Neutral Citation Number: [2023] EWHC 1564 (Ch)

Case No: BL-2022-001940

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
BUSINESS LIST (ChD)

Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: 29 June 2023

Before:

MASTER BRIGHTWELL

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Between:

LAPOME LIMITED	**Claimant**
- and -	
(1) ROSS KEMP	**Defendant**
(2) K CAPITAL LIMITED	

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- -

Aidan Casey KC (instructed by **Nicholas & Co Solicitors**) for the **Claimant**
Stephen Cogley KC and Sanjay Patel (instructed by **RWK Goodman LLP**) for the **Defendants**

Hearing date: 17 March 2023

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Approved Judgment

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Master Brightwell:

1. The defendants apply to strike out this claim of breach of fiduciary duty and knowing receipt on the basis that the open offer of settlement they have made exceeds the maximum sum which the claimant could recover on its claim.

2. The substantive issue raised on the application is whether the law is settled on the question whether a beneficiary under a constructive trust is entitled, as against a wrongdoing fiduciary or recipient of trust property, to trace into property acquired by the trustee from a mixed fund in circumstances where the value of the mixed fund has never fallen below the value of the trust property. The defendants contend that the question is settled by binding authority.

3. The claimant company was incorporated on 20 October 2020 in order to purchase the property at 18 Victoria Park Square, London E2 9PB. It pleads that the first defendant ("Mr Kemp") and his company, Kingsbury Investment and Development Consultants Limited, acted as buyer's agents first for the claimant's directors and then for the claimant in relation to the purchase of the property. The claimant completed the purchase of the property on 22 October 2020 for the sum of £3.7 million, by way of what was described as a sub-sale from the seller's existing contract to purchase it. It is alleged that, in fact, the seller had previously acquired an option to purchase the property for a price of £3.1 million.

4. The claimant's pleaded case is that, in breach of fiduciary duty and in breach of the obligation imposed by section 21 of the Estate Agents Act 1979 (which requires the disclosure by estate agents of personal interests in land with respect to which negotiations are undertaken), Mr Kemp caused the second defendant to obtain a secret profit. He is the sole shareholder of the second defendant. The claimant alleges that Mr Kemp entered into an arrangement with the controller of the seller company (known as Morris Limited), whereby the second defendant would pay £5,000 to the seller and would then share the costs and profits of buying the property and selling it on. It is then said that a reduction in the option price was obtained from the original owner, such that the seller bought the property for £2.9 million. There was thus £800,000 of profit on the onward sale to the claimant, £400,000 of which (less the second defendant's share of the costs of the transaction) was the undisclosed profit realised by the second defendant.

5. The claimant accordingly pleads that the defendants are liable to account for all profits received by the second defendant.

6. I assume for the purposes of the present application that the facts pleaded by the claimant will be proven at trial. The defendants do not dispute that, if they are proven, one or both of them will be required to account to the claimant for the undisclosed profit received by the second defendant.

7. Mr Kemp relies on his witness statement of 30 January 2023, in which he states that after deduction of costs the actual profit made by the second defendant was £322,660. He asserts therefore that the highest amount the claimant could ever hope to achieve from these proceedings would be that sum. Nonetheless, he has made an open offer of £500,000 plus costs, said to be 'in order to make the Offer so attractive that no reasonable director of a claimant company could possibly refuse it'.

8. The claimant has however declined to accept the offer.

9. The issue in this application arises because of the way in which the moneys received by the second defendant were paid over to it and applied. Mr Kemp's evidence is that the sum of £322,660.26 was paid into a National Westminster current account in the name of the second defendant on 19 February 2021. The evidence is that the current account is linked with a business reserve account. Mr Kemp says the following:

> 'The Reserve Account has no ability to make payments to third parties. As the name suggests, it operates solely as a reserve account where interest can be accrued on cash reserves held by K Capital. As and when the balance in the Current Account gets high, we manually transfer funds from the Current Account into the Reserve Account. When funds are needed to make payments to third parties, monies are manually transferred from the Reserve Account back into the Current Account for that purpose. The Current Account and the Reserve Account taken together therefore operate as "one pot" and K Capital has no other banking arrangements.'

10. Heavily redacted copies of bank statements for the current account are exhibited to Mr Kemp's witness statement. These run from 3 August 2020 to 17 January 2023. All of the payors or payees have been redacted, save that the CHAPS transfer in of £332,660.26 on 19 February 2021 is described as "VICTORIA PARK, PCM55CI97260009, MORRIS INVESTMEN , T AND PROPERTY L , CHAPS TFR" [*sic*]. The balance of the current account immediately before this transfer was £51,740.11.

11. The lowest balance on the current account after the transfer was of £2,501.17, on 15 March 2021. Mr Cogley said that the lowest balance on the combined accounts was £1,334,576 on 24 November 2022, which was not contradicted.

12. After 19 February 2021, there were a large number of payments out from the current account, not all being transfers into the reserve account. There was, for instance, a payment out in the sum of £47,500 on 18 March 2021, and a further payment out of £20,851 on 23 March 2021. Before those payments, there were more than 20 others of smaller amounts, many of them in the thousands of pounds.

13. The claimant thus anticipates that the defendants (or either of them) may have acquired assets or investments using monies paid out of the current account, and asserts a right to trace into such property for the purposes of pursuing a proprietary remedy.

The authorities on mixed substitutions

14. It is the defendants' position on the present application that there is binding authority to the effect that, as the value of the monies in the current account and reserve account, when viewed as a single account, never fell below the value of the trust monies wrongfully received by the second defendant, the claimant is not permitted to seek a proprietary remedy against any property bought by the second defendant out of the current account. Accordingly, submits Mr Cogley KC on behalf of the defendants, the claimant is not permitted to "cherry pick" its remedy. It is important to bear in mind that what is in issue for present purposes is the right of the claimant to seek a proprietary remedy through tracing.

15. Two basic propositions about tracing into a mixed fund are uncontroversial:

    i) Where trust monies are mixed with the trustee's own monies, and the trustee spends or dissipates some of that mixed fund, the spent funds are attributed first to the trustee's monies, leaving the trust monies intact: *Re Hallett's Estate* (1880) 13 ChD 696. A trustee for these purposes will include a constructive trustee, being a person who is liable as an accessory for knowingly receiving funds paid in breach of fiduciary duty. The rule in *Re Hallett* is subject to the lowest intermediate balance rule which is that, once the trustee's own funds are fully spent and the trust monies are then reduced by being dissipated by the trustee, they are not reconstituted by further payments into the account by the trustee of its own money. The beneficiary's claim is subsequently limited to the lowest value of the trust monies reached.

    ii) Where mixed trust and personal monies are used to purchase an asset by way of substitution, and the trustee then dissipates what remains, the trustee is deemed to have used trust money to buy the asset: *Re Oatway* [1903] 2 Ch 356. As Joyce J explained in that case, the beneficiary is

> entitled to a charge, or lien, on the property purchased for the amount of the trust money laid out in the purchase or investment. The interest of the trustee is thus subordinated to that of the beneficiary.

16. What is the position, however, if the trustee purchases an asset or investment from the mixed fund, but the value of the mixed fund never falls below the amount of the trust monies originally paid in? That is the position in the present case if the bank accounts are treated as one on the footing that they are linked and withdrawals from the reserve account can be made only into the current account. In other words, as the editors of *Goff and Jones on Unjust Enrichment*, 10th edn, ask at 7-51:

> '[Can] the claimant … "cherry pick" between the rule in *Re Hallett's Estate* and the rule in *Re Oatway*? Suppose that a defendant knowingly mixes £10,000 of his own money with £10,000 of the claimant's money in such a way that the funds lose their separate identities, that he takes £10,000 out of the mixture and uses it to buy a painting that triples in value, but that £10,000 is left. Is the governing authority *Re Hallett's Estate*, deeming the defendant to have kept the claimant's £10,000 intact, or *Re Oatway*, deeming the painting to have been bought with the claimant's money?'

17. In *Shalson v Russo* [2005] Ch 281, one party's tracing claim failed on the grounds that the sums impressed with a trust were either untraceable or had been acquired by a bona fide purchase for value without notice. Rimer J commented on the submission that the party seeking to trace could choose to proceed either against the mixed fund or against an asset bought from it in the following terms. As tracing was in the event not possible, these comments are *obiter*:

> '144 … Normally, it is presumed that if a trustee uses money from a fund in which he has mixed trust money with his own, he uses his own money first: *In re Hallett's Estate*. But Mr Smith submits that this is not an inflexible rule and that if the trustee can be shown to have made an early application of the mixed fund into an investment, the beneficiary is entitled to claim that for himself. He says, and I agree, that this is supported by *In re Oatway*. The justice of this is that, if the beneficiary is not entitled to do this, the wrongdoing trustee may be left with all the cherries and the victim with nothing….'

18. *Turner v Jacob* [2006] EWHC 1317 (Ch) was not a case of a defaulting fiduciary, but where the defendant was beneficially entitled under a resulting trust to part of the proceeds of sale of a property which were paid into a mixed account by the trustee. This mixed fund was then partly transferred to another account and other property sales and purchases were

made from these accounts, as well as other transfers of funds. The defendant sought to trace a sum representing the lowest intermediate balance of £10,339.21 into a particular property, albeit not the first one to have been purchased. Patten J (as he then was) said this, at [102]:

> '102 It seems to me that in a case (such as the present) where the trustee maintains in the account an amount equal to the remaining trust fund, the beneficiary's right to trace is limited to that fund. It is not open to the beneficiary to assert a lien against an investment made using monies out of the mixed account unless the sum expended is of such a size that it must have included trust monies or the balance remaining in the account after the investment is then expended so as to become untraceable. That is not the position here. From May 1995 onwards there was always at least £10,339.21 remaining in the successive deposits and that remained the position even after Clarkfield had been purchased. I take the view that under the rules of tracing, Mrs Jacob's lien remained attached to this fund and not to Clarkfield. If I am wrong about that and one has to assume that the trust monies were invested in property then it must follow that they were used to purchase Merry Acres, which was the first property purchase made using the mixed funds. Either way, the claim to an interest in Clarkfield under a resulting trust is not made out.'

19. It is unclear whether *Shalson v Russo* was cited to Patten J, but the determination at [102] is part of the *ratio*. Mr Cogley accordingly submits that it is binding and is fatal to the claimant's claim to be entitled to more than £332,660.26 on the basis of any tracing claim.

20. Mr Casey KC for the claimant relies on the academic commentaries, which tend to support the view expressed by Rimer J in *Shalson v Russo*, that cherry picking is at least on some occasions permissible. The editors of *Goff and Jones* reach this conclusion in the following way after setting out the key parts of the relevant paragraphs of the two authorities:

> '7-53 The authorities are therefore inconsistent. We believe that Patten J's statement of the principle established by *Re Oatway* is closer than Rimer J's statement to what the case actually decided. However we prefer Rimer J's view of the merits. If the principle that underlies the law in this area is that presumptions should be made against defendants who knowingly create evidential uncertainty by mixing money received from a claimant with their own money, we believe that this principle should extend to giving claimants the right to choose whichever presumption produces the best result for them.'

21. Underhill and Hayton, *The Law of Trusts and Trustees*, 20th edn at 94.28 comes to the same conclusion.

22. Hanbury and Martin, *Modern Equity*, 22nd edn, says at 26-021:

> '26-021 The balance of the money was dissipated in *Re Oatway*. More difficult is the case where property has been purchased from a mixed fund, but where sufficient balance remains to satisfy the beneficiary's claim. The point will be significant where the property purchased has increased in value, or if the balance has been spent on a property which has increased by a smaller amount. *Re Tilley's Will Trusts* [[1967] Ch 1179] suggests that the beneficiaries must be content with a claim to the balance (or the second property, as the case may be)…
>
> The better view, however, is that the beneficiary should be allowed to "cherry pick" if the only contest is between the beneficiary and the wrongdoer. This avoids the wrongdoer being "left with all the cherries". The rule may also be understood as being that the situation is to be interpreted whichever way is less favourable to the trustee.'

23. In reaching that view, the editors rely on the decision of Campbell J in *Re French Caledonia Travel Service Pty Ltd (in liq.)* [2003] NSWSC 1008, who held at [83] that equity would not permit a trustee who has 'wrongfully taken property from a trust fund…to assert that he has unfettered ownership of *any* of the property into which any part of the trust property has been converted or mixed' (emphasis in original).

24. Academic commentary in favour of the right of the beneficiary to cherry pick their remedy at least in some circumstances as envisaged by Rimer J in *Shalson v Russo* can also be found in various other sources:

    i) *Halsbury's Laws of England*, vol 98 at para 697, citing *Foskett v McKeown* [2001] 1 AC 102 at 132: 'As against the wrongdoer and his successors, the beneficiary is entitled to locate his contribution in any part of the mixture and to subordinate their claims to share in the mixture until his own contribution has been satisfied' (Lord Millett), which was not considered in *Turner v Jacob*.

    ii) *The Law of Personal Property*, 3rd edn at 32-047, suggests (contrary to *Goff and Jones*) that, on proper analysis of *Re Oatway* at 361, Rimer J's approach is preferable both as a matter of policy and of authority. This is because Joyce J said in *Re Oatway* that the trustee could not take any asset bought with trust money freed from the beneficiary's charge until the trust fund had been reinstated in the name of the proper trustees, which was never done.

    iii) Smith, *The Law of Tracing*, 1997, expressed a similar view at pp.199-200, before *Shalson v Russo* or *Turner v Jacob* had been decided.

25. I should also mention *Lewin on Trusts* (of which I am a co-author), because it is the textbook which is the most sceptical about the breadth of the proposition for which the claimant contends, and Mr Casey brought it to the court's attention. In the 20th edn, at 44-083, the text says this:

> '44-083 It is clear that the [cherry-picking] solution would be adopted if that accorded with an intention on the part of the trustee or other wrongdoer to apply trust money to the maximum extent possible in the acquisition of the asset which proved to be profitable. But, apart from cases of that kind, we have reservations whether the principle of subordination can be carried so far as to allow the [cherry-picking] solution to be adopted for the purpose of maximising the beneficiary's share of what turns out to be the most profitable asset, even when the claim is against a trustee who has misappropriated trust money. It is one thing to say that the trustee cannot be heard to maintain that money which he has withdrawn and spent for his own benefit should be attributed to the trust money paid into the account if it can be attributed to his own money, another to say that the beneficiary can locate the trust money in the most profitable investment to the maximum extent possible. In the context of a claim to a lien, the principle of subordination never affects the amount which is secured by the lien, and it is irrelevant to determine the extent of the share of the beneficiary in any assets bought from the mixed bank account. What the principle of subordination does is to enable the beneficiary to locate the trust money in all or anything that survives from the trustee's wrongdoing in mixing trust money with his own. Though the beneficiary can take the whole of the benefit of profits made from assets bought out of the mixed bank account so far as they fall within the amount secured by the lien, the beneficiary never makes a profit out of the principle of subordination if he claims a lien, because the amount of recovery is necessarily limited to the amount secured by the lien. Yet, while we have reservations on the point, the law on the tracing rules applicable to the quantification of the beneficiary's proportionate share in assets bought from the mixed account has still to be fully developed. The court may be persuaded to extend the principle of subordination so as to allow the beneficiary to maximise his share in the most profitable investment at the expense of a trustee who has misappropriated trust money for his own benefit or the benefit of another and then mixed it with his own. There is some authority which suggests that the principle of subordination may be extended in this way as against a trustee who misappropriates trust money.'

26. The authority referred to in the final sentence is *Southern Cross Property Ltd v Martin* 1991 SLT 83, and *Shalson v Russo*. The point is also made that Lord Millett's observations in *Foskett v McKeown* (relied on in *The*

Law of Personal Property) were in the context of a claim to a lien, and not of any discussion of the right to cherry pick when quantifying the value of the beneficiary's assets upon tracing through a mixed fund.

27. The final relevant authority, consideration of which took up a significant part of the hearing, is the recent decision of Calver J in *ED & F Man Capital Markets Ltd v Come Harvest Holdings Ltd* [2022] EWHC 229 (Comm). In that case, the claimant company (MCM) was entitled to rescind various repo contracts, thus constituting the defendant contracting parties as constructive trustees of property in their hands (see at [619]). The question of principle arose whether the traceable proceeds of property received by the relevant defendants into a mixed fund and which had been paid on to third parties could now be traced by MCM in such a way (as it submitted) 'to choose a rule that (it believes) will favour its ultimate prospects of recovery' (see at [670]). The question, accordingly, was (unlike the present case) not whether MCM could trace into property still held by the relevant defendants. The claimant put forward two proposed methods of tracing, one presuming that payments made out the mixed account were made first from the constructive trustee's own funds, and one matching such payments first to payments to a particular third party.

28. Another key distinction between the *ED & F Man Capital Markets* case and the present is that the dispute was not merely between the defalcating constructive trustee and the innocent beneficiary. Calver J determined the issue as between the claimant (beneficiary) and a third-party recipient (Straits), albeit one who was not treated as a bona fide purchaser without notice. He accepted the following submissions (see at [671] to [678]):

i) The relevant authorities were not those where payments were applied by the wrongdoing trustee in making an investment. It is those authorities which the claimant in the present case contends are relevant.

ii) The *ratio* of *Re Oatway* extends only to the case where the investment remains in the control of the trustee and not to the case where payments have been made to a third party.

iii) The comments of Rimer J in *Shalson v Russo* were *obiter*, whereas the statement in *Turner v Jacob* that the beneficiary's right to trace is limited to the mixed fund when the trustee maintains in that fund an amount equal to the remaining trust fund is part of the *ratio*.

29. Accordingly, at [680] to [684], on this issue Calver J concluded that:

> '680 ….I agree with Straits that the claimant cannot treat the mere transfer to another party as a *successful investment* and that the logic of

this approach would allow the claimant to cherry pick arbitrarily every single payment out of a mixed account, in disregard of other presumptions. That cannot be right.

681 During the relevant time period there were many payments out of the trust fund *to multiple third parties*. MCM is only entitled to follow monies into the hands of third-party recipients who are not bona fide purchasers. The status of a number of third parties who received funds is uncertain; but it is clear that Mr Kao was not a bona fide recipient of funds and, moreover, the bona fides of Success Sea and Genesis Rover are also seriously in doubt (see further below).

682 Consequently, to endorse the presumption advanced by MCM, the Court would need to find not only that Straits' rights are subordinated to those of MCM as an innocent beneficiary *but also to those of other non-bona fide recipients*.

683 The effect of the presumption [favoured by MCM] is arbitrarily to penalise Straits vis-à-vis the other non bona fide recipients of funds. On MCM's case, Straits is made liable for *all transfers to it* while other non bona fide recipients incur no liability (at least with respect to MCM's equitable proprietary claims).

684 In my judgment, a claimant is not entitled to elect between bringing proprietary claims against different third-party recipients in such an arbitrary manner. To allow MCM a discretion to act in such an arbitrary way appears to have more to do with the fact that Straits was the only solvent defendant to attend trial rather than an equitable exercise of property rights on MCM's part. In short, MCM's submissions and evidence do not justify the approach taken [by MCM].' (all emphases in original)

30. Calver J considered that Patten J's comments about cherry picking were part of the *ratio* in *Turner v Jacob*, but the application of those comments to a case involving a contest such as this between a wrongdoing trustee and an innocent beneficiary was not what was being considered in the *ED & F Man Capital Markets* case. To the extent that policy considerations were taken into account, they were as to why the subordination principle should not entitle a beneficiary to cherry pick as between different recipients, thus leaving one liable to meet equitable proprietary claims, and others free of any such claims. This issue does not arise on the present application (although it might conceivably arise once disclosure has been given).

Discussion

31. It is well established that the court should be reluctant to exercise its power to strike out or to give summary judgment on a controversial question in a developing area of the law, as it is desirable that any further development of the law should be on the basis of actual and not hypothetical facts: see e.g. *Altimo Holdings and Investment Ltd v Kyrgyz Mobil Tel Ltd* [2012] 1 WLR 1804 at [84] (Lord Collins of Mapesbury JSC).

32. It is plain from the discussion above that the academic commentators in the field do not consider the relevant question to be settled. A judge of first instance will usually follow the decision of another judge of first instance unless convinced that the first judgment was wrong. The question for me is whether a High Court Judge hearing the trial of the present claim will necessarily be bound by the comments of Patten J in *Turner v Jacob*, or is it realistically possible that a different view might be taken. It is very relevant that Patten J appears not to have been asked to consider the comments of Rimer J in *Shalson v Russo* or the effect of Lord Millett's comments in *Foskett v McKeown* (as set out in *The Law of Personal Property*, see above), together with the fact that the clearly predominant view of the academic commentators is that the statement of Rimer J in *Shalson v Russo* is to be preferred in principle. Further, I do not consider that the fact that the recipient in this case, the second defendant, was not itself a fiduciary and that there was no trust property before the wrongful receipt was impressed with a constructive trust means that these points are not open for consideration on the facts of this case.

33. The evidence in the present case is incomplete and has, in any event, not been tested. There has been no disclosure of what the payments out of the second defendant's current account in the period after the relevant receipt were for or to whom they were made. On the basis of the defendants' position that the two bank accounts should be treated as one, the combined balance of the two accounts has remained above the initial receipt of trust monies, meaning there is no scope for the application of the lowest intermediate balance rule to limit the value of the trust monies which could thereafter arguably be traced into acquired assets (which could work to the defendants' benefit, given that the balance on the current account reduced to £2,501.17 on 15 March 2021).

34. As Mr Casey submits, large round-sum withdrawals may be consistent with investments and not with other forms of dissipation. It seems to me likely that if cherry picking is allowed, there may be some temporal limit on it, Rimer J having indicated that "early" investments may be traced, and Patten J having said that even if he was wrong on cherry picking, tracing would have been possible only into the first property acquired by the

trustee. It is also not without significance that Patten J expressly contemplated the possibility that the right to trace would in fact lie into a property other than that into which the claimant in that case sought to trace. There is an argument that all that was necessarily decided by *Turner v Jacob* is that an innocent beneficiary cannot trace into a property other than the first acquired from a mixed fund.

35. I consider that in the absence of any disclosure by the defendants of where the monies went, I must assume that it is at least possible that some of the monies from the mixed current account were used to purchase assets or acquire investments. It would have been open to the defendants to adduce evidence on this application showing that the sums withdrawn from the current account had all been dissipated, but they have not done so.

36. For these reasons, I have come to the conclusion that the controversial question of the extent to which a tracing beneficiary can cherry pick as against a wrongdoing trustee should be determined on the basis of the facts as found at trial, and not on the basis of the limited evidence currently before the court. I will accordingly dismiss the application.

37. I would not go so far as to say that the claimant has the better of the arguments, as Mr Casey submits. There are strong arguments that the right to cherry pick should not be unfettered, even if it extends to a case such as the present. On the other hand, Mr Cogley resorts to hyperbole when he submits that such a claim by the claimant faces "millions of hurdles". The arguments either way, both in principle and on authority, are on analysis readily identifiable.

Other points

38. Given my decision above, I will mention the other points raised on the application only briefly.

39. Mr Cogley argued that the claim was an abuse of process because the claimant was pursuing it for the improper and collateral purpose of putting pressure on the defendants in relation to other proceedings which are pursued by Mr Kemp's former joint venture partners in other proceedings in this court, against the defendants and against other parties. It is alleged that the claimants in the two claims are working in tandem, albeit through different solicitors, to put pressure on the defendants in the context of the other (larger) claim. The particulars of claim in those proceedings are in the bundle, but I was not asked to read them.

40. I do not consider that I am in any position to assess the allegation that the present proceedings are pursued for an improper motive. There is certainly

nothing in the claimant's conduct of this claim which is asserted to be improper. The court has no way of assessing the subjective motives of the claimant other than to consider the application on its merits, as I have done above. It would not be an appropriate exercise for me to consider the remedies sought by other parties in the other proceedings and to extrapolate from that that the claimant in the present claim is, essentially, not acting in good faith. I cannot find that the other proceedings are misconceived, as Mr Cogley submitted they are. If they are, then the appropriate course is for the defendants in that claim to bring an application within them and not in the present claim.

41. Mr Casey also relied on other arguments in response to the application, in case I was against him on the cherry-picking point. He submitted that a consensual payment would be precarious because of competing proprietary claims, and also that such a payment would be at risk in the event of the insolvency of either of the defendants. It would be possible, subject to disclosure in order to verify what profit the second defendant received, for an order to be made by consent that the claimant has a lien on the second defendant's bank accounts. The effect of such a lien on third parties may arise in any event. Furthermore, if cherry picking were clearly not permissible, there would be no need for a trial to determine the bounds of any tracing exercise. I have therefore not taken these arguments into account in reaching my decision.