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Equitable Remedies for Breach of Trust

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Imagine that a trustee (A) misapplies trust property that he holds on behalf of the beneficiary (B). It might for example be paid away to C in circumstances where A had no authority to make the payment. B may of course have a remedy against C, either a proprietary claim contingent on tracing or a knowing receipt claim. Those two claims are not the focus of this chapter. The focus here will be on claims that B has against A in cases where A commits a breach of trust: this could be by way of misappropriating or misapplying trust assets. Before that point, as in *Fox v Fox,*[1] we would expect that if the trustee proposed a distribution that was in breach of trust a prohibitory injunction would be available. We also look at reparative claims for negligence in investing trust assets.

Currently a debate exists over the principles by which courts determine the quantum of equitable compensation in those cases where the trustee goes ahead with the misapplication of funds. Traditionally the approach has been through rules of accounting, whereby the trustee was obliged to account for his stewardship. Depending on the type of alleged breach this might take the form of falsifying the account, or surcharging it – terms we examine in detail later. English law in particular has appeared to move away from those rules after the decision in *Target Holdings v Redferns*[2] and *AIB v Mark Redler & Co*[3] towards a more causal approach. This has implications for the interest we think is being protected under a trust and the degree to which it is akin to the interest protected in contract law, or alternatively a strict custodianship interest. There are three main sections to this chapter. The first part examines the accounting proceedings and explains the difference between the accounts of administration. The second part examines the decisions mentioned, and the third part what interests the action is protecting, the requirements of corrective justice and how we might provide a rationalisation of the cases.

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[1] (1870) LR 11 Eq 142

[2] [1996] AC 421

[3] [2014] UKSC 58, [2015] AC 1503

(1) Accounting Obligations

There are three forms of account. These are account of profits, account for wilful default and the common account. Account of profits relates to specific gains after equitable wrongdoing and the principles behind it are uncontroversial. The latter two forms of account are accounts of administration on which we focus.

(A) Accounts of Administration in Common Form

Common accounts, or accounts in common form are available as of right to enforce the beneficiary's right to the provision of information.[4] In *Libertarian Investments Ltd v Hall*[5] X transferred funds to a trust account set up by D with a solicitors firm. Approximately £5.5m was used to purchase shares in C. However, D had fraudulently transferred sums to his own account, including approximately £5.4m he claimed to use to buy the shares. Lord Millett, sitting as a non-permanent justice of the Hong Kong Court of Final Appeal, said that there was no need to prove a breach of trust to obtain an account.[6] All the beneficiary needs to do is request an account of the stewardship of the property. In essence the language of "account" is entirely appropriate in the colloquial sense. The beneficiary asks for an account or a story in the prescribed form of how the trust assets have been used. The beneficiary is then in a position to object to entries in the accounts that he dislikes, and an ancillary order to pay any amount found to be due on completion of the account can be made.[7] He is not though entitled to object to anything and everything. It may be that trust assets are destroyed, and a factual failure to keep the assets safe has taken place, but no breach has taken place as no reasonable trustee would have insured that type of loss.[8] If, however, the assets are disbursed without authority, the account is falsified.[9] Since the disbursement never took place (or we pretend it never took place) the original assets from the trust fund are taken to still be in the trust fund

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[4] *Re Dartnell* [1895] 1 Ch 474; if matters can be dealt with more expeditiously without an order to account, an account will not be ordered *Campbell v Gillespie* [1900] 1 Ch 225. We should distinguish an account of administration in common form from an order for the execution of the trust which is more general and less focussed. R Zakrzewski, *Remedies Reclassified* (OUP, 2004) 145

[5] (2013) 16 HKCFAR 681

[6] Ibid [167]; *Partington v Reynolds* (1858) 4 Drew 253, 62 ER 98; *Angullia v Estates & Trusts (1927) Ltd* [1938] AC 621 (PC) 637-638

[7] R Chambers, 'Liability' in PBH Birks and A Pretto (eds), *Breach of Trust* (Hart 2002) 1, 8; Zakrzewski (n 4) 131-132

[8] Chambers (n 7) 9; J Glister, 'Equitable Compensation' in J Glister and P Ridge (eds) *Fault Lines in Equity* (Hart, 2012) 143, 145; *Morley v Morley* (1678) 2 Ch Cas 2, 22 ER 817

[9] *Pittt v Cholmondeley* (1754) 2 Ves Sen 565, 28 ER 360

and any expenditure is treated as if it were the trustee's own; only if specific restoration is absolutely impossible is a money obligation substituted.[10] This is a purely personal remedy.[11] Consequently the beneficiary is now unable to assert a claim over the original asset in the hands of the transferee. This is because the beneficiary cannot both adopt the transaction and disaffirm it.[12] Lord Millett therefore comments in *Libertarian* that should the beneficiary discover an unauthorised investment which is profitable, he can choose to adopt or ratify the transaction and demand the proceeds be paid into the trust.[13] It would also be possible for the asset to be sold and authorised investments purchased.

Causation is irrelevant. *Magnus v Queensland National Bank*[14] is a good example. The bank held trust property, aware that it was the security for a loan. They released it incorrectly to Goldschmit. He was engaged in a fraud and disappeared. The bank, in defence to the claim, argued that Goldschmit would have succeeded in his fraud anyway; he had effective control over the other trustees and would have bent them to his will in getting hold of the property. That was irrelevant. The beneficiary should not take the risk of the trustee failing to keep the property safe and secure from the third party's fraud.

However, quantum is assessed with the full benefit of hindsight. In *Re Dawson*[15] Street J said that the obligation to make restitution in specie must be measured in the light of fluctuations since the breach.[16] In *Nant-y-glo and Blaina Ironworks Ltd v Grave*[17] Grave had acted as director of the company and had had a number of shares transferred to him for no consideration to induce him to agree to the directorship. He acted as a director for three years and the shares were worth £80 per share at one point. In 1877 when they were worth £1 the company sued, arguing that he was a trustee of the shares or their value. The company received the highest intermediate value of the assets as equitable compensation. In effect we assume in that case that that the misapplied assets would have been sold at the top of the

[10] *Agricultural Land Management Ltd v Jackson (no 2)* [2014] WASC 102, [335-336]; J Penner, 'Duty and Liability in Respect of Funds' in J Lowry and L Mistelis (eds) *Commercial Law: Perspectives and Practice* (Sweet and Maxwell, 2006) 212, 216-217

[11] *Jackson v Dickinson* [1903] 1 Ch 947; *Wright v Morgan* [1923] AC 788 (PC) 799; *Head v Gould* [1898] 2 Ch 250

[12] D Fox, 'Overreaching' in A Pretto and PBH Birks (eds), *Breach of Trust* (Hart, 2002) 95, 105

[13] *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681, [169] (Millet NPJ)

[14] (1888) 37 Ch D 466; *Cocker v Quayle* (1830) 1 Russ & My 535, 39 ER 206; *British Elevator Company v Bank of British North America* [1919] AC 658

[15] [1966] 2 NSWR 211

[16] *Shepherd v Mouls* (1845) 4 Hare 500, 67 ER 746

[17] (1878) 12 Ch D 738; *Eden v Ridsdale Railway Lamp & Lighting Co Ltd* (1889 23 QBD 365

market. While Glister has argued that this is an account of profits case,[18] it has not been consistently treated as such; Ribeiro PJ treated it as a common account in *Libertarian Investments*.[19] The flipside can be illustrated by *Vyse v Foster*.[20] A defaulting trustee was allowed a credit for money earned for the trust through unauthorised use of trust money and in *Knott v Cottee*[21] the trustee had improperly bought exchequer bills and sold them at a loss; she was ordered to repay the money subject to a credit for the sale price of the bills.

On the facts of *Libertarian* the trustee had falsely informed the beneficiary that monies had been used to acquire shares (when they ought to have been), but in fact the funds were misappropriated. The beneficiary requested the profits that would have been made had the shares been obtained. The common account does not allow beneficiaries to argue that the trustee ought to have received more than he did, although a surcharge may allow a party to treat assets actually acquired by the trustee to be included in trust accounts.[22] In *Libertarian* itself, however, the trustee was precluded from setting up a scenario in which he had not purchased the shares, when he said he had.[23] Consequently the court treated the shares as having been acquired, and said that some of those shares would have been sold on at a profit, a profit which could be awarded.

(B) Accounts of Administration for Wilful Default

Wilful default is an alternative form of account of administration, which does allow for an argument that the trustee ought to have received more than he in fact had received,[24] and enables a claim for lost profit where a trustee invested the assets less well than he should have done. Despite the name therefore this type of account does not require "wilfulness", but there must be a specific breach of trust alleged; it cannot simply be tacked onto an account in common form,[25] although it can be used as a way of discovering further breaches if past conduct suggests a reasonable possibility of further breaches being found.[26]

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[18] J Glister, 'Breach of Trust and Conversion in a Falling Market' [2014] LMCLQ 511, 530

[19] *Libertarian Investments Ltd v Hall* [2013] HKCFA 93, (2013) 16 HKCFAR 681, [88] (Ribeiro PJ)

[20] (1872) LR 8 Ch App 309

[21] (1852) 16 Beav 77, 51 ER 705

[22] *Re Fish* [1893] 2 Ch 413

[23] *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681, [121-126] (Ribeiro PJ)

[24] AJ McGhee (ed), *Snell's Equity* (31st edn, Sweet and Maxwell, 2015) para 20.25

[25] *Massey v Massey* (1862) 2 J&H 728, 70 ER 1252; *Partington v Reynolds* (1858) 4 Drew 253, 62 ER 98; *Re Stevens* [1897] 1 Ch 422

[26] *Re Tebbs* [1976] 1 WLR 924

It is not often fully appreciated both that falsification and surcharging the account also apply to accounts of administration for wilful default. Admittedly there is no substantive difference in how falsification is approached. If the trustee cannot explain the entry, it is disallowed. An example might be found, as Conaglen has pointed out,[27] in some negligence cases. If the disbursement to buy stock on the Elbonian stock market was permitted, but ridiculously foolish, it can be falsified. The beneficiary has a choice here, and the option he chooses will obviously depend on how he thinks a prudent trustee would have acted. If losses would have been made anyway falsification (resetting to the start) is more advantageous, and reflects the beneficiary's ability to elect whatever outcome is the most advantageous for him. The trustee cannot object to this because the nature of the obligation he owes is to use the money for the best advantage of the principal, and so whichever (with the benefit of hindsight) course of action that turns out to have been must be what he should have done.

Only where the account is sought to be surcharged is there a procedural difference. We might surcharge the account if property is in fact obtained and has not been accounted for or treated as a trust asset. Here, as we have seen, we add something to the common account that would not otherwise be there.[28] On a wilful default basis matters are slightly different, allowing a party to surcharge the account not merely for assets received, but not accounted for, but also for assets wrongfully not received. Damage or loss caused to the trust fund is measured and valued at the date of judgment.[29] In *Nestle v NatWest Bank*[30] the argument was that due to a negligent failure to review the investments of the trust on a regular basis, the trust was worth less than it otherwise would have been, and the beneficiaries recovered on that basis. The claim in modern terms would be for lost profits. This requires an assessment of what the prudent trustee would have done and the investment performance he would have received. A causal analysis is vital in a way it is not in common form accounts. In *Bristol & West BS v Mothew*[31] Millett LJ, as he then was, considered the difference and said that there was in reparative cases, "... no reason in principle why the common law rules of causation, remoteness of damage and measure of damage should not be applied by analogy."

[27] M Conaglen, 'Equitable Compensation for Breach of Trust: Off Target' (2016) 40 Melbourne UL Rev 126, 142
[28] *Libertarian Investments v Hall* (2013) 16 HKCFAR 680, [170]; *Agricultural Land Management Ltd v Jackson (no 2)* [2014] WASC 102
[29] *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681, [91]
[30] [1993] 1 WLR 1260; *Ultraframe Ltd v Fielding* [2005] EWHC 1638 (Ch), [1513] (Lewison J)
[31] [1996] Ch 1; *Cia de Seguros Imperio v Heath (RBEX) Ltd* [2001] 1 WLR 112; *BSM Marketing Ltd v Take Ltd* [2009] EWCA Civ 45

(C) More Recent Terminology

In more recent terminology we have spoken of substitutive equitable compensation which maps onto falsification of the account in common form, and reparative compensation which maps onto wilful default cases, where the account is surcharged.[32] Substitutive equitable compensation therefore aims to have the trustee replace assets that ought to be there, but are not. Essentially the trust is treated as if the assets were never removed and so the trustee is obliged to provide substitute assets or money and pay into the trust. Causation and remoteness play no role – although quantum is assessed with the benefit of hindsight.

Reparative equitable compensation by contrast does exactly the same job as damages. Put differently, an award of substitutive equitable compensation directly enforces a primary right of the beneficiary to the money in the fund; an award of reparative equitable compensation (or surcharge) in the context of an account for wilful default represents a secondary right to compensation.

(2) The English Cases: Departing from the Account in Common Form

There are two major English appellate decisions on this topic. In this section we will discuss them each in turn. The main point to remember is that the outcome of the two decisions is, in their language at least, a turn away from the accounting process above. Each talks in terms of a causal connection between breach and loss, whereas falsification of an account in common form has not required any causal elements. The view that no causal elements are ever required, I will call, the absolutist approach, protecting a custodianship interest; the other view, the flexible approach, protecting an interest more akin to contract.

(A) Target Holdings v Redferns

In *Target Holdings v Redferns*, Target had agreed to provide a mortgage for £1.5m over the property on the basis of its having been valued at £2m. This was a fraudulent valuation; the purchaser, Crowngate, was only buying the property for £775,000. Redferns, the solicitors, received the mortgage monies from Target, but in breach of trust paid it out too early before

[32] S Elliott and J Edelman, 'Money Remedies against Trustees' (2004) 18 TLI 195

the property had been purchased and mortgaged. Indeed not only was the money paid out too early, but to the wrong party – a dummy sub-seller in the fraudulent chain of transactions. However, despite this the solicitors did regularise the position in that the mortgage documents were received (from the correct party) several days later. In essence the breach can be (crudely) characterised as the lender being unsecured for a period of a few days. Ultimately the borrower defaulted, the financiers exercised their power of sale, but the property only sold for £500,000, causing a loss to Target by reason of the fraudulent valuation and consequent inadequate security. Target wanted £1m. They received nothing.

The traditional approach to such a case would be to say that the beneficiaries of the trust – Target – were entitled to falsify the account. As suggested earlier, this in effect means pretending the payment out had never happened. Because the payment never happened, Redferns must still have the £1.5m and must pay it to Target. Obviously they do not actually have the money on trust, so must use their own money to satisfy their obligation. It is irrelevant on this view whether the money would have been lost anyway. Lord Browne-Wilkinson, who gave the leading judgment, however, began by contrasting traditional and commercial trusts and said only in the former would orders to restore the trust estate be made.[33] The difficulty is the contrast with commercial trusts; that is not a term of art and therefore it is very difficult to understand what counts as traditional and what counts as commercial. What he is really trying to get at though is quite simple, which is that we should not compel trustees to put a trust back together again when it is no longer on foot,[34] or intended to be so. He said,

> The depositing of the money with the solicitor is but one aspect of the arrangements, such arrangements being for the most part contractual… I have no doubt that, until the underlying commercial transaction has been completed, the solicitor can be required to restore to client account moneys wrongly paid away. But to import into such trust an obligation to restore the trust fund once the transaction has been completed would be entirely artificial… flies in the face of common sense and is in direct conflict with the basic principles of equitable compensation.[35]

[33] [1996] AC 421 (HL) 436

[34] *Knight v Haynes Duffell Kentish & Co* [2003] EWCA Civ 223, [38]; by contrast HHJ Seymour argued that there was no limitation and the enquiry was a simple causal one in *Hulbert v Avens* [2003] EWHC 76, [56]

[35] [1996] AC 421 (HL) 436

He went on a few pages later to explain what those basic principles are.[36]

> Equitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests: to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach

Lord Browne-Wilkinson gets to the position he does by relying heavily on the Canadian case of *Canson Enterprises v Boughton & Co*[37] and in particular on the judgment of McLachlin J. She said that an award of equitable compensation for breach of fiduciary duty seeks to restore losses which were, on a common sense view, caused by the breach.[38] McLachlin J was in fact making an analogy between falsification of the account in common form and compensation for breach of fiduciary duty; because those two things are rather different, she ended with something of a hybrid.[39] The wrong in *Canson* was failure to disclose to the plaintiff the defendant's conflicting fiduciary duties to different clients. This is a non-custodial fiduciary duty.[40] The duty on the trustee in *Target Holdings* was a custodial duty – one to hold the money for particular purposes. The different types of duty have different rationales. The rationale for a remedy in custodial duty cases is, as we know, simple; the money that should be there is not identifiable as being there. As Conaglen puts it, the case law on non-custodial client-client conflicts is inconclusive, but the basic rationale is to protect the principal by providing compensation in cases where the fiduciary's choice of one client over the other causes loss.[41] Indeed its being a fiduciary duty means that compensation might even be available in cases of potential conflicts where the principal may have lost the opportunity to acquire alternative un-conflicted representation.[42]

Lord Browne-Wilkinson also relied on decisions such as *Bartlett v Barclays Bank.*[43] That decision (like *Nestle v Natwest* above) involved negligent investment and the question of whether reparative compensation included lost profits – ie gains that would have been made had reasonable investment competency been assumed. That would be an account for wilful

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[36] Ibid 439
[37] [1991] 3 SCR 534
[38] Ibid 555
[39] C Mitchell, 'Equitable Compensation for Breach of Fiduciary Duty' [2013] CLP 307, 325
[40] On the distinction between custodial and non-custodial duties see *Bairstow v Queens Moat Houses* [2001] EWCA Civ 712, [53] (Robert Walker LJ)
[41] M Conaglen, 'Remedial Ramifications of Conflicts between a Fiduciary's Duties' (2010) 123 LQR 72, 89
[42] Ibid 92-95
[43] [1980] Ch 515

default, not an account in common form. Lord Browne-Wilkinson confuses two different sorts of account; consequently he makes a substitutive claim into a reparative one. The end result was that Lord Browne-Wilkinson said no loss had been caused and so no compensation awarded. The fraud was the real cause of the loss – and it was not Redferns' fraud. As will be remembered, this is on its face directly contradictory to the decision in *Magnus v Queensland National Bank*. Subsequent to *Target Holdings*, *Lloyds TSB v Markandan & Uddin*[44] decided that a trustee who was innocently duped by a fraudster into releasing money to a transaction that was a total nullity was nonetheless prima facie liable. That seems right. The beneficiary should not take the risk of fraud when avoiding it is the trustee's responsibility.

However, as Conaglen points out,[45] it is possible to render *Target Holdings* consistent with, what I am calling, the absolutist approach. Remember that the mortgage documents were received a few days later (they were not in *Markandan & Uddin*). For Conaglen this heals the original breach with the solicitors acting as the clients' agents in accepting the mortgage and there are cases allowing for no action where the transaction has been corrected.[46] In *ex Parte Pelly*[47] for example the directors made a resolution, never written down, to pay one of their number £3000. In return he advanced £2600 to the company, secured by debentures and spent £400 on advertisements. The payment was a breach of the directors' duties and "the directors who authorized the payment and who made the payment are liable to replace the money as being guilty of a breach of trust unless they can shew that the money has been otherwise repaid to the company."[48] Repayment then cures the breach. In *Target Holdings* the breach was paying out without the mortgage's being executed. At that point it was incumbent on Redferns to do one of two things: first recover the money, and Lord Browne-Wilkinson accepted that they could have been made to do so,[49] or secondly to get in the mortgage documents. This has the same effect. What Target wanted was to have paid out and have a valid mortgage in return. Once both were in place there was simply no breach to compensate. One kink in this is the question whether the financier would be entitled to refuse to accept the mortgage and demand compensation. Edelman argues yes and further that Target did not

[44] [2012] EWCA 65, [2012] PNLR 20; *Davisons Solicitors v Nationwide BS* [2012] EWCA Civ 1626, [2013] PNLR 12
[45] M Conaglen, 'Explaining Target Holdings' (2010) 4 Journal of Equity 288
[46] Ibid 290
[47] (1882) 21 Ch D 492
[48] Ibid 501
[49] [1996] AC 421 (HL) 437

elect this option.[50] Glister by contrast suggests that the trustee was able to remedy the breach unilaterally by getting in the security without worrying about the beneficiary's election.[51] Whichever we prefer, however, it does only explain the result, and not the reasoning.[52]

(B) AIB v Mark Redler & Co

AIB v Mark Redler & Co cannot be rescued in the same way.[53] The facts were almost, but not quite, identical to Target. The claimant bank transferred funds (£3.3m) to a solicitor to be used in a re-mortgage; the prior mortgage owed to Barclays (£1.5m) was be redeemed before completion of the re-mortgage and the remaining £1.8m paid to the mortgagors, the Sondhis. In other words AIB wanted no competition for funds, no priority competition with Barclays. The solicitor paid the money away in breach of trust, the breach being that there was approximately £300,000 of outstanding debt left owing to Barclays after the payments were made (and a corresponding overpayment to the borrowers, who received £2.1m) and AIB's own charge was executed. In other words there was never the opportunity to say that the money was laid out as required by the trust instrument – AIB never got the first ranking charge it insisted on. Ultimately the property sold for £1.2m and claimant received approx. £900,000 – ie the sale price minus what Barclays got. The claimant sought the remaining outstanding sum of £2.4m from the solicitors.

The Supreme Court suggested there was no intention to depart from the normal rule of reconstitution,[54] but nonetheless, as Lord Toulson put it, where the trust is no longer on foot the normal order would be for payment directly to the beneficiary of the amount he would have received minus what he did receive.[55] Along the same lines, Lord Reed said that compensation was limited to what the bank would have recovered had Barclays been paid off - ie compensation was to place the claimant in the position he would have been in had the obligation been carried out,[56] and equitable compensation was the pecuniary equivalent of the performance of the trust. On that basis it was limited to £300,000.[57] Although some have

[50] J Edelman, 'Money Awards of the Cost of Performance' (2010) 4 Journal of Equity 122
[51] Glister (n 8) 155
[52] Ibid 154; Lord Millett, 'Equity's Place in the Law of Commerce' (1998) 114 LQR 214, 227
[53] A Shaw-Mellor, 'Equitable Compensation for Breach of Trust: Still Missing the Target' [2015] JBL 165, 170
[54] [2014] UKSC 58, [2015] AC 1503, [116]
[55] Ibid [31]
[56] Ibid [93]
[57] Lord Millett, 'The Common Lawyer and the Equity Practitioner' (2015) 6 UKSCY 193, 199

suggested the general tenor of the judgments in *AIB v Mark Redler* is that the traditional/commercial distinction should not apply,[58] the ongoing/closed trust distinction remains in that Lord Toulson implies that if the trust were still "on foot" quantum of compensation might be differently worked out.

This is not reflected in the critique of the Court of Appeal[59] made by Charles Mitchell, writing prior to the Supreme Court decision. For Mitchell, defending the absolutist approach, the solicitors should have been liable for the full amount - £2.4m that is the advance of £3.3m minus the £900,000 received from Barclays.[60] On the falsification of the account, we simply assume that the full amount is still present in the account. If that seems unfair, he argues, the trustees should fall back on section 61 Trustee Act 1925, which allows a court to relieve a trustee of liability if he acted reasonably – albeit in breach of trust.[61] It might be thought that relying on a statutory provision as some sort of *deus ex machina* is unsatisfactory and this is precisely Lord Reed's objection. By contrast, he said that the remedy given should "compensate the beneficiary for the diminution in the value of the trust fund which **was caused by** the breach of trust, to the extent of the beneficiary's interest. The measure of compensation is therefore the same as would be payable on an accounting."[62] This, however, rather misses that an account is a procedural step. An account is taken and on the basis of the account equitable compensation is sought.[63]

More importantly Lord Millett argues that the solicitors had paid the money to the bank to discharge the mortgage. This is what they were asked to do. The bank could disallow the £300,000 that left the mortgage undischarged, but the rest was paid correctly because of the pro tanto reduction in the charge and its replacement with a charge owed to AIB.[64] In other words the wrongful payment of £1.2m to Barclays is offset by the credit to discharge the mortgage, but nothing offsets the wrongful payment to the Sondhis. This is how Lord Millett rationalises the case, and it arguably requires us to believe that the breach is divisible, so that all but £300,000 (ie £3m) was correctly paid and not in breach; the only breach was the payment of £300,000. The Court of Appeal decision that £3.3m was paid in breach of trust

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[58] P Turner, 'The New Fundamental Norm of Recovery for Losses in Express Trusts' [2015] CLJ 188
[59] [2013] EWCA Civ 45
[60] C Mitchell, 'Stewardship of Property and Liability to Account' [2014] Conv 215, 227
[61] Ibid 227-228
[62] [2014] UKSC 58, [2015] AC 1503, [91]
[63] *Libertarian Investment Holdings v Hall* (2013) 16 HKCFAR 681, [98-99] (Ribeiro PJ)
[64] Lord Millett (n 57) 204; L Ho, 'Equitable Compensation on the Road to Damascus?' (2015) 131 LQR 213

was not challenged on appeal, although there is a hint that Lord Reed was amenable to the divisible breach argument.[65] Lord Millett says it makes no difference to the trust account. All you do is work out the deficit.[66] There is again a kink.[67] Let us change the fact scenario and imagine that the charge that AIB was to have received was for £800,000. The mistaken overpayment to the Sondhis remains £300,000. In this case with a sale price of £1.2m AIB would have received the full amount. Barclays would have taken £300,000, leaving £900,000 from which AIB could have been paid in full. It seems difficult to believe on the causal analysis that AIB would have received any compensation at all. Yet Lord Millett may be forced to say that AIB would in both these cases be entitled to £300,000 (subject to application of the Trustee Act) which is the unauthorised payment to the Sondhis.

On the particular facts, the answer in *AIB* turns out to be the same as would be payable under an account for wilful default, where the trustee in breach of trust failed to obtain something that would otherwise have been obtained.[68] Here the trustee failed to obtain full discharge of the first mortgage. There is some similarity to the case of *Re Brogden*.[69] In that case Brogden covenanted for the transfer of £10,000 to trustees as part of a marriage settlement. Two of the three trustees were his sons, who ran the family business, from which the money was to come, after his death. The daughter's husband repeatedly pressed for payment and ultimately the daughter sued but recovered nothing because of the firm's bankruptcy. The third, independent, trustee, Budgett, argued that attempts to recover the money earlier from the sons would have failed. The sons were, as partners in the business, liable themselves to pay and Budgett's obligation was to demand payment and take steps to enforce payment. However, Budgett was obliged to prove what he would have recovered had he tried to do so if he was to reduce his liability.[70] In *AIB* it is absolutely clear what the claimants would have recovered had the defendants done their duty: £300,000. The trustee is therefore able to discharge his burden of proof in reducing the liability. The effect is therefore not merely to prioritise reparative over substitutive awards, but to marginalise falsification of account in common form and prioritise an account for wilful default. Penner puts it slightly differently. He argues that the ratio of the decision is that a beneficiary is disentitled from falsifying the account, but

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[65] *AIB v Mark Redler & Co* [2014] UKSC 58, [2015] AC 1503, [140]. It is also how HHJ Cooke argued the case at first instance. [2012] PNLR 16, [24]
[66] Lord Millet (n 57) 205
[67] D Whayman *The Decline of the Axiomatic Method in Equity* (Newcastle PhD Thesis 2016) 118-119
[68] *Meehan v Glazier Holdings Pty Ltd* (2002) 54 NSWLR 146, 163
[69] (1888) 36 Ch D 546
[70] Ibid 568

the unauthorised payment is a wrong sufficient to allow the surcharging of the account as if the correct asset (a first mortgage) had been obtained, but he also points out that it is far from clear in what circumstances a beneficiary might be so disentitled.[71]

Lord Toulson in fact takes a different tack from either rationalisation of the case. He accepts that the argument in *Magnus* that the fraud would have happened anyway was a bad one,[72] and therefore that there are limits to the causation argument. Yet the scenario in *AIB* was entirely different from *Magnus* because the bank took the risk of the borrowers' default. The beneficiaries in *AIB* had already accepted that loss might be caused to them by the security being inadequate. In *Magnus* the trustees are treated as insurers,[73] and they are not treated as such in AIB. On the facts, this is because AIB accepted the wrongful disbursement,[74] and agreed with Barclays a deed of postponement acknowledging the primacy of the Barclays charge in return for which Barclays consented to the registration of the appellant bank's charge as a second charge. As a result they adopted the £1.2m payment to Barclays and cannot complain about it. Indeed Penner goes rather further and argues that AIB should recover nothing because they accepted the disbursements. It is a composite transaction and so the beneficiary cannot adopt one payment (the £1.2m to Barclays) and falsify (at least part of) the other (the £2.1m to the Sondhis).[75] However, while the extra £300,000 paid to the Sondhis by mistake cannot be split from the £300,000 not paid to Barclays, it can be split from the money in fact paid to Barclays. Lord Toulson characterised the alternative view that the solicitors must pay the whole sum[76] as requiring the obligation to be in the way of debt. There are of course cases that describe it thus,[77] but Lord Toulson could not see the purpose of an equitable debt imposed where even if the obligations had been carried out properly there would have been a loss.[78] Yet unless we wish to effectively prioritise surcharges for wilful default over falsification, or turn falsification into just another way of saying breach of

[71] J Penner, *The Law of Trusts* (10th edn, OUP, 2016) para 11.42
[72] [2014] UKSC 58, [2015] AC 1503, [58]
[73] Conaglen (n 27) 139
[74] Penner (n 71) paras 11.43-11.44; *AIB Group v Mark Redler & Co* [2014] UKSC 58, [2015] AC 1503, [6] (Lord Toulson).
[75] Penner (n 71) paras 11.44, 11.48
[76] [2014] UKSC 58, [2015] AC 1503, [50]
[77] *Ex p Adamson; In re Collie* (1878) 8 Ch D 807
[78] [2014] UKSC 58, [2015] AC 1503, [62]

trust,[79] a distinction between *AIB* and cases like *Magnus* needs to be found. This brings us to the final section.

(3) Balancing the Two Approaches

Those who defend the absolutist approach tend to argue that the account in common form is enforcement of the trustees' custodianship and amounts to a kind of substitute performance,[80] or equitable debt.[81] As such causation and remoteness are always irrelevant. This where the dilemma explored in *AIB* seems to emerge. The most extreme version of the flexible approach is that any losses counterfactually caused by the breach are recoverable and any losses not so caused are not. This view is under-inclusive. The logic is that the beneficiary can obtain no compensation in Penner's Hatton Gardens example.[82] Yet this is not the law. In that example the defaulting trustee removes jewellery subject to the trust from the vault, but enterprising burglars then drill their way in and take everything. The trustee cannot argue that the necklace would have been taken anyway and the beneficiary must stand the loss, and that seems right. It is also over-inclusive. It raises an issue around consequential losses and when it is appropriate for those to be available in equity.[83] We usually require consequential losses to be foreseeable, but Lord Reed acknowledged the general irrelevance of foreseeability in the context of breach of trust.[84] In this he follows the position taken by both LaForest J and McLachlin J in *Canson*. Both judges indicate that compensation for breach of fiduciary duty will not be limited by foreseeability.[85] Although Lord Reed is right that foreseeability is irrelevant, the reason in the breach of trust case is different from the non-custodial fiduciary duty context. When McLachlin J states that foreseeability is irrelevant she suggests the considerations applicable in respect to breach of fiduciary duty are more analogous to deceit than breach of contract. A fraudster does not get to mitigate the impact of his fraud.[86] Neither

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[79] J Glister and J Lee (eds), *Hanbury and Martin: Modern Equity* (20th edn, Sweet and Maxwell, 2015) para 24.012

[80] LD Smith, 'Measurement of Compensation Claims against Trustees and Fiduciaries' in E Bant and M Harding (eds), *Exploring Private Law* (CUP, 2010) 363, 372-373

[81] *Re Collie, ex p Adamson* (1878) 8 Ch D 807

[82] Penner (n 71) para 11.46

[83] P Davies, 'Compensatory Remedies for Breach of Trust' (2016) 2 Canadian Journal of Contemporary Comparative Law 65, 78

[84] [2014] UKSC 58, [2015] AC 1503 [135]

[85] [1991] 3 SCR 534, 545

[86] *Doyle v Olby* [1969] 2 QB 158

by the nature of the duty does a fiduciary;[87] the reasoning behind this is that a fiduciary is by the nature of the obligation he took on obliged to act in the best interests of his principal. Those best interests mean compensating him for any and all losses caused by a failure to do so in the first place. This reflects a rather different rationale to that in the case of equitable compensation for breach of trust where the account is retrospectively falsified and the trust estate reconstituted. There foreseeability is irrelevant because quantum is already limited by the amount paid out.[88] Liability is limited because the trustee does not take responsibility for the further risk of the effect of mismanagement on the beneficiary's wider affairs.[89] Barnett points out that this approximates to the contractual position,[90] and it does once again raise the question of what losses the trustee takes responsibility for.

Might we balance the two approaches by assimilating contract damages and equitable compensation? Lord Toulson does attempt to equate equitable compensation and contract damages[91] in at least some cases. This is a suggestion he derived from David Hayton.[92] However, Hayton is only suggesting that to the extent the claimant is seeking consequential losses common law principles should be applied and the logic of looking to contractual principles actually excludes liability for consequential loss. The argument for assimilating them, however, is this. The relationship between the lender and the solicitors is essentially governed by the contract between them; the trust on this view is merely ancillary, a mechanism for carrying out the contract and so the remedies between contract and trusts law ought to be consistent. Trusts law on this view is protecting an interest akin to the contractual performance interest. This is not a new view. In *Bank of New Zealand v New Zealand Guardian Trust Co. Ltd*[93] Tipping J argued that where the wrong amounted in substance to a breach of contract the rationale for the stricter approach did not apply.[94] Man Yip and James Lee have argued recently that the implication (perhaps unintended) of the speeches in *AIB* is

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[87] *Collins v Brebner* [2000] Lloyds Rep PN 587; S Elliott, 'Remoteness Criteria in Equity' (2002) 65 MLR 588, 592, but contrast *Swindle v Harrison* [1997] 4 All ER 705 (CA) 717 (Evans LJ)
[88] *Robinson v Robinson* (1851) 1 De GM & G 247, 42 ER 547
[89] J Glister, 'Breach of Trust and Consequential Losses' (2014) 8 Journal of Equity 235
[90] K Barnett, 'Equitable Compensation and Remoteness: Not so Remote from the Common Law After All' (2014) 38 UWALR 48, 68-69; D Whayman, 'More Clues as to the Nature of the Remedy for Breach of Trust [2017] Conv 139, 140
[91] [2014] UKSC 58, [2015] AC 1503 [71]
[92] D Hayton, 'Unique Rules for the Unique Institution: The Trust' in S Degeling and J Edelman (eds), *Equity in Commercial Law* (Lexis, 2005) 279, 304-306
[93] [1999] 1 NZLR 664
[94] Ibid 688

that different rules might apply where the trust is accompanied by a contract or when not.[95] That type of bifurcated approach cannot be appropriate; it risks treating like trusts cases differently because of the presence or absence of an entirely different legal mechanism – the contract.

We need therefore to find another way to reconcile the cases. Let us look at matters the other way and take seriously the idea that the trustee must account for his custodianship of the assets to the beneficiary. The sanctity and special nature of the trust relationship appears at the heart of the High Court of Australia's approach to equitable compensation in *Youyang Pty Ltd v Minter Ellison Morris Fletcher,*[96] and a comparison with *AIB* might assist. Youyang agreed to invest A$500,000 in ECCCL, and entered an agreement with them to that effect. Youyang paid the money to Minter Ellison who subsequently paid it out in breach of trust; the first payment was not secured properly, and the second payment (A$220,000) to ECCL as working capital could only be made on that security for the first payment being obtained in the form of a negotiable bearer certificate. ECCCL went bankrupt and Youyang received nothing. The High Court suggested that

> However, there must be a real question whether the unique foundation and goals of equity, which has the institution of the trust at its heart, warrant any assimilation even in this limited way with the measure of compensatory damages in tort and contract. It may be thought strange to decide that the precept that trustees are to be kept by courts of equity up to their duty has an application limited to the observance by trustees of some only of their duties to beneficiaries in dealing with trust funds.[97]

We can distinguish *Youyang* and *Target* on the basis the breach was not cured in *Youyang*;[98] the required negotiable bearer certificate was never acquired. It is less clear that *Youyang* and *AIB* are compatible,[99] precisely because in neither case were the correct documents acquired. The causal analysis adopted in *Target Holdings* and the lower courts in *Youyang* would, according to Conaglen, require that Youyang only receive interest once its entitlement to the A$500,000 crystallised in 2003. Interest in fact ran, it was decided, from the date of the

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[95] M Yip and J Lee, 'The Commercialisation of Equity' (2017) 37 LS 647, 655-656; see also *Purrunsing v A'Court & Co* [2016] EWHC 789, [42]
[96] [2003] HCA 15, (2003) 196 ALR 482
[97] Ibid [69]
[98] Conaglen (n 45) 293-294
[99] PS Davies, 'Remedies for Breach of Trust' (2015) 78 MLR 672, 690

unauthorized payment in 1993. Conaglen therefore argues that *Youyang* is only consistent with the traditional view of falsification of the account.[100] As we have seen, ECCCL went bankrupt and so even if the bearer bonds were received Youyang would have received nothing; importantly the High Court cited *Magnus v Queensland National Bank* for the proposition that the fact the money would have been lost anyway did not matter.[101] The loss occurred as soon as the wrongful disbursement was made.

The logic of the Australian Court's position is that in *AIB* the trustee's liability is the value of the mistaken payment when made, no matter if the loss is in point of fact lower. It was a condition of both payments in *Youyang* that a negotiable bearer certificate be obtained. In AIB it was a condition of both payments (to Barclays and the Sondhis) that the prior mortgage be discharged. At the very least that requires liability of £1.8m (the amount that was paid to the Sondhis) and quite possibly – to be consistent with *Youyang* – the whole £3.3m. Lord Millett, however, as we have seen, argues that the net value – reduced with the benefit of hindsight – of the breach in AIB was £300,000.[102]

The question becomes the extent of the relevance of hindsight. In *AIB*[103] for example we are told that the commercial purpose of the trust is complete. "Complete" cannot mean performed perfectly, but rather that there are no further active obligations to perform, arguably also true of *Youyang*. This could be key. It is hard to see why a beneficiary has an interest in keeping a trust on foot – ie resetting it – when its commercial purpose is complete. That provides the distinction with cases such as where a gemstone kept in Hatton Gardens is sold by the trustee but would have been stolen the following day anyway. The purpose of the "Hatton Gardens trust" is not complete.

The actual remedy fashioned in *AIB* also neatly satisfies the requirements of corrective justice. Zoe Sinel[104] argues that corrective justice simply provides reasons for allocating back. The original obligation to do something – or not do it – is separate from the remedial obligation, but the explanation for the remedy must lie in an understanding of the original

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[100] Conaglen (n 27) 163
[101] (2003) 212 CLR 498, [63]
[102] *Libertarian Investments v Hall* [2013] HKCFA 93, (2013) 16 HKCFAR 681, [168] (Lord Millett)
[103] [2014] UKSC 58, [2015] AC 1503, [74] (Lord Toulson)
[104] Z Sinel, 'Concerns about Corrective Justice' (2013) 26 CJLJ 137

obligation.[105] That is important because for Sinel, the original reason for the obligation remains even after failure to conform. The remedy should be the next best thing and in our context the remedy in *AIB* is the next best thing. It renders Mark Redler & Co a guarantor for the unsecured part of the loan and thus provides next best conformity to AIB's being fully secured given that performance was not in fact forthcoming.[106] It also satisfies any performance interest by giving the claimant what he would have had in the absence of any breach. If the trust is ongoing, the remedial obligation to reset makes sense. It remains possible to make it as if the breach had never happened in the first place, but if the trust is not ongoing to try to reset the world goes further than the requirements of corrective justice and the performance interest by potentially giving the claimant something better than performance.

James Penner points out a number of cases which seem inconsistent with an expansive understanding of *AIB*.[107] He is right to say that they are inconsistent with the expansive view, but they are not inconsistent with this more restrictive interpretation. Indeed given Lord Toulson's acceptance that *Magnus v Queensland National Bank*, where the trust was still on foot, is correct, the expansive view may be inconsistent with *AIB* itself. Two of Penner's counter-examples we have already seen – the Hatton Gardens example and consequential losses (eg loss of a profitable investment opportunity). We examine another three. Penner's approach is similar in all these cases. Essentially he looks at the counterfactual. What would the result have been had there been no breach of trust? In each the counterfactual suggests a loss of zero. He raises[108] firstly *Twinsectra v Yardley.*[109] In that case the first solicitor had been unwilling to provide a guarantee to the lender to cover a loan for the purchase of land. A second solicitor, who subsequently went bankrupt, did give that undertaking and that the loan would only be used for the purchase of property. He released the money to the first solicitor who on the instructions of the client used it for other purposes. This was a bare trust, much as was the trust in *AIB v Mark Redler.* The second solicitor – the trustee – being bankrupt the lender sued the first solicitors arguing that they had notice of the terms of the trust and were dishonest assistants. The first solicitors were held not to have been dishonest, but critically no decision on dishonest assistance would have been necessary except on the view that there was

[105] Ibid 138, 148
[106] Ibid 153-154
[107] J Penner, 'Falsifying the Trust Account and Compensatory Equitable Compensation' in S Degeling and J Varuhas (eds), *Equitable Compensation and Disgorgement of Profits* (Hart, 2016) 143
[108] Ibid 151-152
[109] [2002] 2 AC 164

liability for breach of trust on the part of the second solicitor. Irrespective of the breach, the loss, according to Penner, was caused by the solicitor's insolvency. The loss would have happened anyway and no compensation should be payable. The answer is that it is only in cases where the commercial purpose of the transaction is complete that *AIB* operates. By failing to take steps to ensure the proper application of the funds, the solicitors failed to ensure this so the two cases are not inconsistent. In other words the difference is that in *Target* and *AIB* the money was used to buy the property (although deficiently); here it was not used to buy the property.

A second decision Penner points to[110] is *Thanakharn Kasikhorn Thai Chamkat v Akai Holdings.*[111] There Ting, who did not act with the authority of the Akai board, entered into a loan transaction, secured on the pledge of shares. The loan moneys were used to discharge a loan to Singer in which Ting had an interest. Akai defaulted and the bank sold the shares. Lord Neuberger accepted that Akai was better off because of the bank's sale of the shares.[112] The bank was liable not merely for conversion, but also knowing receipt, because it should have known Ting had no authority. Again Penner examines the counterfactual. What would have happened had there been no breach? The bank would have hung onto worthless shares and the loss would have caused anyway. No compensation should have been payable. Yet no consent to Ting's ever entering the transaction was ever given. Consequently there was – unlike in *AIB* – never any authorised commercial purpose, and so the authorised transaction could never have been completed deficiently or otherwise.

Penner may well object that these are fine distinctions; perhaps he will object that they are unworkable distinctions without differences. *Various Claimants v Giambrone & Law,*[113] however, provides an early indication of the courts' approach. The law firm released monies held on trust on receipt of guarantees from institutions listed under art 106 – as opposed to those listed under art 107 – of the Italian Banking Law. That was a breach of trust, but Giambrone argued that the loss would have been caused anyway even if guarantees from an appropriate institution had been received. The Court of Appeal rejected this, arguing there was a causal link between breach and loss and that since the law firm was not responsible for obtaining the guarantee no active duty had been breached just the custodial duty. In both

[110] Penner (n 107) 152-153
[111] [2010] HKCFA 64, (2010) 13 HKCFAR 479
[112] Ibid [154]
[113] [2017] EWCA Civ 1193, [2018] PNLR 2

Target and *AIB* the duty breached was active as the firm had a specific duty to secure a given result before releasing the monies. That seems a dubious distinction, but Davies argues that it reflects a view that the commercial purpose of the transaction was not fulfilled because the proper guarantees were not received[114] - as opposed to just guarantees. That would allow the parties to dictate what constitutes completion.

Finally,[115] Penner raises the distinct case of a trustee selling trust shares, paying off £100,000 of his own debts, and then buying back the shares when they have fallen in value. The beneficiaries are in the position they would have been in had he not sold the shares; according to the counterfactual scenario loss is zero. We do not, however, and should not leave the beneficiary without a remedy. For Penner the beneficiary adopts the sale of the shares, falsifies the account, and asks for the £100,000 plus interest. That remains the correct answer. The trust is ongoing. Resetting is appropriate. That said, the same result can be arrived at by taking the misapplication as a breach of trust – not a breach of fiduciary duty[116] – and asking for an account of profits to strip the trustee of the unauthorised gains. There seems little reason after all not to allow an account of profits where the trustee has made a profit in such a way as to cause the trust no loss.

(4) Conclusion

The position that we have reached therefore is that the trustee should not be taken to be responsible because he has never accepted responsibility, once the transaction is complete and its authorised commercial purpose ended, for losses out of his control and which would have been suffered anyway. He can be held responsible where there is no effectively completed and authorised transaction. While we always hold fiduciaries and trustees to extra-high standards and we require the trustee to prove the loss was inevitable, we do not ignore reality, risks knowingly taken on by the beneficiary and the importance of the closed/on-going trust dichotomy. The argument must revolve now around whether this suggested more restrictive interpretation of the English decisions is workable.

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[114] PS Davies 'Equitable Compensation and the SAAMCO Principle' (2018) 134 LQR 165
[115] Penner (n 107) 153-154
[116] This is a possibility Penner discusses ibid 154