

Tracing: a General Introduction

1. The subject of tracing is one that can be briefly outlined in a few propositions or one which requires a substantial book. The following paper seeks briefly to explore and explain some of the main features of, and some of the issues that arise in relation to, tracing. In so doing, various references and texts are referred to but citation is very far from complete.
2. The paper is written for the purposes of the SAL/ChBA 2015 conference and from the perspective of theory and of English law. It is hoped that a Singaporean perspective will emerge in the panel debate.¹

What is Tracing?

3. The subject of tracing is one that is bedevilled by a lack of clarity. Part of the reason for this is that it tends to be treated not as a coherent subject of its own and in the round,² but as part of a remedy or claim available in the context of particular factual or legal areas. Thus, to take but some examples, it is dealt with in books on equity,³ personal property,⁴ restitution,⁵ banking law, insolvency law⁶ and so on. Furthermore, the language used by commentators and Judges can obscure, rather than enlighten, fundamental principles underlying tracing.
4. On a proper analysis, tracing needs to be distinguished from:
 - 4.1 following;
 - 4.2 the question of what rights and remedies a party may have in relation to a specific asset into which the rights of that person have been “traced”.

¹ It seems fairly clear that the jurisprudence of Singapore and England share common roots. Thus in *Standard Chartered Bank v Sin Chong Hua Electric & Trading Pte Ltd* [1991] 2 SLR(R)445 the High Court cited and applied English cases including *Hambrouck; Chase Manhattan and Lipkin Gorman*. In *Hongkong and Shanghai Bank Corp Ltd v United Overseas Bank Ltd* [1992] SGHC 61; [1992] 1 SLR(R) 579 the Court discussed and applied English authorities as did the Court of Appeal in *Caltong (Australia) Pty Ltd v Tong Tien See Construction Pte Ltd* [2002] SGCA 28; [2002] 2 SLR (R) 94.

² For a conspicuous exception see *The Law of Tracing* Lionel D. Smith (Clarendon Press Oxford 1997) (“Smith”).

³ *Snell’s Equity* J McGhee (Sweet & Maxwell) ; *The Principles of Equity & Trusts* Graham Virgo (OUP); *Jacob’s Law of Trusts in Australia* (7th Edn) (Lexis Nexis Butterworths).

⁴ *Personal Property Law* Tan Yock Lin (Academy Publishing, 2014); *The Law of Personal Property* Bridge, Gullifer, McMeel and Worthington (Sweet & Maxwell);

⁵ *Goff & Jones The Law of Unjust Enrichment* (Sweet & Maxwell); *An Introduction to the Law of restitution* Peter Birks (Clarendon Press Oxford); *The Law of Restituion* Burrows (OUP); *The principles of the law of restitution* Graham Virgo 2nd Edn (OUP); *Restitution Law in Australia* Mason, Carter & Tolhurst Lexis Nexis.

⁶ *International Asset Tracing and Insolvency* Ed: Felicity Toube (OUP)

(1) Tracing and following

5. So, first of all, what distinguishes “following” and “tracing”? Both are to do with identification. Both may be said to be processes or legal techniques by which property, or interests in property, are identified.
6. Tracing is to do with substitution. *“Tracing identifies a new thing as the potential subject matter of a claim on the basis that it is the substitute for an original thing which was itself the subject matter of a claim. The new thing, as a substitute, stands in the place of the old thing, and therefore can be subject to the same claims.”*⁷
7. Following, on the other hand, may be said to be the process of identifying what has happened to the same asset or identifying the person into whose hands the asset has come.
8. In a simple example, the distinction between the two is easy to understand. Thus, tracing tends to focus on the same person where that person acquires a new thing. Following, on the other hand, tends to focus on whether a new person has acquired the same thing. On a given set of facts both following and tracing may be techniques that a claimant will wish to deploy. Take the situation where a thief steals my laptop and swaps it for a notebook, which he then gives to his mother. I may wish to make a claim in relation the laptop. If I do, I may need to follow it. If a third person acquired the laptop from the thief I may (depending on the applicable law and facts) have a claim to the laptop as against the third person. I do not need to trace in those circumstances. If however, I wish to bring a claim against the mother then I must trace through the substitution of the notebook for the laptop. Then I have to follow the notebook to its receipt by the mother.
9. Following can give rise to more difficult problems, where the property in question is mixed with other property. In brief, a number of scenarios are possible. Taking physical property:
 - 8.1 First, the mixture may be such that it is possible to extract the exact material contributed. This could arise, for example, where identical components are mixed in a store room but each has an identified serial numbers.
 - 8.2 Secondly, the matters mixed may be such that the mixture is divisible but it is not possible to divide it so that the precise contributions are identifiable. Taking the example of gold bullion: In circumstances where A’s 5 bars of bullion are wrongly mixed with B’s 10 bars in a store room by a third party storer, and the bars have no relevant distinguishing characteristics, it may be impossible to identify which 5 bars belonged to A and which belonged to B prior to the

⁷ Smith (infra) pg. 6.

mixture. In that situation, when A and B come to claim the return of their bars of bullion there may be no problem if all 15 bars remain. However, if the bars have been reduced to 10 without any involvement of A or B, it will not be possible to identify who contributed those 10 bars. It can be said that A owns at least 5 of the 10 remaining bars but he might own no more than 5 or up to the full 10. In such circumstances the law will treat the 10 remaining bars as owned in the proportions in which contribution was made (ie. 2:1 as between A and B). A and B can follow into the mixture in proportion to their respective contributions to the mixture and they suffer any losses rateably.⁸ The position where the mixing has occurred by the wrongdoing of one of the parties, A or B, gives rise to a different rule. In that situation the law will assume that the wrongdoing party is the one which first bears the total loss, to the advantage of the innocent party.⁹

8.3 Thirdly, the mixture may be such that it can be said that one of the assets continues to exist, but the other does not because it has acceded to the other asset. A classic example may be the paint used to paint a car or the leather used to repair shoes. In such cases the dominant asset takes the other asset and that other asset ceases to have a separate existence. Following of the non-dominant asset is no longer possible. The issue of which is the dominant asset may, on particular facts, be a difficult one.

8.4 Fourthly, an asset may cease to exist in circumstances where it is consumed or used up in creating some new product. Thus grapes turned into wine may result in an inability to follow the grapes...once turned into wine they no longer exist. Similarly, the consumption of resin and woodchip to create chipboard may result in something new so that neither the woodchip nor the resin can be "followed" into the new product.¹⁰

In the last two scenarios that may well not be the end of the matter, in terms of applicable law. Questions may then arise as to whether tracing into the mixture or the new product is possible.

⁸ There is an academic debate as to whether the legal consequence is a tenancy in common or a situation with some of the characteristics of a tenancy in common but in fact not a tenancy in common.

⁹ See, in the case of oil, *Indian Oil Company Ltd v Greenstone Shipping SA (Panama)* [1988] 1 QB 345; *Glencore International AG v Metro Trading International Inc.* [2001] 1 LIR 284.

¹⁰ *Borden (UK) Ltd v Scottish Timber Products Limited* [1981] Ch 25.

(2) Tracing: an identification exercise, not a claim or a remedy

10. Tracing may be said to amount to be a body of evidential rules and presumptions enabling a claimant to prove that value in an original property is now represented in substitute property.¹¹ As described by Lord Millett in *Foskett v McKeown*:¹²

“Tracing is thus neither a claim nor a remedy. It is merely the process by which the claimant demonstrates what has happened to his property. Identifies its proceeds and the persons who have handled or received them, and justifies his claim that the proceeds can be regarded as representing his property. Tracing is also distinct from claiming. It identifies the traceable proceeds of the claimant’s property. It enables the claimant to substitute the traceable proceeds for the original assets as the subject matter of his claim. But it does not affect or establish his claim.”

11. To similar effect see Lord Steyn:¹³

Tracing “..is a process of identifying assets; it belongs to the law of evidence. It tells us nothing about legal or equitable rights to the assets traced”

12. And Rimer J in *Shalson v Russo* [2003] EWHC 1637 (ch); [2005] Ch 281 para [102] who explained tracing as :

“..the process by which a claimant seeks to show that an interest he had in an asset has become represented by an interest in a different asset.”

13. Thus, tracing (or indeed following) an asset does not tell you whether the claimant has a legal claim against a person or property nor what his remedy (if any) might be. Although tracing is probably most commonly considered in the context of proprietary claims it may be highly relevant in considering whether personal liability (e.g. for dishonest assistance in breach of trust) attaches to a person. Commentators have suggested that tracing would be easier to understand if the question of the claim or remedy which may be available once the tracing process is carried out is considered separately from the question of tracing.

Issues involving tracing

14. There is no room in this paper to develop the points below but the following should be noted.

¹¹ *Virgo (infra)* pg. 631-2.

¹² [2001] 1 AC 102, 127. The *Foskett* case has been cited and adopted in, for example, Singapore (*Caltona (supra)*) and Cayman (*AHAB v Saad Investments Co Ltd* (2013) 17 ITELR 349).

¹³ *Foskett v McKeown (infra)* pg. 113.

(1) Underlying basis

15. There has been much academic debate as to whether tracing is fundamentally based upon unjust enrichment or is simply a matter of vindicating property rights.¹⁴ The difference might become relevant in the context, for example, of arguments of change of position on the part of a defendant. In England at least it seems fairly clear that the theoretical basis underpinning tracing is that of a vindication of property rights rather than unjust enrichment.¹⁵

(2) No room for exercise of judicial discretion turning on “fairness”

16. The *Foskett* case also supports the proposition that tracing itself (as opposed to the question of what consequences flow from a successful tracing exercise), is essentially determined by fixed rules and settled principles and that it is not a matter to be determined by the exercise of discretion.

(3) Tracing involves tracing value not identifying chains of property

17. As Lord Millett said in the *Foskett* case:

“We speak of tracing one asset into another, but this...is inaccurate. The original asset still exists in the hands of the new owner, or it may have become untraceable. The claimant claims the new asset because it was acquired in whole or part with the original asset. What he traces therefore is not the physical asset itself but the value inherent in it.”

This appears to lend support to the proposition that “backwards tracing” (see further below) should be possible.

(4) Based on attribution not causation

18. The *Foskett* case also supports the proposition that tracing turns on attribution rather than causation.
19. In that case investors deposited sums to be invested in property in Portugal. It was settled on trust for them until the land was purchased (the “investor fund”). A few years earlier one of the trustees had set up a unit linked life insurance policy on his life. The terms were that if he died the sum of £1million would be paid. He settled the policy on trust for his children. The policy required payment of an annual premium of £10,220. Under the policy the premium was applied to a notional allocation of units. Units would be cancelled to meet the life cover of the following year. If premiums ceased to be paid, units would continue to be cancelled until

¹⁴ Key proponents of the unjust enrichment theory have been Birks and Burrows.

¹⁵ *Foskett v McKeown (infra)*.

there were no units left. Once there were no units the policy would be cancelled. The trustee paid for the first three premiums from his own pocket, premiums 4 and 5 were paid from misappropriated trust monies. The trustee died. The children were, on the face of things, entitled to receive £1million. The question was whether the beneficiaries of the investor fund were entitled to trace into the £1million and, if so, what sum they should receive. One of the arguments was that tracing was not possible. This was on the basis that the first three payments had bought sufficient units to enable the insurance policy to continue and the £1million payment to be made even if the 4th and 5th premiums had not been paid. As such, the £1 million would have been paid irrespective of the payment of the misappropriated trust funds as the 4th and 5th premium payments.

20. Lord Steyn, who dissented, accepted a causal approach to tracing. As the policy would not have lapsed had the misappropriated monies not been paid they did not contribute to the £1 million payment and tracing into it was not possible. However, for the majority, tracing into the death benefit was possible. The benefit was payable, under the policy, in consideration of the payment of all the premiums paid and therefore including the 4th and 5th payments, using the wrongfully misappropriated money.¹⁶

Tracing: “at law” and “in equity”

(1) Is there a distinction between tracing at common law and in equity?

21. There are a number of reasons to question the apparent continuation (at least in England) of different tracing rules at law and in equity. First, historically the distinction is dubious;¹⁷ Secondly, the administration of law and equity are supposed to have fused since the Judicature Act 1873; Thirdly, if tracing is a bundle of evidential rules about identification, it is difficult to see why the nature of the property right sought to be enforced should matter.
22. However, although much criticised both in case law¹⁸ and by academics, the difference is too established in English law to be ignored, at least up to Supreme Court level. At that level though there is a real prospect that the distinction might be removed.

¹⁶ For criticism of the decision on the facts and the argument that tracing should have been into the units but not straight into the payment out, see *Virgo* at 634-5.

¹⁷ *Virgo* at 636.

¹⁸ *Trustee of the Property of FC Jones & Sons v Jones* [1997] Ch 159; *Foskett v McKeown* [2001] 1 AC 102.

23. Tracing at equity is generally considered to be more generous to claimants than tracing at law. This is because at law, although it is possible to trace into substitutions of property where there is no mixing¹⁹ and even, where there is no mixing, into profits made from the use of property,²⁰ the right to trace is lost where the substitute property has been mixed with other property, such that it has lost its separate identity. This raises a particular problem in the context of the mixing of money, whether in physical terms or in modern terms of accounts where money is exchanged for a chose in action or debt such as in the case of a bank account. The common law rules of tracing as interpreted in English authority do not permit money to be traced through a mixed fund whereas the equitable rules do.²¹

(2) Equitable tracing: need for a fiduciary relationship?

24. However, although more generous in one sense, the equitable tracing rules as applied in England contain a significant restriction. To operate, at least under current English case law, they require the claimant to establish an equitable proprietary base to his claim, the requirement being that there must be some relevant antecedent fiduciary relationship. The result is that there appears to have been a number of cases where a strained or artificial or incorrect “fiduciary” relationship has been identified as being present, so as to enable the court to apply equitable tracing principles.²² At least until Supreme Court level in the UK there seems little hope that this restriction will or can be removed judicially.

Accounts, allocation of value

25. Where monies are mixed in an account and there are no further movements tracing creates no particular problems. However, where withdrawals are subsequently made from the account questions of attribution arise. To deal with these the law has laid down certain rules or principles which are to be applied but, as will be seen, the “starting” rule is not necessarily immutable.

¹⁹ *Banque Belge Pour L'Etranger v Hambrouck* [1921] 1 KB 321.

²⁰ See e.g. *Trustee of the Property of FC Jones v Jones* [1997] Ch 159, 169. There, money was misappropriated by a partner from the partnership bank account and paid to his wife, who paid them into her account with a firm of brokers. The money was applied on a futures market. A large profit was made and deposited by the wife in a deposit account with the bank. There was at no stage any mixing. The trustee in bankruptcy of the partnership was held entitled to trace into the profits of £50,670 obtained from the sum misappropriated of £11,700.

²¹²¹ A view to some extent adopted in Singapore based on the English authorities: *Hongkong and Shanghai Banking Corp Ltd v United Overseas Bank Ltd (infra)*.

²² In cases of theft there will be sufficient equitable title as in cases where property or money is induced to be transferred by a fraudulent misrepresentation, Where money is paid under a mistake of fact the position regarding a fiduciary relationship is less clear: contrast *Chase Manhattan N A Bank Ltd v Israel British Bank (London) Ltd* [1981] Ch 105 and *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669.

26. The problem arises where there are withdrawals from a mixed bank account which includes monies from two different sources. To whose fund is the withdrawal attributed?
27. So far as wrongdoers are concerned there are three principal rules which apply.
- 27.1 First, the mixed fund in the account is presumed to belong to the innocent trust claimant to the extent that the wrongdoer cannot prove that it is attributable to his own contributions to the account.²³
- 27.2 Secondly, where withdrawals take place which are dissipated, the presumption is that they are withdrawn from the wrongdoer's share of the mixed fund.²⁴ However, if the withdrawal is not dissipated but, for example, invested successfully and the remaining sums in the bank account are subsequently dissipated, then the claimant's money may be traced into the investment.²⁵
- 27.3 Thirdly, there is no presumption that subsequent deposits onto the account by a wrongdoer are intended by him to replace any of the claimant's money previously withdrawn. Unless therefore the circumstances are exceptional, the claimant will be limited in any tracing remedy to asserting a claim against the lowest balance that his money has fallen to in the account between the date of deposit of his money and any subsequent deposit of the wrongdoer's money.²⁶
28. Where the contributors to the mixed fund are innocent then the presumptions which apply are different. The traditional starting point is to apply the rule in *Clayton's Case*.²⁷ Specific debits are matched against specific credits, the presumption being that the money first withdrawn from the account is that from the contribution of the depositor whose money was first deposited. This presumption applies irrespective of whether or not the withdrawal is dissipated or capable of being traced into a substitute asset.
29. More recent cases have recognised that this methodology can be expensive or even unworkable and is also capable of operating unjustly because it can essentially penalise the interests of those whose money is deposited first. The English courts have said that the rule in Clayton's case is capable of being displaced "*by even a slight counterweight*" and that "*in terms of its actual application between beneficiaries who have in any sense met a shared misfortune, it might be more*

²³ *E Ajou v DLH plc* [1993] 3 All ER 717 per Millett J; *Re Tilley's WT* [1867] 1 Ch. 1179.

²⁴ *Re Hallett's Estate* (1879) 13 Ch.D, 696

²⁵ *Re Oatway* [1903] 2 Ch. 356

²⁶ *Bishopsgate Investment v Homan* [1995] 1 All ER 347

²⁷ *Clayton's Case, Devaynes v Noble* (1816) 1 Mer 572; [1814-23] All ER Rep 1; 35 ER 781.

accurate to refer to the exception that is, rather than the rule in, *Clayton's Case*.”²⁸ In the *Framjee* case (*supra*) the *Clayton's Case* approach was rejected as operating unfairly regarding those whose sums were paid in earlier compared with those paying in later and on the basis that it would be prohibitively expensive in that case to attempt to reconstruct the relevant accounts if the entity concerned over a period of 10 years to ascertain the precise order in which payments in were matched by payments out.

30. Two main alternative methodologies have been considered by the Courts.
31. The first, was referred to in the *Barlow Clowes* case,²⁹ as the “rolling charge” or “North American” method. The latter description was applied because it is a method which has been applied by the Courts in Canada³⁰ and the United States in place of a *Clayton's Case* approach on the basis that the “rolling charge” basis is more equitable. This approach has been adopted in Jersey and referred to as the “apportionment” method.³¹ The approach is one applicable where funds of several depositors, or sources, have been blended in one account. It involves each debit to the account, unless unequivocally attributable to the moneys of one depositor or source, being attributed to all the depositors so as to reduce their deposits pro rata instead of being attributable (as in *Clayton's Case*) to the earliest deposits in point of time. As explained in *Charity Commission for England and Wales v Framjee & Ors.* [2014] EWHC 2507 (Ch); [2015] 1 WLR 16, this approach really involves a combination of a *pari passu* approach and the lowest intermediate balance principle. The approach requires entitlements at the time of any withdrawal to be determined. Those with an entitlement at that time are treated as bearing the withdrawal in proportion to the sum owed to them compared to the sums owed to all others at the moment immediately before the withdrawal. Their entitlement cannot, in effect, be any larger than the lowest intermediate balance at any time which is attributable to their interest
32. This basis has not been applied on the facts in England to date. In *Barlow Clowes* the methodology was said to involve such complexities which were so great, even with the use of computers, and the cost so high that it was considered to be impracticable. In the *Framjee* case the inadequacies of the is methodology was rejected not because of inherent complexity - a computer programme was thought to be capable of dealing with that - but because of the inadequacies of the raw data keeping by the entity in question involving a need for difficult reconstruction.
33. Interestingly in the *Framjee* decision, the court was urged to adopt a hybrid approach and to create two pools of assets, to each of which the *pari passu* method

²⁸ *Russell-Cooke Trust Co v Prentis* [2003] 3 All ER 478.

²⁹ *Barlow Clowes International Ltd (in liqn) v Vaughan* [1992] 4 All ER 22.

³⁰ *Re Ontario Securities Commission and Greymac Credit Corp* (1986) 55 OR (2d) 673.

³¹ *In re Esteem Settlement* [2002] JLR 53.

would be applied. The pools were created by reference to a specific date. The creation of the two pools had the effect that, at least to some extent, the rolling charge basis was being applied because in effect at the relevant date entitlements were fixed for those beneficially entitled as at that date and they did not share any further by reason of such entitlements in sums thereafter received. This hybrid approach was rejected by Henderson J who said that on balance he did not think that such an approach operated fairly AND that in any event the method ought to be applied in its entirety or not at all throughout the period when the mixed fund has been operated in objectively similar conditions.

34. The third basis (or second alternative basis is that of a *pari passu* distribution among all those entitled to the fund from time to time, in proportion to their entitlements and irrespective of when their entitlements arose and the precise times of any withdrawals. This was the simple approach adopted in *Barlow Clowes and Framjee*. It was also recently applied by the Chancellor, Sir Terence Etherton, in *National Crime Agency v Robb [2014] EWHC 4384 (ch)*. However, it is important to understand the facts of those cases leading to that conclusion. No general rule can be extracted as to what will or will not be fairer or more appropriate. All will depend on the facts.

“Backward” tracing

35. A further issue which arises in tracing is whether it is possible to trace into an asset where the putative “substitute” asset was acquired in economic substance by use of the claimant’s property but in circumstances where it was acquired prior to the claimant’s property being acquired or used by the wrongdoer. A typical example is where property is acquired by a person in the expectation that he will pay for it using someone else’s property but that the way in which the putative “substitute” is acquired is, for example, by way of a loan or overdraft.
36. One view expressed in the cases has been that a claimant cannot trace into property that was already in the defendant’s possession before the claimant’s money was received. This is on the basis that the defendant’s property cannot be regarded as representing the claimant’s money, even if the claimant’s money was used to pay for the property by discharging a debt incurred to acquire it. However, it is clear that this exposition of the position is too narrow. If there is a sufficient transactional link then tracing will be permitted.
37. In *Agip (Africa) Ltd v Jackson [1990] 1 Ch 265*, tracing took place in circumstances where a bank in effect borrowed money from another bank and directed that the lent money should be paid to a certain account. It later paid that loan with a certain value being funds taken from the wronged company in question. That value was held traceable into the payment into the certain account and then on. This approach is supported by the attribution theory of tracing.

38. In *Relfo v Varsani* [2014] EWCA Civ 360, the English Court of Appeal was faced squarely with the issue again. A claim was brought based on both knowing receipt and unjust enrichment. The relevant issue for present purposes, relevant to the knowing receipt claim, was whether a credit to the defendant's account in law substitute property for monies belonging to Relfo and which were misappropriated and paid to a company called Mirren Ltd ("Mirren"). The sum in question was £500,000. The payment was made on 5 May 2004. On the same day a company called Intertrade paid a sum close to £500,000 (in dollars) to an account of Mr Varsani in Singapore. That sum was credited to his account on 10 May 2004. However Relfo could not point to specific transactions linking the Mirren and Intertrade accounts to show how the payment from Relfo to Mirren was translated into the payment to the defendant by Intertrade. The judge found that the payment to Mirren had been caused to be paid with the intention of producing the result that the funds so paid should, by means to be devised, be paid on to the defendant and that it was likely that this result was thus brought about.
39. The Court of Appeal held that tracing was permissible notwithstanding that Mirren did not reimburse anyone in respect of the payment by Intertrade until after that payment had been made:

"...monies held on trust can be traced into other assets even if those other assets are passed on before the trust monies are paid to the person transferring them, provided that that person acted on the basis that he would receive reimbursement for the monies he transferred out of the trust funds...a person may agree to provide a substitute for a sum of money even before he receives that sum of money. In those circumstances the receipt would postdate the provision of the substitute."

Malcolm Davis-White QC

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