

# LAW REFORM COMMISSION OF BRITISH COLUMBIA

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## Backgrounder

### LRC 66—Report on Competing Rights to Mingled Property: Tracing and the Rule in Clayton's Case

Date: September 1983

The rule in *Clayton's Case* is a common-law presumption in relation to the distribution of monies from a bank account. It is based upon the notion of first in, first out to determine the effect of payments from an account. The rule usually applies in the absence of evidence of any other intention. Payments are presumed to be appropriated to debts in the order in which the debts are incurred. The rule is based on the following legal fiction: if an account is in credit, the first sum paid in will also be the first to be drawn out and, if the account is overdrawn, a payment is allocated to the earliest debit on the account which caused the account to be overdrawn.

The rule is generally applicable in certain types of revolving credit arrangements. The essence of a revolving credit arrangement is a debt that is expected to continue over a period of time and to fluctuate in amount as payments are made toward discharging the debt and further extensions of credit are advanced during the life of the arrangement. The commonest example is a deposit with a bank or trust company, but other examples are monies paid in trust to a solicitor or money deposited with a public utility or other supplier, to secure prompt payment of future bills.

This report looks primarily at how the rule in *Clayton's Case* operates when money belonging to two or more people is combined in a single account. For example, where trust monies are mingled in a single trust account and the balance falls below the amount required to satisfy or repay the trust monies, the courts may determine entitlement to the fund by applying the rule. This can sometimes achieve a harsh result. For example, an innocent person may be required to bear an entire shortfall, merely because this person's money was deposited first in time. Recommendations are therefore made to modify the application of the rule in *Clayton's Case* and also in respect of the related topic of tracing or following property.

The report is divided into four main sections. The first part contains a general explanation of the rule in *Clayton's Case*, how it operates in relation to revolving credit arrangements and in particular with regard to mixed funds.

The second part contains a summary of the legal rights and remedies necessary to understand arguments for and against the use of the rule. There is also discussion on the law relating to the tracing or following of property to aid the reader in understanding the issues.

The report turns in the third part to examine the context in which the rule first developed and follows its development into the law of trusts. The application of the rule is considered in relation to several different types of relationships that can exist between parties who assert competing claims to a mixed fund, including non-fiduciaries, monies deposited by a trustee and his beneficiary, trust funds with more than one beneficiary, and cases where the money of a beneficiary is mixed with that of a volunteer.

In the final part of the report a number of recommendations for reform are considered to achieve fairer results. The report concludes that the application of the rule to dealings between a banker and depositor with respect to a single bank account appears to operate reasonably well. However the rule has expanded into a number of other contexts where it was neither needed nor appropriate, particularly mixed monies between two or more parties. This has often resulted in unfair outcomes. Because of the complex nature of this subject the recommendations are in the form of general principles followed by draft legislation.

### **Further Developments**

The report's recommendations have not been implemented by legislation.