Equity & Trusts coursework

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This question raises the issue of whether Quiverful (Q) and Reddypalms (R) are able to trace their property, the method in which they are able to do so and the remedies that they will be able to obtain. Q and R must bring a claim in equity since common law does not allow you to trace property into a mixed fund. To be able to bring such a claim there are four requirements: 1) the claimant must be able to show that he has an equitable proprietary interest in the property; 2) there must be a fiduciary relationship at some point in the transaction; 3) the property must be identifiable and 4) none of the defences must be available.

The equitable proprietary interest and the fiduciary relationship.

Podger, the thief (P), died insolvent hence it will be useless for Q and R, in order to receive their property back, to bring a personal claim against him: they need to be able to bring a proprietary claim. I will discuss P and Q in turn and then turn to the separate issues that arise from the way that P disposes of the money he has fraudulently acquired.

When P steals money from Q he does not acquire legal title to it: hence he will not be able to trace the property at common law- *MCC Proceeds Inc v Lehman Brothers International*[1]. This is also supported by the fact that he deposits the money into his bank account which is already in credit, i.e. a mixed fund, which is similarly not amenable to a tracing process at common law.

Hence Q must trace in equity, since in equity it is always possible to trace into a mixed fund- *Pennell v Deffell*[2]. This is done by imposing a trust. In *Westdeutsche Landesbank Girozentrale v Islington LBC*[3] Lord Brown Wilkinson maintained that a constructive trust would arise as a result of the unconscionable conduct of the thief. However in the Australian case of *Black v Freeman*[4], it was held that the thief would hold the property on resulting trust for the victim and this method was approved in *Lipkin Gorman v Karpnale*[5].

In both cases there is a difficulty in deciding exactly what the thief holds on property since when acquiring property by way of theft there is no passing of legal title and it is hard to see firstly, how the trust itself arises and secondly, how the victim would retain an equitable interest in the property. The *Westdeutsche* case tries to get around this by saying that the constructive trust arises

[1] [1998] 4 All ER 675.
[2] [1853] De M & G 372.
[3] [1996] AC 669.
[4] [1910] 12 CLR 105.
[5] [1992] 2 AC 548.

not when the thief steals the property but when he turns it into money. As we are dealing with money in this case, I will assume that a constructive trust has arisen on the basis of *Westdeutsche*. However if this were not so, or could not be accepted, I would argue that in any case *Black v Freeman* has established that there exists a fiduciary duty between the thief and the victim and that because of this a resulting trust arises.

Much the same can be said for the claim brought by R. Similarly to Q if they are to retrieve their property they must be able to show an equitable proprietary interest. Whether a trust arises in this case is both more apparent and at the same time more difficult to evaluate. P worked as a clerk for R, a firm of solicitors. A fiduciary is defined in *Bristol and West Building Society v Mothew*[6] by Lord Millett as being "someone who has undertaken on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence". Traditionally four classes of fiduciary have been established[7] and I do not think it would be stretching the principle/ agent class to contend that P is an agent of R. Mona Vaswani states that it is important to remember that the list is not exhaustive and that "others lower down in the hierarchy may also be fiduciaries... since 80% of frauds have some inside involvement.[8]"

Just for arguments sake it is worth noting that the requirement of a fiduciary relationship has been questioned and there is an argument for it being dropped altogether. The need for it is based on some feeble dicta in *Sinclair v Brougham*[9]: this was then taken as prescribed in *Re Diplock*[10] as a precondition. However the *Westdeutsche* case expressly overruled *Sinclair v Brougham* on mistaken payments. Lord Brown Wilkinson in *Westdeutsche* stated that he approved of all that was said about tracing in *Re Diplock*, yet this was deduced from *Sinclair*. The requirement hasn't been overruled as of yet but it seems fair to say that the basis for such a requirement is weak.

The property must be identifiable

I now pass to examining the three different ways in which P ahs disposed of the trust money, considering each one in turn as to whether Q and R can identify it as their property.

A. £6,000 spent in the casino.

Assuming that a constructive trust has arisen, P by spending the money in the casino is disposing of the trust property in breach of trust obligations. T his situation bears a resemblance to the case of *Lipkin Gorman* however it is important to remember that this was a case of mistaken payment at common law for moneys had and received. The important dicta to glean from the case is

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[6] [1998] Ch 1.
[7] Trustee and beneficiary; agent and principal; director and company; partner and co-partner.
[8] "Tracing into trust funds"- Association of Corporate Trustees, Issue 17, October 2001.
[9] [1914] AC 398.
[10] [1948] Ch 465.

the assertion by Lord Nicholls that there is a strong case for equity adopting the same strict liability receipt based approach that exists at common law. At law this claim requires no need of knowledge of the mistake, the claimant just needs to prove receipt by the defendant of the moneys.

In equity the position is somewhat different as the claimant would have to prove that the casino received the money unconscionably or with the knowledge that it was trust property. The wording of the situation which specifies that P was "well known" and that he "previously never dealt in sums of more than £50 a day". It is arguable that the owners of the casino or the people to which he was known would have suspected something when on a single day he spent and lost £6,000 in a single evening. Since we are dealing with a commercial transaction, in order to have a remote possibility of repossessing the money, one would argue that the kind of knowledge is of the kind of knowledge represented by categories 1,2 or 3 identified in the *Baden Delvaux v Societe Generale*[11] case, as held in *Re Montagu's Settlement*[12]. I would argue that this is a case of the casino either "willfully shutting their eyes" or at the very least "willfully/ recklessly failing to make the inquiries that a reasonable and honest man" would feel forced to make. Considering that the amount that P spent was extraordinarily above the sums he previously dealt in and taking into consideration the speech by Lord Nicholls, I believe that it is not improbable that a court would hold that the casino should have made inquiries as to the money they quite happily took off him and that the claimants would be able to recover.

B. £6,000 spent on the painting.

In *Ryall v Ryall*[13] it was held the beneficiary should be able to trace the trust property into its product[14]. Similarly in *Taylor v Plumer*[15] it was held that it is perfectly possible for trust property to be traced against the exchanged product. Hence the fact that the money P stole was converted first into a painting and then again back into money is not a bar to the property being identified. The £6000, in itself, is not traceable but the painting is held on trust by his girlfriend, and as a result the £9,000 she obtains on selling it is identifiable as trust property plus profit incurred thereon. Th e question arises of whether the girlfriend is an innocent volunteer or in knowing receipt of trust property: this does not affect the outcome since the only way that she would retain the property free of the interest of the claimant would be if she were the bona fide purchaser without notice of the property in question, and she is not since the painting was given to her as a gift. There remains the

[11] [1983] 1 WLR 509.
[12] [1987] Ch 264.
[13] [1739] 1 Atk 59.
[14] Also *Taylor v Plumer*[1815] 3 M & S 562.
[15] [1815] 3 M & S 562.

question of profits (i.e. £3000) which is resolved with reference to *Re Tilley*[16]: although in this case it was held that there was no trust asset being used, it was held obiter that had trust money been used than the original trust property plus the profits obtained from it would be traceable. Hence I can see no difficulty in arguing that the £9,000 is recoverable form P's girlfriend.

C. £6,000 given to a charity.

The charity in question is not a bona fide purchaser hence it is not automatic that the money will not be traceable against them. If the property is traceable it is worth noting that in any case the claimants would not receive their money back but the books that the charity had bought. The important thing to note in this situation is that the charities used the money to buy books for an old peoples' home which they owned. I think it is arguable that they would not have done so unless they had received the money in the first place. This raises the possibility of the defence of change of position. However it is important to notice that this defence has only been recognized in *Lipkin Gorman* which was, as I have mentioned above, a personal claim at common law and not an equitable proprietary claim. Lord Goff in the case agreed that it was a good defence but failed to specify any of the requirements maintaining that these should evolve in a piecemeal fashion on a case by case basis. Lord Millett on the other hand has stated that he is not sure whether the defence of change of position can be utilized in an equitable claim. If this were not possible I do not know if it is possible to stretch one of the defences discussed in *Re Diplock*, namely that of money used as improvement to land. The books certainly do ameliorate the lifestyle of the residents of the old peoples' home but to classify it as a land improvement does not seem entirely justifiable. However there is another defence raised in *Re Diplock* which states that the property will not be traceable if the court believes that it is grossly unconscionable for the claim to go ahead. Again this does not seem to apply straight to the facts but if it could be shown that some new residents had relied on the improved library when choosing a home, it is possible although I admit, a bit remote that the court would decide not to allow the books to be recovered. Alternatively it is arguable that neither Q nor R are interested in recovering the books and that hence it would be unconscionable for the courts to rid the charity of them as they had bought them in good faith and they were of great use to the residents of the home.

Remedies: how much and to whom?

Since Q and R have brought an equitable proprietary claim the whole of the identifiable property is subject to an equitable charge and gives them priority over other general creditors of P,

[16] [1967] Ch 1179.

as secured creditors. Since the account into which P deposited the money he had fraudulently obtained was already in credit in order to determine apportionment when the money of two trusts is mixed, the first rule to follow is that of *Re Hallett's Estate*[17] which states that P is deemed to have spent his money first. Once this has been established in order to determine of that residual amount how much goes to the claimants, in the case of current account, the rule to follow is that in *Clayton's Case*[18]: the court held that "it is the first sum payed in that is first drawn out". The method is slightly different for deposit accounts where, according to *Sinclair v Brougham* which is still good law on this point, the identifiable money or property is apportioned equally. I mention this because recently as in the case of *Barlow Clowes v Vaughan*[19], the courts have shown a tendency to move in favour of the rule in *Sinclair* over that of *Clayton's Case* even where current accounts are concerned. It is important to note that the reason for this is probably that in *Clowes* the number of claimants was enormous and if the rule in *Clayton's* were followed then only very few of the last persons defrauded would have been able to recover their money hence making it less inequitable for the courts to apportion loss equally between all the claimants. This is to say that the automatic application of *Clayton's* is no longer certain where the number of claimants exceeds a certain number, however for our situation I think the courts would still be likely to apply *Clayton's* as the number of claimants is only two.

Hence assuming that Q and R are able to recover the £6000 from the casino as well as the £9000 from the girlfriend it follows that:

1. P will have spent his money first and that as a consequence only £2000 will be recoverable from the casino; and
2. Of the remaining £11000, £4000 will be fully refunded to R and the remaining £7000 will be recoverable by Q.

[17] [1879] 13 Ch D 696.
[18] [1817] 1 Mer 572.
[19] [1992] 4 All ER 22.