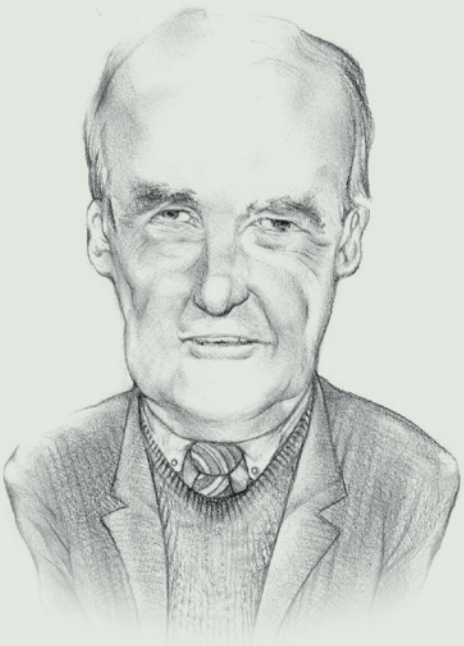
The Right Honourable Lord Browne-Wilkinson



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(*b.* 30 March 1930)

Equity and Commercial Law: Do They Mix?

Having obtained a Bachelor of Arts degree from Magdelan College, Oxford, Lord Browne-Wilkinson was called to the Bar, Lincoln's Inn, in 1953.

In 1972 he was made a Queen's Counsel and from there became a Judge of the Courts of Appeal for Jersey and Guernsey in 1976. He moved on to the High Court, Chancery Division in 1977 and sat there till 1983, a task he fulfilled in conjunction with being the President of the Senate of the Inns of Court and the Bar (1981–1983).

From 1983–1986, Lord Browne-Wilkinson was a Lord Justice of Appeal; and from 1985–1991 was Vice-Chancellor of the Supreme Court, the judge responsible for the Chancery Division of the High Court.

At this point he was made a life peer, as Baron of Camden, when he became a Lord of Appeal in Ordinary from 1991–2000. In 1999, the Queen approved that the Right Honourable The Lord Browne-Wilkinson be appointed as the Senior Lord of Appeal in Ordinary (the UK's most senior permanent judicial position) in succession to the Right Honourable The Lord Goff of Chieveley.

Lord Browne-Wilkinson retired as Senior Law Lord in 2000.

In 2002, the Bank of England appointed him Chairman of the newly established Financial Markets Law Committee. One of the tasks of this Committee is to "act as a bridge to the judiciary to ensure that UK courts remain up-to-date with developments in financial markets practice".

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Equity and Commercial Law: Do They Mix?

Lord Browne-Wilkinson
Lord of Appeal in Ordinary, House of Lords

Text of the Tenth Sultan Azlan Shah Law Lecture delivered on 22 December 1995 in the presence of His Royal Highness Sultan Azlan Shah.

More than 400 years ago and some 9,000 miles away from Kuala Lumpur a new legal system, the English common law, was developing. The dominant factor of its land law was the feudal system of tenure imported at the time of the Norman Conquest. Feudal tenure of land gave rise to unfortunate consequences for the owners of such land, and in consequence a device was invented whereby land was conveyed to one person to the use of another, the beneficiary.

The beneficiary had no title to the land at common law; but they were enforced by the Lord Chancellor. The device of the use, which was financially disadvantageous to the feudal lord, was rendered ineffective by the Statute of Uses 1536 which provided that the legal title should vest in the beneficiary. Not to be thwarted, the ever ingenious lawyers created the use upon the use: land was conveyed to A to the use of B to the use of C. The legal right to the land was vested in B; C did not enjoy any protection at law because he did not have the legal title. Again, the Lord Chancellor intervened to protect the rights of the ultimate beneficiary, C.

The device of a use upon a use came to be known as a trust. The Lord Chancellor, and subsequently the courts of chancery, enforced these trusts against the holder of the legal title. Over the years the principles applicable by the Lord Chancellor in the Court of Chancery—the principles of equity—were developed primarily in relation to land. The methodology adopted was for the courts of chancery to hold that it was contrary to good conscience for the legal owner of the land not to give effect to the trusts upon which he had accepted the transfer of the land. Thus conscience lies at the very root of equity. Further, the Lord Chancellor enforced this law against the owner of the legal title by making orders directly against the legal owner which, if not obeyed, gave rise to severe sanctions for contempt. Thus the second strand of equity emerged, namely that it acts in personam against the individual. Finally, the courts of chancery moved to the position whereby, since the legal owner could be forced to give effect to the rights of the beneficiaries under the trust, the beneficiaries were themselves to be treated as enjoying beneficial interests in equity in the land, ie, a proprietary interest. Thus developed the system of land law under which there were two types of proprietary interest: the legal estate and the equitable interest.

At the same time, the courts of equity were developing remedies much superior to those obtainable in the common law courts. Effectively the only relief obtainable at common law for breach of contract, trespass, nuisance and other torts was an award of damages. But equity, again acting against the person of the defendant, developed the remedies of specific performance and injunction. If the defendant refused to perform a contract, equity would order him to perform it in certain circumstances, the penalty for failure to do so being again imprisonment for contempt of court. If a defendant was committing a continuing trespass, or nuisance, the court of equity would grant an injunction requiring him to desist.

Down to 1875 these two systems of law, common law and equity, were largely administered in separate courts. Since 1875 both law and equity have been administered in the same courts: but since the principles of law and the principles of equity had been developed separately, the two strands, law and equity, remain distinctively separate. One hundred and twenty years after the so-called fusion of law and equity, the two streams of English law remain identifiably distinct.

I must apologise for this short, and inaccurate, survey of the history of the development of law and equity which is probably well known to most people here. But an understanding of this history is essential to the understanding of the current interaction between law and equity in 1995 in Kuala Lumpur. It is necessary to appreciate that equitable doctrines were developed primarily in relation to land and that equity acted on the conscience of the individual who held the legal interest. It is also necessary to understand that equity, being based on good conscience, only exercised its remedies by way of injunction or specific performance in cases where good conscience required the remedy to be enforced. Unlike the right of a litigant at law to damages, many equitable remedies are discretionary and are tailored to what is just in the circumstances.

Status of equity in the commercial world

In every legal system there is a tension between the requirements of certainty on the one hand and justice on the other. A businessman needs to know with certainty what his legal rights are and what the consequences of his acts will be. His primary concern is with this certainty rather than with the justice or injustice of the legal result: if he knows what the risks are he can cover himself against them by insurance or business practices. As Lord Diplock (quoting Lord Goff) has said:

A businessman needs to know with certainty what his legal rights are and what will be the consequences of his acts.

> It is of the utmost importance in commercial transactions that, if any particular event occurs which may affect the parties' respective rights under a commercial contract, they should know where they stand. The court should so far as possible desist from placing obstacles in the way of either party ascertaining his legal position, if necessary with the aid of advice from a qualified lawyer, because it may be commercially desirable for action to be taken without delay, action which may be irrevocable and which may have far-reaching consequences. It is for this reason, of

> course, that the English courts have time and again asserted the need for certainty in commercial transactions—for the simple reason that the parties to such transactions are entitled to know where they stand, and to act accordingly.[1]

In general, the hard-nosed principles of law favour certainty. The more flexible principles of equity, based on concepts of good conscience enforced by discretionary remedies, tend to greater justice but less certainty. It is for that reason that the commercial courts have, for some time, been resistant to the introduction of the concepts of equity. Although the approach of equity is normally more consistent with justice in any given case, that is not the primary concern of commercial law which is to have fixed and inflexible rules which, although no doubt producing hard results in some cases, produce certainty for those engaged in commerce. In the case from which I have quoted Lord Diplock's words, the charterer of a ship was four days out of time in paying a sum due under the charter party. Under the charter party the owner had the right to withdraw his vessel in the event of such breach. The owner exercised that right and the charterer applied for relief against forfeiture, founding himself on the long line of cases in equity where such relief is permissible (particularly in relation to leases) if it would be contrary to the conscience of the other party to stand on his strict legal rights. The House of Lords decisively rejected the introduction of this equitable doctrine into the commercial field for the reasons which I have stated.

However, the rejection of equitable principles by businessmen is by no means uniform. There are aspects of equity which the businessman is only too keen to exploit. For example, the equitable principles of fiduciary duties owed by agents, company directors and others are fundamental in our legal systems. The right to call upon an agent for a full account is an equitable right. The fiduciary duties owed by a director to his company prevent him profiting from his position and, in the event of his being fraudulent, enables equitable rights to trace companies' property into the hands of third parties to be enforced. Again, the injunction to restrain the threatened breach

1 *Scandinavian Trading Tanker Company AB v Flota Petrolera Ecuatoriana* [1983] 2 AC 694 at 704.

of contract or, as in the case of the Mareva injunction, to secure that the defendant does not dissipate his assets, are rights of the utmost importance in the modern commercial world. Therefore, not all principles of equity operate adversely to commercial expediency. The difficulty is to ensure that those elements in the rules of equity which are beneficial to the commercial world operate in a manner which is not detrimental to such interests. That is the question that I am going to address today.

There is no doubt that equitable doctrines—and in particular concepts of trusteeship and fiduciary duties—are becoming ever more common in transactions of a commercial nature. What I propose to do is to give an example of an old-fashioned trust and the principles which have been developed over the centuries relating to such trusts and then go on to consider the modern counterparts of such a trust, pointing out the way in which the old concepts have been modified and adjusted to meet, so far as possible, the dictates of commercial expediency.

First, the example of the old-fashioned trust. A settlor, S, by way of gift vests a piece of land, Blackacre, in a trustee, T, on trust for B1 for life and after his death on trust for B2 absolutely. S reserves to himself a power to rescind or vary the trust. T, in breach of trust, sells Blackacre at an undervalue to P Ltd in which T has an interest. The features of such a trust which, for present purposes, I want to emphasise are the following:

1. S the settlor was giving away his property for the benefit of B1 and B2, the beneficiaries. The beneficiaries are mere recipients of the settlor's bounty.

2. The property is held on an express trust, ie, there is a trust deed setting out the powers and duties of the trustee. There is no doubt that a trust exists; there is not much doubt about the scope of the trustee's duties. In particular, it is a basic rule that the trustee, T, must not put himself in a position where his

personal interest conflicts with his duty as trustee. He must act single mindedly for the benefit of his beneficiaries.

3. The subject matter of the trust is land. The beneficiaries under the trust, B1 and B2, have a proprietary equitable interest in Blackacre which they can enforce against the whole world except a bona fide purchaser for value of the legal estate without notice of their interests. Thus, the land sold in breach of trust to P Ltd will be recoverable if P Ltd had actual or constructive notice of the breach of trust. P Ltd will have constructive notice of the rights of the beneficiaries under the settlement if, in investigating the title to Blackacre, they would have discovered the existence of the trust if they had made proper enquiries. However, since we are dealing with land, the steps that have to be taken in order to conduct a proper investigation of title are well known and well established.

4. The trustee, T, will be personally liable for his breach of trust in selling the land at an under-value. If the land is not recovered from P Ltd, the measure of T's liability for breach of trust will be to pay back into the trust fund by way of compensation a sum equal to the open market value of Blackacre.

Although old-fashioned trusts of this kind continue to exist, their importance is minor compared with commercial trusts (for example, pension funds and investment trusts) and the wide range of relationships into which concepts of trusteeship or fiduciary obligations have been introduced. It is instructive to see how the four factors that I have isolated in the old-fashioned trust are represented in the modern law.

Trusts established not by way of gift but for consideration

In the United Kingdom a very large proportion of private wealth is now concentrated in pension funds established by employers to provide retirement benefits for their employees. Although the trust is established by the employer, as settlor, the position of the employer is in no way comparable to that of the settlor under the old-fashioned trust. The benefits provided for the employees out of the pension fund are part of the remuneration which the employees receive for their work. In some cases, the employees themselves as well as the employing company make financial contributions to the fund. The beneficiaries are giving value for the benefits they receive under the trust. Accordingly, it is not possible simply to lift the old law of trusts applicable to the old-fashioned type settlement made out of the bounty of the settlor and apply it lock, stock and barrel to the position of beneficiaries under pension trust deeds who have given consideration.

I can illustrate the distinction by reference to the power which, it will be remembered, the settlor under the old-fashioned trusts had reserved to himself to rescind or vary the trust. Since in such old-fashioned trusts the settlor was making a gift, he could reserve to himself out of such gift such rights and powers as he thinks fit. Having reserved the power to rescind or vary, he can exercise such power in any way he thinks fit, without having any duty to anyone else. However, as *Imperial Group Pension Group Ltd v Imperial Tobacco Ltd* [2] illustrates, the same is not true in relation to pension funds. In that case the rules of the pension scheme reserved to the employer company the right to give or withhold its consent to an increase in the pension benefits payable to members of the fund. Although there was a very substantial surplus in the pension fund, the employer company was refusing to give its consent to any increase in pension benefits because, so it was alleged, they were seeking to extract a large amount of the surplus for their own benefit. It was held that because a pension scheme is provided for consideration, the employer company could not exercise its power to give or withhold consent in a completely self-regarding manner. It was held that, as part of the employer's duty to act in a way which did not destroy or seriously damage the relationship of confidence and trust between employer and employee, the employer company in exercising its power to give or withhold consent had to act bona fide for the benefit of the

2 [1991] 2 All ER 597.

beneficiaries under the scheme and could not simply have regard to its own self-interest. Thus, the old equitable rules as to the exercise of powers under settlements made by way of gift were modified to reflect the commercial reality of the position, namely that the pension scheme was part of a commercial arrangement between employer and employee in relation to which mutual duties were owed and had to be observed in relation to the exercise of powers.

Constructive trusts and fiduciary duties

In contrast to the old-fashioned trust with its express declaration of trust and clear duties which a trustee had to perform, most of the modern litigation involving trusts is concerned with constructive trusts or fiduciary duties owed by agents, company directors and others. For example, over the last ten years there has been a huge upsurge in litigation flowing from frauds committed upon limited companies. Frequently, the directors of defrauded companies have, in one way or another, been party to the frauds. The law has developed, to my mind beneficently, so as to hold that companies' money abstracted by directors in breach of their fiduciary duties to the company are subject to a constructive trust in the hands of third parties who have either received the trust property with notice of the directors' breach of fiduciary duty or have themselves been dishonestly parties to the directors' breach of trust: see *Royal Brunei Airlines v Tan.*[3]

It is these trusts, arising by operation of law in circumstances which are by definition murky, which raise the greatest problems for the businessman. For the same equitable principles apply to these informal, constructive trusts as apply to express trusts. In particular, the beneficiary under a constructive trust (in the example which I have given, the company which has been defrauded) has a beneficial interest in the moneys of which it has been deprived. Since this beneficial interest is enforceable against third parties into whose hands the moneys come, other than the purchaser for value of a legal interest without notice, the commercial man is faced with an area

3 [1995] 3 WLR 64.

of great uncertainty. The original moneys of which the company was fraudulently deprived will, in the normal course, be paid into a bank account. But under the equitable rules of tracing, the moneys in that bank account can be traced into other money and property which for the time being represents it: *Agip (Africa) Ltd v Jackson.*[4] The consequences can be very serious, particularly in the case of insolvency.

I can illustrate this risk by reference to a company to which bankers have advanced moneys on a floating charge and which goes into insolvent liquidation. In the ordinary case, the company's assets at the date of liquidation will be applied first in paying off the bank's secured loan and then distributed amongst the other creditors. But, say that amongst the insolvent company's assets were moneys which, under the equitable rules of tracing, could be traced as being the products of a fraud on a wholly different company. Those moneys which can be traced are held on a constructive trust for the defrauded company and, as trust assets, do not form part of the insolvent company's assets available for distribution either to the secured bank lender or to the other trade creditors. Therefore those who had been dealing in good faith with the company on the basis that its ostensible assets were its real assets and its book liabilities were its real liabilities suddenly find themselves faced with a position where the apparent assets are found to belong not to the creditor of the insolvent company but to some third party, the defrauded company.

There is another species of trust which, if eventually established as part of the law, presents similar problems to commercial men. In *Chase Manhattan Bank v Israel-British Bank (London) Ltd*,[5] Chase Manhattan paid the Israel-British Bank twice in respect of the same liability. The second payment was, of course, a mistake. Shortly thereafter, the Israel-British Bank became insolvent. Chase Manhattan claimed that the second payment, having been made under a fundamental mistake, was refundable and (this is the important point) Israel-British Bank held the second payment and the assets representing it at the date of insolvency on a constructive

4 [1991] Ch 547, CA, affirming [1990] Ch 265, Ch D.

5 [1981] Ch 105; [1979] 3 All ER 1025, Ch D.

trust for Chase Manhattan. This claim was upheld by the judge. In consequence Chase Manhattan was entitled in priority to all the other creditors of the Israel-British Bank to be repaid in full the moneys it had paid by mistake; in equity the assets representing the mistaken payment were trust moneys held in trust for Chase Manhattan.

That process was taken a stage further in *Westdeutsche Landesbank Girozentral v The London Borough of Islington*.[6] In that case the German bank had paid a large sum of money to a local authority pursuant to a swap agreement. Subsequently, it was held that the swap agreement was ultra vires the local authority. The German bank therefore sought repayment of the moneys it had paid under a void contract. The Court of Appeal held that the moneys were recoverable not only at law (as moneys had and received) but also in equity on the ground that the local authority held the moneys which it had received under the void contract on a resulting trust for the German bank. Although no question of priorities arose in that case, since the local authority was solvent, if it is correctly decided the consequence will be that wherever moneys have been paid under a contract void as being ultra vires or on a consideration which has wholly failed, the recipient of the moneys holds the moneys so paid on trust. In consequence, those moneys will not be available for the creditors of the recipient.

It will be apparent that these trusts, arising in circumstances of great informality and indeed often secrecy, are capable of being very prejudicial to the conduct of ordinary business. Those who deal with a company have to form a view as to the credit worthiness of the company. They will be guided by their experience of that company, its ostensible assets, its balance sheet and the reports of credit societies. All of this information will be rendered valueless if, under the principles of constructive and resulting trusts which I have discussed, the apparent

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6 [1994] 1 WLR 938.

assets of the company do not belong to it at all, but are held in trust for a third party. Such trusts cut across the ordinary assessments of commercial risk. There is no way in which a bank or trader can be aware of the circumstances which give rise to these trust interests since they may well relate to the fraudulent activities not of the company with which they are dealing but of another company, the defrauded company of which they have no knowledge but whose moneys have come into the hands of the company with which they are dealing. There is no way in which the businessman can protect himself against these risks by adopting appropriate practices or by insurance. For these reasons it is important that courts dealing with claims that there are constructive or resulting trusts should proceed with extreme caution in holding that such a trust arises in a purely commercial context. The creation of such a trust operates like some loose cannon depriving third parties of their legitimate expectations and operating unfairly between the competing claims of creditors.

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Constructive notice in commercial dealings

I remind you that, if trust property gets into the hands of a third party, it is recoverable from that third party unless he is a purchaser for value of the legal interest without notice. Thus in the example of the old-fashioned trust which I have given, Blackacre will be recoverable from P Ltd if P Ltd had notice of the breach of trust, actual or constructive. Constructive notice in relation to dealings with land includes notice of all those matters which, if the purchaser had made due enquiry, he would have discovered. As I have said, in relation to dealings in land everybody knows what the enquiries which ought to be made are. But how is this doctrine of constructive notice to be applied in a case where the trust interest is alleged to exist in a sum of money received by a clearing bank or somebody engaged in a commercial transaction? What degree of enquiry is such a commercial man expected to make in order to avoid being held to have constructive notice of a flaw in the title of the person from whom he received the moneys?

In *Manchester Trust v Furness*[7] Lindley LJ said:

> As regards the extension of the equitable doctrine of constructive notice to commercial transactions, the courts have always set their face resolutely against it. The equitable doctrines of constructive notice are common enough in dealing with land and estates, with which the court is familiar; but there have been repeated protests against the introduction into commercial transactions of anything like an extension of those doctrines, and the protest is founded on perfect good sense. In dealing with estates and land, title is everything, and it can be leisurely investigated; in commercial transactions possession is everything, and there is no time to investigate title; and if we were to extend the doctrine of constructive notice to commercial transactions we should be doing infinite mischief and paralysing the trade of the country.

These are fine sentiments, robustly stated. Unfortunately, there was a period starting with the decision in *Selangor United Rubber Estates Ltd v Craddock (No 3)*[8] where this sound advice came to be ignored. Banks and other finance houses were held to have notice of the fact that sums they had received were tainted with frauds committed on another company. Too easily was it held that the receiving bank had been put on enquiry by some minor factor as a result of which it was held to have constructive notice of facts which it would have discovered if it had made due enquiry. I am glad to say that the tide has turned and that the courts are now again reverting to the views of Lindley LJ. In *Eagle Trust plc v SBC Securities Ltd*[9] and *Cowan de Grow Properties Ltd v Eagle Trust plc*[10] the law was re-established that, in commercial transactions, the recipient of a payment is not to be taken as having notice unless he has actual knowledge or wilfully shuts his eyes to the obvious or wilfully and recklessly fails to make such enquiries as an honest and reasonable man would make. In effect, in the commercial context a recipient of moneys is not to have notice attributed to him

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7 [1895] 2 QB 539 at 545.

8 [1968] 1 WLR 1555.

9 [1992] 4 All ER 488.

10 [1992] 4 All ER 700.

unless he actually knows the relevant facts or otherwise behaves in a commercially reprehensible way in failing to make enquiries.

In my view this reassertion of common sense in the commercial sphere is absolutely right and is likely to be upheld in the higher courts. Although it is right that a businessman who deliberately acts unconscionably in a commercial sense should be held liable to recoup what he has received to the true owner, it is contrary to any form of business efficiency to require commercial men to make detailed investigations of the myriad transactions in which they are involved in the course of a year. Equity must recognise the commercial reality in the sphere in which it is operating.

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The scope of fiduciary duties

In the old-fashioned trust which I have taken as an example, there is little doubt as to the duties which T, as an express trustee, has to perform. He has to hold the fund under his control in proper investments; he must not profit from his trust nor put himself in a position where his duty to his beneficiaries conflicts with his own personal interest.

But how are such principles to be applied to, for example, those who are said to be in a fiduciary position and to owe fiduciary duties otherwise than under an express trust, for example, agents and company directors? The agent owes fiduciary duties to his principal; the directors owe fiduciary duties to their company. But to impose on such fiduciaries the full panoply of duties applicable to old-fashioned trusts is completely incompatible with the requirements of their role as agents or directors. Take for example the modern stock exchange where the same market maker may be on both sides of the bargain.

Applying the strict equitable principles applicable to an express trustee, the position of the market maker is untenable. He is acting in a position where his own self-interest competes with that of his clients and he is serving two masters, the seller and the buyer, whose interests conflict.

Some light is thrown on the problem by the decision of the Privy Council in *Kelly v Cooper*.[11] In that case the defendant was an estate agent who had two separate clients, the plaintiff and X, both of whom were selling property. The agents, in their capacity as agent for X, acquired information which was relevant to the affairs of the plaintiff. The plaintiff alleged that since the defendant was his agent, the defendant owed to the plaintiff fiduciary duties which included, inter alia, the duty to disclose to the plaintiff all information relevant to the plaintiff's affairs including the information which the defendant had obtained from his other client, X. This was plainly a ludicrous claim since it was incompatible with what everybody knew to be the case, namely that estate agents by definition have a number of clients on whose behalf they are acting in the sale of properties. Since all vendors are selling into the same market, the interests of the estate agent's clients must, to an extent, conflict. The information received from one client in confidence cannot be made available to another. The Privy Council pointed out that merely to describe somebody as a "fiduciary" did not mean that the fiduciary owed all the duties of a trustee. Where, as is frequently the case in agency and in other spheres, the fiduciary relationship arises out of a contract between the principal and the agent, the extent of the fiduciary duties owed has to be shaped so as to accord with the terms of the underlying contract. Thus, even though the defendant was the agent for the plaintiff, the plain commercial common sense precluded the importation of a duty to make full disclosure to the principal of confidential information acquired by the agent in the course of carrying on his general agency business. It is not enough to label

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11 [1993] AC 205.

someone "a fiduciary" and to say that a whole list of consequences necessarily and in all cases flow from that statement. In each case, the extent of the fiduciary duty owed depends upon the relationship between the parties and particularly upon to the underlying contract which gives rise to the agency relationship. See also *New Zealand Netherlands Society "Oranje" Inc v Kuys*;[12] *Hospital Products Ltd v United States Surgical Corporation.*[13]

I believe that if this principle is kept well in mind, the equitable doctrine of fiduciary duties is a valuable one in upholding the integrity of commercial dealings and ensuring that agents, directors and others in a fiduciary position are accountable for any improper profit that they make from their position. The equitable principle is a sound one and in no sense incompatible with commercial expediency provided that the extent of the duty is defined by reference to the relationship which exists in the particular case.

Damages for breach of trust

In the case of the old-fashioned trust, the trustee T would be liable for his breach of trust in selling the trust property at an under-value. If the property, Blackacre, was not recoverable, he would be bound to pay back into the trust fund by way of compensation the value of Blackacre. The basis for such liability to recoup the trust fund is the fact that the damage is suffered by all the beneficiaries under the trust, ie B1 and B2 in succession. Only by restoring the trust fund can compensation be made to both of them for their loss.

Recently, an attempt was made to apply the same measure of compensation to a breach of fiduciary duties in a commercial context. In *Target Holdings Ltd v Redferns*,[14] the defendants were a firm of solicitors who were acting for the purchasers of a property. They also acted for the plaintiff, a finance house, which was advancing the money to finance the purchase, such advance to be secured on a mortgage of the property being acquired. The plaintiff finance house paid the money to the defendant solicitors pending completion on the

12
[1973] 1 WLR 1126.

13
[1984] 156 CLR 41 at 97.

14
[1995] 3 WLR 352.

basis that the defendant solicitors would only disburse the moneys on receipt of a valid conveyance to the borrowers together with a mortgage on the property executed by the borrowers. The moneys went into the defendant firm's client account and it was common ground that the moneys in the current account were trust moneys. Unknown to the plaintiffs, they were the victim of a mortgage fraud and the property being acquired was worth much less than the valuation on the basis of which they were making the advance. For reasons which were not explained, the defendant solicitors made a series of payments to the borrowers out of the moneys on client account before the necessary documents had been executed. This was a plain breach of trust by the solicitors. However, subsequently the defendant solicitors obtained from the borrowers exactly the security which the plaintiffs had thought they were going to get, ie, a valid mortgage on the properties acquired. The fraud having been discovered and it having emerged that the property on which the plaintiff had a mortgage was worth much less than the sum advanced, the plaintiffs started proceedings for breach of trust against the defendant firm. They alleged that, since the defendant firm was a trustee of the money on client account and those moneys had been distributed in breach of trust, the defendant firm was liable to repay at once the total sum wrongly distributed, ie, the plaintiff firm was seeking to recover on the basis of breach of trust the total sum that they had advanced even though the loss that they had incurred was due, not to the breach of trust by the solicitors, but to the fraud of a third party who had persuaded them to advance too much money.

The House of Lords rejected this claim. It was pointed out that the old rules for assessing the quantum of compensation for breach of trust were established in relation to funds held for persons by way of succession. In such a case it is essential to reconstitute the fund if all the beneficiaries are to be put back into the same position as if there had been no breach of trust. This reasoning has no application to the case of moneys held as bare trustees as part of a wider commercial transaction. In such a case the liability of the defendant firm to pay compensation was to pay the loss actually suffered by reason of the breach of trust. Such loss was, in the event, nil. The solicitors' breach of trust had caused no loss to the plaintiffs who were in exactly the position they had always intended to be, *viz* they had advanced a large sum of money on the security of a first mortgage on the property. The breach of trust, as such, had not given rise to any actual loss suffered by the plaintiffs: such loss was due to the fraud of a third party.

Again, this decision shows a willingness in the courts to appreciate the commercial realities surrounding trusts and fiduciary duties in a commercial context. The placing of moneys and investments in the hands of nominees is an essential feature of modern commercial life. It is right that such nominees should be treated as trustees. But the nature of the trusteeship is wholly different from that occupied by T as trustee of the old-fashioned settlement which I am using as comparator. The basic equitable concept of trusteeship and liability to account is a sound commercial principle. What is not sound is to import into such a commercial trust the detailed rules applicable to trusts of quite a different kind.

Conclusions

What conclusions then are to be drawn from these examples? I think they are the following:

First, that it is no use for commercial lawyers and commercial men to seek to exclude equitable principles from commercial transactions. The English legal system, which you have for better or for worse inherited, has two limbs: common law and equity. Because of the historical existence of the courts of equity which modified, ameliorated and improved the rigidities of the common law, the common law itself never developed a whole range of concepts which are an essential part of any legal system. Any adequate legal system is going to have to find means whereby obligations taken on for the benefit of third parties are enforceable. The trust is the machinery in English law which achieves that purpose; the failure of the common law to develop the law of contract or tort to provide protection for such third parties means that common law by itself is inadequate.

Similarly, the requirement of the utmost good faith in certain relationships is a feature of all developed legal systems but, for the most part, forms no part of the common law. The lack in the common law is provided by the equitable principles of fiduciary duties. Any attempt to have a sector of the law, commercial law, which omits one whole strand of English law as a whole, is doomed to failure.

Second, although the principles of equity are a necessary constituent element in commercial law they must be applied with an appreciation of the commercial realities into which they are being imported. It is profoundly detrimental to lift detailed rules developed in the context of settlements made by way of gift for persons by way of succession and apply them lock, stock and barrel to commercial transactions to which they bear no resemblance. The concepts of trusts and fiduciary duties are sound ones relevant to the commercial sphere: but they must be applied in a way relevant to commercial transactions and which takes account of commercial realities

Third, judges must exercise extreme caution in extending the categories of constructive trust and resulting trust which lead to the existence of hidden property rights incapable of being discovered by third parties whose interests can be most severely affected by their existence. I believe that the way forward may lie in the development of a new form of constructive trust, the remedial constructive trust, which is already part of the law of the United States and Canada and which shows signs of emerging also in Australia and New Zealand. The difficulty of the conventional constructive trust, the institutional constructive trust, is that it arises automatically at the moment at which the constructive trustee is guilty of the conduct which gives rise to the imposition of the constructive trust. At the same moment, the beneficiaries under the constructive trust obtain a property interest. As a result the property which is the subject of the constructive trust may come into the hands of third parties or the recipient constructive trustee may become insolvent. In either event third parties are, possibly unfairly, prejudiced by the existence of the equitable proprietary interest. The remedial constructive trust, if adopted in English law, would not suffer from this drawback. A remedial constructive trust is imposed by the court at the date of trial so as to impose fiduciary obligations on an individual who should be accountable, or on property which, should be recoverable. Dealings with the trust property prior to the court order will not have given rise to equitable proprietary interests which are enforceable. The court, in imposing the remedial constructive trust, can impose it as against those people whom it is just to make accountable and not as against those who are innocent of any wrongdoing and who might be prejudiced by the imposition of such a trust. I believe that the development of such a remedial trust is of considerable commercial importance since it will enable property wrongfully extracted from companies and others to be recovered from wrongdoers without prejudicing the innocent third party recipient and giving rise to the uncertainty which is so antipathetic to commercial efficiency.

Fourthly, equitable concepts of fiduciary duties, damages for breach of trust and no doubt many other equitable principles must be applied in the commercial sphere with a proper understanding of their impact on the commercial community. The equitable principles are sound; their application in a commercial context must be tailored to that context. In particular, I believe the widespread use of the words "a fiduciary" is calculated to give rise to confusion. There is no such person as "a fiduciary": apart from a trustee there are people who owe fiduciary duties. The nature and scope of those duties depend upon the relationship in each case and will be determined by the commercial realities of that relationship.

In sum, commercial expediency requires that the law should, so far as possible, be certain and foretellable. This commercial imperative must inform the application of equitable principles in a commercial context. But provided that is done, equity has an important contribution to make which is in no way inconsistent with the requirements of commercial certainty.