Leeming, "Proprietary Relief and Tracing in Equity" (2016) 90 *ALJ* 92

PROPRIETARY RELIEF AND TRACING IN EQUITY*

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[92] The ruling of the Chancellor, Sir Terence Etherton, in *National Crime Agency v Robb* [2015] Ch 520 illustrates some recurring themes in recognising proprietary relief in equity when a number of investors have been defrauded and their money mingled.

Facts

Mr Gary John Robb had fled during his trial in England (for allowing club premises to be used for the supply of drugs) to Cyprus,[1] and there formed a property development company. From late 2003, the company marketed two large scale projects to investors who bought off-the-plan, and made further payments during construction. At least 178 investors entered into contracts. None of the properties were in fact completed by the company.

In March 2005 and April 2005, Mr Robb and his company promoted two incentive schemes, offering discounts and the promise of preferential treatment to investors who paid in full and in advance. However, in the previous months, Mr Robb had visited Thailand, transferred substantial funds to that country and commenced making a series of large investments there.

A warrant was issued for Mr Robb's arrest in May 2005. He was subsequently convicted and imprisoned for offences in England and in Cyprus. The litigation concerned £1,495,000 which Mr Robb had instructed to be transferred to an account in

* This comment was published at (2016) 90 *Australian Law Journal* 92.

1 In fact, the Turkish Republic of Northern Cyprus, a place not recognised as a country by the United Kingdom.

Thailand in July 2005. The funds had been frozen by court order when in the accounts of the Thai bank's corresponding bank in London. At the time the transfer was made, there was in excess of £3,000,000 in Mr Robb's personal account, not all of which was derived from investors.

A judge in the Queen's Bench Division (Mackay J) found, after a three day trial, that the money represented recoverable property obtained through the unlawful conduct of Mr Robb. Mackay J was not satisfied that the property development scheme had been fraudulent from the outset, but was persuaded that it had become fraudulent when, from around February 2005, Mr Robb formed the intention "to remove himself and as much customer money as he could to make a fresh start in the east".[2] Mackay J observed that such incentive schemes were "often the hallmark of fraud". The proceedings were then transferred to Chancery to determine what would happen to the fund.

After a court supervised advertising regime, some 71 investors made claims, pursuant to s 281 of the *Proceeds of Crime Act 2002* (UK), that the fund represented recoverable property which "belonged" to them.[3] The National Crime Agency was also a claimant, and in effect a contradictor. Mr Robb did not appear. The Chancellor determined a series of preliminary issues, directed to whether the investors had a proprietary interest in the fund recognised by equity, and, if so, how the fund would be distributed among them. Both aspects are of interest.

Did money "belong" to the investors?

The statutory question whether the fund represented property which "belonged" to the claimant investors was treated as requiring them to establish a proprietary interest. Necessarily, any interest would be equitable. The claimants advanced two arguments. First, they submitted that Mr Robb held [93] their money as a constructive trustee when, no later than February 2005, he formed the intention to transfer the money to Thailand. The Chancellor favoured that view, which had been expressed by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London*

2 *Serious Organised Crime Agency v Robb* [2012] EWHC 803 (QB), [68].

3 *Proceeds of Crime Act 2002* (UK), s 281 provided: "(1) In proceedings for a recovery order, a person who claims that any property alleged to be recoverable property, or any part of the property, belongs to him may apply for a declaration under this section. (2) If the applicant appears to the court to meet the following condition, the court may make a declaration to that effect. (3) The condition is that (a) the person was deprived of the property he claims, or of property which it represents, by unlawful conduct, (b) the property he was deprived of was not recoverable property immediately before he was deprived of it, and (c) the property he claims belongs to him."

Borough Council [1996] AC 669, 716, and which has long represented the law in Australia (see below). However, his Lordship considered that he was bound to apply the view that at the time the fraud took place, the investors had only a mere equity to rescind.[4]

Alternatively, the claimants submitted that a trust of the traceable proceeds of the money paid by them arose when they rescinded their contracts, and that this occurred at the latest when they joined the litigation and sought a declaration that part of the fund belonged to them. The Chancellor noted the highly divergent English academic views on questions of this nature: whether a trust is constructive or resulting, whether a trust could arise in circumstances of supervening fraud, and indeed whether a trust could arise at all, even following rescission. His Lordship determined the matter on the basis of appellate decisions binding upon him,[5] and a practical approach to dealing with the consequences of fraud. He held that the transaction was voidable for fraud even though the fraud was supervening, on the basis that fraud unravels everything. His Lordship with respect correctly observed that prejudice to third parties and difficulties in identifying the transferred property or its traceable proceeds were more likely to arise in the case of supervening fraud, but found that those barriers did not arise in the present case.

The recognition of property rights following fraud will, inevitably, pose problems. In part, those problems will be conceptual. There is undoubted force in the proposition stated by Rimer J in *Shalson v Russo* [2005] Ch 281, [110], "If the thief has no title in the property, I cannot see how he can become a trustee of it for the true owner", and this will hold irrespective of whether a property right is derived from the fraud by the defendant, or the rescission by the victim.[6] An Australian court would likely find no difficulty in concluding that Mr Robb held the money on a constructive trust for the investors, either from the time his intentions became fraudulent, or, at least, from the time he instructed the funds to be transferred to Thailand. The views of Lord Browne-Wilkinson in *Westdeutsche*, which the Chancellor favoured but considered himself precluded from applying, are consistent with what Griffth CJ long ago said in *Black v S Freedman & Co* (1910) 12 CLR 105, 109.[7] One distinguished

4 Applying *Banque Belge pour l'Etranger v Hambrouck* [1921] 1 KB 321, 325, 332; *Shalson v Russo* [2005] Ch 281, [108]-[119]; *El Ajou v Dollar Land Holdings plc* [1993] All ER 717, 734.

5 *Car & Universal Finance Co Ltd v Caldwell* [1965] 1 QB 525.

6 For a survey of the controversies relating to the "rescission" analysis, see D Salmons, "The Availability of Proprietary Restitution in cases of Mistaken Payments" (2015) 74 CLJ 534, 541-546.

7 See also *Creak v James Moore & Sons Pty Ltd* (1912) 15 CLR 426, 432.

commentator has observed, "The principle that a thief holds stolen property in trust for the victim [has] been treated as settled law".[8] That may be seen in at least four decisions at the intermediate appellate level since 2004,[9] and indeed, it was anticipated in *Rasmanis v Jurewitsch* [1970] 1 NSWR 650, 652, where Jacobs JA, with whom Wallace P and Mason JA agreed, referred to enforcing a constructive trust to prevent a felon from obtaining any benefit flowing to him from the slaying of a fellow joint tenant. There would appear to be no reason for this principle not to apply to a case of supervening fraud,[10] although no differently from other occasions where a constructive trust is imposed, a court will have regard to any interests of third parties.[11]

The recognition of property rights following fraud will also pose practical problems, which emerge most clearly from considering the second aspect of the Chancellor's rulings.

[94] **Distribution of the fund among investors**

The second half of the judgment concerns the identification of the traceable proceeds of the investors' funds. It turned out that there were nine ways in which investors' money was diverted, and on the evidence it could be shown that payments in six of those nine ways had contributed to the frozen amount. The approach adopted by the Chancellor may be summarised by the following propositions.

First, where investors' money was mixed with non-investor money, the Chancellor applied the assumption stated by Sir George Jessel MR in *Re Hallett's Estate* (1880) 13 Ch D 696 that non-investor money was dissipated before investors' money.

Secondly, where funds which could be attributed to particular investors were mixed with funds which, although attributable to investors generally, could not be attributed to particular investors, the whole of the mixed fund was taken to be a single fund.

Thirdly, the "first in, first out" rule in Clayton's case was displaced, because it was practically impossible to match credits against debits, and because it was found

8 K Handley, "The Black v Freedman Trust: Vindicating Proprietary Rights or Remedying Wrongs" in E Bant and M Bryan (eds), *Principles of Proprietary Remedies*, 117, 118.

9 See *Robb Evans of Robb Evans & Associates v European Bank Ltd* (2004) 61 NSWLR 75, [111]-[116]; *Heperu Pty Ltd v Belle* (2009) 76 NSWLR 230, [93]; *Grimaldi v Chameleon Mining NL [No 2]* (2012) 200 FCR 296, [255]; *Levy v Watt* [2014] VSCA 60; (2014) 308 ALR 748, [65].

10 Contrast the notion of "emerging sham" considered in *Lewis v Condon* (2013) 85 NSWLR 99, [80]-[82].

11 See *Sze Tu v Lowe* [2014] NSWCA 462, [156]-[157].

that all investors intended that their money be used exclusively on the completion of their contracts. It followed, in accordance with *Barlow Clowes International Ltd v Vaughan* [1992] 4 All ER 22, that funds should be treated as derived ratably from the investors.

Fourthly, each claimant was entitled to interest which had accumulated on the fund while it had been frozen, in accordance with ordinary principles.

The result was that 80.57% of the fund was taken to represent the traceable proceeds of each claimant investor's money. Could they obtain more? To that end, the Court rejected two somewhat ambitious submissions but upheld a third. The Court rejected a submission that as a matter of construction, out-of-pocket investors should be repaid in full before any surplus was distributed to the State; that "extravagant result" was contrary to the scheme of the Act, which was not compensatory but restorative of property rights. The Court also rejected a submission that it should be inferred that those investors who had chosen not to advance a claim were associates of Mr Robb and implicated in his fraud; the submission was directed to the presumption that their money had been dissipated in preference to that which was taken to represent the claimant investors' funds.

However, the Court was prepared to infer that investors who had not participated in the litigation (which appears to have been advertised extensively) had not rescinded their contracts. On that basis, his Lordship considered that the "money of investors who are not additional claimants is to be treated, for tracing purposes, in the same way as other money of Mr Robb and [his company] and to have been dissipated before the traceable money of those additional claimants" (at [75]). The result was to enlarge the interest of the claimants.

Conclusions

Quite probably the same outcome would have been reached by Australian courts, although by different reasoning. English judges, faced with submissions based on the rule in Clayton's case, have tended to sidestep its application by resort to an imputed intention on the part of the claimants.[12] Australian decisions, more robustly, have favoured a ratable distribution approach,[13] although, as was said in *Re Magarey*

12 See the third proposition above, and also *Russell-Cooke Trust Co v Prentis* [2003] 2 All ER 478, [55].

13 *Keefe v Law Society of NSW* (1998) 44 NSWLR 451, 460-461; *Re Sutherland; French Caledonia Travel Service Pty Ltd (in liq)* (2003) 59 NSWLR 361, [169]; *Re Global Finance Group Pty Ltd (in liq)* (2002) 26 WAR 385, [106]-[117].

Farlam Lawyers Trust Accounts (No 3) (2007) 96 SASR 337, the remedy must be tailored to fit the facts of each case. That reflects what Allsop P once referred to as the "sensible robust approach to the tracing of moneys from theft".[14]

More generally, it may be seen that this an area where Australian courts have favoured practicality over strict logic. That is not foreign to the common law system. Chief Justice Spigelman wrote in this journal that "the common law has never had the fascination for consistency apparent in the civil [95] law".[15] Equity is no different, especially when dealing with theft and fraud. An English acknowledgement of this may be seen, more recently, in the Privy Council's decision permitting so-called "backwards tracing" in *Federal Republic of Brazil v Durant International Corporation* [2015] UKPC 35, [38], in which Lord Toulson observed that "the availability of equitable remedies ought to depend on the substance of the transaction in question and not upon the strict order in which associated events occur".

All of that said, it remains important not to let "robust" and "practical" approaches to recognising proprietary interests go too far. For all the understandable attraction in providing ample proprietary relief to the victims of fraud, some caution is required, bearing in mind that one is dealing with property, and that in most such cases, the recognition of proprietary rights by some victims will result in the commensurate denial of recovery to the fraudster's unsecured creditors.

14 In *Toksoz v Westpac Banking Corporation* [2012] NSWCA 199; (2012) 289 ALR 577, [9], in a passage endorsed in *Sze Tu v Lowe* [2014] NSWCA 462, [468].

15 JJ Spigelman, "From Text to Context: Contemporary Contractual Interpretation" (2007) 81 *ALJ* 322.