Privy Council Appeal No. 36 of 1984

Space Investments Limited *Appellants*

v.

(1) Canadian Imperial Bank of Commerce Trust Company (Bahamas) Limited
(2) Dennis Cross and
(3) David Patrick Hamilton *Respondents*

FROM

THE COURT OF APPEAL OF THE COMMONWEALTH OF THE BAHAMAS

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 7TH JULY 1986

Present at the Hearing:

LORD KEITH OF KINKEL
LORD TEMPLEMAN
LORD OLIVER OF AYLMERTON
LORD GOFF OF CHIEVELEY
SIR ROBIN COOKE

*[Delivered by **Lord Templeman**]*

The question is whether in the winding up of an insolvent bank trustee the liquidator must pay the trust deposit accounts lawfully maintained by the bank trustee in priority to payment of the customers' deposit accounts and the debts owed by the trustee bank to other unsecured creditors.

A customer who deposits money with a bank authorises the bank to use that money for the benefit of the bank in any manner the bank pleases. The customer does not acquire any interest in or charge over any asset of the bank or over all the assets of the bank. The deposit account is an acknowledgment and record by the bank of the amount from time to time deposited and withdrawn and of the interest earned. The customer acquires a chose in action, namely the right on request to payment by the bank of the whole or any part of the aggregate amount of principal and interest which has been credited or ought to be credited to the account. If the bank becomes insolvent the customer can only prove in the

iquidation of the bank as unsecured creditor for the mount which was, or ought to have been, credited to he account at the date when the bank went into iquidation.

On the other hand a trustee has no power to use :rust money for his own benefit unless the trust .nstrument expressly authorises him so to do. A bank :rustee, like any other trustee, may only apply trust ıoney in the manner authorised by the trust :nstrument, or by law, for the sole benefit of the ›eneficiaries and to the exclusion of any benefit to :he bank trustee unless the trust instrument other- ›ise provides. A bank trustee misappropriating trust ıoney for its own use and benefit without authority :ommits a breach of trust and cannot justify that ›reach of trust by maintaining a trust deposit account which records the amount which the bank has ıisappropriated and credits interest which the bank :onsiders appropriate. The beneficiaries have a :hose in action, namely, an action against the trustee bank for damages for breach of trust and in addition they possess the equitable remedy of tracing the trust money to any property into which it has been converted directly or indirectly.

A bank in fact uses all deposit moneys for the general purposes of the bank. Whether a bank trustee lawfully receives deposits or wrongly treats trust money as on deposit from trusts, all the moneys are in fact dealt with and expended by the bank for the general purposes of the bank. In these circumstances it is impossible for the beneficiaries interested in trust money misappropriated from their trust to trace their money to any particular asset belonging to the trustee bank. But equity allows the beneficiaries, or a new trustee appointed in place of an insolvent bank trustee to protect the interests of the bene- ficiaries, to trace the trust money to all the assets of the bank and to recover the trust money by the exercise of an equitable charge over all the assets of the bank. Where an insolvent bank goes into liquidation that equitable charge secures for the beneficiaries and the trust priority over the claims of the customers in respect of their deposits and over the claims of all other unsecured creditors. This priority is conferred because the customers and other unsecured creditors voluntarily accept the risk that the trustee bank might become insolvent and unable to discharge its obligations in full. On the other hand, the settlor of the trust and the beneficiaries interested under the trust, never accept any risks involved in the possible insolvency of the trustee bank. On the contrary, the settlor could be certain that if the trusts were lawfully administered, the trustee bank could never make use of trust money for its own purposes and would always be obliged to segregate trust money and trust

property in the manner authorised by law and by the trust instrument free from any risks involved in the possible insolvency of the trustee bank. It is therefore equitable that where the trustee bank has unlawfully misappropriated trust money by treating the trust money as though it belonged to the bank beneficially, merely acknowledging and recording the amount in a trust deposit account with the bank, then the claims of the beneficiaries should be paid in full out of the assets of the trustee bank in priority to the claims of the customers and other unsecured creditors of the bank. "... if a man mixes trust funds with his own, the whole will be treated as the trust property, ... that is, that the trust property comes first;" per Sir George Jessel in *Re Hallett's* case (1879) 13 Ch. D 696 page 719 adopting and explaining earlier pronouncements to the same effect. Where a bank trustee is insolvent, trust money wrongfully treated as being on deposit with the bank must be repaid in full so far as may be out of the assets of the bank in priority to any payment of customers' deposits and other unsecured debts.

Equity thus protects beneficiaries against breaches of trust. But equity does not protect beneficiaries against the consequences of the exercise in good faith of powers conferred by the trust instrument.

Although as a general rule, a trustee is not allowed to derive a benefit from trust property, that general rule may be altered by the express terms of the trust instrument. One illustration is an express provision in a settlement which permits a trustee to charge and deduct from trust money remuneration for the services of the trustee. A settlement may also confer on a trustee power to make use of trust money in other ways. Certain of the settlements of which Mercantile Bank and Trust Company Limited ("MBT") were appointed trustee conferred power on MBT:-

> "To open and maintain one or more ... savings accounts or current accounts ... with any bank ... even if ... such bank shall be acting as trustee ... to deposit to the credit of such account or accounts all or any part of the funds belong to the Trust Fund whether or not such funds shall earn interest from time to time ... (and) to withdraw a portion or all of the funds so deposited ..."

The trial judge, da Costa C.J. sitting in the Supreme Court of the Commonwealth of The Bahamas held, the Court of Appeal (Joseph A. Luckhoo P., Sir James Smith and Zacca JJ.A.) agreed and it is not disputed that:-

> "The effect of that clause was clearly to empower MBT as trustee to deposit with MBT as bankers moneys which they received in trust."

The effect of the clause was also to empower MBT to treat trust money so notionally deposited as if MBT were beneficially entitled to the trust money, just as MBT was entitled to treat customers' money deposited with MBT as if MBT were beneficially entitled to that money. Trust money deposited with MBT as bankers and customers' money deposited by customers with MBT as bankers were alike lawfully available to MBT for payment of MBT's expenses, for making investments for the benefit of MBT and in any other manner for the benefit of MBT as money belonging absolutely and beneficially to MBT, to be disposed of without regard to the interests of beneficiaries or customers.

When a customer deposited money with MBT and the amount of the customer's money was credited to a customer's deposit account, the customer did not become entitled to any interest in any asset or in all the assets of MBT. The sole right of the customer was to be paid at his request a sum equal to the amount standing to the credit of his deposit account. There was nothing to trace.

When MBT as trustee lawfully deposited trust moneys with MBT as banker pursuant to the authority in that behalf conferred by the settlement and the amount of the trust fund so deposited was credited to a trust deposit account, the beneficiaries interested under the trust did not become entitled to any interest in any asset or in all the assets of MBT. The sole right of the beneficiaries was for a sum equal to the amount standing to the credit of the trust deposit account, to be applied by MBT in any manner authorised or required by the settlement or by law as and when MBT decided to make such application in the proper exercise and discharge of its discretionary powers and duties in the due course of administration of the trust. If MBT ceased to be trustee and a new trustee were appointed then it would be for the new trustee to decide whether to close the trust deposit account with MBT and to require MBT to pay to the new trustee the amount standing to the credit of the trust in the MBT trust deposit account. There would be nothing to trace.

When MBT became insolvent and went into liquidation the beneficiaries were entitled to obtain and have obtained the appointment of a new trustee in the place of MBT. The new trustee can only prove in the winding up of MBT for the amount standing to the credit of the trust with MBT in the trust deposit account at the date of liquidation. The claim of the new trustee will be as an unsecured creditor ranking *pari passu* with the claims of a customer proving for the amount standing to his credit with MBT in the customer's deposit account.

There is no justification for the intervention of equity. The settlor has allowed trust money to be treated as if it were customers' money. The settlor has allowed MBT to appropriate trust money and to treat the trust money as belonging absolutely and beneficially to MBT. By depositing money with MBT a customer accepted the risk of MBT's insolvency. By allowing MBT to treat trust money as a deposit with MBT the settlor accepted the risk of MBT's insolvency. In these circumstances it would be inequitable if the trust were in a better position than the customer.

Da Costa C.J., supported by the Court of Appeal, held that when MBT transferred trust money "into its banking business that money does not cease to be impressed with a trust". But the trust money did cease to be impressed with the trust. The trust money became the property of MBT in law and in equity and MBT were entitled to use that money for the purposes of MBT in any manner that MBT pleased. The trust fund did not continue to be the money transferred into the banking business of MBT. The trust fund became the obligation of MBT to treat the trust deposit account with MBT as bankers in the same manner as MBT would have dealt with a deposit account credited with trust money lawfully transferred and deposited by MBT as trustee with another independent bank as banker. On the insolvency of that independent bank the trustee MBT could only rank as unsecured creditors for the amount of the deposit account. Similarly, on the insolvency of MBT which lawfully appropriated trust money to itself and credited the amount of the moneys so appropriated to a trust deposit account, the new trustee of the trust can only rank as an unsecured creditor on behalf of the trust.

Their Lordships will humbly advise Her Majesty that the appeal should be allowed, that the orders made by the courts below, save for the orders relating to costs, should be discharged and that it should be declared that the trust creditors of MBT claiming in respect of trust money lawfully treated as on deposit with MBT rank *pari passu* with the unsecured creditors of MBT in the distribution of the assets of MBT in liquidation. The costs of all parties of the hearing before the Board should be paid by the liquidator as expenses of the winding up, on a solicitor and own client basis.