such circumstances; but it remains to be seen whether the principle and its practical implications will generate yet more litigation.

NIGEL P. GRAVELLS

CONTESTS BETWEEN RIVAL TRUST BENEFICIARIES

HAVING been promised 15% *per annum* returns on their investments, hundreds of investors paid a total of over £6m to Mr. Prentis' firm of solicitors, to be invested in short term, high interest mortgages. The payments were held on trust in a client account pending investment. Only some of the payments received were in fact invested in mortgages. For those that were, the documentation was woefully inadequate; frequently it did not identify which investor's money had been applied towards each mortgage or in what amount. There were substantial shortfalls, both in capital and in income. The Law Society intervened and Mr. Prentis was struck off, preventing the firm from continuing to act as trustee. In *Russell-Cooke Trust Co.* v. *Prentis* [2002] EWHC 2227 (Ch), [2003] 2 All E.R. 478 the replacement trustee sought directions as to how it should distribute between the various investors the investments which had been made and the surplus funds remaining in the client account.

There was no contest between the trustee and the beneficiaries. The true contest was between the various beneficiaries, regarding whose claims would prevail over the investments and the remaining funds. In five instances, the documents made clear whose money had been used to invest in each mortgage *and* in what amounts. Those investors could assert a beneficial interest in the relevant mortgages as separate trusts existed for each of them: at [40].

This left the question how the remaining mortgage investments and the funds remaining in the client account were to be distributed. As the client account was a current account, the received wisdom in England is that *Devaynes* v. *Noble; Clayton's Case* (1816) 1 Mer. 572; 35 E.R. 781 provides the starting point, requiring that the beneficiary whose money was first placed in the current account be treated as the person whose money was first taken out of the account. No-one argued in *Prentis* that this rule applied to the mortgage investments where specific investors were identified *but* it had not been made clear in what amounts each identified investor's money had been used. The reason is that it is clear from *Clayton's Case* itself, as well as from later decisions (*In re Hallett's Estate* (1880) 13 Ch.D. 696, 728, 738–739; *Cory Bros. &*

https://doi.org/10.1017/S0008197305356765 Published online by Cambridge University Press

Co. Ltd. v. *Owners of The Turkish Steamship "Mecca"* [1897] A.C. 286, 290, 295), that the "first in, first out" rule from *Clayton's Case* is only a presumption or inference as to the intention of the parties, rather than an invariable rule of law. Thus, where the investments in *Prentis* had been allocated to particular investors, it was their money that had been used, rather than that of other investors whose money was placed into the client account earlier. However, it was not clear in what amounts each identified investor's money had been applied, and so the mortgage investments were held for the identified investors rateably according to their respective contributions of principal: at [46].

Nor was *Clayton's Case* applied to the problem of allocating the remaining funds in the client account. Lindsay J. commented that the rule in *Clayton's Case* "can be displaced by even a slight counterweight. Indeed, in terms of its actual application between beneficiaries who have in any sense met a shared misfortune, it might be more accurate to refer to the exception that is, rather than the rule in, *Clayton's Case*": at [55].

This is eminently quotable, but requires caution when the authorities are borne in mind. *Clayton's Case* involved a dispute between banker and customer, rather than between trust beneficiaries, and numerous jurisdictions have rejected it as a means of resolving the latter kind of dispute (*Re Ontario Securities Commission & Greymac Credit Corp.* (1986) 30 D.L.R. (4th) 1 and (1988) 52 D.L.R. (4th) 767; *Re Registered Securities Ltd.* [1991] 1 N.Z.L.R. 545; *In re Esteem Settlement* [2002] Jersey L.R. 53). However, the Court of Appeal has confirmed that binding authority holds that the rule in *Clayton's Case* is the starting point in English law for the allocation of a deficient fund which has been held on trust for numerous beneficiaries in a current account (*Barlow Clowes International Ltd. (in liq.)* v. *Vaughan* [1992] 4 All E.R. 22, 33, 38–39, 42, 44). *Clayton's Case* does not apply where a contrary intention is evident or can be inferred, or where it would be impracticable and unjust (*Commerzbank Aktiengesellschaft* v. *IMB Morgan plc* [2004] EWHC 2771 (Ch)) or would involve unjustifiable costs, but authority suggests that it cannot be treated as a mere "exception" in England.

The result in *Prentis* is consistent with this orthodoxy. Lindsay J. refused to apply *Clayton's Case* when allocating the remaining funds in the client account because the scheme of investment made it clear that it was not intended to apply: in all the circumstances it was clear that investors' money would not be used in strictly chronological order to make investments, as the investments actually made showed. A rule which presumed a "first in, first out"

https://doi.org/10.1017/S0008197305356765 Published online by Cambridge University Press

process of allocating contributions to investments would have been contrary to the known facts and the reasonable expectations of the investors: at [56]. Accordingly, a *pari passu* scheme of allocation was applied.

The application of *Clayton's Case* to contests between multiple trust beneficiaries needs a thorough review, conducted at a high level on the basis of both precedent and principle, of the sort conducted recently by Campbell J. in *Re French Caledonia Travel* [2003] NSWSC 1008, (2004) 22 A.C.L.C. 498. Here, a travel agency company had received around $1.43m from numerous airlines, travellers and other travel agencies. This had been placed in a trust account, but the account contained only $172,000 at the time of the company's liquidation. As in *Prentis*, neither the company nor its creditors had any beneficial claim to the remaining fund, but there was a contest as to how it should be allocated between the various contributors for whom it was held in trust. Campbell J. held that the fund was to be shared *pari passu* among those contributors.

In refusing to apply *Clayton's Case*, Campbell J. carefully reviewed in detail each of the English cases frequently cited as requiring its application. He accepted that its application did form part of the ratio in *Re Diplock* [1948] 1 Ch. 465, but noted that most of the other cases where it was discussed only contain *obiter* observations as to its applicability.

Perhaps of greatest importance in *French Caledonia* is Campbell J.'s explanation of why, applying basic principles of tracing, *Clayton's Case* need not be considered relevant to allocation of trust money among multiple trust beneficiaries whose money has been wrongfully mixed.

Clayton's Case is relevant to the allocation of debits and credits as between banker and customer. In that situation, one needs to be able to determine, as each payment is made, which debts have been repaid or created by the payment. That sort of strict allocation is unnecessary in a trust context. This is so because, where a trustee has misapplied trust assets, the beneficiaries have a right to *elect* at the time of trial whether to claim against the trust fund, or against assets purchased using money from the trust fund, or against assets transferred out of the fund in breach of trust (*Foskett* v. *McKeown* [2001] 1 A.C. 102, 127, 130, 131). Until such election occurs, the beneficiaries have a charge over all of those various assets. As Campbell J. explained, this charge is notional (see also *El Ajou* v. *Dollar Land Holdings plc* [1993] 3 All E.R. 717, 737), and is distinct from the charge that the beneficiaries obtain from a court when it orders that certain assets be used to raise a sum of money in their favour: at [83]. The notional charge merely indicates a potential

https://doi.org/10.1017/S0008197305356765 Published online by Cambridge University Press

claim against the asset. This is the analysis for a single-beneficiary trust, but there is no reason why it should not apply where more than one beneficiary from more than one trust is interested in the fund from which the trustee makes the transfer. In such a case, the notional charge arises in favour of *all* those interested in the fund from which the transfer was made. The rights of the various contributors to that fund do not need to be calculated precisely until the beneficiaries make their election at trial.

Where there is more than one contributor to the fund from which the transfer was made, their claims *inter se* are determined using the normal default rule for division of property among rival equitable claimants: if the equities are equal, they share rateably. However, as Campbell J. explained, the equities are not always equal: at [176]–[185]. As a simple example, if one of the contributors was the trustee, his claim must wait until the other innocent contributors' claims have been met (*In re Hallett's Estate* (1880) 13 Ch.D. 696; *In re Oatway* [1903] 2 Ch. 356). More importantly in the present context, where money is withdrawn from a fund comprising contributions from two persons, A and B, and, after that withdrawal, money from a third contributor, C, is then added to the fund, the equities between A, B and C are not equal as regards the resultant fund, and are best reflected using the "rolling charge" solution discussed in *Barlow Clowes* [1992] 4 All E.R. 22, 27, 35. If the equities cannot be calculated with sufficient certainty to allow that sort of analysis, a simple *pari passu* sharing can be adopted.

The supposedly "convenient rule" in *Clayton's Case* (so described in *Hallett's Estate* (1880) 13 Ch.D. 696, 728) is simply redundant here. If there is sufficient information to conduct the analysis required by *Clayton's Case,* there should be sufficient information to perform a rolling charge analysis or, at the very least, a simple *pari passu* sharing. The choice between methods of allocation should depend upon the cost and practicability of applying each one in the circumstances, rather than on the false assumption that *Clayton's Case* has any logic or convenience about it in the context of tracing.

MATTHEW CONAGLEN

DIRECTORIAL DISCLOSURE

WHEN Item Software was seeking to renegotiate an important contract with a client, its duplicitous sales director, Fassihi, sought

https://doi.org/10.1017/S0008197305356765 Published online by Cambridge University Press