

ARTICLES

O'Regan, Kate	Cultivating a Constitution: Challenges Facing the Constitutional Court in South Africa	1
Cox, Neville	Victory with Honour or Victory at all Costs? Towards Principled Justification for Anti-doping Rules in Sport	19
Donnelly, Mary	Reforming Personal Property Security Law: Is there a Case for a Single Securities Register?	50
McGrath, Declan	Public Interest Privilege	75
Mee, John	From Here to Eternity?: Perpetuities Reform in Ireland	91
O'Sullivan, David	The Good Friday Agreements: A New Constitutional Agreement for Northern Ireland	112
O'Dell, Eoin	The Use and Abuse of Clayton's Case	161

CASES AND COMMENTS

Cox, Neville	Constitutional Law — Constitutional Interpretation — Passive Judicial Activism — Constitutional Crime of Blasphemy	201
Hogan, Gerard	Constitutional Law — Review of Sentencing and the Judicial Power	207
Binchy, William	Family Law — Divorce — Living Apart	216
Ryan, Fergus	Family Law — Reversal of Fortune — Nullity Law in the Age of Divorce	224
Delany, Hilary	Judicial Review Proceedings — Discretionary Factors and the Effect of Delay	236
Binchy, William	Tort — Damages — Public Policy	254

BOOK REVIEWS

Castello, Cathryn	Kilpatrick (ed.), <i>The Future of Remedies in Europe</i>	259
Cox, Neville	O'Leary, <i>Drugs and Doping in Sport; Socio-Legal Perspectives</i>	262
Bacik, Ivana	Law Reform Commission Consultation Paper on Homicide: <i>The Mental Element in Murder</i> (LRC-Cp17-2001)	264
O'Dell, Eoin	Whelan, <i>Politics, Elections and the Law</i>	269

ISSN: 0332-3250

  
ROUND HALL  
Sweet & Maxwell

43 Fitzwilliam Place, Dublin 2.

## THE USE AND ABUSE OF CLAYTON'S CASE

EIOIN O'DELL\*

### 1. SO, JUST WHAT IS THE RULE IN CLAYTON'S CASE ANYWAY, AND WHY ARE THEY SAYING SUCH TERRIBLE THINGS ABOUT IT?

Assume that I have an apple, which I want to keep safe for the time being, and that you have a sack into which you allow me to put the apple. Let it be that I get four more apples and also put them into your sack, and that I then get a further five apples which I also put there. Now, let it be that, at this point, I take out six apples, and give them away. Four apples remain in the sack.

The six apples which were taken out could count, first against the first apple which I put into the sack, and then against the next four, and finally against one of the further five, so that the four which remain are the remainder of the third group which I placed in the sack.

Or the six apples which were taken out could count, first against the last five which were put into the sack, and then against one of the four previously put in, so that the four which remain are the remaining three from this group plus the single apple first put in.

Or the six apples which were taken out could count proportionately against all ten apples which had been put in, so that the four which remain represent four tenths of the first apple (0.4 of an apple), four tenths of the next four (1.6 apples), and four tenths the next five apples (2.0 apples).

As between us, it probably does not matter how the six apples which I took out count; it probably does not matter, in other words, which method of distribution is applied to appropriate the apples put into the sack to those taken out. However, if we were forced to choose, we would probably not adopt the third method because of the fractions of apples it produces, and then opt for one of the other two more or less at random; and if the law were to say that the first and not the second method should apply, we would probably adopt it without a second thought, happy that a tricky choice has been made for us.<sup>1</sup>

\* Barrister, Lecturer in Law, Trinity College, Dublin. Thanks to Eunice O'Raw, Mary Donnelly and Matthew Conaglen for their comments. The usual disclaimers apply.

1. In fact, the law says that the first method should apply, unless we have indeed made the tricky choice and therefore intend otherwise: see parts 2 and 3 below; see also n.45 and text with and in nn.74-76 below.

devolved or federal basis), regional power-sharing government and mechanisms for ensuring cross-community support on certain issues.

If, however, the institutions set up by the Agreements fail, and are not replaced by broadly similar institutions, so that Northern Ireland is governed without the nationalist community having a share in its government, it would be more likely that a future united Ireland would be a unitary state without a regional assembly or administration than would be the case if the Agreements are implemented.

## THE USE AND ABUSE OF *CLAYTON'S CASE*

EOIN O'DELL\*

### 1. SO, JUST WHAT IS THE RULE IN *CLAYTON'S CASE* ANYWAY, AND WHY ARE THEY SAYING SUCH TERRIBLE THINGS ABOUT IT?

Assume that I have an apple, which I want to keep safe for the time being, and that you have a sack into which you allow me to put the apple. Let it be that I get four more apples and also put them into your sack, and that I then get a further five apples which I also put there. Now, let it be that, at this point, I take out six apples, and give them away. Four apples remain in the sack.

The six apples which were taken out could count, first against the first apple which I put into the sack, and then against the next four, and finally against one of the further five, so that the four which remain are the remainder of the third group which I placed in the sack.

Or the six apples which were taken out could count, first against the last five which were put into the sack, and then against one of the four previously put in, so that the four which remain are the remaining three from this group plus the single apple first put in.

Or the six apples which were taken out could count proportionately against all ten apples which had been put in, so that the four which remain represent four tenths of the first apple (0.4 of an apple), four tenths of the next four (1.6 apples), and four tenths the next five apples (2.0 apples).

As between us, it probably does not matter how the six apples which I took out count; it probably does not matter, in other words, which method of distribution is applied to appropriate the apples put into the sack to those taken out. However, if we were forced to choose, we would probably not adopt the third method because of the fractions of apples it produces, and then opt for one of the other two more or less at random; and if the law were to say that the first and not the second method should apply, we would probably adopt it without a second thought, happy that a tricky choice has been made for us.<sup>1</sup>

\* Barrister, Lecturer in Law, Trinity College, Dublin. Thanks to Eunice O'Raw, Mary Donnelly and Matthew Conaglen for their comments. The usual disclaimers apply.

1. In fact, the law says that the first method should apply, unless we have indeed made the tricky choice and therefore intend otherwise: see parts 2 and 3 below; see also n.45 and text with and in nn.74-76 below.



Now let it be that this scenario dealt not with apples in a sack but with money in a bank account, so that you are the bank with which I lodge first one pound<sup>2</sup> into an account, then four pounds and finally five, before withdrawing six. Although it probably did not matter in the case of apples in a sack, the method of distribution applied to appropriate the lodgments into the account to withdrawals from it can matter quite a lot. Assume that I have a bank account with a zero balance and an overdraft facility; if I now withdraw £100, I will begin to owe interest on it; if I later withdraw a further £100, I will then begin to owe interest on that. Let it be that I later win £100 on the lottery which I lodge to the account. In principle, it could count against the first £100 withdrawal, so that I continue to pay interest only on the second one; or it could count against the second £100 withdrawal, so that I continue to pay interest only on the first one; or it could count against each equally, so that I continue to pay interest on £50 of each withdrawal. If, as is usually the case, such interest were compounded, I would plainly prefer to match the lodgment against my first withdrawal so as to reduce the amount of interest that I owe. On the other hand, if, as is also usually the case, the rate on such interest is variable, and if the rate has increased significantly between withdrawals, I might prefer to match the lodgment against the second withdrawal, to continue to pay interest (even compound) at the lower rate on the first withdrawal. And the combination of compound interest at varied rates can produce circumstances in which dividing the lodgment against each withdrawal would be the most efficient option. Hence, there is no *a priori* solution, and any choice from amongst the three methods will be, by and large, circumstantial if not arbitrary. It is, however, at least settled law that in this context the first method is to be applied, so that the lodgment counts first against the first withdrawal.<sup>3</sup> More generally, where there are many withdrawals and many lodgments, the first lodgment counts first against the first withdrawal, and so on, and *vice versa*, so that withdrawals count first against the first lodgments in time. Hence, in the example at the start of this paragraph, in which I successively lodge one, four and five pounds, before withdrawing six, that withdrawal counts against the first lodgment of one pound, then against the next lodgment of four pounds, and finally against one pound of the final lodgment of five.

Now, let us return to the case of apples in your sack, but take a variation in which, after I have placed one apple in it, a second person, Alan, places the next four apples, and a third person, Betty, places the next five, and then a fourth person, Colin, removes six apples. In this variation, it matters a very

2. If you are reading this after January 1, 2001, the euro will have replaced the pound as legal tender and the sole denominator of money in bank accounts; please read the text as altered *mutatis mutandis*.

3. Again, the law in fact says that this method should apply, unless one of us has made another appropriation; see parts 2 and 3 below.

great deal how the six apples which Colin took out count; it matters a very great deal which method of distribution is applied to appropriate the apples put into the sack to those taken out. On the first method of distribution, my apple, all four of Alan's apples, and one of Betty's were removed; only four of Betty's original five remain. Alan and I suffer the full loss, and though Betty suffers some loss, she is the only one of us to have anything at the end of the story. On the second method, all five of Betty's apples and one of Alan's were removed; three of Alan's original four and my single apple remain. Betty suffers the full loss, Alan loses something but not everything, while I am the only one to have at the end of the story all that I had at the start. On the third method, 0.4 of my apple, 1.6 of Alan's apples, and 2 of Betty's apples remain. We all share the loss equally, and all get something at the end of the story. This third solution is eminently fair, and is much fairer than either of the other two, which apportion losses based upon happenstances of timing which have no bearing upon the substantive merits of the parties. Unlike the original scenario, above, where there was no *a priori* basis upon which to prefer any one of the three possible solutions, here, one method is fair and two are not. It should come as no surprise, then, that in this context, the law has opted for the fairest method, the third method, by which all share the loss proportionately.<sup>4</sup> In principle, each contributor to a mixture can assert that his or her contribution exists in any part of the mixture, subject to the right of other contributors to do likewise; hence, if the mixture remains undiminished, each can take out what he or she put in; however, if the mixture has been diminished in some way, the loss will be borne by each of the contributors in proportion to their individual contributions.<sup>5</sup>

As before, let it now be that this scenario dealt not with apples in a sack but with money in a bank account, so that you are the bank with which I lodge one pound into an account into which Alan then lodges four pounds and Betty five, and from which Colin then withdraws six. It now matters a great deal how the withdrawal counts: on the first method only Betty has a claim against the account, and a partial claim at that; on the second, Betty has no claim,

4. Bell, *Modern Law of Personal Property in England and Ireland* (Butterworths, London, 1989) 71-73; Smith, *The Law of Tracing* (OUP, Oxford, 1996) 70-77; Worthington, *Proprietary Interests in Commercial Transactions* (OUP, Oxford, 1996) 508-514.

5. *Buckley v. Gross* (1863) 3 B&S 563; 122 E.R. 213; *Spence v. Union Marine Insurance Co* (1868) L.R. 3 C.P. 427, 438-439 per Bovill CJ; *Sandeman & Sons v. Tyzack & Branfoot Steamship Co Ltd.* [1913] A.C. 680, 694 per Lord Mouton; *Indian Oil Corp v. Greenstone Shipping SA (Panama)* [1988] Q.B. 345, 368-369 per Staughton J; *Re Stapylton Fletcher* [1994] 1 W.L.R. 1181, 1201 per Judge Paul Baker QC; *Glencore International Ag v. Metro Trading International Inc* [2001] 1 Lloyd's Rep. 284, 321-330 per Moore-Bick J; *cp. Mercer v. Craven Grain Storage Ltd.* [1994] C.L.C. 328 (HL).



Alan has a partial claim and I have a claim for my full amount; and on the third, we all have claims, but partial claims only. Logic suggests that if the law has good reason to apply the third method to apples in a sack, it should for the same reasons apply the third method to the bank account. In particular, if it is fair to apportion losses from the sack equally among all contributors of apples, it should be equally as fair to apportion losses from the bank account equally among all those who made lodgments; and conversely, if it is unfair to apportion losses from the sack on the basis of happenstances of timing unrelated to the substantive merits of the parties, it should be equally as unfair to apportion losses from the bank account in a like manner. The law, then, ought to apportion losses from the bank account equally to all those whose money was lodged to it. But it doesn't. Illogically, and unfairly, it applies the first method instead, and counts withdrawals against lodgments in the order in which they were made.<sup>6</sup>

We have seen that counting withdrawals against lodgments in the order in which they were made is as good a rule as any to apply in the context of the relationship between customer and banker. It can be summed up in the rule of thumb: "first in, first out"; and it was established as the common law's default rule in this banking context in *Clayton's Case*.<sup>7</sup> However, we have also seen that, where there have been many contributors to a mixture which is then depleted, the fairest rule is to apportion those losses proportionally. It should not matter that this mixture subsists in a bank account, but a long line of authority,<sup>8</sup> focussing not on the mixture but on the bank account, has applied the rule in *Clayton's Case* to apportion losses to deposits in the order in which they were made.

"First in, first out", then, in the appropriation of withdrawals to lodgments as between banker and customer, is the rule in *Clayton's Case*; and its illogical application to competing claims to mixtures is why they are saying such terrible things about it. In the recent case of *In re Money Markets International Stockbrokers Ltd*,<sup>9</sup> Laffoy J. had occasion to consider the status of *Clayton's Case* in the context of a mixture of value in a bank account, and all but found it wanting. This article proceeds from an analysis, in section 2, of *Clayton's Case* itself, through a discussion, in section 3, of the proper use of the rule in the context of banker and customer, to a discussion, in section 4, of the abuse of the rule in the context of competing claims to mixtures of value in bank accounts, and to a sketch, in section 5, of the decline of the abuse in other jurisdictions. This is all by way of background to a scrutiny, in section 6, of Laffoy J.'s judgment, leading to the conclusion, in section 7, that whilst the

6. See part 4 below.

7. (1816) 1 Mer. 572; 35 E.R. 781.

8. See part 4 below.

9. [1999] 4 I.R. 267 (HC).

rule in *Clayton's Case* has its proper place in the context of banker and customer, it should not be applied beyond that. In other words, the step not taken by Laffoy J. in *Money Markets International*, abrogating *Clayton's Case* in this context, should be taken at the first opportunity. If so, then, in the disputes between Alan, Betty and me, we should all share the loss equally not only in the context of apples from your sack but also in the context of money from a bank account.

## 2. DEVAYNES V. NOBLE; CLAYTON'S CASE

Devaynes was a partner in a banking firm. He died possessed of a considerable estate; but, eight months later, the firm went bankrupt. From the large number of cases commenced against the partners, eight were selected for hearing.<sup>10</sup> In the first, *Sleech's Case*,<sup>11</sup> Grant MR held that partners were, in equity, jointly and severally liable for the debts of the partnership, with the result that Devaynes' estate was liable for the debts incurred by the firm until his death, but not for any debts incurred thereafter. Hence, Miss Sleech was able to recover from the estate the £366 standing to her credit at the date of Devaynes' death, less her subsequent withdrawal of £50 and the dividend of £100 which she received in the bankruptcy.

*Clayton's Case*<sup>12</sup> was dealt with next. At Devaynes' death, Clayton had a balance of £1713, from which he then withdrew £1260, reducing his balance to £453. Although he had originally claimed £1713 from Devaynes' estate, in light of *Sleech's Case*, he reduced his claim to £453, less his proportion of the bankruptcy dividends. After the withdrawal of £1260, he continued to make lodgments to and withdrawals from his account until the firm's bankruptcy. He argued that the withdrawals should be counted first against the most recent lodgments, – in effect: "last in, first out" – which on the facts would have meant that the £453 would not have been drawn against, and the estate would still have been liable therefor. On the other hand, the estate argued that the withdrawals should be counted first against the earliest lodgments – in effect: "first in, first out" – which on the facts would have meant that the £453 had long since been withdrawn from the account, and the estate would no longer have been liable therefor. Grant MR held that there was

"... no room for any other appropriation than that which arises from the order in which the receipts and payments take place, and are carried into the account. Presumably, it is the sum first paid in, that is first drawn out. It is the first item on the debit side of the account, that is discharged, or

10. *Devaynes v. Noble* (1816) 1 Mer. 529; 35 E.R. 767.

11. *Devaynes v. Noble; Sleech's Case* (1816) 1 Mer. 539; 35 E.R. 771.

12. *Devaynes v. Noble; Clayton's Case* (1816) 1 Mer. 572; 35 E.R. 781.



reduced, by the first item on the credit side. The appropriation is made by the very act of setting the two items against each other. Upon that principle, all accounts current are settled, and particularly cash accounts. Where there has been a continuation of dealings, in what way can it be ascertained whether the specific balance due on a given day has, or has not, been discharged, but by examining whether payments to the amount of that balance appear by the account to have been made? You are not to take the account backwards, and strike the balance at the head, instead of the foot, of it. ... If appropriation be required, here is appropriation in the only way that the nature of the thing permits. Here are payments, so placed in opposition to debts, that, on the ordinary principles on which accounts are settled, this debt is extinguished".<sup>13</sup>

Hence, Grant MR rejected "last in, first out" because it would be to take the account backwards, and instead adopted "first in, first out", so that the first item on the debit side of the account is discharged, or reduced, by the first item on the credit side, with the result that Devaynes' estate's debt of £453 had been extinguished by Clayton's subsequent withdrawals. The decision was regarded as a *tour de force* by Grant MR's contemporaries. Abbott J. said of it that it "was a case decided upon great consideration, and is an authority of great weight";<sup>14</sup> whilst Holroyd J. said that it seemed to him "to have been decided upon the soundest of principles".<sup>15</sup> The effect of the rule is that if there are lodgments to and withdrawals from an active current account, the earlier withdrawals come out of the earlier lodgments, so that any amount in the account at the end of the story represents later lodgments only. Contemporary<sup>16</sup> and modern<sup>17</sup> cases have justified the rule as a matter of logic: the "rule in *Clayton's Case* is to allocate the payments upon an account. Some rule had to be adopted, and though any presumption of intent was a fiction, priority in time was the most natural basis of allocation".<sup>18</sup> What made it logical, in Grant M.R.'s eyes, was the nature of the account.

13. (1816) 1 Mer. 572, 608-609; 35 E.R. 781, 793; see also the seventh of the eight cases, *Devaynes v. Noble*; *Palmer's Case* (1816) 1 Mer. 623; 35 E.R. 798.
14. *Bodenham v. Purchas* (1818) 2 B.&Ald. 39, 46; 106 E.R. 281, 284.
15. (1818) 2 B.&Ald. 39, 46; 106 E.R. 281, 285; see also (1818) 2 B.&Ald. 39, 46; 106 E.R. 281, 284 per Bayley J.
16. "It certainly seems most consistent with reason, that where payments are made upon one entire account, that such payments should be considered as payments in discharge of the earlier items". *Bodenham v. Purchas* (1818) 2 B.&Ald. 39, 46; 106 E.R. 281, 284 per Bayley J.
17. "Logic seems to dictate that as between banker and customer the rule in *Clayton's Case* will apply. ..." *Barlow Clowes International Ltd (in liq) v. Vaughan* [1992] 4 All E.R. 22 (CA) 44 per Leggatt LJ.
18. *In re Walter J. Schmidt & Co. Ex parte Feuerbach* 298 F. 314 (1923) 316 per Learned Hand J.; again, "...it is a rule of common sense derived from the very

### 3. THE PROPER SCOPE OF CLAYTON'S CASE

The "first in, first out" rule, thus unequivocally established in *Clayton's Case*, is a principle of great convenience in the context of banker and customer. Indeed, as "a well-tryed instrument that has been applied to a whole range of identification problems in commercial transactions and its all-pervasive influence has extended even to tracing in equity",<sup>19</sup> it is "fundamental to banking practice".<sup>20</sup> Unsurprisingly, therefore, it has often been followed and applied in this context.<sup>21</sup> The leading case is *Deeley v. Lloyds Bank*.<sup>22</sup> Here, two loans secured by mortgages were withdrawn from the account; applying the rule, subsequent lodgments to the account were applied first to the first loan, which had the effect of paying it off, promoting the second mortgage. Lord Atkinson held that there was "nothing to rebut the presumption that the creditors in this case, the bank branch, ... intended to apply the earlier payments to discharge the earlier debts in the manner indicated in *Clayton's Case*, and, accordingly,

nature of the banker-customer relationship in a current account". *Re Ontario Securities Commission and Greymac Credit Corp* (1985) 19 D.L.R. (4th) 470, 491 per Parker ACJHC; *affid* (1986) 30 D.L.R. (4th) 1 (Ont. CA); *affid* (1989) 52 D.L.R. (4th) 767 (SCC).

19. Goode, "The Right to Trace and Its Impact in Commercial Transactions - I" (1976) 92 *LQR* 360, 396 (footnotes omitted); see also 361.
20. Brindle and Cox (eds.), *The Law of Bank Payments* (2nd ed, Sweet & Maxwell, London, 1999) 10, para 1.17; Ogilvie describes it as constituting "the normal practice in the operation of banking accounts for over a hundred years" (*Ogilvie Canadian Banking Law* (2nd ed, Carswell, Toronto, 1998) 541); *cp Deeley v. Lloyds Bank* [1912] A.C. 756 (HL) 785 per Lord Shaw describing it as a rule "universally known and affirmed in the banking world"; *ANZ v. Westpac* (188) 164 CLR 662 (HCA) 676 describing it as "the ordinary rule of appropriation of debits against credits (and *vice versa*) in single running account between banker and customer".
21. See, *eg*, *Bodenham v. Purchas* (1818) 2 B.&Ald 39, 106 E.R. 281; *Field v. Carr* (1829) 5 Bing 13, 130 E.R. 964; *Laing v. Campbell* (1865) 36 Beav 3, 55 E.R. 1057; *Ex parte Hardcastle* (1881) 44 LT 524; *Ex parte Watson* (1888) 21 QBD 307; *In re Chute's Estate* [1914] 1 I.R. 180 (Ross J.); *National Provincial Bank v. Freedman and Rubens* (1934) 4 LDAB 444 (Clauson J.); *Re Primrose (Builders) Ltd* [1950] Ch. 561 (Wynn Parry J); *AMKMK v. Chettiar* [1955] A.C. 230 (PC); *Re Yeovil Glove* [1963] Ch. 528 (Plowman J) *affid* [1965] Ch. 148 (CA); *Re James R Rutherford & Sons* [1964] 3 All E.R. 137 (Pennycuik J); *Re Daniel Murphy Ltd* [1964] I.R. 1 (Kenny J.); *Station Motors v. AIB* [1985] I.R. 756 (Carroll J); *cf Re Rampgill Mill Ltd* [1967] Ch. 1138 (Plowman J.); *Smurfit Paribas Bank Ltd. v. AAB Export Finance Ltd (No 2)* [1991] 2 I.R. 19, 28-29 per Barron J., noted Doyle, "Statutory Interpretation and the Rule in *Clayton's Case*" [1992] *Gazette ILSI* 115.
22. [1912] A.C. 756 (HL).



it must be taken as established that this was done".<sup>23</sup> Similarly, if a borrower has given security in relation to an earlier loan but not a later one, the rule will apply payments first to the earlier loan, and if it is fully repaid, the lender bank will find itself holding merely the unsecured loan.<sup>24</sup>

As a matter of principle, in the context of an account, the debtor has the right to appropriate credits to debts; if he does not, the creditor has such a right of appropriation;<sup>25</sup> if one or the other does so appropriate, there is no room for the application of a default rule such as *Clayton's Case*;<sup>26</sup> it is only if neither does so that it can apply. In *Clayton's Case*, Grant MR stated the "first in, first out" rule as a deduction from the nature of the account, rather than as a presumption of intention. However, perhaps to accommodate it to the developing rules on appropriation,<sup>27</sup> it was quickly tied to the presumed intentions of the parties. For example, in *In re Hallett's Estate*,<sup>28</sup> Jessel M.R. described it as "a very convenient rule, and I having nothing to say against it unless there is evidence either of agreement to the contrary or of circumstances from which a contrary intention must be presumed, and then of course that which is a mere presumption of law gives way to those other considerations".<sup>29</sup> Baggallay L.J. went further:

23. [1912] A.C. 756, 773. Lord Shaw delivered a speech to the same effect (see esp [1912] A.C. 756, 783-385) and Lord Macnaghten agreed; *cp London and County Banking Co v. Ratcliffe* (1881) 6 App. Cas. 722.
24. Donnelly, *The Law of Banks and Credit Institutions* (Round Hall Sweet & Maxwell, Dublin, 2000) 203, 418-419.
25. *Simson v. Ingham* (1823) 2 B&C 65; 107 E.R. 307; *Philpott v. Jones* (1834) 2 A.&E. 41; 111 E.R. 16; *Mills v. Fowkes* (1839) 5 Bing. N.C. 455; 132 E.R. 1174; *Henniker v. Wigg* (1843) 4 Q.B. 792; 114 E.R. 1095; *City Discount v. McLean* (1874) LR 9 CP 692; *Cory Brothers & Co v. Owners of the Turkish Steamship "Mecca"*. *The Mecca* [1897] A.C. 286, 293-294 *per* Lord Macnaghten; *Smith v. Betry* [1903] 2 K.B. 317; *Seymour v. Pickett* [1905] 1 K.B. 715; *Deeley v. Lloyd's Bank* [1912] A.C. 756, 783 *per* Lord Shaw (adopting the words of Eve J. at first instance); *Re Footman, Bower & Co Ltd* [1961] Ch. 443; see generally Hapgood (ed.), *Paget's Law of Banking* (11th ed, Butterworths, London, 1996) chapter 14; Ellinger and Lomnik, *Modern Banking Law* (2nd ed, Clarendon Press, Oxford, 1994) 586-589; Donnelly *The Law of Banks and Credit Institutions* (Round Hall Sweet & Maxwell, Dublin, 2000) 202-204.
26. *Simson v. Ingham* (1823) 2 B&C 65, 75-76; 107 E.R. 307, 311 *per* Best J.; *City Discount v. McLean* (1874) LR 9 CP 692, 700 *per* Blackburn J.; *Cory Brothers & Co v. Owners of the Turkish Steamship "Mecca"*. *The Mecca* [1897] A.C. 286, 293-294 *per* Lord Macnaghten; *Mutton v. Peat* [1899] 2 Ch. 556, 560-561 *per* Byrne J.; *Deeley v. Lloyd's Bank* [1912] A.C. 756, 783 *per* Lord Shaw; see also *Royal Bank of Canada v. Bank of Montreal* (1976) 67 D.L.R. (3d) 755 (Sask CA) 764-767 *per* Bayda J.A., Brownridge and Hall J.J.A. concurring.
27. See n.25 above, and nn.30-31 below.
28. (1879-1880) 13 LR Ch. 696.
29. (1879-1880) 13 LR Ch. 696, 728.

"Now *Clayton's Case* was decided upon the principle that in the absence of any expressed intention to the contrary, or of special circumstances from which such an intention could be implied, the appropriation of drawings out to the payments in as adopted in that case, represented what must be presumed to have been the intention of the parties concerned; and so viewed the decision is quite consistent with the like presumption being rebutted or modified in another case in which the circumstances were such as to negative any intention to make such an appropriation of the drawings out to the payments in".<sup>30</sup>

Thesiger L.J. took a similar approach.<sup>31</sup> It is in this form, based upon the presumed intention of the parties,<sup>32</sup> that the rule in *Clayton's Case* is usually stated in the modern cases. On this basis, its non-application is then explained as turning on proof of a contrary or inconsistent intention. Thus, for example, in *In re Chute's Estate*,<sup>33</sup> one of the earliest Irish cases on the point, Ross J. said that the:

"rule in *Clayton's Case* is a rule of evidence. It amounts to this, that in the absence of any other evidence of intention the parties must be presumed to have intended that the earliest payments in should be applied in discharge of the earliest items on the debit side.

This presumption can be rebutted by proof of an express contract, or by proof of circumstances that warrant the inference of a different intention."<sup>34</sup>

30. (1879-1880) 13 LR Ch. 696, 738-739; emphasis added, drawing support for this view from *Henniker v. Wigg* and *City Discount v. Maclean* (n.25 above).
31. Agreeing on this point, though dissenting on another (see n.54 below), he described the rule in *Clayton's Case* as a "rule as to appropriation of payments, which is a rule which embodies a presumption of fact rather than of law, and is founded upon the notion that in the absence of any expression of intention an appropriation of drawings out and payments in of moneys upon a banker's account in order of date would in most cases meet the intention of the parties ..." ((1879-1880) 13 L.R. Ch. 696, 749). He also drew support for this view from *Henniker v. Wigg* and *City Discount v. Maclean* (n.25 above): "their *ratio decidendi* was wide enough to apply to the case of a person following his trust property into a banking account" ((1879-1880) 13 LR Ch. 696, 748).
32. Rather than as a default position supplied by operation of law, as it was conceived of by Grant MR in *Clayton's Case* itself, and as it was treated by Turner L.J. in *Pennell v. Deffell* (1853) 4 De. G.M.& G. 373, 391; 43 E.R. 551, 559; *cp* (1853) 4 De. G.M.&G. 373, 384; 43 E.R. 551, 556 *per* Knight Bruce L.J.
33. [1914] 1 I.R. 180 (Ross J.).
34. [1914] 1 I.R. 180, 185; though, on the facts, the presumption was unrebutted and the rule in *Clayton's Case* was thus applied; *cp Re Ontario Securities Commission*



The clearest application<sup>35</sup> of this understanding of the rule occurs in the House of Lords' decision in *The Mecca*.<sup>36</sup> Cory Brothers provided necessaries to the defendants' ship, the *Medina*, in return for a bill of exchange in the amount of £267 14s due on April 7, 1894; Cory then provided necessaries to the defendants' ship, the *Mecca*, in return for a bill for £176 5s due on April 26; and then provided necessaries to both ships in return for bills due on April 27, in the amount of £194 8s in respect of the *Mecca*, and £630 in respect of the *Medina*. The defendants dishonoured the bills, but in August paid £900. Cory acknowledged the payment by a letter which included a statement of account which set out the sums due in the above order, added interest, subtracted the payment, and claimed a balance due of £401 2s 9d. When the *Mecca* was found at Cardiff, Cory sought to execute against it for the outstanding balance; and delivered to the shipowners an account which appropriated the £900 first to the debts due in respect of the *Medina*, so that the outstanding balance would be due in respect of the *Mecca*. However, at first instance and on appeal, *Clayton's Case* was applied, and the payment appropriated to the bills in the above order, so that the balance was due in respect of the *Medina*, for which the *Mecca* could not be held liable.

The House of Lords overruled, holding that the rule in *Clayton's Case* did not apply, both because the account as between the parties was not in a current account,<sup>37</sup> and because, even if it could apply, the circumstances of the

case negated any intention to apply it. Lord Halsbury L.C. stressed that the rule in *Clayton's Case* "is not an invariable rule of law; but the circumstances of the case may afford ground for inferring that transactions of the parties were not so intended as to come under this general rule",<sup>38</sup> and Lord Macnaghten applied the qualifications to the rule as stated in *Hallett*.<sup>39</sup> The statement of the account acknowledging the payment was held not to constitute an appropriation, though the account delivered for the purposes of action did. Hence, in *Deeley*, in which the rule was applied, Lord Atkinson commented that that "the rule laid down in *Clayton's Case* is not a rule of law to be applied in every case, but rather a presumption of fact, and that this presumption may be rebutted in any case, by evidence going to show that it was not the intention of the parties that it should be so applied".<sup>40</sup> Nothing rebutted the presumption on the facts; in particular, though the manager should have done so, he did not open a new account in respect of the second mortgage; had he done so, then the earlier *In re Sherry*<sup>41</sup> demonstrates that the application of the rule would have been excluded.<sup>42</sup> On the other hand, if a guarantee or bond is expressly given as a continuing security, the parties will be taken to have intended that advances made thereunder would not be satisfied by lodgments within the time expressed for the continuance of the security, and the rule in *Clayton's Case* would thereby be excluded.<sup>43</sup> Indeed, nowadays, all standard form

accounts; see, e.g., *Re Diplock* [1948] Ch. 465, 555, below, n.60; *Re Ontario Securities Commission and Greymac Credit Corp* (1986) 30 D.L.R. (4th) 1 (Ont. CA) 16 per Morden J.A., Lacourcière and Tarnopolsky J.J.A. concurring; *Barlow Clowes International Ltd. (in liq) v. Vaughan* [1992] 4 All E.R. 22, 28-29 per Dillon L.J.; cf. *Yeovil Glove* [1963] Ch. 528 (Plowman J., *affid.* without reference to this point: [1965] Ch. 148 (CA)). On whether this is an appropriate restriction, or whether *Clayton* could properly apply to other accounts, see text with and in nn.45 and 76 below.

- and *Greymac Credit Corp* (1985) 19 D.L.R. (4th) 470, 491 per Parker A.C.J.H.C.; *affid.* (1986) 30 D.L.R. (4th) 1 (Ont. CA); *affid.* (1989) 52 D.L.R. (4th) 767 (SCC).
35. See also *Henniker v. Wigg* (1843) 4 Q.B. 792, 794; 114 E.R. 1095, 1096 per Lord Denman CJ: Although the rule in *Clayton's Case* generally applied, nevertheless it was "equally certain that a particular mode of dealing, and more especially any stipulation between the parties, may entirely vary the case". *City Discount v. McLean* (1874) L.R. 9 C.P. 692, 698-699 per Bramwell B: "... we must decide every case according to its own circumstances, ..."; (1874) L.R. 9 C.P. 692, 700-701 per Blackburn J.: "It may be, as a general rule in ordinary cases, and if there is nothing to show a contrary intention, the items of credit must be appropriated to the items of debit in order of date ... The true rule is that laid down in *Henniker v. Wigg*, which is that accounts rendered are evidence of the appropriation of payments to the earlier items, but that may be rebutted by evidence to the contrary" (emphasis added; Mellor and Archibald J.J. and Cleasby and Amphlett B.B. concurred). *Henniker v. Wigg* and *City Discount v. McLean* were important in the development of the rules as to intentional appropriation by debtor and creditor (see nn.25-31, above), and they integrated the rule of *Clayton's Case* into these rules by recasting it from one based upon the nature of the account to one based upon an evidential presumption as to the parties' intentions.
36. *Cory Brothers & Co v. Owners of the Turkish Steamship "Mecca" (The Mecca)* [1897] A.C. 286 (HL).
37. [1897] A.C. 286, 290-291 per Lord Halsbury L.C.; 292 per Lord Herschell. Consequently, *Clayton's Case* has been confined to the operation of current

38. [1897] A.C. 286, 291; as to the nature of the transactions between the parties in this case, *cp Smith v. Betty* [1903] 2 K.B. 317, 323 per Stirling L.J. (Collins M.R. and Mathew L.J. concurring).
39. [1897] A.C. 286, 295-297. Lords Herschell and Morris agreed.
40. *Deeley v. Lloyds Bank* [1912] A.C. 756, 771; cf. *Re Bourne* [1906] 2 Ch. 427.
41. *In re Sherry; London and County Banking v. Terry* (1884) 25 Ch. D. 692 (CA).
42. In other words, the rule can apply only to a single account, and not to multiple accounts: *Bodenham v. Purchas* (1818) 2 B.&Ald. 39, 45; 106 E.R. 281, 284 per Bayley J. Hence, the "rule in *Clayton's Case* applies where there is one unbroken account, ..." *Mutton v. Peat* [1899] 2 Ch. 556, 560 per Byrne J. Consequently, there is a "well-known ... method of protection open to bankers. This method is quite simple. Whenever notice is received of a second charge on which a bank holds a first charge as security for future advances, it is always open to it to rule off the mortgagor's existing account with it and to open a new separate account for subsequent transactions ..." *Siebe Gorman v. Barclays Bank* [1979] 2 Lloyd's Rep. 142, 164 per Slade J.
43. *Henniker v. Wigg* (1843) 4 Q.B. 792, 114 E.R. 1095; *City Discount v. McLean*



contracts of guarantee contain provisions to exclude the application of the rule.<sup>44</sup>

In sum, then, the rule in *Clayton's Case* is now understood to be an evidential presumption that the parties must be presumed to have intended that the earliest credits in a current account should be appropriated to the earliest debits, and *vice versa*, unless there is proof of a contrary intention or evidence from which such can be inferred. In this form, it is a very useful rule. Hence, in the example above, where you are the bank with which I lodge first one pound into an account, then four pounds and finally five, before withdrawing six, in the absence of a contrary intention, the *Clayton's Case* principle of "first in, first out" would appropriate the six withdrawn pounds, first against the first one lodged, and then against the next four, and finally against one of the remaining five.<sup>45</sup>

#### 4. THE INAPPROPRIATE EXTENSION OF CLAYTON'S CASE

It is one thing for a rule to be used in an appropriate context; it is quite another for it to be abused and misused by extending it inappropriately. That this is what has happened with *Clayton's Case* may be illustrated by returning to the example in which you have a sack into which I place one apple, Alan places four and Betty five, before Colin removes six, the law has adopted the principle that Alan, Betty and I should bear this loss proportionately.<sup>46</sup> In principle, if this scenario dealt not with apples in a sack but with money in a bank account, the conclusion should be unaltered.<sup>47</sup> However, this is not the case. *Pennell v. Deffell* applied – nay, misapplied – the rule in *Clayton's Case* to this scenario;<sup>48</sup> it was followed in this by *In re Hallett's Estate*, and the law is only just beginning to recover from this misstep.

(1874) L.R. 9 C.P. 692; *Westminster Bank v. Cond* (1940) 46 Com. Cas. 60; cf *In re Sherry* (1884) 25 Ch. D. 692 (CA).

44. Donnelly, 419, 446-449; O'Donovan and Phillips, *The Modern Contract of Guarantee* (3rd ed, LBC, Sydney, 1996) 225-226, 288, 451.

45. Indeed, although *Clayton's Case* has been confined to current accounts (see n37 above), there is no reason in principle why it would not also provide an acceptable method of appropriation (should it matter) in the very first example where you have a sack into which I place first one apple, then four and finally five, before removing six.

46. See nn.4-5 above.

47. See Smith, 183-194; and text with n.6 above.

48. See, generally, McConville, "Tracing and the Rule in *Clayton's Case*" (1963) 79 *LQR* 388; see also Scott "Some Recent Problems in Applying the Rule in *Clayton's Case*" (1965) 6 *Australian Lawyer* 111; Law Reform Commission of British Columbia, *Competing Rights to Mingled Property: Tracing and the Rule in Clayton's Case* (Working Paper No 36, 1982).

In *Pennell v. Deffell*,<sup>49</sup> Green was an official assignee of the Court of Bankruptcy, who lodged trust money into accounts with two banks into which he also lodged some of his own money. To the claim by his successor to the trust monies in the accounts, the Court of Appeal applied the rule in *Clayton's Case* to the running of the accounts. Knight-Bruce L.J. held that the principles in that case were applicable, "notwithstanding the different nature and character of the sums forming together the balance due from the bank to the trustee ...".<sup>50</sup> Likewise, Turner L.J. held that

"Green opened and kept these banking accounts upon the usual footing, and the Plaintiff, taking the benefit of the accounts, cannot, as I think, be entitled to alter their character. Adopting for the purpose of establishing his demand against Green's estate he must, I think, adopt them with all their incidents, one of which is that the monies drawn out are to be applied to the monies first paid in".<sup>51</sup>

The application of the rule in *Clayton's Case* to the claims of competing beneficiaries as a matter of principle was approved in *In re Hallett's Estate*.<sup>52</sup> and many subsequent cases have affirmed and applied the principle in this context.<sup>53</sup>

49. (1853) 4 De G.M.&G. 373; 43 E.R. 551. This is an important case in the development of the modern law of tracing. The Court of Appeal restated the by then well-established principle that a beneficiary under a trust was able to trace the trust property into its product and claim it in equity (see, e.g. *Ryall v. Ryall* (1749) 1 Atk. 165; 26 E.R. 39; *Lane v. Dighton* (1762) Amb. 409; 27 E.R. 274), and, in a crucial extension, held that the principle applied equally to cases where the product constituted a mixed fund. This extension, confirmed in *In re Hallett's Estate*, was crucial to the development of the modern law of tracing; see Oakley "The Prerequisites of an Equitable Tracing Claim" (1975) 28 *CLP* 64, 65-70.

50. (1853) 4 De G.M.&G. 373, 384; 43 E.R. 551, 556.

51. (1853) 4 De G.M.&G. 373, 393-394; 43 E.R. 551, 560.

52. In *In re Hallett's Estate* "both Jessel M.R. and Baggallay L.J. indorsed the general principle laid down by the Court of Appeal in Chancery in *Pennell v. Deffell* (1853) 4 De G.M.&G. 372, 43 E.R. 551 that the principle of *Clayton's Case* is to be applied, even as against beneficiaries, in allocating the payments out of a bank account in which the account holder has blended his own moneys and money held for different fiduciary purposes." *Barlow Clowes International Ltd (in liq.) v. Vaughan* [1992] 4 All E.R. 22 (CA) 32 per Leggatt L.J.

53. *In re Hallett's Estate* (1879-1880) 13 LR Ch. 696, 738 per Baggallay L.J.: In *Pennell v. Deffell* "the Lords Justices enunciated the proposition that, as a general principle, the rule in *Clayton's Case* must be applied to the banking accounts of trustees for the purposes of determining the proportions in which the *cestuis que trust* and general creditors, or the several classes of their *cestuis que trust*, are entitled to the debt due from the bankers in closing the account. To the general



Ironically, although *Pennell v. Deffell* established this principle, its application on its own facts was overruled in *In re Hallett's Estate*. In *Pennell*, Green had mixed beneficiaries' money with his own and made withdrawals from the accounts, and the Court of Appeal had applied Clayton Case to appropriate the lodgments from the beneficiaries to the withdrawals. However, in *In re Hallett's Estate*, the majority held that "where a man does an act which may be rightfully performed, he cannot say that the act was intentionally and in fact done wrongly" so that it was "perfectly plain that he cannot be heard to say that he [Hallett] took away the trust money when he had a right to take away his own money".<sup>54</sup>

Thus, where Hallett had mixed and withdrawn, the withdrawals were counted first against his interest. To the extent that *Pennell* had not applied this principle, it was overruled. However, the principle of the application of Clayton to the claims of the beneficiaries *inter se*, first established in *Pennell*,

principle so enunciated I readily accede ...". *Hancock v. Smith* (1889) 41 Ch.D. 456 (North J. and CA) 461 per Lord Halsbury L.C.: "... as between *cestuis que trust* the rule is applicable, but it cannot be applied here, because no question arises between the different *cestuis que trust*" (see also *ibid*, per Cotton L.J.); *In re Stenning*. *Wood v. Stenning* [1895] 2 Ch. 433, 436 per North J.: "[a]ccording to *In re Hallett's Estate*, the rule in *Clayton's Case* applies as between two *cestuis que trust*, whose money the trustee has paid into his own account at his bankers"; *Mutton v. Peat* (1899) 2 Ch. 556, 560 per Byrne J.: "The rule in *Clayton's Case* applies ... as between *cestuis que trust* in an appropriate case ..."; *In re Diplock's Estate* [1948] Ch. 465, 554 per Greene MR: "It has been applied in the case of two beneficiaries whose trust money has been paid into a mixed banking account from which drawings were subsequently made, ..."; *Shanahan's Stamp Auctions v. Farrelly* [1962] I.R. 386, 442 per Budd J.: "[i]n general the rule in *Clayton's Case* is applicable as between *cestuis que trustent*: that is, that first drawings out are to be attributed to the first payments in"; *In re Hughes* [1970] I.R. 237 (HC) 242 per Kenny J.; *Re Ararimu Holdings* [1989] 3 N.Z.L.R. 487 (NZ HC) 498 per Wylie J.; *Barlow Clowes International Ltd (in liq) v. Vaughan* [1992] 4 All E.R. 22 (CA).

54. (1879-1880) 13 LR Ch. 696, 709 per Jessel M.R. Similarly, an "honest intention should be attributed to the trustee" (1879-1880) 13 LR Ch. 696, 743 per Baggallay LJ concurring. Indeed, this principle had been stated in *Pennell* (see (1853) 4 De GM&G 373, 382; 43 E.R. 551, 556 per Knight Bruce L.J.), but not applied, and, in *Hallett*, Thesiger LJ dissented on the ground that *Pennell* was rightly decided on this point. This penal principle has often been approved and applied in Ireland: see, eg, *In re Ulster Land, Building and Investment Co, ex parte Fitzsimon* (1889-1890) 25 Lr. I.R. 24, 29 per Chatterton V.-C.; *Shanahan's Stamp Auctions v. Farrelly* [1962] I.R. 386, 425-429, 443, 448-449 per Budd J.; *In re Irish Shipping* [1986] ILRM 518 (HC) 521, 523 per Carroll J. It has recently received the endorsement of the House of Lords: see *Foskett v. McKeown* [2001] 1 A.C. 102, 132 per Lord Millett.

was affirmed in *Hallett*, and has often been subsequently applied. *In re Hughes*<sup>55</sup> illustrates the application of both rules on a single set of facts. A solicitor had made withdrawals from his client account, and then later lodged the sum of £863. Following the *Hallett* principle that the fiduciary is presumed to act lawfully, the withdrawals would have counted first against any funds which the solicitor had in the account; and the £863 was presumed to have been intended by him "to be a replacement of moneys which he had wrongfully withdrawn from the client account".<sup>56</sup> As to the balance of £1,396 11s in the account, Kenny J., applying *Clayton's Case*, held that it "should be applied in paying the claims of those creditors against it whose moneys were most recently lodged to its credit immediately prior to the bankruptcy".<sup>57</sup>

However, the version of the rule in *Clayton's Case* which is applied in this context is not the version stated by Grant MR in the case itself based upon the nature of the account, but is instead the version which *Hallett* did much to establish which bases the rule on the presumed intentions of the parties. Hence, there are many cases accepting in principle the application of *Clayton's Case* in the context of a dispute between competing beneficiaries of a depleted trust fund in a bank account, but then excluding its application of the rule on the facts on the grounds that it is inconsistent with the parties' intentions or with other aspects of the evidence. The notorious decision of the Court of Appeal in *In re Diplock's Estate*,<sup>58</sup> on the recovery of monies distributed under invalid bequests, is a good illustration. Lord Greene MR described the rule as "really a rule of convenience based on so-called presumed intention"<sup>59</sup> and applied it where the bequest had been lodged to a bank account. However, where the bequest went to the purchase of some war stock, of which it already had some and thereafter bought and sold more, the Court declined to apply the rule in *Clayton's Case*, seeing "no justification for extending that rule beyond the case of a banking account".<sup>60</sup>

Again, in *In re British Red Cross Balkan Fund*,<sup>61</sup> Astley J. held that the

55. [1970] I.R. 237 (HC); for similar Canadian and US authorities, see Maddaugh and McCamus *The Law of Restitution* (Canada Law Book Co, 1990) 147 nn.89-90.

56. [1970] I.R. 237, 242 per Kenny J.; for a similar application, see another stage in the Money Markets litigation: *In re Money Markets International Stockbrokers Ltd* [2000] 3 I.R. 437 (HC; Laffoy J.).

57. [1970] I.R. 237, 243.

58. [1948] Ch. 465 (CA); cf *Welwood v. Grady* [1904] 1 I.R. 388.

59. [1948] Ch. 465, 554.

60. [1948] Ch. 465, 555. Chaffee "Book Review" (1950) 36 *Cornell LQ* 170, 176 reviewing Hanbury *Modern Equity* (5th ed, Stevens, London, 1949), "rather regret[ted] that Mr Hanbury [did] not rebel at this judicial distinction between Tweedle-dum and Tweedle-dee".

61. *In re British Red Cross Balkan Fund, British Red Cross Society v. Johnson* [1914] 2 Ch. 419 (Astbury J.); followed in *In re Hobourn Aero Components Limited's*



"rule in *Clayton's Case* as restated by Lord Halsbury LC in *The Mecca* ... is a mere rule of evidence and not an invariable rule of law, and the circumstances of any particular case may or may not afford ground for inferring that the transactions of the parties were not intended to come under the general rule",<sup>62</sup> and he concluded without much warrant that the rule was "obviously inapplicable"<sup>63</sup> on the facts. Similarly, in *In re Eastern Capital Futures (in liq)*<sup>64</sup> Morritt J. would also have excluded the application of the rule, partly because it was impossible properly to presume any intention on the part of the relevant beneficiaries that their payments "into or payments out of the account on his behalf should, *viz-à-viz* other clients, be treated on first in, first out basis",<sup>65</sup> and partly because the records of the company were in such a state that, "it would be impossible, even if *Clayton's Case* were applicable, to attribute the benefit of any particular futures contract to any particular client".<sup>66</sup>

The leading Irish case is *Shanahan's Stamp Auctions v. Farrelly*.<sup>67</sup> Investors in a stamp investment scheme were to be grouped into syndicates to which blocks of stamps would be allocated, and when those stamps would be auctioned, the investors would receive the proceeds of sale. The scheme was bogus; on its insolvency, Budd J. held that the investors who had been grouped into syndicates had proprietary claims to those stamps allocated to them by the company, and, on the basis of *In re Hallett's Estate*,<sup>68</sup> that the investors who

*Air Raid Distress Fund. Ryan v. Forrest* [1945] Ch. 86 (Cohen J.). On the prior question in the case of whether gifts had failed and a resulting trust arose, see *Barlow Clowes International v. Vaughan* [1992] 4 All E.R. 22, 29 *per* Dillon L.J.; see also Meagher and Gummow *Jacobs' Law of Trusts in Australia* (6th ed, Butterworths, Sydney, 1997) 289, para. 1208.

62. [1914] 2 Ch. 419, 421. *The Mecca* is the quintessential application of the presumed intention version of the rule; see text with nn.36-39 above.

63. *Ibid.*

64. [1989] B.C.L.C. 371 (Ch D; Morritt J.).

65. [1989] B.C.L.C. 371, 374 *per* Morritt J.; note that the distaste for the application of the rule in this context has transmuted a presumption of such intention unless the contrary be shown into an enquiry as to whether such an intention is plausible; compare the approach of Woolf and Leggatt L.J. in *Barlow Clowes International v. Vaughan* [1992] 4 All E.R. 22 discussed text with n.85 below.

66. [1989] B.C.L.C. 371, 375 *per* Morritt J.

67. [1962] I.R. 386 (HC; Budd J.); see O'Dell, "Tracing" (1999) 21 *DULJ* (ns) 131, 138, 142-144, 162, 167-168.

68. Crucially, his discussion of subsequent cases such as *Sinclair v. Brougham* [1914] A.C. 398 (HL) and *Re Diplock* was for the most part only to determine whether they supported his analysis of *Hallett*, not for what they themselves might have otherwise. For example, Budd J. concluded that "whether the decision in *Sinclair v. Brougham* extends the principles laid down in *Hallett's Case* or illustrates how these principles can be applied it is not necessary to determine. It does, however, seem evident that the decision does not cut down in any way the principles in

had not been grouped into syndicates could trace their money into and claim the unallocated stamps. The company was presumed to have dissipated its own money first, so that, "having regard to the deficit, no suggestion [could] be made that any of the Company's money [was] represented by the stamps in hands".<sup>69</sup> As between the competing claims of the beneficiaries, however, *Clayton's Case prima facie*<sup>70</sup> applied. Hence, for Budd J., "the rule in *Clayton's Case* is applicable as between *cestuis que trustent*: that is, that first drawings out are to be attributed to the first payments in. In other words, the trustee is deemed to draw out first the money of the *cestuis que trustent* that he paid first into the blended account".<sup>71</sup> On the facts, the investors' value had been mixed twice, first in the bank account and then in the stamps, and though the bank records indicated the order in which the investors' funds were lodged, it was not possible to determine from the company's records what monies were used for the purchase of any given lot of stamps. Hence, there was insufficient evidence for the operation of *Clayton's Case*.<sup>72</sup>

"... there having been a second mixing of the investors' funds into a second mixed amalgam of property, it would not be possible for any particular investor to say that this particular money was used before others in the purchase of property in the shape of stamps. Tracing, in the exact sense of that term, is therefore not possible or practicable. ... Therefore, the rule in *Clayton's Case* does not apply as between the unsyndicated investors ...".<sup>73</sup>

*Hallett's Case*" ([1962] I.R. 386, 432). Similarly, he concluded that *Re Diplock* "follow[ed] and accept[ed] the principles of *Hallett's Case* as explained in *Sinclair v. Brougham* ..." ([1962] I.R. 386, 437). Hence, Budd J. stated the principles in *Hallett* ([1962] I.R. 386, 428), refracted them through *Sinclair v. Brougham* and *Re Diplock*, restated them in almost the same terms as before ([1962] I.R. 386, 438), and then applied them to justify the unsyndicated investors' claims. In other words, *Shanahan's Stamp Auctions v. Farrelly* is merely an application of *Hallett*, rather than of *Sinclair v. Brougham* and *Re Diplock*; it says nothing about any other issues raised in those cases, and in particular does not constitute an adopting of any limitations or restrictions upon tracing or claiming stated in those cases.

69. [1962] I.R. 386, 439; see also 443.

70. Having discussed *Clayton, Pennell* and *Hallett*, ([1962] I.R. 386, 425-428) Budd J. concluded, *inter alia*, that *Clayton's Case* "would appear to apply between beneficiaries" ([1962] I.R. 386, 428; see also 438).

71. [1962] I.R. 386, 442.

72. [1962] I.R. 386, 442; on using records for the tracing exercise, *cp Boscawen v. Bajwa* [1996] 1 W.L.R. 328; [1995] 4 All E.R. 769 (CA) (index cards); on the failure of the application of the rule in *Clayton's Case* due to incomplete records, *cp Eastern Capital Future Ltd (in liq.)* [1989] BCLC 371, text with nn.64-66 above.

73. [1962] I.R. 386, 442-443; see also 449.



Such an easy finding of the non-applicability of *Clayton's Case* is entirely welcome, but it is only a partial solution to the problems posed by the fact that the rule is thought to be relevant in the first place. Indeed, these problems have caused all sorts of exceptions to be grafted upon the rule;<sup>74</sup> for example, Budd J. commented that the rule in *Clayton's Case* might "not apply beyond tracing in a bank account and the principle may have no application to property acquired by means of a mixed fund".<sup>75</sup> Care should be taken with such exceptions, both in their generation and in their application. There has been much cross-pollination of principle between the banker-customer context and the competing contributors context. For example, *Hallett* not only generated the presumption of intention flavour of the rule which is applied in the banker-customer context in *The Mecca* and *Deeley*, it applied this flavour of the rule to the competing contributors context; in turn, *The Mecca* and *Deeley* have guided most subsequent courts not only in the banker-customer context but also in the competing contributors context. The same potentially pernicious process is at work in the generation of exceptions. The rule in *Clayton's Case* is entirely appropriate in the banker-customer context, and, in that context, it should admit only of those exceptions consistent with the nature of the relevant account or of the intentions of the parties. On the other hand, the rule is entirely inappropriate in the competing contributors context, and the desire to get around it in this context can often generate illogical limitations upon or exceptions to the rule; until the rule is properly abrogated in this context, there may be something in this strategy (indeed, the rule may fall under the weight of its exceptions), but any limitations or exceptions generated in this context should not then be transposed to the banker-customer context. Indeed, as and when the rule is abrogated in the competing contributors context, exceptions generated in that context and transposed to the banker-customer context should also be revisited and may even be ripe for revision if not abrogation in their turn.<sup>76</sup> The exception stated by Budd J. is of this nature. It is crafted simply to

74. Ogilvie identifies thirteen exceptions (see Ogilvie, *Canadian Banking Law* (2nd ed., Carswell, Toronto, 1998) 541-543); for a further possible exception, consider the discussion of the non-application of *Clayton* in Canadian stockbroker bankruptcies in Madaugh and McCamus, *The Law of Restitution* (Canada Law Book Co., 1990) 154-156.

75. [1962] I.R. 386, 442; an exception which is not among the thirteen discussed in Ogilvie (see the previous note).

76. It is settled that the rule applies only in respect of running accounts, often stated to be current accounts (see n.37 above). It may be that its application has been confined to such accounts because distaste for the rule in the competing contributors context has overspilled into the banker-customer context. Certainly, the logic of *Clayton's Case* itself, *The Mecca* and *Deeley*, is entirely applicable as much to other running accounts such as deposit accounts, credit card accounts and so on as it is to current accounts strictly so called, and it may be that once the

limit the application of the rule in the competing contributors context. It is difficult to see how it might be transposed to the banker-customer context. Even if it could, it ought not to be, and it should fall with the abrogation of the rule in the competing contributors context.

In many ways, the approach of Budd J. in *Shanahan's* is similar to that taken by the Court of Appeal in the leading English case of *Barlow Clowes International Ltd (in liq) v. Vaughan*.<sup>77</sup> On the liquidation of a fraudulent investment house, where money from a large numbers of investors was mixed in bank accounts, and then applied to the purchase of gilts and misapplied to the purchase of a yacht, it was argued that the rule in *Clayton's Case* was inapplicable both on the facts in its own terms, and as a matter of principle. Dillon L.J. was quite enthusiastic about it,<sup>78</sup> expressly rejecting the attack on it as a matter of principle; whereas Woolf and Leggatt L.J.J. evinced different degrees of reluctance about it, without ever quite expressly rejecting it. For Dillon L.J., *Clayton's Case* was no more or less unfair than its alternatives, and the authorities were consistent in its favour.<sup>79</sup> As a consequence, it was not for the court to reject that long-established general practice.<sup>80</sup> On the other hand, Woolf L.J. was much more grudging, accepting that "short of the House of Lords, it is settled law that the rule in *Clayton's Case* can be applied"<sup>81</sup> he nevertheless quickly asserted that it did not "follow that the rule has always to be applied for this purpose".<sup>82</sup>

Nevertheless, all three members of the Court took the speech of Lord Halsbury LC in *The Mecca* as their template for the application of *Clayton's Case*, holding both that it could *prima facie* apply to the competing claims of the beneficiaries, and that it could be displaced if the circumstances of the case allowed the inference that the parties intended otherwise.<sup>83</sup> Since the investors intended a common investment fund, it would be contrary to their actual or presumed intention to apply *Clayton's Case*.<sup>84</sup> Dillon L.J. examined the nature of the investment pool and held that the application of *Clayton's Case* was inconsistent with it; on the other hand, the exercise undertaken by

misuse of *Clayton's Case* in the competing contributors context ceases, it may come to be applied to other types of account as between bank or other credit institution on the one hand and customer on the other; (on another application possible in principle, see n.45 above).

77. [1992] 4 All E.R. 22 (CA).

78. As he had been as a first instance judge in the earlier *Norton Warburg Investment Management Ltd. v. Gibbons* (July 31, 1981, unreported).

79. [1992] 4 All E.R. 22, 32-33; cf 45 per Leggatt L.J.

80. [1992] 4 All E.R. 22, 33.

81. [1992] 4 All E.R. 22, 38-39, emphasis in original.

82. [1992] 4 All E.R. 22, 39.

83. [1992] 4 All E.R. 22, 30 per Dillon L.J., 36-39 per Woolf L.J., 44 per Leggatt L.J.

84. [1992] 4 All E.R. 22, 31 per Dillon L.J., 41 per Woolf L.J., 45-46 per Leggatt L.J.



Woolf and Leggatt L.J. was quite different. It was to examine the nature of the pool, seek to infer or presume the intention of the investors,<sup>85</sup> and then to compare that inferred or presumed intention with that postulated by *Clayton's Case*. The approach of Dillon L.J. is consistent with *Clayton's Case* on its terms, whereas that of Woolf and Leggatt L.J. almost entirely eviscerates it. By looking to other elements of the facts to generate a presumed intention, they have undertaken the work that *Clayton's Case* was supposed to do. This may be a welcome departure from an unfair case, but it is not a consistent or principled manner in which to do it. To presume an intention, and then to say that this presumed intention displaces another presumption of intention is to heap fiction upon fiction. It would have been much better had Woolf and Leggatt L.J. simply and expressly declined to apply *Clayton's Case* in the first place.

*Pennell v. Deffell* was the crucial error. The case concerned contributors making competing claims to money mixed in a bank account, and the Court of Appeal focussed simply on the bank account and applied the rule which applies to bank accounts as between banker and customer, rather than on the fact that the bank account constituted a mixture from the perspective of the competing claimants and ought therefore to have attracted the rule appropriate to mixtures. The result in *Pennell* was, in Smith's words "rigid, and internally inconsistent as between physical mixtures and bank accounts".<sup>86</sup> in the case of physical

85. "In these circumstances the court has to presume what would have been the intention of the investors had they contemplated the creation of this pool. It can be presumed that they would not want to subject what was left of the pool to the vagaries of chance which would follow from the application of the first in, first out principle" ([1992] 4 All E.R. 22, 41 per Woolf L.J.). "Whatever the reason why losses were suffered by the fund, it accords with what presumably would have been the intention of the contributors that they should share rateably in what remains of it" ([1992] 4 All E.R. 22, 46 per Leggatt L.J.). This presumption provides no principled means of distinguishing *Barlow Clowes* from cases such as *Pennell*, *Hallett*, and every other case in which *Clayton* has been applied, to which it would seem equally applicable. Furthermore, it is by no means clear that it can safely be presumed that the investors would want a rateable distribution rather than a first in, first out rule. Under the latter, those investors whose money went in last would stand to benefit, and it can just as easily be presumed that these investors at least would want the application of the *Clayton* rule (as did the applicant in *In re Money Markets International* [1999] 4 I.R. 267 (HC, Laffoy J.) section 6 below). Indeed, if investors did not know the order in which their brokers transmitted the money to BCI, some at least would be prepared to take the chance that theirs went in late, and thus gain it all back; some could be prepared to gamble a small proportionate return for the chance of the full amount, and it could be assumed that such risk takers would want the application of the *Clayton* rule. It is because so many presumptions are always possible that the law adopted the rule in *Clayton's Case* in the first place, to conclude as between such presumptions of intention in favour of the "first in, first out" rule.

86. Smith, 190.

mixtures, each contributor has a proportionate share, and this ought also to apply where the mixture is of money in a bank account. The proper perspective, therefore, is not that of the banker, but of the competing claimants.<sup>87</sup>

When tools are inadequate to the task to which they are applied, they are apt to do more harm than good. This is precisely what has happened with the extension of *Clayton's Case* from the banker-customer context to the competing contributors context, where it has drawn a chorus of disapproval: it is inconsistent with principle,<sup>88</sup> arbitrary and unfair,<sup>89</sup> an abhorrent,<sup>90</sup> absurd<sup>91</sup> and erroneous rule which works rough justice<sup>92</sup> and provides purely accidental advantages<sup>93</sup> to later contributors to the account. The remedy is to fashion a new and more appropriate tool. The raw material has been provided by some statements of principle in the recent decision of the House of Lords in *Foskett v. McKeown*.<sup>94</sup> For example, Lord Browne-Wilkinson commented that in the case of mixing of funds, "it is established law that the mixed fund belongs proportionately to those whose moneys were mixed",<sup>95</sup> and Lord Millett, added that where "the fund is deficient ... all must share rateably in the fund",<sup>96</sup> so that the "primary rule in regard to a mixed fund, therefore, is that gains and losses are borne by the contributors rateably".<sup>97</sup> This is entirely logical, and

87. McConville, "Tracing and the Rule in *Clayton's Case*" (1963) 79 LQR 388, 399-401.

88. Meagher and Gummow, *Jacobs' Law of Trusts in Australia* (6th ed, Butterworths, Sydney, 1997) 749, para.2712.

89. McConville, "Tracing and the Rule in *Clayton's Case*" (1963) 79 LQR 388, 401; cf Goff and Jones, *The Law of Restitution* (5th ed, Sweet & Maxwell, London, 1998) "capricious and arbitrary" (108); Hayton and Marshall, *Commentary and Cases on The Law of Trusts and Equitable Remedies* (11th ed, Sweet & Maxwell, London, 2001) "arbitrary and inconvenient" (873); cf Burrows, *The Law of Restitution* (Butterworths, London, 1993) "arbitrary and unjust" though nonetheless "even-handed in the sense that each party stands equally to gain or lose" (72); a rule which is arbitrary and unjust does not become less so simply because it is equally arbitrary and unjust to every party affected by it.

90. Hayton, "Equity's Identification Rules" in Birks (ed) *Laundering and Tracing* (Clarendon Press, Oxford, 1995) 3, 16.

91. Oakley, *Parker and Mellows: The Modern Law of Trusts* (7th ed, Sweet & Maxwell, London, 1998) 735, 736.

92. Keane, *Equity and the Law of Trusts in the Republic of Ireland* (Butterworths, Dublin, 1988) 286, para.20.13.

93. Higgins, "Re Diplock - A Reappraisal" (1963-1964) 6 UWALR 428, 433, 442.

94. [2001] 1 A.C. 102 (HL).

95. [2001] 1 A.C. 102, 109; again, any "credit balance on the account belongs to the [contributors, in the example, the] trustee and the beneficiaries rateably according to their respective contributions" [2001] 1 A.C. 102, 110.

96. [2001] 1 A.C. 102, 132.

97. *Ibid.*, see also [2001] 1 A.C. 102, 141: He comes to these conclusions in the



must sound the death-knell for the application of *Clayton's Case* in this context. Even if it does not amount to an explicit rejection of the rule,<sup>98</sup> it provides a compelling argument against it which should prove decisive on the next occasion when the rule is called into question in this context. Similar logic has already been applied in many cases in the US, New Zealand, Canada and Australia which have therefore simply declined to apply *Clayton's Case* as a matter of principle in the competing contributors context, whilst properly preserving its application in the banker-customer context.

##### 5. THE DECLINE OF THE INAPPROPRIATE EXTENSION OF CLAYTON'S CASE

In the United States, the charge has been led by the decision of Learned Hand J. in *In re Walter J. Schmidt & Co. Ex parte Feuerbach*.<sup>99</sup>

"The rule in *Clayton's Case* ... has no relevancy whatever to a case like this. Here two people are jointly interested in a fund held for them by a common trustee. There is no reason in law or justice why his depredations upon the fund should not be borne equally between them. To throw all the loss upon one, through the mere chance of his being earlier in time, is irrational and arbitrary, and is equally a fiction as the rule in *Clayton's Case*, ... When the law adopts a fiction, it is, or at least it should be, for some purpose of justice. To adopt it here is to apportion a common misfortune through a test which has no relation whatever to the justice of the case. ... Such a result, I submit with the utmost respect, can only come from a mechanical adherence to a rule which has no intelligible relation to the situation."<sup>100</sup>

Although he was bound by authority<sup>101</sup> to apply the rule to the case before

context of bank accounts expressly by analogy with the rules as to following into and through physical mixtures.

98. *Cp.* the rejection of the fiduciary requirement in a similar *sub silentio* manner by Lord Browne-Wilkinson's thief example in *Westdeutsche Landesbank Girozentrale v. Islington LBC* [1996] A.C. 669 (HL) 716, on which see Smith "Tracing" in Birks and Rose (eds) *Lessons of the Swaps Litigation* (Mansfield/LLP, London, 2000) 233, 234-235; on this rejection, see further *Foskett v. McKeown* [2001] 1 A.C. 102, 128 *per* Lord Millett (*cp.* his earlier comment in the Court of Appeal in *Bristol and West Building Society v. Mothew* [1998] Ch.1 (CA) 23), on which see O'Dell "Tracing" (1999) 21 *DULJ* (ns) 131, 166-168.
99. 298 F 314 (1923).
100. 298 F 314, 316; see Scott "The Right to Follow Money Wrongfully Mingled with Other Money" (1913) 27 *Harv L Rev* 125, 130.
101. *State Surety Co v. Carroll County* 194 Fed 593 (1912); *In re Bolognesi & Co* 254 Fed 770 (1918); see also *Hewitt v. Hayes* 205 Mass 356 (1910); *Cunningham v.*

him, this critique has since been adopted in those not only in those states of the United States which had not adopted the rule<sup>102</sup> but also in other common law jurisdictions when the rule has come under scrutiny. Thus, for example, it was cited with approval by Woolf and Leggatt L.J.J. in *Barlow Clowes International v. Vaughan*,<sup>103</sup> and it was an important building block for the Court of Appeal in New Zealand in its repudiation of *Clayton's Case* in *Re Registered Securities*.<sup>104</sup>

"The automatic application of the rule in *Clayton's Case* as between beneficiaries will not in our view withstand scrutiny. In the first place, the rule is founded on presumed intention. It is in truth a fiction and cannot be allowed to work an injustice. ... In the second place, because the rule in *Clayton's Case* is based upon a presumed intent, it must give way to an express contrary intention or to circumstances which point to a contrary conclusion ... It must follow in our view that where a trustee mixes the funds of different beneficiaries a withdrawal which is expressly or by implication intended to be to the account of one particular beneficiary must be so treated. In such a case there is no apparent equity in that beneficiary entitling him to impose part of the loss on the other".<sup>105</sup>

The first line of this passage seems to constitute a repudiation of the rule in *Clayton's Case*.<sup>106</sup> However, in the reasons given in the remainder, it sounds at times almost as partial a repudiation as that in *Barlow Clowes International*

*Brown* 265 US 1(1924); authority which still applies in New York: *Chase Manhattan Bank NA v. Traditional Investments Corp* 1995 WL 72410, a case which confusingly describes the application of the rule in *Clayton's Case* as "last in, first out" because Sotomayor J. focussed not on the appropriation of withdrawals to lodgments (which, according to *Clayton*, is "first in, first out") but on the process of distribution of the existing funds, which, if earlier lodgments have been appropriated to earlier withdrawals means that only the later lodgments can be claimed, and the easiest means to do this is to work back from the last lodgments, on a "last in, first out" basis.

102. *Murry v. Bhale* 203 F Supp 583 (1962); *In re Rhine* 241 F Supp 86 (1965); *Ruddle v. Moore* 411 F 2d 718 (1968); *Commodity Futures Trading Commission v. Franklin* 652 F Supp 163 (1986).
103. [1992] 4 All E.R. 22, 35 *per* Woolf L.J., 44 *per* Leggatt L.J.
104. [1991] 1 N.Z.L.R. 545 (NZ CA: Richardson, Somers and Casey JJ.); see also *Re Securitbank* [1978] 1 N.Z.L.R. 97, 174 *per* Barker J.
105. [1991] 1 N.Z.L.R. 545, 553 *per* Somers J. (Richardson and Casey JJ. concurring).
106. *Cp.* Goff and Jones, *The Law of Restitution* (5th ed, Sweet & Maxwell, London, 1998) stating that the "fiction of Clayton's case was rejected by the New Zealand Court of Appeal in *Re Registered Securities* ..." (108, n32); to similar effect, see Delany, *Equity and the Law of Trusts in Ireland* (2nd ed, Round Hall Sweet & Maxwell, Dublin, 2000) 640.



v. *Vaughan*, and for the same reason: by basing the non-application of the rule upon a presumed intention of the parties which is different to and thereby displaces that intention presumed on the basis of *Clayton's Case*, lip service is still paid to the rule, at least as recast on the basis of presumed intention in cases such as *The Mecca*.<sup>107</sup> Although, then, the rule is not entirely dead, it is nevertheless unlikely to be revived in New Zealand,<sup>108</sup> and it would be better if it were killed off completely there as soon as possible.

The Canadian courts have shown no such scruples. The leading case is *Re Ontario Securities Commission and Greymac Credit Corp.*<sup>109</sup> Greymac held \$4,683,000 on trust for a group of companies, and deposited it into a bank account. It later lodged a further \$1,013,600 into this account, being \$841,285.26 which it held on trust for participants in an investment scheme and \$172,314.74 of its own money. Greymac then withdrew \$4,000,000 and lodged it to another account. Finally, in various withdrawals from the first account, Greymac misappropriated and dissipated \$1,343,191.34. That misdirection was allocated first to the trustee's own money, and the question was whether the remaining loss should be borne *pro rata* across both accounts and by both beneficiaries, or whether the rule in *Clayton's Case* should apply, so that the \$4,000,000 transferred into the second account would come from the first lodgment of \$4,683,000 and the loss would be borne by the money remaining in that account after the withdrawal. The companies supported the *Clayton's Case* solution, and the participants advocated the *pro rata* solution. The *Clayton's Case* solution was repudiated at every level.

At first instance,<sup>110</sup> Parker A.C.J.H.C. commented that although "the rule is framed at least in part in terms of the debtor's presumed intention, in fact, it is a rule of common sense derived from the very nature of the banker-customer relationship in a current account"<sup>111</sup> in which context he would have been happy to apply the rule; the difficulty arose with its extension to the context of

107. *Ibid.*

108. Indeed, Dal Pont and Chalmers observe that after *Barlow Clowes and Re Registered Securities*, it "would, therefore, appear that the death knell of the rule in *Clayton's Case* in so far as it applies to allocate interests in trust property, is imminent" (Dal Pont and Chalmers, *Equity and Trusts in Australia and New Zealand* (2nd ed, LBC, 2000) 1011).

109. (1985) 19 D.L.R. (4th) 470 (Ont. HC); *affd* (1986) 30 D.L.R. (4th) 1 (Ont. CA); *affd* (1989) 52 D.L.R. (4th) 767 (SCC); for the position in Canada prior to this decision, see Waters, *The Law of Trusts in Canada* (2nd ed, Carswell, Toronto, 1984) 1045, 1050-1053. In *Re Law Society of Upper Canada and Riviera Motel (Kitchner)* (1981) 123 D.L.R. (3d) 409, 413 Pennell J. considered that the operation of *Clayton* in the context of mixtures could "work some odd and harsh results" but nevertheless felt constrained by authority to apply it

110. (1985) 19 D.L.R. (4th) 470 (Parker A.C.J.H.C.; Ont. HC).

111. (1985) 19 D.L.R. (4th) 470, 491.

the competing claims of contributors to a depleted mixture such as beneficiaries of a depleted trust account. Consequently, he held that

"the rule in *Clayton's Case* arose out of the debtor-creditor relationship and should be restricted to that relationship. ... As between the two innocent beneficiaries, they each had an interest in the mingled fund in proportion to their respective traceable contributions to the fund. Those interests ranked equally. Therefore, losses to that fund should be allocated against the interests of beneficiaries in proportion to the their respective traceable interests in the fund at the time the loss occurred. ... [This conclusion is] both logical and fair. In this age of computerized banking, it can hardly be argued that in most instances an application of such principles will cause much inconvenience, difficulty or complication".<sup>112</sup>

The Ontario Court of Appeal affirmed.<sup>113</sup> For Morden JA, the rule in *Clayton's Case* had no role to play in the resolution of competing beneficial entitlements to a mingled and depleted trust fund,<sup>114</sup> Turner LJ's extension of the rule in *Pennell* was misconceived,<sup>115</sup> and Learned Hand J's critique of an arbitrary and unfair rule hit its target.<sup>116</sup> In a single page, the Supreme Court of Canada affirmed: "... we agree with the conclusion of the Court of Appeal and we adopt the reasons therefor delivered by Morden JA on behalf of the court".<sup>117</sup> As a matter of Canadian law, therefore, the rule in *Clayton's Case* does not apply to the claims of competing contributors to a depleted mixture such as the beneficiaries of a depleted trust account. This is as it should be.

This is also how it is in New South Wales. In the High Court, Kearney J. has twice rejected the rule<sup>118</sup> on the grounds that *Clayton's Case* "regulates

112. (1985) 19 D.L.R. (4th) 470, 496-498.

113. (1986) 30 D.L.R. (4th) 1 (Ont. CA; Lacourcière, Morden and Tarnopolsky J.J.A.).

114. (1986) 30 D.L.R. (4th) 1, 13 *per* Morden J.A., Lacourcière and Tarnopolsky J.J.A. concurring.

115. (1986) 30 D.L.R. (4th) 1, 14, adopting the critique of McConville "Tracing and the Rule in *Clayton's Case*" (1963) 79 L.Q.R. 388, 401 discussed above, text with nn.86-87.

116. (1986) 30 D.L.R. (4th) 1, 15.

117. (1989) 52 D.L.R. (4th) 767 (SCC) 767 *per* Dickson C.J.C. (McIntyre, Lamer, Wilson, La Forest, L'Heureux-Dubé and Sopinka J.J. concurring); followed in *British Columbia v. National Bank of Canada* (1994) 119 D.L.R. (4th) 669, 686 (BC CA; McEachern C.J.B.C., Legg and Hollinrake J.J.A.); *Law Society of Upper Canada v. Toronto-Dominion Bank* (1999) 169 D.L.R. (4th) 353 (Ont. CA; Osborne and Labrosse J.J.A. and Blair J. *ad hoc*).

118. *Shoreline Currencies (Australia) Pty Ltd and the Companies (New South Wales) Code* (New South Wales High Court, unreported, Kearney J, October 14, 1988); *Hagan v. Waterhouse* (1994) 34 N.S.W.L.R. 308.



the state of account between banker and customer, and has nothing to say as to the relationship of trustee and beneficiary".<sup>119</sup> And in *Keefe v. Law Society*,<sup>120</sup> in the Court of Appeal, Priestly J.A. held that the approach of Kearney J. "should be approved by this court,"<sup>121</sup> with the consequence that once the balance in a solicitor's client account became less than it should have been, he was in breach of trust to all of the clients whose funds were lodged to it.

However, although the Canadian courts did a good day's work when they repudiated Clayton's Case in *Greymac*, then they went and spoiled it all by saying that the lowest intermediate balance rule should fall with it.<sup>122</sup> To understand the problem with this, let us return to our basic example where I placed ten apples in your sack, first one, then four, and finally five, and then took out six and so had four left. My claim is to those four apples. Assume that they are green apples. Now let it be that your cousin Debbie gave you six red apples to keep for her, and you put them into the sack as well. This addition does not alter my position *vis à vis* you and the apples in the sack. My claim is still only to my four green apples; while Debbie has her claim to her six red apples. Although there are now again ten apples in the sack, my claim is only to the four of mine which remain; it is limited, in other words to the lowest intermediate balance of four apples.<sup>123</sup> The lowest intermediate balance rule thus follows as a matter of logic<sup>124</sup> from the nature of property: the tracing rules seek to identify property or its proceeds in the hands of another; and if

neither the property nor its proceeds exist in the hands of that other, then no claim contingent upon tracing can be made.

This conclusion does not change if Debbie's apples added to the sack are green too: although there are now again ten green apples in the bag, my claim is only to four of them. Neither does it change if the removal of the six apples had been by a third hand. Nor does it change if, as before, the apples are changed to pounds in a bank account, so that I lodge first one, then four, and finally five pounds, before six are misappropriated, and six more of Debbie's are eventually lodged: my claim is still only to the four pounds of mine which remained in the account after the misappropriation and before the lodgment of Debbie's money, and is thus to the lowest intermediate balance of four pounds.

Bank accounts provide an important and special example of the lowest intermediate balance at work. If I lodge ten pounds, and then make withdrawals amounting to the same amount, before Debbie's funds are lodged, I have no claim at all to the funds in the account: all of my money is gone; or, in other words, my claim is limited to the lowest intermediate balance of zero. If the account has an overdraft facility upon which I can call, and I lodge ten pounds and lodge eleven before Debbie's funds are lodged, I again have no claim at all to the funds in the account: again, all of my money is gone; my claim is limited to the lowest intermediate balance of less than zero. In other words, an overdraft defeats subsequent tracing of lodgments into an account made before the account went into overdraft.<sup>125</sup> The leading Irish case is *In re Ulster Land, Building and Investment Co, ex parte Fitzsimon*.<sup>126</sup> A first mortgagee exercised its power of sale over certain property, lodged the proceeds to their bank account, and then made a withdrawal from that bank account which put it into overdraft. That withdrawal was lodged to another account, which also subsequently went into overdraft. The sale of the property had realised more than the debt secured by the mortgage, so the second mortgagee on the property claimed the surplus, but Chatterton VC held against him on the ground that it no longer existed. It was, he thought, well settled that "after the whole of the mixed fund has been paid away, and no portion of that held in the fiduciary character remains in the possession or power of the trustee, or quasi trustee, or can be traced into money or property remaining in his possession or control, the right [to claim it] is at an end, because it cannot be given effect to".<sup>127</sup> Indeed, the appropriateness of this overdraft aspect of the lowest intermediate

119. *Hagan v. Waterhouse* (1994) 34 N.S.W.L.R. 308, 358, referring to McConville and adopting, *inter alia*, Meagher and Gummow, *Jacob's Law of Trusts in Australia* (5th ed, Butterworths, Sydney, 1986) 695, para.2714; see now (6th ed, Butterworths, Sydney, 1997) 746, para.2709.
120. (1998) 44 N.S.W.L.R. 451 (NSW CA; Priestly, Sheller and Powell JJ.A.), noted Handley, "Tracing and the Rule in Clayton's Case" (1999) 115 *LQR* 186.
121. (1998) 44 N.S.W.L.R. 451, 461, referring to McConville and to Meagher and Gummow, *Jacob's Law of Trusts in Australia* (6th ed, Butterworths, Sydney, 1997) 749-751, paras.2711-2712.
122. *Law Society of Upper Canada v. Toronto-Dominion Bank* (1999) 169 D.L.R. (4th) 353 (Ont. CA; Osborne and Labrosse JJ.A. and Blair J. (*ad hoc*)).
123. See Smith, 80-85, 201-203, 265-270; *James Roscoe (Bolton) Ltd. v. Winder* [1915] 1 Ch. 62 (Sargant J); *Re Norman Estate* [1952] 1 D.L.R. 174 (Ont. CA); *Lofts v. MacDonald* (1974) 3 ALR 404 (Campbell J); *Carroll Group Distributors Ltd. v. G and JF Bourke Ltd* [1990] 1 I.R. 481 (HC) 486-487 *per* Murphy J.; *In re Goldcorp Exchange* [1995] 1 A.C. 74 (PC) 107-108, noted Birks, "Proprietary Restitution: An Intelligible Approach" (1995) 9 *TLI* 43; *Bishopsgate Investment Management v. Homan* [1995] Ch. 211 (CA), noted Smith, "Tracing, 'Swollen Assets' and the Lowest Intermediate Balance" (1994) 8 *TLI* 102; Smith, "Tracing in Bank Accounts: The Lowest Intermediate Balance Rule on Trial" (2000) 33 *CBLJ* 75.
124. Maddaugh and McCamus, *The Law of Restitution* (Canada Law Book Co, 1990) 146, 153.

125. Although the claimant cannot trace into and through the account in its present state, it may be possible to trace into the asset purchased with the withdrawal which put the account into overdraft; see, generally, Smith "Tracing into the Payment of a Debt" [1995] *CLJ* 290.

126. (1889-1890) 25 Lr. I.R. 24 (Chatterton V.C.); see also *PMPs v. PMPA* High Court, unreported, June 27, 1994, Murphy J.

127. (1889-1890) 25 Lr. I.R. 24, 29.



balance rule has been accepted in many of the cases which have doubted *Clayton's Case*.<sup>128</sup>

All of this is entirely logical, but it is undermined by the decision of the Ontario Court of Appeal in *Law Society of Upper Canada v. Toronto-Dominion Bank*,<sup>129</sup> in which the judgment of Blair J. throws the lowest intermediate balance rule baby out with the *Clayton's Case* bathwater. A solicitor had misapplied funds from his client account. After the last misappropriation, the balance stood at \$66,242.68. The bank then made a lodgment into the account of \$173,000. The bank argued that the clients' claims were limited to the lowest intermediate balance of \$66,242.68, so that it was entitled to trace its \$173,000 into the account and claim it. This argument should have succeeded, but it failed at first instance and on appeal, where Blair J. held that the bank's

"attempt to invoke the lowest intermediate balance rule in the circumstances of this case amounts to nothing more, in my opinion, than an attempt to reinvoke the rule in *Clayton's Case*, which was rejected by this Court and by the Supreme Court of Canada in ... *Greymac*. The effect of applying the 'lowest intermediate balance rule' to the competing claims of the trust fund beneficiaries is to permit the bank – the last contributor – to recover what for practical purposes is all of its deposit, exactly the result which would transpire upon the application of the rule in *Clayton's Case*. I do not think that that result is called for in the circumstances of this case".<sup>130</sup>

This is entirely and fundamentally misconceived. What is wrong with *Clayton's Case* is the route, not the destination in a particular case. If the right route arrives at the same destination, we should not reject it simply because we might have arrived there by the wrong route as well. Most of the time, of course, taking the wrong route will lead to the wrong destination, and indeed it is just this propensity to reach the wrong destination that is the problem with *Clayton's Case*. However, when the wrong route leads exceptionally to the

128. See, eg, *Barlow Clowes International v. Vaughan* [1992] 4 All E.R. 21, 40 per Woolf L.J.; *Re Registered Securities* [1991] 1 N.Z.L.R. 545, 554; *British Columbia v. National Bank of Canada* (1994) 119 D.L.R. (4th) 669 (BC CA) 687-688 per Hollinrake J.A., McEachern C.J.B.C. and Legg J.A. concurring.

129. (1999) 169 D.L.R. (4th) 353; on which see Ogilvie, "Pari Passu Distribution of Commingled Funds" (2000) 15 *BFLR* 545 (wrongly approving this aspect of the decision; cp Dal Pont and Chalmers, *Equity and Trusts in Australia and New Zealand* (2nd ed, LBC, 2000) 1004-1005) and Smith, "Tracing in Bank Accounts: The Lowest Intermediate Balance Rule on Trial" (2000) 33 *CBLJ* 75 (rightly critical of this aspect of the decision).

130. (1999) 169 D.L.R. (4th) 353, 358 per Blair J. (*ad hoc*), Osborne and Labrosse JJ.A. concurring.

right destination we should welcome rather than condemn this fortuitous outcome; and when a further route also reaches this right destination, we should not reject it simply because the wrong route on this exceptional set of facts would also have led to it.

When the rule in *Clayton's Case* is put to one side, and the lowest intermediate balance rule is allowed to operate as it must,<sup>131</sup> then the identification of contributions to a depleted mixture such as a bank account can proceed simply as a matter of logic. Take the case of my lodgments amounting to ten pounds in the bank account, where six are then misappropriated before Debbie makes a lodgment of six. I can claim four and Debbie six of the ten pounds. Now let it be that five more are misappropriated, since we share in the loss equally, I can claim four tenths of the five remaining, and Debbie six tenths, so that I can claim two and Debbie three. Now, let Emma lodge a further fifteen pounds, bringing the total up to twenty. This does not increase my claim or Debbie's; our claims are limited by the lowest intermediate balance rule, so that I can claim only two, Debbie three, and Emma fifteen, of the twenty pounds in the account. Assume that ten pounds are now misappropriated from the account, so that ten remain: I can claim two twentieths of the remaining ten, Debbie three twentieths, and Emma fifteen twentieths; so that I can now claim one pound, Debbie one pound fifty pence, and Emma seven pounds fifty pence.

This approach explains how losses ought to be attributed in an account to which there are many lodgments and from which there have been many misappropriations. It therefore allows the identification of the proportions of the various contributors to the mixture. In many cases, such a process of identification will involve

"both tracing and following. These are both exercises in locating assets which are or may be taken to represent an asset belonging to the plaintiffs and to which they assert ownership. The processes of following and tracing are, however, distinct. Following is the process of following the same asset as it moves from hand to hand. Tracing is the process of identifying a new asset as the substitute for the old. ... Tracing is thus neither a claim nor a 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

131. Indeed, most commentators who have called for the abrogation of the rule in *Clayton's Case* nevertheless see the lowest intermediate balance rule as fundamental: see, eg, Oliver, "The Extent of Equitable Tracing" (1995) 9 *TLI* 78; McCormack, "The Eye of Equity: Identification Principles and Equitable Tracing" [1996] *JBL* 225, 230-233 (discussing *Clayton* and *Barlow Clowes*), 234-237 (discussing the lowest intermediate balance rule).



claim that the proceeds can properly be regarded as representing his property.<sup>132</sup>

In other words, the tracing process is not a monolith but rather proceeds in two stages, by which a plaintiff, first, identifies his property or its exchange product by following and/or tracing it into the defendant's hands, and, then, makes a claim to it. All that has been said so far goes simply to the identification leg of this process. As an element of his argument that there is a single set of identification rules shared by the common law and equity in support of claims to identified assets, Birks<sup>133</sup> has more than once observed that the rule in *Clayton's Case* is an identification rule shared by law and equity.<sup>134</sup> Granting both that there ought to be such a single set of identification rules,<sup>135</sup> and that the rule in *Clayton's Case* ought to be abrogated, it follows that any replacement approach ought also to be an element of a set of rules shared between the common law and equity. Nevertheless, the most common claim made by a plaintiff who has successfully traced value to a defendant's hand is to an equitable charge over the asset to which the value has been traced.<sup>136</sup> The equitable charge is a flexible device, capable of expanding or contracting as the occasion requires; and nowhere is this more obvious than where it expands and contracts to accommodate differing proportions as an account is lodged to and drawn from. In this context, it has been conveniently described as a "rolling charge"; and although cases like *Schmidt* and *Greymac* are North American, leading to its characterisation in *Barlow Clowes*<sup>137</sup> and subsequent literature<sup>138</sup>

132. [2001] 1 A.C. 102, 128; compare his earlier comments in the Court of Appeal in *Boscawen v. Bajwa* [1996] 1 W.L.R. 328, 334; [1995] 4 All E.R. 769, 776 and *Trustees of the Property of FC Jones & Co. v. Jones* [1996] 4 All E.R. 721, 729; see generally, Smith, chapter 1.
133. Though he has argued that *Clayton* "should be regarded as open to review. It rests on the undemonstrated strength of the reasons of convenience and so-called presumed intention. Goff and Jones also condemn it" (Birks, *An Introduction to the Law of Restitution* (rev ed, Clarendon Press, Oxford, 1989) 364).
134. See, eg, Birks "Overview: Tracing and Defences" in Birks (ed.), *Laundering and Tracing* (Clarendon Press, Oxford, 1995) 289, 296; Birks, "On Taking Seriously the Difference Between Tracing and Claiming" (1997) 11 *TLI* 2, 5; Birks, "The Necessity of a Unitary Law of Tracing" in Cranston (ed.), *Making Commercial Law. Essays in Honour of Roy Goode* (Clarendon Press, Oxford, 1997) 239, 256.
135. On which see O'Dell, "Tracing" (1999) 21 *DULJ* (ns) 131, 132, 146-147, 162-163, 170-171.
136. The most recent example is *Foskett v. McKeown* [2001] 1 A.C. 102, and it is the proprietary remedy imposed in all of the cases discussed in this article (such as *Hallett*, *Shanahan's*, *Greymac*, *Barlow Clowes*, and *Money Markets*) in which the tracing identification exercise was successful (whether on the basis of *Clayton's Case* or an alternative rule).
137. [1992] 4 All E.R. 22, 27 per Dillon L.J., 35 per Woolf L.J.

as the "North American rolling charge", it is not peculiar to North America but instead is simply a consequence of the logical identification of competing claimants' value in ever-changing mixtures such as bank accounts.

Of course, this approach requires that there be sufficient evidence of lodgments, withdrawals and so on. Often, this will be forthcoming from bank records, though this will often have to be supplemented by the insolvent company's own records.<sup>139</sup> Where these records are insufficient, as they were in *Shanahan's Stamp Auctions v. Farrelly*<sup>140</sup> then the rolling charge may very well be rendered inapplicable on the facts. Even with full records, sheer weight of numbers of contributors, lodgments and withdrawals may well confound the application of the rolling charge, especially where large numbers of contributors would receive relatively small amounts and exact calculation would be prohibitively difficult or expensive.<sup>141</sup> Hence in *Barlow Clowes International v. Vaughan*, Dillon LJ observed that, "[t]he complexities of this method would, however, in a case where there are as many depositors as in the present case and even with the benefits of modern computer technology be so great, and the cost would be so high, that no one has sought to urge the court to adopt it, and I would reject it as impracticable in the present case".<sup>142</sup> In such situations, the best that can be done is to allow the contributors to claim in proportion to their individual lodgments.<sup>143</sup> In *Barlow Clowes*, Woolf L.J. characterised this

138. Lowrie and Todd, "In Defence of the North American Rolling Charge" [1997] *Denning LJ* 43.

139. As in *Re Registered Securities* [1991] 1 N.Z.L.R. 545

140. [1962] I.R. 386, 442; cp *Eastern Capital Future Ltd (in liq)* [1989] B.C.L.C. 371.

141. Cp. Conaglen, "'Retaining' Title to Mixtures and Manufactured Goods: A Principled Re-Appraisal" [1996] *Denning LJ* 23, 53-54.

142. [1992] 4 All E.R. 22, 28.

143. Cp. *Shanahan's Stamp Auctions v. Farrelly* [1962] I.R. 386; *Eastern Capital Future Ltd (in liq)* [1989] B.C.L.C. 371 and *Barlow Clowes International Ltd (in liq) v. Vaughan* [1992] 4 All E.R. 22 which imposed a *pari passu* solution when *Clayton's Case* was displaced. They all cited *Sinclair v. Brougham* [1914] A.C. 398 (HL) in which Lord Sumner said that "if precedent fails, the most just distribution of the whole must be directed" and ordered that the remaining funds be distributed *pari passu* among the remaining shareholders and depositors (see [1914] A.C. 398, 458). But this is, at best, an unreliable authority (see O'Dell, "The Case that Fell to Earth. *Sinclair v. Brougham* (1914) in O'Dell (ed.), *Leading Cases of the Twentieth Century* (Round Hall Sweet & Maxwell, Dublin, 2000) 28); *Sinclair* in turn got the notion of the charge from *Hallett*, as did Budd J. in *Shanahan's* (see n.68 above). These and similar cases are right; this solution is justifiable both in principle and by reference to *Hallett*; and *Sinclair v. Brougham* should be allowed to slide out of the picture in this context as it has everywhere else.



as the "*pari passu ex post facto*" approach.<sup>144</sup> But it is a sub-optimal or second-best solution, adopted only because the most appropriate solution cannot be achieved on the facts. Where the rolling charge can be implemented, it should be; possible complexities "do not detract from the soundness of its application in straightforward situations".<sup>145</sup> It is only where it cannot be applied in any individual case that it will be necessary to fall back upon the *pari passu ex post facto* approach.<sup>146</sup>

In *Law Society of Upper Canada v. Toronto-Dominion Bank*, as part of his rejection of the lowest intermediate balance rule, Blair J. rejected the rolling charge as too complicated both in principle<sup>147</sup> and on the facts of the case,<sup>148</sup> and adopted instead the administratively simpler *pari passu ex post facto* approach.<sup>149</sup> However, contributors to funds should not lose their property rights and proprietary claims to their traceably identifiable value in those funds simply because it is judicially inconvenient to vindicate those rights and claims. Furthermore, as Smith caustically comments, "the perceived difficulty may be related to lawyers' general disinclination to become involved in numerical calculations. No operation more complex than long division is required".<sup>150</sup> Indeed, any commercially available spreadsheet computer program will often be able to handle the calculations involved.<sup>151</sup> Even where the calculations are complicated by many generations of lodgments, valid withdrawals, and defalcations, they should not be beyond the capabilities of accountants, who after all constitute the great majority of examiners, administrators, receivers and liquidators upon whom the responsibility of making these calculations will most often fall, or at least it should not be beyond them to commission any necessary bespoke software or source any necessary forensic consultants.

144. [1992] 4 All E.R. 22, 36.

145. *Keefe v. Law Society* (1998) 44 N.S.W.L.R. 451, 461 per Priestly JA.

146. Hayton, "Equity's Identification Rules" in Birks (ed.), *Laundering and Tracing* (Clarendon Press, Oxford, 1995) 3, 16; see also *Winsor v. Bajaj* (1990) 75 D.L.R. (4th) 198.

147. The rolling charge "is too complex and impractical to be accepted as a general rule for dealing with cases such as this" ((1999) 169 D.L.R. (4th) 353, 364); "it is manifestly more complicated and more difficult to apply than other solutions" ((1999) 169 D.L.R. (4th) 353, 366).

148. (1999) 169 D.L.R. (4th) 353, 368.

149. The *pari passu* approach has the "advantage of relative simplicity" and is justified by reasons of "convenience" and "workability" ((1999) 169 D.L.R. (4th) 353, 367).

150. Smith, "Tracing in Bank Accounts: The Lowest Intermediate Balance Rule on Trial" (2000) 33 *CBLJ* 75, 86, and he goes on to argue that there were no real factual difficulties with the application of this approach in the case itself.

151. *Cp. Re Ontario Securities Commission and Greymac Credit Corp* (1985) 19 D.L.R. (4th) 470, 498 per Parker ACJHC set out, text with n.112 above.

Applying the *pari passu ex post facto* approach, Blair J. ordered that all of the claimants to the bank account, including the bank, should recover in proportion to their lodgments. That this amounted to the unjustifiable expropriation of the bank's money and distribution thereof to the other claimants can easily be demonstrated by returning to the sack of apples: let it be that I had put in ten, and six were removed by a third hand, and six more were then lodged by Debbie. At this point, as a matter of principle, I am entitled to four apples and Debbie to six. If however the approach of Blair J. is adopted, so that Debbie and I are entitled to recover in proportion to our lodgments, since I lodged ten and Debbie six, I should get ten sixteenths of the apples remaining in the sack and Debbie should get six sixteenths; on this basis, I get six and a quarter apples, and Debbie gets three and three quarters. What has happened is that two and quarter of Debbie's apples have been expropriated from her and transferred to me, without justification. In exactly the same way, by Blair J's order, the bank's money was unjustifiably expropriated and transferred to the other claimants to solicitor's account.

Blair J. did seek to address this issue of principle: he held that the proprietary remedy of the charge need not be inflexibly tied to a pre-existing proprietary right<sup>152</sup> because he regarded a bank account as a blended fund – "an indistinguishable blend of debts and credits"<sup>153</sup> – rather than "as an amalgam of the contributions which have been placed in it".<sup>154</sup> This is deeply problematic, for at least two reasons. First, the two views of the bank account, as a blend and as an amalgam, are not competing views, but instead represent the account at different and successive stages in the tracing and claiming process: before each sum of money is lodged into an account, it is separate from all the other lodged sums, and lodging each sum creates an amalgam of that sum with the money already in the account; however, once it is lodged, it loses its separate identity, and in that sense, the account is a blend of all the various lodgments; nevertheless, once a plaintiff successfully identifies value in the account, the account once again becomes an amalgam of the plaintiff's realisable value and the remaining money in the account. Second, the analogy between placing apples into and taking them out of a sack, on the one hand, and lodgments to and withdrawals from a bank account, on the other, upon which all of the arguments from principle in this article are constructed, works with such ease precisely because both mixtures begin as amalgams of their lodgments, and

152. (1999) 169 D.L.R. (4th) 353, 365: "... In determining how a *pro rata* distribution is to be effected in circumstances of commingled trust funds, the issue whether this *proprietary remedy* must be inflexibly tied to a pre-existing *proprietary right* – i.e., the purely logical application of tracing rules – is an important question".

153. (1999) 169 D.L.R. (4th) 353, 369, adopting Klinck, "Two Distinct, Divisions None!": Tracing Money into (and out of) Mixed Accounts" (1987-1988) 2 *BFLR* 147.

154. (1999) 169 D.L.R. (4th) 353, 370.



can be realised back into such amalgams. From his characterisation of a bank account simply as a blend, he drew the *non sequitur* that the equitable remedies of the charge, lien or constructive trust need not "be confined to any part of the fund because, by their very nature, they have always been applied against the whole of the fund".<sup>155</sup> However, although such remedies can apply against the whole of the blended fund, they do so only to the extent that the actual property (or its proceeds) can be identified in (that is, traced into) the fund, and they have the effect of realising the fund back into its component amalgamated parts so identified.

In summary, then, the law took a mis-step when it extended the rule in *Clayton's Case* from the banker-customer context to the context of the competing claims of multiple contributors to a depleted fund. Correcting that misstep involves accepting the logic of the lowest intermediate balance rule, and applying the rolling charge as the appropriate solution where it is possible, and, if not, accepting the sub-optimal *pari passu ex post facto* approach. The opportunity to take all of those steps as a matter of Irish law presented itself to Laffoy J. in the High Court in one stage of the liquidation of the firm of stockbrokers, Money Markets International.

#### 6. MONEY MARKETS INTERNATIONAL: THE ROAD NOT TAKEN

The present Chief Justice, writing extra-judicially, has expressed doubts as to whether "the courts would now continue to apply *Clayton's case* (which has always been regarded as based on rather crude if convenient assumptions) to the case of competing claims of beneficiaries to money in a bank account".<sup>156</sup> The opportunity to test this claim was presented to the courts in *In re Money Markets International Stockbrokers Ltd.*<sup>157</sup> MMI carried on business as a stockbroker. On 15 February 1999, the applicant instructed MMI to purchase shares, as a consequence of which, £293,740.90 would be due by him on 22 February. On 18 February, he transferred that sum into MMI's current account, which, it seems, had subsequent lodgments and withdrawals.<sup>158</sup> On 19 February, the Stock Exchange suspended MMI from the exchange, and MMI's share purchase on behalf of the applicant was not completed. MMI was subsequently wound up and the applicant claimed the return of his £293,740.90 in full.

In principle, there would seem to be three routes by which this application could be resolved: the rule in *Clayton's Case*, the rolling charge, or the *pari passu ex post facto* approach.

155. (1999) 169 D.L.R. (4th) 353, 371

156. Keane, *Equity and the Law of Trusts in the Republic of Ireland* (Butterworths, Dublin, 1988) 286, para 20.13.

157. [1999] 4 I.R. 267 (HC, Laffoy J.).

158. [1999] 4 I.R. 267, 272, 273-274.

First, on the application of the rule in *Clayton's Case*, his claim could proceed as follows. At close of business on 17 February, the client account had a credit balance of £107,216.84. On the following day, 18 February, there were two lodgments, the applicant's £293,740.90 and a lodgment from CREST, of £16,456.91. Thereafter, until the account was frozen, there were various lodgments and only four relevant withdrawals (£31,835.88, £17,639.18, £2,661.97 and £16,843.79) totalling £68,980.82. Since, on the application of the rule in *Clayton's Case*, this withdrawal of £68,980.82 would count first against the existing balance of £107,216.84, and not exhaust it, the applicant's subsequent £293,740.90 would still exist in the account. Hence, the applicant supported the use of the rule in this case.

Second, on the application of the principles developed in this paper, the operation of the account and the calculation of the various parties' claims, could<sup>159</sup> proceed as follows. At close of business on 17 February, the account had a credit balance of £107,216.84, to which firms' existing clients had their various claims.

On the following day, 18 February, there were two lodgments, the applicant's £293,740.90 and a lodgment from CREST, of £16,456.91, for a total of £417,414.65. At this point, the clients were entitled to claim £107,216.84 of £417,414.65, which is 25.69%; the applicant was entitled to claim £293,740.90 of £417,414.65, which is 70.37%; and the lodgers through CREST were entitled to claim £16,456.91 of £417,414.65, which is 3.94%. On the same day, there were three withdrawals (£31,835.88, £17,639.18 and £2,661.97) reducing the total in the account to £365,277.62. If the clients, the applicant and the CREST lodgers shared in the £417,414.65 in the proportions, respectively, of 25.69%, 70.37% and 3.94%, then they share the reduced balance of £365,277.62 in the same proportions; so that the clients would be entitled to £93,839.82, the applicant £257,045.86, and the CREST lodgers £14,391.94.

On the following day, 19 February, there was a second CREST lodgment

159. In the absence of evidence, and simply to demonstrate how the calculation *might* have proceeded, I have made three assumptions: first, that rounding off percentages to two decimal places is an acceptable approximation; second, that it is impossible to know the order of lodgments and withdrawals within a given day, so I have taken all the lodgments first, and then dealt with all of the withdrawals; and third, that the various CREST lodgments and withdrawals are separate. As to the first assumption, a computer spreadsheet would be able to handle many more decimal places, and render more exact shares. As to the second and third assumptions, actual evidence of the order of lodgments and withdrawals, or evidence linking CREST lodgments and withdrawals in some way (as treated in the text to the next note), or even evidence making other assumptions more appropriate, would, of course, affect the actual outcome of the calculations. However, when that evidence and/or other assumptions are factored in, the new calculations would still proceed on the basis of the same principles.



of £15,123.24, for a total of £380,400.86, of which the clients would be entitled to £93,839.82, the applicant £257,045.86, the first CREST lodgers £14,391.94, and the second CREST lodgers £15,123.24. In percentages, the clients were entitled to 24.67%, the applicant 67.57%, the first CREST lodgers 3.78%, and the second CREST lodgers 3.98%. On the same day, there was a withdrawal of £16,843.79, reducing the balance to £363,557.07. If the clients, the applicant, the first CREST lodgers and the second CREST lodgers shared in the £380,400.86 in the proportions, respectively, of 24.67%, 67.57%, 3.78% and 3.98%, then they share the reduced balance of £363,557.07 in the same proportions; so that the clients would be entitled to £89,689.53, the applicant £245,655.51, the first CREST lodgers £13,742.46, and the second CREST lodgers £14,469.57.

Finally, on 22 February, there was a further client lodgment of £32,944.94, which on 25 February was partially cancelled in the amount of £8,797.88. If this is treated simply as a single lodgment<sup>160</sup> of £24,147.06, then it simply brings the total up to £387,704.13. This client thus has a claim on the account for £24,147.06, and the four existing classes of claimant have their existing claims in the amounts set out at the end of the last paragraph. At this point, the account was frozen. It is therefore worth recapitulating how the claims break down: the clients are entitled to £89,689.53, the applicant £245,655.51, the first CREST lodgers £13,742.46, the second CREST lodgers £14,469.57, and the final client to £24,147.06. This procedure was not advocated by any of the parties to the application before Laffoy J.

As to the third route to resolve the application, the liquidator opposed the application of the rule in *Clayton's Case*, and proposed instead the application of the *pari passu ex post facto* approach as a matter of principle, and it would plainly have meant that the applicant's claim would have been drastically reduced.

Comparing the three approaches, under the rule in *Clayton's Case*, the existing clients are prejudiced and the applicant gets £293,740.90; under the *pari passu ex post facto* approach, the applicant is prejudiced, whilst the other clients benefit at his expense; whereas under the rolling charge, the existing clients, the applicant, and all the other contributors to the account are treated in exactly the same way, and the applicant gets £245,655.51. This last is the most preferable outcome, and should have been the approach taken by Laffoy J. She took two steps in that direction, but failed to complete the journey. For her first step, she quite properly called the correctness of *Clayton's Case* into question; for her second, started out on the road to a rolling charge, though she

160. This is probably right. However, if it is treated instead as a separate lodgment and withdrawal, then the lodgment increases the total amount, the various proportions of the five classes of claimants (the clients, the applicant, the first and second CREST lodgers, and now this new client) are recalculated, and when the withdrawal reduces the total amount, they share rateably in the reduction.

did not quite get there. Starting from the judgment of Budd J. in *Shanahan's Stamp Auctions v. Farrelly*, which stated the rule but applied the exception, and proceeding via the Chief Justice's extrajudicial criticisms of the rule, she arrived at *Barlow Clowes International v. Vaughan*, and concluded that:

"in the case of a current account such as the account in issue here where trust funds sourced from various beneficiaries are mixed or pooled in the account, it is settled law that the rule in *Clayton's case* is applicable in determining to whom the balance on the account belongs. However, the application of the rule may be displaced in the particular circumstance[s] of a case, for instance, if it is shown or to be inferred that it does not accord with the intention or the presumed intention of the beneficiaries of the trust fund".<sup>161</sup>

However, she was equally as unhappy with the alternative *pari passu ex post facto* approach submitted by the liquidator:

"Having regard to the uniqueness of the applicant's position, I do not think that, applying equitable principles, the applicant should be bound by a *pari passu* distribution. The applicant transferred the monies in issue to the current account for a specific purpose, to discharge the sums due in respect of the share purchase transaction confirmed on the 15th of February 1999, to enable that purchase to be completed. The applicant transferred the monies into the company's account prior to the settlement day and all the company did was to receive them. However, after the transfer and receipt of the monies and before settlement day the suspension of the company as a member of the stock exchange supervened, so that the company was not in a position to complete the purchase transaction. It seems to me that, given this combination of circumstances, the applicant must have a better equity than the other client creditors who have a claim against the monies represented by the balance on the current account. The equities are not equal and equitable principles do not require that the applicant be subjected to a *pari passu* distribution under which he would be treated in the same way as other clients who have equitable claims against the funds".<sup>162</sup>

It was clear to Laffoy J. that neither the rule in *Clayton's Case* nor the *pari passu ex post facto* approach was appropriate to resolve the issue. On the one hand, the application of *Clayton's Case* would have been entirely unfair to the existing clients. On the other hand, a *pari passu* distribution would have been

161. [1999] 4 I.R. 267, 276-277.

162. [1999] 4 I.R. 267, 277.



unfair to the applicant whose lodgment was made late in the story, and who must therefore, in Laffoy J's words, have had a better equity than the clients whose money comprised the existing £107,216.84, when the applicant's £293,740.90 was lodged. However, if the existing clients' equities are affected by the applicant's subsequent lodgment, then it follows that the applicant's equity must equally be affected by the subsequent dealings with the account; indeed the existing clients' equities and the applicant's equity must be affected by such subsequent dealings. Allowing the applicant simply to remove his lodgment without taking the subsequent dealings into account does not therefore give proper effect to his equity. In particular, if his lodgment gives him an equity *vis-à-vis* the existing clients, then subsequent lodgments give those subsequent lodgers a similar equity *vis-à-vis* the applicant and the other existing clients, and failing to take such lodgments into account is unfair to the subsequent lodgers. Furthermore, in the subsequent dealings, there were not only lodgments but also withdrawals which were greater than the lodgments and which therefore reduced the overall balance of the account, and each of the subsisting equities would have been affected by these withdrawals. By not taking them into account in some way, but instead allowing the applicant to withdraw his lodgment in full, the loss is cast in full upon all of the other contributors to the account. It is unfair that all of the contributors – especially the unfortunate existing clients – should bear the full loss whilst the applicant bore none. For all of these reasons, by simply allowing him to withdraw the full amount of his lodgment, his equity is given a disproportionately privileged effect.

Laffoy J., by distinguishing between the position of the existing clients and the applicant, properly modified the equities of the existing contributors in the light of a subsequent dealing. She ought, however, to have continued to apply the logic of this distinction, successively modifying the equities of each contributor to the account in the light of each subsequent dealing. Had she done so, she would have properly balanced all of the competing equities. As it happened, she went too far in protecting the position of the applicant. Nevertheless, her judgment must stand as a good start on the journey towards the repudiation of the rule in *Clayton's Case* in the competing contributors context and its replacement with the rolling charge (or, if that is not possible in any given case, a *pari passu* distribution).

#### 7. CONCLUSION: THE ROAD AHEAD

By means of the rule in *Clayton's Case*, lodgments to and withdrawals from bank accounts are appropriated on a first in, first out basis. Though the rule was first stated as a deduction from the nature of the bank account, it is now applied as a presumption of intention, which allows the intention of either or

both of the parties to displace the basic default rule. In this intention-based form, the rule seems to be a product of *Hallett*; it was affirmed by the House of Lords in *The Mecca and Deeley v. Lloyd's Bank*; and it is now a fundamental principle of banking practice. This is the proper use of *Clayton's Case*.

Where a mixture suffers losses, the losses should be borne proportionately by the contributors to the mixture at the time. This principle is applied by the law to mixture such as of apples in a sack, but it should apply to mixtures of money in a bank account: if it is fair to apportion losses from the sack equally among all contributors of apples, it should be equally as fair to apportion losses from the bank account equally among all those who made lodgments. However, focussing not on the mixture but upon the bank account, the Court of Appeal in *Pennell v. Deffell* applied the first in, first out rule to apportion losses between contributors to a bank account. This extension was approved in *Hallett*, but it constitutes an abuse of *Clayton's Case*.

One means to minimise the negative impact of this misuse of *Clayton's Case* is to expand the scope of the exceptions to the rule, in particular by finding that the parties could not have intended its application. This is the approach taken by Budd J. in *Shanahan's Stamp Auctions v. Farrelly* and is very similar to that of the Court of Appeal in *Barlow Clowes International Ltd v. Vaughan*. In this case, Woolf L.J. in particular was openly hostile to the application of the rule in this context, as was the New Zealand Court of Appeal in *Re Registered Securities* following the lead of Learned Hand J. nearly three-quarters of a century before in *In re Walter J. Schmidt & Co. Ex parte Feuerbach*. The abrogation of the rule then in *Greymac* in Canada and in *Keefe v. Law Society* in New South Wales comes as no surprise and ought to be followed elsewhere in the common law world as the opportunities arise. This should of course be done with care, and with sensitivity to principle: for example, the subsequent abrogation of the lowest intermediate balance rule in Canada is misconceived; and the exceptions to the rule forged in the competing contributors context should fall with its abrogation in that context if they are inappropriate to the banker-customer context.

In the absence of the rule in *Clayton's Case*, the identification of contributions to and depletions of mixtures such as a bank account – even over several generations of lodgments and withdrawals – is simply a matter of logic. The contributors to the account have a charge over the account for the proportion to which they are each entitled, a charge which is sufficiently flexible to reflect any changes to those proportions as a consequence of subsequent dealings with the account. Where evidence fails, and the application of the rolling charge is impossible, the contributors should share *pari passu*.

In *In re Money Markets International*, Laffoy J. took two important steps towards establishing this as a matter of Irish law. First, she quite properly called the application of *Clayton's Case* in this context into doubt; and, second, by recognising that the charge of the existing clients should in some way be



affected by that generated in by the lodgment of the applicant's money, she took a faltering step towards a rolling charge solution. However, rather like the courts in *Re Registered Securities* and *Barlow Clowes* (with the latter of which she was quite taken), although she called the rule into question it nevertheless formally lives to fight another day. She should have taken the next step and slain the dragon. Furthermore, although distinguishing between the existing clients and the applicant is the first step down the road to the rolling charge, having taken that first step Laffoy J. thereafter faltered on the journey, and failed to apply the same logic to the position as between the existing clients and the applicant on the one hand, and the subsequent dealers with the account, on the other.

Hence the decision in *In re Money Markets International* at best goes only part of the way towards bringing Irish law into line with principle; two further steps still need to be taken: the formal abrogation of the rule in *Clayton's Case* and the adoption of the rolling charge as the proper means to appropriate losses from a bank account to which there are many contributors. This is the destination of the road ahead; Laffoy J. has begun the journey; and in the next appropriate case, it is a destination at which Irish law ought easily arrive.

## CASE AND COMMENT

CONSTITUTIONAL LAW – CONSTITUTIONAL INTERPRETATION – PASSIVE JUDICIAL  
ACTIVISM – CONSTITUTIONAL CRIME OF BLASPHEMY

### Introduction

Fear of unwarranted judicial activism is a theme which runs through much discussion on the broad theme of constitutional interpretation<sup>1</sup>. Judges after all are unelected, and hence, even if Ireland as a common law system is prepared to turn something of a blind eye to the occasional judicial intrusion into the exclusive law making domain of the legislature as guaranteed by Article 15.2 of the Irish constitution, nonetheless any creation of social policy through second guessing of legislative intention is to be regarded with suspicion. Naturally, such suspicion tends to focus on cases where the Courts *do* things that perhaps they should not be doing, whether that be the creation of unenumerated rights or the development of areas of legal controversy. Just as telling a form of activism, however, is the case where a judiciary refuses to act in an area where it is constitutionally obliged to do so. This 'passive activism' was witnessed in 1999 in the case *Corway v. Independent Newspapers*,<sup>2</sup> when the Supreme Court refused to give effect to the terms of a constitutional clause, on the basis of the extraordinary explanation that they could not tell for certain what was meant by the central word in that clause.<sup>3</sup>

### The facts of the case

In 1995, the Irish people by slender majority voted in favour of a referendum to the constitution that would have the effect of removing the existing constitutional prohibition on divorce. As part of its campaign of opposition to this

1. Thus G. Hogan comments that "If the legitimacy of judicial review is to continue to be accepted decisions in major constitutional cases must be seen to represent more than the personal opinions of judges". "Constitutional Interpretation" at p. 188 in Litton (ed.) *The Constitution of Ireland 1937-1987*, (Institute of Public Administration, Dublin 1988). For discussion in this area see R. Bork, *The Tempting of America; The Political Seduction of the Law*, (Free Press/Sinclair Stevenson, London 1990) [hereafter Bork], Dworkin, *Freedom's Law*, (Oxford University Press, 1996) and Cox, 'Judicial Activism, Constitutional Interpretation and the Problem of Abortion', in O'Dell ed. *Leading Cases of the Twentieth Century*, (Round Hall Ltd, 2000).

2. High Court [1997] 1 I.L.R.M. 432, Supreme Court [2000] 1 I.L.R.M. 426.

3. For analysis see Cox, *Blasphemy and the Law in Ireland*, (Edwin Mellen Press, 2000) and Ranalow, "Bearing a constitutional cross: examining blasphemy and the judicial role in *Corway v. Independent Newspapers*" (2000) 3 *TCLR*, 95.