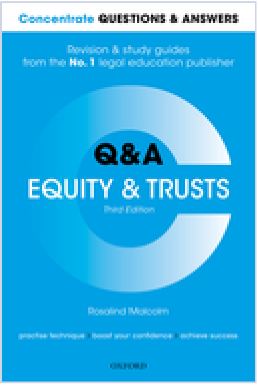

Concentrate Questions and Answers Equity and Trusts: Law Q&A Revision and Study Guide (3rd edn)

Rosalind Malcolm

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13. Breach of Trust

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Abstract

The Concentrate Questions and Answers series offer the best preparation for tackling exam questions. Each book includes typical questions, bullet-pointed answer plans, suggested answers, and author commentary. This book offers advice on what to expect in exams and how best to prepare. This chapter covers questions on breach of trusts.

Keywords: breach of trust, remedies, trustees, property, fiduciary relationship, equity tracing, liability, common law, monies, bank account

Are You Ready?

In order to attempt the questions in this chapter you will need to have covered the following topics:

- Role of fiduciary
- Liability for breach of trust—personal and proprietary remedies
- Defences

Key Debates

Debate: the role of tracing for breach of trust and the change in position defence.

Cases such as ***Re Diplock [1948] Ch 465, CA***, ***Lipkin Gorman v Karpnale Ltd [1991] 2 AC 548, HL***, ***Westdeutsche Landesbank Girozentrale v Islington LBC [1996] AC 669, HL***, and ***Foskett v McKeown [2001] AC 102, HL*** form part of this debate.

Question 1

> The only restriction on the ability of equity to follow assets is the requirement that there must be some fiduciary relationship which permits the assistance of equity to be invoked.
>
> (Per Millett J, ***Agip (Africa) Ltd v Jackson [1990] Ch 265***)

Discuss, in the light of this quotation, the requirement that there must be some fiduciary relationship before tracing in equity is permitted.

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Caution!

- The central issue in this question is the requirement of a fiduciary relationship, so the answer requires a thorough discussion of the case law on this point. The crucial thing is to ensure that the answer does not deteriorate into one of the 'write all you know' type. Related ideas can therefore be explored, but only to the extent that they throw light on the central issue.

Diagram Answer Plan

Brief statement of requirements for assets to be followed in equity

Requirement of need for both an equitable proprietary right and a fiduciary relationship—discussion of cases where doubt as to this point (***Westdeutsche Landesbank*** case—compared with ***Bristol and West Building Society v Mothew***; ***Foskett v McKeown***)

Extent of requirement for equitable proprietary right

Discussion of types of fiduciary relationship and the courts' flexible approach

Suggested Answer

There are certain requirements which must be satisfied before a claimant may follow assets in equity. [1] These are: there must be an equity to trace; the property must be traceable; and the result must not be inequitable. The issue in the question is whether the first of these requirements, the equity to trace, imports the need for a fiduciary relationship.

> 1 Set out the legal context.

Before the **Judicature Acts 1873** and **1875**, [2] the courts of common law and the Court of Chancery applied their own distinctive rules relating to tracing. Just as tracing at common law was available only to a person who had a proprietary right at law, so tracing in equity was available only to a person who had a proprietary right in equity. Following those Acts, it might have been thought that equitable tracing would be available to a beneficial legal owner where common law tracing proved inadequate. This indeed appears to have been recognised in ***Banque Belge Pour L'Etranger v Hambrouck [1921] 1 KB 321, CA***. In ***Re Diplock [1948] Ch 465***, however, the Court of Appeal expressed the view that, in order to
p. 186 be able to trace in equity, it was ↵ not sufficient for the claimant merely to have an equitable proprietary right, there also had to be a fiduciary relationship. [3] In ***Westdeutsche Landesbank Girozentrale v Islington LBC [1996] AC 669***, the House of Lords seemed to accept the correctness of this proposition. Other cases, however, reveal some judicial reluctance to accept such a requirement.

Doubts were expressed by Millett LJ in ***Bristol and West Building Society v Mothew [1998] Ch 1***, at p. 23; and in ***Foskett v McKeown [2001] 1 AC 102***, Lord Millett (then in the House of Lords) stated that he could see no logic in the requirement. These observations may indicate that the Supreme Court might at some future time wish to reconsider ***Re Diplock***. The requirement for a fiduciary relationship in order to trace in equity remains, however, for the present at least. [4]

[2] Brief discussion of development of tracing to show current status.

[3] An important point which mustn't be missed with supporting cases.

[4] Shows you recognise the possibility of change in the future.

Where the claimant has an equitable proprietary right, there will be a fiduciary relationship. [5] The classic example of this is, of course, the trust, whether express, implied, or constructive. A trust is not, however, a prerequisite: a person who entrusts property to a fiduciary, for instance, will retain an equitable proprietary interest sufficient to enable her to trace. Thus, in ***Re Hallett's Estate (1880) 13 ChD 696***, one Mrs Cotterill paid money to her solicitor to invest on her behalf; instead he paid part of this into his personal bank account. It was held that, in these circumstances, Mrs Cotterill was entitled to trace her money in equity. The same principles apply to all fiduciary relationships, such as those between a company and its directors, between a principal and agent, and between partners in a business *inter se*.

[5] Explain how fiduciary relationship arises.

It is clear, however, that a fiduciary relationship is not itself sufficient to enable the claimant to trace. [6] Tracing is, after all, the process of identifying the claimant's property or its product in a third party's hands, so there can be no right to trace if the claimant has no proprietary right to the assets in question. In the ***Westdeutsche Landesbank*** case, the House of Lords held that the bank retained no proprietary interest in money which it had paid to the defendant local authority under an interest rate swap arrangement which was *ultra vires* the local authority. The claimant would therefore have had no right to trace such money in equity. On the other hand, it may be that the requisite proprietary right need not be equitable. In ***Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd [1976] 1 WLR 676***, it was held that, where a fiduciary relationship existed, even a legal owner (with no distinct equitable proprietary right) could trace in equity.

[6] Explain need for proprietary right.

Because no fiduciary relationship exists in respect of property vested in a beneficial legal owner, it might appear that tracing is not available to such owner if the property is stolen from him by a thief. If the property stolen is money and is mixed by the thief in his own bank p. 187 account, the victim, whilst possessing a personal remedy against the thief, cannot claim any legal proprietary remedy against the money in the account. In such circumstances, however, the House of Lords accepted that, once the victim's legal title to the money passes (upon mixing in the account), a constructive trust is imposed upon the thief, and it is this trust which gives rise to a fiduciary relationship enabling the victim to trace in equity into the mixed fund: see ***Lipkin Gorman v Karpnale Ltd [1991] 2 AC 548*** (Lord Templeman); and the ***Westdeutsche Landesbank*** case (Lord Browne-Wilkinson).

The case law provides other illustrations of the courts' willingness to interpret the requirement for a fiduciary relationship flexibly. [7] It does not, for example, matter that such relationship does not exist between the claimant and the person against whom the tracing claim is brought. In ***Re Diplock*** itself, money was wrongfully distributed by the executors of a will to a number of charities. It was held that the next of kin, who should have been entitled to such money, were entitled to trace into the hands of the money's innocent recipients. The right of the next-of-kin to trace arose from their equitable right against the executors to have the estate properly distributed. In that case, therefore, the fiduciary relationship was between the next-of-kin and the executors.

[7] Illustrate with case law.

Another example of the courts' flexible approach is in relation to payments made under a mistake. [8] A fiduciary relationship, giving rise to a right to trace in equity, can also arise where the defendant receives the claimant's property as a result of a mistake. In ***Chase Manhattan Bank NA v Israel-British Bank (London) Ltd [1981] Ch 105***, the plaintiffs, as a result of a bookkeeping error, wrongly made a double payment of $2 million into the account of the defendant bank. At that time, the common law action of money had and received did not apply to money paid as a result of a mistake of law, which that was (but this is no longer so: see ***Kleinwort Benson Ltd v Lincoln City Council [1999] 2 AC 349, HL***). The plaintiffs therefore needed to be able to trace in equity. It was held that the mistaken second payment gave rise to a fiduciary relationship, which gave the plaintiffs a right to trace. The House of Lords in the ***Westdeutsche Landesbank*** case has since doubted that the fiduciary relationship arose at

the time of the mistaken second payment; rather, their Lordships considered that it arose only when the defendant's conscience was affected, i.e. when it became aware of the mistake two days later. In ***Angove's Property Ltd v Bailey [2016] UKSC 47***, the Supreme Court suggested that where money is transferred with the intention of transferring the entire beneficial interest then a constructive trust will only arise where that intention is vitiated by a fundamental mistake or where the money has
p. 188 come into the wrong hands through fraud or theft or other ↵ like actions. A fundamental mistake is a narrow concept only arising where the payment is made to the wrong person or where the wrong item is transferred. This casts further doubt on ***Chase Manhattan*** although the comments in ***Angove's Property*** are only obiter. So the decision in ***Chase Manhattan*** nevertheless remains good law insofar as it illustrates that the fiduciary relationship needed to trace does not need to be a pre-existing one.

[8] More examples given here with cases to illustrate.

Looking For Extra Marks?

- Further detail on the cases could be added for extra marks.

Question 2

Brown is a solicitor and a trustee of the Rainbow Trust. His co-trustee, Grey, is not a solicitor, but is a member of the Rainbow family. Grey is content to leave the entire management of the trust to Brown. Under the terms of the trust, Leone has a life interest, and the capital is held for Azure and Grey in equal shares.

In 2004, Brown invested half of the trust fund in the family company, Rainbow Ltd, which he understood to be an authorised investment within the terms of the trust deed. In fact, the trust deed expressly prohibited the trustees from investing more than one-fifth of the trust fund in Rainbow Ltd. When Rainbow Ltd went into insolvent liquidation in 2015, the trust's total investment in that company was lost. All the other investments which Brown made have been very successful, however, and during the period he has been administering the trust a healthy capital growth has been achieved.

Between 2004 and 2015, Brown made advances of capital sums out of the trust to Leone, which comprised breaches of trust. Brown did not realise that these payments were in breach of trust, as he did not check the terms of the trust deed, which he kept in his office safe.

Advise Azure.

Caution!

- The question is not difficult but requires a knowledge of the statutory provisions imposing liability and providing defences. Discussion of the case law dealing with the possibility of setting off a profit made by successful investments against losses sustained by an improper investment is required, however, to achieve a good mark.
- There is only one devious point hidden in the question and that relates to the limitation period. The clue to look out for is the careful use of dates. If they are not relevant, the examiner would probably have simply set the events in the previous year.

Diagram Answer Plan

Identify the issues	■ Liability of trustee for breach of trust
Relevant law	■ **Trustee Act 1925, s. 61** and case law including ***Target Holdings v Redferns***; ***AIB v Redler***; ***Dimes v Scott***; etc.
Apply the law	■ Establishing the breaches of trust in the problem and the nature of the liability of the trustees • Effect of breach which results in enhancement of profits for beneficiaries (rule in ***Dimes v Scott***) • Reversal of rule where gain and loss made in single transaction (***Fletcher v Green***) • Effect of limitation in the **Limitation Act 1980, s. 21(3)** on problem • Relief for trustee acting honestly and reasonably and who ought fairly to be excused (**Trustee Act 1925, s. 61**) • Distinction between status of professional trustee (Brown) and lay trustee (Grey) • Unjust enrichment of Leone; tracing and the defence of change of position • Partial indemnities
Conclude	■ Advise Azure

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Suggested Answer

The basic principle is that trustees who commit a breach of trust which results in a loss to the trust estate are personally liable to the beneficiaries to make good the loss. [1] Brown's excessive investment in Rainbow Ltd and the wrongful advances of capital were both in breach of the terms of the trust deed. Brown is therefore prima facie liable to make good such losses to the trust fund. The liability of trustees is personal, not vicarious: ***Townley v Sherborne (1643) J Bridg 35***. Grey is not therefore vicariously liable for Brown's breaches of trust. Grey may be personally liable for his own breach, however, in failing to participate in the management of the trust and merely leaving matters in the hands of his co-trustee: ***Bahin v Hughes (1886) 31 ChD 390***. Equity does not, after all, countenance a sleeping trustee.

[1] Introduction setting out the law with reference to facts of problem.

p. 190 ↵ The investment in Rainbow Ltd is a breach of trust to the extent that the amount invested exceeded the one-fifth limit imposed by the trust instrument. [2] The measure of the trustees' liability is the loss caused to the trust. In this instance, the onus would be on Azure to establish that there is a loss which would not have occurred but for the breach: ***AIB Group (UK) plc v Mark Redler & Co Solicitors [2014] UKSC 58***; ***Target Holdings Ltd v Redferns [1996] 1 AC 421, HL***, at p. 440. Unless there are circumstances which indicate that the trustees were in breach of trust in investing in Rainbow Ltd at all, it would seem that the trustees' liability would be limited to the loss of the excess over one-fifth only.

[2] Establish the breaches of trust in the problem and the nature of the liability of the trustees.

Brown has, however, invested the remaining assets profitably. Normally, a gain made in one transaction may not be set off against a loss suffered in another. This is the rule established in ***Dimes v Scott (1828) 4 Russ 195***, [3] where the trustees retained an unauthorised investment for longer than the prescribed period. When the investment was eventually sold, the trustees were able to invest extensively in Consols, as the price had dropped. This resulted in a greater gain for the remaindermen. The trustees were nevertheless held liable for the loss caused by the retention of the unauthorised investment without being allowed to set off the gain.

[3] Set out the rule then deal with the circumstances when it is reversed.

If the gain and the loss were made in a single transaction, though, then the rule is reversed. [4] In ***Fletcher v Green (1864) 33 Beav 426***, the proceeds of sale of an unauthorised investment were invested in Consols, the value of which then rose. It was held that the trustees were entitled to take advantage of such rise. The difficulty, as these cases illustrate, is often in determining whether the gains and losses occur in the same or in separate transactions. In ***Bartlett v Barclays Bank Trust Co. Ltd (No. 1)***

[1980] Ch 515, the trustees had engaged in a sequence of speculative investments. One of these, the Guildford project, was successful; but another, the Old Bailey project, was a disaster. The bank pleaded that it should be permitted to set off the profit from one against the loss on the other. Brightman J allowed them to do so, expressing the view that it would be unjust to deprive the bank of the element of salvage in assessing the cost of the shipwreck. In the question, Brown and Grey would be able to set off the gains only if they could show that the activities which produced such gains were so connected to the losses as to form part of one transaction. On the facts as stated, there is no evidence of such connection, and so the trustees are unlikely to succeed.

[4] Here comes the reversal of the rule.

A claim brought by a beneficiary against a trustee for breach of trust must be brought within six years from the date on which the right of action arose (**Limitation Act 1980**, **s. 21(3)**). [5] There is a proviso to the sub-section that time does not start to run against a remainderman until his interest falls into possession. As the advances made by Brown were in breach of trust, they would not cause Azure's interest to fall into possession for the purposes of the **Limitation Act**: ***Re Pauling's Settlement Trusts [1964] Ch 303, CA***. Azure's interest falls into possession only on the death of Leone, and as the question suggests that Leone is still alive, it would appear that time has not yet even started to run against Azure. He will not, however, be permitted to bring any claim against the trustees if it is shown that he participated in, or consented to, the breach, or if it can be shown that he later acquiesced in the breach: ***Re Pauling's Settlement Trusts***.

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[5] Deal here with the devious limitation point.

A trustee who would otherwise be liable for breach of trust may be relieved if he can show that he acted honestly and reasonably and ought fairly to be excused (**Trustee Act 1925**, **s. 61**). [6] It is unlikely that the court would grant relief under this section to a person who is professionally involved with the management of trusts, such as Brown (***Santander UK plc v RA Legal Solicitors [2014] EWCA Civ 183***). It is the trustee who has the onus of showing that he acted honestly and reasonably: ***Re Stuart [1897] 2 Ch 583***. There are no general principles in applying the statute; every case turns on its own circumstances: ***Re Turner [1897] 1 Ch 536***. Nevertheless, it might be surmised that if Grey left everything to Brown and never asked for explanations, [7] he would probably not be considered to have acted reasonably, and he might not even count as honest for this purpose: ***Re Second East Dulwich Building Society (1899) 79 LT 726***. A trustee may also be able to escape liability by relying on an express exclusion clause in the trust instrument; the question does not indicate, however, whether the Rainbow Trust contained any such clause.

[6] Legal position of trustee acting reasonably etc.

[7] Application to problem.

The fact that Brown is a solicitor and Grey apparently a layman [8] may be a relevant factor in determining the liability of Brown and Grey *inter se*: if it can be shown that Brown exercised a controlling influence over Grey, the latter might be entitled to an indemnity from the former (***Re Partington (1887) 57 LT 654***). It seems unlikely, however, that an indemnity could be claimed by a non-participating trustee. Apart from this, it might be possible for Grey to claim a contribution from Brown under the **Civil Liability (Contribution) Act 1978**, although there is no reported case law as yet to indicate what the attitude of the courts might be where such a claim is brought by a passive trustee. Rights of indemnity or contribution between the trustees do not, however, affect the personal liability of each to Azure; so that if each of the trustees is personally liable, Azure could recover the full amount of the loss from either of them, leaving it to that trustee to make a claim against his co-trustee.

[8] From hereon application to problem continues.

Leone received the advances in breach of trust. Leone has therefore been unjustly enriched, and she
p. 192 will be liable to repay to the ↵ trust the sums advanced to her if they can be traced into her hands, unless she can rely on the defence of change of position. The trustees' personal liability will be reduced to the extent of any sums so recovered from her. If, however, Leone can establish such a defence (so that she can show that she is an innocent volunteer who has, for example, spent the money so that it cannot be traced), ***Re Diplock [1948] Ch 465*** suggests that she will not be personally liable to repay the advances, since she did not receive the money from the personal representatives of an estate in the course of administration. The modern principle of unjust enrichment nevertheless suggests that she should remain personally liable, since she has still had the benefit of the sums she received (as where she spent them on a holiday). If Leone is held personally liable to repay, her liability is reduced to the extent that such sums can be personally recovered from the trustees (***Re Diplock***, at p. 503). If, on the other hand, Leone instigated or requested the breach, the trustees are entitled to impound her beneficial interest by way of indemnity: ***Chillingworth v Chambers [1896] 1 Ch 685***; **Trustee Act 1925, s. 62**. The trustees will also be entitled to withhold payments of income from Leone in order to repair the breach: cf. ***Re Balfour's Settlement Trusts [1938] Ch 928***.

If it were to be shown that Grey had participated in the breach of trust, he will be required to indemnify Brown to the extent of his beneficial interest under the trust, which would effectively give Brown a partial indemnity: ***Chillingworth v Chambers***.

Looking For Extra Marks?

- Further discussion of the cases would earn extra marks. The impact of ***AIB v Redler*** on the decision in ***Target Holdings*** could be examined in further detail and the academic commentary (seeing 'Taking Things Further') and especially P. Turner, 'The new fundamental norm of recovery for losses to express trusts' (2015) 74 CLJ 188) incorporated in the answer.
- The point doesn't expressly arise in the question but look out for possible limitation points further to ***Creggy v Barnett [2016] EWCA Civ 1004*** where the question of an acknowledgement which could restart the limitation period was discussed (obiter) in relation to claims for breach of trust or where a fiduciary had misapplied funds. On this limitation point, see the Law Commission Report, *Limitation of Actions* (Law Com No. 270, 2001), paras 3.146–3.155 and this case commentary: D. Whayman, 'More clues as to the nature of the remedy for breach of trust' [2017] Conv 139.

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Question 3

George was appointed the sole executor of Harriet's will. Harriet died last year leaving her entire estate, worth £130,000 after payment of debts, to her cousin Albert in Australia. George died recently. Albert has only just learned of this and has discovered that George, believing that as executor he was entitled to the estate beneficially and knowing that he was terminally ill, has made the following dispositions of the estate:

a £40,000 of the estate was contributed to the purchase of a house by George's daughter, Peggy. The house was purchased for £60,000 and Peggy contributed the remaining £20,000. The house is now worth £80,000.

b George settled £40,000 on trust for his son Felix as part of a marriage settlement on the occasion of his marriage to Matilda.

c George used £20,000 to buy a valuable antique Grecian urn which he gave to his service club.

d George used £20,000 to finance his gambling habits and this has all been lost at the Spend Casino.

e George gave the remaining £10,000 to his housekeeper May. May paid this into her current account, in which there was a balance of £5,000, but has since drawn out £10,000.

Advise Albert whether he has any claim against the recipients of Harriet's estate.

Caution!

■ This problem raises a number of different permutations of the tracing remedy. Most problems raised in this field relate to the issue of tracing in equity. You will need to know the limitations of the remedy of tracing at common law.

■ The issue of the defence of change of position is also raised so you should discuss the important House of Lords' decision in ***Lipkin Gorman v Karpnale Ltd [1991] 2 AC 548***, although this case is concerned with tracing at common law.

Diagram Answer Plan

Identify the issues	■ Tracing
Relevant law	■ Case law such as ***Sinclair* v *Brougham*, *Re Diplock*, *Boscawen* v *Bajwa*, *Lipkin Gorman* v *Karpnale Ltd*, *Clayton's Case*, *Barlow Clowes (in liquidation)* v *Vaughan***
Apply the law	(a) Position of Peggy as innocent volunteer; equitable proprietary interest of Albert; mixing of funds; inequitable results and the loss of the tracing remedy; equitable claims *in personam* (b) Marriage consideration and status of Felix with an equitable interest; Felix not 'equity's darling'; claim *in personam* (c) Status of club as volunteer; equitable tracing into volunteer's hands; identifiable proceeds of trust money (d) Position where trust money dissipated; tracing into hands of the casino which is a volunteer; defence of change of position; claim *in personam* (e) Mixing of trust money with that of innocent volunteer; rule in ***Clayton's Case***; position where money used to buy investment
Conclude	■ Advise Albert

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Suggested Answer

Introduction [1]

[1] It is important to dispose of the common law position and this brief explanation by way of introduction does just that.

The right to trace is available at common law if the claimant retains the legal title to the property. Here, tracing at law is not available because George, the legal owner, has disposed of the property and the legal title has passed. It is necessary, therefore, to consider the availability of the remedy in equity.

Part (a)

Peggy is presumably an innocent volunteer. [2] The trust funds have been mixed with her money. The mixed funds have been used to purchase a house. The value of the house has now risen.

[2] Position of Peggy as volunteer.

Albert is the true beneficiary, and therefore has an equitable proprietary interest. [3] £40,000 of the trust property is in the hands of an innocent volunteer and has been used for the acquisition of property. An equitable proprietary remedy may be available which will enable Albert to trace the property.

[3] State Albert's interest.

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↵ In equity, where the trust property has been transferred in breach of trust to an innocent volunteer who has mixed it with her own, [4] the trust and the volunteer share *pari passu* in the property purchased with the mixed fund: ***Sinclair v Brougham [1914] AC 398, HL***, ***Re Diplock [1948] Ch 465, CA***. They will share the profits and the capital in the proportions in which they contributed.

[4] Deal here with the mixing of funds.

The right to trace may be lost where it would produce an inequitable result. [5] In ***Re Diplock***, it was held that where trust money was spent on altering or improving land then it would be inequitable to force the innocent volunteer to sell the land to satisfy a charge on it. Peggy has used the money to buy land. It might be argued, therefore, that her circumstances have changed as a result of the receipt of the trust money, thus rendering it inequitable for the remedy to be enforced against her. This would, however, mean that Peggy would be unjustly enriched. In the light of ***Boscawen v Bajwa [1996] 1 WLR 328***, the most appropriate solution would be for the court to defer Albert's right to enforce the equitable charge until Peggy has had a reasonable opportunity to raise and pay the amount due, e.g. by mortgaging the house.

[5] Right to trace lost comes next.

If the proprietary claim fails, then an equitable claim *in personam* can be brought for the principal sum of £40,000 without interest. [6] However, Peggy will only be liable to the extent that the money cannot be recovered directly from George's own estate. The claim in these circumstances is limited to claims arising out of the administration of estates and is subject to the primary liability of the executor: ***Re Diplock***.

[6] Final point is the equitable claim ***in personam***.

Part (b)

£40,000 was settled on trust under a marriage settlement for Felix. He is within the marriage consideration and, therefore, not a volunteer. [7] Where trust property has been transferred to a bona fide purchaser of a legal estate for value and without notice of the equitable interest, the property is taken free from the claims of the beneficiaries. However, Felix has acquired merely an equitable as opposed to a legal interest and does not receive the protection of 'equity's darling'. [8]

[7] Explain marriage consideration.

[8] Explain here why he is not 'equity's darling'.

Alternatively, and especially if the tracing remedy does not satisfy Albert's loss, he may recover the loss (or the balance) in a claim *in personam*. In this case, Albert should look to the personal remedy against George's estate in the first instance, [9] but may recover the balance from Felix in a claim *in personam*.

[9] Again final point is about personal remedy.

Part (c)

The service club is a volunteer [10] as it has given no consideration for the urn. Presumably it is also innocent. Equitable tracing is, [11] however, available against an innocent volunteer if the property can
p. 196 be traced into the volunteer's hands. The trust money has been exchanged for ↵ the urn with no mixing of other funds. The club have the identifiable proceeds of the trust money. Albert can therefore trace in equity [12] into the urn and obtain an order to restore the urn, being property acquired with the £20,000.

[10] Explain volunteer status of club.

[11] Explain equitable tracing here.

[12] Tracing remedy works (for once).

Part (d)

£20,000 of trust property was dissipated by George on gambling at the Spend Casino.

The right to trace is lost where the property has ceased to be identifiable. Where the money has been dissipated, therefore, it can no longer be identified and cannot be traced. However, the money has passed into the hands of the Spend Casino, which is a volunteer, as no valuable consideration is given: ***Lipkin Gorman v Karpnale Ltd [1991] 2 AC 548***. However, a casino stands the risk of losing or winning when it permits someone to place bets. The defence of change of position [13] was considered in ***Lipkin Gorman v Karpnale Ltd***, a case which was concerned with legal tracing only. In ***Lipkin Gorman v Karpnale Ltd***, it was held by the House of Lords that a casino was entitled to set off any winnings made by the gambler on the basis that it had changed its position by paying such winnings to him. Change of position was not a complete defence and the club was held liable in an action for money had and received for the net amount he had lost gambling at the club. It was stated, *per curiam*, by the House of Lords, that it is right to recognise the defence of change of position in good faith in restitution claims, based on the unjust enrichment of the defendant. The House of Lords, however, left the development of this doctrine to future cases. So, although it is likely that future courts will develop this doctrine, there is presently no direct authority for this defence to be raised by the Spend Casino in a claim to trace in equity.

[13] The defence of change of position is the big point here.

The Spend Casino will also be subject to a claim *in personam* under ***Re Diplock***, as confirmed on appeal in ***Ministry of Health v Simpson [1951] AC 251, HL***. This will be for the amount which Albert has been unable to claim from George's estate and will be limited to the principal sum without interest.

Part (e)

£10,000 of trust money has been mixed in May's current account with £5,000 of her own money. [14] Where trust money is mixed with that of an innocent volunteer, tracing in equity is available. However, May has withdrawn £10,000. As the account is a current account, the rule in ***Clayton's Case (1816) 1 Mer 572***, first in, first out applies. [15] The rule in ***Clayton's Case*** is a rule of convenience and applies unless it is impracticable or would result in injustice (***Barlow Clowes International Ltd (in liquidation) v Vaughan [1992] 4 All ER 22***). p. 197 If the prima facie rule is to apply here, then, as May had £5,000 of her own money in the account, she is presumed to draw that out first, followed by £5,000 of trust money. The remaining money is, therefore, trust money.

[14] Mixing again but this time with innocent volunteer (so tracing available).

[15] The rule in ***Clayton's Case*** is the big point here.

If the £10,000 withdrawn has been used to buy an investment, Albert will be able to claim a charge on the investment and rank *pari passu* with May. If, however, the £5,000 trust money cannot be traced (if, for example, it has been dissipated), Albert will be left to pursue a claim *in personam* as discussed previously.

Looking For Extra Marks?

- You could aim to get some more academic discussion in especially on the change of position defence. But the facts are complex and the question is quite long so you would be pushing it to get much more in (unless it was for coursework).

Question 4

On 1 January 2019, Tonto, who was trustee of the Una Charitable Trust, in breach of trust paid into his bank account £10,000 of the charity's money. There was already £6,000 of his own money in his account. One week later he bought shares to the value of £5,000 and withdrew this amount from his account. The next day, he drew out £3,500 which he used to buy a boat. On 1 March 2019, he paid into the account in breach of trust £5,000 belonging to the Duo Trust Fund, of which he was also trustee. The next day he drew out £5,000 which he used to pay debts which he had incurred in his business. The following day he withdrew a further £5,000 which he gave to his daughter, Dora, which she used as a deposit on a house she was buying.

The boat has now been destroyed in a hurricane. The shares are now worth £6,000.

Tonto has just been declared bankrupt.

Advise the beneficiaries of the two trusts.

Caution!

- This question deals with the mixing of monies in a bank account. Once money or other property has been mixed, it is not possible to trace at common law. The question therefore requires an application of the rules for tracing in equity. The answer takes account of the significant decision of the Court of Appeal in ***Boscawen v Bajwa [1996] 1 WLR 328***.
- p. 198 It is important to be aware that different rules apply to the mixing of trust monies with a trustee's own money, and the mixing of the monies of two trusts that are both treated as innocent volunteers.
- Where there is a series of transactions involving payments into and out of a bank account, as here, it is essential to work the transactions through in draft form first, calculating the amounts remaining in the bank account and to whom they belong after each transaction.
- Also be sure to apportion the rights to any property purchased from the mixed account according to whose money has been used for its purchase.

■ You should, of course, explain which rule you are applying in each transaction, so that a kind-hearted marker will be able to give you credit for legal knowledge even if you slip up on your arithmetic!

Diagram Answer Plan

Identify the issues

- Tracing

Relevant law

- Case law including ***Clayton's Case***, ***Re Diplock***, ***Lipkin Gorman* v *Karpnale Ltd***, ***Boscawen* v *Bajah***

Apply the law

- First transaction: mixing of Tonto's own funds with Una's in Tonto's bank account: tracing in equity available (***Re Diplock***; ***Re Hallett's Estate***). Calculation
- Principle applied to purchase of boat
- Displacement of rule in ***Re Hallett's Estate*** where balance dissipated (***Re Oatway***)
- Trustee not allowed to allocate profitable transactions to himself (***Shalson* v *Russo***)

Conclude

- Calculation and advise beneficiaries

Suggested Answer

As Tonto is bankrupt, a personal claim against him for breach of trust is likely to be of little value to the Una Charitable Trust ('Una') or to the beneficiaries of the Duo Trust ('Duo'). Una and Duo should therefore first try to trace their funds into the property to which the funds have been applied.

p. 199 ↵ The first transaction [1] involves the mixing in Tonto's bank account of Tonto's own money and money belonging to Una. Tracing at law is not possible as the money has been applied by its legal owner, Tonto; and, in any event, money or other property cannot be traced at law once it has been mixed. Tracing is, however, possible in equity, as Tonto is a trustee and therefore in a fiduciary relationship (***Re Diplock [1948] Ch 465***), and property can be traced in equity even after it has been mixed.

[1] The first transaction.

The shares which Tonto buys for £5,000, paid for from the account, are prima facie deemed to have been purchased out of his own £6,000 in the account, on the basis that a trustee is deemed not to be acting in breach of trust: ***Re Hallett's Estate (1880) 13 ChD 696***. If this is the case, the shares belong to Tonto, and the money remaining in the account belongs as follows:

Tonto: £1,000

Una: £10,000

If the same principle is applied on the purchase of the boat, then the boat represents £1,000 of Tonto's money and £2,500 of Una's money. The bank account then has no money of Tonto's left in it, and there is £7,500 of Una's money remaining.

The rule in ***Re Hallett's Estate***, however, is displaced where the trustee, [2] having purchased an investment, subsequently dissipates the balance in the account, which, on the application of ***Re Hallett's Estate***, would mean that the beneficiary's money would have been dissipated. In such circumstances, ***Re Oatway [1903] 2 Ch 356*** held that the beneficiary is entitled to treat the investment as having been purchased first out of the trust monies, so as to enable the beneficiary to trace into the investment. The underlying principle may be that a trustee should not be permitted to allocate profitable transactions to himself, as this would allow him to benefit from his own wrongdoing: ***Shalson v Russo [2005] Ch 281*** (Rimer J). But the notion that it is the beneficiaries who may 'cherry pick' opposed to the trustee may go too far the other way: ***Turner v Jacob [2008] WTLR 307***. The fact that some money of Una's remains in the bank account should not, therefore, affect Una's right to trace into the shares, which, in view of the boat's destruction, it would obviously be better advised to do.

[2] Displacing the rule in ***Hallett's*** case.

The remedy granted in ***Re Oatway*** itself was an equitable charge over the investment to the value of the trust monies used in its purchase. That case did not deal with the position in the event of the investment's increasing in value. It would, however, appear to follow from dicta in ***Re Tilley's Will Trusts [1967] Ch 1179*** (where trust money had been mixed with the trustee's own), that Una should be able to benefit from the entire increase in value, i.e. to claim that the shares are held for it upon a constructive trust.

p. 200 ↵ If the view in ***Shalson v Russo*** is applied, the money remaining in the bank account immediately after the shares have been purchased belongs as follows:

Una: £5,000

Tonto: £6,000 [3]

[3] Include the calculation as a ready reckoner as you go along.

The rule in ***Re Hallett's Estate*** is then applied to the purchase of the boat, [4] which is therefore bought entirely from Tonto's own money. After the purchase of the boat, the money remaining in the bank account is as follows:

[4] Next the boat.

Una: £5,000

Tonto: £2,500

The rest of this answer proceeds on the basis that the view expressed in ***Shalson v Russo*** applies to the application of ***Re Oatway***.

Tonto's payment into the account of £5,000 belonging to Duo [5] means that there is then £12,500 in that account. When Tonto subsequently withdraws the first £5,000 from the account, the withdrawal first comprises £2,500 of Tonto's own money (***Re Hallett's Estate***). As between innocent volunteers, the appropriation of withdrawals from an active bank account is governed by the rule in ***Clayton's Case (1816) 1 Mer 572***, whereby withdrawals are treated as made in the same order as payments in, i.e. first in, first out. As Una and Duo are both innocent volunteers, the balance of £2,500 withdrawn is treated as Una's money. The second withdrawal of £5,000 therefore comprises the remaining £2,500 of Una's money, and £2,500 of Duo's. This leaves £2,500 in the bank account which can be traced by Duo.

[5] Payment into Duo's account.

Assuming that the creditors are bona fide purchasers without notice, Una cannot trace its £2,500 applied in the discharge of Tonto's debts into their hands. [6] Una can, however, claim to be subrogated to the creditors' claims against Tonto: ***Boscawen v Bajwa [1996] 1 WLR 328, CA***. If the creditors' claims were secured, e.g. by a mortgage over Tonto's assets, Una would be able to claim an equitable charge over those assets to the extent of £2,500. If, however, the creditors' claims were unsecured, there is no advantage to Una, as a personal claim would not give it priority over Tonto's creditors in Tonto's bankruptcy.

[6] Tracing into creditors' hands?

Assuming that Dora is an innocent volunteer, [7] Una and Duo can prima facie trace the monies which she has received into the house she has bought. In ***Re Diplock***, however, the Court of Appeal held that where an innocent volunteer had applied trust monies in building an extension to its existing premises, tracing would not be permitted as this would produce an inequitable result, i.e. the plaintiff could compel a sale of the entire premises. That principle, however, p. 201 seems to be giving way to a broader principle that tracing will be permitted unless the defendant can establish the defence of change of position. In ***Lipkin Gorman v Karpnale Ltd [1991] 2 AC 548***, the House of Lords held that such a defence was available to a tracing claim; ***Lipkin Gorman*** itself concerned tracing at common law, but it has been suggested by Millett J that such a defence is also available in equitable tracing: ***Boscawen v Bajwa***. However, in ***Foskett v McKeown [2001] 1 AC 102*** Lord Millett suggested that the defence of change of position is available only where the basis of the claim is unjust enrichment. Where the claimant uses the tracing process to vindicate a property right, by contrast, the only defence is that of the bona fide purchaser for value.

[7] Dealing with Dora.

The most appropriate remedy might be for the court [8] to grant Una and Duo an equitable charge over the house, but to defer their right to enforce it for a reasonable time in order to enable Dora to raise (e.g. by mortgaging the house) the amount necessary to satisfy the equitable charge. If the house has increased (or fallen) in value, Dora, Una, and Duo, all being innocent volunteers, share the increase (or the loss, as the case may be) rateably: ***Sinclair v Brougham [1914] AC 398, HL***; ***Re Diplock***.

[8] The appropriate remedy.

If Dora is indeed an innocent volunteer, no personal claim will lie against her: ***Ministry of Health v Simpson [1951] AC 251***. If, however, she receives the £5,000 with constructive notice that it is trust money, she will be personally liable as a constructive trustee to account for it under the principle of knowing receipt: ***Agip (Africa) Ltd v Jackson [1990] Ch 265*** (Millett J).

Looking For Extra Marks?

■ Further discussion of the restitution point and reference to the literature on unjust enrichment would gain extra marks.

Taking Things Further

■ Whayman, D., 'Obligation and property in tracing claims' [2018] Conv 157–174.

This article discusses the basis of the tracing claim, that is, should it be property-based or obligation-based. This is an article which could be useful if you are undertaking coursework which requires you to analyse the basis for the tracing claim.

The following references provide a discussion of liability issues for breach of trust:

■ Chambers, R., 'Liability', in *Breach of Trust* (P. Birks and A. Pretto, eds), Hart Publishing, 2002, chapter 1.

p. 202 ↵ ■ Lowry, J. and Edmunds, R., 'Excuses', in *Breach of Trust* (P. Birks and A. Pretto, eds), Hart Publishing, 2002, chapter 9.

■ Payne, J., 'Consent', in *Breach of Trust* (P. Birks and A. Pretto, eds), Hart Publishing, 2002, chapter 10.

■ Smith, L., *The Law of Tracing*, Clarendon Press, 1997.

■ Turner, P., 'The new fundamental norm of recovery for losses to express trusts' (2015) 74 CLJ 188.

This article discusses the decision in ***AIB Group (UK) plc v Mark Redler & Co Solicitors.***

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