

## EQUITABLE COMPENSATION: THE TRADITIONAL VIEW

### Introduction

1. Once upon a time equitable compensation was the preserve of the trust lawyer. Now, its award is more often to be found in commercial cases whether relating to solicitors finding themselves embroiled in mortgage fraud or cases involving dubious commercial dealings.
2. This paper aims to strip the principles of equitable compensation to their bare bones, to tie them in with the trustee's fundamental duty to account to his beneficiaries and to distinguish equitable compensation from an award of damages which is a different creature altogether.

### The General Principles

3. There is no way better of understanding equitable compensation than to go back to the speech of Lord Browne-Wilkinson in the House of Lords in *Target Holdings Ltd v Redferns*<sup>1</sup> . :

*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. Thus, in relation to a traditional trust where the fund is held in trust for a number of beneficiaries having different, usually successive, equitable interests, (e.g. A for life with remainder to B), the right of each*

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<sup>1</sup> [1996] AC 421

*beneficiary is to have the whole fund vested in the trustees so as to be available to satisfy his equitable interest when, and if, it falls into possession. Accordingly, in the case of a breach of such a trust involving the wrongful paying away of trust assets, the liability of the trustee is to restore to the trust fund, often called 'the trust estate,' what ought to have been there.*

4. Stopping there the principles of equitable compensation are most easily understood if that one fundamental issue is kept in mind: a fiduciary is obliged to keep the fund safe and if he does not do so, then he is obliged to restore it<sup>2</sup>. Lord Browne-Wilkinson went on in *Target*:-

*The equitable rules of compensation for breach of trust 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. 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. Courts of Equity did not award damages but, acting in personam, ordered the defaulting trustee to restore the trust estate: see *Nocton v. Lord Ashburton* [1914] A.C. 932 , 952, 958, per Viscount Haldane L.C. If specific restitution of*

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<sup>2</sup> Something which Lord Millet made clear in the recent case of *Tang Ying Ip and others v. Tang Ying Loi* [2017] HKCFA 3; FACV 9/201 would have made the analysis much easier had it been borne in mind that the executor had taken assets from the estate and therefore had to restore the estate to what it would have been.

*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: Caffrey v. Darby (1801) 6 Ves. 488 ; Clough v. Bond (1838) 3 M. & C. 490 . 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: see Underhill and Hayton, Law of Trusts & Trustees 14th ed. (1987), pp. 734-736; In re Dawson, decd.; Union Fidelity Trustee Co. Ltd. v. Perpetual Trustee Co. Ltd. [1966] 2 N.S.W.R. 211 ; Bartlett v. Barclays Bank Trust Co. Ltd. (Nos. 1 and 2) [1980] Ch. 515 . 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: see also In re Miller's Deed Trusts (1978) 75 L.S.G. 454 ; Nestle v. National Westminster Bank Plc. [1993] 1 W.L.R. 1260 .*

5. Pausing there again, it is clear that the rules which relate to the assessment of damages: remoteness and causation do not apply when the Court is deciding what equitable compensation to award. This is because the process being undertaken is restitution of the trust fund. However, there has to be some causal link between the loss to the trust

fund and the breach. If the loss would have occurred even if the breach had not taken place then, the trustee will not be liable.

6. However foreseeability is not relevant and the Court judges matters with hindsight. The appropriate approach was very usefully summed up by McLachlin J in *Canson Enterprises Ltd v Boughton & Co*<sup>3</sup>:

*“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.”*

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<sup>3</sup> [1991] 3 SCR 534 at 552-553

7. The Court therefore looks back at the date of trial to see what would have happened to the trust fund if the breach had not occurred. The fiduciary cannot raise any arguments which would be inconsistent with his duties. A good example of the application of these principles can be found in *Libertarian Investments Ltd v. Hall*<sup>4</sup> where equitable compensation was fixed based not only on the monies which the fiduciary had taken for his own purposes but which had been given to him to purchase shares but also for the lost opportunity suffered by the Plaintiff in being unable to purchase those shares and then sell them on at a profit. In other words the Court looked at the what state the trust fund would have been in had the breach not occurred.

#### Where the trust no longer exists

8. Different considerations apply where the trust no longer exists. Returning to Lord Browne-Wilkinson:-

*“Hitherto I have been considering the rights of beneficiaries under traditional trusts where the trusts are still subsisting and therefore the right of each beneficiary, and his only right, is to have the trust fund reconstituted as it should be. But what if at the time of the action*

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<sup>4</sup>[2013] HKCFA 93

*claiming compensation for breach of trust those trusts have come to an end? Take as an example again the trust for A for life with remainder to B. During A's lifetime B's only right is to have the trust duly administered and, in the event of a breach, to have the trust fund restored. After A's death, B becomes absolutely entitled. He of course has the right to have the trust assets retained by the trustees until they have fully accounted for them to him. But if the trustees commit a breach of trust, there is no reason for compensating the breach of trust by way of an order for restitution and compensation to the trust fund as opposed to the beneficiary himself. The beneficiary's right is no longer simply to have the trust duly administered: he is, in equity, the sole owner of the trust estate. Nor, for the same reason, is restitution to the trust fund necessary to protect other beneficiaries. Therefore, although I do not wholly rule out the possibility that even in those circumstances an order to reconstitute the fund may be appropriate, in the ordinary case where a beneficiary becomes absolutely entitled to the trust fund the court orders, not restitution to the trust estate, but the payment of compensation directly to the beneficiary. The measure of such compensation is the same, i.e. the difference between what the beneficiary has in fact received and the amount he would have received but for the breach of trust.*

9. Therefore if there no longer a trust fund in existence and the beneficiaries have become absolutely entitled the court will award equitable compensation in their favour. In doing so the function of the

court will be to put them in the position they would have been in but for the breach.

### Different Types of Breach

10. It is important to distinguish between different types of breach on the part of trustees in order to apply the *Target* principles. In *BNZ v NZ Guardian Trust Co Ltd*<sup>5</sup> Tipping J distinguished between three types of breach:-

*“Breaches of duty by trustees and other fiduciaries may broadly be of three different kinds. First, there are breaches leading directly to damage to or loss of the trust property; second, there are breaches involving an element of infidelity or disloyalty which engage the conscience of the fiduciary; third, there are breaches involving a lack of appropriate skill or care. It is implicit in this analysis that breaches of the second kind do not involve loss or damage to the trust property, and breaches of the third kind involve neither loss to the trust property, nor infidelity or disloyalty.”*

11. It is breaches of the first kind where there is clear loss to the trust fund that equitable compensation is appropriate if the trust fund cannot otherwise be reinstated. The second type of breach is one not resulting in loss to the trust fund but there has been some breach of fiduciary duty. The third category of breach, lack of skill and care may be treated more as a claim in negligence because it is not strictly speaking a breach of

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<sup>5</sup>[1999] 1 NZLR 664 at 687

trust<sup>6</sup>. Not all acts of a fiduciary are in fact fiduciary in nature<sup>7</sup>. In that latter case questions which apply to the measure of damages for a negligence claim will come back into the picture. That will include identifying the loss from which the trustee was under a duty to keep the beneficiary harmless as well as applying the rules as to foreseeability and mitigation.

### Accounts

12. An account is sometimes regarded as a remedy for breach of trust but in fact a trustee always has a duty to account to his beneficiaries regardless of any breach. Whether to order an account is a matter for the discretion of the Court. Therefore there are not many cases where a breach has not occurred when an account will be ordered. The traditional remedy in a breach of trust case was to require the trustee to account. In more recent times claimants normally seek equitable compensation as the taking of an account can be a costly and complex process.

13. As Lord Millett said in the *Libertarian* case a beneficiary does not elect between equitable compensation and an account. An account is the first step in process identifying what the trust fund or the beneficiary has lost. The process whereby accounting takes place is however instructive in looking at how a trustee must compensate the trust fund or the beneficiary if he is in breach. Whether an account is necessary or not

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<sup>6</sup> Lewin on Trusts 19<sup>th</sup> edition para 39-16;

<sup>7</sup> *Bristol and West Building Society v Mothew* [1998] 1 Ch 1 at 17 [

will depend on what has been established at trial. Sometimes the facts are sufficiently established to render the account unnecessary.

14. The beneficiary when the account is provided to him can falsify and surcharge it. So, for example if the account discloses trust monies being used to invest in an unauthorized investment, the plaintiff may falsify it, that is to say ask for the monies paid out to be disallowed. Similarly if assets of the fund are wrongly distributed or if the trustee takes the assets for himself falsification is the appropriate response. In that case, either the trustee has to restore the assets to the fund or pay money. As Lord Millett said in the *Libertarian* case:-

*Where the defendant is ordered to make good the deficit by the payment of money, the award is sometimes described as the payment of equitable compensation; but it is not compensation for loss but restitutionary or restorative. 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 full benefit of hindsight.*

15. An exception is where a trustee uses the monies to invest and makes a profit where the beneficiaries can adopt the investment or trace into it.
16. Surcharging the account is where trustee has failed to get in assets he ought to have done. It is more commonly known as accounting on the

basis of wilful default described by Millet J as he then was in *Armitage v Nurse*<sup>8</sup> as follows:-

*“A trustee is said to be accountable on the footing of wilful default when he is accountable not only for money which he has in fact received but also for money which he could with reasonable diligence have received.”*

17. So for example if a trustee fails to collect interest on a debt or rent on a property held within the trust he will be liable to account on this basis. Where compensation is awarded at the end of taking an account of this kind, it is compensation for loss and much more akin to damages..

### Summary

18. Equitable compensation is not compensation for loss; it is restitution of the trust fund;

19. If the defaulting trustee cannot restore the assets to the trust fund, then he must pay money into the trust instead;

20. How much has to be paid into the trust fund is assessed by looking at the matter with hindsight to see what would be comprised in the trust fund but for the breach.

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<sup>8</sup> [1998] Ch. 241 {K2A/30/1}

21. Issues of remoteness, causation and mitigation have no place in the assessment of equitable compensation as they do with damages;
22. However there has to be a causal link between the breach and the loss to the trust fund.
23. If the trust fund has come to an end then the equitable compensation will be paid to the beneficiary absolutely entitled but the same principles as to quantum apply as set out above.
24. It is important to work out the nature of the breach. A breach by a fiduciary which is not a breach of fiduciary duty but breach of his duty of care will be treated like a claim for damages.
25. Equitable compensation is not an alternative to an account. An account may be a step on the way to assessing equitable compensation.

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