 138):

> *Substituting dog Latin for bastard French, we would be better to describe such persons today as de facto trustees. In their relations with the beneficiaries they are treated in every respect as if they had been duly appointed. They are true trustees and are fully subject to fiduciary obligations. Their liability is strict; it does not depend on dishonesty.*

13.111 One example of a *de facto* trustee/trustee *de son tort* is that of an agent of the trust who takes it upon himself to exercise trustee functions over the property beyond the scope of his agency. Today most cases of *de facto* trusteeship probably arise where a trustee, although not effectively appointed, believes, and therefore acts as if, he is (see eg *Re Coates to Parsons* (1886); *Jasmine Trustees Ltd v Wells & Hind* (2007).

Trustee's liability when a breach of trust is procured by a third party

13.112 In *Eaves v Hickson* (1861), the father of five children forged a marriage certificate in order to make it appear that his five children were legitimate, which he presented to the trustee of the trust, who paid each of the children the shares of the estate to which they would have been entitled had they been legitimate. Now, in a case such as this, where someone procures or induces the trustee to misapply the trust property, two principles regarding a trustee's liability come into conflict. The first is that a trustee is strictly liable for the misapplication of the trust property—the other beneficiaries should have the right to falsify the trust account and make the trustee personally liable to restore the property wrongfully paid away to these five children. The second principle, however, is that a trustee is not to be held liable for the loss or theft of the trust property through no fault of his own (*Morley v Morley* (1678)); he is not an insurer of the trust property (*Speight v Gaunt*; *Learoyd v Whiteley*; *Re Chapman* (**8.13**–**8.16**)). Here the trustee was defrauded of the trust funds through no fault of his own. Normally, of course, if the trustee is defrauded of trust funds, the second principle alone will apply, because most frauds do not involve the misapplication of trust property. Consider the case of a trustee entitled under the terms of the trust to buy works of art, and who purchases a painting from an apparently reputable dealer. If this dealer sells the trustee a stolen painting, the trust will not receive good title to the painting, and the dealer will have defrauded the trustee of the purchase money. The trustee, not being at fault, will not be personally liable for this loss, because the purchase of the painting was not a misapplication of the trust money, because the trustee was entitled to invest in art. He was defrauded in the course of properly applying the trust funds. But in *Eaves* the fraud induced a misapplication of the funds, ie a paying out to non-beneficiaries, for which the trustee would normally be strictly liable. In *Eaves* the court gave weight to both principles in the form of its order: the illegitimate children were liable to repay what they received with interest; and to the extent they could not repay the whole, then their fraudster father must pay the balance; only to the extent there was then any deficiency, would the trustee be liable.

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Further reading

Birks and Pretto (2002)

Davies (2015b)

Glister (2014a, 2014b)

Mitchell (2013, 2014)

Penner (2002, 2014a, 2017, 2018a)

Smith (2000, 2009)

Trust Law Committee (1999, 'Trustee Exemption Clauses')

Turner and Ho (2020)

Must-read cases: *Re Pauling's Settlement Trusts* (1963); *Armitage v Nurse* (1997); *Target Holdings v Redferns* (1995); *AIB Group v Redler* (2014); *Main v Giambrone* (2017); *Bristol & West Building Society v Mothew* (1996)

Self-test questions

1. What does it mean for a beneficiary to (a) 'falsify the account'; and (b) 'surcharge the account'? How are these ways of dealing with breaches of trust related to the concept of 'equitable compensation'? Give examples from actual cases where these terms can be employed to explain the decisions.
2. What distinguished a 'substitutive' money award from a 'compensatory' money award?
3. What is a 'de facto' trustee, or a 'trustee de son tort'? How might someone become such a thing?
4. What test(s) will the court apply in determining whether a beneficiary has concurred/consented or acquiesced in a breach of trust?
5. T, the trustee of a trust of shares for two investors, breaches the terms of the trust in 2010 by purchasing 100,000 XYZ (Pte) Ltd preference shares, an unauthorised investment, instead of 100,000 XYZ (Pte) Ltd ordinary shares, the investment T was required to make under the terms of the trust. The preference shares have fallen in value by 30 per cent, whilst the ordinary shares have fallen in value by 80 per cent. The breach has now come to light. Advise the two investors. What would your advice be if the preference shares had risen in value by 30 per cent, whilst the ordinary shares had risen in value by 5 per cent? What if the preference shares had fallen in value by 10 per cent, but the ordinary shares had risen in value by 50 per cent?

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