Michaelmas Term
[2014] UKSC 58
On appeal from [2013] EWCA Civ 45

JUDGMENT

AIB Group (UK) Plc (Appellant)
v
Mark Redler & Co Solicitors (Respondent)

before

Lord Neuberger, President
Lady Hale, Deputy President
Lord Wilson
Lord Reed
Lord Toulson

JUDGMENT GIVEN ON

5 November 2014

Heard on 5 June 2014

Appellant	*Respondent*
Jeremy Cousins QC	Graeme McPherson QC
Nicholas Davidson QC	Sian Mirchandani
John Brennan	Nicole Sandells
(Instructed by Moran & Co, Tamworth)	(Instructed by Mills and Reeve LLP)

LORD TOULSON

Introduction

1. 140 years after the Judicature Act 1873, the stitching together of equity and the common law continues to cause problems at the seams. The present appeal concerns the remedy available to the appellant bank against the respondent, a firm of solicitors, for breach of the solicitors' custodial duties in respect of money entrusted to them for the purpose of completing a loan which was to be secured by a first charge over the borrowers' property. As is customary in such transactions, the solicitors acted for both the bank and the borrowers.

Facts

2. In June 2006 Mr and Mrs Sondhi applied to borrow £3.3m from the appellant ("the bank"). The loan was to be secured by a first legal charge over the borrowers' home, which had been valued at £4.25m. The property was at that time the subject of a first legal charge in favour of Barclays Bank plc ("Barclays"). The Barclays charge secured borrowings on two accounts amounting to about £1.5m.

3. The bank agreed to the borrowers' proposal and made a formal offer on terms which included a condition that the existing mortgage was to be redeemed on or before completion of the mortgage advance. The bank retained the respondents ("the solicitors") to act for it by a letter of instruction dated 5 July 2006.

4. The letter of instruction stated that the solicitors were instructed in accordance with Council of Mortgage Lenders' ("CML") Handbook for England and Wales, 2nd edition. The handbook stated among other things that on completion the mortgage lender required a fully enforceable first charge over the property by way of legal mortgage, and that all existing charges must be redeemed on or before completion. The handbook also stated:

> "You must hold the loan on trust for us until completion. If completion is delayed, you must return it to us when and how we tell you".

The letter of instruction included copies of the bank's offer to the borrowers and its conditions of offer.

5. The solicitors were told by the borrowers that the property was mortgaged to Barclays. On 31 July Barclays provided them with information about the two accounts, which showed the total balance due as a little over £1.5m, but this was not a redemption statement. Meanwhile the solicitors asked the bank to forward the funds because completion was imminent. The bank did so on 1 August, and the solicitors telephoned Barclays for a redemption figure. Unfortunately there was then a misunderstanding. The solicitors were given a redemption figure for one of the two Barclays accounts which they mistakenly took to be the total figure. They were at fault because they should have realised from the information supplied by Barclays that the figure related only to one account. However, on 1 August the solicitors remitted to Barclays the figure which they wrongly believed was the total necessary to redeem the Barclays mortgage and remitted the balance of the £3.3m less expenses to the borrowers. The borrowers had executed what was intended to be a first charge over the property in favour of the bank, but there remained due to Barclays a debt of approximately £309,000 secured by the prior Barclays charge.

6. Barclays naturally refused to release its charge unless the outstanding debt was paid in full. At first the borrowers promised to pay the necessary sum to Barclays but they failed to keep their word. The solicitors did not immediately tell the bank of their error, as they should, because they hoped to be able to resolve it. When eventually they informed the bank there were negotiations between the bank and Barclays with the result that the bank executed a deed of postponement acknowledging the primacy of the Barclays charge and Barclays consented to the registration of the appellant bank's charge as a second charge.

7. Subsequently the borrowers defaulted, and the property was repossessed and sold by Barclays in February 2011 for £1.2m, of which the bank received £867,697.

8. The issue is how much the bank is entitled to recover from the solicitors. The bank claims that it is entitled to the full amount of its loan less the amount recovered by it. The solicitors contend that their liability is limited to the amount by which the bank suffered loss by comparison with its position if the solicitors had done as they should, which was to have paid Barclays the full amount of the Barclays debt so as to redeem the Barclays charge. The difference, leaving interest aside, is between £2.5m and £275,000 in round figures.

The action

9. The bank alleged that the solicitors acted in breach of trust, breach of fiduciary duty, breach of contract and negligence. It claimed relief in the forms of (i) reconstitution of the fund paid away in breach of trust and in breach of fiduciary duty, (ii) equitable compensation for breach of trust and breach of fiduciary duty, and (iii) damages for breach of contract and negligence, in each case with interest. The solicitors admitted that they acted negligently and in breach of contract but denied the other allegations and they claimed relief under section 61 of the Trustee Act 1925 if found to have acted in breach of trust.

10. At the trial, before His Honour Judge Cooke, the bank accepted that the solicitors had acted in good faith.

11. The judge found that the solicitors acted in breach of trust, which he analysed as follows:

> "23. In the present case, . . . what the defendant's instructions authorised them to do with the funds paid to them was to pay to Barclays (or to its account) such sum as was required to procure a release of its charge, and pay the balance to the borrowers or to their order. Had they complied with their instructions they would have paid (taking all the figures in round terms) £1.5m to Barclays and £1.8m to the borrowers. In the event they paid £1.2m to Barclays and £2.1m to the borrowers. In my judgment, in so doing they committed a breach of trust in so far as payment was made contrary to the authority they had been given.
>
> 24. It does not however in my judgment necessarily follow that the whole of the payment of £3.3m was made in breach of trust. The difference between what the defendant did and what it ought to have done if it had complied with its instructions was the £300,000 that should have been paid to Barclays but was instead paid to the borrowers. That in my judgment was the extent of the breach of trust committed. It was not a breach of trust to pay £1.2m to Barclays; that payment was made as partial performance of the authority and obligation to discharge Barclays' secured debt. It was not a breach of trust to pay £1.8m to the borrowers, as that was the sum to which they were entitled. The breach consisted of the failure to retain an

> additional £300,000 and apply that to the discharge of the Barclays debt."

12. As to the remedy, the judge held that prima facie the bank was entitled to reconstitution of the trust fund by repayment of the amount wrongly paid away. As to the bank's alternative claim for equitable compensation or damages, he said that where the breach consisted of failure to discharge a prior mortgage, with the result that the bank's interest had been postponed to the Barclays charge, the bank was entitled to equitable compensation for the additional amounts due to Barclays for which Barclays had security in priority to the bank. The solicitors were therefore liable to the bank for the additional amount ultimately obtained by Barclays by reason of its prior security.

13. The judge added that in those circumstances he did not intend to venture into the argument as to the appropriate remedy if the solicitors committed a breach of trust in paying out any part of the advance, except to find as a fact what would have happened but for the breach of trust.

14. That question, he said, could be approached on one of two bases, namely what would the outcome have been if the solicitors had either (i) dealt with the funds held in the manner they were authorised to do or (ii) instead of making the unauthorised payment they did, had asked the bank for instructions at that point, disclosing the reasons why the payment was outside their existing authority. He concluded that on either approach the answer would be the same on the facts of the case. There would have been a short delay while the solicitors obtained a redemption figure in a form that bound Barclays to release its charge; they would then have paid that amount to Barclays; they would in due course have received a release and they would have registered the bank's charge as a first charge. He added that, on the implausible scenario that the solicitors realising that they did not have a valid redemption quotation had approached the bank for further instructions, the bank would not have withdrawn from the transaction but would have instructed the solicitors to carry on with it, complying with their existing instructions. The judge added that it was clear from the evidence that the bank was anxious to lend to the borrowers and that the domestic re-mortgage was driven by the need to facilitate business lending which the bank was very keen to make.

15. The judge therefore gave judgment for the bank in the sum of £273,777 plus interest. It was not necessary in the circumstances for him to deal with the issue of relief under section 61 of the Trustee Act, which would have arisen

if he had held that the bank was prima facie entitled to recover the entire amount of the loan.

16. The Court of Appeal (Arden, Sullivan and Patten LJJ) held that the judge was wrong to treat the breach of trust as limited to that part of the mortgage advance which was paid to the borrowers instead of being used to discharge their liability to Barclays on the second account. The judgment of the court was given by Patten LJ. Citing earlier authorities and the provisions of the CML Handbook, he held that the solicitors had no authority to release any part of the funds advanced by the bank unless and until they had a redemption statement from Barclays coupled with an appropriate undertaking which enabled them to be sure that they would be able on completion to register the bank's charge as a first charge over the property. The solicitors have not challenged the Court of Appeal's reasoning on that point. However, the Court of Appeal upheld the judge's decision regarding the relief to which the bank was entitled and dismissed the bank's appeal.

17. In reaching its conclusion the Court of Appeal applied what it understood to be the reasoning of the House of Lords in *Target Holdings Ltd v Redferns* [1996] AC 421. It held that where the breach of trust occurred in the context of a commercial transaction such as the present, *Target Holdings* established that equitable principles of compensation "although not employing precisely the same rules of causation and remoteness as the common law, do have the capacity to recognise what loss the beneficiary has actually suffered from the breach of trust and to base the compensation recoverable on a proper causal connection between the breach and the eventual loss" (per Patten LJ at para 47).

18. Applying that principle to the facts found by the judge, Patten LJ said at para 49:

> "If one asks as at the date of trial and with the benefit of hindsight what loss AIB has suffered then the answer is that it has enjoyed less security for its loan than would have been the case had there been no breach of trust. If [the solicitors] had obtained from Barclays a proper redemption statement, coupled with an undertaking to apply the sums specified in the statement in satisfaction of the existing mortgage, then the transaction would have proceeded to complete and AIB could have obtained a first legal mortgage over the Sondhis' property. But although that did not happen, AIB did obtain a valid mortgage from the Sondhis which they were eventually able to register as a second charge and use to recover part of their loan

> from the proceeds of the security in priority to the Sondhis' other creditors. Even had there been no such mortgage they would have been subrogated to Barclays' first charge insofar as they discharged part of the Sondhis' indebtedness by the payment of the £1.2m. In my view all of these are matters to be taken into account in considering what loss has ultimately been caused by the solicitors' breach of trust. In the light of the judge's findings it is not open to AIB to contend that but for the breach of trust it simply would have asked for its money back."

19. As to the point made by the bank that in the present case the breach of trust was never made good because the bank never obtained a first charge over the intended security (by contrast with the position in *Target Holdings*), Patten LJ considered this irrelevant to the question of principle about how the bank's equitable compensation was to be calculated. *Target Holdings* stood as authority for the broad principle identified by Lord Browne-Wilkinson as follows:

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

Like the trial judge, the Court of Appeal did not find it necessary to express any views about section 61 of the Trustee Act.

Target Holdings

20. The present case bears a close similarity to *Target Holdings*, but there is one factual difference which the bank submits is of critical importance. Both parties rely on *Target Holdings* in support of their respective cases. Neither party has expressly asked this court to depart from its reasoning, but part of the bank's argument involves a re-interpretation of the reasoning in *Target Holdings* which is in truth a dressed up attack on it. The reasoning in *Target Holdings* has attracted a considerable amount of commentary, partly supportive but mostly critical. There was only one speech, given by Lord Browne-Wilkinson. In view of the arguments to which it has led, it is necessary to look at his speech in some detail.

21. The facts of *Target Holdings* were described by Lord Browne-Wilkinson as redolent of fraud, but the murky aspects did not affect the decision of the House of Lords. The matter reached the House of Lords on an appeal by the defendant solicitors against an order for summary judgment. The undisputed facts were that the plaintiff finance company agreed to make loans to a company called Crowngate on the security of commercial property, for which Crowngate provided a professional valuation at £2m. The solicitors acted both for the finance company and for Crowngate. For the purposes of the transaction the finance company transferred about £1.5m to the solicitors without any express instructions as to its release. It was common ground that the solicitors had implied authority to pay the money to or to the order of Crowngate on completion of the conveyance of the land to Crowngate, provided that Crowngate had executed a charge in favour of the finance company. The solicitors wrongly released the bulk of the money to Crowngate before completion of the conveyance or the execution of a charge by Crowngate. The conveyance of the property to Crowngate and its execution of a legal charge in favour of the finance company took place some days later. Crowngate later defaulted on repayment of the loans and was wound up as insolvent. The finance company sold the property as mortgagee for £500,000.

22. The finance company sued the solicitors for breach of trust and negligence in releasing funds to Crowngate at a time when they had no authority to do so. On an application for summary judgment, the judge at first instance gave the solicitors unconditional leave to defend the claim in negligence, and there was no appeal against that part of his order. On the claim for breach of trust he gave the solicitors conditional leave to defend, but the Court of Appeal by a majority gave summary judgment to the finance company for the amount which the solicitors had advanced prematurely to Crowngate, less the amount recovered by the finance company.

23. Peter Gibson LJ (with whom Hirst LJ agreed) held that the basic liability of a trustee in breach of trust was not to pay damages, but to restore to the trust fund that which had been lost to it or to pay compensation to the beneficiary for what he had lost. If a trustee wrongly paid away trust monies to a stranger, there was an immediate loss to the trust fund and the trustee came under an immediate duty to restore the monies to the trust fund. The remedies of equity were sufficiently flexible to require the finance company to give credit for monies received on the subsequent realisation of its security, but otherwise the solicitors' liability was to pay the whole of the monies wrongly paid away.

24. In a dissenting judgment Ralph Gibson LJ held that it was necessary for the court to examine the nature of the relationship between the parties out of

which the solicitors' equitable duty arose. If, having regard to the relationship and its purpose, the obligations of the parties, its purpose and the obligations of the parties within it, it appeared just to regard the breaches as having caused no loss, because the loss would have happened if there had been no breach, the court should so hold.

25. Lord Browne-Wilkinson began his speech by saying that the appeal raised a novel point on the liability of a trustee who commits a breach of trust to compensate beneficiaries for such breach. He framed the issue in this way:

> "Is the trustee liable to compensate the beneficiary not only for losses caused by the breach but also for losses which the beneficiary would, in any event, have suffered even if there had been no such breach?"

26. He observed that at common law there are two principles fundamental to an award of damages. First, the defendant's wrongful act must cause the damage of which complaint is made. Second, the plaintiff is to be put "in the same position as he would have been in if he had not suffered the wrong for which he is now getting his compensation or reparation" (*Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39, per Lord Blackburn). Equity, he said, approaches liability for making good a breach of trust from a different starting point, but the same two principles are applicable as much in equity as at common law. Under both systems liability is fault-based: the defendant is only liable for the consequences of the legal wrong he has done to the plaintiff and to make good the damage caused by such wrong. He therefore approached the consideration of the rules of equity relevant to the appeal with a "strong predisposition" against holding that Redferns should be held liable to compensate Target for a loss caused otherwise than by the breach of trust.

27. Lord Browne-Wilkinson examined two arguments made on behalf of the finance company. First, he considered whether Redferns were under a continuing duty to reconstitute the trust fund by paying back into client account the monies paid away in breach of trust (argument A). Secondly, he considered the argument accepted by the majority of the Court of Appeal that there was an immediate right to have the trust fund reconstituted at the moment of the breach of trust, which gave rise to a cause of action regardless of later events (argument B).

28. Lord Browne-Wilkinson prefaced his consideration of the arguments by some important observations about the nature of a beneficiary's rights under a trust. His starting point was that the basic right of a beneficiary is to have

the trust duly administered in accordance with the provisions of the trust instrument, if any, and the general law. It followed that in relation to a traditional trust where a fund is held in trust for a number of beneficiaries having different, usually successive equitable interests, the right of each beneficiary is to have the whole fund vested in the trustees so as to be able to satisfy his equitable interest.

29. The "equitable rules of compensation for breach of trust", he said, have been largely developed in relation to such traditional trusts, where the only way in which all the beneficiaries' rights can be protected is to restore to the trust fund what ought to be there. (As will be seen, some commentators have criticised his use of the term "compensation for breach of trust" in this context. They say that it confuses compensation with the primary accounting responsibility of a trustee.)

30. In such a case, according to Lord Browne-Wilkinson, the basic rule is that a trustee in breach of trust must either restore to the trust the assets which have been lost by reason of the breach of trust or pay monetary compensation to the trust estate. In so doing, courts of equity did not award "damages" but would make an in personam order for the payment of equitable compensation: *Nocton v Lord Ashburton* [1914] AC 932, at paras 952, 958, per Viscount Haldane LC.

31. Having thus considered how courts of equity would enforce the basic right of a beneficiary to have the trust duly administered in a case where the trust was subsisting and where the only right of each beneficiary was to have the trust fund reconstituted as it should be, Lord Browne-Wilkinson went on to consider the position if at the time of the action the trust had come to an end, for example by the beneficiary becoming absolutely entitled to the trust fund. In such a case, there was no need for restitution to the trust fund in order to protect other beneficiaries. The normal order would therefore be for the payment of compensation directly to the beneficiary. The measure of compensation would be the difference between what the beneficiary had in fact received and the amount which he would have received but for the breach of trust.

32. That analysis (which I will refer to as Lord Browne-Wilkinson's fundamental analysis) provided the foundation for all that followed.

33. Lord Browne-Wilkinson rejected the argument that a beneficiary had automatically a continuing right to the reconstitution of the trust fund (argument A). He repeated that in relation to a "traditional trust", a

beneficiary who was absolutely entitled to a trust fund had no automatic right to have the fund reconstituted. Moreover, while the fundamental principles of equity apply to all trusts, certain detailed rules applicable to one form of trust (a traditional trust) do not necessarily have to be applied to other forms of trust (a commercial trust) if the rationale does not sensibly apply to the latter.

34. The House of Lords was concerned with a bare trust. Bare trusts may arise in a number of different contexts. In the case under consideration, it was one incident of a commercial transaction involving agency. The purpose of the solicitors' retainer was to achieve the bank's commercial objective. It was one aspect of arrangements between the parties which were mostly contractual. He said at p 436:

> "I do not intend to cast any doubt on the fact that monies held by solicitors on client account are trust monies or that the basic equitable principles apply to any breach of such trust by solicitors. *But the basic equitable principle applicable to breach of trust is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach. I have no doubt that, until the underlying commercial transaction has been completed, the solicitor can be required to restore to client account monies wrongly paid away.* But to import into such trust an obligation to restore the trust fund once the transaction has been completed would be entirely artificial." (My emphasis).

He added that, once a conveyancing transaction has been completed, the client has no right to have the solicitor's client account reconstituted as a trust fund.

35. To anticipate the argument discussed below, the bank relied on the second italicised sentence in this passage. It was submitted that in this case, in contrast with *Target Holdings*, the "underlying commercial transaction" was never completed because the shortfall in the payment needed to redeem the Barclays charge was never paid.

36. To return to Lord Browne-Wilkinson's analysis, argument B was the rationale of the judgments of the majority in the Court of Appeal. In rejecting it Lord Browne-Wilkinson cited the (dissenting) judgment of McLachlin J in *Canson Enterprises Ltd v Boughton & Co.* (1991) 85 DLR (4th) 129 and, in particular, the following passage at p 163:

> "In summary, compensation is an equitable monetary remedy which is available when the equitable remedies of restitution and account are not appropriate. By analogy with restitution, it attempts to restore to the plaintiff what has been lost as a result of the breach, ie, the plaintiff's loss of opportunity. The plaintiff's actual loss as a consequence of the breach is to be assessed with the full benefit of hindsight. Foreseeability is not a concern in assessing compensation, but it is essential that the losses made good are only those which, on a common sense view of causation, were caused by the breach."

Lord Browne-Wilkinson added:

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

On that approach Lord Browne-Wilkinson held that Target was not entitled to the summary judgment which the Court of Appeal had ordered.

The arguments

37. There were two branches to the arguments advanced on behalf of the bank by Mr Jeremy Cousins QC and Mr Nicholas Davidson QC. I have referred to the first in para 35.

38. The second was advanced partly by Mr Cousins but in greater detail by Mr Davidson, who reinforced his argument by reference to the Solicitors' Accounts Rules.

39. Mr Davidson adopted in his argument the views expressed by Lord Millett (then Sir Peter Millett) in his article "Equity's Place in The Law of Commerce" (1998) 114 LQR 214 and more recently in his judgment in *Libertarian Investments Ltd v Hall* [2013] HKCFA 93; [2014] 1 HKC 368. A trustee owes a duty to hold trust funds and apply them for the purposes of the trust (a stewardship or custodial duty). He is bound to answer for his stewardship when called on by the beneficiary to do so. If for any reason he misapplies the trust fund, or part of it, he must immediately reconstitute the trust fund in full. If he fails to do so, the court will order him to reconstitute

the fund in specie, if that is possible, or pay the equivalent sum in money so as to produce the same result in financial terms. So in *Target Holdings*, where the solicitor wrongly paid out the funds before obtaining an executed mortgage, he remained liable to restore the fund; but he was deemed notionally to have done so and to have paid out the money properly at the moment when the preconditions for an authorised disposal of the fund were met.

40. The present case is different, it was submitted, because the solicitors failed on discovering their mistake to pay Barclays the additional sum necessary to redeem its charge. They could and should have done so, in which case their position would have been indistinguishable from that of Redferns. But it was now too late. This, Mr Davidson submitted, is the correct analysis of *Target Holdings.*

41. Solicitors' Accounts Rules are made under section 32 of the Solicitors Act 1974 (amended by the Legal Services Act 2007). At the material time the relevant Rules were the 1998 Rules. (On 6 October 2011 the Solicitors Regulation Authority made the SRA Accounts Rules 2011, which replaced the 1998 Rules.)

42. The payment out of the bank's money to the borrowers on 1 August 2006 was unauthorised by the bank and so was a breach of rule 22 of the 1998 Rules regarding the operation of a solicitor's client account. Rule 7 obliged the solicitors to remedy the breach on its discovery. The rule provided:

> "(1) Any breach of the rules must be remedied promptly upon discovery. This includes the replacement of any money improperly withheld or withdrawn from a client account.
>
> (2) In a private practice, the duty to remedy breaches rests not only on the person causing the breach, but also on all the principals in the practice. This duty extends to replacing missing client money or controlled trust money from the principals' own resources, even if the money has been misappropriated by an employee or fellow principal, and whether or not a claim is subsequently made on the Solicitors' Indemnity or Compensation Funds."

43. Mr Graeme McPherson QC submitted on behalf of the solicitors that the Court of Appeal was right to see the case in terms of causation of loss, and it was also right in concluding that the proper measure of the bank's loss was

the difference between its actual financial position and the position in which it would have been if the solicitors had not acted in breach of trust. On the findings of the trial judge, the loss to the bank (excluding interest) was the amount by which the value of its security was less than it should have been, which was the same as the amount of the overpayment to the borrowers and underpayment to Barclays.

44. Mr McPherson submitted that the Court of Appeal correctly applied the fundamental principles stated by Lord Browne-Wilkinson. The commercial transaction in which the solicitors were instructed was completed in the sense that Lord Browne-Wilkinson used that expression when the loan monies were advanced to the borrowers, thereby creating the relationship of lender and borrower between the bank and the borrowers, notwithstanding that the solicitors had wrongly failed to see that a sufficient part of the loan money was paid to Barclays on completion of the loan for the redemption of the Barclays mortgage. The bank was entitled to have the solicitors' breach of trust remedied, but the appropriate remedy was for the solicitors to make good the shortfall. That remedy was provided by the judgment of Judge Cooke.

45. The bank was right, he submitted, to concede that if the shortfall had been made good before Barclays enforced its charge by selling the land, the bank would not have been entitled to recover the additional amount claimed by it. The argument that since the solicitors failed to do so, they were liable additionally for the loss which the bank would still have suffered if the shortfall had been made good, lacked justice or common sense. Whether the amount for which Barclays had superior security was paid by the solicitors before or after the sale of land made no difference to the bank's financial position and ought not to affect the legal result.

46. As to the Solicitors' Accounts Rules, rule 7 was not prescriptive about the form of remedy or how money improperly withdrawn from a client account should be replaced. In this case, Mr McPherson submitted, a proper form of replacement would have been to pay to Barclays the amount which had been wrongly paid to the borrowers rather than to Barclays. The solicitors' failure to do so promptly might expose them to a risk of disciplinary proceedings, but did not affect the legal analysis.

Discussion

47. The debate which has followed *Target Holdings* is part of a wider debate, or series of debates, about equitable doctrines and remedies and their inter-

relationship with common law principles and remedies, particularly in a commercial context. The parties have provided the court with nearly 900 pages of academic writing. Much of it has been helpful, but to attempt even to summarise the many threads of argument which run through it, acknowledging the individual authors, would be a lengthy task and, more importantly, would not improve the clarity of the judgment. Nor is it necessary to set out a full historical account of all the case law cited in the literature reaching back to *Caffrey v Darby* (1801) 6 Ves Jun 488.

48. In the present case the solicitors owed a compendium of duties to the bank. Their relationship was governed by a contract but they held the money advanced by the bank on trust for the purpose of performing their contractual obligations. They broke their contract and acted in breach of trust when they released to the borrowers the money advanced by the bank, less a part of the sum required to redeem the Barclays mortgage, when they should have paid to Barclays the full amount required for that purpose, in return for an undertaking to issue a redemption certificate, and should have released the diminished balance to the borrowers.

49. The determination of this appeal involves two essential questions. The more important question in the appeal is whether Lord Browne-Wilkinson's statement in *Target Holdings* of the fundamental principles which guided him in that case should be affirmed, qualified or (as the bank would put it) reinterpreted. Depending on the answer to that question, the second is whether the Court of Appeal properly applied the correct principles to the facts of the case.

50. Two main criticisms have been made of Lord Browne-Wilkinson's approach. They have been made by a number of scholars, most recently by Professor Charles Mitchell in a lecture on "Stewardship of Property and Liability to Account" delivered to the Chancery Bar Association on 17 January 2014, in which he described the Court of Appeal's reasoning in this case as incoherent. He expressed the hope that "if the case reaches the Supreme Court their Lordships will recognise that Lord Browne-Wilkinson took a false step in *Target* when he introduced an inapt causation requirement into the law governing … substitutive performance claims." He added that if it is thought too harsh to fix the solicitors in this case with liability to restore the full amount of the loan (subject only to a deduction for the amount received by the sale of the property), the best way to achieve this is "not to bend the rules governing substitutive performance claims out of shape", but to use the Trustee Act 1925, section 61, to relieve them from some or all of their liability.

51. The primary criticism is that Lord Browne-Wilkinson failed to recognise the proper distinctions between different obligations owed by a trustee and the remedies available in respect of them. The range of duties owed by a trustee include:

(1) a custodial stewardship duty, that is, a duty to preserve the assets of the trust except insofar as the terms of the trust permit the trustee to do otherwise;

(2) a management stewardship duty, that is, a duty to manage the trust property with proper care;

(3) a duty of undivided loyalty, which prohibits the trustee from taking any advantage from his position without the fully informed consent of the beneficiary or beneficiaries.

52. Historically the remedies took the form of orders made after a process of accounting. The basis of the accounting would reflect the nature of the obligation. The operation of the process involved the court having a power, where appropriate, to "falsify" and to "surcharge".

53. According to legal scholars whose scholarship I have no reason to doubt, in the case of a breach of the custodial stewardship duty, through the process of an account of administration in common form, the court would disallow (or falsify) the unauthorised disposal and either require the trust fund to be reconstituted in specie or order the trustee to make good the loss in monetary terms. The term "substitutive compensation" has come to be used by some to refer to a claim for the value of a trust asset dissipated without authority. (See the erudite judgment in *Agricultural Land Management Ltd v Jackson (No 2)* [2014] WASC 102 of Edelman J, who attributes authorship of the term to Dr Steven Elliott.)

54. In a case of breach of a trustee's management stewardship duty, through the process of an action on the basis of wilful default, a court could similarly falsify or surcharge so as to require the trustee to make good the loss resulting from the breach. The phrase "wilful default" is misleading because, as Brightman LJ explained in *Bartlett v Barclays Bank Trust Co Ltd (Nos 1 and 2)* [1980] Ch 515, 546, conscious wrongdoing is not required. In this type of case the order for payment by the trustee of the amount of loss is referred to by some as "reparative compensation", to differentiate it from "substitutive

compensation", although in a practical sense both are reparative compensation.

55. In a case of breach of the duty of undivided loyalty, there are possible alternative remedies. If the trustee has benefited from it, the court will order him to account for it on the application of the beneficiary. In *Bristol and West Building Society v Mothew* [1998] Ch 1 Millett LJ described such relief as "primarily restitutionary or restorative rather than compensatory". Alternatively, the beneficiary may seek compensation in respect of his loss.

56. The history of the account of profits is more complex than this summary might suggest, and the whole concept of equitable compensation has developed and become far more prominent in the law since *Nocton v Lord Ashburton.* However, what I have said is sufficient to identify the main criticism advanced against Lord Browne-Wilkinson's approach in *Target Holdings.* It is said that he treated equitable compensation in too broad-brush a fashion, muddling claims for restitutive compensation with claims for reparative compensation.

57. The relevant principle, it is suggested, in a case of unauthorised dissipation of trust funds is that "the amount of the award is measured by the objective value of the property lost, determined at the date when the account is taken and with the benefit of hindsight", per Millett NPJ in *Libertarian Investments Ltd v Hall* [2014] 1 HKC 368, para 168. In determining the value of what has been lost, the court must take into account any offsetting benefits received, but it is not relevant to consider what the trustee ought to have done. The court is concerned only with the net value of the lost asset.

58. This argument has the approval of Edelman J in *Agricultural Land Management Ltd v Jackson (No2)*, and there are statements in the authorities cited by him which support that approach, for example, by Lord Halsbury LC in *Magnus v Queensland National Bank* (1888) 37 Ch D, at paras 466, 472, although the issue in that case was different. The defendant advanced an argument which Bowen LJ, at para 480, likened to a case where "A man knocks me down in Pall Mall, and when I complain that my purse has been taken, the man says, 'Oh, but if I had handed it back again, you would have been robbed over again by somebody else in the adjoining street.'" It is good sense and good law that if a trustee makes an unauthorised disbursement of trust funds, it is no defence to a claim by the beneficiary for the trustee to say that if he had not misapplied the funds they would have been stolen by a stranger. In such a case the actual loss has been caused by the trustee. The hypothetical loss which would have otherwise have occurred through the stranger's intervention would have been a differently caused loss, for which

that other person would have been liable. Bowen LJ's example is far removed in terms of causation of loss from the present case, where the loan agreement involved the bank taking the risk of the borrowers defaulting, and the fault of the solicitors lay in releasing the funds without ensuring that the bank received the full security which it required, with the consequence that the amount of the bank's exposure was greater than it should have been.

59. In *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 Tipping J rightly observed that while historically the law has tended to place emphasis on the legal characterisation of the relationship between the parties in delineating the remedies available for breach of an obligation, the nature of the duty which has been breached can often be more important, when considering issues of causation and remoteness, than the classification or historical source of the obligation.

60. Tipping J identified three broad categories of breach by a trustee. First, there are breaches of duty leading directly to damage or to loss of trust property. Secondly, there are breaches involving an element of infidelity. Thirdly, there are breaches involving a lack of appropriate skill and care. He continued at para 687:

> "In the first kind of case the allegation is that a breach of duty by a trustee has directly caused loss of or damage to the trust property. The relief sought by the beneficiary is usually in such circumstances of a restitutionary kind. The trustee is asked to restore the trust estate, either in specie or by value. The policy of the law in these circumstances is generally to hold the trustee responsible if, but for the breach, the loss or damage would not have occurred. This approach is designed to encourage trustees to observe to the full their duties in relation to trust property by imposing on them a stringent concept of causation [ie a test by which a "but for" connection is sufficient]. Questions of foreseeability and remoteness do not come into such an assessment."

61. According to the bank's argument, the responsibility of the solicitors is still more stringent. It seeks to hold them responsible for loss which it would have suffered on the judge's findings if they had done what they were instructed to do. This involves effectively treating the unauthorised application of trust funds as creating an immediate debt between the trustee and the beneficiary, rather than conduct meriting equitable compensation for any loss thereby caused. I recognise that there are statements in the authorities which use that language to describe the trustee's liability. For example, in *Ex p Adamson; In*

re Collie (1878) 8 Ch D, at paras 807, 819, James and Baggallay LJJ said that the Court of Chancery never entertained a suit for damages occasioned by fraudulent conduct or for breach of trust, and that the suit was always for "an equitable debt, or liability in the nature of a debt". This was long before the expression "equitable compensation" entered the vocabulary. Equitable monetary compensation for what in that case was straightforward fraud was clothed by the court in the literary costume of equitable debt, the debt being for the amount of the loss caused by the fraud. Whatever label is used, the question of substance is what gives rise to or is the measure of the "equitable debt or liability in the nature of a debt", or entitlement to monetary compensation, and what kind of "but for" test is involved. It is one thing to speak of an "equitable debt or liability in the nature of a debt" in a case where a breach of trust has caused a loss; it is another thing for equity to impose or recognise an equitable debt in circumstances where the financial position of the beneficiaries, actual or potential, would have been the same if the trustee had properly performed its duties.

Conclusion

62. There are arguments to be made both ways, as the continuing debate among scholars has shown, but absent fraud, which might give rise to other public policy considerations that are not present in this case, it would not in my opinion be right to impose or maintain a rule that gives redress to a beneficiary for loss which would have been suffered if the trustee had properly performed its duties.

63. The same view was expressed by Professor Andrew Burrows in Burrows and Peel (eds.), *Commercial Remedies*, 2003, pp 46-47, where he applauded *Target Holdings* for impliedly rejecting older cases that may have supported the view that the accounting remedy can operate differently from the remedy of equitable compensation. Despite the powerful arguments advanced by Lord Millett and others, I consider that it would be a backward step for this court to depart from Lord Browne-Wilkinson's fundamental analysis in *Target Holdings* or to "re-interpret" the decision in the manner for which the bank contends.

64. All agree that the basic right of a beneficiary is to have the trust duly administered in accordance with the provisions of the trust instrument, if any, and the general law. Where there has been a breach of that duty, the basic purpose of any remedy will be either to put the beneficiary in the same position as if the breach had not occurred or to vest in the beneficiary any profit which the trustee may have made by reason of the breach (and which ought therefore properly to be held on behalf of the beneficiary). Placing the

beneficiary in the same position as he would have been in but for the breach may involve restoring the value of something lost by the breach or making good financial damage caused by the breach. But a monetary award which reflected neither loss caused nor profit gained by the wrongdoer would be penal.

65. The purpose of a restitutionary order is to replace a loss to the trust fund which the trustee has brought about. To say that there has been a loss to the trust fund in the present case of £2.5m by reason of the solicitors' conduct, when most of that sum would have been lost if the solicitors had applied the trust fund in the way that the bank had instructed them to do, is to adopt an artificial and unrealistic view of the facts.

66. I would reiterate Lord Browne-Wilkinson's statement, echoing McLachlin J's judgment in *Canson*, about the object of an equitable monetary remedy for breach of trust, whether it be sub-classified as substitutive or reparative. As the beneficiary is entitled to have the trust properly administered, so he is entitled to have made good any loss suffered by reason of a breach of the duty.

67. A traditional trust will typically govern the ownership-management of property for a group of potential beneficiaries over a lengthy number of years. If the trustee makes an unauthorised disposal of the trust property, the obvious remedy is to require him to restore the assets or their monetary value. It is likely to be the only way to put the beneficiaries in the same position as if the breach had not occurred. It is a real loss which is being made good. By contrast, in *Target Holdings* the finance company was seeking to be put in a better position on the facts (as agreed or assumed for the purposes of the summary judgment claim) than if the solicitors had done as they ought to have done.

68. Other considerations reinforce my view that the House of Lords did not take a wrong step in *Target Holdings*.

69. Most critics accept that on the assumed facts of *Target Holdings* the solicitors should have escaped liability. But if causation of loss was not required for them to be liable, some other way had to be found for exonerating them from liability (unless the court was to use section 61 of the 1925 Act as a *deus ex machina*). The solution suggested by the bank is that the solicitors in *Target Holdings* should be treated as if the moneys which had been wrongly paid out had remained in or been restored to the solicitors' client account and had then been properly applied after the solicitors had obtained the necessary

paperwork. There is something wrong with a state of the law which makes it necessary to create fairy tales.

70. As to the criticism of the passage in *Target Holdings* where Lord Browne-Wilkinson said that it would be “wrong to lift wholesale the detailed rules developed in the context of traditional trusts” and apply them to a bare trust which was “but one incident of a wider commercial transaction involving agency”, it is a fact that a commercial trust differs from a typical traditional trust in that it arises out of a contract rather than the transfer of property by way of gift. The contract defines the parameters of the trust. Trusts are now commonly part of the machinery used in many commercial transactions, for example across the spectrum of wholesale financial markets, where they serve a useful bridging role between the parties involved. Commercial trusts may differ widely in their purpose and content, but they have in common that the trustee’s duties are likely to be closely defined and may be of limited duration. Lord Browne-Wilkinson did not suggest that the principles of equity differ according to the nature of the trust, but rather that the scope and purpose of the trust may vary, and this may have a bearing on the appropriate relief in the event of a breach. Specifically, Lord Browne-Wilkinson stated that he did not cast doubt on the fact that monies held by solicitors on client account are trust monies, or that basic equitable principles apply to any breach of such trust by solicitors. What he did was to identify the basic equitable principles. In their application, the terms of the contract may be highly relevant to the question of fact whether there has been a loss applying a “but for” test, that is, by reference to what the solicitors were instructed to do. If the answer is negative, the solicitors should not be required to pay restitutive monetary compensation when there has in fact been no loss resulting from their breach. That is not because special rules apply to solicitors, but because proper performance of the trustee’s obligations to the beneficiary would have produced the same end result.

71. I agree with the view of Professor David Hayton, in his chapter “Unique Rules for the Unique Institution, the Trust” in Degeling & Edelman (eds), *Equity in Commercial Law* (2005), pp 279-308, that in circumstances such as those in *Target Holdings* the extent of equitable compensation should be the same as if damages for breach of contract were sought at common law. That is not because there should be a departure in such a case from the basic equitable principles applicable to a breach of trust, whether by a solicitor or anyone else. (If there were a conflict between the rules of equity and the rules of the common law, the rules of equity would prevail by reason of section 49(1) of the Senior Courts Act 1981, derived from the provisions of the Judicature Act 1875.) Rather, the fact that the trust was part of the machinery for the performance of a contract is relevant as a fact in looking at what loss the bank suffered by reason of the breach of trust, because it would be

artificial and unreal to look at the trust in isolation from the obligations for which it was brought into being. I do not believe that this requires any departure from proper principles.

72. There remains the question whether the Court of Appeal properly applied the reasoning in *Target Holdings* to the facts of the present case. It was argued on behalf of the bank that this case falls within Lord Browne-Wilkinson's statement that "[u]ntil the underlying commercial transaction has been completed, the solicitor can be required to restore to the client account monies wrongly paid away."

73. This argument constricts too narrowly Lord Browne-Wilkinson's essential reasoning. Monetary compensation, whether classified as restitutive or reparative, is intended to make good a loss. The basic equitable principle applicable to breach of trust, as Lord Browne-Wilkinson stated, is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach. In this case, proper performance of the obligations of which the trust formed part would have resulted in the solicitors paying to Barclays the full amount required to redeem the Barclays mortgage, and, as Patten LJ said, the bank would have had security for an extra £300,000 or thereabouts of its loan.

74. When Lord Browne-Wilkinson spoke of completion he was talking about a commercial transaction. The solicitors did not "complete" the transaction in compliance with the requirements of the CML Handbook. But as a commercial matter the transaction was executed or "completed" when the loan monies were released to the borrowers. At that moment the relationship between the borrowers and the bank became one of contractual borrower and lender, and that was a fait accompli. The Court of Appeal was right in the present case to understand and apply the reasoning in *Target Holdings* as it did.

75. The further argument advanced on behalf of the bank in this court about the Solicitors' Accounts Rules takes matters no further, for the reasons which Mr McPherson gave in his response to it. The solicitors were at fault in not reporting to the bank what they had done and in failing at that stage to remedy their breach of trust by ensuring that the shortfall was paid to Barclays. Their failure to do so was a breach of the rules, which could have disciplinary consequences but it does not affect the outcome in the present appeal. There is, as Mr McPherson submitted, no satisfactory logical reason why the question of the solicitors' liability to provide redress to the bank for a loss which it would have suffered in any event should turn on their compliance or non-compliance with their obligations under rule 7.

76. My analysis accords with the reasoning of Lord Reed and with his general conclusions at paragraphs 133 to 138. Equitable compensation and common law damages are remedies based on separate legal obligations. What has to be identified in each case is the content of any relevant obligation and the consequences of its breach. On the facts of the present case, the cost of restoring what the bank lost as a result of the solicitors' breach of trust comes to the same as the loss caused by the solicitors' breach of contract and negligence.

77. For those reasons I would dismiss the appeal.

LORD REED

78. I agree that this appeal should be dismissed. I have reached that conclusion for reasons which are substantially the same as those of Lord Toulson. Given the importance of the case, I have thought it right to set out my own reasoning, which considers the relationship between equitable compensation and common law damages on a somewhat broader basis.

79. In his speech in *Target Holdings Ltd v Redferns* [1996] AC 421, Lord Browne-Wilkinson drew upon the minority judgment of McLachlin J in *Canson Enterprises Ltd v Boughton & Co* (1991) 85 DLR (4th) 129. It may be helpful to begin by considering that case before turning to *Target Holdings* itself, not only because of the influence of McLachlin J's judgment upon the reasoning in that case, and in other cases in common law jurisdictions around the world, but also because the judgments in the case illustrate two approaches to equitable compensation: approaches which differ in respect of the relationship which they postulate between equitable compensation and common law damages. That issue lies at the heart of the arguments in this appeal.

Canson Enterprises Ltd v Boughton & Co

80. The *Canson Enterprises* case was not concerned with a breach of trust, but with a breach of fiduciary duty by an agent. The claim was brought by developers of land against the lawyers who had acted for them in the purchase of the land. The lawyers acted in breach of their fiduciary duty by failing to disclose their knowledge that a third party was making a secret profit from the purchase. The development proved to be a failure as a result of the negligence of the engineers and contractors involved. The appellants sought to recover the loss incurred on the development from the lawyers, on the basis

that they would not have proceeded with the purchase if they had known of the secret profit. Recognising that the loss would not be recoverable in an action founded on breach of contract, negligence or deceit, the appellants instead sought equitable compensation for breach of fiduciary duty, arguing that such compensation was unlimited by principles of causation, remoteness or intervening acts.

81. La Forest J, giving the judgment of the majority of the Supreme Court of Canada, distinguished at p 146 between the breach of a trustee's obligation to hold the object of the trust, where "on breach the concern of equity is that it be restored … or, if that cannot be done, to afford compensation for what the object would be worth", and on the other hand "a mere breach of duty", where "the concern of equity is to ascertain the loss resulting from the particular breach of duty." In the former situation the difference between restoration and damages was abundantly clear, but in the latter situation "the difference in practical result between compensation and damages is by no means as clear" (p 145). La Forest J went on to observe at p 148, in relation to claims of the latter kind:

> "The truth is that barring different policy considerations underlying one action or the other, I see no reason why the same basic claim, whether framed in terms of a common law action or an equitable remedy, should give rise to different levels of redress."

On that footing (and subject to the proviso contained in the first part of that sentence), principles developed in the common law, such as the mitigation of damages and contributory negligence, could also be applied to analogous claims brought in an equitable context. In the instant case, damages equivalent to those for deceit were appropriate, and the appellants' claim was therefore rejected. La Forest J acknowledged that the same result could have been produced using equitable principles alone.

82. McLachlin J agreed in the result, but based her analysis entirely on equitable principles. Her judgment, with which Lamer CJC and L'Heureux-Dubé J concurred, merits detailed consideration.

83. First, she rejected the argument that the starting point, when quantifying compensation for breach of fiduciary duty, should be an analogy with tort or contract. In her view, that approach overlooked the unique foundation and goals of equity. In negligence and contract the parties were taken to be independent and equal actors, concerned primarily with their own self-

interest. Consequently, the law sought a balance between enforcing obligations by awarding compensation, and preserving optimum freedom for those involved in the relationship. The essence of a fiduciary relationship, by contrast, was that one party pledged herself to act in the best interests of the other. The freedom of the fiduciary was diminished by the nature of the obligation she had undertaken. The fiduciary relationship had trust, not self-interest, at its core.

84. It therefore could not be assumed that an analogy with tortious damages was appropriate. Such an analogy would also have suggested that some well-established equitable principles should not operate, such as the presumption that trust funds would be put to the most profitable use, and the requirement to disgorge profits gained through a breach of duty, even though such profits were not made at the expense of the person to whom the duty was owed. An analogy with tort would not be of great assistance in any event, since tort offered different measures of compensation, depending on the nature of the wrong. Rather than attempt to decide which tort was the closest analogy, the better approach was to look at the policy behind compensation for breach of fiduciary duty and determine how best to further that policy. In so far as shared concerns made it helpful, insights might be accepted from the law of tort.

85. Furthermore, an analogy with tort would require an artificial distinction to be drawn between a breach of trust involving the misapplication of property, where the tort analogy was on any view inapplicable, and other breaches of trust or of fiduciary obligations. In the former case, equity required property wrongfully appropriated to be restored together with an account of profits. Where there was no property which could be restored, the court could award compensation in lieu, with the ideal of restoring that which was lost through the breach of duty. That distinction should not obscure the fact that the measure of compensation was restitutionary in both cases. Any further distinction was difficult to support.

86. It followed that equitable compensation was assessed at a different time from damages in tort or contract, and that the foreseeability of loss was not relevant. In a passage cited with approval in *Target Holdings,* McLachlin J said:

> "In this area tort and contract law are of little help. There, the general rule is that damages are assessed … as at the time of the wrongful act, in view of what was then foreseeable, either by a reasonable person, or in the particular expectation of the parties. … The basis of compensation at equity, by contrast, is

> the restoration of the actual value of the thing lost through the breach. The foreseeable value of the items is not in issue. As a result, the losses are to be assessed as at the time of trial, using the full benefit of hindsight." (p 162)

That result reflected the nature of fiduciary obligations. In negligence, the law protected reasonable freedom of action of the defendant, and the reasonableness of his or her action could be judged by what consequences could be foreseen. In the case of a breach of fiduciary duty, as in deceit, there was no need to look to the consequences to judge the reasonableness of the actions. A breach of fiduciary duty was a wrong in itself, regardless of whether a loss could be foreseen.

87. Liability was however not unlimited. There was in the first place a requirement of causation:

> "Just as restitution *in specie* is limited to the property under the trustee's control, so equitable compensation must be limited to loss flowing from the trustee's acts in relation to the interest he undertook to protect." (p 160)

A further limitation arose from the plaintiff's responsibility not to act unreasonably. When the plaintiff, after due notice and opportunity, failed to take the most obvious steps to alleviate his or her losses, then it could rightly be said that the plaintiff had been the author of his own misfortune. I would comment that, rather than being a distinct principle, this might be regarded as following from the requirement of a direct causal connection.

88. A further potential limitation related to the interventions of third parties. McLachlin J distinguished between cases such as *Caffrey v Darby* (1801) 6 Ves Jun 488, where the failure of the trustees to take reasonable steps to recover payments owed to the trust had enabled a third party to default, and cases such as the instant case, where the plaintiff suffered loss as a result of the act of a third party after the fiduciary's obligation had terminated and the plaintiff had taken control of the property. These cases illustrate how the intervention of a third party may, or may not, interrupt the causal connection between a breach of trust and subsequent loss.

89. McLachlin J summarised her conclusions in another passage which was cited with approval in *Target Holdings*:

> “In summary, compensation is an equitable monetary remedy which is available when the equitable remedies of restitution and account are not appropriate. By analogy with restitution, it attempts to restore to the plaintiff what has been lost as a result of the breach, ie the plaintiff's lost opportunity. The plaintiff's actual loss as a consequence of the breach is to be assessed with the full benefit of hindsight. Foreseeability is not a concern in assessing compensation, but it is essential that the losses made good are only those which, on a common sense view of causation, were caused by the breach. The plaintiff will not be required to mitigate, as the term is used in law, but losses resulting from clearly unreasonable behaviour on the part of the plaintiff will be adjudged to flow from that behaviour, and not from the breach. Where the trustee's breach permits the wrongful or negligent acts of third parties, thus establishing a direct link between the breach and the loss, the resulting loss will be recoverable. Where there is no such link, the loss must be recovered from the third parties.” (p 163)

Discussion

90. It may be helpful at this stage to discuss three important points which can be derived from this illuminating judgment, and to which I shall return after considering other relevant authorities. The first is the distinction between liability and remedy. A breach of trust involving the misapplication of trust property can be remedied by means of proceedings designed to secure the performance of the trust. Such proceedings can include the drawing up of an account as a preliminary to the distribution of the trust fund. If property has been misapplied, the relevant entry in the account will be disallowed and the property must be restored by the trustee. If the property cannot be restored *in specie*, the trustee must restore the trust fund to the position it would have been in but for the breach, by paying into the fund sufficient pecuniary compensation to meet that objective. The compensation then forms part of the trust fund and is held on the same terms as the remainder of the fund. Alternatively, and more commonly in practice, proceedings may be brought directly for such a monetary remedy.

91. As I shall explain, another remedy can be sought where the trust is no longer subsisting, namely the payment of compensation directly to the beneficiary absolutely entitled to the trust fund. The liability, in that situation, is to compensate the beneficiary for the diminution in the value of the trust fund which was caused by the breach of trust, to the extent of the beneficiary’s interest. The measure of compensation is therefore the same as would be payable on an accounting, although the procedure is different.

92. The second point is that the loss resulting from a breach of duty has to be measured according to legal rules, and that different rules apply to the breach of different obligations. The rules applicable to the tort of negligence, for example, have a rationale related to the nature of that tort. In general, and subject to special rules applicable to particular situations, which have their own rationale, the liability resulting from a failure to take reasonable care to guard against a reasonably foreseeable risk is limited to such consequences as are reasonably foreseeable at the time of the negligent act. The different rule applicable to the tort of deceit has a different rationale, related to the different nature of that tort: the liability of a person who intentionally deceives another is to compensate for all the loss which that person suffers in consequence, whether it is foreseeable or not. In that situation, foreseeability does not enter into the wrongfulness of the defendant's conduct, and there is no reason why it should limit the extent of his responsibility. The tort of conversion has a different rule again: the defendant is liable to pay the value of the asset in question, measured as at the date when it was converted. And so, mutatis mutandis, for other breaches of duty, whether in tort, contract or equity.

93. The rules appropriate to a breach of duty by a trustee similarly have to be determined in the light of the characteristics of the obligation in question. This focus upon the trustee's obligations is the third and most important point. Putting the matter very broadly, compensation for the breach of an obligation generally seeks to place the claimant in the position he would have been in if the obligation had been performed. Equitable compensation for breach of trust is no different in principle: again putting the matter broadly, it aims to provide the pecuniary equivalent of performance of the trust.

94. Some of the typical obligations of the trustee of a fund are strict: for example, the duty to distribute the fund in accordance with the purposes of the trust. Others are obligations of reasonable care: for example, the duty to exercise reasonable care and skill in the management of the fund. Since these equitable obligations relate to a fund held for trust purposes, the trustee's liability for a breach of trust will, again putting the matter broadly, depend upon its effect upon the fund: the measure of compensation will generally be based upon the diminution in the value of the fund caused by the trustee's default.

95. The only other observation I need make in relation to the judgment of McLachlin J concerns the statement that causation should be assessed "on a common sense view". In its context, that statement served to emphasise that principles of causation developed in other contexts cannot be applied automatically in an equitable setting. Difficult questions of causation do not however always have an intuitively obvious answer. Legal analysis is as important in equity as in the common law.

Target Holdings Ltd v Redferns

96. The facts of *Target Holdings Ltd v Redferns* are well known. The case concerned a claim against a firm of solicitors, sued for its involvement in a mortgage fraud. Fraud as well as negligence was pleaded. The solicitors had parted with the mortgage advance to the wrong person, prior to the completion of the transaction and without obtaining the security. The transaction was however subsequently completed and the security was obtained. It later proved hopelessly inadequate. The claimant sought summary judgment on the basis of the unauthorised payment. They argued that the solicitors came under an immediate duty to restore the money paid away in breach of trust, and that it was irrelevant that the claimant had subsequently received exactly the security that it was intending to obtain. This was described by Lord Browne-Wilkinson as argument (B). Before the House of Lords, it was also argued that the claimant remained entitled at the date of judgment to have the solicitors reconstitute the trust fund (argument (A)).

97. The Court of Appeal gave judgment in favour of the claimant. An appeal was allowed by the House of Lords, for reasons given by Lord Browne-Wilkinson. The reasoning has been much debated, and in view of the invitation to review it in the present appeal it is necessary to consider it in some detail.

98. His Lordship began by noting that the case was concerned with the rights of a beneficiary, and summarised the nature of such rights:

> "The basic right of a beneficiary is to have the trust duly administered in accordance with the provisions of the trust instrument … The equitable rules of compensation for breach of trust have been largely developed in relation to … traditional trusts, where the only way in which all the beneficiaries' rights can be protected is to restore to the trust fund what ought to be there. In such a case the basic rule is that a trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss. … If specific restitution of the trust property is not possible, then the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach not been committed … Even if the immediate cause of the loss is the dishonesty or failure of a third party, the trustee is liable to make good that loss to the trust estate if, but for the breach, such loss would not have

> occurred. ... Thus the common law rules of remoteness of damage and causation do not apply. However there does have to be some causal connection between the breach of trust and the loss to the trust estate for which compensation is recoverable, viz the fact that the loss would not have occurred but for the breach." (p 434)

99. Where the trust was still subsisting, the only right of each beneficiary was to have the trust fund reconstituted as it should be. Where however the trust had come to an end, and the beneficiary had become absolutely entitled, it was normally inappropriate to order the reconstitution of the trust fund and its subsequent distribution: instead, the court ordered the payment of compensation directly to the beneficiary:

> "The measure of such compensation is the same, ie the difference between what the beneficiary has in fact received and the amount he would have received but for the breach of trust."

Accordingly, in traditional trusts for persons by way of succession, once those trusts had been exhausted and the fund had become absolutely vested in possession, the beneficiary was not normally entitled to have the exhausted trust reconstituted: his right was to be compensated for the loss he had suffered by reason of the breach.

100. What Lord Browne-Wilkinson was discussing at this point was a question of remedy. The pecuniary remedy for a breach of trust affecting the trust fund cannot involve a payment to a particular beneficiary, unless the beneficiary is absolutely entitled to the fund. Absent such entitlement, the only way to ensure that each beneficiary is appropriately compensated is for the payment to be made into the trust fund, to be held in accordance with the terms of the trust. This is accomplished by adding the appropriate amount to the fund, so that the fund is restored or replenished. Where, on the other hand, the trust is no longer subsisting, compensation for the breach of trust can be paid directly to the beneficiary absolutely entitled. As Lord Browne-Wilkinson explained, the measure of compensation is the same as if there had been an accounting and execution of the trust: in other words, the difference between what the beneficiary ought to have received and what he has in fact received as a result of the diminution in the trust fund.

101. His Lordship then turned to argument (A). He began by stating that "even if the equitable rules developed in relation to traditional trusts were directly

applicable to such a case as this", a beneficiary absolutely entitled to a trust fund had no automatic right to have the trust fund reconstituted. He had already explained why that was so, but had also explained the corollary, namely that the beneficiary would in that event be entitled to compensation in the same measure (unless the trustee was under no liability, for example by reason of acquiescence by the beneficiary in the breach of trust). His Lordship's focus was again on the question of the appropriate remedy, rather than the measure of liability. He continued:

> "But in my judgment it is in any event wrong to lift wholesale the detailed rules developed in the context of traditional trusts and then seek to apply them to trusts of quite a different kind. In the modern world the trust has become a valuable device in commercial and financial dealings. The fundamental principles of equity apply as much to such trusts as they do to the traditional trusts in relation to which those principles were originally formulated. But in my judgment it is important, if the trust is not to be rendered commercially useless, to distinguish between the basic principles of trust law and those specialist rules developed in relation to traditional trusts which are applicable only to such trusts and the rationale of which has no application to trusts of quite a different kind." (p 435)

102. This is one of a number of passages in the speech which have given rise to debate. The point that there are different types of trust, and that it would be mistaken to think that they must all be governed in every respect by identical rules, had also been made by McLachlin J in *Canson Enterprises* at pp 156-157. In particular, as Lord Browne-Wilkinson pointed out, commercial trusts, usually arising out of contractual relationships rather than the transfer of property by way of gift, differ in a number of respects from the more traditional trust. That is not to say that there is a categorical distinction between trusts in commercial and non-commercial relationships, or to assert that there are trusts to which the fundamental principles of equity do not apply. It is, on the other hand, to recognise that the duties and liabilities of trustees may depend, in some respects, upon the terms of the trust in question and the relationship between the relevant parties (cf *Kelly v Cooper* [1993] AC 205, 214-215).

103. Lord Browne-Wilkinson then considered the particular type of trust with which the appeal was concerned. He began by identifying the relevant characteristics of the trust:

> "This case is concerned with a trust which has at all times been a bare trust. Bare trusts arise in a number of different contexts: eg by the ultimate vesting of the property under a traditional trust, nominee shareholdings and, as in the present case, as but one incident of a wider commercial transaction involving agency. In the case of moneys paid to a solicitor by a client as part of a conveyancing transaction, the purpose of that transaction is to achieve the commercial objective of the client, be it the acquisition of property or the lending of money on security. The depositing of money with the solicitor is but one aspect of the arrangements between the parties, such arrangements being for the most part contractual." (p 436)

104. Lord Browne-Wilkinson continued:

> "I do not intend to cast any doubt on the fact that moneys held by solicitors on client account are trust moneys or that the basic equitable principles apply to any breach of such trust by solicitors. But the basic equitable principle applicable to breach of trust is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach. I have no doubt that, until the underlying commercial transaction has been completed, the solicitor can be required to restore to client account moneys wrongly paid away. But to import into such trust an obligation to restore the trust fund once the transaction has been completed would be entirely artificial. The obligation to reconstitute the trust fund applicable in the case of traditional trusts reflects the fact that no one beneficiary is entitled to the trust property and the need to compensate all beneficiaries for the breach. That rationale has no application to a case such as the present. To impose such an obligation in order to enable the beneficiary solely entitled (ie the client) to recover from the solicitor more than the client has in fact lost flies in the face of common sense and is in direct conflict with the basic principles of equitable compensation. In my judgment, once a conveyancing transaction has been completed the client has no right to have the solicitor's client account reconstituted as a 'trust fund.'" (p 436)

105. This passage contains a number of ideas. The first is that "the basic equitable principle applicable to breach of trust is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach." That is a broad proposition, which leaves open what precisely is meant by "loss", and how it is assessed. As McLachlin J explained in *Canson*

Enterprises, the basic obligation of a defaulting trustee is to restore the trust fund to the position it would have been in but for the default. In relation to the breach of a fiduciary duty, her Ladyship said (in the passage cited at para 89, also cited by Lord Browne-Wilkinson with approval at a later point in his speech) that, by analogy, compensation for breach of such a duty attempts to restore to the plaintiff what has been lost as a result of the breach. Lord Browne-Wilkinson's dictum should in my view be understood in that sense: the "loss" is what the beneficiary has been deprived of as a result of the breach.

106. The second idea is that, where a solicitor holds money on trust as an incident of a commercial transaction, he can be required to restore moneys paid away until the commercial transaction has been completed, but not after that point, since it would be artificial to impose the same obligation once the transaction has been completed. Lord Browne-Wilkinson is again focusing on procedure: as he had previously explained, the appropriate remedy where the trust is no longer in subsistence is the payment of compensation directly to the beneficiary. Consistently with that general approach, it would be inappropriate to require a trustee to reconstitute the trust fund (such as a solicitor's client account) in a case where a bare trust had come into being for the purpose of a commercial transaction which had in practical terms been completed, leaving no active obligations for the trustee to perform. As he had previously explained, the measure of compensation would be the same as the loss to the trust fund.

107. The third idea, expressed in the penultimate sentence of the passage I have cited, is that to impose an obligation to reconstitute the trust fund, in order to enable the client to recover more than he has in fact lost, "flies in the face and is in direct conflict with the basic principles of equitable compensation". That is clearly correct. As Lord Browne-Wilkinson went on to explain, an obligation to reconstitute the trust fund does not inexorably require a payment into the fund of the value of misapplied property: for example, where the consequences of the breach of trust have been mitigated by subsequent events.

108. Lord Browne-Wilkinson might however be understood, from the juxtaposition of the two final sentences (the last sentence stating a conclusion which might be read as being based on his rejection of the idea postulated in the preceding sentence), to be envisaging that the remedy of an accounting might result in the trustee's paying more into the trust fund than had actually been lost by the beneficiary entitled to the fund. I doubt however whether that was what Lord Browne-Wilkinson meant. The direct payment of equitable compensation to the beneficiary is procedurally different from the reconstitution and distribution of the trust fund, but the end result should not

be different: otherwise, the beneficiary would receive something other than his entitlement under the trust. Equally, the remedy of an accounting and execution of the trust cannot require more to be paid into the trust fund than is missing from it.

109. Argument (A) was thus dismissed on a procedural ground: the wrong remedy had been sought. Lord Browne-Wilkinson then turned to argument (B). He noted that the Court of Appeal had drawn a distinction between the case in which the breach of trust consisted of some failure in the administration of the trust, and the case where a trustee wrongfully paid away trust moneys. There was, he said, no doubt that in the former case, the restitution or compensation payable was assessed at the date of trial, not of breach. In the latter case, however, the Court of Appeal considered that events between the date of breach and the date of trial were irrelevant in assessing the loss suffered by reason of the breach.

110. As Lord Browne-Wilkinson remarked, the fact that there was an accrued cause of action as soon as the breach was committed did not mean that the quantum of the compensation payable was fixed on that date. The quantum was fixed at the date of judgment, as the figure then necessary to put the trust fund or the beneficiary back into the position it would have been in had there been no breach.

111. In that regard, Lord Browne-Wilkinson cited the judgment of McLachlin J in *Canson Enterprises*, which he described as containing "an illuminating exposition of the rules applicable to equitable compensation for breach of trust". In particular, he cited passages from the judgment which I also have cited at paras 86, 87 and 89, in which her Ladyship discussed causation, foreseeability and the time of assessment. He commented:

> "In my view this is good law. Equitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests: to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach." (p 439)

In the instant case, the claimant obtained exactly what it ought to have obtained, namely a valid security for the sum advanced, and therefore suffered no compensatable loss.

112. Finally, there was accepted to be a triable issue as to whether the premature payment of the mortgage advance to its recipients had been essential to enable the entire transaction to proceed. Lord Browne-Wilkinson commented that if that was established, the loss suffered by the claimant by reason of the breach of trust would be the total sum advanced less the proceeds of the security. That comment is consistent with the approach to foreseeability, and to interventions by third parties, adopted by McLachlin J.

113. Although the passages which I have discussed in paras 102 and 105-108 may be capable of a different interpretation, at least if read in isolation, it appears therefore that Lord Browne-Wilkinson intended his approach to be consistent with that of McLachlin J in *Canson Enterprises*.

114. The result of the appeal was undoubtedly correct. The mortgage advance had been paid out prematurely and to the wrong person, with the consequence that at that point the trustee did not have the charges which he ought to have had. That deficiency was however remedied when the charges were obtained some weeks later. The assets under the control of the trustee were then exactly what they ought to have been. There was nothing missing from the trust fund, and therefore no basis for a claim for restoration. For the same reason, there was no basis for a claim to compensation by the mortgagee.

115. Lord Browne-Wilkinson's judgment has been interpreted by some academic lawyers as adopting a "reparative" measure of compensation, as distinct from McLachlin J's "substitutive" analysis. That interpretation is based primarily on Lord Browne-Wilkinson's statement that "the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach." That dictum has been interpreted as meaning that equitable compensation is to be assessed in the same way as common law damages, either generally or at least in circumstances such as those with which the case was concerned.

116. I do not understand that to have been Lord Browne-Wilkinson's meaning. As I have explained at paras 99-100, 105-108 and 110-111, and particularly in view of his endorsement of the passages cited from McLachlin J's judgment, which I discussed at paras 86 and 87-89, I am not persuaded that Lord Browne-Wilkinson intended to depart from the orthodox view that the equitable obligation arising from a breach of trust affecting the trust fund is to restore the fund to the position it would have been in but for the breach, and that the measure of compensation, whether it is payable into the trust fund or directly to a beneficiary, should be assessed on that basis. Furthermore, as I shall shortly explain, *Target Holdings* has not been understood in other leading common law jurisdictions as having established that the basis upon which equitable compensation is assessed is the same as

the basis upon which common law damages are calculated. If that were its effect, the development of equity in English law would be at odds with its development in those jurisdictions.

The case law since Target Holdings

117. It remains to consider, prior to turning to the present case, some of the most significant cases in this area since *Target Holdings.*

118. In *Bristol and West Building Society v Mothew* [1998] Ch 1, a case concerned with a negligent misrepresentation made by a solicitor to his client, Millett LJ drew a distinction at pp 16-17 between a duty which is special to fiduciaries, such as the fiduciary duty of loyalty, and a duty which is incumbent upon a fiduciary but is not peculiar to a person in that position, such as the duty of care imposed on those who have assumed responsibility for the property or affairs of others. Millett LJ commented:

> "Although the remedy which equity makes available for breach of the equitable duty of skill and care is equitable compensation rather than damages, this is merely the product of history and in this context is in my opinion a distinction without a difference. Equitable compensation for breach of the duty of skill and care resembles common law damages in that it is awarded by way of compensation to the plaintiff for his loss. There is no reason in principle why the common law rules of causation, remoteness of damage and measure of damages should not be applied by analogy in such a case." (p 17)

119. As I shall explain, that dictum has been questioned, or given a restrictive application, in a number of other jurisdictions. It is unnecessary to consider it in detail in the present appeal. It may however be helpful to make two observations. First, Millett LJ was not considering the liability of a trustee. Secondly, as McLachlin J pointed out in *Canson Enterprises*, the application by analogy of "the common law rules" is complicated by the fact that there is no single set of common law rules. It is necessary to consider the specific characteristics of the obligation in question (such as the duty to exercise care in the management of a trust fund), and the respects in which it resembles or differs from obligations arising in other areas of the law (such as duties of care in contract or in tort), in order for the law governing liability for the breach of these various obligations to be coherent.

120. The only other decision in this jurisdiction which need be mentioned is *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45; [2014] 3 WLR 535. The case concerned the question whether a principal had a proprietary claim to a secret profit received by his agent in breach of his fiduciary duty. I note in passing that the alternative remedy, a personal claim to payment of the amount brought out by an account of profits, was described by the court as "equitable compensation". In order to avoid confusion, it is necessary to note that the expression was being used in a different sense from the one that it bears in the present context.

121. In reaching its conclusion in the *FHR* case, the court was influenced by the case law of other common law jurisdictions, remarking at para 45 that it seemed highly desirable for all those jurisdictions to learn from each other, and at least to lean in favour of harmonising the development of the common law round the world. With that observation in mind, I turn to the more recent case law of Canada, Australia, New Zealand and Hong Kong.

122. In Canada, the argument in *Canson Enterprises* has been carried forward in a number of cases. In *M(K) v M(H)* [1992] 3 SCR 6, 80-81, 86 it was agreed that where "the same policy objectives underlie two different causes of action similar measures of compensation may be appropriate"; and the same approach can be seen in *Cadbury Schweppes v FBI Foods* [1999] 1 SCR 142. In *Hodgkinson v Simms* [1994] 3 SCR 377 La Forest J, giving the judgment of the majority, drew the same distinction as had been drawn by McLachlin J in *Canson Enterprises* between fiduciary relationships and commercial interactions governed by the common law, the former being characterised by one party's duty to act in the other's best interests, and often by power on the one hand and dependency on the other, whereas the common law generally respected the pursuit of self-interest. The proper approach to damages for breach of a fiduciary duty was said to be restitutionary. On that basis, the majority of the court concluded that the claimant was entitled to be compensated for the loss sustained on investments which he had made on the advice of a fiduciary who had failed to disclose a conflict of interest, notwithstanding that the loss had resulted from an unforeseen general economic downturn. The decision of the majority in *Canson Enterprises* was explained as holding that a court exercising equitable jurisdiction was not precluded from considering the principles of remoteness, causation and intervening act where necessary to reach a just result.

123. In Australia, McLachlin J's analysis of the distinction between fiduciary relationships and those regulated by tort and contract has been accepted by the High Court: *Pilmer v Duke Group Ltd* [2001] HCA 31; (2001) 207 CLR 165, para 71. The court has consequently questioned the view, based on the dictum of Millett LJ in *Bristol and West Building Society v Mothew*, that

equitable compensation for breach of the duty of skill and care in the administration of a trust should be governed by common law rules: *Youyang Pty Ltd v Minter Ellison Morris Fletcher* [2003] HCA 15; (2003) 212 CLR 484, paras 39-40. The Australian cases proceed on the basis that liability in respect of losses sustained by reason of a breach of duty by a trustee or other fiduciary is determined by equitable principles, and that these may require different rules from those which govern the assessment of damages in tort or contract: see for example *Maguire v Makaronis* [1997] HCA 23; (1997) 188 CLR 449, which concerned causation, and *Pilmer v Duke Group Ltd,* which concerned contributory negligence. In the latter case, McHugh, Gummow, Hayne and Callinan JJ said at para 85:

> "In Australia, the measure of compensation in respect of losses sustained by reason of breach of duty by a trustee or other fiduciary is determined by equitable principles and … these do not necessarily reflect the rules for assessment of damages in tort or contract."

124. *Target Holdings* was considered by the High Court of Australia in *Youyang Pty Ltd v Minter Ellison Morris Fletcher,* a case on broadly analogous facts, with the important distinction that the security – which would have been good - was never provided (in addition, the plaintiff investor was not the client of the solicitor trustee). The court distinguished *Target Holdings* on the basis that it was a case where, ultimately, the property was conveyed to the mortgagor and the charges were executed. That element being absent in *Youyang,* the defendant solicitors were ordered to repay the monies which they had paid out in breach of trust. The court regarded it as beside the point that, after the money had been disbursed in breach of trust, there was also conduct by third parties which resulted in the loss of the unsecured funds. In those respects the decision appears to me to be consistent with the approach adopted in *Target Holdings*.

125. As in *Target Holdings,* the court observed that the nature of the remedy for breach of trust could vary to reflect the terms of the trust and the breach of which complaint was made. In particular, as in *Target Holdings*, the solicitors did not hold the moneys for indeterminate or contingent beneficial interests, and the case was not one where the appropriate remedy was to have duly administered a restored trust fund.

126. McLachlin J's approach in *Canson Enterprises* to the assessment of compensation for the breach of a fiduciary duty, as set out in the passage which I have cited at para 89, was also accepted by Elias CJ in the Supreme Court of New Zealand: *Premium Real Estate Ltd v Stevens* [2009] NZSC 15;

[2009] 2 NZLR 384, paras 34-36. In relation to remoteness of damage, it was observed that the question of foreseeability in common law claims was effectively overtaken by the relationships out of which fiduciary duties arose, and that different policy considerations might affect remoteness of damage in cases of breach of fiduciary duty than in common law claims. But the necessity of demonstrating that a loss was caused by the claimed breach of fiduciary duty followed from the compensatory justification for the remedy.

127. In the earlier case of *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664, Millett LJ's dictum in *Bristol and West Building Society v Mothew* [1998] Ch 1, 17 was cited with approval by the Court of Appeal. The case was not concerned with the duty of a trustee to exercise reasonable care and skill in the management of a trust fund, but, like *Mothew,* with a duty of care relating to the provision of information. The trustee was required, under a debenture deed securing advances by banks to a property investment company, to take care to detect breaches of the deed by the company. The plaintiff bank claimed to have suffered loss as a consequence of the trustee's negligent failure to detect and report breaches by the company, notwithstanding the absence of any diminution in the value of the security. The case illustrates how the obligations of a trustee under a commercial trust can differ from those typically imposed by more traditional trusts: as Tipping J observed, the relationship of trustee and beneficiary was "in a sense, incidental" (p 688).

128. This rapid, and inevitably somewhat superficial and selective, *tour d'horizon* can be completed by considering two decisions of the Hong Kong Final Court of Appeal. First, in *Akai Holdings Ltd v Kasikornbank PCL* [2011] 1 HKC 357, it was said, under reference to *Target Holdings* and the Australian case of *Maguire v Makaronis,* that "the notion that equitable compensation is assessed on a somewhat different basis from common law damages is clearly right (albeit that the difference can be overstated)" (para 131). It was also accepted, under reference to those cases and to the judgment of McLachlin J in *Canson Enterprises,* that "the losses made good are only those which, on a common sense view of causation, were caused by the breach" (para 152).

129. Secondly, in *Libertarian Investments Ltd v Hall* [2014] 1 HKC 368 Ribeiro PJ carried out a valuable review of the authorities concerned with equitable compensation in the context of a commercial relationship. He noted that where a relationship was fiduciary, there might be obligations which were not fiduciary in nature; and, equally, even in a commercial relationship, there might be aspects which engaged fiduciary obligations. As Blanchard J had stated in *Amaltal Corpn Ltd* v *Maruha Corpn* [2007] NZSC 40; [2007] 3 NZLR 192, para 21:

> "That is because in the nature of that particular aspect of the relationship one party is entitled to rely upon the other, not just for adherence to contractual arrangements between them, but also for loyal performance of some function."

Hence the important focus was on the nature of the obligation in question.

130. Ribeiro PJ accepted the suggestion made by Brennan CJ in *Breen v Williams* (1996) 186 CLR 71 that fiduciary duties could arise either from agency or from a relationship of ascendancy or influence by one party over another, or dependence or trust on the part of that other. An obvious example of the "agency" type of situation was the case where a person received money or other property for and on behalf of or as trustee of another person. Accordingly:

> "It is plain that fiduciary duties may well arise as aspects of a commercial relationship. Moreover, it is clear that legal and equitable rights and remedies are capable of co-existence, even in a single transaction." (para 70)

131. Ribeiro PJ accepted McLachlin J's explanation of the distinction between fiduciary and common law relationships in a commercial context, and its reflection in the differences between equitable compensation and common law damages in relation to causation, foreseeability, mitigation of loss and the time of assessment (at paras 72, 80-81, 90-92 and 96).

132. Ribeiro PJ also considered the distinction drawn by Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1, 17, between the breach of a duty of skill and care within a fiduciary relationship and the breach of a duty which is fiduciary in nature. He accepted the view expressed by Tipping J in *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* that, where there was a breach of a duty of care by a trustee which did not result in any loss to the trust fund, any liability in damages which might arise would be assessed by applying common law rules (para 77). On the other hand, where loss was caused by the fiduciary to trust property, strict rules on causation applied. Those were rules borrowed from those developed in relation to traditional trusts, requiring the trustee to restore to the trust fund what he had caused it to lose as a result of his breach of trust. In support of that restitutionary theory of equitable compensation, Ribeiro PJ cited Lord Browne-Wilkinson's dictum in *Target Holdings* at p 434:

> "If specific restitution of the trust property is not possible, then the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach not been committed."

Causation was established on a "but for" basis, without the constraints of common law rules on remoteness and foreseeability.

General conclusions

133. Notwithstanding some differences, there appears to be a broad measure of consensus across a number of common law jurisdictions that the correct general approach to the assessment of equitable compensation for breach of trust is that described by McLachlin J in *Canson Enterprises* and endorsed by Lord Browne-Wilkinson in *Target Holdings.* In Canada itself, McLachin J's approach appears to have gained greater acceptance in the more recent case law, and it is common ground that equitable compensation and damages for tort or breach of contract may differ where different policy objectives are applicable.

134. Following that approach, which I have discussed more fully at paras 90-94, the model of equitable compensation, where trust property has been misapplied, is to require the trustee to restore the trust fund to the position it would have been in if the trustee had performed his obligation. If the trust has come to an end, the trustee can be ordered to compensate the beneficiary directly. In that situation the compensation is assessed on the same basis, since it is equivalent in substance to a distribution of the trust fund. If the trust fund has been diminished as a result of some other breach of trust, the same approach ordinarily applies, mutatis mutandis.

135. The measure of compensation should therefore normally be assessed at the date of trial, with the benefit of hindsight. The foreseeability of loss is generally irrelevant, but the loss must be caused by the breach of trust, in the sense that it must flow directly from it. Losses resulting from unreasonable behaviour on the part of the claimant will be adjudged to flow from that behaviour, and not from the breach. The requirement that the loss should flow directly from the breach is also the key to determining whether causation has been interrupted by the acts of third parties. The point is illustrated by the contrast between *Caffrey v Darby,* where the trustee's neglect enabled a third party to default on payments due to the trust, and *Canson Enterprises,* where the wrongful conduct by the third parties occurred after the plaintiff had taken

control of the property, and was unrelated to the defendants' earlier breach of fiduciary duty.

136. It follows that the liability of a trustee for breach of trust, even where the trust arises in the context of a commercial transaction which is otherwise regulated by contract, is not generally the same as a liability in damages for tort or breach of contract. Of course, the aim of equitable compensation is to compensate: that is to say, to provide a monetary equivalent of what has been lost as a result of a breach of duty. At that level of generality, it has the same aim as most awards of damages for tort or breach of contract. Equally, since the concept of loss necessarily involves the concept of causation, and that concept in turn inevitably involves a consideration of the necessary connection between the breach of duty and a postulated consequence (and therefore of such questions as whether a consequence flows "directly" from the breach of duty, and whether loss should be attributed to the conduct of third parties, or to the conduct of the person to whom the duty was owed), there are some structural similarities between the assessment of equitable compensation and the assessment of common law damages.

137. Those structural similarities do not however entail that the relevant rules are identical: as in mathematics, isomorphism is not the same as equality. As courts around the world have accepted, a trust imposes different obligations from a contractual or tortious relationship, in the setting of a different kind of relationship. The law responds to those differences by allowing a measure of compensation for breach of trust causing loss to the trust fund which reflects the nature of the obligation breached and the relationship between the parties. In particular, as Lord Toulson explains at para 71, where a trust is part of the machinery for the performance of a contract, that fact will be relevant in considering what loss has been suffered by reason of a breach of the trust.

138. This does not mean that the law is clinging atavistically to differences which are explicable only in terms of the historical origin of the relevant rules. The classification of claims as arising in equity or at common law generally reflects the nature of the relationship between the parties and their respective rights and obligations, and is therefore of more than merely historical significance. As the case law on equitable compensation develops, however, the reasoning supporting the assessment of compensation can be seen more clearly to reflect an analysis of the characteristics of the particular obligation breached. This increase in transparency permits greater scope for developing rules which are coherent with those adopted in the common law. To the extent that the same underlying principles apply, the rules should be consistent. To the extent that the underlying principles are different, the rules should be understandably different.

The present case

139. In the present case, AIB transmitted £3.3m to Redler for the purpose of discharging the Sondhis' debt to Barclays, discharging the related charge which Barclays held over their property, paying the balance of the money to the Sondhis and obtaining a first charge over the property. If Redler had performed their trust, they would on completion have held a registrable first charge which secured a debt of £3.3m. In the event, on completion they held a second charge in respect of that debt; but Barclays continued to hold a first charge in respect of an undischarged debt of £309,000, and AIB's charge could not be registered because Barclays' charge included a covenant against the registration of other charges. Following negotiations between AIB and Barclays, it was agreed during 2008 that AIB's charge could be registered and that Barclays' priority would be limited to £273,777.42, with the consequence that AIB's interest was worth £273,777.42 less than it should have been. That proved to be the position in 2011, when the security was enforced and these proceedings were begun: the proceeds of sale were insufficient to meet the Sondhis' liabilities to both Barclays and AIB, and in consequence AIB received £273,777.42 less than they would have done if Redler had fulfilled their instructions.

140. AIB argue that they are entitled to payment of the entire £3.3m, less the £867,697.78 which they received on the sale of the property, on the basis that Redler's liability for their breach of trust is unlimited by causation or remoteness. In my opinion that argument is based on three fallacies, each of which is fatal to AIB's claim. First, it assumes that Redler misapplied the entire £3.3m, whereas in my opinion all that was misapplied was the £309,000 which was paid to the Sondhis rather than Barclays. Since the Court of Appeal's decision to the contrary was not challenged, however, it is necessary to consider the appeal on the basis on which it was argued by both parties, namely that the breach of trust involved the misapplication of the entire £3.3m. On that premise, the appeal fails because it rests on the remaining fallacies. The second fallacy in AIB's argument is that it assumes that the measure of Redler's liability was fixed as at the date of the breach of trust: a proposition which was rejected in *Target Holdings* and in the Commonwealth authorities which I have cited. The third fallacy is that the argument assumes that liability does not depend on a causal link between the breach of trust and the loss: Redler is sought to be made liable for the consequences of the hopeless inadequacy of the security accepted by AIB before Redler's involvement, despite the fact that Redler's breach of trust did not affect that security except to the extent, initially, of £309,000, and finally of £273,777.42. That proposition also was rejected in *Target Holdings* and in the Commonwealth cases.

141. In these circumstances, applying the approach to the assessment of equitable compensation which I have explained, it appears to me that the loss to the trust estate as a result of Redler's breach of trust proved to be £273,777.42: that amount proved to be the pecuniary value of the difference between a first ranking security and one which was postponed to Barclays'. That was also the loss to AIB, who were absolutely entitled to the trust estate. The trust no longer being on foot, the appropriate order is for Redler to pay AIB £273,777.42 plus interest from 2011.

142. Since AIB have already been awarded £273,777.42 plus interest against Redler (and no issue being raised in relation to the interest), it follows that they are not entitled to anything more. Their appeal should therefore be dismissed.

LORD NEUBERGER, LADY HALE AND LORD WILSON

143. We agree that this appeal should be dismissed for the reasons given by Lord Toulson and Lord Reed.