There is no Law of Tracing and this is why it Matters

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Introduction

A simple idea unites contemporary tracing theory across the common law world: we trace by following a continuous thread – value – from one asset to another.\(^1\) Tracing’s ‘central case’ is a straightforward one: if T, a trustee, misappropriates £10 from an account held on trust for B and buys with it a bottle of wine worth £10, value moves from T’s rights against the bank to title to the bottle of wine, so that B can track the path of value from the former to the latter. And he can do this irrespective of the fact that T intended to use money from his own account, or could have bought the wine without the trust money.

It is immediately clear that we are using value in an unusual sense. It is neither wealth (abstract value) nor exchange value (the market value of particular things, rights and services). Value, in tracing, is the exchange potential of a right, exploited when another is acquired in its place. Since exchange potential is a label for what can be done with a right, it cannot actually move from one right to another. But, so the argument goes, there is continuity in the direct exchange by some actor: the right changes, but the right-holder does not.

This narrowing of definition helps to remove some problems, but it unearths more: how can value move from one right into another if the new right is acquired by someone different from the person who had the original one? How can we trace value if we cannot identify the exact trail of exchanges that leads to the acquisition of the new right, or if intermediate steps in the trail contain rights that are acquired from several sources? What happens if the new right is exchanged for a debt? Because they stem from the resolution of a shared theory of tracing with contemporary payment mechanisms, we face these problems in each of our common law jurisdictions.

It is argued here that our starting point is incorrect: we do not follow value – as exchange potential or otherwise. Rather, we look for a transactional link between the loss and acquisition of rights. There is no magic in ‘transaction’ here: like any transaction, you cannot work out its content and character without reference to the intention of the parties, deduced from the agreement as a whole. And, as in many other areas of private law, if the parties intend several steps to operate as a single, overarching transaction, we characterise it accordingly. This, manifestly, is all that we are doing when we connect two rights through the multiple steps of a bank transfer, and when we ignore the interposition of credit.

If this seems obvious, it should. Yet the insistence that there is some directness in substitution, a continuous thread that, because it is ‘in the very nature of things’,\(^2\) can be established independently of intention, continues to lead courts to conclude that it is automatically thwarted if money is paid into an overdrawn bank account,

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2 C. Hare, ‘Tracing Value and the Value of Tracing’ (2013) 24 JBFLP 249, 266.
because there is no asset into which we can trace,³ or paid into a clearing system, because its identity is lost,⁴ even that tracing is not possible through a bank transfer, because there is nothing but a ‘stream of electrons’ travelling between accounts.⁵ As payment mechanisms become more complex, these problems become ever more pressing. There is no continuous thread, nothing that we can trace, and this is why it matters.

Exchange Value

Exchange is fundamental to the idea of quantitative comparison between different things. Imagine a market of 10 people, in which there is a limited supply of apples and pears. If each of those 10 people wants an apple, this tells us that apples are valued by the group, but it does not, of itself, tell us anything about their value compared with other the things that those people might want. If 10 people want an apple, whilst only 5 want a pear, we can see that a smaller number of people in the group value pears. But we do not yet have a yardstick according to which we can measure the relative values of apples and pears. For this we must introduce the concept of exchange.

If 5 of our 10 people want apples, and each of them has a pear, and the other 5 of our 10 people want pears, and each has an apple, the apple group and the pear group might wish to swap. That they are able to swap gives them a choice: which do they value more, apples or pears? If the apple group all decide they value pears more, and the pear group all decide they value apples more, they probably will swap. So, an exchange occurs when two or more persons place different values on two or more commodities, and it allows us to conclude that, in our hypothetical market, ‘apples are worth pears’, or ‘the exchange value of an apple is a pear.’

Whether this statement holds true will depend upon the cumulative desires of the market and the supply of apples and pears. If we flood our hypothetical market with pears, and desire for pears and apples remains the same, then the exchange value of an apple might be or become 10 pears. In Benedetti v Sawiris, in order to illustrate the fact that market value is ‘specific to a given place at a given time,’⁶ Lord Reed cites a passage from Vanity Fair in which the battle of Waterloo causes demand for horses to soar, so that Becky Sharp realises a price for her horses far in excess of the ordinary price.⁷ Just as it can soar, so too can market value plummet: in the early spring of 1637, at the height of the so-called ‘tulip mania’ a Dutch merchant named François Koster paid 6650 guilders for a few dozen tulip bulbs. Less than a week later, the same bulbs in the same market were worth less than 665 guilders.⁸

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⁵ Agip (Africa) Ltd v Jackson [1990] Ch 265 (Millett J).
⁷ Ibid.
So, we can measure the exchange value of apples by reference to a quantity of pears and *vice versa*, and the quantity of pears that apples are worth, or apples that pears are worth, will depend both upon the cumulative desires of players in the market, and the supply of apples and pears to that market. Value is thus a quantitative representation of the relationship between apples and pears, and it is founded upon exchange. It expresses a prediction: if you go into the market with pears, looking to exchange them for apples, you are likely to find that you will have to swap $x$ amount of pears for $y$ amount of apples. We often, therefore, distinguish ‘exchange value’ (a prediction about what you are likely to obtain in return for your pears) from ‘realising the exchange value’ (what you do, as a matter of fact, obtain in return for your pears).

Societies would have developed extremely slowly if every time someone who had pears but wanted an apple had to find someone who wanted pears, or someone willing to trade something for pears that the person who had apples wanted. The division of labour thus creates a problem, famously called the ‘double coincidence of wants’,9 that, so the argument goes,10 has been solved throughout history by the introduction of a common instrument of commerce, which is what we call ‘money’.11

Although, like the Romans, we use metal money, countless other commodities have been preferred: the Aztecs, for example, chose cacao seeds; the ancient Babylonians and Assyrians used barley; several parts of Southeast Asia used standardised measures of rice;12 and the Uap of the Caroline Islands chose thick limestone wheels of 6-12 feet in diameter carried on rafts and canoes from an island some 400 miles away.13 As commodities are more frequently exchanged for money than for other non-money commodities, it then becomes more natural and obvious to estimate value according to a quantity of money. Money thus becomes the medium of expression of all the exchangeable value of commodities.

Exchange value is thus predicted relative worth of particular things, rights and services, and it can be expressed as a money figure. This brings us to the first sense in which we might say that value ‘moves’ and can be traced through a transaction: if T misappropriates £10 held on trust for B and buys a bottle of wine, the exchange value of the trust right is somehow represented by the exchange value of title to the wine, so that B can trace and claim the latter.

Yet, quite how this works, and what exactly we mean by the statement that value ‘moves’ from one to the other, is not clear. To take a an extreme example, in 2006, in a story worthy of the Japanese legend of the ‘Straw Millionaire’, a 26 year old Canadian man called Kyle MacDonald traded a paperclip, through a series of 14 trades, for a two-story farmhouse in Kipling, Saskatchewan. The cases are clear that the vast divergence in the respective values of titles to the paperclip and farmhouse is no impediment to tracing from one to the other.

In *Jones v FC Jones* Mr Jones made a series of unauthorised transfers from his firm’s account to his wife.15 She multiplied that money fivefold by speculating in

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9 Coined by W. S. Jevons.
11 cf Martin who argues that this is not the starting point in money’s history. Money began as transferable credit, and not as a common instrument of commerce. See also now C. Desan, *Making Money: Coin, Currency, and the Coming of Capitalism* (OUP).
15 *Jones v Trustee of FC Jones & Sons* [1997] Ch 159.
potato futures, before transferring it to a deposit account with Raphaels. The Court of Appeal unanimously upheld the trustee in bankruptcy’s proprietary claim to those (far more valuable) rights against Raphaels, concluding: ‘There is now ample authority for the proposition that a person who can trace his property into its product, provided the product is identifiable as the product of his property, may lay legal claim to that property.’

In Foskett v McKeown the trustee misappropriated trust funds and used them to pay two out of five premiums of a life insurance policy. The beneficiaries of the trust were held entitled to claim two fifths of the insurance payout even though the share of the proceeds recovered by the beneficiaries far exceeded that of the contributing trust funds.

The substitute right might equally be worth less than the substituted right. If T misappropriates £10 held on trust for B and buys a bottle of wine worth £1, B can still trace and claim title to the bottle of wine. In Smith’s words, ‘there are good and bad bargains, and the invocation of ‘value’ as the object of the verb ‘to trace’ does not entail that an asset must have the same market value as the asset used to acquire it.’ Indeed, there is no reason to think that either right need have any exchange value at all.

If this is correct, and it seems difficult to avoid the conclusion that it is, we are no closer to solving our problem: if T, a trustee, misappropriates £10 held on trust and buys a bottle of wine worth £100 (or 10p), how is it that value can be said to move from one right to the other?

**Wealth: Abstracted Exchange Value**

The sum of the immediate exchange value of an individual’s assets, minus that individual’s liabilities, produces a net amount that can be expressed as a money sum. This is often referred to as ‘wealth’. This brings us to the second sense in which we might say that value ‘moves’ and can be traced through a transaction: if A has title to a scooter worth £20, and swaps it with B for title to a bicycle worth £10, the cumulative exchange value of the assets in B’s hands is greater than it was prior to the transaction, and the cumulative exchange value of the assets in A’s is less, so that £10 can be said to have “moved” from A to B.

If this is what we mean when we say that we trace value, there is no particular reason to tie it to the notion of an exchange of particular things or rights at all. After all, ‘value may be received (and, more importantly, retained) by the defendant in a manner causally linked to the claimant without any transactional link between them.’ Accordingly, Evans argues that we ought to free parties seeking to trace from the obligation of proving a transactional link. This point is a good one. We can’t have it both ways: we are either interested in (i) a transfer of value between individuals, in which case there is no obvious reason to insist upon the presence of an exchange of rights; or (ii) the exchange of particular rights, in which case there is no obvious reason to insist upon a transfer of wealth between individuals.

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16 Ibid 171 (Millett LJ).
17 *Foskett v McKeown*.
20 S. Evans, ‘Rethinking tracing and the law of restitution’ 115 Law Quarterly Review 469, 479.
21 Ibid.
It is abundantly clear, however, that Evans’ solution is not that which has been adopted by our authorities. In *OJSC Oil Co Yugraneft v Abramovich* OJSC Oil Company Yugraneft (“Yugraneft”), which had a participation interest in LLC Oil Company Sibneft-Yugra (“Sibneft-Yugra”), claimed to have been the victim of a massive fraud perpetrated by Mr Abramovich, and sought to trace into the proceeds of sale of Sibneft to Gazprom on the basis that a part of the (increased) value of the shares in Sibneft represented the (decreased) value of its interest in Sibneft-Yugra.\(^\text{22}\)

The judge held that it could not, saying: ‘At best there is a causal connection between the transfer and the increased value… when what is required is a transactional link by which a new asset is exchanged for, and acquired with, the old one.’\(^\text{23}\) Though Abramovich was better off as a result of the breach of trust (and Yugraneft was worse off), his rights as a shareholder in Sibneft were not exchanged for Yugraneft’s participation interests, which still existed at the time of the claim.\(^\text{24}\)

By contrast, if the claimant can demonstrate that some right in the defendant’s hands is the exchange product of a right originally held by or for the claimant, it is neither here nor there that the transaction has made no difference to the defendant’s wealth. In *Foskett* the defendants argued that the claimant could not trace from the premiums paid to the policy payout because:\(^\text{25}\)

Those premiums were not made in *exchange* for anything since they did not increase the value of the policy or policy moneys. The same sum would have been paid out on M’s death whether or not those premiums had been paid.\(^\text{26}\)

Lord Millett dealt with that point swiftly:

>[T]he question is one of attribution not causation. The question is not whether the same death benefit would have been payable if the last premium or last few premiums had not been paid. It is whether the death benefit is attributable to all the premiums or only to some of them. The answer is that death benefit is attributable to all of them because it represents the proceeds of realising the policy, and the policy in turn represents the product of all the premiums.\(^\text{27}\)

That leaves (ii): when we trace we are not seeking to connect two different *people* by reference to a transfer of wealth, but two different *rights*. If A swaps title to a scooter for title to a bicycle, that B is better off as a result of the transaction is irrelevant: tracing simply connects A’s prior title to the scooter with A’s new title to the bicycle, and B’s prior title to the bicycle with B’s new title to the scooter, which it does on the basis of the exchange, not on the basis of the effect on the net worth of either A or B.

**Exchange Potential**

\(^{22}\) *OJSC Oil Co Yugraneft v Abramovich* [2008] EWHC 2613 (Comm)

\(^{23}\) Ibid. [365].

\(^{24}\) Ibid.

\(^{25}\) *Foskett v McKeown*, 137.

\(^{26}\) Ibid [105].

\(^{27}\) Ibid 137.
One of the things that the holder of an assignable right can do is exchange it and by doing so obtain something in return. This does not tell us what he will receive in return: that must be determined by reference to the supply and demand of a particular market, in comparison with other assets within it. This will produce the ‘exchange value’ of that right, which, we have seen, is a prediction about what price the right will fetch. So, ‘exchange potential’ expresses the idea that ‘I can exchange this right’, whilst ‘exchange value’ expresses the idea that ‘if I do I will be likely to receive x’. Exchange value is subject to constant change. Exchange potential is not: even onerous assignable rights have exchange potential.

Control over the exchange potential of a thing is one of the incidents of title to it. This is the idea articulated by Hegel’s statement that ‘as full owner of the thing, I am owner both of its value and of its use’. The ‘ownership’ of value is not, of course, ownership in the sense of ‘best title’. Rather, it captures the idea that a person with best title to something is in the best position to exploit its exchange potential. Penner puts this clearly: ‘the right regarding value which ownership gives us is the right to realise, to capture, the exchange value of our property. It is a right to act in a certain way, not a right to something that is somehow already there.’

This, finally, is what we mean when we say that value moves from one right to another:

If a £100 banknote is used to buy a painting, then the value inherent in ownership of the banknote is traceable into ownership of the painting. Ownership of the painting might be, or might become, worth £10 or £10,000. This does not change the conclusion that this asset was acquired with the other; the seller transferred ownership of the painting in exchange for receiving ownership of the banknote. This is what is meant by the notion that it is value which is traced from the first asset into the second.

Of course, the same explanation is applied, as it must be, outside the context of title, to cases involving personal rights, so that it is not a feature of title, but of the capacity for exchange of any right, personal or proprietary. For Birks, therefore, the ‘key question’ for tracing is simply ‘whether the value inherent in the one asset has in whole or in part been used to acquire the other.’ In other words, has one right (with any, no or negative exchange value) been exchanged for another right (with any, no or negative exchange value)? Value is thus simply a ‘reification’ of exchange potential.

So, if T, a trustee, misappropriates £10 held on trust for B and buys with it a bottle of wine worth £100, value can be said to move from the trust right to title to the bottle of wine because T exploited the exchange potential of the former in acquiring the latter.

28 Benedetti v Sawiris, [105] (Lord Reed).
31 Penner 309.
32 Smith 16-17.
33 R. Chambers, ‘Tracing and Unjust Enrichment’ in J. Neyers; M. McInnes; S. Pitel (ed), Understanding Unjust Enrichment (OUP) 265; 278.
34 P. Birks, ‘Overview: Tracing, Claiming and Defences’ in Peter Birks (ed), Laundering and Tracing (OUP) 289.
35 Smith 157.
The Problem with Tracing Exchange Potential

Exchange potential is exploited when a thing or right is, in fact, exchanged. Because it is a description of what can be done with a right, it cannot ‘move’ from one right to another any more than ‘edible’ can move from an apple to the person that eats it. The language of tracing value simply expresses the continuity that, on this view, is accounted for by a quality of the original asset:

The owner of the thing owns the value in the sense that ownership of the thing carries with it an entitlement to something equivalent when the thing is exchanged or injured. Value is thus the potentiality that is realised through a set of legal operations – exchange and liability – with respect to the things that one owns… The entitlement to value thus marks the continuity through the process of exchange…

So, if substitution is exchange, and continuity is provided by exchange potential, then the substitute is whatever is acquired by the holder of the right. In Smith’s words, ‘the only connection between the old and the new asset is the exchange; that is, the substitution of one for the other by some person.’

The problem with the value-as-exchange-potential explanation of the link between rights is that identifying a direct exchange by some person is impossible in almost all contemporary methods of payment. One of the simplest examples of this is the attempt to link rights through a bank transfer from one account to another.

Agip v Jackson concerned a payment order that had been fraudulently altered to name Baker Oil as beneficiary. That order was executed by the claimant’s bank, Banque du Sud, which debited their account with $518,822.92 and instructed Baker Oil’s bank (Lloyds Bank) to credit Baker Oil’s account in London with $518,822.92, giving instructions to its correspondent bank in New York to reimburse Lloyds Bank with a similar amount. Lloyds Bank acted on those instructions. At the third defendant’s behest, Lloyds Bank then transferred the sum to the account of the defendants’ firm with the bank.

Millett J held that the claimants were unable to trace at common law for two reasons, one of which was that it simply was not possible to show that the defendants’ right was acquired in exchange for the claimant’s right: all that had happened was that the claimants had lost a right and the defendants had acquired one. Whilst the common law could trace rights through substitutions in the same set of hands, it could only follow physical things from one set of hands to another:

In following the plaintiff’s money into an asset purchased exclusively with it, no distinction is drawn between a chose in action such as the debt of a bank to its customer and any other asset... But it can only

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37 Smith 134 (emphasis added).
38 The second reason was that the payment through clearing meant that there was a mixed fund. That point is considered below.
39 Agip (Africa) Ltd v Jackson 286.
follow a physical asset, such as a cheque or its proceeds, from one person to another.\textsuperscript{40}

This has been misunderstood, for two reasons. The first is that Millett J uses ‘following’ and ‘tracing’ interchangeably throughout that part of his judgment.\textsuperscript{41} The second is that, rather bizarrely, he seemed to think that money – even in an account – counted as a physical asset, so that the old rules about physical money losing its identity once mixed with other money applied in full force:\textsuperscript{42}

[The common law] can follow money but not a chose in action. Money can be followed at common law into and out of a bank account and into the hands of a subsequent transferee, provided that it does not cease to be identifiable by being mixed with other money in the bank account derived from some other source.\textsuperscript{43}

Of course, money in an account is a chose in action, so that this statement collapses. Agip is widely cited for the proposition that we cannot trace at common law through a mixed fund. It actually stands for the proposition that we cannot follow at common law into mixtures of physical money. That proposition has no bearing whatsoever on banking.\textsuperscript{44}

The other proposition for which Agip is cited as authority is that it is possible to trace through bank accounts in Equity. In Nimmo v Westpac Blanchard J said:

It is also said that common law tracing is defeated by a transmission of funds electronically, by a stream of electrons rather than by transfer of a physical asset… There was certainly no transfer of any physical asset. Equity could, of course, trace such transactions but at common law they cannot be traced.\textsuperscript{45}

But Millett J’s statements were nothing to do with tracing: following was, said the judge, impossible at common law in the absence of a physical thing (and “money” counted, so long as it was unmixed), but possible in Equity, which simply regarded it as the same right, transmuted. Tracing, on the other hand, was altogether impossible when seeking to connect two different people.

Relfo v Varsani concerned a claim brought by the liquidator of Relfo Ltd (“Relfo”) against Mr Varsani to recover $878,479.35 that had been misappropriated by its former director, Mr Gorecia.\textsuperscript{46} Mr Gorecia, in breach of fiduciary duty, caused

\begin{itemize}
\item \textsuperscript{40} Ibid 285 (emphasis added). He then said: ‘It can follow money but not a chose in action.’ This has been the source of a great deal of confusion. This case is widely cited for the proposition that we cannot trace at common law through mixtures. The difficulty was that Millett J considered money to be a ‘physical asset’, so it is really only reiteration of the old proposition that physical money has no earmark, so that following and tracing necessarily end when it is mixed with other physical money: Whitecomb v Jacob 91 ER 149; (1710) 1 Salk 160; Scott v Surman (1742) Willes 400. That proposition has no bearing whatsoever on banking.
\item \textsuperscript{41} Agip (Africa) Ltd v Jackson 289-290.
\item \textsuperscript{42} Whitecomb v Jacob; Scott v Surman. The problem is not a current one, since almost all money is a chose in action.
\item \textsuperscript{43} Agip (Africa) Ltd v Jackson 285.
\item \textsuperscript{44} cf Smith164.
\item \textsuperscript{45} Nimmo v Westpac Banking Corp 238.
\item \textsuperscript{46} Relfo v Varsani [2012] EWHC 2168 (Ch)
\end{itemize}
Relfo to pay $890,050 to a company called Mirren Ltd (“Mirren”). The next day, another company, Intertrade Group LLC (“Intertrade”), paid $878,479.35 to Mr Varsani’s bank account. Both the High Court and Court of Appeal held that the liquidator was entitled to trace the Relfo/Mirren payment into the Intertrade payment in Varsani’s hands and that Varsani was obliged to account in knowing receipt for the full amount of the Intertrade payment. Ardemn LJ said, ‘when funds are transmitted through the banking system, what matters is that there has been an exchange of the value of the claimant’s property into the next product for which it is substituted and so on down the chain of substitutions.’

‘Exchange… into’ is revealing. Relfo and Agip follow the same basic pattern: B misappropriates A’s funds and transfers them to C. A cannot, in such a case, follow his right: when a bank transfer is made the transferee does not acquire the right that the transferor gave up. There is nothing to follow but a ‘stream of electrons’. But neither can he trace into C’s right, if tracing is the exploitation of exchange potential: the appeal to value lies in explaining claims to whatever is acquired by the actor in exchange for the original right. A’s right, on this account, is exchanged for the bank’s promise to give C a right. It is not exchanged for performance of that promise, which simply involves the discharge of the bank’s obligation. The kind of value that moves from A to C is wealth, not exchange potential.

Since it has never been suggested that Equity has different requirements for what counts as an ‘exchange’, this problem arises at law and in Equity. Nevertheless, it is now well established that, even though we cannot trace through bank transfers at common law, we can in Equity. If that conclusion is to be preserved – which it must, if tracing is to continue to exist as tangible forms of payment disappear – we must find a different explanation for it.

The most we can say about cases like Agip and Relfo is that the claimant loses a right and the defendant acquires one, and that both of those things happen as part of the same transaction. It what follows it is argued that these things – loss of a right, acquisition of a right, and a transactional link – are the proper hallmarks of the exercise that we have called ‘tracing’. However, precisely because there nothing ‘in the nature of things’ that allows us to connect two separate rights – no continuous thread to follow or ‘trace’ – that exercise is hereafter called ‘substitution’.

Loss of the Substituted Right

The first hallmark of a substitution is that the transaction involves the loss of the right alleged to have been substituted. In the Abramovich case, considered in the previous chapter, Yugraneft sought to trace from its participation interest in Sibneft-Yugra into the proceeds of sale of Sibneft to Gazprom on the basis that a part of the inflated value of the shares in Sibneft represented the decrease in value of its participation

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47 Relfo v Varsani [2014] EWCA Civ 360 [60].
49 Agip (Africa) Ltd v Jackson 286.
50 El Ajou v Dollar Land Holdings; Nimmo v Westpac Banking Corp 238; ASB Securities Ltd v Geurts [2005] 1 NZLR 484 [57]; Baton Construction Ltd v Jorna (No 2) [2006] DCR 290 [11]-[12]; Hillig v Darkinjung Pty Ltd.
51 Hare 266.
interest. The judge held that it could not. Yugraneft was unable to demonstrate that its rights had been substituted when it still had those rights:

The chose in action represented by those participation interests remains where it always has been – with Yugraneft. No property has ever been substituted for it. No question of substitution can arise when nothing has taken the place of that chose, nor have the new participation interests been obtained by the use of, or in exchange for, Yugraneft’s original interest.

In most of our substitution cases, this element causes no problem for the claimant. According to McFarlane, if B transfers $100 from his account to A’s, the consequences of such a transfer are that, ‘B loses a right to claim $100 from B’s bank, and A acquires a right to claim $100 from A’s bank.’ Those of our authorities that address the point directly express the idea in the same way, as the extinction and creation of a right to demand from the relevant bank the sum transferred. In *R v Preddy* the defendants, who had procured the transfer of funds as part of a fraudulent mortgage scheme, could not be convicted of obtaining property ‘belonging to another’ for the purposes of the Theft Act 1968 because, as Lord Jauncey explained:

When a sum of money leaves A’s account his chose in action *quo ad* that sum is extinguished. When an equivalent sum is transferred to B’s account there is created in B a fresh chose in action being the right to demand payment of that sum from his bank.

Some caution is necessary, because misunderstanding such statements has led to the conclusion that a claimant cannot ever demonstrate a substitution where a bank transfer is involved. Bank accounts do not consist of a series of several claims, but one unitary claim, so that the transfer of funds from one account to another involves, not the destruction and acquisition of one claim in respect of the sum transferred, but the destruction of two rights against each bank to whatever is the sum total in each account, and the acquisition of two more against each bank to whatever is the new sum total in each account. So, if B starts with $200 and A with $100, B loses a right to $200 and acquires a right to $100, and A loses a right to $100 and acquires a right to $200. We can connect B’s loss of a right and A’s acquisition of a right by virtue of the transaction by which both occur.

It is often suggested in our academic literature that a claimant from whom something is stolen is entitled to ‘trace’ from that thing into whatever the thief exchanges it for:

If someone steals my car and swaps it for a motorcycle, I can follow my car, or I can trace into the motorcycle. If a trustee pays trust money

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52 *OJSC Oil Co Yugraneft v Abramovich*

53 Ibid, 356.


56 *R v Preddy* 841.

57 *Robb Evans of Robb Evans & Associates v European Bank Limited* [139]; *Hillig v Darkinjung Pty Ltd* [20].

58 *Foskett v McKeown*, 128 (Lord Millett).
into a bank account, the beneficiary can follow the money into the hands of the bank, or it can trace into the trustee’s bank account. 59

But there is an important distinction between these two examples. In the second, we have already seen, the rights held for the beneficiary are substituted for new rights. The beneficiary can, therefore, show that there has been a substitution. By contrast, in the first, the thief, when he steals the car, acquires a new, relative, title to it. 60 That title is then realised in acquiring the motorcycle. Unless, for some reason, he is able retroactively to divest himself of it, 61 the pre-existing title of the person from whom the car was stolen remains with that person (although it may not be as valuable to him without possession of the car as it was with it). He cannot, therefore, say that title to the motorcycle is its substitute.

So, the first hurdle for a claimant to overcome in order to demonstrate that there has been a substitution of rights is proof that the transaction involves the loss of the right alleged to have been substituted. This will be so in a case involving the transfer of funds from one account to another, but not where the defendant exchanges his own (relative) title to some thing in respect of which the claimant has a better claim.

**Acquisition of a Substitute Right, or Release of a Liability in Respect of a Right**

The second element of substitution is that the transaction that involves the loss of a right must also involve either (i) (usually) the acquisition of another ‘substitute’ right or (ii) (exceptionally) the release of a liability in respect of a particular right.

**Acquisition of a right**

In *Re Diplock* money was mistakenly paid by the executors of the deceased’s estate to certain charities, some of which was used to carry out improvements to land and buildings to which the charities had title. 62 A series of claims were made against the charities. The proprietary claims were held to involve attempting to trace into those improvements. Giving a joint judgment, Greene MR, Wrottesely and Evershed LJ rejected that possibility: at first, the charities had ‘a negotiable instrument which in origin belonged to the residuary estate and in which the next-of-kin were, in the eyes of equity, interested;’ 63 then it had a claim against the account, once the money was paid in; 64 but once that money was spent making the alterations and improvements, that claim disappeared. 65

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59 Smith 133-134.
60 *Armory v Delamirie* (1722) 93 ER 664.
61 See Smith, 380-381. That argument produces its own problems. For Smith, claims in respect of substitute rights are claims in unjust enrichment. It is not at all clear that the election to give up a right can ever amount to the kind of injustice that justifies a claim to restitution.
63 Ibid 522.
64 Ibid 522-545 (although there was the separate problem that other funds also stood in the account, which a vast majority of the judgment is dedicated to discussing).
65 Ibid 547-548.
According to Smith and the editors of *Goff and Jones*, that conclusion is incorrect.\(^{66}\) It is certainly true that the arguments that their Lordships made were not wholly convincing. But the decision was, it is submitted, the right one. Although the initial transfer of funds from the executors to the charities was a substitution, the rights held by the charities in the form of title to land pre-existed those initially dissipated under the will and were not acquired using them. There was no substitution in respect of those rights.

The necessity to show that there is some new right in the defendant’s hands that is the product of the claimant’s prior right is one of the reasons why a claimant who seeks to claim rights following a period of credit can fail, and why where that period of credit is an overdraft he regularly will fail. In Smith’s words:

> If we do not know what a person did with some money, it cannot be traced into its proceeds; the tracing trail is lost. It is the same if we do not know what was acquired in exchange for the incurring of an obligation; or, if we know that money was borrowed, but we do not know what was done with that money.\(^{67}\)

### Release of a liability in respect of a right

The reason for seeking to prove a substitution is usually either an equitable proprietary claim to particular rights in the defendant’s hands, or a claim in knowing receipt. If the rights in the defendant’s hands are not those lost by the claimant, then the second type of claim requires the claimant to show that the defendant received trust rights that were the substitute of the claimant’s, and the first type of claim requires the claimant to show that he still has them. Most claims will therefore fail without the presence of a substitute right. Exceptionally, however, the claimant will be able to show that there is a substitution where the right or rights in respect of which he had a claim have been used, not to acquire a right, but to release some obligation or liability owed by another person in respect of a particular right.

In *Boscawen v Bajwa* Bajwa had title to a house over which Halifax had a charge.\(^{68}\) Bajwa contracted to sell the house to purchasers who were to obtain a mortgage from Abbey National. Abbey National paid the purchase money to the purchasers’ solicitors, who paid it to Bajwa’s solicitors, Hill Lawson. Hill Lawson paid off Halifax’s charge. When the sale fell through, judgment creditors of Bajwa brought a claim to enforce their charging order and the house was sold. Abbey National’s counterclaimed that it was entitled to priority over the proceeds by subrogation to Halifax’s charge.

Millett LJ held that Abbey National could successfully trace £137,405 into Hill Lawson’s client account. Since it was able to point to a series of substitutions up to and including that which released Bajwa’s debt and liability under the charge, the court held that it ought to be entitled to an interest equivalent to Halifax’s original charge, in order to prevent Bajwa’s unjust enrichment at Abbey’s expense. Dismissing an argument that tracing and subrogation were mutually exclusive, Millett LJ said:

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\(^{66}\) Smith 353.

\(^{67}\) Ibid 148. It was on this basis that the claimants in *Rea v Russell* whose money had been paid into an overdrawn bank account, could not link any right in the defendant’s hands with their own: *Rea v Russell*.

\(^{68}\) *Boscawen v Bajwa* [1996] 1 WLR 328.
Tracing was the process by which the Abbey National sought to establish that its money was applied in the discharge of the Halifax’s charge; subrogation was the remedy which it sought in order to deprive Mr Bajwa (through whom the appellants claim) of the unjust enrichment which he would thereby otherwise obtain at the Abbey’s National’s expense. 69

So, the second hallmark of a substitution is the acquisition of a new right, or the release of a liability in respect of a particular right.

‘Transactional link’

In order for a claimant to connect a right in the defendant’s hands with a right previously held by or for him, he must show that the new right is ‘the product or substitute’ of the old right.70 Various terms are used to describe this link between rights: ‘exchange’; 71 ‘transaction’; 72 ‘attribution’. 73 They are not all equally useful. ‘Attribution’ simply expresses a conclusion: the acquisition of one right can, in certain circumstances, be attributed to another. ‘Exchange’ is problematic for the reasons considered above: substitution includes situations in which the right claimed is acquired by someone different from the person who gives up a right. The term preferred here is ‘transaction’.

However, even ‘transaction’ is not without difficulty. Because we have explained substitution, until now, as the process of tracing a continuous stream of value from one right to another, we have assumed that we must map each step by which one right is lost and another acquired. Accordingly, ‘transactional link’ is understood to refer to the list of legal mechanisms involved in arriving at that result. It follows from this that if we cannot produce such a list, or if producing such a list reveals a period of time in which there is no right at all to link with the old one, we cannot prove a substitution.

Clearing

The other reason for Millett J’s conclusion that the claimant could not trace at common law in Agip was that the source of the payment could not be identified without going through the New York clearing system, where it would inevitably have been mixed with other funds.74 References to ‘mixed funds’ in the context of banking are confusing. We have already seen that ‘value’ does not mean ‘pool of wealth’, and a ‘mixed fund’ is not a bag of coins: these analogies, although they are common, are not helpful. A ‘mixed fund’ in the context of tracing refers to a right acquired with several different rights.75 It is this kind of right that supposedly causes problems for the common law. So, in Relfo the judge at first instance held that tracing at common law was not possible where the intermediate accounts through which funds travelled

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69 Ibid 335.
70 Taylor v Plumer (1816) 105 ER 721 (Lord Ellenborough) 575.
72 OJSC OIL Co Yugraneft v Abramovich [349] (Christopher Clarke J), emphasis added.
74 Agip (Africa) Lid v Jackson.
75 Foskett v McKeown.
were not ring-fenced,\textsuperscript{76} the assumption being that they would have been dealt with multiple times, so that it would be impossible to work out whether the right that represented each account at each stage was in fact the product of the right that represented the misappropriated funds.

Clearing does not create this kind of problem. When the bank creates a credit obligation to a customer in execution of a payment order, the source of the right is simply the payment order, which may or may not be the product of another payment order. Settlement and clearing are not the same thing: clearing is the process of exchanging payment orders between participating banks,\textsuperscript{77} whilst settlement is payment between the banks in settlement of their obligations \textit{inter se}.\textsuperscript{78} Settlement is irrelevant here. In Smith’s words, tracing through a payment order made by A to Bank A to pay B £400, which B does by instructing Bank B to credit B’s account, ‘does not require that when Bank A paid £400 to Bank B it was the same £400 A paid to Bank A, or even that it was its traceable proceeds. It would not matter if Bank A settled with Bank B by giving it £400 worth of kiwi fruit.’\textsuperscript{79} The problem that \textit{clearing} supposedly creates for the idea that we are tracing value through a series of exchanges is the necessity of identifying the precise series of payment orders that link A’s right to C’s.\textsuperscript{80}

Even though it entails the conclusion that whether tracing at common law is possible depends entirely upon whether the banks happen to have a common correspondent, so that the payment does not have to go through clearing,\textsuperscript{81} Millett J’s views on the clearing of electronic payments have been approved in several cases in the UK,\textsuperscript{82} Canada,\textsuperscript{83} Singapore,\textsuperscript{84} and New Zealand,\textsuperscript{85} which creates doubt about the consequences for tracing of other payments mechanisms that involve some form of clearing, such as debt and credit cards.\textsuperscript{86} By contrast, tracing at common law \textit{is} considered to be possible where the facts involve cheque clearing,\textsuperscript{87} although there is very little difference in operation between the two.

\textbf{Credit}

Linking a right acquired with credit that is later repaid using another right is typically expressed as ‘tracing into the payment of debt’,\textsuperscript{88} or ‘backward tracing’.\textsuperscript{89} One objection this process is temporal, and was voiced by the defendants in \textit{Foskett}:
The moneys used to pay the 1989 and 1990 premiums cannot be identified as being represented by the policy moneys since the policy was acquired prior to the payment of the premiums, and one cannot trace into an asset already acquired.90

This objection to credit can be dealt with easily. If T holds title to a plot of land on trust for B and agrees with X to exchange it for title to a house, it will make no difference to our conclusion about the nature of the transaction if X in fact transfers title to the house to T prior to T transferring title to the plot of land to X. As Ardern LJ put it in Relfo, ‘in order to trace money into substitutes it is not necessary that the payments should occur in any particular order, let alone chronological order.’91

The real crux of the problem is this: if a buyer buys an asset on credit and repays it with the claimant’s money, ‘The asset that the vendor accepted in return for agreeing to pass title in the goods to the purchaser was the benefit of the debt, not cash,’ so that even if the debt is later realised by payment of cash ‘that is satisfaction of the debt rather than payment of the consideration for which the asset was acquired.’92 In other words, if B buys a bicycle from C for £10 on credit and A subsequently gives B £10, which B uses to meet the debt, however we look at it, A’s rights have been substituted for the release of an obligation, and there is no immediate product of that release. The product of the substitution of A’s rights is in C’s hands: C exchanged title to the bicycle for a right to £10, and then the right to £10 for £10.

Accordingly, the little explicit judicial support we have limits backwards tracing to those cases in which the defendant intended all along to use the claimant’s money to repay the loan.93 Our most recent authority on the point even suggests that the creditor must also intend that the defendant will use the claimant’s money to repay the loan.94 In cases where an intention to use the claimant’s right to pay the debt with which a right is acquired can be shown a causal link can be established between the claimant’s loss of rights and the defendant’s acquisition of rights.95 But it is not altogether clear why being unable to establish the right kind of link (an exchange) is resolved by pointing to a different kind of link (causal).

Understanding ‘transaction’

Although we use the term ‘transaction’ often, it is not easily defined without reference to a particular context. The etymology of ‘transaction’ does not help us narrow its conceptual limits: transaction comes from the Latin ‘transigere’. ‘Trans’ means ‘across or through’ and ‘agere’, which also takes the form ‘actus’, means ‘to do, drive, lead, or pass time’.96 The only idea that appears in each use of ‘transaction’ is, accordingly, that there is some element of bilaterality of action or effect. So, ‘transactional analysis’ is an approach to psychological theory that developed from a study of human interaction by reference to individual developmental history. In

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90 Foskett v McKeown [105].
91 Relfo v Varsani, [63].
93 Bishopsgate Investment Management Ltd v Homan, 216; Foskett v McKeown [1998] Ch 265, 283 (Scott VC); Conlan v Connolly [73]-[83] (in which case the lack of evidence of such intention proved fatal to the claimant’s claim).
94 Relfo v Varsani [63].
95 A. Burrows, A Restatement of the English Law of Unjust Enrichment (OUP) 62.
computer science, ‘transaction processing’ is the unification of a sequence of information exchange.

‘Transaction’ in law contains this element of reciprocity, though it is not reciprocity of action or intention, but of legal effect. It is, as a consequence, broader than contract, which is our paradigm bilateral transaction: a gift is a transaction. If A gives B a bicycle there is an act – the physical movement by A of the bicycle – but there is also a ‘transaction’, because that act is both intended to and does change both parties’ positions in law. Importantly, that change in the parties’ rights and obligations arises out of the intention to change them: a car crash is not a transaction, nor does it become one if the driver intends to bring about the crash. This is so because the liability that arises from the wrong does not depend on the intention to create it. So, a legal transaction is the performance of an act that is intended to and does in fact change the legal rights and obligations of two or more persons, precisely because that is what is intended.

Characterising transactions

Since transactions depend, at root, upon intention, it is to the transactor’s (or transactors’) intentions that we look in order to determine the content and type of transaction that they have created, deduced from consideration of the transaction as a whole.

In In re George Inglefield a furnishing company went into liquidation. A large proportion of its business consisted in letting out furniture on hire-purchase agreements, which it financed by virtue of a number of agreements with a discount company for the sale of furniture and the benefit of the hire-purchase agreements, on terms by which it guaranteed payment by customers of the outstanding hire-purchase instalments.

At first instance Eve J held that these agreements amounted to a charge upon the future instalments payable under the hire-purchase agreement, void for non-registration. The Court of Appeal reversed that decision, holding that the agreements were ‘out-and-out’ sales. Lord Hanworth MR explained that the appropriate approach to characterisation was to ‘see what are the rights and obligations of the parties to be derived from the consideration of the whole agreement’ in order ‘ascertain the substance of the transaction’. Often, this process will reveal that multiple transactions are intended to operate together to form one overarching transaction, which may change the legal category into which the transaction falls. In Curtain Dream plc v Churchill Merchanting Ltd Curtain Dream plc agreed to sell fabric under a finance agreement to a finance company (‘CML’) and to enter into a separate ‘trading agreement’ by which CML purported to resell the fabric to Curtain Dream plc, on terms reserving title in the fabric to CML. Knox J held that there was an ‘indissoluble link between the various parts of the transaction’, so that it had to be regarded as a whole, and not as a series of independent transactions. Viewed in this way, its effect was to

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98 In Re George Inglefield Ltd [1933] Ch 1 19 (Lord Hanworth MR).
100 Ibid 352.
produce an ‘exact degree of mutuality’ with regard to the passing of the title, conclusively indicative of a mortgage or charge.\textsuperscript{101}

We take precisely the same approach in land law in determining whether the parties to a lease or licence have created the agreement indicated by the chosen label. In \textit{Antoniades v Villiers} the landlord granted partners the right to occupy a small flat by separate but identical agreements, entered into contemporaneously.\textsuperscript{102} The agreements were expressed to be licenses and expressly stated that exclusive possession was not granted, and that the use of the rooms was ‘in common with the licensor and such other licensees or invitees as [he] may permit from time to time to use the said rooms.’ The landlord later served a notice to quit on the occupants. The House of Lords unanimously held that the two agreements were interdependent and must be read together because, ‘There is an air of total unreality about these documents read as separate and individual licenses in the light of the circumstance that the appellants were together seeking a flat as a quasi-matrimonial home.’\textsuperscript{103}

In tax law, individual transactions that appear to create a particular balance-sheet result, but which are designed to work as part of a network of transactions, will often be disregarded when the court determines the tax consequences of the wider transaction. In \textit{Ramsay v IRC} the taxpayer company entered into a scheme known as the ‘capital loss scheme’ that was designed to create artificial capital losses on share transactions for the sole purpose of reducing the amount of the capital gains tax payable.\textsuperscript{104} Concluding that it would be ‘quite wrong, and a faulty analysis, to pick out, and stop at, the one step in the combination which produced the loss, that being entirely dependent upon, and merely, a reflection of the gain,’\textsuperscript{105} the House of Lords held that, viewed as a whole, the transaction produced neither gain nor loss. In the words of Lord Wilberforce:

\begin{quote}
It is the task of the court to ascertain the legal nature of any transactions to which it is sought to attach a tax or a tax consequence and if that emerges from a series or a combination of transactions, intended to operate as such, it is that series or combination which may be regarded.\textsuperscript{106}
\end{quote}

\textbf{Substitution and intention}

English judges continue to suggest that, even though we are looking for a transactional link, and even though the existence of a transaction depends fundamentally upon intention, still there is some way of demonstrating a substitution without reference to intention. \textit{El-Ajou v Dollar Land Holdings} the claimant was one of many victims of a massive share fraud carried out in Amsterdam by three Canadians between 1984 and 1985.\textsuperscript{107} It had substantial funds and securities deposited with the First National Bank of Chicago in Geneva which were under the control of an investment manager. The manager misappropriated those funds to invest in shares traded by two Dutch companies, Tower Securities BV and UC United Consultants.

\begin{flushright}
\textsuperscript{101} Ibid 351. \\
\textsuperscript{102} AG Securities v Vaughan; Antoniades v Villiers [1988] 3 WLR 1205.  \\
\textsuperscript{103} Ibid 467-8. \ \\
\textsuperscript{104} Ramsay v IRC [1982] AC 300 . \\
\textsuperscript{105} Ibid 328 (Lord Wilberforce). \\
\textsuperscript{106} Ibid 323 (Lord Wilberforce). \\
\textsuperscript{107} El Ajou v Dollar Land Holdings
\end{flushright}
Each time a sum was received by the Dutch companies, a corresponding amount was deducted from that account and credited to two accounts in Geneva. The fraudsters created three Panamanian companies in order to receive their individual shares in the profits. Those funds were then transferred, through an intermediary, into three more Panamanian companies, and then again into accounts in London, after which they were invested in a joint venture to carry out a property development project in Battersea in conjunction with the first defendant, Dollar Land Holdings plc (“DLH”). DLH argued that the claimant had not established that the money in the Geneva account used to secure an advance to finance the project represented the proceeds of the fraud remitted from Gibraltar to Panama.

At first instance Millett J held that although the claimant was ‘unable by direct evidence’ to demonstrate that the money received into Geneva account represented money sent to Panama, the evidence that had been adduced was ‘sufficient, though only just, to enable the inference to be drawn.’ One of the two sums received into the Geneva account was almost exactly the same as that sent from the Gibraltar account to the Panama account, and there was no evidence that the fraudsters had any significant sum available to them that did not represent proceeds of the fraud. In the judge’s words, ‘It is not much, but it is something; and there is nothing in the opposite scale.’

What form could ‘direct evidence’ have taken? It could not have been evidence that the money in the Geneva account was the money in the Panama account. Each debt was a different debt, owed by and to different people. The question for the judge was whether the former was the substitute of the latter. That question could have been answered by direct evidence of an intention that the transactions should operate as a single whole. Or it could have been answered – as it was – by evidence that tipped the balance towards that conclusion.

That the inference is one of intention was clear at first instance in Relfo v Varsani. In that case, considered above, the liquidator of Relfo Ltd brought a claim against Mr Varsani to recover $878,479.35 that had been misappropriated by its former director, Mr Gorecia. Despite the fact that the court had ‘insufficient evidence to be able to map each step in the process’ – in particular Relfo could not point to specific transactions passing between the Mirren and Intertrade accounts to show how the Relfo/Mirren payment was translated into the Intertrade payment which went to Varsani’s account – Sales J held, at first instance, that payments were so closely linked in time and amount that:

[I]t is a fair inference that the Intertrade payment was the product of a series of transactions between a number of entities and across a number of bank accounts designed to produce the result that funds paid in the Relfo/Mirren payment were (subject to the 1.3% deduction) paid on to Bhimji Varsani.

On appeal Varsani argued that this reasoning was incorrect: ‘Intention cannot make an exchange of property a case for tracing. It must still be shown by evidence or inference that there is a direct chain of substitutions whereby the claimant’s property was exchanged for another asset.’ Ardern LJ kept one foot firmly on either side of

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108 Ibid 713 (Millett J).
109 Ibid 713 (Millett J).
110 Relfo v Varsani [77] (emphasis added).
111 Relfo v Varsani [32].
the fence, suggesting that the decision at first instance could only be explained on the basis that intention was not a ‘major part of the evidence on which the judge based his inference.’\footnote{Ibid [58].} That is simply false: the only basis on which we can show that a new right in person Y’s hands is the product of an old right in person X’s hands is by reference to intention: that is the transactional link, which is exactly what Sales J said.

**Substitution and characterisation**

When it is juxtaposed with our approach to the construction of transactions everywhere else in private law, our approach to ‘transactional link’ in substitution looks nothing short of bizarre. According to Conaglen, regarding a right acquired with a debt that is later repaid with the claimant’s right as the product of that right ‘ignores the legal mechanism by which the trustee acquired the asset.’\footnote{Conaglen, 450.} So it should. The process of characterising a transaction as a substitution is no different from characterising a transaction as a lease, charge or capital gain. If the parties have intended to bring about the loss and acquisition of a right, and have in fact brought about the loss and acquisition of a right, then the interposition of credit is neither here nor there: the courts will simply read two transactions involving (i) the acquisition of a right and assumption of an obligation to pay and (ii) loss of a right and discharge of a debt, are simply read as (iii) one transaction involving the loss and acquisition of a right.

In *Agricultural Credit Corp. of Saskatchewan v Pettyjohn* the claimant agreed to loan the defendants money to buy cattle.\footnote{Agricultural Credit Corp. of Saskatchewan v Pettyjohn 1991 CarswellSask 172.} The defendants bought the cattle before the loan was made, using an overdraft facility, which the defendants later repaid with funds advanced by the claimant. The Saskatchewan Court of Appeal held that that made no difference to the establishment of a ‘close and substantial connection’ between the claimant’s funds and title to the cattle.\footnote{Ibid 60}

In *Agip v Jackson*, considered in the previous chapter, Lloyds Bank actually credited Baker Oil’s account before Banque du Sud instructed its correspondent New York bank to reimburse Lloyds Bank’s correspondent New York bank. At first instance Millett J held that this did not prevent tracing in equity,\footnote{Agip (Africa) Ltd v Jackson, 280.} and the judgment was affirmed on appeal without consideration of the point.\footnote{Agip (Africa) Ltd v Jackson .}

*Foskett v McKeown* is another good example of this phenomenon. Burrows argues that the substitute asset was the insurance pay-out, so that tracing can ‘be seen as straightforwardly going forwards from the premiums paid to the pay-out.’\footnote{Burrows 62.} However, the payout was not the direct product of the premiums, but of the policy,\footnote{Penner 321.} which constituted the ‘right to payment of a debt payable on a future event.’\footnote{Foskett v McKeown, 134.}

In *Brazil v Durant* the claimants sought to trace the proceeds of a wide-scale fraud carried out in the late 1990s in connection with a major public works contract in Sao Paulo, Brazil. They had to show that money paid into an account in the name “Chanani” at Safra International Bank in New York could be connected with an account in the name of Durant at Deutsche Bank, Jersey. At first instance, they were
held able to do so. One of the issues the Jersey Court of Appeal had to consider was the status of two payments made into the Chanani account after the last of the payments out of it.

After considering the authorities on so-called ‘backwards tracing’, the court concluded that they did not lead to ‘binary answers’, so that courts in Jersey ‘should not feel constrained either to adopt or reject any particular rules.’\(^{121}\) Concluding that the rule that the defendant must have intended to repay the debt with money misappropriated from the claimant, if it existed at all, was simply ‘one means of demonstrating the necessary link,’\(^{122}\) the court said:

[I]n a case such as this where an asset is acquired by making a transfer out of an account before trust money is paid into the account, the true question is whether the plaintiff can establish a sufficient link between the trust money of which he was originally deprived, and the asset which has now been acquired.\(^{123}\)

On the facts, that link was clear, and the appeal against the tracing claim was dismissed.

*Moffatt v Crawford* stands in contrast to *Pettyjohn, Agip, Foskett* and *Durant*.\(^{124}\) In that case Heiner used proceeds of trust funds to pay for title to a piano previously bought on credit. He gave the piano to his wife on Christmas Day, and she later gave it to her daughter. Lukin J held that title passed on delivery of the piano to Heiner and that the trust funds could not be followed in any case involving payment by credit.\(^{125}\) That decision was affirmed on appeal.\(^{126}\)

Of course, there are several cases in which no method of construction will help the claimant to claim a new right in the defendant’s hands: we have already seen that this is so in most of our cases involving payments into overdrawn accounts, in which, often, no right initially acquired in return for the debt can be identified.\(^{127}\) But, in cases like *Moffatt,* (and *Pettyjohn, Agip, Foskett* and *Durant*) a right is acquired and can be identified. *Moffatt,* it is submitted, is incorrectly decided.

The example often relied upon to show that tracing is transactional rather than causal is along the following lines: if, as a result of A paying B £10, B uses £10 from a different account to buy ten lottery tickets, one of which is the winning ticket, A cannot show that B’s right in respect of any winnings is the product of his own.\(^{128}\) This is no small problem, because it leads to the conclusion that clearing does indeed thwart substitution, unless A can prove a precise set of payment orders.

The reason A cannot demonstrate that B’s right in respect of the winnings is the product of his own is not because there are two different accounts involved, but rather because there is no basis for us to construe the whole thing as one transaction: A had no intention with respect to the second step. If, by contrast, the whole point of the transaction was for B to buy ten lottery tickets, then A *ought* to be able to show that B’s right in respect of the winnings is the product of his own, irrespective of the

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\(^{121}\) *Brazil v Durant* [2013] JCA 071 [62].

\(^{122}\) Ibid [63].

\(^{123}\) Ibid

\(^{124}\) *Moffatt v Crawford* [1924] St R Qd 241.

\(^{125}\) Ibid 245-246.

\(^{126}\) Ibid, 248 (McCawley CJ).

\(^{127}\) *Re Registered Securities Ltd* [1991] 1 NZLR 545; *Conlan v Connolly; Rea v Russell*.

fact that B uses £10 from a different account. This is why clearing is no problem at all.

The courts in Hong Kong have been much more open about this process of construction. In *Kwai Hung Realty Co Ltd v Yip Fung Sheung* the defendants sought to argue that it was impossible to connect two rights once the facts involved any kind of clearing – of a cheque or electronic payment.  

The judge in the Hong Kong High Court addressed this with the words: ‘The point is after all a simple one, namely whether the money received by Wing Lung under each cheque of the plaintiff is the money from the plaintiff and of the plaintiff. Any layman would have no hesitation in saying yes.’

In *PBM (Hong Kong) Ltd v Tang Kam Lun & Ors* the first defendant (“AT”) diverted funds due from a substantial customer of the claimant to his own bank accounts. A proprietary claim was brought against another defendant, Regent Trinity Investment Ltd (“RTIL”) in respect of the proceeds of the sale of a substantial property owned by it. The shares in RTIL were purchased and owned by AT and another defendant, before they were transferred to two more of the defendants. The share transfer was alleged to have been a sham.

Relying upon evidence such as the size of the transfers made, obvious collaboration with the other defendants, and the fact that AT was spending well above his ordinary means, making no reference to the application of any tracing rules, the judge said ‘I have no difficulty in drawing the obvious inference that these monies originated from funds misappropriated from PBM.’ That judgment was affirmed on appeal.

Yeung suggests that the approach of the judge might be inconsistent with authority, because ‘It does not seem to have been based on what has been described as the transactional approach to tracing, which requires identification of each of the exchanges in an unbroken chain of substitutions.’ Properly understood however, the ‘transactional approach’ is no more or less than demonstrating that a act or series of acts was intended to, and did, bring about the loss and acquisition of a right. *PBM (Hong Kong) Ltd v Tang Kam Lun & Ors* is perfectly consistent with that approach, and a welcome departure from the insistence elsewhere that we are bound to itemise the legal mechanisms by which those changes occur.

**Conclusion**

It is often said that tracing is a neutral process, ‘rather like finding keys. You either can find them or you cannot’ – an exercise which is wholly uninfluenced by intention. Substitution, where it involves the physical replacement of one thing with another, can be entirely value neutral: fishermen who harvest the claws of brown crabs do so in the knowledge that a crab can, over a period of months, generate new claws in their place; when my toothpaste runs out I replace the tube with another, a substitute for the empty tube. But the substitution of rights is not at all like finding

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129 *Kwai Hung Realty Co Ltd v Yip Fung Sheung*

130 Ibid

131 *PBM (Hong Kong) Ltd v Tang Kam Lun & Ors* [2002] HKCU 632; [2002] HKEC 646.

132 Ibid 38.

133 *PBM (Hong Kong) Ltd v Tang Kam Lun & Ors* [2003] HKCU 199.


136 Smith, *The Law of Tracing* 139.
keys, regenerating claws or replacing toothpaste. A transaction that is designed to, and
does, involve the loss and acquisition of a right is a substitution. Several transactions
designed to work together to bring about the loss and acquisition of a right are a
substitution. That a transaction or set of transactions is designed to bring about the
loss and acquisition of a right can be proven by direct evidence of intent, or by
sufficient evidence to tip the balance of probabilities. The inference, where it is
drawn, is an inference of intent. Substitution is a normative process that depends
fundamentally upon intention.

This is important, and it becomes more important as payment mechanisms
develop. Cash and cheques are fast disappearing, and payments that involve neither
bank transfers, nor clearing, nor credit will soon be almost inconceivable in the
industrialised world. Reconciling these developments with the idea that there is a
continuous thread that runs through the steps of payment is impossible, and continued
attempts to do it are resulting in an increasing number of unprincipled distinctions: a
claimant can trace at common law when the banks have a common correspondent, not
if they do not; a claimant can trace at common law through payment by cheque, but
not bank transfer, unless (possibly) the transfer is simply from one branch to
another; a claimant cannot trace at all into a debt, unless the debtor, or (possibly)
the creditor, intends all along that the claimant’s funds will be used to meet it.

These decisions show us clearly that it is high time that we abandoned the
language of tracing altogether, and adopted openly the approach that is already used
with, and without, acknowledgment in several of our cases: we look for a
substitution, which is one transaction involving the loss and acquisition of a right. We
do this by reference to ordinary rules of construction and characterisation, which are
focused centrally on the parties’ intentions.

137 Agip (Africa) Ltd v Jackson; Nimmo v Westpac Banking Corp.
138 Jones v Trustee of FC Jones & Sons.
139 Agip (Africa) Ltd v Jackson.
140 Hongkong and Shanghai Banking Corp Ltd v United Overseas Bank Ltd [1992] 1 SLR 579.
141 Rea v Russell
142 Relfo v Varsani.
143 Agricultural Credit Corp. of Saskatchewan v Pettyjohn; Kwai Hung Realty Co Ltd v Yip Fung Sheung; PBM (Hong Kong) Ltd v Tang Kam Lun & Ors; Brazil v Durant .
144 Agip (Africa) Ltd v Jackson; Foskett v McKeown.