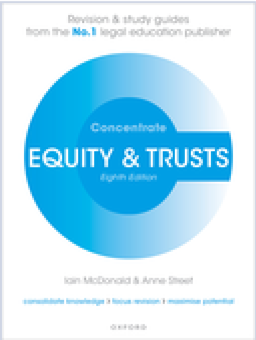

Equity and Trusts Concentrate: Law Revision and Study Guide (8th edn)
Iain McDonald and Anne Street

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12. Remedies for breach of trust

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https://doi.org/10.1093/he/9780192865632.003.0012
Published in print: 05 August 2022
Published online: September 2022

Abstract

Each Concentrate revision guide is packed with essential information, key cases, revision tips, exam Q&As, and more. Concentrates show you what to expect in a law exam, what examiners are looking for, and how to achieve extra marks. When property is held on trust, arising expressly or implied by law, any breach of the trustee/fiduciary obligation will lead to a remedy. This chapter explains the personal and proprietary remedies available to the claimant. A personal claim is one made against the trustee/fiduciary personally; it is not based upon the recipient having the property in their possession. A proprietary claim is based upon the defendant having the property or its replacement in their possession and being required to return it, or its substitute, to the claimant. The claimant, after identifying the breach, will often have the choice of which claim to make and there may be more than one possible remedy.

Keywords: trustees, fiduciary obligation, personal claim, proprietary claim, remedy

Key facts

- Beneficiaries will have a claim against a trustee in breach.
- Liability between trustees is joint and several.
- A remedy can be provided for breach of a trust or fiduciary obligation.
- The fiduciary obligation can arise in a variety of factual situations.
- Remedies can be against the trustee or third parties.
- The remedy can be personal or proprietary.
- The remedy can be at common law or in equity.

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Introduction

A breach of the trustee/fiduciary obligation will lead to a remedy. This chapter will explain the personal and proprietary remedies available to the claimant:

- A personal claim means that the claim is made against the trustee/fiduciary personally; it is not based upon the recipient having the property in his or her possession.
- A proprietary claim is based upon the defendant having the property or its replacement in his or her possession and being required to return it, or its substitute, to the claimant.

The claimant, after identifying the breach, can use the tracing process to identify whether to make a proprietary or personal claim and to identify who the claim may be against.

Revision tip

The first step in an answer is to identify the breach, who committed the breach, and where the property is held. This will enable your answer to take the correct approach.

Figure 12.1 illustrates the possible routes for a claimant.

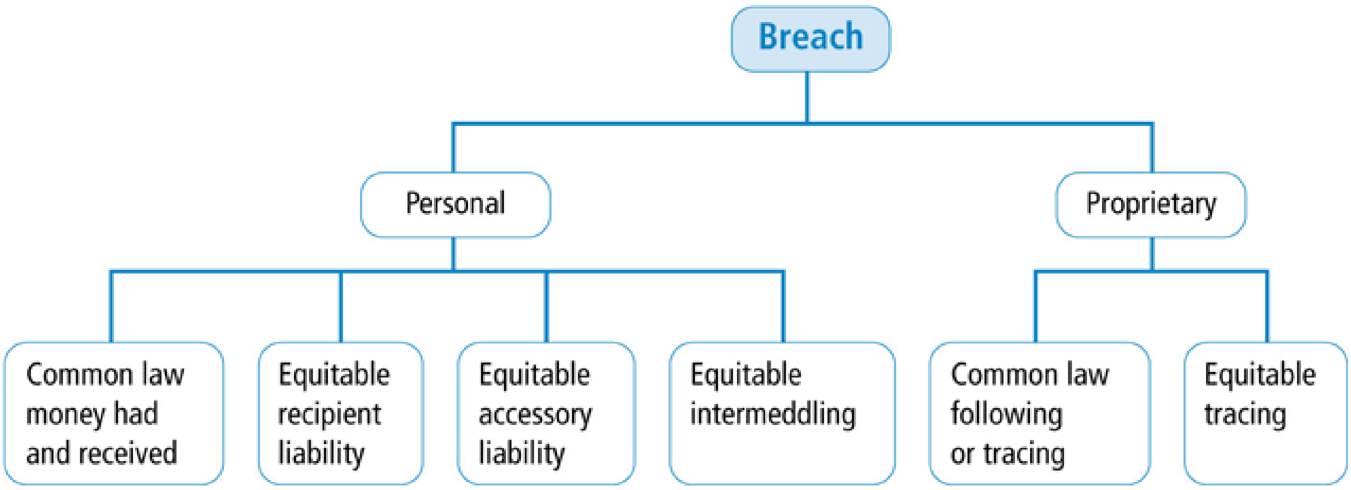

Figure 12.1 Possible routes for remedy

Personal actions

Against the trustee

Trustees have certain powers and duties under a trust (see chapter 11). These powers and duties can lead to a breach, where:

1. there is a failure to carry out a duty;
2. a trustee acts outside his or her powers;
3. a trustee acts without the required standard of care.

p. 182 ↵ If there is more than one trustee, you should identify which of the trustees the claim is against. A trustee is not **vicariously** liable for the actions of other trustees. However, a failure to act with due care (that exercised by the prudent and reasonable person (***Speight v Gaunt (1883)***) or a breach of the statutory duty of care contained in **s 1 Trustee Act 2000**) is a breach in itself. Breaches include:

- leaving one trustee in sole control of the trust property; and
- inaction or standing by while other trustees breach their duty: ***Styles v Guy (1849)***.

Trustees are not responsible for breaches that occur *before* they became a trustee or for breaches which occur after they have retired. However, every trustee who participates, actively or passively, in the breach is **jointly and severally** liable for any loss. So, although there is no vicarious liability, the fact that you have not exerted control over the actions of your fellow trustees—your inaction—may be a breach in itself, incurring liability.

A trustee also has core fiduciary duties (see chapter 11) which will also lead to remedies. A breach of trust duty is compensatory. A breach of a fiduciary duty is restitutionary in nature. If there is more than one breach it is important to identify the losses which flow from each breach: ***Target Holdings Ltd v Redferns [1995]***. If one breach creates a profit (eg an unauthorized investment generates a profit), this cannot be offset against losses caused by a different breach.

The claims are made directly against the trustee—a personal action—to compensate the claimant for losses caused by the breach in the same way as an action for damages for a breach of a contractual obligation. This issue was recently reviewed in the case of ***AIB Group v Mark Redler & Co Solicitors [2014]***.

Revision tip

In structuring your answer, having established the breach and the liability, consider whether there are any defences available to the defendant.

Defences

Against a claim by beneficiaries

A trustee may be granted relief or an **indemnity** from the breach. The following are situations which will provide the defendant trustee with a defence to an action for breach of trust.

Exemption clauses

The trust documents may include an exemption clause. Such clauses usually cover breaches which occur despite the trustee acting with all care, but if widely drafted it could include negligent breach. Where the trustee is a professional, the courts are less likely to allow a broadly drafted exemption clause to allow a trustee to avoid liability for gross negligence: ***Armitage v Nurse [1998]***.

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Consent and acquiescence

Consent of the *sui juris* beneficiary in the breach will provide a defence to the trustee against claims by that beneficiary but not against other beneficiaries who may have suffered a loss. **Section 62 Trustee Act 1925** provides the court with a discretion to impound the beneficial interest of a beneficiary who has encouraged or acquiesced in a breach. This will be used to pay compensation to the beneficiaries who did not participate in the breach: ***Re Pauling's ST [1964]***.

Judicial discretion

Section 61 Trustee Act 1925 provides wide discretionary power for the courts to grant relief if the trustee in breach has acted honestly and reasonably: ***Santander UK plc v RA Legal Solicitors [2014]***. However, the court will also take into account the effect of any breach on the beneficiary so that even an honest and reasonable trustee may still be refused relief: ***P & P Property v Owen White & Catlin LLP and others [2018]***.

Time barred

Section 21 Limitation Act 1980 bars claims made after six years, although this does not apply if there has been fraud: **s 21(1)(a) Limitation Act**. If the basis of a claim is recipient and accessory liability (see 'Recipient liability and accessory liability' at p) then **s 21(1)(a)** does not engage: ***Williams v Central Bank of Nigeria [2014]***.

Against a co-trustee's claim

As the trustees are jointly and severally liable for their breaches, a claimant may decide to bring a claim against all of the trustees or just one—usually the richest. As the breach may also include a trustee's inaction, this could be said to be inequitable—the beneficiary may target the wealthiest rather than the most culpable. However, the trustee may have a claim against his or her fellow trustee which is independent of the beneficiary's claim.

The trustee who has been required to pay compensation may be able to require the other trustees to contribute to his or her costs. The following situations may provide some relief:

- A co-trustee may be ordered to indemnify a trustee for the compensation he or she has paid out where:
  - there has been a fraud by the co-trustee;
  - the co-trustee has breached for his or her own benefit: ***Bahin v Hughes (1886)***;
  - a solicitor has exercised a controlling influence on a lay trustee: ***Re Partington (1887)***.
- The **Civil Liabilities (Contribution) Act 1978** grants the courts powers to order co-trustees to contribute to the losses claimed if it is 'fair, just and reasonable'.

The remedies against the trustee may be adequate as long as the trustee is solvent. However, if there are no available remedies or the trustee is unable to compensate the beneficiary, the most appropriate remedy for a claimant may be against a third party to the trust (refer to Figure 12.2 and Figure 12.3 at the end of the chapter).

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Personal actions against third parties

Actions may be brought against those who are not appointed as trustees—termed 'strangers' as they are strangers to the trust. The actions may be personal or proprietary and available at common law or in equity.

Common law personal claims

The remedy for money had and received is based upon a remedy in the law of restitution. The law of restitution has developed immensely over the last decades and the scope of this book means that it cannot be fully developed here. The basic requirements are that:

- property is *received* in an unmixed form;
- the claimant is the legal title holder.

The basic principle is that the law will identify property which the recipient has or had in his or her possession. Property that is identified as belonging to the claimant will be followed into the possession of the recipient. The courts may require that the property be returned to the claimant (the proprietary remedy). However, for reasons explained later, the claimant may elect to take the personal remedy of requiring the recipient to account for the benefit received, the restitutionary value.

Revision tip

In order to identify the person who must compensate, the claimant must prove that the defendant actually has or had the claimant's property. Students often become confused about the interplay between the following and tracing *process* and the *proprietary remedies* which may follow this process.

Tracing or following is used to locate the property, after which the claimant will usually be able to elect which remedy to pursue against the defendant.

The liability for the claim is strict; once the breach has been established it is 'unjust' for the recipient to retain that benefit.

Lipkin Gorman v Karpnale [1991] 2 AC 548

A solicitor removed clients' money from the client account and used the money for gambling at the Playboy Club. This was a breach of the solicitor's fiduciary obligations. The Playboy Club had received that money under a void contract (gambling contracts were void at the time). As the Playboy Club had no legal claim to the money it was required to return its value to the 'real' owner.

The Playboy Club was unaware of the breach by the solicitor. It was the fact that it had received the money that gave rise to the claim for restitution. The club had to return the value received (subject to defences).

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Defences to the claim

Equity's darling

An absolute defence to any claim is that the recipient obtained the property as a **bona fide** purchaser for valuable consideration without notice, or 'equity's darling'.

- *Bona fide*: this is a question of fact for the courts to decide. If the party can prove that he or she acted 'without notice' then he or she is likely to be bona fide.
- *Purchaser for valuable consideration* requires that the receipt forms part of a valid contract, which is only valid if there is consideration.

Change of position

The 'change of position' defence is a development by the courts which has softened the impact of the strict liability of restitutionary claims; having identified the property '**in the hands**' of the recipient, that recipient may be able to retain some benefit. The extent will be measured by how much the recipient has 'changed his or her position' in reliance of the receipt: ***Lipkin Gorman v Karpnale Ltd [1991]*** (see Table 12.1).

Table 12.1 What constitutes change of position?

CHANGE OF POSITION	SUCCESS?
Paying off a mortgage: ***Scottish Equitable v Derby [2000]***	Unsuccessful as the mortgage payment was not a change of position
Paying off a mortgage: ***Boscawen v Bajwa [1996]***	Successful—the claimant can be 'subrogated' to the mortgage provider. This means that the claimant takes the place of the mortgage lender. The debt that was paid is now owed to the claimant. This was recently confirmed in ***Bank of Cyprus UK Ltd v Menelaou [2015]***
Paying out winnings from gambling: ***Lipkin Gorman v Karpnale Ltd [1991]***	Successful—the club had acted in good faith and paid out money in reliance of the bets placed

Revision tip

This defence has been developed in response to a common law claim, but it has also been suggested as a defence for an equitable claim.

Equitable personal claims

In addition to the common law claim, there are claims which can be made in equity. The courts treat the intermeddler, recipient, or assistant *as if he or she were a trustee* in the following situations:

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- a person who intentionally intermeddles with a trust;
- the recipient of trust property; and
- a person who assists in a breach of trust.

Intermeddling

A person who makes a deliberate decision to interfere with trust property and the duties of a trustee will be considered a '*trustee de son tort*': ***Mara v Browne [1895]***. This means that that person acts in relation to the trust property as if they were a trustee. The meddling is not itself a breach, but that person will be liable for any later breaches as if they had been a properly appointed trustee.

Recipient liability and accessory liability

This is often referred to as 'stranger liability'. The 'stranger' refers to the fact that the person on whom liability is imposed is not appointed a trustee, nor does he or she elect to intermeddle with the trust. Although not appointed a trustee, the courts have imposed upon such a person a liability as extensive as a trustee properly appointed.

The origins of stranger liability come from the statements in ***Barnes v Addy (1874)***, where Lord Selborne said that liability shall not arise unless the stranger 'receives and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees'.

The 'stranger' will become liable 'as if he or she were' a constructive trustee, although they are not constructive trustees; ***Williams v Central Bank of Nigeria [2014]*** UKSC 10 (see Millett LJ in ***Paragon Finance v Thakerar [1999]***, where he stated that they were 'persons whose trusteeship is merely a formula for giving restitutionary relief'). This is because the stranger's conscience is so affected that equity will not 'suffer a wrong without a remedy'.

The relevant knowledge required to establish such liability is an area of much academic and judicial debate. A starting point can be the decision in ***Baden, Delvaux and Lecuit v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France [1989]*** (referred to now as ***Baden***). However, this has been modified by subsequent decisions. ***Baden*** set out five categories of knowledge that may be relevant:

1. actual knowledge;
2. wilfully shutting one's eyes to the obvious;
3. wilfully and recklessly failing to make such enquiries as an honest and reasonable man would make;
4. knowledge of circumstances which would indicate the facts to an honest and reasonable man; and
5. knowledge of circumstances which would put an honest and reasonable man on enquiry.

p. 187 ↵ The first three categories are often referred to as *actual knowledge* and the latter two as *constructive knowledge*: ***Agip (Africa) Ltd v Jackson [1990]***. Whether the knowledge needs to be dishonest, which would affect the conscience of the defendant, has been problematic; however, the courts struggle with exactly what equates to knowledge and dishonesty.

Recipient liability

This is when the 'stranger' actually receives trust property into their possession. It was once labelled 'knowing receipt', which raises issues of what knowledge is required to impose liability. If the stranger has the requisite knowledge, then a constructive trust will arise on the property.

In ***BCCI v Akindele [2000]*** the Court of Appeal relied upon the decision in ***Belmont Finance Corpn v Williams Furniture Ltd (No 2) [1980]*** and Nourse LJ referred to the constructive trust being based upon whether it was 'unconscionable' for the recipient of trust property to retain the benefit of receipt.

On the facts of ***Akindele [2000]*** it is difficult to see exactly what 'unconscionable' means. One factor may be that in a commercial context there is a need to encourage commercial flexibility. It is worth keeping in mind as you study this area that the financial markets are important to the British economy. Many of the debates and decisions are aimed at oiling the financial market.

Looking for extra marks?

Read a summary of ***Re Montagu's Settlement [1987]*** and ***Belmont Finance [1980]*** on the different and conflicting interpretations of knowledge in relation to recipient liability. The decision of the Court of Appeal in ***BCCI v Akindele [2000]*** was questioned by Lord Millett in the House of Lords in ***Twinsectra v Yardley [2002]***. The concept of 'unconscionability' has been seen in other areas: see ***Pennington v Waine (2002)***. As equity acts *in personam* the issue of unconscionability is a very live issue in creating rights. It is a thread in many areas of equity.

Accessory liability

This has been called both 'dishonest assistance' and 'knowing assistance'. The change in labels reflects the problem of defining what knowledge is needed to impose liability for an accessory. It may be wrong to call such a person a constructive trustee as the property never vests in the 'stranger'. The label stems from the fact that liability is imposed upon accessories 'as if they were trustees'.

In ***Royal Brunei Airlines Sdn Bhd v Tan [1995]***, Lord Nicholls in the Privy Council stated that the accessory would be liable if he or she acted dishonestly which 'means simply not acting as an honest person would in the circumstances. This is an objective standard.' He admitted that honesty had a strong subjective element and suggested that 'a court will look at the circumstances known to the third party at the time; having regard to the personal attributes of the third party, such as his experience and intelligence, and the reason why he acted as he did'.

p. 188 ↵ This decision was interpreted by the House of Lords in ***Twinsectra v Yardley [2002]***. A majority of the House *seemed* to equate Lord Nicholls's *ratio* with that of the ***Ghosh*** test in criminal law. Lord Hutton's judgment suggests that a person is dishonest if:

- his or her actions are seen as dishonest by the standards of the ordinary reasonable person (the *objective element*); and
- the defendant realized that by those standards he or she was dishonest (*the subjective element*).

However, Lord Millett's strong dissenting judgment took an alternative view of Lord Nicholls's judgment in ***Royal Brunei***. In ***Barlow Clowes International v Eurotrust International [2005]***, the Privy Council, with Lord Hoffmann, a member of the majority in ***Twinsectra***, on the panel, sought to 'clarify' the test in ***Twinsectra***. The two-stage test is there but follows Lord Millett's explanation. The Privy Council, a persuasive authority, was followed by the Court of Appeal in ***Abou Rahma v Abacha [2006]*** and more recently in ***Starglade v Nash [2010]***, where the court asked the same first question but then imbued the reasonable person with the ‘characteristics’ of the defendant. It is unsatisfactory that there should be conflicting persuasive and binding authority; this will hopefully be avoided in future after the decision in ***Willers v Joyce [2016]*** which now allows the Pricy Council to state that their decisions are intended to be binding in domestic courts.

Looking for extra marks?

The Court of Appeal in ***Group Seven Limited v Notable Services LLP [2019]*** has reviewed this area in the light of the decision on dishonesty in ***Ivey v Genting Casinos [2017]*** and seemed to equate some of the discussion as being ‘blind eye knowledge’. We might consider if this is a reflection of the old *Baden* criteria?

Conclusion

Personal remedies can be against a fiduciary/trustee who is in breach but also against those indirectly associated with a breach, those who receive trust property, or those who assist in the breach of duty.

Proprietary claims

An alternative would be to make a proprietary claim to vindicate the property rights of the claimant. If the property belonging to the claimant can be identified, then it will be returned to the claimant. Note that it is the property interest you have in an object not the object itself that is being claimed.

There are a number of advantages to bringing a proprietary claim:

- If the trustee/recipient has become bankrupt the beneficiary takes **priority** over other creditors.
- p. 189 Any increase in value of the property taken by the trustee is recoverable.
- There are no time limitations to bring a proprietary claim.

The first step is to identify the property in the hands of the trustee, or a third party, as being the trust property, which will then help you decide on a personal or proprietary (or combination of both) claim.

Looking for extra marks?

Much judicial and academic ink has been spilt over the issue of whether a fiduciary who accepted bribes and secret commissions was subject to a personal claim or proprietary remedy. This matter has been masterfully summarized by Lord Neuberger delivering the decision of the Supreme Court in ***FHR European Ventures LLP v Cedar Capital Partners [2014]*** (see chapter 11).

The tracing (following) process

It is important that the following rules are seen as a process. The aim for the claimant is to find who now has possession of the property which is being reclaimed. Once the property interest has been identified then the claim is made.

Revision tip

If the trust property has remained unchanged then the courts *follow* the asset into the hands of the trustee, or third party. If the property has changed in nature, then the courts *trace* the property. These are often called the equitable remedies of following or tracing, but they are in fact a process by which the property is identified: ***Westdeutsche Landesbank Girozentrale v Islington LBC [1996]***.

Example 1

In breach, a trustee spends £5,000 to buy a horse.

If the seller of the horse is a bona fide purchaser for valuable consideration without notice (‘*equity’s darling*’) there is no claim against that purchaser for the money. So, the money has now become a horse. The property that is being claimed is the horse: its nature has changed but the property rights in it are the same.

Revision tip

It is important to note that in the tracing process the purpose is to identify the property. Once the property has been identified the next step is to see if the claimant’s best interest is to bring a proprietary remedy—if the value of the property has increased—or a personal remedy—if the value has gone down. Once identified, to protect the personal claim an equitable ***lien*** can be placed on the property (similar in principle to that of a mortgage), which will give the claimant a priority over claims on *that* property: ***Foskett v McKeown [2001]***.

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Common law proprietary claim

When a party receives property to which that party is not legally entitled, he or she is under an obligation to return the property to the rightful owner. The party may receive this property because:

- it is received under a void contract; or
- it is received without the recipient giving valuable consideration.

The law will follow the property to the recipient, into the hands of another, by the process identified earlier. The liability for this claim is strict: once the property is found in the hands of the recipient, the property must be returned, subject to defences. A common law claim requires that:

- the claimant has legal title (so a beneficiary cannot use this remedy, but a trustee can); and
- the property is unmixed.

Following at common law cannot be used when the property has been **mixed** with another person's property: ***Agip (Africa) Ltd v Jackson [1990]***. This means that the property claimed has been combined with another person's property. The common example is where money is taken in breach and placed in a bank account with the recipient's own money. But the principle applies to all property.

However, the *clean* substitution of one property for another does not prevent the claim: ***Taylor v Plumer (1815)***. In this case the claimant's money was used to buy bonds and bullion; Lord Ellenborough said that 'the product or the substitute for the original thing still follows the nature of the thing itself'.

Looking for extra marks?

Compare the tracing process with the protection of suppliers of materials to a company (creditors) offered under a (***Romalpa***) retention of title clause: ***Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd [1976]***. In this way the supplied goods never become the property of the company and should the company be liquidated the goods are reclaimed by the seller: ***Hendy Lennox Ltd v Grahame Puttick Ltd [1984]***.

Problems arise when the property supplied with such a clause is used to manufacture goods. In ***Re Peachdart Ltd [1984]***, leather supplied was deemed to have been mixed in the production of handbags; although the leather was legally physically recognizable, it had lost its identity. See also ***Borden UK Ltd v Scottish Timber Products Ltd [1981]***.

Revision tip

The principle with the retention of title is exactly the same as common law tracing. The seller retains the legal title. You may see in the cases that the buyer may hold a position as **bailee** or agent; but keep in mind what the purpose of the clause is—to retain a property interest.

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Equitable proprietary claim

In contrast to following at common law, tracing in equity does not 'stop at the doors of the bank': ***Chief Constable of Kent v V and another [1983]***. Tracing in equity is therefore more flexible than following at common law as it can be used to trace property into mixed funds. The problem is identifying how much of the mixed property belongs to the claimant.

Essential elements for an equitable proprietary claim

From ***Re Diplock [1948]*** it is clear that to use equitable tracing there must be two requirements:

- a fiduciary relationship; and
- an equitable interest.

In a trust situation there will be a fiduciary relationship between the trustee and the beneficiary. In chapter 9 we identified classic relationships where a fiduciary relationship exists. However, it has become increasingly easy to establish a fiduciary relationship. Lord Browne-Wilkinson in ***Westdeutsche Landesbank Girozentrale v Islington LBC [1996]*** stated that a thief creates a 'fiduciary relationship' when he or she takes property belonging to another.

It is not necessary that the equitable interest pre-exists the acquisition of property by another. This leads to a 'chicken-and-egg' situation in relation to the two requirements for equitable tracing, which may be more apparent than real. This may be why Lord Millett doubted whether a fiduciary relationship was even necessary: ***Foskett v McKeown [2001]***.

Revision tip

Once a constructive trust has been established this gives the claimant a right to trace the property in equity. Therefore, if property is found in the possession of a recipient with the requisite knowledge to create recipient liability, the recipient becomes a trustee and the claimant can decide to make a proprietary claim, not merely a personal one. This is the point at which the personal claim and the proprietary claim overlap. Often students are uncertain as to which claim to pursue; the answer for a claimant is usually financial. Which claim will give the best financial result? See Figures 12.2 and 12.3 at the end of the chapter.

Where there has been a breach of trust the claimant must identify where the remedy lies. There will always be a personal remedy against the trustee but a common problem, especially in exams, is that the trustee has become bankrupt or has disappeared. In this situation, the personal claim may be worthless.

Terminology tip

Students sometimes say in this situation that there is no personal claim. This is not true. There is a personal claim—it is just not worth pursuing.

p. 192 **Identifying who has the property**

The rules in the tracing process need to be understood as falling into two categories:

- claims against the fiduciary (trustee); and
- claims between two 'innocent' claimants.

Revision tip

Always identify who has the property that is being claimed. The claim may be made against the fiduciary or trustee in breach, but it may sometimes happen that the trustee has mixed two trust funds' monies in the same account or purchased property with a mixed fund, so two innocent parties' money has been used.

Chapter 9 established that property which is purchased with the funds of two people is shared between them in proportion to their contribution under a resulting trust. ***Sinclair v Brougham [1914]*** presumes between all parties tracing their property that it is shared **rateably**: *pari passu*. The same reasoning applies to tracing claims where more than one person's money has been used to purchase property subject to a tracing claim, regardless of whether the claim is against the fiduciary or another innocent claimant. The courts are seeking to identify the property that is owned by the beneficiary. If the property being traced is an asset that has been purchased or exchanged for the trust property, the basic principle is to identify how much of the asset belongs to the trust and how much to an innocent contributor, a recipient, or a trustee in breach.

So, if a trustee takes a painting from the trust property and exchanges the painting and his or her own gold watch for a car, the courts would need to ascertain in what proportion the car belonged to the trust and to the trustee in breach. It is more common in exam questions that the value is represented in monetary figures. This is the process of tracing.

Claim against a trustee in breach

The rules in relation to claims against a trustee in breach will be explained by working through an example.

Revision tip

In an exam, be clear where the money is coming from and where it is going. It may be useful in your answer plan to draw an accounting table of the sums you are dealing with. This is one suggested layout, but any method that can help you identify who owns what share of property is helpful. Carefully planning the answer in this way will pay dividends.

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Payments into an overdrawn account

In breach of trust, a trustee takes £2,000 from Trust Fund A and places it into his current account which has an overdraft of £1,000 (see Table 12.2).

Table 12.2 Overdrawn account

BALANCE IN THE CURRENT ACCOUNT AFTER TRANSFER	TRUSTEE'S INTEREST	TRUST A'S INTEREST
£1,000	*−£1,000*	£2,000

The money to pay the overdraft has been dissipated; there is no asset into which to trace the property.

Looking for extra marks?

It has been suggested that 'backwards tracing' may provide an answer for payments into an overdrawn account. This means that if the overdraft was caused by purchasing an asset for the trustee then the claimant should have a claim on that asset. In ***Bishopsgate Investment Management Ltd v Homan [1995]***, Leggatt LJ rejected the principles, but Dillon LJ said that it was arguable whether the facts could allow an inference that there was an intention by the trustee to repay the overdraft with trust money. This view found favour in ***Foskett v McKeown*** and was discussed by the Privy Council in ***Federal Republic of Brazil v Durant International Corpn [2015]***.

The presumptions of honesty

(a) Trustee in breach takes £2,000 from Trust Fund A and places it into his current account, which has an existing balance of £1,000.

At this point the money in the account would be shared one-third for trustee and two-thirds for Trust Fund A because this is the proportion in which they made the contributions.

Revision tip

In an exam question, commonly the trustee will spend the money in the account, because otherwise, although the trustee may be imprudent with the trust money, there is no difficulty in reclaiming the money.

Re Hallet's (1880) deals with the situation where money is taken from the trustee's account. The court uses a presumption of honesty, meaning that the trustee is deemed to spend his or her *own money* first. So, when the trustee then buys a painting for £1,500, the painting would be purchased in the same proportion as the contribution: two-thirds by trustee and one-third p. 194 by Trust A. This rule will be applied even if the value of the painting increases: ***Re Tilley's WT [1967]***. The beneficiary is protected as the fund is safe and identifiable and the share of the painting is identifiable. The remedy is not to punish the trustee but to protect the property of the trust fund (see Table 12.3).

Table 12.3 *Re Hallet's*

BALANCE IN THE CURRENT ACCOUNT	TRUSTEE'S INTEREST	TRUST A'S INTEREST
£3,000 (after transfer)	£1,000	£2,000
−£1,500 (purchase of picture)	*£1,000*	*£500*
£1,500 (after purchase)	0	£1,500

(b) If the balance in the bank (in example (a)) was then dissipated by the trustee, the courts may reverse the application of ***Re Hallet's (1880)*** by using ***Re Oatway [1903]***.

Revision tip

A common mistake made by students in exams is to apply ***Re Oatway*** immediately. More marks will be gained for explaining the presumption in ***Re Hallet's***, and how that would affect distribution of property rights, then explaining how ***Re Oatway*** modifies that.

Applying ***Re Oatway (1903)***—trustee in breach takes £2,000 from Trust Fund A and places it in his current account, which already has £1,000 in it. Then he purchases a painting worth £1,500. He then spends the balance of the bank account on a world cruise (see Table 12.4).

Table 12.4 Re Oatway

BALANCE IN THE CURRENT ACCOUNT	TRUSTEE'S INTEREST	TRUST A'S INTEREST
£3,000 (after transfer)	£1,000	£2,000
−£1,500 (purchase of picture)		*£1,500*
£1,500 (after purchase of picture)	£1,000	£500
−£1,500 (purchase of cruise)	*£1,000*	*£500*

This means that the money used to buy the painting, which remains an identifiable asset, was in fact that of the trust. So, the painting is owned by Trust A and the money dissipated is only £500 of Trust A's money and the bulk is the trustees' money. This preserves the property of p. 195 the trust fund as much as possible. If the painting has increased in value, there will be a proprietary claim. If the painting has reduced in value, the claimant can place an equitable lien over the property to the value of the money taken (not the money spent on the painting) to protect any personal claims the claimant may make.

The aim is to protect the interest of the (innocent) beneficiary and ensure that the wrongdoer risks the loss. The presumption would be that (still trying to be honest) the trustee in fact spent the trust fund money and dissipated his own. This then secures the trust funds against the asset. It is unclear from ***Re Oatway*** whether all the money from the account needs to be dissipated or if the beneficiary will be allowed to 'cherry-pick' the rules to apply and ensure the most returns for his claim: see Rimer J in ***Shalson v Russo [2003]***. The ability to 'cherry-pick' was rejected in ***Turner v Jacob [2008]*** when there were funds remaining in the account to cover the loss.

Terminology tip

'Dissipated' means that there is no asset to attach a property right to, not that the property is worthless. For example, the money has been spent on a holiday or a meal. It does not mean that shares or other property purchased with the trust money now have no value.

The seller of the painting cannot be made to return the money as the seller is 'equity's darling'. This is an absolute defence for the seller. However, if the money had been donated to a charity or given as a gift, the equity's darling defence would not apply. The trust can trace 'into the hands' of the innocent volunteer.

Later payments into the account by the trustee in breach

The rule in ***Roscoe v Winder [1915]*** is that if a trustee in breach mixes his or her own, later-acquired, money in the same bank account with trust money, the presumption is that this is *not* a repayment of the money used in breach. The presumption will only be rebutted if there is clear evidence that the intention of the trustee was to repay the money taken in breach.

The trustee takes £500 he won on the lottery and places it into the account that has £1,000 of Trust A money remaining in it after the trustee spent £1,000 on a holiday (see Table 12.5).

Table 12.5 Lowest immediate balance

BALANCE IN THE ACCOUNT	TRUSTEE'S INTEREST	TRUST A'S INTEREST
£2,000		£2,000
−£1,000 (spent on a holiday)	0	*£1,000*
+£500 (lottery winnings)	£500	
£1,500	£500	£1,000

p. 196 ↵ The trustee has the property right in this money and is not deemed to repay the beneficiary unless there is evidence of that intention: ***Roscoe v Winder [1915]***. This may seem an anomaly to the 'presumption of honesty' but the claim is proprietary and as such the £500 was never the property of the trust. On this basis, it makes sense that Trust A cannot claim that the £500 represents its property. It has no pre-existing property right in the £500 that the court will protect. Its personal claim remains intact.

Two innocent volunteers mixed funds in a bank account

The rules that operate between two innocent parties are different in some aspects. If the trust property remains identifiable then the property is shared rateably as between the trustee and the trust fund: ***Sinclair v Brougham [1914]***.

The trustee takes £1,000 from Trust B and places that in the account which already has £750 of Trust A funds in it (see Table 12.6).

Table 12.6 Innocent volunteers mixed fund

BALANCE IN THE ACCOUNT	TRUSTEE'S INTEREST	TRUST A'S INTEREST	TRUST B'S INTEREST
£1,750 (after transfer)	0	£750	£1,000

The position is now that there is a mixed fund between two innocent parties. Different rules apply in relation to how they are dealt with between each other compared with how the trustee is dealt with in relation to them. If the trustee now spends the money in the bank the rule in ***Clayton's Case (1817)*** will apply. This states that, in a current account, money is assumed to be taken on a 'first in, first out' basis. This means that between the two innocent parties the money that was in the account first will be the first to be spent. This is a simple accounting issue.

Following on from that, the trustee spends £1,500 on shares, which, since purchase, have reduced in value and are now worth £500. Trust A had its money in the account for several months before Trust B had its money placed in the account (see Table 12.7).

Table 12.7 *Re Clayton's*

BALANCE IN THE ACCOUNT	TRUSTEE'S INTEREST	TRUST A'S INTEREST	TRUST B'S INTEREST
−£1,500 (purchase of shares)	0	*£750*	*£750*
£293	0	0	£293

As Trust A was the first to have money in the account the 'first in, first out' rule from ***Clayton's Case (1817)*** will take that money first, then the balance will come from Trust B.

The remaining money in the bank belongs to Trust B. This rule can work harshly, for example if Trust A will
p. 197 be exhausted on this interpretation but Trust B still has a significant amount left. ↵ If this does cause an inequitable result, then the rule in ***Clayton's Case*** can be set aside: ***Barlow Clowes v Vaughan [1992]***. Although ***Clayton's Case*** was stated to be the default position in ***Barlow Clowes v Vaughan***, the court found that this could not have been the intention of the contributors. One option is to consider that the money is contributed subject to a 'rolling charge' (the North American approach) so funds are allocated proportionately at each withdrawal or at the final stage regardless of when contributions and withdrawals were made. This found approval in ***Shalson v Russo [2003]***.

Innocent volunteers who receive trust property

'Innocent volunteer' also applies to situations where a person receives property under an invalid contract, such as the Playboy Club in ***Lipkin Gorman [1991]***. Tracing will identify the property in the possession of the innocent recipient. Once it has been found in the possession of the recipient, liability is strict.

Defences available to the innocent volunteer

Re Diplock [1948] suggested that in this situation the innocent volunteer may claim that it would be unconscionable to return the property. The personal claim against the trustee in breach remains (***Ministry of Health v Simpson [1951]***), but the proprietary claim may fail. This is the same principle as the change-of-position defence in common law claims. In ***Boscawen v Bajwa [1996]*** it was stated that the common law defence of change of position could apply to the equitable claims.

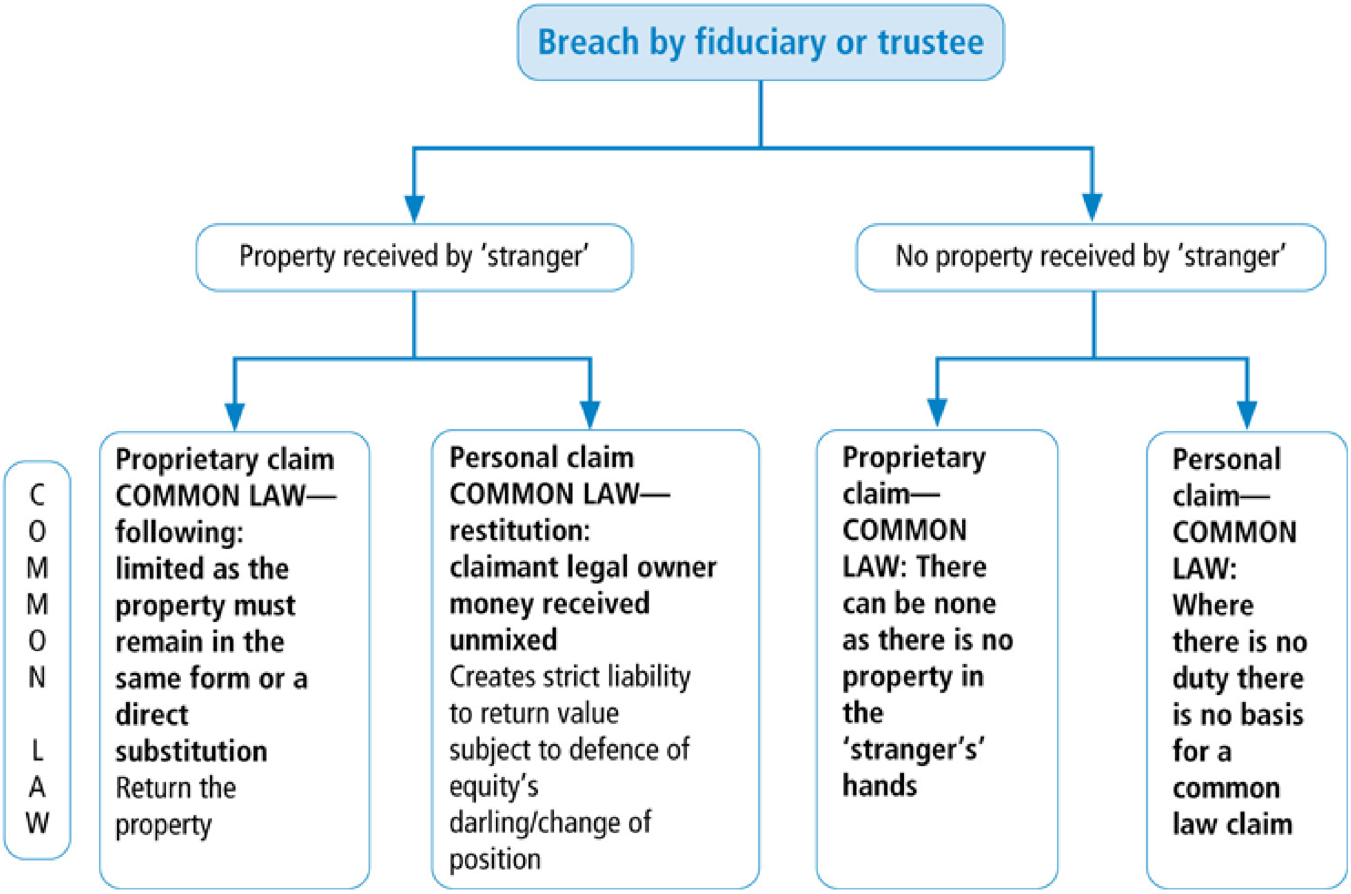

Figure 12.2 Summary of potential claims in common law

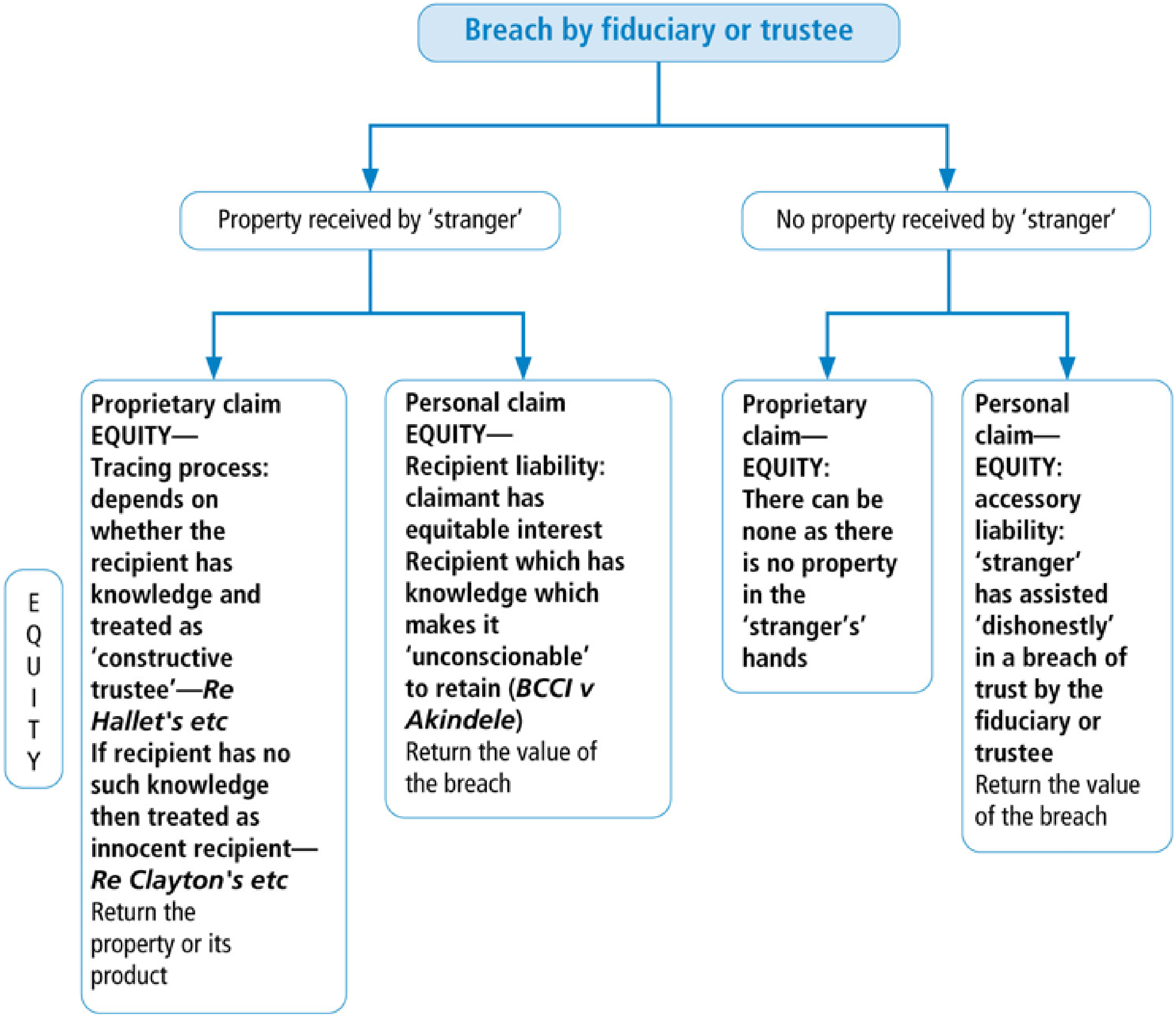

Figure 12.3 Summary of potential claims in equity

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Conclusion

The remedies for breach of trust can be personal against the trustee as with any breach of obligation. In addition to these claims, a proprietary process can be used to help identify property taken in breach of trust. Once the property has been identified in the possession of another (this can be in its original form or in replacement property (substitutes)), the claimant can elect to make a personal claim or a proprietary one.

Claims can be brought not only against the trustee in breach but also against innocent recipients, dishonest recipients, and people who assist in a breach of trust. The key step is to identify where the property taken in breach is, then decide what type of claim would be most beneficial. The Figures 12.2 and 12.3 may help in deciding which claim to make against a third party involved in a breach of trust.

Key cases

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CASE	FACTS	PRINCIPLE
↵ ***Agip (Africa) Ltd v Jackson [1990] Ch 26***	A senior officer innocently signed a forged payment order. The forger, an accountant, was employed by the company. Payment was made by innocent banks. The forgery was discovered too late to stop payment.	Where there had been no mixing the property could be traced at common law. Money was transferred by electronic transfer so there was no physical asset which could be traced. The fraudulent accountant owed a fiduciary duty to the company. He would be liable to account as constructive trustee as he knowingly assisted in the fraud.
BCCI v Akindele [2000] 4 All ER 221	Money was loaned on very favourable terms. BCCI collapsed, and the creditors tried to claim against the money paid to Chief Akindele for his assistance in fraud.	The level of dishonesty needed to create liability as constructive trustee was 'such that it would make it unconscionable for them to retain the receipt'.
Foskett v McKeown [2001] 1 AC 102	Deposits paid for property were used to pay for insurance premiums by M. M committed suicide and over £1 million was paid on the insurance policy. The claimant traced the money into the insurance payment.	The claimant was entitled to a charge over the payment, with interest paid on that amount, but his claim was not restricted to this (as the Court of Appeal had found). He could claim a proportion of the payment equivalent to his contribution.
Lipkin Gorman v Karpnale Ltd [1991] 2 AC 548	A solicitor removed clients' money from the client account and used the money or gambling at the Playboy Club. This was a breach of the solicitor's fiduciary obligations. The Playboy Club had received that money under a void contract (gambling contracts were void at the time). As the Playboy Club had no legal claim to the money it was required to return its value to the 'real' owner.	The liability to repay the solicitor was strict but subject to a defence of change of position. The argument by the Playboy Club that it was equity's darling failed as its contract was void under the existing gambling laws of the time.

CASE	FACTS	PRINCIPLE
Twinsectra v Yardley [2002] 2 AC 164	Money was lent to Sim, acting for Yardley, for the sole purpose of buying property. In breach, Sim paid the money to Yardley's solicitor, Leach. He released it to Yardley. On default Leach was sued for dishonest assistance.	The loan was made as a ***Quistclose*** trust. The case decided on the 'combined test'. Has D transgressed the standards of conduct? Does D realize the transgression? Note: the test was 'reviewed' by the ***Privy Council in Eurotrust v Barlow Clowes [2006]***.

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Key debates

Topic	**Meaning of dishonesty in accessory liability**
Academic/ author	Lord Millett
Viewpoint	The liability should be objective and not have a subjective element.
Source	Lord Millett's dissenting judgment in ***Twinsectra v Yardley [2002]***. For an overview of the issues, see Pearce and Barr, *Pearce and Stevens' Law of Trusts and Equitable Obligations*, 7th edn (2018), pp 719–45.
Topic	**Strict liability for recipient liability**
Academic/ author	Birks
Viewpoint	Liability should be strict subject to defences as with common law money had and received.
Source	Birks [1989] LMCLQ 296.
Topic	**Backwards tracing**
Academic/ author	Matthew Conaglen
Viewpoint	Considers the policy in relation to backwards tracing.
Source	'Difficulties with Tracing Backwards' (2011) 127 LQR 432

Exam questions

Problem question

Jack, a solicitor for Badger & Co, takes £3,000 out of the customer account. He spends £2,000 at the local casino, Fungirls & Co. He places the remaining £1,000 in his bank, which already has a balance of £500. He takes £1,000 and buys a painting from his friend Augustus, which is now worth £2,000. The remaining £500 in his account, he spends on a holiday weekend in France.

Advise Badger & Co as to its remedies.

See the Outline answers section in the end matter for help with this question.

Essay question

The rules on common law and equitable tracing should be united into a coherent system of rules.

Discuss.

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Online resources

This chapter is accompanied by a selection of online resources to help you with this topic, including:

- An outline answer *<https://iws.oupsupport.com/ebook/access/content/mcdonald-concentrate8e-student-resources/mcdonald-concentrate8e-chapter-12-outline-answers-to-essay-questions?options=showName>* to the essay question
- Further reading *<https://iws.oupsupport.com/ebook/access/content/mcdonald-concentrate8e-student-resources/mcdonald-concentrate8e-chapter-12-further-reading?options=showName>*
- Interactive key cases *<https://iws.oupsupport.com/ebook/access/content/mcdonald-concentrate8e-student-resources/mcdonald-concentrate8e-chapter-12-interactive-key-cases?options=showName>*
- Looking for extra marks quiz *<https://iws.oupsupport.com/ebook/access/content/mcdonald-concentrate8e-student-resources/mcdonald-concentrate8e-chapter-12-looking-for-extra-marks?options=showName>*
- Multiple choice questions *<https://iws.oupsupport.com/ebook/access/content/mcdonald-concentrate8e-student-resources/mcdonald-concentrate8e-chapter-12-multiple-choice-questions?options=showName>*

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