The future after *Durant*: is backwards tracing the way forward?

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**Introduction**

In the seminal case of *Foskett v McKeown and Others*¹ (‘*Foskett*’) Lord Millet clearly explained that tracing is ‘neither a claim nor remedy. It is merely the process by which a claimant demonstrates what has happened to his property, identifies its proceeds and the persons who have handled or received them, and justifies his claim that the proceeds can properly be regarded as representing his property’. The rules governing the tracing process are more generous to claimants in equity than at law (for example, allowing tracing through a mixed fund). However, the fundamental principles are the same in either case: tracing is simply the process by which trust assets or their exchange products are identified following transactions.

It is for this reason that the possibility of backwards tracing has traditionally been rejected by the English courts. Also sometimes referred to as ‘tracing into the payment of a debt’, backwards tracing would allow the process of tracing to occur in the situation where an asset has been acquired in exchange for the creation of a debt and, subsequently, misappropriated trust assets are used to discharge that debt. Hence, it differs from traditional tracing which operates only where there is a substitute asset which has been legally acquired using the trust assets; in backwards tracing cases, the asset being traced has already been acquired before the trust assets are used. In the case of *Bishopsgate Investment v Homan*,² Leggatt LJ clearly sets out that ‘there can ordinarily be no tracing into an asset which is already in the hands of the defaulting trustee when misappropriation occurs’ because that asset ‘existed and so had been acquired before the money was received and therefore without its aid’. Although this statement was *obiter* and made without express agreement from the other members of the Court of Appeal, it reflects the typically unenthusiastic response of the English courts to the possibility of such backwards tracing.

However, since *Foskett* definitively clarified the identificatory purpose of tracing, the status of the doctrine of backwards tracing in English law has been unsettled. Despite receiving judicial endorsement in *obiter* in several cases,³ it is yet to be formally recognized as permissible in English law. The main reason for this uncertainty is that there has not yet been an English case directly addressing this issue.

However, the recent Privy Council decision *The Federal Republic of Brazil v Durant International Corporation*⁴ (‘*Durant International*’), on appeal from Jersey, did deal squarely with the subject of backwards tracing. The case involved a series of payments, which the Royal Court of Jersey found represented bribes, made through three different bank accounts. The dispute concerned the quantum of liability of Durant and Kildare as constructive trustees of the bribe money; the appellant companies appealed on the basis that their liability should be USD$7.7m, rather than USD$10.5m.

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⁴ [2015] UKPC 35.

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Their argument relied on both the ‘no backwards tracing’ doctrine and the ‘lowest intermediate balance’ doctrine. It is the former submission which is pertinent for present purposes, although the two doctrines are inter-related.

The specific facts of the case are crucial. The full sum of the bribe proceeds, USD$10.5m, was paid in instalments into the first account, i.e. the ‘Chanani account’. Before the USD$10.5m had been fully paid into the Chanani account, six payments totalling USD$13.1m were transferred from the Chanani account into a second account, i.e. the ‘Durant account’. Lastly, there were four payments of USD$13.5m from the Durant account to the third and final account, i.e. the ‘Kildare account’.

The respondents argued that the full USD$10.5m sum could be traced through to the Kildare account. However, the appellants pointed out that three of the payments into the Chanani account were made only after the sixth payment had already been made to the Durant account. Thus, there could be no tracing of those three payments into the Durant account because the chronology meant that they could not be regarded as substitute assets for the original bribe payments into the first Chanani account which had not yet been made. Accordingly, only the USD$7.7m which had been transferred in the correct order should be traceable.

Despite explicitly acknowledging that ‘conceptually the appellants’ argument is coherent and it is supported by a good deal of authority’, this reasoning was not accepted and the appeal was accordingly dismissed. Contrary to traditional English authority, Lord Toulson, on behalf of the Privy Council, ‘reject[ed] the argument that there can never be backward tracing’ and proposed a test based on ‘coordination between the depletion of the trust fund and the acquisition of the asset which is the subject of the tracing claim’ to determine when it should be permitted.

The first part of this essay argues that Durant International was rightly decided to the extent that the law of tracing should be expanded to allow backwards tracing, albeit only in some, well-defined situations. This is because:

a. This position is consistent with the equitable principles of tracing, as described by the majority of the House of Lords in Foskett;

b. It is desirable from a policy perspective because:
   i. It is necessary to combat complicated financial fraud;
   ii. It would better serve justice to trust beneficiaries; and
   iii. It would not unduly prejudice unsecured creditors.

c. It is accepted that the current rigid, chronological approach to tracing provides legal certainty. However, it does not do justice to the parties and results in some arbitrary distinctions. Therefore, on balance, a more nuanced, purposive solution, which allows for backwards tracing in some circumstances, should be preferred.

However, the case of Durant International does not satisfactorily or fully illuminate the law on backwards tracing because the test propounded by Lord Toulson is too vague and imbues judges with too great a degree of discretion. The test requires structure and its boundaries more precise clarification. On the other hand, on one interpretation, the test may limit too greatly the circumstances in which backwards tracing can operate.

In light of this conclusion, the second part of this essay considers a range of different, more specific tests to determine when the process of tracing should be allowed to operate backwards. The conclusion of this discussion is that a test founded on the intention of the party acquiring the relevant

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5 Durant International (n 4) [18].
6 ibid [40].
asset, as suggested by Sir Richard Scott in the Court of Appeal in *Foskett v McKeown* is the preferable approach because:

a. Intention provides a solid and ascertainable link between the relevant transactions;
b. The courts are experienced at applying tests of intention;
c. Such a test is structured and so does not rely on unbounded judicial discretion; and
d. It is consistent with the flexible, commonsense approach applied to tracing in *Foskett*.

### 1. Should backwards tracing be recognized?

#### A. As a matter of principle: substance over form

In order to maintain coherence and consistency in this area of the law, any legitimate expansion of the current scope of the tracing process, including the recognition of backwards tracing as valid, should be consistent with the accepted principles of tracing. The most recent and authoritative elucidation of these principles is provided by the House of Lords in the seminal case of *Foskett*, the facts of which are well-known and so do not bear repeating here.

Lord Millet, with whom the majority agree, makes it very clear that what is traced ‘is not the physical asset itself but the value inherent in it’. Furthermore, whether tracing can or cannot occur is a question of 'attribution not causation'. Thus, by favouring a flexible approach over a strict, chronological approach and stressing transactional links, Lord Millet leaves scope for backwards tracing. Professor Graham Virgo is a proponent of this view: he points out that ‘if tracing is not concerned with causation as such, in the sense that but-for the receipt of the claimant's property, the substitute asset would not have been obtained, but is concerned with attribution of value, it is surely possible to attribute value from the original asset to the substitute asset if the claimant's money has been used to discharge a debt incurred in respect of the substitute asset’.

This discussion of debt discharge can be exemplified by the *Durant* case: not all of the money transferred from the Chanani account into the Durant account could be, strictly speaking, regarded as the bribe proceeds because not all of the bribe proceeds had yet been transferred into the Chanani account and it is trite law that *nemo dat quod non habet*, i.e. nobody can give what they do not have. Thus, when the rest of the bribe money did subsequently come into the Chanani account, rather than being transferred to the Durant account, it simply filled the gap left by the payment which had already been made; it effectively paid off a debt.

Virgo’s argument is that, by abandoning causation as the justifying concept, it is not necessarily fatal to the process of tracing that the payments in *Durant* were made in the wrong order or, as another example, title to an asset passed before trust money was used to discharge the debt incurred.

In the opposite camp is Professor Matthew Conaglen. He initially relies on the idea that tracing is a process whereby assets are identified and that the discharge of a debt ‘is not the same thing as the acquisition of an asset’. Therefore, it does not make sense to talk about ‘tracing into a debt’ for the purposes of backwards tracing.

However, this misses the point of the attribution model, which tracks the value of the asset. In the case of a discharge of a debt that has been incurred in the acquisition of an asset, this value is the amount of the debt, which can then be traced into the asset (the purchase of which incurred that debt).

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7 [1998] Ch 265, 284.
8 *Foskett* (n 1) 128.
9 ibid 138.
12 ibid 447.
as if it had been the purchase price. Conaglen does not accept this rationalization because he does not consider that there is ‘a substitution of one asset for another asset (…) where one seeks to trace money (or other valuable property) into the repayment of a debt’.\(^{13}\) However, this is because he has taken too narrow a view of the concept of substitution. In these backwards tracing cases, there is indeed a form of indirect substitution because when the debt is incurred to acquire title to the asset and the trust money is then used to discharge that debt, the end situation is the same as if that money had been used to acquire the asset in the first place. In other words, as Professor Lionel Smith puts it, the payment to discharge the debt is essentially ‘delayed payment’\(^{14}\) for the asset. This is what is often referred to as a ‘substance over form’ approach.

In fact, later on in his article, Conaglen appears to accept the possibility of such indirect substitution, saying that ‘when the trustee uses trust funds to pay the debt, the beneficiaries’ money has been used to pay the price of the asset’ although ‘only in a loose sense’ because ‘in return for the asset, the vendor accepted the debtor’s obligation to pay the debt’,\(^{15}\) not the beneficiaries’ trust money. This concession suggests that Conaglen’s position is not in reality very far removed from that expressed by Smith, Virgo, and this essay.

In *Durant International* itself, the Privy Council seems to accept that the appellants’ argument that ‘a property interest cannot turn into (or provide a substitute for) something which the holder already has; the later acquisition cannot be the source of the earlier’\(^{16}\) is coherent and supported by authority. Nevertheless, the court ultimately rejects it, and embraces the possibility of backwards tracing, which implies that they do recognize some form of substitution, even where title has already passed. However, there is no in-depth discussion of this conceptual point, and Lord Toulson seems satisfied to treat Conaglen’s acceptance ‘that there is nothing conceptually impossible’\(^{17}\) about backwards tracing as conclusive of the matter. The case therefore does not provide much insight on the present question of whether backwards tracing fits within the general conceptual framework of tracing.

Conaglen concludes that the adoption of backwards tracing ‘by the courts would mark a significant departure from, or addition to, the traditional principles of the law of tracing’.\(^{18}\) Whereas I agree that it was a significant step for the Privy Council to recognize backwards tracing (if only because there was no real prior authority for it), it was not a dramatic departure from the principles of tracing, as presented in *Foskett*, because, as demonstrated above, backwards tracing fits quite neatly within the flexible, attribution model.

On a slightly different note, Professor Andrew Burrows,\(^{19}\) in a passage quoted by the Privy Council in *Durant International*, argued that “backwards tracing” must be accepted if one is to explain tracing into and through “in credit” bank accounts, in light of the common banking practice of crediting accounts before the relevant transferred funds are actually received. In other words, he explains ‘the debt owed by the bank to the customer, which is treated as a substitute for the funds, exists in advance of the funds being received’. Thus, English law should recognize backwards tracing, not merely because it is conceptually sound or normatively desirable, but because it already regularly occurs. It is perhaps too wide a proposition to say that this provides a convincing basis on which to accept backwards tracing in all, or even a wide range of, circumstances; after all, the particular fact pattern, relating to online banking, is very specific and depends to a certain degree on the technology involved. However, Burrows’ bank account example does serve to illustrate that the courts are willing

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\(^{13}\) Conaglen (n 11) 448.

\(^{14}\) Lionel Smith, *Tracing into the Payment of a Debt* (1995) 54 CLJ 290, 292.

\(^{15}\) Conaglen (n 11) 450.

\(^{16}\) *Durant International* (n 4) [17].

\(^{17}\) Conaglen (n 11) 455.

\(^{18}\) Conaglen (n 11) 449.

to depart from a strictly chronological approach where to do otherwise would run contrary to reality and produce absurd results. This further backs up my conclusion that recognizing backwards tracing is not a giant leap for the courts to take, but a small sensible step in the right direction.

B. As a matter of policy: fighting fraudsters and striking a balance

It has been demonstrated that English law on tracing would not have to significantly readjust in order to accommodate backwards tracing. However, this alone is not sufficient reason to recognize backwards tracing; as Conaglen rightly notes,\(^{20}\) it must also be beneficial as a matter of policy. The two most pressing policy arguments relate to the fight against large scale financial crimes and ensuring a fair balance between the position of trust beneficiaries and the unsecured creditors of the trustee(s).

I. Combating financial crimes

In *Durant International*, the decisive argument in favour of permitting backwards tracing was that it is necessary in order to prevent criminals benefitting from complex financial transactions designed for the specific purpose of circumventing the law on tracing. As the Royal Court of Jersey pointed out, ‘otherwise any sophisticated fraudster would be able to defeat an otherwise effective tracing claim simply by manipulating the sequence in which credits and debits were made to his account’.\(^{21}\) Accordingly, a strict, chronological approach to tracing is highly undesirable, especially in the context of modern day commerce, which allows for not only much more sophisticated and complex transactions, but also much more complex and hard-to-detect crime. This was highlighted by Lord Toulson in *Durant International*: ‘the development of increasingly sophisticated and elaborate methods of money laundering, often involving a web of credits and debits between intermediaries, makes it particularly important that a court should not allow a camouflage of interconnected transactions to obscure its vision of their true overall purpose and effect’.\(^{22}\) This view is clearly right and perfectly consistent with the substance over form approach taken to tracing in *Foskett*.

However, this objective is only relevant in cases involving complicated financial transactions, as were present on the facts of *Durant International*. It does not apply to the more basic examples of backwards tracing, such as where a debt is incurred by the purchase of a car, which is then paid off with trust assets, because this could widen the scope of tracing too far and result in tracing even where the link between the two transactions is very weak. Thus, although strong in this particular context, this argument only supports backwards tracing in the limited situations involving the risk of financial crime.

II. Fair balance between beneficiaries and creditors

A more far-reaching concern relates to the impact of recognizing backwards tracing on the parties involved. Conaglen\(^{23}\) particularly emphasizes that it would be to the detriment of unsecured creditors in the event of insolvency because it would effectively reduce the pool of the trust assets available to them (as beneficiaries would be able to carry out more far-reaching claims). This is undoubtedly true. However, it is not a very strong objection to recognizing backwards tracing; there are several possible counter-arguments

Firstly, not all situations in which backwards tracing could conceivably apply involve unsecured creditors. Often, as in *Durant International* itself, there is no risk of insolvency and therefore it is difficult to use the detriment argument to justify a bar on backwards tracing in those cases. However, Conaglen is right to point out that ‘one of the primary reasons for trust beneficiaries wanting to be

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\(^{20}\) Conaglen (n 11) 446: ‘a question of legal policy rather than principle’.

\(^{21}\) *Durant International* (n 4) [13].

\(^{22}\) Ibid [38].

\(^{23}\) Conaglen (n 11) 445.
able to trace backwards is in order to improve their recovery rate in the event of the trustee being made bankrupt because that is when a secured proprietary claim becomes most useful.

A second, more convincing argument, is that the majority of unsecured creditors are voluntarily unsecured; they may, for example, have turned down the opportunity to obtain security in exchange for a better price. As Smith explains such creditors could have taken security interests, which most commentators agree would give them priority over any tracing claim. If they did not, then they were exposed to the risk of tracing claims, like all unsecured creditors. This principle applies equally in the rare situations where the unsecured creditor gave the loan between the trustee’s acquisition of the asset and the use of trust assets to pay off the debt used to acquire it (i.e. when it was impossible for the creditor to know that a proprietary right, able to trump their personal right, would later arise in favour of the beneficiaries). Moreover, ‘there is no reliable way to determine whether an asset is subject to a tracing claim anyway, regardless of whether the process is operating backwards or forwards. Therefore, the creditor is unlikely to know about the beneficiaries’ proprietary interest in any circumstances.

This concern for unsecured creditors, however, was taken seriously by the Royal Court of Jersey in Durant International. The Privy Council reported them as holding that ‘at least where the account remained in credit during the relevant period, so there was no question of possible insolvency and prejudice to unsecured creditors, and where there was no suggestion of an intervening bona fide purchaser for value, the question should be whether there was sufficient evidence to establish a clear link between credits and debits to an account’. Thus, consideration of the position of other parties was incorporated into their proposed ‘clear link’ test for backwards tracing.

Similarly, the Privy Council in Durant International, acknowledged that ‘the courts should be very cautious before expanding equitable proprietary remedies in a way which may have an adverse effect on other innocent parties’ and, more specifically, that ‘if a trustee on the verge of bankruptcy uses trust funds to pay off an unsecured creditor to whom he is personally indebted, in the absence of special circumstances it is hard to see why the beneficiaries’ claim should take precedence over those of the general body of unsecured creditors’. Lord Toulson nevertheless decided that backwards tracing should, in principle, be permissible. This conclusion is difficult to reconcile with his concern for the unsecured creditors of trustees, making his position appear untenable. It would, for example, be incoherent to find by the process of backwards tracing that value from the trust fund had been attributed to a certain asset, prima facie giving the trust beneficiaries a proprietary stake in it, but then prevent them from taking the benefit of that security in order to protect unsecured creditors. Either the beneficiaries have a proprietary claim, in which case they gain priority over unsecured creditors, or they do not, in which case they do not. After all, we are dealing with ‘hard-nosed property rights’. And if it is justifiable for beneficiaries to have priority over unsecured creditors in the context of conventional tracing, it is not clear why a different approach should be taken to backwards tracing: the detriment to the creditors is the same in both cases.

However, this was all that was said on the topic and Lord Toulson did not explain how his policy concerns relate to his test of coordination. Moreover, he did not engage with any of the counter arguments raised above. Therefore, this aspect of his judgement in Durant carries little persuasive weight and no firm conclusions can be drawn from it.

24 Conaglen (n 11) 451.
25 Smith (n 14) 304.
26 Smith (n 14) 304.
27 Durant International (n 4) [13].
28 ibid [33].
29 Foskett (n 1) (Lord Browne-Wilkinson) 109.
Having said this, admittedly, it is inevitable that if English law were to expand the territory in which proprietary claims can operate, this would sometimes reduce the area in which unsecured creditors can operate. Secondly, this objection that unsecured creditors could be prejudiced carries more weight in the context of backwards tracing than conventional tracing because the law is currently unsettled in this area; for the notion to be officially recognized it would effectively entail a change in the law. This is problematic because many creditors would have entered into arrangements and perhaps declined security, on the presumption that backwards tracing is not possible. It could be regarded as unfair if these creditors subsequently missed out on the entitlements they expected due to a retrospective change in the law.

My response to this argument is simply that this trade-off is necessary because justice nevertheless requires that beneficiaries are able to trace backwards in certain circumstances. This is because, for all intents and purposes, it is their money (or other assets) which has been used to acquire the asset in question, albeit indirectly. It is unfair to allow the strict order in which the wrongdoing trustee chose to act to destroy their otherwise sound proprietary claim. By maintaining formalistic, chronological tracing rules, there continues to be arbitrary distinctions relating to the availability of a proprietary remedy, depending only on the particular way the trustee misuses the trust assets. In order to do justice to those parties who have truly been wronged, i.e. the trust beneficiaries, this situation needs to be rectified by the recognition of backwards tracing – even if this would put some unsecured creditors at a greater disadvantage. To address the specific difficulty raised in the previous paragraph, relating to creditors who acted on the basis that backwards tracing does not operate, the courts could potentially invoke the Re Spectrum Plus power of prospective common law ruling in appropriate cases in order to preserve their pre-existing rights.

In conclusion, contrary to Conaglen’s argument, backwards tracing does not significantly unduly prejudice unsecured creditors, the majority of whom are voluntarily unsecured and therefore run the risk of being displaced in a priority contest on the debtor's insolvency. Moreover, they are not in a radically different position in the context of backwards tracing than they are under conventional tracing rules; any distinction would be illogical and arbitrary because the beneficiaries would have a proprietary claim in both cases. Thirdly, any undue detriment to unsecured creditors, such as where the link between the original debt acquisition and the subsequent use of trust money is very remote, could be prevented by limiting the availability of the backwards tracing process to when certain conditions are met or particular facts exist. Finally, it is accepted that there would inevitably be some negative impact on some creditors if backwards tracing were permitted; however, it is justified in the overall interests of justice and legal coherence.

2. Test for backwards tracing

Having concluded that there should be no absolute bar against recognizing backwards tracing in English law, the next key question to consider is when, and to what extent, backwards tracing should be recognized. It is clear from the preceding discussion that there must be some boundaries on the allowable limits of backwards tracing (for example, to prevent undue prejudice to unsecured creditors where the transactional link is very weak). However, how the test for backwards tracing is conceived depends on what we wish to achieve. In my view, an optimal test would be one which effectively addresses the specific problems identified above, the existence of which justify the expansion of the tracing doctrine in the first place. Furthermore, it should be as certain, clear and easy to apply to the facts of any given case as possible.

The following are a series of different possible tests for determining when backwards tracing is permissible. It is by no means an exhaustive list, but serves to provide a flavour of the different options open to the court, should they decide to recognize the possibility of backwards tracing.

31See Section 2, below, for discussion on this.
A. Coordination between depletion of the trust fund and acquisition of the relevant asset

A good place to start is with the test proposed by Lord Toulson in *Durant International*. He states that ‘the claimant has to establish a coordination between the depletion of the trust fund and the acquisition of the asset which is the subject of the tracing claim, looking at the whole transaction, such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund’.

On first reading, this test is logical, flexible and serves to prevent the circumvention of tracing rules by sophisticated money laundering schemes. However, in reality, it is an unhelpful test which essentially imbuces judges with an extremely broad discretion to decide the matter in any given case. The problem with Lord Toulson’s formulation is that it does not give any principled guidance to the court as to the circumstances where such a ‘coordination’ will be found to exist; there are clearly cases, such as Burrows’ bank account example above, and the case of *Durant International* itself, where the coordination between the transactions is self-evident. On the other hand, there are likely to also be many cases on the margin, where the ‘coordination’ is less obvious and such a vague test will not help to solve them. For example, it could be said that there is some degree of coordination in any circumstances where misappropriated trust funds are used to pay off a debt which arose on the acquisition of an asset. The statement that the coordination must be ‘such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund’ does not provide any solid way of drawing the boundary line.

There is an argument that a wide discretion might initially be necessary to allow the courts some time to flesh out the specific details of the test. However, this does not appear to be what Lord Toulson intended to do in the case. Moreover, such an approach would likely result in inconsistencies and conflicting later judgments in which ‘coordination’ is interpreted in different ways. In order to best minimise any legal uncertainty caused by recognizing backwards tracing, the test should have a clear structure and realm of application from the very beginning.

On the other hand, reading Lord Toulson’s test in conjunction with his comments earlier in the judgement, it becomes apparent that it may actually be too narrow in its scope. For example, as noted above, he stresses the importance of dealing with large scale financial crime and makes specific reference to ‘the various steps’ in a ‘coordinated scheme’. Read in this context, it may be that he meant ‘coordination’ in his formulation of the test to refer only to coordinated financial schemes, not any form of coordination in the sense of merely closely related transactions. Thus, the objectives of achieving justice for trust beneficiaries whose assets have been used to discharge debts incurred in acquiring other assets and removing arbitrary distinctions from the law of tracing are not well-met by this test. On this view, perhaps Lord Toulson’s great leap forward was more of a small step after all.

Whether the latter interpretation is correct or not, Lord Toulson’s test is still in need of refinement in order to clarify when backwards tracing is available, if not complete reformulation. Hopefully, this will be provided by the courts in time, fleshing out and building on Lord Toulson’s somewhat tentative judgment rather than ignoring it.

B. Temporal test

One possible interpretation of the ‘coordination’ requirement from *Durant International* is that it refers to some sort of temporal coordination. The court could presume that where transactions occur within a very short space of time of one another, they are sufficiently linked to allow for backwards tracing, regardless of the strict order in which they take place. The burden would then shift on the defendant to demonstrate that, despite the close time connection, there was no such coordination as to warrant tracing. This model explains why Burrows’ bank account example works: the credit to the

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32 *Durant International* (n 4) [40].
33 ibid.
account and the payment in occur almost contemporaneously and it is this fact which justifies allowing tracing into the account even when the payment into the account came after the account was credited. Once the court had decided on the timeframe triggering this presumption, it would become straightforward to apply and the law would be fairly certain.

However, this is nevertheless an unsatisfactory approach, for several reasons. Firstly, it has the potential to be highly arbitrary. There is no simple answer as to where the line should be drawn: transactions which occur on the same day? Within the same week? On the facts of Durant International, there was found to be coordination between the payments into the Chanani account which occurred between the 26th January and the 6th February, and the payments from the Chanani account to the Durant account between the 14th and 23rd January. Therefore, clearly some time can elapse between transactions without severing the connection. How much time exactly, however, is a question which invites no easy answer.

One potential solution is that the appropriate timeframe be determined with reference to the context of the case thus allowing for flexibility to deal with different possible fact-patterns. However, this sort of nuanced solution would take significant time to properly work out and its flexibility would come at the expense of simplicity and certainty.

On the other hand, a rigid, temporal approach based on the close proximity of transactions, is unattractive because it fails to take account of the various other ways by which transactions may be connected, for example, to the intentions of the parties involved. It is therefore poorly equipped to deal with the problem of fraudulent schemes that the Privy Council was so concerned about in Durant International. It therefore seems clear that Lord Toulson could not have been referring to merely temporal coordination, and rightly so.

C. Fraudulent exception

As explained above, in Durant International, the primary, and perhaps decisive, policy consideration was the need to combat fraud. There is a strong feeling that fraudsters should not be able to design their financial transactions with the particular purpose of defeating tracing claims. One solution to this problem would be to maintain the current bar on backwards tracing as a general rule, but carve out an exception for when the court finds that the financial scheme was intentionally structured in such a way as to prevent the operation of tracing.

However, this is too narrow a view. It ignores the possibility that there may be other scenarios, not involving any fraudulent intention, where the transactions so closely linked that it may be desirable to allow backwards tracing.

Moreover, from a practical implementation perspective, this sort of approach could lead the court into some difficult, time-consuming inquiries because trying to identify whether a given financial transaction or scheme is legitimate or a deliberate attempt to circumvent the tracing rules necessarily involves, not only assessing the parties' intentions but also an in-depth investigation of how the scheme operates.

However, courts do routinely use such methods to make these sorts of determinations, so the above cannot be a decisive objection. A stronger argument against such a test is to consider the problems it raises in relation to the relevant standard of proof. Typically, in private law proceedings, disgruntled beneficiaries should be able to vindicate their property rights on a simple balance of probabilities. However, under the Fraud Act 2006, fraud in several different forms is also a criminal offence. This suggests that any finding of fraud should be made on the basis that it is beyond reasonable doubt, a significantly more onerous standard of proof. An analogy could perhaps be drawn with the tort of deceit, for which the claimant must only establish on the balance of probabilities that the defendant made a false statement. However, a finding of fraud could destroy a trustee's
commercial reputation, resulting in dramatic financial consequences for them and thus it is arguably important that such a finding is not made without the due process and safeguards of a criminal trial. This tension highlights the difficulty with a test that involves an investigation into the legitimacy and honesty of the transaction in question, an inquiry that strays dangerously close to criminal law.

D. Test of intention

Another different, and, it is submitted, better, way of defining the requisite coordination is by reference to the intention of the trustee(s) who misappropriate(s) the trust assets.

Returning to the case of *Foskett*, in the Court of Appeal, Sir Richard Scott 34 was a strong advocate of permitting backwards tracing, commenting that there is no reason ‘why the order in which the events happen should be regarded as critical to the claim’. However he does not propose that backwards tracing should always be allowed; the limit he seems to suggest is that it must be shown that ‘it was always the intention to use the trust money to acquire the asset’.

More recently, Virgo and Davies 35 have similarly suggested that ‘where a defendant incurred a debt in order to acquire an asset, and always planned to discharge the debt with a beneficiary’s property, then this seems likely to satisfy the “coordination” and “close causal and transactional link” requirements demanded by the Privy Council’.

Employing the concept of intention as a limiting device has been suggested by other proponents of backwards tracing, and I argue that they are correct to do so. This is because it provides a sufficiently strong and ascertainable link between the original transaction, by which the asset in question is acquired, and the second transaction, the discharge of the debt incurred in the first. The intention for the trust money to ‘take the place’ of the debt means that the asset acquired by the incurring of the debt can be regarded as the genuine substitute asset for the trust money. This is consistent with Smith’s proposition that the money used to discharge the debt constitutes ‘delayed payment’. It is this intention, linking the relevant transactions, which warrants allowing backwards tracing.

The flipside of this argument is that it would be completely illogical to allow tracing into an asset purchased on credit where it was never intended that the trust money be used to discharge the debt incurred. For example, when somebody incurs a debt when acquiring an asset before they are even appointed to be a trustee, and then later use misappropriated trust funds to pay it off, there is less strong justification for allowing the beneficiaries of the trust to trace into that previously acquired asset: the acquisition and the discharge of the debt might be two entirely detached transactions if there was no intention at the time of acquisition that the trust money would be used in any way to fund it. The fact that it was so used is purely coincidental and hence insufficient to justify backwards tracing. Similarly, there would be no backwards tracing where trust funds were mistakenly used to pay off a previously incurred debt because the necessary intention is missing. Just as it is the presence of such an intention which sometimes links two transactions, it is the lack of intention which separates them.

This appears to be the logic relied upon by Virgo and Davies; they argue that ‘where a defendant incurred a debt in order to acquire an asset, and always planned to discharge the debt with a beneficiary’s property’, ‘allowing the beneficiary to assert a proprietary interest in the acquired asset might not unfairly prejudice the defendant or other creditors since the asset would never have been acquired by the defendant had he or she not known that he or she would be able to exploit the

34 *Foskett* (CA) (n 7), 283.

beneficiary’s property’. They introduce a requirement of a finding that the asset would not have been acquired or the debt not incurred but-for the intention that trust assets would be used to pay for it. This certainly provides a substantial link between the two transactions. However, it is a requirement which arguably limits the scope of Virgo and Davies’ test for backwards tracing to too great an extent, failing to cater for other fact-patterns which may also warrant backwards tracing. One example would be where a trustee agrees to take on that role solely because he wants to have access to trust funds to pay off previously incurred debt. In this scenario, there may have been no intention to use misappropriated trust funds to pay the debt at the moment the debt was incurred; however, there was such an intention when the trustee took up their trusteeship. It is submitted that, contrary to the view of Virgo and Davies, this latter intention should also be sufficient for backwards tracing to operate; it constitutes a sufficient link between the two transactions because the trusteeship was only taken due to an immediate desire to use the newly acquired funds to pay off the debt.

Thus the test should be formulated more precisely as allowing backwards tracing when a trustee:

1. Misappropriates trust assets to pay off an existing debt; and
2. Had an intention or desire to use trust assets to do so, either
   a. At the time the debt was originally incurred; or
   b. At the point the trusteeship was taken up.

Fundamentally, this two-fold formulation of the intention based test seeks to identify a real link between the transaction which incurs the debt and the later use of trust funds to discharge it. This is why it is not enough that trust funds are mistakenly used to pay off a previous debt.

A possible objection to this test is that it focuses solely on the intention of the trustee even though there are likely to be cases where the trustee is insolvent and the suit is therefore only between the creditor and beneficiary, whose rights then depend upon the actions of a third party whom neither has control over. However, this position is justified because one of the most pressing justifications for permitting backwards tracing, as explored above, is preventing the trustee from succeeding in a fraudulent scheme. Moreover, on a conceptual level, it is only the intention of the trustee when dealing with the trust assets which can legitimately indicate whether or not the property in question can properly be regarded as a ‘substitute’ for the misappropriated trust assets (the inquiry upon which the whole process of tracing, backwards or otherwise, hinges); the intentions of either the creditors or beneficiaries are irrelevant in this regard.

Furthermore, this intention based test is preferable to Lord Toulson’s formulation in Durant International because it does not rely on the court’s discretion: the requisite transactional link, or ‘coordination’, will always be found where the requisite intention is found.

In his article, Conaglen floats this idea of limiting the scope of backwards tracing by reference to the trustee’s intention at the time the asset was acquired. However, he discounts it on the basis of the ‘evidential difficulties inherent in a test that is focused on the defalcating trustee’s intentions’. In Durant International, Lord Toulson similarly did not seem attracted by the idea of an intention-based test, despite its previous judicial endorsement. An insight into why this is so can be gained from his statement that the establishment of the requisite coordination is ‘likely to depend on inference from the proved facts, particularly since in many cases the testimony of the trustee, if available, will be of little value’. He, like Conaglen, doubts the utility of an intention-based test in practice.

It is perhaps true that the actual personal testimony of a trustee who has misused trust assets may not be the most reliable. However, this counter argument is weak because judges frequently employ tests of intention in all areas of the law, including equity. The personal liability of third parties

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36 Conaglen (n 11) 455.
37 Durant International (n 4) [40].
to breaches of trust is a good example: to prove dishonest assistance or knowing receipt, the intention of the assistor or receiver is crucial and accordingly, the courts have to determine this issue. Admittedly, there can be evidential uncertainty in such tests, especially when they are subjective. However, these difficulties can be circumvented by adopting a quasi-objective test, based, not on what the parties involved actually did intend, but on what a reasonable person would infer the parties’ intentions to be from their actions and all the circumstances. Judges are experienced at taking into account all of the evidence available to them in their inquiries into intention. The application of an intention based test for backwards tracing would be no different.

Nevertheless, there will inevitably be difficult, complicated fact-patterns which are not clearly covered by this relatively simple formulation of the intention test. One example would be where the trustee originally intended to pay off only one debt with the trust assets, but ended up paying off several others as well; the original debt would clearly be captured by the test but the other payments would not fit as obviously. Or where the trustee intended to pay off Debt A but later decided to pay off Debt B instead. These hard cases inevitably will have to be resolved sensibly by the courts, keeping in mind the goals they seek to achieve by permitting backwards tracing in the first place (namely preventing financial crime and doing justice between the parties). For example, one possible solution to the second hard case described above would be if the court decided that an intention to pay off any debt at the point of taking the trusteeship is sufficient even if the specific debt subsequently paid was not envisaged at that time. Alternatively, the court may hold that backwards tracing only operates where the intention is to pay the particular debt which is paid off; on this view, a general intention to discharge debts is not enough. It is submitted that this latter approach is preferable because it better preserves a strong link between the incurring and subsequent discharge of the debt, and prevents backwards tracing from operating too broadly, in situations where the relevant assets cannot sensibly be described as substitutes for the misappropriated trust assets (which would be the case where the intention, i.e. to pay Debt A, did not strictly match the later action, i.e. paying Debt B).

3. Conclusion

The law, like the commerce it regulates, is a living, breathing, ever-evolving entity. As a result, laws which were once justifiable and appropriate can later appear outdated and in need of reformulation. The current embargo on backwards tracing in English law is just such an example. The world in which we live has changed dramatically since the days where transactions were carried out with gold bullions in a bag;38 very many financial transactions take place using online systems, and they can be extremely complex, involving several countries, multiple currencies and a substantial period of time.

This is the context in which Durant International was decided; Lord Toulson was very much alive to the risks of high value financial crime and this was one of the main reasons why he was willing to recognize that backwards tracing is indeed the only way forward. This was an important step which hopefully the English courts will follow. However, the English courts should not follow the Privy Council in adopting the vague, yet limiting, proposed test of coordination to determine when backwards tracing should be permitted. Instead, the most practical and conceptually sound way of implementing backwards tracing is by reference to the intentions of the parties, ensuring that cases where backwards tracing is allowed are restricted to where there has always been an intention to use the funds held on trust to make the transfer or acquire the asset. This solution is just, conceptually coherent and brings the law of tracing in line with modern day commerce, where debt plays a key role. If it were ultimately adopted, the case of Durant International would undoubtedly have played its part in getting us there, although maybe not for entirely the right reasons!

38 Taylor v Plumer [1815] EWHC KB J84 (CA).