Asset tracing and recovery reassessed

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Professional Liability & Regulatory Conference

4 February 2020

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Nicole Sandells QC

Call: 1994 Silk: 2018

Nicole's practice in recent years has focused heavily on financial and property law, civil fraud, restitution, trusts, probate and equitable remedies alongside Chambers' mainstream professional indemnity work. She has significant experience of unjust enrichment, subrogation, breach of trust and fiduciary duty claims. She is never happier than when finding novel answers to tricky problems.

Nicole is described as ***'a mega-brain, with encyclopaedic legal knowledge and the ability to cut through complex legal issues with ease'*** *and* ***'a master tactician who is exceptionally bright and has a fantastic ability to condense significant evidential information'*** (Legal 500). Apparently, she is also ***"exceptionally bright and a ferocious advocate. She gives tactical advice and is a pleasure to work with. Clients speak extremely highly of her." "If you want someone to think outside of the box and really come up with an innovative position, then she's an excellent choice."*** – Chambers & Partners, 2020 Professional Negligence.

Her practice has given her the opportunity to argue a number of 'interesting' legal points in the Court of Appeal – such as *MAS(No 2) Ltd v. Chater* (undue influence), *Mortgage Express v Filby* (subrogation, unjust enrichment, restitution), *Bradford & Bingley v Rashid* (also House of Lords, limitation, acknowledgment), *Bank of Scotland v Joseph* (land registration, priority, unilateral notices), *Lloyds TSB Bank plc v Markandan & Uddin* (breach of trust, completion of conveyancing transactions), *Re North East Property Buyers* (overriding interests, trusts), *Mortgage Express v Lambert* (overriding interests, overreaching, subrogation), *NRAM v Evans* (mistake, rectification and land registration) and *Swynson v Lowick Rose* (the subrogation and unjust enrichment elements). Most of those were, she says, good examples of the kinds of claims advocated in her talk today.

She enjoyed two trips to the Supreme Court in 2014 (*Re North East Property Buyers* and *AIB v Redler)* followed by *Swynson v Lowick Rose* in 2016. Her trip to the Privy Council in July 2019 was less fun – since it was the first time she had lost in that building! Publicly, she claims the time will come for her innovative solution to a Ponzi scheme. Privately, she grudgingly admits that you can't win them all.

Miles Harris

Call: 2003

Miles conducts a wide range of commercial litigation specialising in professional liability, insurance, property damage and disciplinary work. He has been recommended by the legal directories in the field of professional negligence for many years.

Kind comments in the directories have included: ***"All that he does is measured, calm and wise"*** - Legal 500 ; ***"You want him in your corner for a tricky application hearing"*** **-** Chambers & Partners **and** ***"He provides silky smooth drafting skills and a very calm and measured approach – an absolute joy to work with."*** - Legal 500

Miles acts in a wide range of cases within his areas of expertise, led and unled, from straightforward to complex high value multi-party disputes, from the County Court to the High Court and the Court of Appeal. He has also been published and lectured widely, especially in matters related to the civil liability of lawyers and insurance. Miles is also an established and accredited mediator, accepting instructions in a range of civil disputes.

Miles has wide experience of all issues relating to professional liability including associated claims for recovery. He has represented both claimants and defendants in matters involving solicitors, barristers, licensed conveyancers, surveyors, managing agents, insurance brokers, financial advisers, tax consultants, accountants, auditors, architects and veterinary surgeons.

ASSET TRACING AND RECOVERY REASSESSED

Tricks and tools for the professional liability lawyer

Nicole Sandells QC and Miles Harris

Introduction

Professional liability claims, especially claims against solicitors, frequently arise in circumstances where assets have been misappropriated or misallocated or a transaction is void, voidable or otherwise defective for reasons that are the professional responsibility of the defendant – but where he can feel genuinely aggrieved at being held liable while others take a windfall.

Despite this sense of grievance, claimants more commonly pursue claims for damages against the apparently easy target with the deep pockets rather than the primary villain. However, a claimant in such circumstances may be concerned about the hurdles of establishing breach or perhaps face significant issues with causation or contributory negligence or insurance coverage – and should have mitigation, and indeed loss, in mind. After all, if he has a proprietary claim to the missing asset, which can be traced and claimed – where is the loss? And while a defendant facing a claim in such circumstances (or more especially his insurer) may feel understandably irritated that the stationary and insured target is obliged to shoulder the burden of such a claim while the parties who have actually benefited from the defect in the transaction or the misappropriated monies keep their ill-gotten gains, he will need to offer – or demand - an alternative.

And don't forget the elephant in the room – insurance cover can be pulled. Even solicitors' minimum terms allow cover to be pulled for dishonesty in specific circumstances – and other professionals often have less generous terms. If the claim that has to be pleaded to make the case against the professional runs the risk of avoiding the policy, then looking to alternative claims and seeking the assistance of the professional and his insurer may give a better prospect of recovery. And if there's a straightforward asset recovery claim, insurers might consider funding that rather than an expensive fight over cover …

It is in such circumstances that it is invaluable to have a sound knowledge of the substantive principles relating to asset tracing and recovery so that, whether one's client is a potential claimant or a potential defendant, an assessment of strategy and tactics is fully informed and all options are considered. Should the claimant pursue recovery action before seeking damages from a solicitor? Should the solicitor or its insurer take an assignment of any such rights, or offer an indemnity to a potential

claimant to allow them to enforce them? Should they indeed join forces to track and claim the missing asset?

The aim of this talk is to examine the substantive principles relevant to tracing and recovery actions with an eye to this context, although, of course, the legal principles relating to such actions apply whether or not they arise in a professional liability context.

OVERVIEW

For the purpose of tracing and enforcing against assets, there are two basic types of claim – and one oddity. The easiest starting point is to consider the nature of the underlying claim. How are you going to vindicate your claim? What is your legal argument for claiming the asset?

The big question - is your claim proprietary or personal?

The answer will dictate the remedies available – and it can change during the course of a claim or an investigation.

Asset recovery really only applies to proprietary claims - the clue is in the name. The aim is to recover assets belonging to the claimant – rather than seek damages or compensation for assets that have been lost.

PROPRIETARY v PERSONAL – AND THE WILD CARD

Proprietary claims assert ownership of property in the hands of another – a claim against the asset not the person. They arise from theft/misappropriation, breaches of trust, and some breaches of fiduciary duty. The claim is simple – "That is mine. Give it back".

Personal claims are made against the person, not the property – the damages claim against the aggrieved professional/insurer. They arise where the property has been lost and the claim is for damages or compensation – against the wrongdoer, accessories, or third parties. The claim is more complex - "I can't get it back – compensate me" – and there is little scope for asset recovery as such. Unjust enrichment is an oddity. It is not a proprietary claim – title has passed, which is what gives rise to the injustice. Restitution is a remedy granted not on the basis "it's mine", but on the basis "it should be mine – please reverse it and make them give it back."

Because the remedy is a reversal of the transaction, or a form of specific performance, it is very close to a proprietary remedy – and tracing procedures can be relevant in such claims.

PROPRIETARY CLAIMS

Proprietary claims are based on a simple premise – until property passes through a completed transaction designed to pass title, it remains the property of the original owner who can reclaim it from whoever is holding it.

Where property passes from A to B under a completed contract, property passes even if the contract is voidable. If it is merely voidable, while it is subject to being unwound, the unwinding needs to happen before you can claim the property – so you need to skip to unjust enrichment.

However, where the contract is void, property remains with the original owner – subject to equity's darling. The claim is as simple as "that is mine, you must give it back" – unless you are a bona fide purchaser for value without notice.

Since that is the simplest way to recover assets – and the hardest to defend – it pays to start by looking for a trust, or a breach of fiduciary duty.

TRUSTS

Trusts are not limited to private client or traditional Chancery situations. They can – and do - arise in all kinds of commercial contexts. Any time assets belonging to A pass through or to the hands of a third party without the beneficial interest also passing there is a good chance that a trust has arisen. Don't forget – trusts include express, implied, bare, constructive, resulting, and *Quistclose* purpose trusts.

Target Holdings v Redferns [1996] AC 421 started the "commercial trusts" ball really rolling– the basic point to take from the case is: "moneys held by solicitors on client account are trust moneys" and "the basic equitable principles apply to any breach of such trust by solicitors".

That raises the obvious fact that any claim that involves money passing through a client account, or indeed any agent's account, will raise the possibility of a trust claim.

In considering whether there is a trust, the basic questions are always: who is the asset held for? and what are the terms on which the asset is held? If the person holding the asset does not own it legally **and** beneficially, then there is likely a trust. If he does – you are back to looking at unjust enrichment.

If you are looking to asset trace and recover, then the following are the basic questions:

- What is the asset in question?
- Who owned it at the beginning?
- Why did it pass out of his possession/control?
- Where did it go?
- Did it then belong to the person possessing or controlling it?
- If not, on what terms was he holding it?
- Did he deal with it on those terms?

If the person holding the asset does not own it and he did not deal with it on the terms on which he held it – you probably have the basis of a trust claim.

If he does own it and/or has dealt with it in accordance with the terms on which he holds the asset – there is no trust claim.

If there is no simple breach of trust, is there is breach of fiduciary duty claim which can preserve the proprietary claim?

If not, is there an unjust enrichment or restitutionary claim?

FIDUCIARY DUTY

Fiduciaries owe duties of loyalty. They may owe other duties as well, but a breach of *fiduciary* duty involves the breach of a duty of loyalty – such as acting in conflict. There is no such thing as a negligent breach of fiduciary duty – it involves a deliberate or conscious decision to act inconsistently with the duty. This is a fundamental difference from a breach of trust, which can be negligent – or even completely innocent.

It is also a giant red flag in the professional liability/insurance context. Follow the thought – if a breach of fiduciary duty requires the conscious and deliberate preference of one client over another, or of

the professional over the client, just how far is that from dishonesty, or whatever the policy avoidance clause happens to be in the particular insured's contract? As a claimant, ALWAYS think very hard about the consequences of alleging breach of fiduciary duty – and go for simple breach of trust if you can!

The most authoritative case is *Bristol and West Building Society v Mothew* [1998] Ch 1

Many breaches of fiduciary duty will not give rise to a proprietary remedy – although the law is complex and moving on this point, as can be seen from the law on recovery of bribes. However, if the breach involves moving assets you treat it like a breach of trust giving rise to a proprietary claim – and look for an asset to reclaim. This is particularly useful in company cases. For example, a breach of fiduciary duty by a company director which results in payments out that should not have been made is the equivalent of a breach of trust and will give rise to a proprietary claim – unless the asset is in the hands of equity's darling. If it is, then you have to fall back on personal remedies.

UNJUST ENRICHMENT

The modern root of unjust enrichment is *Banque Financiere de la Cite v Parc (Battersea) Ltd* [1999] AC 221, which gave us the current test for unjust enrichment:

- Has the defendant been enriched?
- Was the enrichment at the expense of the claimant?
- Was that enrichment unjust?

It ***should*** be obvious that those questions can only be answered affirmatively if the claimant has lost something which has ended up in the defendant's hands. There has been some form of direct transfer – it used to be known as the "direct providers" rule.

However, a raft of recent cases illustrated that a lack of analysis had led to some serious confusion about when unjust enrichment arises – and when it doesn't. Even the Supreme Court got lost – as can be seen from a quick glance at *Bank of Cyprus v Menelaou* [2016] AC 176.

The convoluted reasoning of the majority, including Lord Neuberger, led to some strange attempts to create exceptions to the direct providers rule, and direct attacks on the basic principles underlying unjust enrichment. *Menelaou* has been roundly criticized – not for the result but for the route followed to get there.

It was clear that some re-assessment was required. Unjust enrichment was losing its usefulness and becoming entirely unpredictable.

The appeal in *Investment Trust Companies v Revenue & Customs Commissioners* [2018] AC 275 ("*ITC*") required the Supreme Court to address the real meaning of the *Banque Financiere* test and fix the muddle created by *Menelaou*. Lord Reed did not shrink from the task or spare Lord Neuberger's blushes:

- The existing tests for whether enrichment was at the expense of the claimant – "sufficient nexus" or "proximity" - were too vague and failed to answer the critical question;
- The Court had a responsibility to establish more precise criteria, given the uncertainty resulting from the use of "vague and generalized language".

Lord Reed set out the new criteria in [38]-[66] - including a few timely reminders:

- Unjust enrichment is dealing with personal not proprietary claims;
- It is based on legal principle not discretion or an amorphous concept of "fairness";
- The rules must be easily ascertainable and consistently applied;
- The *Banque Financiere* test provides a structured approach which should underpin, not dispense with, a careful legal analysis;
- The purpose of "unjust enrichment" is to correct normatively defective transfers of value – restitution is the most common remedy precisely because it restores the disrupted balance;
- The Court is searching for a defect recognized by law which has resulted in a gain to the defendant at the cost of the claimant;
- Incidental benefits do not count.

This illustrates why unjust enrichment is relevant to asset recovery. It does not give rise to proprietary remedies BUT, if the transfer is complete but defective so there is unjust enrichment, the remedy is restitution. Since restitution unwinds the defective transaction and restores the property to the claimant, it is effectively a proprietary remedy with an added step. The added step comes first, making it easier to evade, but if the property can be found in the hands of someone who has been unjustly enriched, it can be recovered.

ENFORCING PROPRIETARY CLAIMS

If you have found the basis for a proprietary claim – or an unjust enrichment – the next step is to enforce it, which means you have to find the asset. The questions are: where is it? and how did it get there? The first is practical, the second sets up the legal basis for the claim.

PRACTICALITIES – WHERE ARE THE ASSETS?

The first step is to find the assets – there is no claim if you can't find them.

The CPR provides some assistance in obtaining information about where assets are, particularly in Part 25, Interim Remedies. See, for example:

CPR 25(1)(g) – orders to provide information about the location of assets;

CPR 25(1)(h) – search orders.

There are, however, other routes outside the procedural code. Often, a claimant will want to see documents such as ledger cards, banks statements, transaction slips, company records and books, or underlying financial documents. There are contractual, trust and agency arguments to support such claims – which take the claims out of the realms of procedural discretion.

CONTRACT

In terms of contracts, the claimant may have contractual rights to claim the relevant documents from his own solicitors, accountants, agents, or even his bank – whether they are implicated in the wrongdoing or not. Less obviously, he may also have the right under a contract with the wrongdoer to see the wrongdoer's documents in the hands of third parties – even the wrongdoer's solicitor. It is always worth reviewing any and all contracts to see if there is any right to documents and information – or any waiver of rights.

A common answer to such a request is that confidentiality or privilege apply. It should be remembered that unless the documents requested contain any form of legal advice, there is no issue of privilege – see *Nationwide v Various (No 1)* [1999] PNLR 52 at 76. As to confidentiality - that only applies to the parties whose financial interests are recorded in the documents. If the documents deal with the claimant's assets or interests, it is the claimant's confidentiality that is to be protected – not that of the wrongdoer.

TRUST

Trustees owe duties to beneficiaries to keep proper records of their handling of the beneficiaries' assets. The trust, and the obligations imposed thereunder, entitle the beneficiary to demand sight of any document which forms part of the trustee's record of its dealings as trustee - see *Schmidt v Rosewood Trust* [2003] 2 AC 709.

Schmidt provides that:

(1) Beneficiaries' rights to seek disclosure of documents are part of the Court's inherent and fundamental jurisdiction to supervise/intervene in the administration of a trust;

(2) The right to inspect documents is founded upon the trustee's fiduciary duty to keep the beneficiary informed, and to render accounts; and

(3) There may be circumstances where an absolute beneficiary can be denied access to documents, such as the competing interests of other beneficiaries, but those circumstances are very limited, such as cases where there are competing interests and release to the requesting beneficiary may harm the interests of other beneficiaries.

The boundaries of *Schmidt* have not yet been fully tested. In circumstances where it is being used not to seek an advantage over other beneficiaries, or to question choices made by trustees between beneficiaries, but to uncover and cure a breach of trust, it seems likely that it will be applied broadly, in line with the general trend of cases dealing with recovery of misappropriated assets. It also seems likely that it will be applied beyond cases of express trust – and may even be available in constructive trust cases by analogy, in the right circumstances.

AGENCY

A principal also has an entitlement to documents from his agent. There are three particularly useful cases: *Dadswell v Jacobs* (1887) L.R. 34 Ch. D. 278, *Re Burnand* [1904] 2 KB 68 and *Yasuda Fire & Marine Insurance Co v Orion Marine Insurance* [1995] QB 174.

Dadswell makes clear there is an absolute duty imposed on an agent to deliver up accounts kept for a principal, and that the principal has an absolute right to inspect accounts kept by the agent of his dealing with the principal's property. This will include the underlying and supporting documents.

Re Burnand is to the same effect. In that case a Lloyds agent kept ledgers recording his transactions with and for 5 names. It was held that the names had joint property in the ledgers and were all entitled to possession of them, and rights of inspection.

Yasuda provides that a principal is entitled as a legal consequence of the agency relationship to continuing access to the agent's records relating to acts done in the principal's name unless that right was expressly excluded by any contract between them.

LEGAL BASIS - HOW DID THEY GET THERE?

Once you know where the assets are, you then need to use the information to establish how they got there from the claimant in order to establish a legal claim. The Chancery concepts of tracing and following are used to establish that the property you have found came from the claimant and can be reclaimed – on a proprietary basis or by way of unjust enrichment.

The claim will either be to the original property, or its replacement, in the hands of the recipient, or, if that recipient is equity's darling, the claim will be to the purchase price paid by him for the asset – and this is where tracing and following come in.

Where assets are disbursed in breach of trust, or misappropriated, they are *followed* into the hands of the recipient – see *Lewin on Trusts*, 41-003. If they remain in the same form in which they were disbursed, they can be reclaimed from any recipient who is not equity's darling – no matter how long the chain of transactions. If they do not remain in the same form, the assets can be *traced* into any replacement property which has been substituted for the original (subject to any barriers which may have arisen) – *Lewin*, 41-005. They may be in a different form either because the recipient has converted them – eg spent money on a diamond necklace – or because they have been converted into the purchase price received from equity's darling. Traced assets are therefore claimed *either* from the recipient of the property *or* the recipient of the price from equity's darling. It is simply a matter of identifying what asset represents the trust property/misappropriated asset, and which recipients are vulnerable to a claim.

You can make proprietary claims not just to chattels or to land, but also to more amorphous property such as charges, liens, or even covenants to pay, contractual debts and other assignable rights – which is where subrogation can come in.

EQUITABLE SUBROGATION

This is, of course, a distinct concept from insurance subrogation – and much more fun and flexible!

Equitable subrogation at its most basic means stepping into the shoes of a third party to enforce the third party's rights against a defendant. It applies where the claimant intended to get rights but failed, and a third party had those rights but no longer needs them, as a result of something the claimant did. For example, A has mortgaged his property to B. A wants to remortgage and C offers to lend him the money in exchange for a mortgage. C pays the money to B, which clears the existing mortgage, but A doesn't sign the mortgage. C can subrogate to B's mortgage and enforce it against A.

Equitable subrogation can be a remedy for both a proprietary claim and an unjust enrichment claim. *Banque Financiere* was a subrogation case – indeed the first case to use it as a remedy for unjust enrichment.

It built on *Boscawen v Bajwa* [1996] 1 WLR 328 – the genesis of the modern law on subrogation in proprietary cases.

The principles are the same in both circumstances, and have recently been drawn together by Lord Sumption in *Swynson v Lowick Rose* [2018] AC 313. Succinctly, he indicated (with my comments added) that:

- Subrogation is available where C bargains for a benefit which fails and D obtains a resulting windfall for which he has not bargained - all the modern subrogation cases are cases of defective transactions in this sense (and note the unsaid point that this can mean defective as in void, or defective in the unjust enrichment sense);
- The windfall character of the benefit means, uniquely in subrogation cases, that it is not unjust to give effect to the failed unilateral expectation of C – even if D had no part in that expectation (a point which it is unnecessary to make proprietary cases);
- Subrogation is also unique in that it does not restore the parties to their position prior – it operates to specifically enforce, so far as possible, the defeated expectation;
- The real basis of the rule is the defeat of an expectation of benefit which formed the basis of C's payment – and its real purpose is to rectify that defect (which applies in proprietary cases where the asset is not available for return).

So, if your asset was paid into an overdrawn bank account, reducing the overdraft – subrogate to the covenant to repay the overdraft to the bank. If it was used to repay a loan - subrogate to the creditor's rights under the loan contract. If it was used to buy a property – subrogate to the unpaid vendor's lien. If it was used to buy life insurance – subrogate to the benefits under the contract. The possibilities are virtually endless - and property is a broad concept.

A FINAL THOUGHT – BACKWARDS TRACING

Most of the barriers to recovery in the examples given above go to the remedy – they arise when the asset itself can no longer be claimed and can be dealt with by some form of subrogation. There is an exception, however - backwards tracing. This has long been a problem – not in terms of remedy but route. It is a conceptual problem in applying the principles. However, since tracing is now seen as a process and not a remedy, it looks as it the problem is being resolved – in favour of the claimant.

Backward tracing arises where an asset has been acquired in exchange for the creation of a debt and, subsequently, misappropriated trust assets are used to discharge that debt. The chronology is the wrong way round.

Two cases, Privy Council and Court of Appeal, have tackled this:

- *The Federal Republic of Brazil v Durant International Corporation* 4 [2015] UKPC 35
- *Relfo Limited v Varsani* [2014] EWCA Civ 360

They seem to suggest that rigid chronology is no longer the test - co-ordination is more relevant. And the necessary evidence can be pretty flimsy if suspicion is high and the merits are with the claimant! Given her recent elevation, it is most interesting to look at what Lady Arden said in the Court of Appeal in *Relfo*:

> "what matters is that there has been an exchange of the value of the claimant's property into the next product for which it is substituted and so on down the chain of substitutions"
>
> "monies held on trust can be traced into other assets even if those other assets are passed on before the trust monies are paid to the person transferring them, provided that that person acted on the basis that he would receive reimbursement for the monies he transferred out of the trust funds. The decision in *Agip* demonstrates that in order to trace money into substitutes it is not necessary that the payments should occur in any particular order, let alone chronological order. … a person may agree to provide a substitute for a sum of money even before he receives that sum of money. In those circumstances the receipt would postdate the provision of the substitute. What the court has to do is establish whether the likelihood is that monies could have been paid at any relevant point in the chain in exchange for such a promise."
>
> and:

> "I see no reason in logic or principle why this particular way of proving a substitution should be limited to payments to or by correspondent banks. … there is no logical reason why the substituted product of a claimant's money cannot be traced through any number of accounts. There is no limit on the number of substitutions that can in theory take place. However, the number of substitutions and the fact that they do not occur in chronological sequence may make it harder to substitute one asset for another."

Given that in *Relfo* they couldn't even show the money moving between the various accounts at all, let alone chronologically, it is clear that the Courts are prepared to be far more flexible than in the past.

CONCLUSIONS

In light of that, and the developments in the application of unjust enrichment, the law in this area should not be seen as static. We are going through a period where creative expansion of principle and innovative thought is being rewarded – but be careful not to go too far. *Swynson* is an example of pushing imagination beyond the bounds of law.

Nicole Sandells QC and Miles Harris

4 New Square Professional Liability & Regulatory Conference

Asset Tracing and Recovery Reassessed

- Tricks and tools for the professional liability lawyer

Nicole Sandells QC & Miles Harris
4 February 2020

Why? I'm a Professional Liability lawyer!

It's not always just about the policy payout.

Asset tracing can avoid the need for a claim or mitigate the impact of a claim.

Claimant – routes to recovery from the actual wrongdoer, without the need for establishing breach by the professional but perhaps at his expense …

Insurer/Defendant – cut the policy payout, and maybe the premium increase! And feel the vindication …

It really can work!

- Principal or employed professional misappropriates funds belonging to client.
- Loan monies advanced by A wrongly paid out by Solicitor B without the consideration in place. Or in the wrong amount. Or to the wrong person!
- Solicitor B releases trust or estate monies to the wrong beneficiary. Or a new beneficiary turns up after distribution …

If you can find it – you can claim it.

Overview

- For the purpose of tracing and enforcing against or recovering assets, there are two types of claim. Start by considering the nature of the underlying claim.
- Is your claim proprietary or personal?
- Type will dictate remedy – and can affect tracing and recovery options.
- Type can change during the process – depending on the target.
- Asset recovery really only applies to proprietary claims.

Two types of claims

- Proprietary claims –

Arise from misappropriation, breach of trust, breach of fiduciary duty.

"It's mine – give it back."

- Personal claims -

Arise where it is no longer the Claimant's property – third party claims, damages.

"I can't get it back – compensate me."

- The oddity - unjust enrichment and restitution.

These are NOT proprietary claims – but the remedies can come close and they are relevant to asset tracing.

Proprietary claims

Simple premise – until property passes through a completed transaction designed to pass title, it remains the property of the original owner.

The question – was the transaction void or voidable?

Breach of trust = void.

If it was void, the owner can reclaim it from anyone except equity's darling. "It's mine – give it back"

Trusts – can you find one?

Can arise in all kinds of commercial contexts – not just private client.

Any time assets belonging to A pass through or to the hands of a third party without the beneficial interest also passing.

For example - *Target Holdings v Redferns:*

"moneys held by solicitors on client account are trust moneys"

Don't forget – trusts include express, implied, bare, constructive, resulting, and *Quistclose* purpose trusts.

Trusts – the basic questions

2 basic questions arise:

- Who is the asset held *for*?
- On what terms are the asset held?

These questions determine the existence of a trust – and its terms.

These questions need to be at the back of your mind at all stages.

Trusts – the basic questions

In any transaction:

- What is the asset in question?
- Who owned it at the beginning?
- Why did it pass out of his possession/control?
- Where did it go?
- Did it then belong to the person possessing or controlling it?
- If not, on what terms was he holding it?
- Did he deal with it on those terms?

Next steps

If he did not deal with it on those terms – trust claim.

If he did – no trust claim.

Is there is breach of fiduciary duty claim which can preserve the proprietary claim?

If not, is there an unjust enrichment or restitutionary claim?

Next steps – breach of fiduciary duty

A breach of fiduciary duty involves the breach of a duty of loyalty – such as acting in conflict.

It is not negligent – it must be deliberate.

Bristol and West Building Society v Mothew [1998] Ch 1

If it involves moving assets, treat it like a breach of trust – look for an asset to reclaim.

Breach of fiduciary duty by company director resulting in payments out = breach of trust. Claim it from him – not the policy of the professional who didn't spot it.

Next steps – unjust enrichment

If you can't find a proprietary claim, can you find an unjust enrichment claim?

Law is now set out in:

Banque Financiere de la Cite v Parc (Battersea) Ltd [1999] AC 221

Investment Trust Companies v Revenue and Customs Commissioners [2018] AC 275

Swynson v Lowick Rose [2018] AC 313

Next steps – unjust enrichment

The *Banque Financiere* test:

- Has the Defendant been enriched?
- Was the enrichment at the expense of the Claimant?
- Was that enrichment unjust?

Has the Claimant lost something which has ended up in the Defendant's hands?

This is why it is close to a proprietary claim – but not. The asset belongs to the Defendant.

If not, he is not enriched – he is a trustee!

Next steps – unjust enrichment

Lord Reed finessed the test in *ITC* – and set out a few timely reminders:

- Unjust enrichment is dealing with personal claims.
- It is based on legal principle not discretion or an amorphous concept of "fairness".
- The rules must be easily ascertainable and consistently applied.
- The *Banque Financiere* test underpins a careful legal analysis.
- The purpose of "unjust enrichment" is to correct **normatively defective transfers of value** – restitution restores the disrupted balance.
- The Court is searching for a defect recognized by law which has resulted in a gain to the Defendant at the cost of the Claimant.
- Incidental benefits do not count.

Next steps – unjust enrichment

If there is a defective transfer leading to unjust enrichment, the remedy is restitution.

Defective here means complete *technically* so that title has passed – but defective eg because of a mistake.

Although the asset no longer belongs to the Claimant, the Defendant, who does now own it, is ordered to return it as the transaction is unwound.

Enforcing proprietary claims

Once you have identified a proprietary claim, ask the basic questions –

- Where is the property?
- How did it get there?

Answered by using the equitable principles of tracing and following.

Where is the property?

If we can't find it, we can't grab it.
How can lawyers help to find assets?

Usual CPR methods

- CPR 25(1)(g) – provide information about the location of assets.
- CPR 25(1)(h) – search orders.

Outside the CPR – contract, trust, agency.

How do we find it?

- Contract – is anyone holding documents we have a contractual entitlement to see?
- Think of solicitors, accountants, other professionals.
- Privilege is not always a ground for refusal. Is it privileged at all? Is there a waiver?

How do we find it?

- Trust or fiduciary duty cases
- Trustees and fiduciaries have a duty to keep records – which the beneficiary may be entitled to see.
- The boundaries have not been fully tested.
- *Schmidt v Rosewood Trust* [2003] 2 AC 709

How do we find it?

Schmidt provides that:

- Beneficiaries' rights to seek disclosure of documents are part of the Court's inherent and fundamental jurisdiction to supervise/intervene in the administration of a trust;
- The right to inspect documents is founded upon the trustee's fiduciary duty to keep the beneficiary informed, and to render accounts; and
- There may be circumstances where an absolute beneficiary can be denied access to documents, such as the competing interests of other beneficiaries, but those circumstances are very limited.

Unlikely to apply when the purpose is to cure trustee default.

How do we find it?

Agency

- Any agent of the Claimant handling the asset has a duty to keep records relating to acts done in the principal's name.
- The principal has the right to access those records, unless that right is expressly excluded by the contract.
- *Dadswell v Jacobs* (1887) L.R. 34 Ch. D. 278
- *Re Burnand* [1904] 2 KB 68
- *Yasuda Fire & Marine Insurance Co v Orion Marine Insurance* [1995] QB 174

How it got there - tracing and following

Proprietary claim – assets recoverable from anyone except equity's darling:

"Bona fide purchaser for value without notice"

If there **is** an equity's darling, then he will have provided value – so go looking for that value in the hands of someone you can target.

The target is no longer the asset, it is the consideration provided for the asset.

Technicalities

Trusts assets disbursed in breach of trust are **followed** to their destination.

If they remain in the same form and have not passed to equity's darling, following leads to a simple proprietary claim.

If they have changed form – either in the hands of the recipient or into "value" from equity's darling, the following turns into **tracing**.

Tracing identifies the new property into which the trust asset has been converted. And then there is a proprietary claim!

How it got there – impact on remedy

Following gives you a simple claim – that's mine, give it back.

At the interim stage - proprietary freezing injunction rather than being confined to a non-proprietary freezing injunction. And the evidence is easier!

Tracing can be more complicated and face barriers - overdrawn bank accounts, backward tracing, mixed funds.

Other proprietary remedies have to be relied on to overcome most barriers – not give it back, but give me something else.

Proprietary claims – form?

- Diamond necklace still in that form – followed, it's mine, give it back.
- Money to a diamond necklace – traced, it's mine, give it back.
- Money to a property purchase using other monies as well – barrier. Answer - subrogation to an unpaid vendor's lien.
- Money used to repay a loan – barrier. Answer – subrogation to the loan contract, or the security.
- Money into an overdrawn bank account – barrier. Answer - subrogation to the bank's right to be repaid.

Equitable subrogation

NO – not insurance subrogation!

Subrogation here means stepping into the shoes of a third party and exercising his right to recover your property.

Equitable subrogation is a remedy in two situations:

- A proprietary remedy to vindicate proprietary rights where you cannot simply get the asset back; and
- An unjust enrichment remedy as an alternative to restitution where the transaction cannot be unwound.

Equitable subrogation – the Swynson way

Lord Sumption's definition:

- Subrogation is available where C bargains for a benefit which fails and D obtains a resulting windfall for which he has not bargained - all the modern subrogation cases are cases of defective transactions in this sense;
- The windfall character of the benefit means, uniquely in subrogation cases, that it is not unjust to give effect to the failed unilateral expectation of C – even if D had no part in that expectation;
- Subrogation is also unique in that it does not restore the parties to their position prior – it operates to specifically enforce (so far as possible) the defeated expectation.

Equitable subrogation – the Swynson way

Lord Sumption said –

- The real basis of the rule is the defeat of an expectation of benefit which formed the basis of C's payment – and its real purpose is to rectify that defect.
- So - the role of equitable subrogation is to replicate as far as possible that element of the transaction whose absence made it defective.

Subrogation is a form of specific performance in place of restitution/return of the asset.

Backward tracing – the Wild West

- Most barriers go to remedy and can be dealt with by some form of subrogation.
- Backward tracing has always been a problem – not in terms of remedy but route.
- It arises where an asset has been acquired in exchange for the creation of a debt and, subsequently, misappropriated assets are used to discharge that debt.

Backward tracing – the Wild West

The Federal Republic of Brazil v Durant International Corporation 4 [2015] UKPC 35
Relfo Limited v Varsani [2014] EWCA Civ 360

Rigid chronology is no longer the test - co-ordination is more relevant.

Lady Arden:

"what matters is that there has been an exchange of the value of the claimant's property into the next product for which it is substituted and so on down the chain of substitutions"

Backward tracing – the Wild West

Lady Arden:

"monies held on trust can be traced into other assets even if those other assets are passed on before the trust monies are paid to the person transferring them, provided that that person acted on the basis that he would receive reimbursement for the monies he transferred out of the trust funds. The decision in *Agip* demonstrates that in order to trace money into substitutes it is not necessary that the payments should occur in any particular order, let alone chronological order. … a person may agree to provide a substitute for a sum of money even before he receives that sum of money. In those circumstances the receipt would postdate the provision of the substitute. What the court has to do is establish whether the likelihood is that monies could have been paid at any relevant point in the chain in exchange for such a promise."

Backward tracing – the Wild West

Lady Arden:

"I see no reason in logic or principle why this particular way of proving a substitution should be limited to payments to or by correspondent banks. … there is no logical reason why the substituted product of a claimant's money cannot be traced through any number of accounts. There is no limit on the number of substitutions that can in theory take place. However, the number of substitutions and the fact that they do not occur in chronological sequence may make it harder to substitute one asset for another."

Conclusion

Unjust enrichment is still developing.

Tracing is still developing.

The law is moving. Get creative!


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