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Obligation and Property in Tracing Claims

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Abstract

Tracing is said to be merely a process and separate from claiming. It is then characterised as a set of pure property identification rules which cannot vary from claim to claim. However, the development of tracing in equity relied heavily on the fiduciary obligation to support its rules. While many of tracing's rules can be justified independently of the fiduciary obligation or rationalised as evidential presumptions, others cannot. This means it is impossible to detach the process from the claim. Furthermore, it would be undesirable to do so because it would reduce the flexibility of tracing.

Introduction

Tracing, according to the present conventional wisdom, is a process used to support a number of separate, mostly proprietary, claims. "[A] clear distinction must be drawn between the rules of following and tracing, which are essentially evidential in nature, and rules [of claiming] which determine substantive rights."[1] Any peculiarities of the claim should remain there and not fall in the rules of tracing. All tracing does is make the link – it identifies where the value is, whether it passes through a link between old property and its new substitute and to what extent. For example, if I spend £100 on a vase, tracing only says that the vase is subject to any claim that the £100 was. If I spend £50 of my money and £50 of someone else's on the vase, the vase is subject to a proportionate claim. However, the nature of my wrongdoing – conversion, breach of trust, breach of fiduciary duty or otherwise – does not affect this rule of attribution.

This view of tracing was popularised by Lionel Smith[2] and championed soon after by, *inter alios*, Lord Millett in the leading case of *Foskett v McKeown*.[3] The central argument of this article is that this position (the "separation claim") is ahistoric, false on the current law and moreover undesirable.

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[1] *Glencore International AG v Metro Trading International Inc (No.2)* [2001] 1 All E.R. (Comm.) 103 at [180].

[2] L. D. Smith, *The Law of Tracing* (Oxford: Clarendon, 1997) (hereafter, "*The Law of Tracing*").

[3] [2001] 1 A.C. 102. It is accepted or acknowledged in, e.g., L. Tucker, N. Le Poidevin and J. Brightwell, *Lewin on Trusts*, 19th edn (London: Sweet & Maxwell, 2015), para.41–006 (hereafter *"Lewin"*); D. Hayton, P. Matthews and C. Mitchell, *Underhill and Hayton: Law of Trusts and Trustees*, 19th edn (London: LexisNexis, 2016), para.90.3 (hereafter *"Underhill"*); J. McGhee, *Snell's Equity*, 33rd edn (London: Sweet & Maxwell, 2015), para.30–051 (hereafter *"Snell"*).

The separation claim holds that tracing is property-based. Then, its rules are based in and justified with respect to property norms, such as *pari passu* apportionment of ownership of the substitute according to the proportions of ownership of the original. The alternative, which I argue is the case on the present law, is that tracing is obligation-based. Its rules were developed and justified with respect to the underlying claims, namely breach of trust and breach of fiduciary duty, and this brought in the principles of those claims. Obligation-based tracing rules certainly *mimic* a property basis of tracing in equity, but this is a corollary of the requirement for specific property in a trust or constructive trust.

If the separation claim is correct, there must be a single set of tracing rules, presumptions and justifications that apply to every claim. That there are different rules at common law vis-à-vis equity is mere historic artefact. The rules cannot rely on unique aspects of the fiduciary obligation or any other. They must rely on generalities such as status as innocent party or wrongdoer. But if the rules of tracing do not fit this template, tracing cannot truly be based in property and instead has aspects of obligation. I make out the argument by showing they do not fit.

In doing so, I show how, from the eighteenth century through to the twenty-first, equity's tracing rules developed with respect to the fiduciary obligation. Supporters of the property model of tracing argue that they can be rationalised as rules of evidence. Then, the argument goes, the transformation simply has not been completed but will be in time. However, many of the rules of tracing cannot be explained well under a property model, particularly the presumptions in *Re Hallett's Estate*.[4] Moreover, even recent cases, paradoxically including *Foskett* itself, have gone the other way to the separation claim, positively relying on the fiduciary obligation to develop rules of tracing. It is not possible to rationalise these cases' rules under a property model of tracing. It is therefore impossible to detach tracing, the process, from the underlying claim or claims.

I also illustrate how an obligation model of tracing offers increased flexibility in complex situations. While the separation claim is laudable in the simplicity it brings, this should not be at the expense of justice.

The reasoning in many tracing cases is unsatisfactory. One often finds a mix of justifications and *obiter dicta* to a narrower *ratio decidendi*. Much of the time these *dicta* can be interpreted to fit either model of tracing. A cautious approach is therefore required. Rather than taking *dicta* explaining the nature of the liability at face value, I focus on outcomes and the issues, actual, elided or omitted, and ask if they fit only one model of tracing. Otherwise, if a case or rule can be rationalised as fitting either, given the contested nature of tracing, it cannot be said to point conclusively one way or the other.

Models of Tracing

Obligation: Fiduciary Account of Profits

First, each model of tracing must be substantiated and its material characteristics extracted. Consider first the obligation model of tracing. It has long been noted that tracing is very similar to the remedy for breach of the no-profit rule (the obligation not to make an unauthorised profit

[4] (1880) 13 Ch. D. 696.

from one's fiduciary office).[5] Hence I propose that it is rooted in the fiduciary obligation that imposes a constructive trust *de novo* over each substitution in response to breach of that obligation. This builds on the explanation, advanced by Lord Millett and Richard Nolan, that tracing is transaction-based. It is analogous to a trustee's power of investment, buying and selling trust property[6] and "[t]racing seeks to mimic, so far as possible, the due administration of the [trust] fund".[7] This explains the need for specific property and the concomitant rejection of swollen assets tracing where no direct link to the receipt is required, only that the recipient's wealth is swollen by it.[8] Transactions may be authorised or unauthorised. If an authorised transaction, the ordinary process of overreaching applies to transfer the trust interest to the substitute. If an unauthorised transaction, the same occurs by operation of law on the election of the beneficiary.[9] That operation of law, I suggest, is the no-profit rule.

This easy fluidity between original and substitute property relies on a characterisation of the proprietary characteristics of equitable interests behind a trust – as "equitable property" is more precisely defined – as rooted in obligation.[10] This view has a long history. Equity acts, said Maitland, *in personam*.[11] The opening paragraph in *Underhill and Hayton: Law of Trusts and Trustees* states: "A trust is an equitable fiduciary obligation, binding a person (called a trustee) to deal with property (called trust property) owned and controlled by him".[12]

Certainly, in terms of claims against the trustee this may be characterised an *in personam* right. Of course, equity began to enforce trust interests against third party transferees.[13] Then, given this "transmitted fiduciary obligation",[14] equity acts *in personam* against all persons affected by notice of the trusts. The ability to follow the same property into the hands of another results. Tracing is more difficult but providing there is some rule of attribution, the substitute property is considered trust property. That rule is the no-profit rule.

In order for this to work with non-fiduciary recipients, one must take the label "constructive trustee" seriously. Such recipients may well be constructive trustees, but they certainly do not owe a full range of trustees' duties – their primary duty is simply to preserve and hand back the trust property. Mitchell and Watterson have detailed a number of additional duties owed by recipients of trust property that suggest there is something more in constructive trusteeship, once knowledge of the breach is acquired. These include discharging the duty to restore the property to a proper third party rather than the trustee if the trust obligations demand it (or the trustee is likely to breach the trust) and to recover it from an improper third party and liability

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[5] E.g. J. Story, *Commentaries on Equity Jurisprudence*, A. E. Randall (ed.), 3rd English edn (London: Sweet & Maxwell, 1920), p.529 § 1261 (hereafter *"Story"*).
[6] P. Millett, "Proprietary Restitution" in S. Degeling and J. Edelman (eds.), *Equity in Commercial Law* (Sydney: Lawbook Co, 2005), p.315.
[7] R. C. Nolan, "The Administration and Maladministration of Funds in Equity" in P. G. Turner (ed.), *Equity and Administration* (Cambridge: Cambridge University Press, 2016), p.73.
[8] *Re Goldcorp Exchange Ltd* [1995] 1 A.C. 74.
[9] See D. Fox, "Overreaching" in P. Birks and A. Pretto (eds.), *Breach of Trust* (Oxford: Hart, 2002) for the fine details of the distinction.
[10] The detailed scholarship: R. C. Nolan, "Equitable Property" (2006) 122 L.Q.R. 232; B. McFarlane and R. Stevens, "The Nature of Equitable Property" (2010) 4 J. Eq. 32.
[11] F. W. Maitland, *Equity: A Course of Lectures*, J. Brunyate, A. H. Chaytor and W. J. Whittaker (eds.) (Cambridge: Cambridge University Press, 2011) (hereafter *"Maitland"*).
[12] *Underhill*, para.1.1.
[13] *Maitland*, p.12.
[14] *John v Dodwell & Co Ltd* [1918] A.C. 563 at 569.

for profits made from it.[15] It is only a small stretch to say this is an attenuated form of the fiduciary obligation that permits a further, limited, account of profits claim against the constructive trustee in respect of the trust property received. Then, tracing can reach past the first substitution to remoter substitutions not made by an express trustee.

Finally, consider how this model of tracing leads to election. Without this, the beneficiary would be entitled to claim both original and substitute, resulting in a true "geometric multiplication of the plaintiff's property".[16] Election comes from the fact that, for an account of *profits*, credit must be given for any property put in to realise the profit. On the facts of a tracing claim, that is the original property. The beneficiary can follow the original property and forgo the tracing claim. Alternatively, she may elect to take the tracing claim, but must give credit for the original property used to obtain the substitute.

This explains why, at least functionally, a tracing claim is proprietary and not just personal. Following, leading to a pure proprietary claim (i.e. over the original property) can be justified on the basis that the recipient does not have title to someone else's property and hence the true owner may take it back. But the same is not true of tracing, which is a restitutionary proprietary claim because it yields substantially new and different rights over different property.[17] There is no inherent reason why that claim should not be merely personal and limited to the original value. The account of profits rationale explains why it is not. It is the standard remedy for fiduciary wrongdoing, where the principal is given more powerful remedies on account of her vulnerable position.

Property: Tracing Value In Rem

The broad difficulty with this is that a right enforceable against an indeterminate class of people looks very much like a proprietary one, which leads to the argument that tracing is property-based. Consider the characteristics of that model now.

As Oakley and Televantos have shown in detailed scholarship, equity once permitted tracing by the legal owner of property not subject to a trust.[18] Televantos' argument is that tracing was considered an *in rem* process for much of the eighteenth century and until the end of Lord Eldon LC's retirement in 1827. Tracing simply assisted a claim over property based on title. The owner had a better title than the recipient and that justified the claim. The term "fiduciary" narrowed over this time to mean only the duty of loyalty, where previously non-fiduciaries such as bailees and factors had a "fiduciary character" such that tracing and related remedies could be brought against them in equity.[19] Equity acted in its auxiliary jurisdiction to support a common law claim, but otherwise followed the law[20] and thus permitted legal owners to trace property through a chain of substitutions until that property or its substitute became "indistinguishable", including when it was mixed. It was not until the later nineteenth century that there was a considerable inflow of the personal rules of fiduciary law (in the sense of the

[15] C. Mitchell and S. Watterson, "Remedies for Knowing Receipt" in C. Mitchell (ed.), *Constructive and Resulting Trusts* (Oxford: Hart, 2010), p.132.
[16] P. Birks, *An Introduction to the Law of Restitution* (Oxford: Clarendon, 1989), p.394.
[17] C. Rotherham, *Proprietary Remedies in Context: A Study in the Judicial Redistribution of Property Rights* (Oxford: Hart, 2002), p.96.
[18] A. J. Oakley, "The Prerequisites of an Equitable Tracing Claim" (1975) 28 C.L.P. 64, 65 at fn.11; A. Televantos, "Losing the Fiduciary Requirement for Equitable Tracing Claims" (2017) 133 L.Q.R. 492.
[19] A. Televantos, "Losing the Fiduciary Requirement for Equitable Tracing Claims" (2017) 133 L.Q.R. 492, 503.
[20] A. Televantos, "Losing the Fiduciary Requirement for Equitable Tracing Claims" (2017) 133 L.Q.R. 492, 508, 514.

duty of loyalty). For Televantos, this was the "unprincipled mixing of the personal and proprietary aspects of fiduciary law and trusteeship".[21]

This *in rem* or property model of tracing is attractively simple. Indeed, it is the new orthodoxy that we trace value. The value that was in the £100 is now in the vase. The strongest argument that this is the operative model, if that model is not obligation, is from the acceptance of backwards tracing. This is where substitute is obtained before the original property is parted with, for example if I buy a car on credit and then pay my creditor with trust money.

Moreover, in *Federal Republic of Brazil v Durant International Corporation*, where the Privy Council accepted backwards tracing, it expressly adopted the tracing value justification: the "court is concerned with tracing the value inherent in a trust asset … [it] should concentrate on the substance of the transaction and not the form."[22] Such a claim was also permitted, earlier, in *Boscawan v Bajwa*[23] and *Relfo Ltd v Varsani*. In the latter case, Arden L.J. held that the ordering was not important if the transferor "acted on the basis that he would receive reimbursement for the monies he transferred out of the trust funds".[24] This is an appeal to the intention of the exchanger in determining a tracing link. In *Durant International*, the condition was phrased differently. In order to trace, it is necessary to:

> establish a co-ordination between the depletion of the trust fund and the acquisition of the asset … such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund.[25]

This is, it is submitted, merely an implicit appeal to intention. The testimony of such fraudsters is likely to be worthless and the inference drawn by establishing a coordination is clearly that the coordination was intended. It is just a practical wrapper for Arden L.J.'s theoretical enquiry.

The view that we trace value has been analysed in great detail by Cutts. Her most pertinent point is that changes in value across transactions make this unconvincing. If a trustee misappropriates £10 and buys a bottle of wine worth £100, this can be traced into. However, one is not making a connection through the value but through the transaction because the value changes.[26] Moreover, the content of the transaction cannot be established unless one takes into account the intentions of the exchanger and other transacting party. Ultimately, then, the road beginning at tracing value leads to intention and a transactional model of tracing. I merely go further: that transactional model is the obligation model.

Reception of the Fiduciary Obligation

The particular model of tracing adopted determines its rules and *vice versa*. It is therefore time to look at how tracing actually developed in the cases and see which model fits best. One must be astute as to the matters raised thus far: the fiduciary no-profit principle, the idea of tracing value and the role of intention. It turns out that two circumstances are very difficult to rationalise under a property basis: (i) how fault affects the tracing rules; and (ii) where not

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[21] A. Televantos, "Losing the Fiduciary Requirement for Equitable Tracing Claims" (2017) 133 L.Q.R. 492, 515.
[22] [2015] UKPC 35; [2016] A.C. 297 at [32].
[23] [1996] W.L.R. 328.
[24] [2014] EWCA Civ 360; [2015] 1 B.C.L.C. 14 at [63].
[25] [2015] UKPC 35; [2016] A.C. 297 at [40].
[26] T. Cutts, "Tracing, Value and Transactions" (2016) 79 M.L.R. 381, 395.

merely an evidential gap, but positive evidence against a connection is disregarded. In both circumstances the rules follow from and are justified by the fiduciary obligation.

Around the Eighteenth Century

As Oakley notes, the earlier cases were rationalised in the second half of the seventeenth century as instances of the doctrine of notice.[27] Innocent donees and those other than *bona fide* purchasers were subject to the equitable interest in the property, which justifies following and tracing. However, if one examines the contemporary treatises, one sees that in the eighteenth and nineteenth centuries the issues that exercised the courts suggest things were not so simple.

In the early eighteenth century it was thought that it was only possible to trace into property exchanged in pursuance of the trust or fiduciary relationship.[28] While the cases overlap and there is no single case cutting off this restriction, it only became established that tracing was possible where the trustee converted trust property in "abuse" of trust by the start of the nineteenth century.[29] This suggests that tracing was very much seen as a function of trust management and dependent on the particular obligation breached, not something rooted in an enduring or transmissible property right.

Knowing receipt emerged in the eighteenth century and continued to develop in the nineteenth. Here, recipients with notice of the breach of trust were treated as if trustees and following became possible, as did tracing into substitute property where the third party was responsible for the exchange.[30] These cases also see tracing as based on trustees' obligations.

Nineteenth Century

Given its reception into tracing, the background of the trust and fiduciary obligation is important context. The jurisprudence of Lord Eldon (1801–1806; 1807–1827) settled and hardened the fiduciary obligation. Nonetheless, his influence on tracing was indirect. Of the leading tracing cases, only *Lupton v White*[31] and *Lord Chedworth v Edwards*[32] were decided by him. The former holds that a beneficiary can trace into all parts of a physical mixture save for what the trustee can show is his own, i.e. a reverse burden of proof applies. The latter is an example of it being inferred from the long passage of time that the remaining money in a bank account was not trust money. Nonetheless, despite the appeal to the fiduciary status of the defendants, these presumptions can easily be characterised as evidential. Indeed, in *Lupton v White*, Lord Eldon cited *Armory v Delamirie* as an instance of the principle upon which he decided that case:[33] The defendant who creates the evidential difficulty will find it resolved against him. This principle in not especially fiduciary and the defendant in *Armory v Delamirie*, a shopkeeper, was most certainly not a fiduciary.

Many no-profit cases followed Lord Eldon's retirement, where the defaulting fiduciary's profits were disgorged to the principal. In *Fawcett v Whitehouse*, a partner who took a lease

[27] A. J. Oakley, "The Prerequisites of an Equitable Tracing Claim" (1975) 28 C.L.P. 64, 65.
[28] T. Lewin and F. A. Lewin, *A Practical Treatise on the Law of Trusts*, 6th edn (London: Maxwell & Son, 1875), p.730 (hereafter *"Lewin 6th edn"*); G. Jeremy, *A Treatise of the Equity Jurisdiction of the High Court of Chancery* (London: Clarke, 1828), p.87.
[29] *Lewin 6th edn*, 730.
[30] *Story*, p.528 § 1258 et seq; C. Harpum, "The Stranger as Constructive Trustee: Part 2" (1986) 102 L.Q.R. 267.
[31] (1808) 15 Ves. Jun. 432; 33 E.R. 817
[32] (1802) 8 Ves. Jun. 46; 32 E.R. 268.
[33] (1722) 1 Str. 505; 93 E.R. 664: *Lupton v White* (1808) 15 Ves. Jun. 432 at 435; 33 E.R. 817 at 818.

for himself rather than for his partnership held it for them on trust. Lord Lyndhurst gave a particular explanation:

> [H]e was bound to obtain the best terms possible for the intended partnership … and that all he did obtain will be considered as if he had done his duty and had actually received the £12,000 for the new partnership[.][34]

There are many similar *dicta* in other cases.[35] This led to the "good man theory", a rationalisation of how equity treated fiduciaries. It is *irrebuttably* presumed that his actions are done in pursuance of, not against, the trust, therefore the profits wrongly obtained must be handed over to the beneficiaries.[36]

The good man theory is clearly a fiction, and similar to the idea that the claimant waives the tort and can thus claim the gain instead of compensation, which has been rejected at the highest level.[37] Nonetheless, the good man theory is functionally correct and, as shall be seen, useful to determine the breadth of the obligations. Particularly, it says that the obligations of fiduciaries are such that the law goes much further than the evidential presumption in *Armory v Delamirie*. It explains why there was acceptance of tracing into property substituted in "abuse" of trust as well as in pursuance of the trust – the trustee was treated as though he was acting for his beneficiary. The good man theory explains how the remedy does not merely jump an evidential gap; it goes beyond what is possible on the evidence. Since the defaulting fiduciary is not really a good man and is positively acting against his principal to make profit for himself, the presumption is irrebuttable – a rule of law – and most certainly not evidential. It disregards this intention.

Subordination and Mixtures

One significant problem remained in the early nineteenth century. Tracing was only possible through physical mixtures, but not mixtures of intangibles such as money. By this what is meant is mixed substitutions where multiple inputs go into one or more outputs. The tracing value rationalisation came later, and the old basis of tracing was that changes in form do not matter requires the property to have an identifiable subject matter, which disappears upon mixing.[38] Consider how this problem was solved using the fiduciary obligation, and how the solution cannot be rationalised into a property model of tracing that characterises the relevant rules as evidential presumptions.

The first successful case of tracing into a mixed intangible was *Pennell v Deffell*, a claim for trust money put into a bank account and mixed with other monies.[39] The Court of Appeal in Chancery held that tracing was possible and the rule in *Clayton's Case*[40] applied, meaning the first sums paid out were attributable to the first sums paid in. This is not a rule of

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[34] (1829) 1 Russ. & M. 132 at 149; 39 E.R. 51 at 57.

[35] *Phayre v Peree* (1815) 3 Dow. 116 at 128; 3 E.R. 1008 at 1012; *Morison v Thompson* (1874) 9 Q.B. 480 at 483; *Mathias v Mathias* (1858) 3 Sm. & G. 552 at 563; 65 E.R. 777 at 781; *Sugden v Crossland* (1856) 3 S. & G. 192 at 194; 65 E.R. 620 at 621.

[36] Sir P. Millett, "Bribes and Secret Commissions" [1994] R.L.R. 7, 20; *Story*, p.568 § 1211.

[37] *United Australia Ltd v Barclays Bank Ltd* [1941] A.C. 1.

[38] *Taylor v Plumer* (1815) 3 M. & S. 562 at 575; 105 ER 721 at 726.

[39] 4 De G.M. & G. 372, 43 E.R. 551.

[40] (1816) 1 Mer. 572; 35 E.R. 781.

subordination. Such a rule was first mooted in *Frith v Cartland*, where Page-Wood VC opined, *obiter dictum*:

> If a man has £1000 of his own in a box on one side, and £1000 of trust property in the same box on the other side, and then takes out £500 and applies it for his own purposes, the Court will not allow him to say that that money was taken from the trust fund.[41]

Page-Wood VC goes too far by modern standards. Because the monies are separated he suggests in effect swollen assets tracing, later rejected emphatically in *Re Goldcorp*.[42] Nonetheless, he thought the good man theory should apply.

Consider now *Re Hallett's Estate*. The problem was that the trustee Hallett, who had mixed trust money with his own money in his account, drew out some money then dissipated it. The remaining money was enough to satisfy the trust claims, but not the trust claims and the claims of Hallett's creditors. The beneficiaries wished to trace into the remaining monies, but an application of the rule in *Clayton's Case* would have lead them to the earlier withdrawals whereupon the claim would be defeated as the monies has been dissipated..

Sir George Jessel M.R. advanced two bases as to why Hallett's fiduciary obligations permitted this. The first basis was his own, the "notional charge theory". The trust money in the account was considered charged, and adding more money to the account simply meant the whole was charged to the value of the trust money.[43] After a withdrawal, a beneficiary could simply rely on the charge on what was left. It is notable that Jessel M.R. expressly said that the claimant is entitled to a "charge" after mixing in contradistinction to the position without mixing where the claimant would also be entitled to take the property itself.[44] This had been taken to mean that the claimant is limited to a lien after tracing through mixed substitutions.[45]

It is not clear from the relevant passages where the charge comes from, but context is provided later. In the second basis, Jessel M.R. relied on good man reasoning. He stated that "[t]he guiding principle is, that a trustee cannot assert a title of his own to trust property."[46] He quoted the passage reproduced from *Frith v Cartland* above and adopted the reasoning: the defendant "could not be allowed to say that the £284 deposited … was his own".[47] Yet this basis would not restrict claimants to a lien. The logical consequence of the good man reasoning is that what is left in the account is owned in equity by the beneficiary to the value of the transfer. Jessel M.R.'s view of the good man theory was therefore that it had this inherent limitation. It permits presuming against the fiduciary such that the most favourable actions are attributable to investment of the trust monies, but because of the mixing, one cannot access increases in value and is only given priority over other creditors. This was, apparently, the *quid pro quo* for the severity of the remedy.

Re Oatway came two decades later. In a similar mixing scenario, the trustee was presumed to draw out trust money first. This meant that it could be traced into profitable investments upon which a charge was declared, the remainder of the account having been dissipated.[48]

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[41] (1865) 2 Hem. & M. 417 at 422; 71 E.R. 525 at 527.
[42] [1995] 1 A.C. 74.
[43] (1880) 13 Ch. D. 696 at 711.
[44] (1880) 13 Ch. D. 696 at 709.
[45] *Foskett* [2001] 1 A.C. 102 at 131.
[46] *Re Hallett* (1880) 13 Ch. D. 696 at 719.
[47] (1880) 13 Ch. D. 696 at 720.
[48] [1903] 2 Ch. 356.

Joyce J. took note of the decision in *Re Hallett* and used the good man theory to justify the decision. The logical outcome of the good man reasoning in *Re Hallett* and the outcomes of both *Re Hallett* and *Re Oatway* is of course that the beneficiary can "cherry-pick" from the transactions a trustee makes to her best advantage.

The combination of *Re Hallett* and *Re Oatway* leaves other questions to be answered. First, are they evidential presumptions or can they be better rationalised as evidential presumptions because they are based on a fiction? Second, what are the lasting effects of the notional charge theory and how does it affect the rules concerning subsequent mixing by non-fiduciaries, whether innocent or wrongdoers? Third, do they actually go to their logical end point and allow unrestricted cherry-picking from very complex sets of transactions?

Rationalisation of the Subordination Rules as Evidential

Lionel Smith argues that the principle of subordination *Re Hallett* is an expression of is an evidential presumption against a wrongdoer.[49] That necessarily requires rejection of the restriction of the remedy to a lien. The familiar example of the stolen bag of coins mixed with the thief's own coins is helpful. If the thief dissipates some coins, the claimant can insist those remaining include hers. The evidential gap is overcome by presuming against the wrongdoer. This may be a rule with a normative basis, but rules of evidence – such as who bears the burden of proof – do carry norms and this just takes that a little further. No recourse to the fiduciary obligation is required.

In the simple example of the bag of coins, it is natural to say that one may presume against the wrongdoer and take either what is left or what was removed to be the claimant's property. However, when the withdrawals become more complex, the analysis fits less well. Consider a more complex example. Suppose the recipient mixes £5,000 of trust money with £5,000 of her money, and then invests £2,000, dissipates £2,000, dissipates another £2,000, invests £2,000 and finally dissipates £2,000 in that order. On the "good man reasoning", even as attenuated by *Re Hallett*, it follows as a matter of logic that the beneficiary can cherry-pick and trace into all the non-dissipated funds. There are three particular difficulties in rationalising this as an evidential presumption.

First, its precision and granularity is not found in ordinary evidential presumptions. The presumption in *Armory v Delamirie* was that the missing jewel should be valued as the finest jewel that would fit the socket because the converter had refused to produce the actual jewel taken from it.[50] In the law of succession, if a testator incurs a debt and then leaves a legacy at least as beneficial as that debt to his creditor, it is presumed that that legacy is in satisfaction of that debt so that the creditor does not take its value twice. These presumptions are simple. They do not have the granularity of the cherry-picking approach which can pluck the very best outputs from, theoretically, a huge number of transactions.

Second, the presumptions are irrebuttable. The exchanger cannot adduce evidence to show she did not use trust money in a particular transaction. This is unlike the usual presumptions of evidence where the defendant may undo the evidential difficulty he created; in *Armory* the defendant was free to produce the actual jewel to displace the presumption applied against him. Likewise, in *Lupton v White* the defendant could have proved which parts of a physical mixture

[49] *The Law of Tracing*, p.77–80, 199 (particularly p 80).
[50] (1722) 1 Str. 505; 93 E.R. 664.

belonged to him to avoid the presumption.[51] As Lionel Smith says, "evidentiary difficulties are resolved against wrongdoers who created them, but this principle does not allow findings contrary to the evidence."[52] This means the presumptions cannot truly be evidential. They are rules of law.

Third, none of the usual evidential presumptions respond to the election of the *claimant*. Here, the claimant may simply demand, at her whim, which parts of a mixture belong to her in equity. This, it is submitted, goes far beyond what evidence-based rules can do. This is a rule of subordination, but it is subordination in line with the good man theory. This is where its utility remains.

The evidential presumption rationalisation looks extremely shaky, if not impossible, when compared with the fiduciary obligation. The trustee is presumed to act in furtherance of the trust and not against it. This better explains the claimant's power to elect to take away his profits. If his intention is consistent with the trust or the beneficiary's wishes, it is accepted, as in the backwards tracing cases. If not, it is disregarded, as in the mixing cases. To call this near-total subordination evidential simply wraps fiduciary law up in an artificial rule of evidence. And if that rule of evidence is actually more in line with the fiduciary obligation than normal rules of evidence, we should accept that it is the fiduciary obligation.

Moreover, adopting this rationalisation would be to treat fiduciaries the same as non-fiduciaries. This is contrary to a long line of *dicta* insisting that they are held to higher standards and that the law will press hard against them if they do not.[53]

There is also concern over the severity of the remedy. The authors of *Lewin on Trusts* have "reservations" as to whether the principle should be carried so far that a beneficiary can claim into the most profitable investments possible. They argue that if the remedy is confined to a lien, the principle at least is limited from such an extreme outcome.[54] Rationalising these rules so they fit under a property model of tracing forecloses the possibility of having this flexibility.

Rationalisation of the Dicta *as supporting a Property Basis*

Before dealing with that and the other questions left open by *Re Hallett*, consider Televantos' interpretation of that case. This illustrates the risks in taking the *obiter dicta* of tracing cases and extracting principle or theory from them.

Televantos supports his argument as follows. Jessel M.R.'s reasoning reflected a belief that all that mattered was beneficial ownership, rather than having a separate equitable title, because tracing was an entirely *in rem* process. Hence the fiduciary relationship in its modern sense, including the good man presumptions, subordination rules and the ready creation of equitable property for breach of fiduciary duty, did not matter. Instead, so long as one of the fiduciary relationships in the older, wider, sense existed, there would be standing in equity and principals (who had rights over the legal title) would be able to assert the same remedies as trust

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[51] (1808) 15 Ves. Jun. 432; 33 E.R. 817.

[52] *The Law of Tracing*, p.81.

[53] E.g. *Ex p. Bennett* (1805) 10 Ves. Jun. 381 at 396; 32 E.R. 893 at 898; *Parker v McKenna* (1875) 10 Ch. App. 96 at 124; *Bray v Ford* [1896] A.C. 44 at 51; *Regal (Hastings) Ltd v Gulliver* [1967] A.C. 134; [1942] 1 All E.R. 378 at 138.

[54] *Lewin*, paras.41–079 – 41–080, noting that authority tends towards suggesting cherry-picking is permitted.

beneficiaries.[55] This must be addressed because it is in opposition to an obligation model of tracing. It turns out that these *dicta* are also consistent an obligation model of tracing and, given the basis of the decision, that is the better interpretation.

Televantos relies on, *inter alia*, two sets of *dicta* of Jessel M.R. First is his definition of a fiduciary relationship: "one in respect of which, if a wrong arise, the same remedy exists against the wrongdoer on behalf of the principal as would exist against a trustee on behalf of the *cestui que trust*".[56] Second:

> Has it ever been suggested, until very recently, that there is any distinction between an express trustee, or an agent, or a bailee, or a collector of rents, or anybody else in a fiduciary position? I have never heard, until quite recently, such a distinction suggested … It can have no foundation in principle, because the beneficial ownership is the same, wherever the legal ownership may be.[57]

On the face of it, these *dicta* support Televantos' argument. But they can be read another way. At first instance, Fry J. had allowed the claim. However, he had to avoid his own reasoning in *Ex p. Dale*, where he refused tracing into a mixture of money on the grounds that old authority held that following and tracing money was only possible when kept physically separate from other money.[58] The justification was that money had no earmark and thus became indistinguishable and lost in a mixture. The earmark theory had become obsolete by at least the time of *Miller v Race* (1758)[59] and accordingly *Ex p. Dale* and its reliance on the earmark theory was criticised by Jessel M.R.[60] Rather than tackle this head on, Fry J. had distinguished *Ex p. Dale* on the grounds that the defendant there was a factor and the defendant in *Re Hallett* was a solicitor.

Jessel M.R.'s remarks can be read in this light. Given his heavy reliance on the fiduciary obligation to craft liability in *Re Hallett*, it is submitted that the better explanation of these *dicta* is that Jessel M.R. was merely criticising the artificial distinction Fry J. had cleaved between different kinds of fiduciaries.

Moreover, just because the same remedy arises whether the defendant is a trustee or any other kind of fiduciary does not necessarily mean the principles are precisely the same. While Televantos is right in emphasising what matters is ultimate beneficial ownership rather than an initial separation of legal and equitable title, we achieve that separation in any event. Upon breach of fiduciary duty by a non-trustee fiduciary, a constructive trust arises leading to that separation, and, because of that, the same remedies then result. Televantos' claim can be put no higher than that these *dicta* are consistent with both property and obligation models.

This demonstrates the need for caution sounded earlier. The *dicta* are inconclusive. Moreover, they speak of generalities. One must concentrate instead on the specific rules and

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[55] A. Televantos, "Losing the Fiduciary Requirement for Equitable Tracing Claims" (2017) 133 L.Q.R. 492, 504. See above, discussion to fn.21.
[56] A. Televantos, "Losing the Fiduciary Requirement for Equitable Tracing Claims" (2017) 133 L.Q.R. 492, 505.
[57] A. Televantos, "Losing the Fiduciary Requirement for Equitable Tracing Claims" (2017) 133 L.Q.R. 492, 504–505, Televantos' emphasis.
[58] (1879) 11 Ch. D. 772.
[59] (1758) 1 Burr. 452; 97 E.R. 398.
[60] *Re Hallett* (1880) 13 Ch. D. 696 at 713 et seq; see D. Fox, "Bona Fide Purchase and the Currency of Money" (1996) 55 C.L.J. 547.

outcomes and reason back inductively from them. They point to an obligation-based, not property-based, model of tracing.

Continued Reliance on the Fiduciary Obligation and its Flexibility

Innocent Volunteers and Non-Fiduciary Wrongdoers

Now we come to the twentieth and twenty-first century cases, which show the continuing reliance on the fiduciary obligation and the increased flexibility it offers. *Re Diplock* (1948) is useful to examine because it shows how the obligation model of tracing was cemented. It also left open possible avenues to increase tracing's flexibility that would be closed off under a property model.

At first instance, Wynn-Parry J. thought tracing into mixtures made by innocent donees was not possible. He noted Jessel M.R.'s quotations from *Frith v Cartland* in *Re Hallett* and declared that "[t]he decision of *In re Hallett's Estate* … reeks of trust and fiduciary relationship … it is the existence of the fiduciary relationship which enables equity to give that further remedy".[61] The Court of Appeal reversed him on this point, ostensibly relying on the reasoning that originated in *Re Hallett*: "a declaration of charge … enabled equity to identify money in a mixed fund."[62] I.e. there is an initial fiduciary relation; this gives rise to a charge; that charge passes with the property into the hands of the recipient; and that charge persists in the mixture. Then it does not matter that the mixer is not a fiduciary. This explains the oft-criticised requirement for tracing that there must be an initial fiduciary relationship, albeit only for mixing and not for other tracing rules.[63]

The Court of Appeal thus confirmed Oakley's rationalisation of how we can follow into the hands of innocent volunteers.[64] At this point in time, the courts accepted the position I advocate. However, the simple situations in *Re Diplock* can easily be rationalised under a property basis of tracing. Simple receipt of equitable property by a volunteer leads to a claim based on title. Likewise for mixtures: the ownership of the substitute is proportionate to the ownership of the original. This is not a particularly fiduciary rule – it is one based on property norms.

The difficulties arise, again, when matters that are not easily or desirably characterised as ones of property come into play. The first is the proposition that tracing into land would not be permitted if it would be inequitable to do so.[65] While this can be rationalised as accession and thus the destruction of the subject matter of the trust – a principle of property – it can also be characterised as a prototype *bona fide* change of position defence.[66]

While it is uncertain, as a matter of law, if this defence applies to a proprietary claim,[67] there is some justification for it. Since tracing claims are restitutionary proprietary claims, there is justification for having restitutionary defences, because one is not really claiming on the basis

[61] [1947] Ch. 716 at 754, 750.
[62] [1948] 1 Ch. 465 at 520.
[63] See further R. A. Pearce, "A Tracing Paper" (1976) 40 Conv. (N.S.) 277, 288; A. J. Oakley, "The Prerequisites of an Equitable Tracing Claim" (1975) 28 C.L.P. 64, 82; R. H. Maudsley, "Proprietary Remedies for the Recovery of Money" (1959) 75 L.Q.R. 234, 252.
[64] *Re Diplock* [1948] 1 Ch. 465 at 530.
[65] [1948] 1 Ch. 465 at 546.
[66] It was suggested in *Lipkin Gorman v Karpnale Ltd* [1991] 2 A.C. 548 at 581 that this defence could be adopted in tracing.
[67] W. Swadling, "Policy Arguments for Proprietary Restitution" (2008) 28 L.S. 506, 514 et seq.

of title.[68] One claims on the basis of the obligations the defendant owes, where those obligations could take into account the justice of barring a claim where the defendant has, in good faith, changed her position on account of the receipt. A property basis of tracing, characterising the claim as based in a pre-existing property right, would foreclose this possibility.

The second difficulty concerns one of the questions posited earlier: how one might extend the presumptions in *Re Hallett* and *Re Oatway* to non-fiduciaries who are at fault. Whether they apply in this situation is not clear; the literature is inconsistent[69] and there is little case law. Millett J. held they did in *El Ajou v Dollar Land Holdings (No.1)*.[70] He adopted the *Diplock* analysis: the notional charge survives the substitution and operates to fix upon the mixture the non-fiduciary recipient makes, meaning the claimant can trace.

There are two problems with this. The first is that for an innocent mixer the charge ranks *pari passu*[71] and for wrongdoers it takes priority. If it is a transmitted form of the initial charge, created by the initial fiduciary relation, it is strange that it is affected by the fault of the mixer, particularly a non-fiduciary mixer, at a later stage. It is less artificial to say that the recipient is a constructive trustee and the relevant obligations in constructive trusteeship create this remedy *de novo*. Under a property model of tracing, one might try to rationalise this, again, as an evidential presumption, but the same criticisms as before would apply, particularly that it is rather closer to the substantive obligations than any rule of evidence.

The second is that it is inconsistent with Lord Millett's later abrogation of the rule limiting the claimant to a lien if tracing through mixtures in *Foskett v McKeown* (because that rule has its roots in the notional charge theory).[72] It is doubtful whether this analysis is consistent with *Foskett* and this makes *El Ajou* inconclusive on this matter. Therefore, it is submitted, the better analysis is the simple constructive trust one, where a recipient with notice is affected by an (attenuated) fiduciary duty, which is firmly rooted in obligation.

Transactional Links against the Evidence

The first leading tracing case of the twenty-first century was *Foskett v McKeown*. It is significant because, ostensibly, the majority speeches applied the property-based justifications of tracing and advanced the separation claim: "Tracing is … neither a claim nor a remedy … Tracing is also distinct from claiming."[73] Lord Millett's reasoning, however, sits uneasily with this. His leading speech reveals reliance on the fiduciary obligation that cannot be rationalised away as distinct from tracing.

The facts are complex, but must be set out in some detail order to show this. *Foskett* began as another simple case of a trustee appropriating trust money. The trustee was one Murphy and

[68] C. Rotherham, "Tracing Misconceptions in *Foskett v McKeown*" [2003] R.L.R. 57, 74.
[69] On the side of the rule applying to both: J. E. Penner, "The Difficult Doctrinal Basis for the Fiduciary's Proprietary Liability to Account for Bribes" (2012) 18 T. & T. 1000, 1007; C. C. J. Mitchell, P. Mitchell and S. Watterson, *Goff & Jones: The Law of Unjust Enrichment*, 9th edn (London: Sweet & Maxwell, 2016), para.7–49 et seq (hereafter *"Goff & Jones"*); *The Law of Tracing*, p.194; *Lewin*, para.41–068. Cf G. Virgo, *The Principles of Equity & Trusts*, 2nd edn (Oxford: Oxford University Press, 2016), p.664 who says the rules apply to fiduciary mixers; R. Pearce and W. Barr, *Pearce & Stevens' Trusts and Equitable Obligations*, 6th edn (Oxford: Oxford University Press, 2015), p.975; and *Snell*, para 30–057, which begins with "other contributor at fault" but continues to deal with "the wrongdoing trustee".
[70] [1993] 3 All E.R. 717 at 735–6.
[71] *Re Diplock* [1948] 1 Ch. 465 at 524.
[72] [2001] 1 A.C. 102 at 131.
[73] [2001] 1 A.C. 102 at 128.

the beneficiaries were investors in a property development. Murphy had previously taken out a complex life insurance and investment policy with a death benefit of £1m, which would increase once the investment exceeded that value. After paying two of the £10,220 annual instalments with his own money, he began using trust money. The final two payments were made with the trust money and there was a dispute over the origins of the third. Assume it was made with his own money. Murphy committed suicide, triggering the £1m payout, which went to his family as innocent donees.

Lord Millett, who gave the leading and only fully reasoned non-dissenting speech, said that the case was "a textbook example of tracing through mixed substitutions."[74] It would have been but for the complexity of the policy. If it had been a simple life policy with no investment element, three-fifths of the input would have been clean money. The amount attributable to the trust would have been £400,000, consistent with the outcome of the case. However, it was not so simple on the facts. The policy had a life insurance account and an investment policy account. Payments in were allocated to notional "units". Once the premiums required by the life insurance account were satisfied, the units were allocated to the investment side. Had subsequent payments not been made, these units would have been reallocated back to the life insurance side in order to keep the life cover on foot. Crucially, two payments were more than sufficient to keep the life insurance on foot up to the point where Murphy took his own life. So even if the last payments had not been made, the life policy would have paid out. This means that there was no causal link between the breach of trust and the realisation of the substitute property, the £1m, because the trust money went to the notional investment account.

The first issue was that the claimants wanted to assert proportionate ownership, and thus take £400,000. A lien would have limited them to the money put in, only £20,440. Lord Millett noted the criticism of the restriction and its origins in *Re Hallett* and claimed that:

> Any authority that this dictum might otherwise have is weakened by the fact that Sir George Jessel MR gave no reason for the existence of any such rule, and none is readily apparent.[75]

This is difficult to accept. Jessel M.R. based the rule on his notional charge theory, which clearly explains the limitation. Moreover, even if his reasoning is unsatisfactory, the unease shown by the authors of *Lewin* shows good reasons for limiting the remedy. Nonetheless, Lord Millett abrogated the rule and held it was possible to assert ownership and thus take *pari passu*. In doing so he ostensibly severed a major link to the fiduciary obligation basis of tracing. He certainly implicitly rejected the notional charge theory.

The second, more difficult, issue was the absence of a causal link between inputs and output. Lord Millett argued that the order of payments did not matter.[76] He relied on an 1888 article by Williston that gave a reason to do so. Williston's reason, quoted by Lord Millett, was that:

> [T]he trustee cannot be allowed to make a profit from the use of the trust money, and if the property which he wrongfully purchased were held subject only to a lien for the amount invested, any appreciation in value would go to the trustee.[77]

There are five things to be observed from this. The first is the return of the hitherto declining good man theory. The second is that Williston, unsurprisingly, did not consider the issue of

[74] [2001] 1 A.C. 102 at 126.
[75] [2001] 1 A.C. 102 at 131.
[76] [2001] 1 A.C. 102 at 138.
[77] S. Williston, "The Right to Follow Trust Property when Confused with other Property" (1888) 2 Harv. L. Rev. 28, 29; *Foskett* [2001] 1 A.C. 102 at 130–131.

causation in his article. Third is that that passage could be used just as easily in *support* of a causation requirement because it requires the "use" of trust money. The fourth is that the juristic basis of Williston's proposition is not in tracing, but in the remedy for breach of fiduciary duty which creates *new* property rights. The fifth, following from the fourth, is that there are leading English authorities holding this very thing. Lord Millett did not cite them. They are not obscure: *Keech v Sandford*,[78] *Regal (Hastings) Ltd v Gulliver*[79] and *Boardman v Phipps*.[80] Instead, Lord Millett cited the little-known case of *Frith v Cartland*, which relied on the good man theory and the no-profit rule.[81]

Putting aside the casuistry in the reasoning, the problem with *Foskett* is the route used to get to its decision. The justification of tracing espoused was the mere identification of existing property rights; "It is merely the process by which a claimant demonstrates what has happened to his property".[82] The reality is, however, that tracing in *Foskett* was underpinned by the fiduciary obligation that creates new property rights upon breach of that obligation, in order to overcome the absence of a causal link to the substitute property.

A mere evidential presumption would not have overcome this problem because presumptions are displaced by actual facts, and the actual fact was that trust money was not used in the life insurance account. Nor would recourse to the fiduciary's intention do. Murphy certainly intended to use trust money, but ultimately failed to do so. Moreover, this means we cannot rationalise *Foskett* as tracing value because the value did not end up in the substitute property – even if one puts aside the issue of the increase.

There is of course a limit – rather than the claim being over the entire £1m, as Berg argues is the logical conclusion of Lord Millett's argument·[83] ownership is reduced proportionately. This is a result of the need to take only profit, albeit something of a deemed profit based on an intuitive rule of apportionment that matches the proportion of money put in. But despite this analogy to that property principle, this case does not truly sever the link between tracing and the underlying claim. It strengthens and renews it.

Furthermore, this is not simply a combination of the different principles of the proprietary remedy for breach of fiduciary duty and a wholly property-based law of tracing applied syllogistically. They are inextricably linked and interact with and inform each other. An unconstrained remedy for breach of fiduciary duty would have allocated all the gain to the beneficiaries. A wholly property-based rule of tracing would have allocated none of it to them. The obligation rule, namely the restriction of the remedy for breach of the no-profit rule, is informed by the property norm that the proportion owned in the output is the proportion owned in the input. The tracing rule that permits attribution in the absence of a causal link is informed by the no-profit rule that says there must be an account of profits for breach of fiduciary duty. They combine, in this case to yield *pari passu* apportionment.

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[78] (1726) Sel. Cas. Ch. 61; 25 E.R. 223.
[79] [1967] A.C. 134; [1942] 1 All E.R. 378.
[80] [1967] 2 A.C. 46.
[81] *Foskett* [2001] 1 A.C. 102 at 133.
[82] [2001] 1 A.C. 102 at 128.
[83] A. Berg, "Permitting a Trustee to Retain a Profit" (2001) 117 L.Q.R. 366. Berg is to be credited with spotting this issue.

Another unsettled part of law concerns the situation where a trustee mixes trust money with her own money in an account, but preserves the value of the trust in the account at all times. Should the claimant be able to cherry-pick the best transaction and trace into one of the withdrawals, or should the claimant be limited to the money in the account? This is essentially the complex cherry-picking example posited above, but the severity of the remedy is heightened because of the lesser wrongdoing.

The authorities are inconsistent. *Re Hallett* and its reasoning suggests that cherry-picking should be allowed. This conclusion is supported by *dicta* in *Shalson v Russo*.[84] However, the opposite conclusion was reached in *Turner v Jacob*[85] and *Re Tilley's Will Trusts*.[86] An examination of these cases reveal how their reasoning and outcomes are tightly connected to fiduciary and trust obligations and the flexibility the obligation-based approach yields.

In *Re Tilley*, a trustee mixed trust money with her own. She made a considerable profit in what was ostensibly her own dealings in property, but after she had wrongfully mixed trust money with her own. The ultimate beneficiary wished, on an application of *Re Hallett*, to trace into this as substitute property. However, Ungoed-Thomas J. found that the trustee was innocent of intentional wrongdoing; while she was under a duty to keep her own money separate from the trust's, that breach of trust was as far as it went. She had an ample overdraft facility, and this was sufficient for her dealings without relying on the trust money. The withdrawals merely avoided the use of this overdraft facility. This reasoning is supported by the remarks about how tracing through an overdraft was possible (to an extent) in *Durant International*;[87] if tracing trust money through an overdraft is possible, it must also be possible to trace non-trust money through an overdraft. Ungoed-Thomas J. thus held that since the trust money had been preserved at all times, this was as far as the beneficiary could claim.

Oddly, the easier escape route available at the time was not considered – the beneficiary could have been limited to a lien, which could have been discharged through simple payment and no increase in value could have been taken. No such escape route existed by the time of *Turner v Jacob*, which came after the abrogation of that restriction in *Foskett v McKeown*. Here, again, the claimant wished to cherry-pick the best withdrawal and trace into a profitable investment. Patten J. limited him to the value of the trust money in the account. This was justified by "the requirement that the trustee will preserve the fund and not utilise it for purposes unauthorised by the beneficiary."[88] Since the trust money had been preserved, the claim was limited accordingly.

These cases have been considered by some to be wrong turns and it has been said that the claimants should have been allowed to trace further into the profits.[89] However, both can be rationalised by seeing the breach and mixing as innocent. In *Turner v Jacob*, no breach of trust or fiduciary duty was alleged (indeed, the trust was a resulting trust).[90] Thus this case was also unlike *Re Hallett* and *Re Oatway* where breach was pleaded and proven. Without a greater

[84] [2003] EWHC 1637 (Ch); [2005] Ch. 281 at [141]; *Goff & Jones*, paras.7–51 – 7–53.
[85] [2006] EWHC 1317 (Ch).
[86] [1967] Ch. 1179.
[87] [2015] UKPC 35; [2016] A.C. 297 at [39].
[88] [2006] EWHC 1317 (Ch) at [100] relying on *Re Oatway* [1903] 2 Ch. 356 at 361.
[89] J. Lee and J. Glister, *Hanbury and Martin: Modern Equity*, 20th edn (London: Sweet & Maxwell, 2015), para.26–021; *Goff & Jones*, para.7–53.
[90] [2006] EWHC 1317 (Ch) at [85].

degree of fault, the account of profits remedy is not activated. Here there is no breach of fiduciary duty: there has been no use of the trust property to make a profit, so the strict liability no-profit rule is not engaged; and there has been no bad faith, which means this fault-based facet of the duty of loyalty is not engaged either. It is a mere breach of trust, not a breach of fiduciary duty, which triggers less severe remedies.[91]

Clearly this brings flexibility and assuages some of the concerns the authors of *Lewin* have. Again, one must ask if this is merely the wrong explanation and if this rule should be rationalised as an evidential presumption, in which case a property basis of tracing could accommodate it. But, since it distinguishes between breach of fiduciary duty and breach of trust, it is so close to the fiduciary obligation that it is unreal to call it anything else. It is not a case of wrongdoer or innocent. It is a question of what kind of wrongdoing counts – breach of trust or breach of fiduciary duty, whether it is fault-based or strict liability, as well as the state of mind of the exchanger. Delineated precisely by the underlying claim, it is artificial to characterise it as an evidential presumption.

Conclusion

Tracing contains competing theories and justifications, many of them inconsistent. But, if one cuts through them and examines the operative principles, it becomes apparent that it is both ahistoric and false *per se* to see tracing as the obligation-free expression of a set of property law rules. The obligation-based tracing that is the current law does mimic a property model of tracing, but that is because it works to attribute a substitution in a transaction as if it were a trust transaction and this requires specific property to fix upon. But the converse is impossible: a property model of tracing cannot mimic the obligational aspects of tracing – particularly the subordination of fiduciary wrongdoers – and attempts to rationalise them as evidential presumptions are unconvincing. Thus in the current rules of tracing, there is both obligation and property but, while perhaps not obvious at first blush, it is obligation that dominates.

It is true that the courts could continue to develop tracing so as to purge obligation from it. But this would take away much of its flexibility and make it unjust. It would go too easy on the worst wrongdoers such as the trustees in *Foskett v McKeown* and the complex cherry-picking situation where the breach is intentional, and go too hard on lesser wrongdoers such as those in *Turner v Jacob* and *Re Tilley* who did not deliberately breach their duties. It would take away the ability to develop defences such as *bona fide* change of position and to distinguish between pure proprietary claims and restitutionary proprietary claims, which have different justifications and therefore potentially different remedies. Moreover, there are valid reasons for having different tracing rules for different claims, which might be more compelling than maintaining the doctrinal purity of the separation claim.[92]

Regardless of these possibilities, the theoretical consequences of the continuing presence of obligation in the present law of tracing are profound. Unless and until the courts actively remove it, the proposition that the process of tracing is wholly separate from the claim is false.

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[91] *Bristol and West Building Society v Mothew* [1998] Ch. 1 at 16: "not every legal claim arising out of a relationship with fiduciary incidents will give rise to a claim for breach of fiduciary duty."

[92] E.g., J. Stevens, "Vindicating the Proprietary Nature of Tracing" [2001] 64 Conv. 94, 100; D. Whayman, "Remodelling Knowing Receipt as a Gains-Based Wrong" [2016] J.B.L. 565, 588.