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SNARK HUNTING: A SEARCH FOR TRACING'S UNDERLYING RATIONALE

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I THE DEBATE

The underlying rationale for tracing in equity is a much-debated topic and has seemingly resulted in more theories than there are commentators. For a relatively minor area of the law, it has attracted substantially more than its fair share of attention from academic theorists, each of whom vie to include it as part of their particular speciality. They include the restitutionalists; those who regard tracing as an inherent right of property; those who regard it as underpinned by the Roman Law notion of *obligatio*;¹ and those who regard it as the enforcement of fiduciary duties.

The intense debate necessarily reflects a lack of jurisprudential consistency in the authorities and there are myriad doctrinally diverse cases from which academics can choose to support their respective theories.

II WHY SEARCH FOR AN UNDERLYING RATIONALE?

It is not irrational to ask, why does it matter that there be an identifiable basis for equitable tracing? It is well understood as a process by which a person, whose right, interest or claim in respect of property has been misapplied, seeks to advance a proprietary claim against different property which can be regarded as a substitute for the original property.² Hence, it may be regarded as no more than a useful tool which applies in a variety of circumstances, such that there is no need

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¹ See Rachael Short, 'A Common Law *Vindicatio*? Property Rights as an Independent Basis for Restitution' (2022) 51(2) *Australian Bar Review* 264.

² *Heperu Pty Ltd v Belle* (2009) 76 NSWLR 230, 252 [89] (Allsop P), 269–70 [179]–[180] (Campbell JA and Handley AJA agreeing).

to identify one ‘Very Big Idea’, as Gageler J termed it, which might provide coherence to it.³

However, the identification of a consistent doctrinal basis is essential for transparency and certainty in the application of legal principle. Permitting a claimant to utilise the tracing process in whimsical ways, as has occurred with the concept of ‘backward tracing’, leaves a stain on the administration of justice.

Nevertheless, as we shall see, the search for an underlying rationale for tracing faces impediments similar to those adverted to by Lewis Carroll in his nonsense poem, ‘The Hunting of the Snark’. It may be that no one person is suitably equipped for the task; the object of the inquiry may well be completely ethereal — and the paths to the anticipated conclusion point in many different directions. Worse still, the moment that that which has been searched for is located, it vanishes.

III WHAT IS TRACING?

If one starts by asking, ‘what is tracing?’, the confusion immediately commences. As the former Court of Appeal judge, the Hon J Campbell KC, has observed,⁴ the word ‘tracing’ is an imprecise term incapable of exact legal definition, and its generally accepted meaning has altered over time. He correctly noted that lawyers use the expression with different meanings or conceptions, and there is sometimes debate as to whether the awarding of a proprietary remedy in some of the authorities occurred by reliance on tracing or not.

The present discussion is concerned with that form of tracing where the owner of misapplied property seeks to assert a proprietary remedy over different property, which is said to be a substitute for the original. This is referred to by Campbell KC as ‘archetypal tracing’, which is a useful nomenclature.

Even when one settles on what is the nature of tracing, a further dispute arises as to what it is that is traced. As will be discussed, some perceive that the tracing is of a right in respect of property or a proprietary right, others that it is of ‘value’, while still others eschew a metaphorical analysis and assert that the end result of the tracing process is the creation of a new right or, in other words, that tracing does not really exist at all.

³ See the salutary observations of Gageler J in *Mann v Paterson Constructions Pty Ltd* (2019) 267 CLR 560, 598 [80].

⁴ J C Campbell, ‘*Republic of Brazil v Durant and the Equities Justifying Tracing*’ (2016) 42(1) *Australian Bar Review* 32, 40, 50.

IV TRACING AND INSOLVENCY

In the search for legal principle, consideration should be given to outcomes. For tracing, which is particularly important in the insolvency context, one outcome can be that a successful claimant will enforce a proprietary claim against a person which takes precedence over the claims of that person's other creditors. So, if it is underpinned by no more than unperformed fiduciary obligations, why should it confer an advantage over creditors to whom obligations have also been breached?

V WHAT GENERATES THE RIGHT TO TRACE?

That which divides some commentators concerns the identity of tracing's essence, or that which justifies a party's invocation of the tracing process. It may well be that a satisfactory answer will provide some identification of a coherent exegetical principle for tracing more generally.

The issue can be contextualised by the following example.

T is the trustee of a trust of which B is the beneficiary. A painting worth \$10,000 is part of the trust assets, but T takes it from the trust and keeps it at his house. T then sells it and, after mixing the proceeds in a bank account, buys another painting, paying \$10,000 from the account. Subsequently, T gives the second painting to his friend, V, who keeps it. The artist who painted the second painting dies and the value of his works increases tenfold so that the substitute painting is now worth \$100,000. B seeks to recover the substitute painting from V's insolvent estate.

In equity, B is entitled to trace their interest through the transactions, including through the mixed funds, and make good a claim to the beneficial interest in the \$100,000 painting.

But what was it in the nature of B's right, claim or interest in relation to the original painting or in the relationship with the trustee that enabled the invocation of such a process, which resulted in such a windfall?

As mentioned above, the theories are abundant and diverse:

- (a) One view, which has growing support in Australia, is that the right to invoke tracing in equity stems from the presumptive paramouncy which our society affords to individual property ownership. In general terms, the bundle of rights which constitute ownership of property includes a right over or with respect to anything for which the original property is substituted. This is the approach which Lord Millett strongly favoured in obiter in *Foskett v McKeown*.⁵

⁵ [2001] 1 AC 102, 127–9. See also 108 (Lord Browne-Wilkinson), 115 (Lord Hoffman).

- (b) A view which, despite much debate,⁶ persists in the United Kingdom and also in Australia to some extent, is that the right to invoke tracing in equity is a consequence of the trust or fiduciary obligations which a person in control of property of another, owes to that other.⁷ So where T has sold the painting and cannot anymore hold it on trust for B, he is required to do the ‘next best thing’ and hold the proceeds or substitute painting on trust.⁸ The theory runs into difficulties when the property finds its way into the hands of a third-party volunteer, although there it is argued that such a person has no greater interest than the original errant trustee.⁹
- (c) A different approach appears from the rather excellent analysis of Dr Aruna Nair in her work *Claims to Traceable Proceeds: Law, Equity and the Control of Assets*.¹⁰ Her theory is that the right to trace is derived from the inherent power of one person to deal with assets in which another person has an interest in such a way to defeat that interest, and the obligations which are attached to that power. Her analysis provides a solid taxonomy for the wide variety of cases where tracing has been allowed, including those in which the equitable powers are non-existent or irrelevant. It also explains why some equitable rights do not generate a right to trace.
- (d) A somewhat related view is expressed by Mohammad Jaamae Hafeez-Baig and Jordan English in *The Law of Tracing*.¹¹ They also present a compelling analysis of the authorities and suggest that the right to invoke tracing arises from the unauthorised use of rights to acquire substituted rights and that the party seeking to trace in equity becomes entitled to newly created equitable proprietary rights against those rights which were acquired.
- (e) The view advanced in *Meagher, Gummow and Lehane’s Equity: Doctrines and Remedies*¹² is that the right to trace is not dependent upon any antecedent proprietary interest, but on the person seeking to trace having a sufficient right in relation to property which arises from a trust

⁶ See the discussion in Mohammad Jaamae Hafeez-Baig and Jordan English, *The Law of Tracing* (Federation Press, 2021) 153 [5.106].

⁷ See, eg, *Boscawen v Bajwa* [1996] 1 WLR 328, 335 (Lord Millett); *CFHW Pty Ltd v Burness* [2014] VSC 451 [35] (Warren CJ).

⁸ See the observations of Campbell (n 4) 58–9. See also *Evans v European Bank Ltd* (2004) 61 NSWLR 75, 106–7 [159]–[166] (Spiegelman CJ).

⁹ *Foskett v McKeown* (n 5) 132 (Lord Millett).

¹⁰ Aruna Nair, *Claims to Traceable Proceeds: Law, Equity and the Control of Assets* (Oxford University Press, 2018).

¹¹ Hafeez-Baig and English (n 6).

¹² J D Heydon, M J Leeming and P G Turner, *Meagher, Gummow and Lehane’s Equity: Doctrines and Remedies* (LexisNexis, 5th ed, 2014) [4–110].

or other fiduciary duty. That right does not need to exist prior to any wrongful dealing with the property in question; rather, it may arise subsequently.

- (f) Not unexpectedly, the restitutionalists argue that the right to trace is justified by the principle of ‘unjust enrichment’.¹³ Although an initial reaction might be to say, ‘they would say that, wouldn’t they’,¹⁴ the strength of that analysis is enhanced by the growing support for the proprietary interest rationale for tracing.

These theories are not entirely disparate and they tend to overlap, have similar components, or emphasise different aspects of shared principles. In general, but not exclusively, most accept that the party seeking to trace held, at least at one stage, a right, claim or interest in relation to property which has been adversely affected by the actions of another and has been the subject of some form of substitution.¹⁵

A An Equitable Proprietary Interest in Property or a Proprietary Right

Though each of these theories could be discussed at length, this paper is focussed on that issue which arises regularly across these theories, being whether the right to trace is based in the obligation of a fiduciary or in the claimant’s interest with respect to the misappropriated property.

There is insufficient opportunity on this occasion to evaluate the debate as to the nature of proprietary rights as opposed to rights with respect to property, despite its essentiality to the coherence of some theories. In summary, those who assert that the right to trace stems from a fiduciary’s equitable obligation commence with the proposition that, save in the case of a beneficiary of a vested fixed trust, beneficiaries do not have any proprietary interest at all in the subject matter of the trust. Rather, they have equitable rights which are engrafted onto the trustee’s rights over the trust property,¹⁶ and it is that which enables them to compel the trustee to exercise their rights in a particular way.¹⁷ While that analysis of beneficial rights can be accepted, it must be acknowledged that, historically, the authorities have regarded a beneficiary’s beneficial interest in a trust as a proprietary interest of sorts, regardless of whether it was vested.¹⁸

¹³ James Edelman and Elise Bant, *Unjust Enrichment* (Hart Publishing, 2nd ed, 2016) 100–13.

¹⁴ To paraphrase Mandy Rice Davies.

¹⁵ Hafeez-Baig and English (n 6) 115–116 [5.2].

¹⁶ Heydon, Leeming and Turner (n 12) [4]–[110].

¹⁷ *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 268 CLR 524, 560–1 [82] (Bell, Gageler and Nettle JJ).

¹⁸ *Foskett v McKeown* (n 5) 108, 127 (Lord Millett).

In any event, so the theory goes,¹⁹ as beneficiaries of all trusts are entitled to rely upon equitable tracing, it follows that the underlying rationale for it is not the existence of any proprietary interest, but a consequence of the fiduciary's continuing obligations.

But there is a danger in seeking to cleave the concepts of property rights and proprietary interests. After all, 'ownership' is merely a bundle of rights with respect to an asset or thing in connection with which, in a Hohfeldian sense, others have obligations. Those ownership rights, which are separate from the physical asset itself, include the right or, perhaps, the power to alienate, destroy, sell, charge as security and lease amongst other rights.²⁰ They also include concomitant rights against other persons who interfere with those rights. So, as proprietary interests may be merely an aggregation of various rights with respect to property, the distinction between a proprietary interest and a beneficiary's rights with regard to trust property may well be more chimerical than real.

For present purposes, it suffices to generalise somewhat and proceed upon the presumption that a person has a proprietary interest in an asset if they hold certain specific rights in relation to it. In order to avoid the ire of some theorists, it might be best to describe these rights or interests as 'property rights' rather than 'proprietary interests'.

VI WHAT IS TRACED?

A debate also rages between the theorists about precisely what it is that is 'traced', though, here too, the discussion is fuelled by inconsistency in the nomenclatures used. Nevertheless, its discussion has the potential to illuminate tracing's underlying rationale.

It is commonly accepted that in the tracing process the property right neither enlarges nor diminishes and nor does it change its character as it is 'transferred' from property to property.²¹ That is so regardless of whether the property to which the right attaches is sufficient to satisfy the value of the original owner's interest or has increased in value. In *Foskett v McKeown*, Lord Millett held in relation to the nature of the right which is traced:

That [the nature] will depend on a number of factors including the nature of his interest in the original asset. He will normally be able to maintain the same claim to the substituted asset as he could have maintained to the original asset. If he held only

¹⁹ Heydon, Leeming and Turner (n 12) [4]–[110].

²⁰ The strength of that interest will depend upon the admixture of the rights which the person has, including whether there is a right to possession: see the discussion in *Yanner v Eaton* (1999) 201 CLR 351, 365–8 [17]–[25] (Gleeson CJ, Gaudron, Kirby and Hayne JJ).

²¹ Lionel Smith, *The Law of Tracing* (Oxford University Press, 1997) 348.

a security interest in the original asset, he cannot claim more than a security interest in its proceeds.²²

Returning to the example previously postulated, by the tracing process B is entitled to assert a beneficial interest in the substitute painting even though its value has increased tenfold. But what is it that is traced through the transactions and why is B now entitled to the painting worth \$100,000?

In *Foskett v McKeown*,²³ Lord Millett identified 'value' as the subject matter of the tracing process and that which can be asserted in any substitute property. But it was not monetary value to which his Lordship was referring. In his reasons, he was concerned with the application of the tracing links which operate to identify whether the original asset is represented by a substitute asset or part of it and in the course of that consideration he identified that '[t]he transmission of a claimant's property rights from one asset to its traceable proceeds is part of our law of property, not of the law of unjust enrichment'.²⁴ By this he clarified that it is the right of property which is the 'value' inherent in an asset.²⁵

In that way, 'value' 'reifies that which inheres in an asset and which can be seen as passing into another form when that asset is exchanged for another asset'.²⁶ It is difficult to conceive of this 'value' as being other than the original owner's property or proprietary right.

Some of the theories tend to converge around this issue. At the least, it is recognised that a property right which existed in relation to the original misappropriated property can be traced through the transactions and be applied as against the substitute asset. The legal nature of that right does not alter, even if the monetary value of the proceeds or substitute asset fluctuates.²⁷

Given the nature of this area of discourse, it goes without saying that this is not a universally accepted concept. Hafeez-Baig and English postulate that nothing is traced; rather, the original right in respect of property disappears and is replaced by a new right.²⁸ They surmise that the confusion arises consequent upon the adoption of metaphorical explanations for aspects of tracing, such as 'value' and 'property', which presuppose there exists something to trace.²⁹ While that might be fair comment, there is also some irony in it, given that the use of the word 'tracing' is, itself, entirely metaphorical.

Nevertheless, there is a degree of acceptance, at least in the authorities, that tracing is concerned with ascertaining property which has been substituted for the original property in respect of which a claimant's property right existed and

²² *Foskett v McKeown* (n 5) 128.

²³ *Ibid.*

²⁴ *Ibid* 127.

²⁵ *Ibid* 130.

²⁶ Smith (n 21) 16. See also the discussion of the nature of value in Nair (n 10) 57–82.

²⁷ See *Foskett v McKeown* (n 5) 128 (Lord Millett).

²⁸ Hafeez-Baig and English (n 6) 6 [1.20].

²⁹ *Ibid* 11–12 [1.34].

in which that right now inheres. In other words, that which is traced is a right of property.³⁰ That is consistent with the paramountcy which the common law, and Western jurisprudence in general, has historically attached to property rights. Such rights are not easily defeated by unauthorised transactions. They will survive the wrongful misappropriation of the subject matter to which they attach and can annex themselves, in the sense of being exigible against third parties, to substitute property.³¹

Such a conclusion supports the view that it is the existence of the right, as opposed to any concomitant duties attached to it, which underpins the right to trace. However, the nature of that right remains elusive and, particularly so, in the light of the considerable focus in the authorities on the requirement that the right be derivative of a fiduciary duty. Many theorists rely on that requirement to support the argument that the right to trace is derivative of the obligations imposed by the duty rather than any specific right in relation to property.

VII IS A PRE-EXISTING FIDUCIARY RELATIONSHIP A REQUIREMENT?

A brief perusal of the salient English authorities reveals the evolution of the precondition for tracing of the presence of an initial fiduciary relationship.

In *Re Hallett's Estate*,³² the point made by Sir George Jessel MR was that, where the property dealings in question involved a fiduciary, the party whose interest had been misapplied might utilise the processes of tracing provided in the Courts of Equity. He contrasted that with the position where the loss of the interest in property had occurred in the course of a common law relationship, the same relief there being unavailable. There is nothing in his reasons which suggests that the existence of a fiduciary duty did other than provide a method by which access to the Courts of Equity arose. Nevertheless, the case has long been seen as the epicentre of the fiduciary duty requirement.

The case was, for a while, also taken as standing for the proposition that the right to trace could only be applied against the fiduciary themselves. That was rejected in *Re Diplock*,³³ where it was held that the right could be used to identify a claimant's property in the hands of a third party. There, the Court of Appeal recognised that a beneficiary of a wrongfully distributed estate could trace into the bank accounts of volunteers who had received part of the estate, even where the funds received were mixed with their own. The Court said that, so long as 'there was originally such a fiduciary or quasi-fiduciary relationship between the

³⁰ See *Foskett v McKeown* (n 5) 127 (Lord Millett).

³¹ Ross Grantham and Charles Rickett, 'Tracing and Property Rights: The Categorical Truth' (2000) 63(6) *Modern Law Review* 905, 910–911.

³² (1879) 13 Ch D 696, 710.

³³ *Re Diplock*; *Diplock v Wintle* [1948] Ch 465, 540 (CA), affd sub nom *Ministry of Health v Simpson* [1951] AC 251 (HL) ('*Re Diplock*').

claimant and the recipient of his money as to give rise to an equitable proprietary interest in the claimant',³⁴ the right to trace existed. In this way, equity could 'protect and enforce what it recognises as equitable rights of property which subsist until they are destroyed by the operation of a purchase for value without notice'.³⁵ The Court said:

[E]quity may operate on the conscience not merely of those who acquire a legal title in breach of some trust, express or constructive, or of some other fiduciary obligation, but of volunteers *provided that as a result of what has gone before* some equitable proprietary interest has been created and attaches to the property in the hands of the volunteer.³⁶

The reference to 'what has gone before' would encompass the creation of an equitable interest in property consequent upon the presence of an anterior fiduciary duty with respect to it.³⁷ But that is not necessarily the only way in which such an interest might arise. This appears to have been accepted earlier in the Court's reasons, where it held that the tracing process was available where the claimant had established as the starting point 'the existence of a fiduciary or quasi-fiduciary relationship *or of a continuing right of property recognised by equity*'.³⁸

The reference to '*or of a continuing right of property recognised by equity*'³⁹ has been latched onto by commentators as eschewing any singularity in the nature of the interests which attract the right to trace. To a similar effect were the Court's subsequent observations, where it referred to the powers of equity to 'protect and enforce what it recognises as equitable rights of property which subsist until they are destroyed by the operation of a purchase for value without notice'.⁴⁰ If, therefore, the right to trace arose from the existence of the proprietary interest rather than the fiduciary duty, there was no reason why third party recipients of property, who were not bona fide purchasers for value without notice, would not be subject to the tracing rules.⁴¹

On this issue, the decision of the House of Lords in *Foskett v McKeown* is pivotal. Although the Court confirmed the requirement of a relevant fiduciary relationship, numerous observations in the leading speech of Lord Millett indicated a clear preference for the view that tracing's foundation was the existence of a proprietary interest. In his Lordship's analysis he recognised that, by the tracing process, a claimant asserts a 'continuing beneficial interest' in the

³⁴ Ibid 467.

³⁵ Ibid 525.

³⁶ Ibid 530 (emphasis added).

³⁷ This being the proposition for which *Re Diplock* (n 33) was said to stand for by Goulding J in *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105, 113, 118–20 ('*Chase Manhattan Bank*').

³⁸ *Re Diplock* (n 33) 520 (emphasis added).

³⁹ Ibid (emphasis added).

⁴⁰ Ibid 525.

⁴¹ The conclusion reached by the Court of Appeal in *Re Diplock* (n 33) had been presaged by the High Court of Australia some 38 years before in *Black v S Freedman & Co* (1910) 12 CLR 105 ('*Black*').

substituted asset as the result of a transmission of their property rights from one asset to its traceable proceeds such that tracing is an incident of property rights. He held:

A beneficiary of a trust is entitled to a continuing beneficial interest not merely in the trust property but in its traceable proceeds also, and his interest binds every one who takes the property or its traceable proceeds except a bona fide purchaser for value without notice.⁴²

So adamant was his Lordship that the underlying justification for tracing was the property interest that, in obiter, he moved to denounce the existence of an initial fiduciary interest as a precondition. He said:

Given its nature, there is nothing inherently legal or equitable about the tracing exercise. There is thus no sense in maintaining different rules for tracing at law and in equity. One set of tracing rules is enough. The existence of two has never formed part of the law in the United States ... There is certainly no logical justification for allowing any distinction between them to produce capricious results in cases of mixed substitutions by insisting on the existence of a fiduciary relationship as a precondition for applying equity's tracing rules. The existence of such a relationship may be relevant to the nature of the claim which the plaintiff can maintain, whether personal or proprietary, but that is a different matter. I agree with the passages which my noble and learned friend, Lord Steyn, has cited from Professor Birks's essay 'The Necessity of a Unitary Law of Tracing', and with Dr Lionel Smith's exposition in his comprehensive monograph ...⁴³

His Lordship, however, considered that the case before him was not the occasion to explore those matters further, given that it was clear that the proprietary interest in question was the subject of a fiduciary relationship. Similar views were expressed by Lords Browne-Wilkinson⁴⁴ and Hoffman.⁴⁵

Despite Lord Millett's obvious reservations, *Foskett v McKeown* recognised that the established position in England was that the existence of a fiduciary duty, and possibly a pre-existing one, was essential to the invocation of tracing in Equity.

It might be that the perceived requirement of a fiduciary duty with respect to misappropriated property is merely a function of its almost ubiquitous presence in cases where tracing in equity is relied upon. Where a fiduciary duty exists with respect to property, there is often a bifurcation of interests in, or rights with respect to, that property which provides the opportunity and ability for the fiduciary effectively to dispose of the property to a third party. A trustee, executor or agent has both the power and capacity to dispose of title to property in respect

⁴² *Foskett v McKeown* (n 5) 127.

⁴³ Ibid 128–9 (emphasis added), citing Austin Wakeman and William Franklin Fratcher, *Scott on Trusts* (Little, Brown, 4th ed, 1989), 605–9; P Birks, 'The Necessity of a Unitary Law of Tracing' in R Cranston (ed), *Commercial Law: Essays in Honour of Roy Goode* (Clarendon, 1997), ch 9; Smith (n 21) 120–30, 277–9, 342–7.

⁴⁴ *Foskett v McKeown* (n 5) 108.

⁴⁵ Ibid 105.

of which the beneficiary has rights, so the occasions on which a party will need to rely upon tracing in Equity will most frequently arise from those circumstances. Thus, it may simply be that the presence of an anterior fiduciary relationship is the cause of the need to invoke tracing in equity, rather than a precondition for it.

A *The Position in Australia*

It will come as no surprise that there is a lack of uniformity in Australia as to whether the existence of a fiduciary relationship is a precondition to a right to trace.

In 2014, in *CFHW Pty Ltd v Burness*, Warren CJ observed that ‘the authorities make it clear that in order to rely on equitable tracing and the subsequent constructive trust, the party seeking that remedy must show a breach of fiduciary duty’.⁴⁶ That emphatic statement was apparently a reflection of the force of *Re Diplock*,⁴⁷ on which the Chief Justice relied.

A perhaps similar view was adopted by Colvin J in *Goldus Pty Ltd v Cummins* (No 4), where his Honour said:

What the above analysis [in *Grimaldi v Chameleon Mining* (No 2) (*‘Grimaldi’*)] indicates is that in the absence of a ‘proprietary base’ (that is, a foundational property claim) on the part of the claimant which takes the form of a vested beneficial interest in trust property, including such an interest that arises by reason of the recognition of a remedial constructive trust, there is an insufficient foundation for the tracing process. Equity only affords the characteristic of property that allows for tracing into the hands of third parties where the interest takes the form of a vested beneficial interest in trust property.⁴⁸

Although his Honour referred to a proprietary base, he identified its necessary attachment to the duties arising from either a fixed trust or a constructive trust, which, in context, effectively means a breach of fiduciary duty. His Honour then said:

Putting to one side the effect of the Australian possibilities of a remedial constructive trust and the application of the reasoning in *Black v S Freedman & Co* there appears to be no Australian decision that has embraced a complete departure from the requirement that there must be a fiduciary relationship before tracing can apply on the basis of an equitable foundation.⁴⁹

The decision in *Grimaldi* is important.⁵⁰ Part of that extremely complex and, at times Byzantine, decision concerned whether company property which had been misapplied by directors could be traced. In the context of the authorities, the difficulty was that there was no antecedent fiduciary duty owed to the company

⁴⁶ [2014] VSC 451 [35].

⁴⁷ *Re Diplock* (n 33).

⁴⁸ [2021] FCA 1095, 73 [288], citing *Grimaldi v Chameleon Mining* (No 2) (2012) 200 FCR 296 (*‘Grimaldi’*).

⁴⁹ *Ibid* 73–4 [290], citing *Black* (n 41).

⁵⁰ *Grimaldi* (n 48).

from which any equitable proprietary interest arose. The company, itself, owned the property which had been misapplied and transferred through the directors' exercise of their powers. This absence of an initial fiduciary duty was overcome by the application of the principle in *Belmont Finance Corporation v Williams Furniture Ltd (No 2)*,⁵¹ that a misapplication of company property by directors involves a breach of their fiduciary duties even though they do not hold any title in it, and a third party recipient with knowledge of the breach of duty becomes a constructive trustee of it for the company. In that case, Buckley LJ said:

A limited company is of course not a trustee of its own funds: it is their beneficial owner; but in consequence of the fiduciary character of their duties the directors of a limited company are treated as if they were trustees of those funds of the company which are in their hands or under their control, and if they misapply them they commit a breach of trust (*Re Lands Allotment Co ...*). So, if the directors of a company in breach of their fiduciary duties misapply the funds of their company so that they come into the hands of some stranger to the trust who receives them with knowledge (actual or constructive) of the breach, he cannot conscientiously retain those funds against the company unless he has some better equity. He becomes a constructive trustee for the company of the misapplied funds.⁵²

So, in *Grimaldi*, the difficulty was that the improper transfer of property occurred prior to the company holding any equitable interest in it that was derivative upon a breach of fiduciary duty, and there was no pre-existing beneficial interest which the authorities seemed to require. Nevertheless, the Full Court appeared to hold that it was sufficient if the property in respect of which the right was held passed through the hands of a party who owed the owner a fiduciary duty. Certainly, there was express authority for that proposition. In *Re Global Finance Group Pty Ltd*, McLure J had held: 'Further, it is probably still the case that the right to trace in equity (but not of course at law) requires that the property being traced *has passed into or through* the hands of a fiduciary'.⁵³

Such an analysis might be said to be supported by those cases where the right to trace has been recognised in relation to the equitable interest in property which arises in consequence of a fiduciary's wrongful conduct, such as where an agent receives a bribe.⁵⁴ The same point arises where tracing is permitted in relation to the proceeds of a payment made by mistake.⁵⁵ In such cases there is no antecedent fiduciary relationship which is productive of any equitable interest in property. It arises subsequently and from the conduct of the fiduciary.⁵⁶

⁵¹ [1980] 1 All ER 393, 405.

⁵² Ibid, citing *Re Lands Allotment Co* [1894] 1 Ch 616, 631, 638 (Lindley and Kay LJJ).

⁵³ (2002) 26 WAR 385, 407 (emphasis added), citing see *Re Diplock* (n 33); cf *Foskett v McKeown* (n 5) 1324; 121 (Lord Millett).

⁵⁴ *Attorney-General of Hong Kong v Reid* [1994] 1 AC 324.

⁵⁵ *Chase Manhattan Bank* (n 37).

⁵⁶ See generally the discussion of proprietary claims which arise consequent upon a breach of fiduciary duty in *Twigg v Twigg* [2022] NSWCA 68 [203]–[244] (Brereton JA).

Other cases have held that either the existence of a proprietary right derivative upon a fiduciary duty or other form of equitable duty is sufficient. In *Robb Evans of Robb Evans & Associates v European Bank Ltd*,⁵⁷ Spigelman CJ (with whom Handley and Santow JJA agreed) held that, in order for a party to invoke the tracing process in equity, they required 'a duty or interest arising pursuant to the doctrines of equity'.⁵⁸ This echoes the Court of Appeal in *Re Diplock*, where the Court recognised the relevant precondition as being either a fiduciary relationship or a continuing right of property recognised in Equity.

There is a growing number of cases which reject the precondition of a pre-existing fiduciary relationship. Justice Einstein was particularly enthusiastic on this in *Commonwealth Bank of Australia v Saleh*, where he observed:

There is a view that, in equity, tracing can only be obtained where some pre-existing fiduciary relationship can be shown. But the better view must now be that tracing protects rights of property, rather than enforcing fiduciary obligations. That view is supported by the House of Lords decision in *Foskett v McKeown* ... in which Lord Millet at 124, in particular, stressed that tracing was a process intended to vindicate rights or property rather than to prevent unjust enrichment, even though it may result in that effect.⁵⁹

That is one reading of *Foskett v McKeown*, though it tends to elevate his Lordship's obiter above that which he actually held.

Justice Santow has also advanced the view that the right to trace is not dependent upon any pre-existing fiduciary duty in a trilogy of cases: *Woodson (Sales) Pty Ltd v Woodson (Aust) Pty Ltd*;⁶⁰ *Opus Productions Pty Ltd v Popwing Pty Ltd*;⁶¹ and *Hurt v Freeman*.⁶² However, those cases were concerned with the imposition of a constructive trust consequent upon unconscionable conduct and the entitlement of the wronged party to enforce a proprietary claim with respect to the subject of that trust. They were not cases of 'archetypal tracing' and his Honour's comments must be treated with some caution.

Nevertheless, there are many commentators who reject altogether, as a precondition to tracing, the existence of a fiduciary duty from which the relevant right arises.

The learned authors of the current edition of *Ford and Lee: The Law of Trusts* make it clear where they stand when they observe: 'In equity theory a plaintiff's proprietary claim to a traceable asset is seen as a response to, and a vindication of, the plaintiff's proprietary right in the original asset'.⁶³

⁵⁷ (2004) 61 NSWLR 75.

⁵⁸ Ibid 104 [141] (emphasis added).

⁵⁹ [2007] NSWSC 903, [29], citing *Foskett v McKeown* (n 5).

⁶⁰ (1996) 7 BPR 14,685, 14,706–7 (Santow J).

⁶¹ (Supreme Court of New South Wales, Santow J, 28 February 1995).

⁶² [2002] NSWSC 264 [223].

⁶³ Thomson Reuters, HAJ Ford and WA Lee, *Ford and Lee: The Law of Trusts* (online at 22 March 2024) [17.4010], citing *Foskett v McKeown* (n 5); *Conlan v Registrar of Titles* (2001) 24 WAR 299, 338 (Owen J).

Similarly, Professor Denis Ong, in *Ong on Tracing*, after discussing *Re Diplock*, observed that it was the continuing right of property recognised by Equity which was the essential foundation of tracing and that there was no requirement for any pre-existing fiduciary relationship:

This pronouncement of the English Court of Appeal in *Diplock* makes it pellucidly clear that ‘a continuing right of property recognised in equity’ forms the essential foundation of equitable tracing, and that the apparent insistence that the tracing claimant is, additionally, required to demonstrate that the property sought to be traced was originally held by a fiduciary to the tracing claimant, is an inept attempt to describe what is, in essence, the tracing claimant’s continuing equitable right in property.⁶⁴

To the same effect are the comments of Professor Lionel Smith in *The Law of Tracing*,⁶⁵ where the learned author also identified that the more accurate analysis of *Re Diplock* is that the existence of an equitable proprietary interest in the original asset in respect of which a wrongful disposition occurred generates the right to trace. He observed that the precondition of a fiduciary relationship was artificial and resulted in courts engaging in increasingly fictitious attempts to identify a relevant relationship in order to advance the interests of a wronged individual:

So long as it is thought that a fiduciary relationship must be established to permit a plaintiff to commence the exercise of tracing in a court of equity, the inevitable result will be increasingly fictitious attempts to locate fiduciary relationships in facts which do not support them.⁶⁶

Certainly, there are examples of scenarios in which tracing in equity has permitted the recovery of proprietary rights despite the absence of an initial fiduciary:

- (a) As Professor Smith observes, ‘purchase money resulting trusts’ are examples of tracing despite the absence of any pre-existing fiduciary duty;⁶⁷
- (b) Similarly, a trustee-in-bankruptcy can trace the proceeds of a disposition of property which has been rescinded for fraud: *Official Trustee in Bankruptcy v Alvaro*;⁶⁸

⁶⁴ Denis S K Ong, *Ong on Tracing* (Federation Press, 2019) 106, citing *Re Diplock*

⁶⁵ Smith (n 21) 121–30.

⁶⁶ Ibid 128.

⁶⁷ Smith (n 21) 129.

⁶⁸ (1996) 66 FCR 372, 426–7 (Wilcox and Cooper JJ).

- (c) The same applies to stolen money: *Black v S Freedman and Co* (although there the thief did, in fact, owe fiduciary duties);⁶⁹ and the proceeds of stolen property: *Creak v James Moore & Sons Pty Ltd*;⁷⁰
- (d) There is an acknowledged right for equitable mortgagees or chargees to trace the proceeds of misapplied property which was subject to the security: *Buhr v Barclays Bank plc*;⁷¹ *ASIC v GDK Financial Solutions Pty Ltd (in liq)* (No 5).⁷²

This list is not exhaustive, but the cases in these categories defy a taxonomic characterisation by reference to the existence of an anterior or intermediately occurring fiduciary duty from which a relevant property interest arises.

Further, there is a solid doctrinal basis for the proposition that the right to trace in equity is grounded in proprietary rights. It is extremely well encapsulated in the article by Professors Ross Grantham and Charles Rickett, 'Tracing and Property Rights: The Categorical Truth',⁷³ where the learned authors argue that tracing is a process by which a person's continuing right of property inheres in any property which, through an unauthorised transaction, has been substituted for the property in respect of which the right originally existed. The authors observe:

Once it is recognised that, in cases where the plaintiff retains legal or equitable property rights in the original asset even after the transfer of possession to the defendant, those persisting property rights are alone the (and, indeed, are the only) basis for recovery, then it follows that the most likely event to which the creation of rights in the traceable product are a response is also the property rights held in the original asset. This is most obviously so where the claim is in respect of equitable property rights. As *Foskett v McKeown* illustrates, where the plaintiff's claim is one to vindicate his property rights in the asset, the law's response is simply to declare that the plaintiff's rights in the original asset are now exigible against the traceable product.⁷⁴

They also identified this as a natural consequence of the importance placed on property rights by the Anglo-American legal system:

It should not be surprising that the property rights in the traceable product arise as a response to the plaintiff's rights in the original asset. Indeed, it would be more surprising if they did not. Property rights are a significant matter in the common law and represent one of the fundamental building blocks of the Anglo-American legal tradition.⁷⁵

⁶⁹ *Black* (n 41).

⁷⁰ (1912) 15 CLR 426. See also *Re Brumm* [1942] St R Qd 52.

⁷¹ [2001] EWCA Civ 1223.

⁷² [2008] FCA 1700.

⁷³ Grantham and Rickett (n 31).

⁷⁴ *Ibid* 910.

⁷⁵ *Ibid* 911.

There is support for that conclusion given that civil law jurisdictions do not provide for such a result.⁷⁶

Despite that, the existing authorities do not bespeak of any doctrinal purity. As opponents of the property interest approach identify, there are cases where the right to trace has been recognised despite the claimant not holding any relevant initial interest in property. For instance, tracing has been permitted where a party rescinds a contract in equity for fraud. The innocent party may trace the pre-contractual beneficial title in any property transferred under the contract, including into any proceeds of that property.⁷⁷ In such a case, the claimant has not had any relevant initial beneficial interest in the property in question and, indeed, had intended to transfer all title to the other contracting party.

Similarly, beneficiaries of discretionary trusts who hold no beneficial interest in the trust property have been held entitled to invoke tracing in order to recover any misappropriated trust property or its proceeds,⁷⁸ as have legatees of an un-administered estate.⁷⁹ Neither have any initial proprietary interest in property, but merely a transmissible right to the proper administration of the trust or estate.

Now, there exists a further unsurprising debate about these cases and, though they may be explained as being the result of the fluidity of equitable procedure,⁸⁰ they demonstrate the generally unsatisfactory nature of the jurisprudence in this area.

VIII CONCLUSION

This paper has not discussed ‘backward tracing’, which is quite possibly a doctrinally bankrupt concept, but its emergence will not advance the clarification of any underlying rationale for tracing.

The small part of tracing discussed in this paper reveals the existence of great uncertainty. Moreover, even if some consensus was reached as to whether property rights or fiduciary duties underpinned the right to trace, that would not resolve many secondary issues on which the commentators disagree.

It remains to be seen whether any court can identify any coherency in this area or whether it will remain as elusive as the Snark.

⁷⁶ Craig Rotherham, *Proprietary Remedies in Context: A Study in the Judicial Redistribution of Property Rights* (Hart Publishing, 2002) 89.

⁷⁷ See, eg, *Official Trustee in Bankruptcy v Alvaro* (1996) 66 FCR 372, 426–7; *Shalson v Russo* [2005] Ch 281, 321 [122].

⁷⁸ *Elliot v Secretary, Department of Education, Employment & Workplace Relations* (2008) 249 ALR 182, 193 [39]; *Orb ARL v Ruhan* [2015] EWHC 262 (Comm) [110].

⁷⁹ *Commissioner of Stamp Duties (Qld) v Livingston* [1965] AC 694 (Privy Council).

⁸⁰ Hafeez-Baig and English (n 6) 122 [5.18].