THE UNIVERSITY OF HULL

CONCEPTUALISING THE CONSTRUCTIVE TRUST: A NEW APPROACH AND ITS SPECIFIC APPLICATION TO ACQUISITIVE BREACHES OF FIDUCIARY OBLIGATION

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by

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Preface

In this thesis I examine the conceptual nature of the constructive trust. In particular I provide a critique of those contemporary theories which view the conceptual choice as one of clear alternatives between the "institutional" and "remedial" constructive trust. Having rejected these unhelpful and somewhat confusing alternatives a new framework for analysis is proposed. The aim of the proposal is to facilitate the reaching of normatively desirable results within a framework that is coherent, rational and illuminating. The framework is applied (and its benefits illustrated) in the second half of the thesis, which focuses on the specific context of acquisitive breaches of fiduciary obligation.

The writing of this thesis has extended over a considerable period of time – partly through work commitments and partly through medical circumstances which led to the particularly untimely onset of visual impairment. This makes the support that I have received from a number of friends, family and colleagues all the more valuable. There are a small number of people to whom I remain particularly indebted and who deserve a special mention. Nick Parry has supervised the entire thesis from day one. Over that time he has become a valued colleague and, more importantly, a true friend. Craig Rotherham of Nottingham University assumed the role of *de facto* second supervisor for a period of time. His extensive comments – particularly on Chapters 2, 3 and 6 - have proved invaluable and thought provoking. Moving away from the academic environment, my most personal and greatest debts of gratitude are owed to my family - to my parents, John and Jackie, and to my wife, Lee-Anne, for their patience, kindness and unwavering support. Lee-Anne in particular deserves special mention for reading on to tape materials in which she has little interest and for proof reading each chapter. Without her this work would not have been completed.

Andrew Hicks
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For
LARH

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INTRODUCTION

The Question

How should we conceptualise the constructive trust? That is the deceptively simple question that this thesis seeks to answer. The question is an important one. How we conceptualise the constructive trust is not merely of theoretical or esoteric interest. It guides decisions in concrete cases. Whether the defendant can be compelled to hand over property to the claimant, whether the claimant can take property ahead of the claims of competing third parties such as secured and unsecured creditors, the applicability of various statutes, and the types of factors that a court will consider in reaching a decision are all dependant to some extent on the way in which we conceptualise the constructive trust.

Conceptions of the Constructive Trust and Their Critique

Most constructive trust discourse proceeds on the assumption that the conceptual choice is two-fold - between the constructive trust as an "institution" and the constructive trust as a "remedy". Although these two terms capture a plurality of meanings two dominant points of distinction have emerged in recent years. These are (a) legal form – whether the constructive trust is rule-based or discretionary; and (b) timing – whether the constructive trust arises automatically upon the facts giving rise to the claimant's cause of action or only if and when judicially declared in a court of competent jurisdiction.[1] Thus, the

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[1] See generally, *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 at 714-715 per Lord Browne-Wilkinson; *Re Polly Peck International plc (in administration) (No 2)* [1998] 3 All ER 812; *Fortex Group Ltd v MacIntosh* [1998] 3 NZLR 171 at 172-173, 175-177 per Tipping J; *Commonwealth Reserves I v Chodar* [2001] 2 NZLR 374 at [36]-[63] (Glazebrook J); *Dickie v Torbay Pharmacy (1986) Ltd* [1995] 3 NZLR 429 at 441 (Hammond J); *Atlas Cabinet & Furniture Ltd v National Trust Co* (1990) 45 BCLR (2d) 99 at 112 per Lambert JA; P. Maddaugh & J. McCamus, *The Law of Restitution* (2nd edn, 2004), pp.106-128; C. Rotherham, *Proprietary Remedies in Context: A Study in the Judicial Redistribution of Property Rights* (2002), pp.12-32; P.B.H. Birks, "Rights, Wrongs, and Remedies" (2000) 20 OJLS 1 at

"institutional" constructive trust is a rule-based entitlement that arises automatically; the "remedial" constructive trust is discretionary and exists only if and when it is ordered by the court. This is the dominant contemporary polemic, the framework within which most now talk and think about the constructive trust.

This thesis rejects the conceptual approaches that together form the dominant contemporary polemic. It then goes on to develop and apply an alternative conceptual framework. Both endeavours are moderated by three important background considerations: fairness, system and transparency.

The first consideration is fairness. The chosen approach should facilitate the consideration and implementation of the relevant normative concerns. Fairness must be considered both as between the claimant and the defendant and the claimant and innocent third parties. The simple fact that a constructive trust may do justice between claimant and defendant says nothing about whether it will do justice where competition for property is between claimant and the defendant's creditors. The chosen remedial framework should be capable of securing justice in both contexts.

It is important to note that the pursuit of fairness is not a call for discretionary adjudication on a case by case basis. Whether or not adjudication should be more or less discretionary or more or less rule-based is itself a normative issue that will depend on a variety of factors. The pursuit of fairness simply recognises that requiring the defendant to surrender property, or allowing one innocent party to recover in priority to others, is something that demands justification. How we implement the justification is a different matter. The important point is that if we are to construct acceptable, rational and workable legal norms we must know the goals that we are pursuing. Justification cannot

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pp.9-19; P.B.H. Birks, "Proprietary Rights as Remedies" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 2, p.214; D.W.M. Waters, "The Nature of the Remedial Constructive Trust" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol. 2, p.165; D.M. Wright, *The Remedial Constructive Trust* (1998); D.M. Wright, "The Remedial Constructive Trust and Insolvency" in *Restitution and Insolvency* (2000, ed. F. Rose), p.206; S. Gardner, "The Element of Discretion" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 2, p.186.

be avoided and should not be obscured by resort to metaphors, fictions, evidential presumptions, and arcane maxims.

The second consideration is system. "Constructive trust" is not a physically observable phenomenon but an organisational tool. Like "contract", "property" and similar concepts it facilitates the organisation of legal norms.[2] The chosen conceptual framework should therefore facilitate systematic organisation and presentation of the law. Without system we cannot expect coherent development and synthesis.

The final consideration is transparency. The way in which we portray the constructive trust should reflect realistically what a court does in fact when it declares that one party holds property on constructive trust for another. In short, our concepts should be illuminating rather than obfuscatory or confusing.

This thesis demonstrates that the "institutional" and "remedial" approaches fail, for a number of different reasons, to further these considerations as fully as we might expect. From this critique a more promising framework is developed. That framework recognises both the constructive trust and a purely personal order to transfer specific property. The constructive trust is conceptualised as a judicially imposed proprietary interest operating retrospectively, from the time of the facts giving rise to the claimant's cause of action. The personal order to transfer specific property does not recognise or create a proprietary interest. It simply confers on the claimant a personal right against the defendant to have a particular asset transferred. It is suggested that the new approach permits the pursuit of normatively desirable results within a framework that is coherent, rational and illuminating.

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[2] See e.g. J. Waldron, "'Transcendental Nonsense' and System in the Law" (2000) 100 Colum L Rev 16; A. Ross, "Tu-Tu" (1957) 70 Harv L Rev 812.

The Organisation of This Work

This work is divided into three Parts. Part I comprises three chapters. It tracks the development of the institutional and remedial theories, provides a critique of those theories and develops a new framework for analysis. More specifically, Chapter 1 puts the institutional-remedial debate into its historical context. It also discusses the various meanings of these terms and isolates the dominant contemporary use: the rule-based institutional constructive trust that arises automatically and the discretionary remedial constructive trust that arises if and when declared by a court of competent jurisdiction.

Chapter 2 focuses on the distinction of legal form. The nature of rules and discretion and their relationship with the constructive trust are examined. It is suggested that it would be unwise to press the proposed distinction too far or to pursue wholeheartedly either a discretionary or rule-based constructive trust. There are four principal reasons for this: (1) there can be no clear distinction between rules and discretion in practice; (2) attempts to maintain a clear distinction are misleading because rules and discretion are best viewed as points on a finely shaded and infinitely varied continuum of legal forms; (3) the appropriate legal form cannot be determined once and for all in the abstract but is a matter of context; and (4) the extravagant pursuit of either rules or discretion is likely to generate a number of undesirable consequences.

Chapter 3 focuses on the issue of timing. The different conceptions of the constructive trust in the Commonwealth and America are examined and their flaws identified. This critique leads to the development of the new framework which recognizes both the constructive trust, conceptualised as the retrospective grant of a proprietary interest, and the personal order to transfer specific property. The development of the latter is fundamental to the coherent development and just application of the former. By recognising a purely personal order to transfer specific property the constructive trust need not be asked to do too much and can be kept within appropriate limits.

Part II comprises four chapters. It considers further the flaws of the institutional and remedial theories and applies the framework developed in Part I in the specific context of acquisitive breaches of fiduciary obligation. The focus is on three instances of acquisitive breach: the renewal of leases and the rule in *Keech v Sandford*;[3] the receipt of bribes and secret commissions; and the wrongful exploitation of fiduciary opportunities. For each of these I examine, amongst other things: (1) the extent to which authority demands the recognition of a constructive trust; (2) explanations for the general recognition of a constructive trust; (3) the normative considerations that determine the appropriate relief; and (4) the extent to which the new framework would prove beneficial.

The narrow focus of Part II is necessary as it provides the opportunity for a detailed consideration of relevant case law and a thorough evaluation of the explanations for proprietary relief. It also provides the opportunity to develop detailed normative guidance that should influence the law. Acquisitive breaches of fiduciary obligation are the preferred focus for three main reasons. First, the area has been viewed historically as central constructive trust territory[4] and many of the texts concede an ineluctable link between acquisitive breach of fiduciary obligation and constructive trust.[5] Nevertheless the authorities on this point are not as settled as one might expect. Second, a strong minority have expressed concern over the broad availability of the constructive trust in this context. One reason for this is its potential impact on the fiduciary's creditors.[6] Another, albeit less persuasive concern, is that the constructive trust blurs the conceptual boundaries between ownership and obligation.[7] The role of the constructive trust in this context can be therefore hardly regarded as settled. Thirdly, it is possible to construct a

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[3] (1726) Sel Cas Ch 61.

[4] As Austin Wakeman Scott observed "in the English books they play up the *Rumford Market* case as though it were *the* constructive trust": A.W. Scott, "Constructive Trusts" (1955) 71 LQR 39 at p.47.

[5] E.g. A.J. Oakley, *Constructive Trusts* (3rd edn, 1997), p.178 (noting that a constructive trust arises "more or less automatically" upon the fiduciary's breach).

[6] See e.g. G. McCormack, *Proprietary Claims and Insolvency* (1997), Chapter 5; R.M. Goode, "Ownership and Obligation in Commercial Transactions" (1987) 103 LQR 433, especially pp.441-445.

[7] See P.B.H. Birks, *An Introduction to the Law of Restitution* (1989), pp.387-389; P.B.H. Birks "Obligation and Property in the Equity: *Lister & Co v Stubbs* in the Limelight" [1993] LMCLQ 30. The concern is linked to the desire to avoid unwarranted preferences, but that policy is poorly illuminated through the ownership-obligation distinction. Moreover, a sharp conceptual distinction along those lines is neither possible nor desirable: see C. Rotherham, "The Redistributive Constructive Trust: 'Confounding Ownership With Obligation'?" (1992) 5 Canterbury Law Rev 84.

strong case against the broad availability of the constructive trust in this context. However, there is reason to believe that cutting back the constructive trust will be easier if we recognise a personal form of specific relief.

Moving on to the details of Part II, Chapter 4 deals generally with fiduciaries, the fiduciary obligation and the normative foundations of specific relief as between principal and fiduciary and principal and third parties. It suggests that the constructive trust is appropriately limited to situations in which the fiduciary either misappropriates benefits directly from his principal or intercepts benefits that would otherwise have arrived at his principal in the ordinary course of events. In both instances the fiduciary's actions frustrate the objectives that the fiduciary relationship was entered into to achieve. A constructive trust, conferring priority over creditors and affording a degree of protection against remote recipients, is necessary to facilitate the productive use of fiduciary organisation. Absent misappropriation or interception the fiduciary must be stripped of his gain, but there is no justification for priority. A purely personal order to transfer specific property is appropriate.

Chapter 5 focuses on the renewal of leases and the development of the so-called rule in *Keech v Sandford*.[8] In this context the constructive trust has become entrenched. This leaves little room for judicial manoeuvre to limit the constructive trust to cases in which the renewal is intercepted. However, this is not a significant concern since the risk that third parties will be prejudiced by a constructive trust of the lease is minimal. The more important lesson of Chapter 5 is that the rules relating to constructive trusts of leases were developed in a unique historical context and should not be extended outside their narrow confines. The so called "principle" of *Keech v Sandford* (*viz.* that any acquisitive breach of fiduciary obligation generates a constructive trust of the benefit) is also considered in detail. It is demonstrated that this apparent principle has no firm jurisprudential basis.

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[8] n3 above.

Chapter 6 deals with bribes and secret commissions. A detailed analysis of recent and historic case law demonstrates equivocation as to the appropriate relief. The much criticised *Attorney General for Hong Kong v Reid*[9] has not settled the issue. We see in this Chapter that there is no theoretical or normative basis for the view that a constructive trust is the necessary and automatic response to a fiduciary's receipt of a bribe or secret commission. Applying the justifications developed in Chapter 4 it is suggested that a constructive trust is arguably appropriate in most (if not all) cases of commissions paid to purchasing agents but not in cases of bribes paid for non-pecuniary benefits.

Chapter 7 deals with the fiduciary's exploitation of proscribed opportunities. Again, I suggest that the authorities in this area do not necessarily support an ineluctable link between breach of fiduciary obligation and constructive trust. The leading cases might be just as well read to support the recognition of a constructive trust in cases of interception but not otherwise. That understanding would lead to normatively appealing outcomes, particularly if the personal order to transfer specific property was recognised and available in cases in which a demonstrable interception was not present. Other attempts to explain or rationalise the automatic recognition of a constructive trust are considered but are found wanting. The Chapter ends with discussion of the difficult issue of businesses developed and conducted in breach of fiduciary obligation. The orthodox "institutional" approach of English law is shown to be particularly deficient when applied in this context.

Part III comprises just one chapter, the conclusion of the thesis. Like most chapters of this nature its aims are rather modest. It draws together the threads and reminds the reader why the institutional and remedial approaches have been rejected and why the new approach is more likely to lead to the attainment of normatively desirable outcomes within a framework that is coherent, rational and illuminating

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[9] [1994] 1 All ER 1.

PART I: CONCEPTUALISING THE CONSTRUCTIVE TRUST

CHAPTER 1: The Constructive Trust and the Evolving Discourse of "Institution" and "Remedy"

I. INTRODUCTION

To fully understand the "institutional"-"remedial" debate it is instructive to place it in historical context. The present Chapter therefore looks at the orthodox characterisation of the constructive trust and its historical development. In England, the courts have tended to view the constructive trust as a residual category of trust that arises on an *ad hoc* basis. Academic attempts to establish a unifying rationale have proved unsuccessful. The courts for the most part, have been content to describe the facts upon which the "trust" will be recognised and the proprietary consequences of such recognition. However, it is doubtful whether in the formative era full proprietary consequences were an intended and consciously imported feature of the constructive trust.

The combination of *ad hoc* categories of constructive trust and a potentially accidental commitment to full proprietary consequences increasingly generated dissatisfaction with the constructive trust. This dissatisfaction stimulated questions about the appropriate nature and role of the constructive trust. The language medium through which the debate took place was and remains, that of "institution" and "remedy". However, as the debate developed it became increasingly apparent that clarification was necessary: "institution" and "remedy" could mean many different things. If confusion was to be avoided greater precision and a more careful definition of terms would be necessary.

What emerged from the increased scrutiny of the nature of the constructive trust, particularly in the 1990s, was a dominant polemic that centred on two issues: (1) the issue of legal form, that is whether the constructive trust is rule based or discretionary; and (2) the issue of timing, that is whether the constructive trust arises at the time the claimant's cause of action arises or at the time of judicial declaration. It became

established that an "institutional" constructive trust is a rule-based entitlement that arises at the time of the facts giving rise to the dispute; the "remedial" constructive trust is a discretionary entitlement that arises only when declared by the court. Taken together, these alternatives form a pervasive contemporary polemic, a framework within which most now talk and think about the constructive trust and within which our choices are made. This framework and the choices that it provides, are rejected in this thesis.

II. Traditional Ideas: The Constructive Trust as an *ad hoc* Trust Institution

1. The Absence of Clear Definition

What is a constructive trust? This is not an easy question to answer because, notwithstanding the numerous cases and academic comments dealing with the subject, a clear, all embracing and generally accepted definition remains illusive. Definition is attempted typically in a combination of positive and negative terms: the constructive trust is a trust that is not express or resulting.[1] Express and resulting trusts are products of the parties' intentions, whether express, inferred or presumed. Constructive trusts, we are told are different. As Oakley explains in the opening passage of his text:

> "Constructive trusts arise by operation of law. Unlike all other trusts, a constructive trust is imposed by the court as a result of the conduct of the trustee and therefore arises quite independently of the intention of any of the parties."[2]

This tracks the historical classification of trusts, developed by the treatise writers of the nineteenth century.[3] However, as a definition of the constructive trust it is not entirely satisfactory. First, intention is an ingredient of some constructive trusts which might be viewed as operating to "perfect" the intentions of the parties.[4] Indeed, some go so far as

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[1] See, e.g. M. Cope, *Constructive Trusts* (1990), pp.5-8.
[2] A.J. Oakley, *Constructive Trusts* (3rd edn, 1997), p.1. See also Cope, *ibid.* at p.7.
[3] See, e.g. E.H.T. Snell, *The Principles of Equity* (1868), p.105; A. Underhill, *A Concise Guide to Modern Equity* (1885), pp.63-64; W. Ashburner, *Principles of Equity* (1902), pp.124-125. Writing in 1964, Waters went so far as to claim that imposition by law and absence of intention are definitional points "upon which all would agree": D.W.M. Waters, *The Constructive Trust: The Case for a New Approach in English Law* (1964), p.1.
[4] G. Elias, *Explaining Constructive Trusts* (1990), pp.9-16, 56-66.

to say, somewhat untenably, that all constructive trusts further an actual intention of the parties that is not otherwise legally cognisable.[5] Second, the lack of clear definition has left the boundary between the constructive trust and other doctrines somewhat unclear. Birks and Chambers suggest that the resulting trust covers much of the territory traditionally claimed by the constructive trust, such as the receipt of trust property by a stranger who is a volunteer or not otherwise a *bona fide* purchaser.[6] Others suggest that secret trusts are express rather than constructive trusts[7] or are more appropriately accommodated, like mutual wills and conveyances subject to unregistered third party rights, within a contractual framework that recognises enforcement by third parties.[8]

Much of the confusion arises because English judges have for the most part been content to take a somewhat uncritical empirical approach, taking what has been judicially labelled as a constructive trust to be such.[9] This has encouraged description of the facts that give rise to a constructive trust and the consequences that it generates. A constructive trust is simply viewed as a trust that is constituted by the occurrence of one of several historic and enumerated empirical triggers - "categories of accepted constructive trust"[10] that arise in "certain definite situations".[11] Being a type of trust, it necessarily generates an equitable proprietary interest in the beneficiary. A constructive trustee does not however, necessarily assume the same personal obligations and

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[5] E.g. C.E.F. Rickett, "The Classification of Trusts" (1999) 18 NZULR 305.

[6] R. Chambers, *Resulting Trusts* (1997); P.B.H. Birks, "Persistent Problems in Misdirected Money: A Quintet" [1993] LMCLQ 218 at pp.236-237; P.B.H. Birks, "Restitution and Resulting Trusts" in *Equity and Contemporary Legal Developments* (1992), p.335. Consider also the proprietary consequences of a fraudulently induced transaction following avoidance by the defrauded party. Some characterise the restoration of equitable title to the claimant as an instance of constructive trust (e.g. *Papamichael v National Westminster Bank* [2003] 1 Lloyd's Rep 341; S. Worthington, "The Proprietary Consequences of Rescission" [2002] RLR 28 at pp.37-38) while Sir Peter Millett has characterised it as "an old-fashioned institutional resulting trust" (*El Ajou v Dollar Land Holdings* [1993] 3 All ER 717 at 734). Maintenance of a clear distinction between constructive and resulting has not been helped by the view of some judges that distinction between the two is not necessary: e.g. *Gissing v Gissing* [1971] AC 886 at 905 per Lord Diplock. More recently, see *London Allied Holdings Ltd v Lee & Ors* [2007] EWHC 2061 at [276].

[7] P.V. Baker & P. St John Langan, *Snell's Equity* (29th edn), p.108.

[8] C. Harpum, "The Uses and Abuses of Constructive Trusts: The Experience of England and Wales" (1997) 1 Edinburgh L Rev 437 at pp.442-443.

[9] Similarly, Harpum suggests that such is the confusion surrounding the constructive trust that the only sensible methodology that can be adopted during discussion of the area is to take what has been judicially labelled a constructive trust at face value: *ibid.* at p.438

[10] A.J. Oakley, "Has the Constructive Trust Become a General Equitable Remedy?" (1973) 26 CLP 17 at p.20.

[11] *Rathwell v Rathwell* [1978] 2 SCR 436 at 453 per Dickson J.

disabilities as an express trustee.[12] The extent to which these are assumed (if at all) depends on the context.[13]

The basic and fundamental feature of a constructive trust, therefore, is that one person (the "constructive trustee") holds an asset or assets for the benefit of another (the "constructive beneficiary") and this situation arises upon the occurrence of apparently well-defined but disparate empirical triggers.

2. The Disparate Constructive Trust Triggers

The historically enumerated triggers that give rise to a constructive trust comprise a wide variety of fact situations and serve a number of purposes.[14] These are generally said to include: the protection of existing property rights;[15] the perfection of intentions despite the absence of the normally required formalities;[16] the enforcement of irrevocable agreements;[17] the regulation of some consensual transactions;[18] prevention of the unconscionable acquisition of property;[19] and the stripping of unauthorised fiduciary profits.[20] Thus, while a clear rationale underpins the express trust - namely the furtherance of a manifested intention on the part of the settlor - the enumerated situations that trigger a constructive trust exhibit no clear and uniform *raison d'etre*.[21]

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[12] *Lonrho v Fayed (No.2)* [1992] 1 WLR 1 at 11-12 per Millett J; L. Smith, "Constructive Fiduciaries" in *Privacy and Loyalty* (1997, ed. P.B.H. Birks), p.249 at 263-267.

[13] For discussion, see A. Hudson & G. Thomas, *The Law of Trusts* (2003), pp.848-851.

[14] For consideration and classification of constructive trust triggers, see Oakley, n2 above; R. Chambers, "Constructive Trusts in Canada" (1999) 37 Alta L Rev 173; Cope, n1 above; Elias, n4 above; S. Gardner, *An Introduction of the Law of Trusts* (1990), Chapter 15; R.P. Austin, "Constructive Trusts" in *Essays in Equity* (1985, ed. P.D. Finn), p.196 at 196-197.

[15] For example, the constructive trust imposed on a recipient of trust property who is not a *bona fide* purchaser for value of the legal estate without notice: *Boscawen v Bajwa* [1996] 1 WLR 328 at 334-335 per Millett LJ.

[16] E.g. the rule in *Re Rose* [1952] Ch 499 and the operation of *donatio mortis causa*: *Sen v Hedley* [1991] Ch 425. See Elias, n4 above, at pp.9-16, 49-66.

[17] E.g. mutual wills: *Re Cleaver* [1981] 1 WLR 939; *Re Newey* [1994] 1 NZLR 590.

[18] E.g. the acquisition of land subject to a specifically enforceable contract for sale, such land being held on trust by the vendor for the purchaser prior to transfer of the legal title: *Lysaght v Edwards* (1876) LR 2 Ch D 499.

[19] See the cases discussed in Chapter 2 of Oakley, n2 above.

[20] E.g. *Attorney General for Hong Kong v Reid* [1994] 1 All ER 1.

[21] Oakley, n2 above, at p.1. Austin refers to constructive trust doctrine as comprising a "rag bag of situations": Austin, n14 above. The sentiment is perhaps best captured in Sykes' comment that constructive trust doctrine is a "vague dust-heap for the reception of relationships which are difficult to classify or which are unwanted in other branches of law": E.I. Sykes, "The Doctrine of Constructive Trust" (1941) 15 Aus L J 171 at p.175.

Suggestions have been put forward that all constructive trusts have in common the pursuit of good conscience or the avoidance of unconscionable outcomes.[22] However, such vague and indeterminate standards hardly provide firm guidance. They are more suggestive of a general attitude towards the constructive trust rather than a statement of its role or the circumstances in which it will be recognised.

We find, therefore, that English constructive trust jurisprudence is represented by a bewildering array of fact situations in which a constructive trust has been previously found and from which credible analogies may be drawn to encompass new cases. This uncritical empirical approach has proved problematic for a number of reasons.

First, absent a clear and uniform *raison d'etre* there has arisen considerable disagreement over the appropriate content of the list of constructive trust triggers. Almost the whole of the list has, at one time or another, been questioned. Equally, there are peripheral categories vying for admittance to the list of accepted constructive trust triggers but whose position continues to remain of considerably uncertain.[23]

Second, the list causes considerable confusion, particularly when novel circumstances emerge for consideration. The existence of a list of constructive trust categories encourages cases to be resolved by use of ill-considered analogies or simple pigeon-holing: if the case does not fit into a category there is no constructive trust, regardless of the policy demands of the situation. As Weinrib commented in the context of fiduciary relationships:

> "The existence of a list of nominate relations dulls the mind's sensitivity to the purposes for which the list has evolved and tempts the court to regard the list as exhaustive and to refuse admittance to new relations which have been created as a matter of business exigency."[24]

Third, reliance on the list does little to encourage the court to justify the imposition of a constructive trust in those cases that apparently fall within a listed category, or to justify

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[22] E.g. Hudson & Thomas, n13 above, at pp.25-27.
[23] A notable example is property obtained through the exploitation of confidential information: see T.H. Wu, "Confidence and the Constructive Trust" (2003) 23 LS 135; A.J. Penk, "Confidential Information in a Commercial Context: An Analysis of the 'Use' of Confidential Information and the Availability of a Proprietary Remedy for Breach of Confidence" (2001) 9 Auckland U Law Rev 470.
[24] E.J. Weinrib, "The Fiduciary Obligation" (1975) 25 UTLJ 1 at p.5.

the exclusion of a constructive trust in cases which fall out with the listed categories. Time and energy is spent showing that a specific instance falls within or outside an enumerated category rather than establishing whether or not a constructive trust is an appropriate response. This is particularly damaging in the present context because, as will be seen below, the classes of constructive trust that history has given us have evolved without current needs in mind.

3. Proprietary Consequences

(a) The Constructive Trust as a Proprietary Concept

In its traditional and orthodox sense a finding of "constructive trust" denotes that the defendant holds a particular asset or assets for the benefit of the claimant. The defendant holds bare legal title to the asset or assets as constructive trustee while the claimant has an equitable property right as a constructive beneficiary. The proprietary nature of the constructive beneficiary's claim makes it particularly important to carefully and precisely delimit the circumstances in which constructive trusts are available. This is because proprietary claims have a number of important and far-reaching consequences which make their recognition highly advantageous to the claimant.[25] What is advantageous to the claimant however, may be also highly disadvantageous to the defendant and third parties.

The first advantage is that of quantum: a constructive trust may allow the claimant to recover more. A finding that the defendant holds property at the outset on constructive trust will provide access to the tracing process. By this process a claimant may, at his election and with the aid of favourable presumptions,[26] trace the value of money or other property into a substitute and claim that substitute as his own. Since the substitute

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[25] See R. Goff & G. Jones, *The Law of Restitution* (5th edn, 1998), pp.76-77; L. Smith, *The Law of Tracing* (1997), pp.24-29; D. Dobbs, *Law of Remedies: Damages – Equity – Restitution* (3rd edn, 1993), pp.394-398; S.R. Scott, "The Remedial Restitutionary Proprietary Remedy: An Evaluation of the Extent to Which Preferential Recovery Should Be Available for the Recovery of Money" (1995) 6 Canterbury Law Rev 123 at pp.126-133; J. Glover, "Equity, Restitution and the Proprietary Recovery of Value" (1991) 14 UNSWLJ 247 at pp.251-253; D. Stevens, "Restitution, Property, and the Cause of Action in Unjust Enrichment: Getting By With Fewer Things – Part I" (1989) 39 UTLJ 258 at pp.290-295.

[26] Such as those established in *Re Hallet's Estate* (1880) 13 Ch D 696 and *Re Oatway* [1903] 2 Ch 356.

may be greater in value the claimant may be placed in a position superior to that which he would have occupied had he simply claimed back the original.[27] It also follows from the claimant's proprietary rights in the original property or its substitute that any fruits generated by such property belong to the claimant: ownership of fruits vests in the owner of the property that produces them.[28]

> "If the claimant is successful in establishing the proprietary remedy, he will be entitled to the transfer of his property or its identifiable substitute. It will be transferred to him in the state in which it is when the order is enforced; so that if the property (or its substitute) has increased in value, the claimant will receive the benefit of that increase. Equally, if there have been additions or accretions to the property, he will receive those too."[29]

It is irrelevant whether or not it appears just, fair or reasonable for the defendant to transfer traceable proceeds to the claimant. In English law, the scope and quantum of proprietary relief are determined not by discretion but by "hard-nosed property rights."[30]

The second advantage is that of scope: proprietary rights are can be exercised against an indefinite class of person. Thus, the constructive trust claimant may recover property from a remote recipient who is not a *bona fide* purchaser of the legal estate for value without notice. Moreover, since the purchaser of an equitable interest does not fall within the *bona fide* purchaser defence, the constructive trust beneficiary's claim will also rank ahead of a party with an equitable security interest that is later in time, such as the interest of an equitable mortgagee.[31] However, perhaps the most significant third party against whom the constructive beneficiary can enforce his claim is the defendant's trustee in bankruptcy. The constructive beneficiary is thereby conferred priority over the defendant's general creditors.[32] This advantage, it should be remembered, may be combined with the advantage of quantum to provide a priority claim to substitutes that have appreciated in value as well as the fruits of the property

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[27] For particularly graphic illustrations at both equity and common law, see *Foskett v McKeown* [2000] 3 All ER 97 and *Trustee of the Property of F.C. Jones & Sons (a firm) v Jones* [1996] 4 All ER 721.
[28] *Brown v IRC* [1965] AC 244; *Solloway v McLaughlin* [1938] AC 247.
[29] *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 at [1521] (Lewison J).
[30] *Foskett*, n27 above, at 109 per Lord Browne-Wilkinson.
[31] *Re Morgan* (1881) LR 18 Ch D 93.
[32] Insolvency Act 1986, s283(3)(a) (excluding from a bankrupt's distributable estate "property held by the bankrupt on trust for any other person").

claimed.[33] It is the priority advantage in particular that has proved especially difficult to justify and which makes the application of the constructive trust in many cases controversial.

The third advantage of proprietary claims is procedural. The usual consequence of establishing a constructive trust (at least in the absence of a joint interest) is that the property will be transferred to the claimant *in specie*. The benefit of this is that it avoids potential valuation difficulties that can arise when a money remedy is sought.[34] A proprietary claim may also facilitate the preservation of disputed property pending judgment. Thus, it may bring into play statutory devices designed to prevent dealings in property[35] and makes it easier to secure an interim injunction against the alienation of the property claimed.[36] Of equal significance, a proprietary claim may also provide the claimant with access to a remedy when a personal claim is barred[37] or give the claimant access to longer limitation periods.[38]

The consequences of recognising a constructive trust are therefore significant and far-reaching. They impact not only on the defendant but also on third parties claiming through and innocently dealing with the defendant. These attributes often make the recognition of a constructive trust particularly difficult to justify or explain. Much of the time they rest on historical accident.[39]

(b) "Constructive Trusts" That Are Not

Unless we use language and legal ideas consistently we cannot expect to avoid

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[33] For critical discussion and illustrations of how the advantages of quantum and scope might be combined, see D.A. Oesterle, "Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC §9-306" (1983) 68 Cornell L Rev 172 at pp.208-215.
[34] *LAC Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th) 14 at 48-49 per La Forest; *Erehwon Exploration Ltd v Northstar Energy Corp* (1993) 108 DLR (4th) 709 at 728 (Hunt J).
[35] This was the primary reason for the Hong Kong government's claim to a constructive trust in *Attorney General for Hong Kong v Reid* [1994] 1 All ER 1. A subsisting proprietary interest would allow a caveat to be registered on the land register, something which receives greater attention in the report of the decision of the New Zealand Court of Appeal: [1992] 2 NZLR 385.
[36] Smith, n25 above, at p.27.
[37] *Sinclair v Brougham* [1914] AC 398. For further procedural advantages, see Smith, n25 above, at pp.27-29.
[38] *Paragon Finance v DB Thakerar & Co* [1999] 1 All ER 400; *J.J. Harrison (Properties) v Harrison* [2002] 1 BCLC 162. See M. Hemsworth, "'Constructive Trusts' and 'Constructive Trustees' – What's in a Name?" (2000) 19 CJQ 154.
[39] Below, Section III.1.

confusion. One problem with "constructive trust" is that it has been used in different ways to mean different things. Three inappropriate uses of the constructive trust label might be identified. These are examples of "constructive trusts" that are not since they have no proprietary character. The language of "constructive trust" in these cases should be jettisoned because it invites confusion.

First, the language of constructive trust has been adopted to describe the position of a defendant, usually a fiduciary, who is liable to account for the net value of his gain as equitable debtor of the sum due.[40] We already have appropriate terminology to describe this situation: the defendant is personally liable to account. The use of "constructive trust" does nothing but cause confusion as to the true nature of that liability.

Second, the language of constructive trusteeship has been adopted to denote that a person stands in a position analogous to an express trustee and is therefore subject to fiduciary obligations. Thus, in *Boardman v Phipps* Lord Hodson opined that the "persons concerned in this case, namely, Mr. Thomas Boardman and Mr. Tom Phipps, are not trustees in the strict sense but are said to be constructive trustees by reason of the fiduciary position in which they stood."[41]

Third, the language of constructive trusteeship has been used for the purpose of denoting that a person is subject to some of the remedies that are available against an express trustee. The most obvious illustration of this third usage is the practice of describing as a constructive trustee a defendant who dishonestly assists in a breach of trust or fiduciary relationship.[42] Such use of constructive trust language is indisputably unwarranted and generates nothing but confusion.[43] The defendant, who will usually have received no property, is personally liable in equity to pay compensation for the claimant's loss.[44] Nevertheless, this usage has persisted, leading some to the spurious conclusion that a constructive trust may "create or recognise no proprietary interest".[45]

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[40] See J. Martin, *Modern Equity* (17th edn, 2005), p.630; *Ultraframe*, n29 above, at [1513]-[1517].
[41] [1967] 2 AC 46 at 105.
[42] See e.g. C. Harpum, "The Stranger as Constructive Trustee - Part I" (1986) 102 LQR 114.
[43] P.B.H. Birks, "Trusts in the Recovery of Misapplied Assets: Tracing, Trusts, and Restitution" in *Commercial Aspects of Trusts and Fiduciary Obligations* (1992, ed. E. McKendrick), p.149 at 153-154.
[44] L.Smith, "Constructive Trusts and Constructive Trustees" [1999] CLJ 294 at p.300.
[45] *Giumelli v Giumelli* (1999) 161 ALR 473 at 475. See also *Westedeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 at 705 per Lord Browne-Wilkinson (dishonest assistance cases an exception to the general rule that a constructive trust requires trust property).

III. Historical Developments and Their Impact

1. The Impact of Express Trust Thinking

(a) The Pervasiveness of the Trust Concept in Early Chancery Thought

The most significant influence on the early development of the constructive trust, the effects of which are still felt greatly today, was the distinct Chancery mind that had been rooted over the centuries in the idea of the express trust. Wherever equity established that a person ought for some reason to be obliged to transfer property to another, notwithstanding the absence of an intention sufficient to found an express trust, his position was naturally deemed to be analogous to that of a person appointed as an express trustee. As Waters observed in his seminal work:

> "The truth of the matter is that the constructive trust was coined as a term because Chancery was invited to adjudicate in disputes where the relationship of the parties was rooted in the common law, and upon which Chancery imposed the language of trust. The language of trust came naturally, moreover, when Chancery was invited to impose the rudiments of trust obligation upon persons who were not trustees by express or implied creation. But…..there was never a theme behind the use of constructive trust by Chancery. It was never any more than a convenient and available language medium through which for the Chancery mind the obligations of the parties might be expressed or determined. Whereas the divided jurisdictions of law and equity gave rise to the ready use of trust language where common law language might equally well have served, the dominance of the trust in all Chancery thinking after the seventeenth century brought about the process of ready thinking by analogy. In short, a separated Court of Chancery gave us the term constructive trust, and the application of the term by analogy with the express trust was Chancery's practice from the beginning."[46]

Consequently, the constructive trust and express trust were regarded as two species of the same genus. The only difference lay in their mode of creation. While the express trust was created by the legally cognizable intention of the parties, the constructive trust was created by the courts according to vague and relatively ill-defined notions of constructive fraud and unconscionability.[46a] The situations of constructive fraud and

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[46] Waters, n3 above, p.39. See also D.W.M. Waters, *The Law of Trusts in Canada* (2nd edn, 1984), p.404.

[46a] As Dawson observed memorably, "[t]he constructive trust emerged, like the equitable accounting, from the dark and unexplored recesses of the early Chancery": J.P. Dawson, "Restitution or Damages?" (1959) 20 Ohio St LJ 175 at p.181.

unconscionability in which one person would be subject to a duty to convey property to another gradually became the subject of more certain rules.[47] Together, these rules formed a relatively closed and stable list of constructive trust triggers.

A good deal has been written about the somewhat limited scope of the historical triggers and how by using the trust analogy, the circumstances in which one party would be duty bound to convey property to another were unnecessarily restricted.[48] The adoption of the trust as a convenient medium by which to express the relationship of the parties also appeared to lead equity to the conclusion that the same proprietary consequences followed a finding of constructive trust as followed a finding that property was held on express trust. Indeed, similar reasoning to this has been adopted in more recent times, even in jurisdictions in which the constructive trust is regarded as a general remedy for unjust enrichment.

In one American case the court rejected as "illogical" the assertion that full legal and equitable ownership stays with the defendant until the constructive trust is ordered by the court on the basis that, "if legal and beneficial titles are never in two different persons, there would be no reason to use the trust analogy".[49] On this reasoning it was held that a constructive trust necessarily created equitable property rights in the claimant at the time of the unjust enrichment and thus conferred priority over the government's later Federal tax lien. Similarly, in *Re General Coffee Corporation*[50] a bank sought a constructive trust over the traceable proceeds of property fraudulently obtained by a company that had become insolvent. The US Court of Appeals, Eleventh Circuit, found for the claimant on the basis that: (i) where property is fraudulently obtained a constructive trust arises; (ii) a constructive trust is a true trust relationship; (iii) in a true trust relationship the beneficiary has equitable property rights in the property and by virtue of those rights takes priority over the trustee's creditors; and (iv) the constructive trust claimant, as the beneficiary of a true trust, must therefore be conferred the same priority.[51]

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[47] For an early attempt to provide a comprehensive account of constructive trust triggers, see J. Hill, *A Practical Treatise on the law Relating to Trustees* (1845), Chapter II ("Trustees by Virtue of Constructive Trust").
[48] See especially Waters, n3 above, Chapter 1.
[49] *United States v Fontana* 528 F Supp 137 at 143 (1981).
[50] 828 F 2d 699 (1987).
[51] *ibid.* at 706.

(b) Was the Commitment to Full Trust Consequences Accidental?

Did Chancery consciously develop the constructive trust as a proprietary concept? Those who have considered this question are divided. On one view, use of the trust idea to express the obligations of the parties led to an accidental commitment to full trust consequences in any case caught by a constructive trust trigger. In the early cases the courts were invited to adjudicate on disputes where competition for the property was between the claimant and wrongdoer, the former seeking to recovery the property *in specie*. The trust was nothing more than a convenient medium through which to express the parties' personal rights and obligations.

Given that the constructive trust was labelled a trust however, it was later taken to mean that the constructive trust triggers must generate the same proprietary consequences as an express trust. This pre-empted consideration of whether the full bundle of trust consequences were necessary or warranted. Consequently, the facts of cases were "not pleaded in such a way that none trust issues could be raised; arguments were not addressed to other issues; and judges did not consider them".[52] It followed that "equitable principles came to be learned, if at all, as principles leading to a single result, the existence of a trust."[53] This is evident in Sir William Grant MR's interrogative "[u]pon what ground is a Court of Equity ever called upon to direct one man to convey a real estate to another, except upon the ground of a trust, either actual or constructive?"[54] Gretton thus suggests that:

> "the constructive trust developed neither as a means of capturing priority nor as a means of capturing added value: these were accidental benefits which may have helped to keep the constructive trust in existence……the constructive trust was an accident, caused by a combination of two circumstances: the separation of law and equity, and the absence of an autonomous enrichment law. Since enrichment law had to arrive, to a large extent, through equity, it was almost inevitable that it would become trust-like."[55]

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[52] R.P. Austin, "The Melting Down of the Remedial Trust" (1988) 11 UNSWLJ 66 at p.70.
[53] *ibid.*
[54] *Beckford v Wade* (1805) 17 Ves 87 at 96.
[55] G. Gretton, "Constructive Trusts and Insolvency" (2000) 8 European Review of Private Law 463 at p.466.

It is for this reason that Scots lawyers are sceptical of the recognition of the constructive trust. Why they ask, should Scottish insolvency law be determined by the historical accidents of another system?[56]

The competing view is that Chancery judges adopted the trust idea with one eye already on its proprietary nature, particularly its ability to insulate the beneficiary from the risk of the constructive trustee's bankruptcy. Thus, in his comparative study of unjust enrichment, Dawson suggested that the purpose of the constructive trust "was always plain enough, to promote the creation of preferences".[57]

While Dawson did not provide evidence for this view it remains plausible. Chancery judges must have been mindful of the priority implications of the trust concept. By the formative era of the constructive trust in the late seventeenth and early eighteenth centuries,[58] the express trust had ceased to be viewed as an unassignable personal obligation and had assumed the hallmarks of an equitable proprietary interest.[59] Importantly, a beneficiary's interest was held to prevail over the claims of a trustee's creditors,[60] including those who had enforced judgment against trust property.[61]

The economic environment of the time may also suggest that Chancery judges intended to import the priority advantage of the express trust in at least some constructive trust cases. For example, the seminal decision of Lord Chancellor King in *Keech v Sandford*[62] came on the back of the bursting of the South Sea bubble, an event which caused losses and bankruptcies on a grand scale, including to Chancery Masters who had speculated with funds paid into court and which were therefore irrecoverable. Lord

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[56] G. Gretton, "Constructive Trusts" (1997) 1 Edinburgh L Rev 281 & 408 at pp.410-411.
[57] J. Dawson, *Unjust Enrichment: A Comparative Analysis* (1951), p29.
[58] Constructive trusts were "well established in Lord Nottingham's time": D.E.C. Yale (ed) *Lord Nottingham's Chancery Cases, Volume II* (79 Seldon Society, 1961), p.124. Lord Nottingham was chancellor from 1673-1682.
[59] The medieval "use", from which the trust was developed, had also developed a number of proprietary characteristics before its abolition in Tudor times: J. Baker, *An Introduction to English Legal History* (3rd edn, 1990), pp.285-287; A.W.B. Simpson, "The Equitable Doctrine of Consideration and the Law of Uses" (1965-66) UTLJ 1 at pp.24-28.
[60] *Medley v Martin* (1673) Rep Temp Finch. See also *Ex parte Marsh* (1744) 1 Atk 158; *Ex parte Pease* (1812) 19 Ves Jun 25 at 43-44.
[61] *Finch v Earl of Winchelsea* (1715) 1 P Wms 277. See F.W. Sanders, *On Uses and Trusts, and on the Nature and Operation of Conveyances at Common Law and Those Deriving Their Effect from the Statute of Uses* (2nd edn, 1799), Vol. 1, pp.230-231.
[62] (1726) Sel Cas Ch 61.

King was one of those who had to deal with the unpleasant aftermath.[63] In the ensuing protectionist environment insulating the beneficiary in *Keech* from the risk of trustee bankruptcy may well have been a significant consideration.

However, there remains little direct evidence that priority was generally considered by judges developing the constructive trust categories, the cases for the most part being unconcerned with bankrupt trustees.[64] Moreover, a finding that priority followed in one case would not necessarily support a similar outcome in all constructive trust cases given the disparate constructive trust triggers. There were also ideological and political reasons which might have influenced Chancery's characterisation of the constructive beneficiary's interest as proprietary.[65] Finally, there has developed in the intervening years a much greater awareness of the impact, efficacy and fairness of equitable proprietary rights in bankruptcy that was lacking during the formative period. In today's complex commercial world, history alone might be thought to justify little.

2. Some Problematic Consequences

The peculiar historical development of the constructive trust in English law, influenced as it was by the analogy to the express trust, has generated problems in terms of the scope of the trust and the consequences that its recognition produces. These problems stimulated debate over the final three decades of the twentieth century, particularly in the Commonwealth, about the proper nature of the constructive trust.[66] The problems are of three kinds.

First, injustice might be created because a constructive trust is not available on the facts of the case; that is, there is no trigger on the historically enumerated list of triggers that

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[63] E. Heward, "The Early History of the Court Funds Officer" [1983] Journal of Legal History 46.
[64] Priority *was* an issue in some cases concerning the renewal of leases by trustees. However, these must be understood in their special historical context and are less likely to prejudice creditors: see Chapter 5.
[65] For example, Chancery judges may have been drawn to characterise equitable norms as property rights to explain judicial intervention at a time when the protection of property was identified as the reason for government: C. Rotherham, *Proprietary Remedies in Context* (2002), p.9.
[66] D. Hayton, "Remedial Constructive Trusts of Homes - An Overseas View" [1988] Conv 259; D.W.M. Waters, "Where is Equity Going?" (1988) 18 WALR 1 at pp.6-21; J. Dodds, "The New Constructive Trust: An Analysis of its Nature and Scope" (1988) 16 MULR 482; J. Dewar, "The Development of the Remedial Constructive Trust" (1982) 60 Can Bar Rev 265. See also the works cited below, Section

covers the facts before the court. The injustice can be removed by expanding the situations in which a constructive trust will be recognised. For example, in the context of determining property rights in the family home, English courts have repeatedly expressed an unwillingness to expand the availability of the constructive trust for the sake of avoiding injustice in the instant case.[67] A cohabitee is therefore often left without a remedy in instances of substantial indirect contribution where a common intention to share the home is absent.[68] This contrasts with other jurisdictions in which there has occurred an expansion of liability beyond that previously envisaged in order to provide more would-be claimants with a gateway to the constructive trust.[69]

Second, injustice might be created because the constructive trust extends too far; it is available in circumstances where another available remedy might be more appropriate. Here injustice can be removed by cutting back the constructive trust - for example, by narrowing a trigger or by removing it from the enumerated list. Thus, a constructive trust of profits acquired in breach of fiduciary obligation will in some circumstances risk creating unfair priorities over third parties. At least where the fiduciary's gain or its traceable proceeds are in the form of money, an account of profits can serve the essential function of stripping the fiduciary of his gains while also avoiding the risk of prejudicing F's creditors should F be bankrupt.[70]

Third, in some instances neither a constructive trust nor any other existing remedy may be appropriate. A major force behind the development of the "remedial" constructive trust has been the recognition that in some types of case specific relief is necessary to do justice between claimant and defendant but only to the extent that innocent third parties are not prejudiced.[71] In these circumstances the constructive trust, traditionally conceived, risks unwanted and unintended side effects as a result of its capacity to bind third parties claiming through the defendant. However other available responses which do not bind third parties, such as an account of profits or equitable compensation, fail to

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IV.3(b).

[67] E.g. *Gissing v Gissing* [1971] AC 886; *Pettit v Pettit* [1970] AC 777.

[68] E.g. *Burns v Burns* [1984] Ch 317.

[69] *Peter v Beblow* 1993) 101 DLR (4th) 621; *Pettkus v Becker* (1980) 117 DLR 257. The expansion has, however, been coupled with a growing acceptance that the constructive trust may be moulded to avoid injustice to third parties: see further Chapter 3, Section III.

[70] Chapter 4, Section VI.

[71] Chapter 3, Section III.

provide the required specific relief. One way to avoid unfairly prejudicing third parties might be to grant judges a power to refuse a constructive trust where third parties would be prejudiced but grant a constructive trust where third parties are absent. An alternative might be to create an entirely new remedy[72] which is both specific and personal and therefore enforceable against the immediate defendant only.[73]

IV. The Appropriate Conceptual Framework: "Institution" or "Remedy"?

1. The Origins of the Distinction

It is against the above historical background and dissatisfaction with its consequences, that debates about the appropriate conceptualisation of the constructive trust developed. Discourse has typically proceeded under the rubric of "institutional" and "remedial". While these terms have been around for some time it is only recently that they have been the subject of sustained analysis. They have their origin in Pound's article in the Harvard Law Review in 1920.[74] When looking at "a few interesting applications of existing principles",[75] Pound observed that the constructive trust was used as a "remedial" rather than a "substantive" institution.[76] Interestingly, the language used by Pound was "remedial" and "substantive" rather than "remedial" and "institutional". Seventeen years later the American Law Institute's *Restatement of the Law of Restitution* adopted the view that the constructive trust was a "remedy" for unjust enrichment.[77] However, the precise meanings of the "remedial" and "substantive" labels were explained in neither the *Restatement* nor Pound's essay.

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[72] That is, the judiciary make an order of a kind not known before, as it did with the creation of *Anton Piller* Orders (now Search Orders) in *EMI Ltd v Pandit* [1975] 1 WLR 302 and *Anton Piller v Manufacturing Processes* [1976] 1 Ch 55 (CA) and *Mareva* injunctions (now freezing orders) in *Nippon Yusen Kaisha v Karageorgis* [1975] 1 WLR 1093 and *Mareva Compania Naveira SA v International Bulkcarriers SA* [1975] 2 Lloyd's Rep 509.

[73] These alternatives are analysed fully in Chapter 3.

[74] R. Pound, "The Progress of the Law 1918-1919" (1920) 33 Harv L Rev 420.

[75] *ibid.* at p.421.

[76] *ibid.* at pp.420-421.

[77] W. Seavey & A.W. Scott (reporters), *Restatement of the Law of Restitution* (1937), §160.

Pound's distinction was introduced to English lawyers by the influential American trust scholar (and joint reporter of the *Restatement*), Austin Wakeman Scott.[78] Scott wrote that "a constructive trust, unlike an express trust, is a remedy and not a substantive institution".[79] While the import of these terms remained somewhat vague, Scott was keen to emphasise the broad scope of the American constructive trust in contrast to its more limited English counterpart.[80] He was also keen to emphasise that the constructive trust and express trust had little in common.[81] For Scott, the courts compelled a defendant to surrender property to a claimant not because a trust had been created but because it was necessary to avoid an unjust enrichment. It was because the court would give this relief that it declared the defendant a constructive trustee.[82]

Impressed by Scott and Pound, Maudsley grappled with the distinction in 1959. In an often quoted article he observed that "English law has always thought of the constructive trust as an institution, a type of trust".[83] However, he went on to explain that this characterisation was only partially correct. In many constructive trust cases "a full and complete trust exists, as for example where trust property is conveyed to a purchaser with notice".[84] The constructive trust in these cases is "an institution, a type of trust".[85] However, other constructive trusts simply require "that the 'trustee' shall convey the property to the 'beneficiary' and do not put him under any active duty of management".[86] In these cases, which "are concerned solely with the property of the plaintiff being wrongly in the defendant's hands," the constructive trust is remedial or, in Maudlsey's rather unhelpful language, a "constructive quasi trust".[87] Thus, like Scott, Maudsley identified a distinction between a trust institution and a device that facilitated the surrender of property in the wrong hands. Maudsley's language was, however,

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[78] A.W. Scott, "Constructive Trusts" (1955) 71 LQR 39.
[79] *ibid.* at 41.
[80] *ibid.* at p.39 ("It is, I think, coming to be recognised, particularly in the United States, that the constructive trust is a concept of wide scope which is gradually growing wider.")
[81] Any resemblance was "superficial": *ibid.* at p.40.
[82] *ibid.* at p.41.
[83] R.H. Maudsley, "Proprietary Remedies for the Recovery of Money" (1959) 75 LQR 234 at p.237. Pettit continues to view the constructive trust as belonging to the same family as the express trust, commenting that the constructive and express trust are "two species of the same genus": P.H. Petitt, *Equity & The Law of Trusts* (9th edn, 2001), p.64.
[84] n83 above, at p.237.
[85] *ibid.*
[86] *ibid.*
[87] *ibid.* The language appears to derive from Maitland, who described constructive trusts as "quasi-trusts": F.W. Maitland, *Equity* (2nd edn, 1936), p.75.

subtly different: the distinction identified was not "substantive"/"remedial" but "remedial"/"institutional".

The idea that the constructive trust was "remedial" rather than "substantive"/"institutional" gained further prominence with the publication of Donovan Waters' seminal work in 1964.[88] However, with the exception of Lord Denning's swiftly rejected constructive trust of a "new model"[89] in the 1970's there were few further developments in England until the last decade of the twentieth century.[90] By that time it had become painfully apparent that the distinction between the two conceptions was hopelessly unclear. Scott and Maudsley had adopted just one of a plurality of possible meanings. The first task, therefore, was to clarify the terms of the debate. Only then would it be possible to choose between them and determine whether the constructive trust was or should be viewed as a "remedy" or an "institution".

2. "Institutional" and "Remedial": The Many Meanings

At least eight meanings might be assigned these respective labels, each suggesting different things about how jurists think about the constructive trust. Some of these meanings are less informative than others.

(a) The Solution to a Problem

First, we might consider an expansive, non-dichotomised meaning. It is regularly commented that, in a broad sense, a remedy can be regarded as a solution to a problem.[91] Thus, a constructive trust might be considered both remedial and institutional: it is a legal institution[92] that provides a solution to particular problems.[93] This meaning is of limited utility as a result of its generality.

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[88] n3 above.
[89] E.g. *Hussey v Palmer* [1972] 1 WLR 1286 at 1289.
[90] Particularly noteworthy are the papers in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 2, pp.165-223.
[91] E.g. Dobbs, n25 above, p.21.
[92] That is, an "institution of law" as described by N. MacCormick, "Law as Institutional Fact" (1974) 90 LQR 102.

(b) Primary Rights and Secondary (Remedial) Rights

Some suggest that the language of "institutional" and "remedial" tracks the Austinian distinction between primary and secondary or remedial rights.[94] A primary right is a right which exists independently of a breach of a legally recognised duty, such as the right not to be subjected to negligently inflicted harm. A secondary right arises from a breach of primary duty, for example the right to receive payment of damages following a negligent infliction of harm.[95] Thus, while the constructive trust in Canadian law is typically viewed as a remedial response to the cause of action in unjust enrichment,[96] it is said that the constructive trust and tracing in English law "are not so much remedies as part of establishing the substantive rights of the parties".[97]

However, to argue whether the constructive trust is more appropriately viewed as a primary or secondary right does little to sharpen our analysis of when a constructive trust is or is not appropriate. Nor does it help us to determine the appropriate consequences of the recognition or imposition of a constructive trust. Where the claimant has a remedy he must be able to point to a right that determines its availability; and where the claimant has a right the law must provide a remedy for its infringement. As Goulding J observed in *Chase Manhattan Bank v Israel British Bank,*[98] "it is as idle to ask whether the court vindicates the suitor's substantive right or gives the suitor a procedural remedy, as to ask whether thought is a mental or cerebral process. In fact the court does both things by one and the same act."[99]

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[93] *Muschinski v Dodds* (1986) 160 CLR 583 at 613 per Deane J.
[94] J. Austin, *Lectures on Jurisprudence* (5th edn, 1885), pp.762-763. The distinction has been pressed recently by some restitution scholars: e.g. K. Barker, "Rescuing Remedialism in Unjust Enrichment Law: Why Remedies are Right" [1998] CLJ 301 at pp.319-322.
[95] On the distinction generally, see A. Pretto, "Primary Rights and Rights *in rem*" in *Themes in Comparative Law: Essays in Honour of Bernard Rudden* (2002, eds. A. Pretto & P.B.H. Birks), p.65.
[96] *Sorochan v Sorochan* (1986) 29 DLR (4th) 1 at 7 per Dickson CJC; *Pettkus v Becker* (1980) 117 DLR 257.
[97] R. Megarry & P.V. Baker, *Snell's Equity* (27th edn, 1978), p.572, quoted in Rotherham, n65 above, at p.13.
[98] [1981] Ch 105.
[99] *ibid.* at 124.

(c) Facilitative Institutions and Judicially Imposed Remedies

A distinction is often made between legal institutions that are the product of the intentions of the parties concerned and legal institutions that are judicially created to resolve a problem troubling the claimant.[100] Thus, the parties to an express trust are "characteristically not acting in innocence, with the trust concept coming in from outside to deal with the consequences of what they have done. Instead, they are acting with their eyes already on the concept, and deliberately interacting with it."[101] By contrast, in many instances the constructive trust is a relationship imposed by the court from the "outside" as a means of resolving a particular problem that has arisen as a consequence of the parties' actions, even though the parties did not necessarily intend to set off down the road of trust creation. Thus, the constructive trust might be considered remedial when compared to the express trust. [102] Alternatively, given that an intention to benefit another is an essential ingredient of some constructive trusts, a different distinction may be made between these (institutional) constructive trusts, which are analogous to express trusts, and other (remedial) constructive trusts.[103]

The distinction is, however, problematic for a number of reasons. If the distinction to be made is between the express trust and constructive trust, the "remedial" label is hardly illuminating and does nothing to resolve the problems created by the haphazard historical development of the constructive trust. A proposed distinction between intention based constructive trusts and non-intention based constructive trusts is equally troubling. The existence of intention *per se* is usually insufficient to found a constructive trust; another element, such as detrimental reliance, is often required. [104] There may therefore be less unity between the events giving rise to the constructive trust than we are led to believe. Why then focus on intention? One answer may be that it

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[100] Thus, express trusts have been termed "remedial" in those situations where the finding of the requisite intention is the product of a creative process of judicial inference and others have drawn a distinction between "pure" and "remedial" trust law philosophies, the latter being a policy orientated rather than intention-based approach, in the context of resulting trusts: Austin, n52 above, at pp.66-67; C.E.F. Rickett, "Different Views on the Scope of the *Quistclose* Analysis: English and Antipodean Insights" (1991) 107 LQR 608.

[101] Gardner, n14 above, at p.13.

[102] Rotherham, n65 above, at pp.14-16.

[103] R. Grantham & C.E.F. Rickett, *Enrichment and Restitution in New Zealand* (2000), Chapter 18. See also *Bathurst CC v PWC Properties Pty Ltd* (1998) 157 ALR 414 at 423-424.

[104] Chambers, n14 above, at pp.182-207.

assuages anxiety about the judicial variation of property rights.[105] Another is that it facilitates analogy to the express trust in order to explain away the impact of the constructive trust on the constructive trustee's insolvency.[106] Consequently, such approaches risk encouraging extreme artifice.[107]

(d) Judicial Recognition and Judicial Creation of Property Rights

Restitution scholars have for some time distinguished "pure" from "restitutionary" or "remedial" proprietary claims. The former is a claim "where the plaintiff asserts that the property which he has identified in the defendant's hands belongs, and has always belonged, to him";[108] the essence of the latter is that the law "actively creates a proprietary interest".[109] While in England the constructive trust is portrayed as "arising by operation of law" upon the facts creating the claimant's cause of action, this should not obscure the point that constructive trusts both recognise what have come to be seen as existing property rights[110] and create new ones.[111]

Some see this distinction as an illuminating basis by which to distinguish the "institutional" from the "remedial".[112] However, while the distinction is analytically useful because it illuminates different normative aspects,[113] it is poorly illuminated by the labels. It also fails to capture other important distinctions. For example, in some cases it may be necessary to treat a claimant asserting a claim to assets he never previously owned in the same way as a claimant who is seeking to recover assets that he owned prior to the act of which he complains.[114]

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[105] See generally, Rotherham, n65 above.
[106] See Chapter 7, Section IV.1.
[107] See Chapter 6, Section V.3.
[108] R. Goff & G. Jones, *The Law of Restitution* (3rd edn, 1986), p.56.
[109] P.B.H. Birks, *An Introduction to the Law of Restitution* (1989 rev'd ed.), p.14. See also Goff & Jones, *ibid.* at p.55.
[110] E.g. constructive trusts in cases of subtractive enrichment where property has not passed, as in *Chase Manhattan*, n98 above.
[111] E.g. constructive trusts of benefits acquired from a third party by a fiduciary in breach of the obligation of loyalty: R. Grantham, "Doctrinal Bases for the Recognition of Proprietary Rights" (1996) 16 OJLS 561 at pp.575-578.
[112] A. Ooesterhoff & E.E. Gillese, *Commentary & Cases on Trusts* (4th ed, 1992), p.377; *Lac Minerals v International Corona Resources* (1989) 61 DLR (4th) 14 at 50 per La Forest.
[113] See, generally, Rotherham, n65 above, Chapter 4.
[114] This will be appropriate in some (though not all) instances in which a fiduciary acquires assets from a third party in breach of the obligation of loyalty. Such cases are the focus of Chapters 4-7.

(e) From Defined Relationships to General Principle

The availability of the constructive trust in English law is determined by reference to a list of categories of particular relationships, contexts and situations in which a constructive trust has been previously found. It is not determined by reference to a broad, unifying principle.[115] By contrast, in the United States the constructive trust has long been viewed as a general remedy that will be imposed "in any case where to fail to do so will result in an unjust enrichment".[116] To move from *ad hoc* categories to a response to a general cause of action is thus to move from the institutional to the remedial.[117] This movement has been identified with some precision in the United States. In *Newton v Porter*[118] a New York court utilised the constructive trust to reach the product of stolen goods, thus dispensing with the requirement of an antecedent fiduciary relationship. For Dawson, "[t]his is the point that most clearly marks the transformation of the constructive trust into a generalised remedial device".[119] Similarly, constructive trusts imposed in English law on the basis of good conscience[120] or following a ritualistic and functional finding of a required fiduciary relationship[121] have been described as "remedial" rather than "institutional".[122]

Viewing the constructive trust as a more broadly available equitable remedy can alleviate some of the problems created by the constructive trust's *ad hoc* historical development. However, the distinction is not as significant as initially appears. Broad unifying principles tend to be over-inclusive. Thus, not all instances of unjust enrichment or unconscionability warrant proprietary relief. Consequently, it remains

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[115] Consider the importance attached to the fiduciary relationship and a rejection of the constructive trust as a general response to unjust enrichment in *Halifax Building Society v Thomas* [1996] Ch 217 at 226 per Gibson LJ.

[116] *D'Ippolito v Castoro* 242 A.2d 617 at 619 (1968). See *Restatement*, n77 above, §160; A.W. Scott & W. Fratcher, *Law of Trusts* (4th edn, 1989 & supps), §462; G. Palmer, *Law of Restitution* (1978 & supps) §§1.3-1.4.

[117] Waters, n3 above, at p.42; S. Hoegner, "How Many Rights (or Wrongs) Make a Remedy? Substantive, Remedial and Unified Constructive Trusts" (1997) 42 McGill LJ 437.

[118] 69 NY 133 (1877).

[119] Dawson, n57 above, at p.28. See also *Rathwell v Rathwell* [1978] 2 SCR 436 at 453-454 per Dickson J.

[120] *Neste Oy Ltd v Lloyd's Bank plc* [1983] 2 Lloyd's Rep 658.

[121] E.g. *Reading v A-G* [1951] AC 507 at 516 per Lord Porter; *Chase Manhattan*, n98 above.

[122] J. Dewar, "The Development of the Remedial Constructive Trust" (1982) 60 Can Bar Rev 265 at p.273; S.R. Scott, "The Constructive Trust and the Recovery of Advanced Payments - *Neste Of v Lloyds Bank plc*" (1991) 14 NZULR 375; J. Dixon, "The Remedial Constructive Trust Based on Unconscionability in the New Zealand Commercial Environment" (1992) 7 Auckland U Law Rev 147 at pp.152-153.

necessary to categorise those situations of unjust enrichment or unconscionability in which a constructive trust will be recognised.[123] Any difference made on this footing between institutional and remedial is therefore one of degree rather than type.

(f) Enduring Trust Relationship or Duty to Convey?

A further view of the institutional-remedial distinction concerns what the constructive trust does. Some view the institutional constructive trust as creating an enduring substantive legal relationship like the express trust, potentially with active duties of management. The remedial constructive trust, by contrast, is viewed more as a procedural device by which the defendant is compelled to hand over property to the claimant.[124] It is a "terminological vehicle for conferring specific property upon the claimants".[125] A distinction along these lines between US and English constructive trust jurisprudence was noted by Maudsley and Scott.[126]

This division helps to clarify the role of the constructive trust in many cases: often, a constructive trust is used purely as a means by which to transfer property from one party to another. This idea may also be of use in emphasising that the court order need not necessarily bind third parties. However, the orthodox view in the United States remains that, while the constructive trust is essentially a conveyancing device, it is proprietary in effect and necessarily binds creditors and other third parties.[127]

(g) Availability and Operation: Rule-Based Right or Discretionary Remedy?

Rights are often viewed as reflecting pure and absolute values derived from some privileged source of legitimacy. Remedies, on the other hand, are associated with

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[123] G. Bogert & G.T. Bogert, *The Law of Trusts and Trustees* (Rev 2nd edn, 1978), §471 (noting that the "main problem in the field....is the cataloguing of the types of unconscionable or unethical conduct which have been sustained as bases for the constructive trust").
[124] *Giumelli v Giumelli* (1999) 161 ALR 473 at 475 (remedial constructive trust is "akin to orders for conveyance" made in proprietary estoppel cases).
[125] D.W.M. Waters, "The Nature of the Remedial Constructive Trust" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol. 2, p.165 at 183. See also H. Monaghan, "Constructive Trust and Equitable Lien: Status of Conscious and the Innocent Wrongdoer in Equity" (1960) 38 U Det LJ 10 at p.11 ("The constructive trust is a purely procedural device to effect a result and is not to be confused with the substantive issues determining its invocation.....the constructive trust is thus sharply distinguished from the express trust").
[126] Above, Section IV.1.

flexibility; functional, fact-specific policy concerns, prudential considerations and the like, that translate ideals into something usable in the real world.[128] It is in a similar vein that modern authorities have demarcated the institutional constructive trust from the remedial constructive trust. The institutional constructive trust is taken to be a rights-based entitlement, determinable by reference to general rules of law and abstract legal principles. [129] The remedial constructive trust, by contrast, involves the discretionary determination and implementation of entitlements *ex post*, following a finely tuned assessment of the relative positions of the affected parties.[130]

To the extent that we wish to address directly the historically created problems identified above, this contrast initially sounds more promising. The remedial conceptualisation focuses our attention on the justice of the individual case. The idea of the institutional constructive trust offers a steady, conservative opposition, reminding us that substantive justice is not the only matter with which we need be concerned.

(h) The Time the Constructive Trust Arises

The final oft-noted point of distinction between "institutional" and "remedial" concerns the time at which the constructive trust arises. An institutional constructive trust "arises upon the happening of certain events which bring it into being. Its existence is not dependent on any order of the Court".[131] By contrast, it is said that a true remedy, cannot arise until it is declared by the court.[132] It follows that "[b]ecause a constructive trust, unlike an express trust, is a remedy, it does not exist until a plaintiff obtains a judicial decision finding him to be entitled to a judgment 'impressing' the defendant's property or assets with a constructive trust."[133]

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[127] Scott & Fratcher, n116 above, at §462.4.
[128] This association is particularly prevalent in American literature on constitutional rights: see D.J. Meltzer & R.H. Fallon, "New Law, Non-Retroactivity, and Constitutional Remedies" (1991) 104 Harv L Rev 1733 at pp.1764ff; D.J. Levinson, "Rights Essentialism and Remedial Equilibration" (1999) 99 Colum L Rev 857.
[129] Below Section IV.3.(a).
[130] Below Section IV.3.(b).
[131] *Fortex Group Ltd v MacIntosh* [1998] 3 NZLR 171 at 173 per Tipping J.
[132] See e.g. D.M. Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priority Over Creditors" (1989) 68 Can B Rev 315 at p.319.
[133] *In re Omegas Group Inc.* 16 F.3d 1443 at 1451 (6th Cir. 1994).

An institutional constructive trust thus arises at the date of the facts giving rise to the claimant's cause of action; a remedial constructive trust arises only when declared by a court of competent jurisdiction. Since the institutional constructive trust arises prior to judicial proceedings the court appears to have limited control over its operation. By contrast, while issues of discretion and the effects of a constructive trust are analytically distinct, if the court is conceived as creating the remedy, it is more likely to pursue outcomes that accord with the court's conscience since judicial responsibility for the outcome is emphasised. Thus, Lord Browne-Wilkinson has on more than one occasion expressed support for the development of a remedial constructive trust on the basis that, since it is imposed by the court, unwarranted priorities can be avoided by the court taking into account the positions of innocent third parties at the time it makes the order.[134]

3. The Dominant Contemporary Polemic

The contemporary polemic that the language of "institutional" and "remedial" now predominantly reflects draws upon the last two meanings of "institution" and "remedy". [135] Thus, in *Westdeutsche Landesbank v Islington LBC*, Lord Browne-Wilkinson commented:

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[134] *Westdeutsche Landesbamk Girozentrale v Islington LBC* [1996] AC 669 at 714 and Sir Nicholas Browne-Wilkinson, "Equity in a Fast Changing World" in *The 1996 New Zealand Law Conference Papers* (1996), Vol 2, p170. See also Sir Nicholas Browne-Wilkinson, *Constructive Trusts and Unjust Enrichment* (1991), p4 (remedial constructive trust would avoid unjust consequences for third parties in *Gissing*-type cases but its development would be probably inconsistent with principle).

[135] *London Allied Holdings Ltd v Lee & Ors* [2007] EWHC 2061 at [259]-[274]; *Turner v Jacob* [2006] EWHC 1317 at [85]; *Papamichael v National Westminster Bank plc* [2003] EWHC 164, [2003] I Lloyd's Rep 341 at [221]; *Satnam Investments Ltd v Dunlop Heywood & Co* [1999] FSR 722 at 742 per Nourse LJ; *Kuwait Oil Tamker Company SAK v Al Bader*, The Independent, Jan 11 1999, reversed on separate issue [2003] UKHL 31; *Re Polly Peck International plc (in administration) (No 2)* [1998] 3 All ER 812; *Fortex Group Ltd v MacIntosh* [1998] 3 NZLR 171 at 172-173, 175-177 per Tipping J; *Commonwealth Reserves I v Chodar* [2001] 2 NZLR 374 at [36]-[63] (Glazebrook J); *Dickie v Torbay Pharmacy (1986) Ltd* [1995] 3 NZLR 429 at 441 (Hammond J); *Atlas Cabinet & Furniture Ltd v National Trust Co* (1990) 45 BCLR (2d) 99 at 112 per Lambert JA; *Muschinski v Dodds* (1985) 160 CLR 583 at 614 per Deane J; J. Maddaugh & P. McCamus, *The Law of Restitution* (2nd edn, 2004), pp.106-128; Rotherham, n65 above, at pp.12-32; D.M. Wright, *The Remedial Constructive Trust* (1998); J. Martin, *Hanbury & Martin: Modern Equity* (16th edn, 2001), pp301-304; D.M. Wright, "The Remedial Constructive Trust and Insolvency" in *Restitution and Insolvency* (Rose ed., 2000), p.206; P.B.H. Birks, "Rights, Wrongs, and Remedies" (2000) 20 OJLS 1 at pp.9-19; Sir Peter Millett, "Restitution and Constructive Trusts" (1998) 114 LQR 399.

"Under an institutional constructive trust, the trust arises by operation of law as from the date of the circumstances that give rise to it: the function of the court is merely to declare that such trust has arisen in the past. The consequences that flow from such trust having arisen (including the possibility of unfair consequences to third parties who have in the interim received trust property) are also determined by rules of law, not under a discretion. A remedial constructive trust, as I understand it, is different. It is a judicial remedy giving rise to an enforceable equitable obligation: the extent to which it operates retrospectively to the prejudice of third parties lies in the discretion of the court." [136]

In this section, a little more conceptual meat will be put on the skeletal "institutional" and "remedial" concepts. A note of caution is however required. The respective conceptualisations that together form the contemporary polemic represent different patterns of thought; they are not akin to physically existing phenomena that can be tracked down, captured and naturally dissected into their constituent parts. Consequently, we cannot talk about the defining characteristics of the "institutional" and "remedial" with the same precision and lack of controversy with which we can talk about the defining characteristics of amphibians and birds. While a certain affinity between the views of different scholars exists with respect to each conceptual approach, there are also important differences. Consequently, at this stage, an artificially purified account of the respective conceptualisations will be offered as a basis for more detailed analysis in subsequent chapters.

(a) Dominant "Institutional" Theory

Contemporary institutional theory has two central tenets. First, the availability and operation of the constructive trust is determined by fixed and ascertainable rules of law. Second, the constructive trust arises automatically at the time of the facts giving rise to the claimant's cause of action. Given that the constructive trust is viewed as a true trust, like an express trust, equitable property rights arise in the same way that they arise in an express trust relationship, with similar consequences. These consequences are those that equity has over the centuries worked out in detail to be the consequences of equitable property. Determining the outcome once a constructive trust is found therefore simply involves looking at the "cases on how property behaves". [137] Since the

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[136] n 134 above, at 714.
[137] P.B.H. Birks, "Trusts Raised to Reverse Unjust Enrichment: The *Westdeutsche* Case" [1996] RLR 3 at p.5.

availability and operation of a constructive trust is rule-based, when a court declares a constructive trust it thus simply confirms and records the parties' pre-existing rights and duties. These central tenets have broader implications. They are most clearly expressed by the late Peter Birks, whose work continues to form the foundations of contemporary institutional theory. We might also find elements of this theory strongly reflected in the work of others, such as Oakley,[138] Burrows,[139] and Lord Millett.[140]

The idea that the court simply confirms the pre-existing rights of the parties rather than constitute new ones emphasises the declaratory role of the judge. Substantive legal norms provide an answer to the case; the role of the judge is to find and declare it. Issues of policy are marginalised or not considered openly. Thus, the institutional constructive trust forms one part of Birks' broader methodological commitment to a rational science of law. His methodology involves looking "downwards to the cases" and "adds nothing to the existing law and effects no change except what comes from better understanding what is already there".[141] Lawyers can and should only deal in technical conceptual questions, using the law library to find the right legal answer to the given facts.[142] Consequently, the law must be applied regardless of the acceptability of the result: a constructive trust must never be raised to respond to the justice of a particular case.[143] The unacceptable results created by this approach are not of any great concern to the institutional theory. If change is required, it is the responsibility of Parliament, not the judge.[144] Emphasis is placed on the benefits that a legal form in the shape of rules and formal legal principles brings with it.[145]

This does not of course rule out legal development altogether but any development must be referable to principle established by precedent.[146] Thus, Birks rules out proprietary relief for breach of confidence in English law on the basis that a detailed search of the English cases show that a constructive trust has "never yet appeared on the

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[138] Oakley, n2 above.
[139] A. Burrows, *Law of Restitution* (1993), pp.35-36.
[140] P.J. Millett, "Equity - The Road Ahead" [(1995-6) 6 KCLJ 1 at pp.18-19; Millett, n135 above.
[141] Birks, n109 above, pp.23, 27.
[142] P.B.H. Birks, "The End of the Remedial Constructive Trust?" (1998) 12 TLI 202 at pp.214-215.
[143] P.B.H. Birks, "Establishing a Proprietary Base" [1995] RLR 83 at p.84.
[144] *Re Polly Peck (in administration) (No2)* [1998] 3 All ER 812 at 832 per Nourse LJ; Birks, n137 above, at p.14.
[145] Chapter 2, Section IV.1.
[146] *Cowcher v Cowcher* [1972] 1 All ER 943 at 948 per Bagnall J.

list of available remedial options" for this particular wrong.[147] Similarly, Oakley approves of the outcome in *Attorney General for Hong Kong v Reid*[148] less on the basis that it represents a sensible application of underpinning policy concerns and more on the basis that it rids us of an anomalous exception to the general principle that fiduciaries making secret profits are liable to account as a constructive trustees.[149]

(b) Dominant "Remedial" Theory

There are two central tenets to contemporary remedial theory. First, the availability and operation of the constructive trust is viewed as discretionary. Judges engage in a balancing of various relevant factors to determine the appropriate form of relief, and its precise content, on the specific facts of each case. The judge is to ask "what is the best result all things considered?" Emphasis is placed on the substantive merits of the particular case before the court. It is a goal-orientated approach, focusing on doing what is practically just. Second, since the outcome is the result of an *ex post* balancing of various factors rather than an *ex ante* specification of legal rights, the constructive trust arises when declared by a court of competent jurisdiction. It is therefore "the judge" rather than "the law" that determines the entitlements of the parties.

Once it is recognised that the judge determines the entitlements of the parties, a number of further possibilities are created. While the constructive trust can "arise" only once the claimant's entitlement to it is declared by the court, the nature of that entitlement or, as it is more commonly put, the time at which the constructive trust is held to take effect, is another matter. A number of possibilities emerge:

(i) The constructive trust might have retrospective effect and the claimant treated as though he was the equitable owner of the disputed asset from the time his cause of action accrued;

(ii) The constructive trust might have prospective effect, so the claimant is treated as equitable owner of the property from the date of court order only;

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[147] P.B.H. Birks, "Remedies for the Abuse of Confidential Information" [1990] LMCLQ 460 at p.462.
[148] [1994] 1 All ER 1.
[149] Oakley, n2 above, at pp.134-137.

(iii) The judge might exercise a power to choose whether the constructive trust is to take effect prospectively from the date of judgment or retrospectively from the date the claimant's cause of action accrued;

(iv) The judge might exercise a power to choose whether the constructive trust is to take effect prospectively, retrospectively or operate from some interim date or from some later date.

As we move down the list from (i) to (iv) the degree of flexibility and judicial choice increases. However, regardless of the precise model adopted, a common theme of the remedial approach is that those considerations held dear to the institutional theory are rejected or marginalised. Rather than being demonised, the pro-active and creative role of the judge is embraced as essential in providing a measure of individualised justice. Unjust outcomes created by the application of rules or historical classifications are not tolerated; indeed, there is a limited role for rules precisely because they have the capacity to be over- and under-inclusive. Elements of this approach can be found to varying degrees in the work of Waters,[150] Wright,[151] and Justice Paul Finn,[152] amongst others.

V. SUMMARY

In the latter part of the twentieth century the constructive trust was increasingly viewed with dissatisfaction. The dominant contemporary polemic is a product of that dissatisfaction. To resolve problems created historically a number of jurists developed new ideas about the role and nature of the constructive trust. In doing so they sought to resolve apparent injustices by making the constructive trust available where it previously was not, while limiting its role and application in other areas where it was previously recognised. They also sought to address the risk of injustice to third parties

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[150] D.W.M. Waters, "The Constructive Trust in Evolution: Substantive and Remedial" in *Equity and Contemporary Legal Developments* (1992, ed. S. Goldstein), p.457; Waters, n125 above.
[151] D.W.M. Wright, *The Remedial Constructive Trust* (1998).
[152] P.D. Finn, "Equitable Doctrine and Discretion in Remedies" in *Restitution: Past Present and Future* (1998, eds. W. Cornish *et al.*), p.251.

by developing means of granting specific relief without necessarily prejudicing innocent third parties. The "institutional" theory by contrast, developed as a conservative counter theory. It emphasises stability, incremental change and making sense of that which is already there in the cases. The submission in this thesis is that neither approach is entirely satisfactory.

CHAPTER 2: The Role of Rules and Discretion

I. INTRODUCTION

Rules and discretion are of crucial importance to the dominant contemporary polemic. The constructive trust is "institutional" when it is a product of settled rules and is "remedial" when it is a product of judicial discretion. The former arises automatically upon the facts as rules of law determine the entitlements of the parties *ex ante*; the latter arises only when declared by a competent court, the court determining the entitlements of the parties *ex post*. In this Chapter we examine in greater detail the persuasiveness of this proposed distinction.

The ideas of discretion and rules upon which the alternative constructive trust models are premised are assumed to be clearly distinct. Premised on these ideas, the "institutional" and the "remedial" are portrayed as polar opposites; different species whose genetic boundaries are uncontroversial, clean, simple and neat. The only live issue with which the courts need be concerned, it appears, is which of these alternatives English law should adopt. The choice between the two is often made by reference to an unsophisticated vices-virtues test. Either we prefer the virtues of rules while rejecting the vices of discretion, hence adopt the institutional conceptualisation; or we prefer the virtues of discretion and reject rules for their vices, hence adopt the remedial conceptualisation.[1]

In this Chapter I argue that things are not so simple. In practice, there can be no clear and simple distinction between rules and discretion. Such a distinction, moreover, is misleading because it obscures subtle differences of degree. Rules and discretion are best viewed not as black and white but as occupying points at opposite ends of a finely shaded continuum. The appropriate point on that continuum cannot be determined once and for all, in the abstract. At different times and in different contexts it will be

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[1] Consequently, the institutional and remedial are portrayed as distinct and clearly separable not only in theory but also in practice. Sir Peter Millett, for example, feels sufficiently confident in the dichotomy to conclusively identify constructive trusts in Canada and the US as discretionary, hence remedial, while constructive trusts in England and Australia are, and ought remain, non-discretionary, hence institutional: P.J. Millett, "Restitution and Constructive Trusts" (1998) 114 LQR 399.

appropriate to draw upon the continuum at different points. It is therefore too simplistic to view the constructive trust as either rule-based or discretionary.

II. Rules, Discretion and Conceptualising the Constructive Trust

1. Rules and Discretion

Let us first look at the basic analytical division between rules and discretion so that we might identify how the nature of these devices feed into the different conceptualisations of the constructive trust as an "institution" and "remedy".

(a) Rules

A key feature of rules is their *ex ante* quality: they determine the result of any given case in advance. All prescriptive rules are reducible to a two part formulation: a trigger that identifies some phenomenon; and a response that requires a legal consequence whenever that phenomenon is present.[2] The paradigm example of a rule has a clear and precise empirical trigger and a clear, determinate consequence:[3] it requires for its application nothing more than the occurrence or non-occurrence of a particular factual event.[4] A rule can therefore be seen to settle in advance any case that falls within its empirical trigger because it dictates, before the case arises, the course of action to be taken in all instances that fall within its terms. The responsibility of the decision-maker is to simply establish the facts that happened. The relevant rule then determines the entitlements of the parties. Thus, rules provide a degree of normative force independent of their underlying justifications.[5]

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[2] See W. Twining & D. Miers, *How To Do Things With Rules: A Primer of Interpretation* (3rd edn, 1991), pp.140-144; F. Schauer, *Playing by the Rules: A Philosophical Examination of Rule-Based Decision-Making in Law and in Life* (1991), pp.23-24.

[3] Rules are therefore often contrasted with standards, the latter having either or both more evaluative triggers, such as "reasonableness", and adjustable responses: see, for example, D. Kennedy, "Form and Substance in Private Law Adjudication" (1976) 89 Harv L Rev 1685 at pp.1695-1701.

[4] R. Dworkin, *Taking Rights Seriously* (1977), p.24, puts the matter thus: "If the facts a rule stipulates are given then either the rule is valid, in which case the answer it supplies must be accepted, or it is not, in which case it contributes nothing to the decision".

Rule-based decision-making thus requires that the rule itself supplies the reason for the decision rather than an assessment of its underlying purpose or of what is fair, just or reasonable in the circumstances. Were a rule defeasible on any occasion that its application would lead to a result incongruent with its underpinning justification, the distinction collapses between rule-based decision-making and discretionary decision-making by reference to the merits of the individual case. A commitment to reasoning by rules therefore prevents the controversial weighing and balancing of potentially conflicting underlying policies in every case. As such, rules appear objective, creating fixed and determinate outcomes. It is however, a consequence of this that the application of rules can create unreasonable or unjust results because they are not perfectly tailored to each individual instance to which they are applied; they are over and under-inclusive when assessed by reference to their background justifications.[6]

(b) Discretion

A judge has discretion whenever he has "the power to choose between two or more courses of action each of which is thought of as permissible".[7] Since the extant law does not compel a particular outcome, whichever alternative is chosen will be lawful.[8] A discretionary decision therefore, represents an *ex post* allocation of legal entitlements. No one can claim that the judge has failed to reach the correct or single right answer because neither party has a pre-existing right to a particular outcome.[9]

Most analyses of discretion in law concern the discretion that occurs interstitially, when existing legal materials do not determine any outcome as the uniquely correct one. In particular, attention has focused on whether such discretion exists at all in developed

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[5] See, in particular, F. Schauer, n2 above, Chapters 5 & 6; J. Raz, *Practical Reasons and Norms* (1975), Chapter 1.

[6] This is a long recognised consequence of rules of law. Thus, Aristotle's conception of equity was "a correction of Law, where Law is defective by reason of its universality": J. Mitchell (ed) *The Nicomachean Ethics of Aristotle*, p.157.

[7] H. Hart & A. Sachs, *The Legal Process: Basic Problems in the Making and Application of Law* (1958), p.162. See further A. Barak, *Judicial Discretion* (1989), p.8.

[8] Barak, *ibid.*, at pp.9-10.

[9] Although the judge can be criticised for reaching a *wrong* answer: if a judge is permitted to choose between outcomes A and B he cannot choose C: *ibid.* at pp.19-20.

legal systems.[10] There is however, another kind of discretion that is "given" or "conferred". In these situations, an existing law *is* applicable to the circumstances before the judge but the law is a "law of discretion", conferring on the judge a power to decide the case as he thinks appropriate.[11]

(c) Typologies of "Given" Discretion

The basic idea of "given" discretion is that a power of choice is deliberately conferred on a decision-maker. However, beyond that basic idea there are a number of different typologies. In particular, we may differentiate the discretion conferred on the basis of the reason for its grant and the degree of choice that is given.

Discretion may be conferred on a decision-maker for a number of different reasons. First, discretion may be conferred because a decision-maker is considered wise and possesses special personal qualities. This is often referred to as "khadi discretion".[12] It is the most complete form of discretion, exercised on a purely individual basis according to the decision-maker's own conscience, ethics and morality. As such, it is alien to developed Western legal systems.[13] Second, discretion might be created when it is believed that cases will arise in which the facts are so varied, complex and unpredictable that rules which achieve appropriate results in a sufficient number of cases cannot be written. This is "rule failure discretion".[14] Unlike rules, discretion allows each case to be considered on its own merits, avoiding the over and under-inclusiveness of rules. Third, discretion might be granted where it is likely that better rules can be developed incrementally, by decision-makers themselves as they deal with individual cases. This is "rule-building discretion".[15] The discretion that is conferred is

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[10] Compare R. Dworkin, *A Matter of Principle* (1985), pp.119-145 and H.L.A.Hart, *The Concept of Law* (1961), pp.132, 141.

[11] J. Raz, "Legal Principles and the Limits of Law" (1972) 81 Yale LJ 823, reprinted in *Ronald Dworkin & Contemporary Jurisprudence* (1984, ed. M. Cohen), p.73 at 76; A.V. Levontin, "'Equitable' 'Discretion': Impact on Remedies and on Rights" in *Equity and Contemporary Legal Developments* (1992, ed. S. Goldstein), p.1 at 2.

[12] C.E. Schneider, "Discretion and Rules: A Lawyer's View" in *The Uses of Discretion* (1991, ed. K. Hawkins), p.47 at 61-62.

[13] See e.g. *Jennings v Rice* [2002] EWCA Civ 159 at [43] per Walker LJ: "It cannot be doubted that in this as in every other area of law, the court must take a principled approach, and cannot exercise a completely unfettered discretion according to the individual judge's notion of what is fair in any particular case."

[14] Schneider, n12 above, at pp.62-63.

[15] *ibid.* at pp.64-65.

not envisaged to be permanent but transient, shrinking over time as appropriate rules are created.[16]

We may also differentiate kinds of "given" discretion by reference to the degrees of choice conferred on the decision-maker: the decision-maker may be more or less constrained, though not totally constrained. Constraint may take one or both of two forms. First, the number of permissible outcomes from which a decision maker may choose may be limited. Where the permissible outcomes are many in number discretion is "broad"; where the permissible outcomes are few discretion is "narrow".[17] Second, the exercise of discretion may be guided by considerations which the decision-maker must take into account. Thus, there may be no guidance, or at least no effective guidance as where the decision-maker is directed to reach a "just" and "fair" outcome. Dworkin terms this "strong" discretion, meaning the decision-maker is "simply not bound by standards".[18] Alternatively, the discretion conferred may be "weak", in the sense that while articulated standards apply they "cannot be applied mechanically but demand the use of judgement".[19]

2. The Institutional Constructive Trust

(a) A Rule-Based Entitlement

Much modern opinion suggests that constructive trusts are the product of settled rules and formal legal principles.[20] A determination that the defendant holds property on constructive trust in any given case is assumed to follow inexorably from the straightforward application of clearly applicable and easily located legal norms. It is this determinate nature that makes the constructive trust "institutional".[21] This view of

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[16] In *Jennings*, n13 above, at [44], Walker LJ appeared to understand the discretion in proprietary estoppel in these terms.
[17] Barak, n7 above, at pp.8-9.
[18] Dworkin, n4 above, at p.32.
[19] *ibid.* at p.31. For discussion and criticism of Dworkins notions of "strong" and "weak" discretion, see D. Galligan, *Discretionary Powers* (1986), pp.14-21; Twining & Miers, n2 above, pp134-135. See also Section III.1(c), below.
[20] See Chapter 1, Section IV.3(a).
[21] This definitional point is also accepted by remedial theorists. Thus, D. Wright, *The Remedial Constructive Trust* (1998), pp.103-104 suggests that "if there is no choice other than to award a

the constructive trust is regularly presented as a descriptively accurate portrayal of its operation in English law. [22]

The categorical approach to the constructive trust in English law is very much rule-like.[23] The availability of the constructive trust is presented in terms of factual conditions that are both sufficient and necessary to create the institution, these conditions being represented by a list of discrete, clearly delineated and well-established triggering situations in which a constructive trust has been previously found. The only issue with which the courts are concerned is "whether those criteria exist, on the facts, to give rise to the constructive trust in question".[24] The institutional constructive trust is thus characterised as "a limited doctrine applying in limited, clearly defined cases".[25] The emphasis is not on finding the most appropriate outcome in the circumstances but on finding and applying the relevant rule of law. Thus, in *Cowcher v Cowcher*, Bagnall J expressed the following broadly held view:

> "In any individual case the application of these propositions may produce a result which appears unfair. So be it; in my view that is not an injustice. I am convinced that in determining rights, particularly property rights, the only justice that can be attained by mortals, who are fallible and are not omniscient, is justice according to law; the justice which flows from the application of sure and settled principles to proved or admitted facts. So in the field of equity the length of the Chancellor's foot has been measured or is capable of measurement. This does not mean that equity is past childbearing; simply that its progeny must be legitimate -- by precedent out of principle."[26]

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constructive trust, this would indicate that it was not a remedy". Institutional proprietary claims are "those in which there is no doubt that the plaintiff has an equitable interest, even prior to any court giving its ruling upon the claim" (p.153).

[22] See, e.g. *Re Farepak Food & Gifts Ltd (in administration)* [2006] EWHC 2272 at [38], [40] (Mann J). The odd anomaly inevitably requires pruning, e.g. Lord Denning's "new model" constructive trust, imposed regardless of established legal rules to reach a result dictated by justice and good conscience: *Hussey v Palmer* [1972] 1 WLR 1286 at 1289. The approach has been subject to heavy judicial criticism on the basis that it would consign the law to some "formless void of individual moral opinion": *Muschinski v Dodds* (1985) 160 CLR 583 at 615-616 per Deane J. See also *Springette v Defoe* [1992] 2 FLR 388 at 393 per Dillon LJ; *Burns v Burns* [1984] 1 Ch 317 at 334 per May LJ; *Cowcher v Cowcher* [1972] 1 All ER 943 at 948. Thus, its acceptance would "effect a complete swing on the pendulum so far as the principles of English law concerning constructive trusts are concerned": J. Martin, *Modern Equity* (16th edn, 2001), p.332.

[23] For discussion of the categorical approach, see Chapter 1, Section II.(2).

[24] D. Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priority Over Creditors" (1989) 69 Can Bar Rev 315 at pp.320-321.

[25] *Rawluk v Rawluk* (1990) 65 DLR (4th) 161 at 183-184 per McLachlin J. See further *Rathwell v Rathwell* [1978] 2 SCR 436 at 453-454 per Dickson J.

[26] n22 above, at 948. See further, *Pettit v Pettit* [1970] AC 777 at 793 (Lord Reid), 801, 803 and 805 (Lord Morris), 809 (Lord Hodson), 825 (Lord Diplock), all asserting that property rights are not to be determined according to what is reasonable and fair in all the circumstances.

More recently, when rejecting the idea of the remedial constructive trust, Lord Justice Nourse vigorously defended the proposition that the application of strict legal rules might well give rise to illogical or unjust results, but that is no concern of the judge.[27] The duty of the judge, he maintained, is to apply the law; it is the concern of Parliament to change it.[28]

(b) Conceptual Consequences

The portrayal of the constructive trust as rule-based has repercussions on its perceived conceptual nature. This follows from the apparent *ex ante* nature of rules. If a judge is characterised as following established rules of law that determine both the facts upon which a constructive trust is created and its consequences once in existence, it appears to follow that the judge does not create the claimant's entitlement. Rather, the judicial role is passive and declaratory. The constructive trust that arises is simply "a mandatory consequence of certain events".[29] Consequently, from the moment of the defendant's breach of legal duty, the claimant has a right to the award of a constructive trust and the court is duty-bound to recognise that right.[30] The constructive trust arises "by operation of law as from the date of the circumstances which gave rise to it"[31] and the function of the court is simply to "declare that such trust has arisen in the past".[32] Birks thus characterises the institutional constructive trust as an example of "non-consensual proprietary rights which indisputably arise as facts happen in the world beyond the

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[27] *Re Polly Peck International plc (in administration) (No 2)* [1998] 3 All ER 812 at 832. Such opinion reflects the generally conservative heritage of English judges, whose "duty is to seek to do justice according to law rather than common sense": *Waren Import Gesellschaft Krohn & Co v Afred C Toepfer (The 'Vladimir Ilich')* [1975] 1 Lloyd's Rep 322 at 329 (Donaldson J). See further, *Campbell Discount Ltd v Bridge* [1969] 1 QB 445 at 459 per Harman LJ, reversed [1962] AC 600.

[28] *ibid.*

[29] *Commonwealth Reserves I v Chodar* [2001] 2 NZLR 374 at [39].

[30] P.B.H. Birks, "Rights, Wrongs, and Remedies" (2000) 20 OJLS 1 at pp.15-16. The court therefore has no power to deny relief where it would apparently have unfair consequences on third parties: *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 at 714 per Lord Browne-Wilkinson; *Atlas Cabinet & Furniture Ltd v National Trust Co* (1990) 45 BCLR (2d) 99 at 112 per Lambert JA

[31] *ibid.* at 714 per Lord Browne-Wilkinson.

[32] *ibid.* In *Fortex Group Ltd v MacIntosh* [1998] 3 NZLR 171 at 173, Tipping J put the matter thus: "an institutional constructive trust arises upon the happening of the events which bring it into being. Its existence is not dependent on any order of the Court. Such order simply recognises that it came into being at the earlier time and provides for its implementation".

court".[33] The declaration of the court confers on the claimant no right to which he was not already entitled by law and, correlatively, imposes on the defendant no duties to which he was not already subject. The judicial function is to simply clarify, confirm and record the parties' pre-court rights.[34]

3. The Remedial Constructive Trust

(a) A Discretionary Response

The essence of the remedial constructive trust, it is often remarked, is its discretionary nature.[35] The discretion is of the "given" or "conferred" type and is apparently awarded to allow the attainment of justice in each individual case. Thus, in *Rawluk v Rawluk*[36] McLachlin J noted that the "significance of the remedial nature of the constructive trust is not that it cannot confer a property interest, but that the conferring of such an interest is discretionary".[37] Its award is based on that which "is just in all the circumstances of the case".[38] Similarly, the noted Australian remedial theorist David Wright explains that "if there is no choice other than to award a constructive trust this would indicate that it was not a remedy".[39] The remedial constructive trust therefore involves a claim "in which the interest being claimed is so claimed as a matter of conscience".[40] Numerous English scholars characterise the remedial constructive trust in a similar fashion, although on the whole they remain sceptical about the normative desirability of such discretionary doctrine.[41]

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[33] P.B.H. Birks, "Proprietary Rights as Remedies" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 2, p.214 at 215. See further *Muschinski*, n22 above, at 614 per Deane J, suggesting that "institution" is to be "understood as connoting a relationship which arises and exists under the law independently of any order of a court". Riddall comments that the institutional constructive trust is "a thing with its own existence": J.G. Riddall, *The Law of Trusts* (4th edn, 1992), p.390.

[34] D. Hayton, *Hayton & Marshall: Commentary and Cases on the Law of Trusts and Equitable Obligations* (11th edn, 2001), p.351; A. Burrows, *The Law of Restitution* (1993), pp.35-36.

[35] See Chapter 1, Section IV.3(b).

[36] (1990) 65 DLR (4th) 161. See also *Atlas Cabinet*, n30 above, at 169-170 per Lambert JA; *Soulos v Korkontzilas* (1997) 146 DLR (4th) 214 at 232-234 per Sopinka J.

[37] *ibid.* at 185.

[38] *Soulos*, n36 above, at 227.

[39] Wright, n21 above, at pp.103-104.

[40] *ibid.* at p.153.

[41] Most notably, see Birks, n33 above and Birks, n30 above, at p.17 ("remedial" is used "essentially as a synonym for 'discretionary'").

The discretionary determinations that are essential to the remedial constructive trust apparently occur at one or both of two points in the decision-making process.[42] First, once liability is established, it is suggested that a judge exercises discretion whether or not to award a constructive trust.[43] Thus, the constructive trust is but one remedy on a menu from which judges can select at their discretion, following a context specific evaluation of what the justice of the case demands.[44] Second, it is further claimed that the courts possess discretion to mould the operation of the constructive trust to fit the facts of each case.[45] Thus, both the availability of the constructive trust and its precise operation are dependant on a context-specific balancing of all the relevant factors and not on an *ex ante* specification of legal rights.

(b) Conceptual Consequences

Certain conceptual consequences are deemed to follow from the recognition of the element of discretion.[46] If the court has discretion whether or not to impose a constructive trust, or discretion as to its precise operation, it follows that the claimant's entitlement cannot be determined prior to the exercise of that discretion. Prior to the grant of a remedial constructive trust, the claimant is simply "a supplicant for the court's discretionary mercy" whose interest is "wholly uncertain".[47] His only right is to "bend the ear of the court of conscience to listen sympathetically to his tale".[48] If the claimant is to have an entitlement at all, it is created only when ordered by a court of

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[42] It is arguable that discretion may also exist at the stage of determining liability: see S. Gardner, "The Element of Discretion" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 2, p.186 at 188. However, remedial theorists do not claim that discretion is given or conferred at that stage.

[43] *Lac Minerals v International Corona Resources* (1989) 61 DLR (4th) 14 at 48 per La Forest J; Wright, n21 above, Chapters 3 & 5.

[44] See P.D. Finn, "Equitable Doctrine and Discretion in Remedies" in *Restitution: Past, Present and Future* (1998, eds. W. Cornish *et al*), p.251 at 267; D. Wright, "The Statutory Trust, the Remedial Constructive trust, and Remedial Flexibility" (1999) 14 JCL 221; D Wright & V. Waye, "Trial Strategy When Selecting a Remedy From the Remedial Smorgasbord" (1998) 17 Australian Bar Rev 263; D.W.M. Waters, "The Nature of the Remedial Constructive Trust" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 2, p.165; E.W. Thomas, "An Endorsement of a More Flexible Law of Civil Remedies" (1999) 7 Waikato L Rev 23.

[45] D.W.M. Waters, "The Constructive Trust in Evolution: Substantive and Remedial" in *Equity and Contemporary Legal Developments* (1992, ed. S. Goldstein), p.457 at 498-504; Wright, n21 above, at pp.263-270. As to the various ways in which the constructive trust can be moulded, and the extent to which such moulding is necessary or appropriate, see Chapter 3, Section III.

[46] See, in particular, Waters, n44 above, at p.179; Birks, n33 above.

[47] D. Hayton, "Equitable Rights of Cohabitees" [1990] Conv 370 at p.372.

[48] *Lloyds Bank v Rosset* [1991] 1 AC 107 at 115.

competent jurisdiction:[49] "no trust can arise until it is known if a court is prepared to act".[50] Thus, Lord Justice Nourse described the remedial constructive trust as "an order of the court granting, by way of remedy, a proprietary right to someone who, beforehand, had no proprietary right."[51] Similarly, in *Fortex*, it was asserted that "this kind of trust does not exist at all until the Court creates it".[52] Rather than being confirmatory, the court order is therefore constitutive of a new legal relationship.[53]

III. The Relative Nature of Rules and Discretion

The contemporary polemic assumes that a clear and practically useful distinction can be maintained between rules and discretion, and that this distinction provides a clear and practically useful foundation for distinguishing and choosing between the "institutional" and the "remedial". However, in this section we see that the distinction between rules and discretion is not as clear as is often assumed. "Rule" and "discretion" are relative concepts, shading into each other on a continuum. There is no clear dichotomy. Concepts premised on the clear separation of rules and discretion are therefore unpromising.[54]

1. The Problem of Discretion in Rules

(a) Sources of Discretion

The rule-based institutional conceptualisation appears logical and coherent. However, it is only superficially so since it rests on an overly simplistic account of rules and their

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[49] The court is the "*fons et origo* of the constructive trust": Waters, n45 above, at p.512.
[50] A.J. McLean, "Constructive and Resulting Trusts - Unjust Enrichment in a Common Law Relationship" (1982) 16 UBC Law Rev 155 at p.174.
[51] *Re Polly Peck*, n27 above, at 830. In the same case (at 823) Mummery LJ referred to the remedial constructive trust as a right "created by the court after the event". See also *Re Goldcorp* [1994] 3 WLR 199 at 217 (a remedial constructive trust "would be created by the court as a measure of justice after the event").
[52] *Fortex*, n32 above, at 175 per Tipping J. Tipping J had earlier commented (at 172) that a "remedial constructive trust is imposed by the Court as a remedy in circumstances where, before the order of the Court, no trust of any kind existed". See also the rejection of a remedial constructive trust claim by Parker LJ in *Mountney v Treharne* [2002] EWCA Civ 1174, [2003] Ch 135 at [40].
[53] *ibid.* at 173 per Tipping J; *Muschinski*, n22 above, at 614 per Deane J.
[54] For similar reasons discretion-based classifications of remedies generally are unpromising: see R.

ex ante quality. Modern scholarship increasingly recognises the artifice of a clear distinction between rules and discretion: "the use of rules involves discretion, while the use of discretion involves rules." [55]

There are, for instance, choices to be made by judges when finding facts. That is, they exercise a "fact-finding discretion".[56] The choices that are made when finding the facts will often determine the parties' entitlements because they dictate whether or not a particular case falls within the empirical trigger of a particular rule.

Having found the facts it may then be uncertain whether a rule applies as a result of the unavoidable element of a rule's open texture: human language is insufficiently precise to provide clear answers to all of the infinite variety of fact situations with which a decision-maker might be confronted.[57] Moreover, even after a judge has established that the facts of a case fall within the language of a rule, he may still exercise discretion in deciding whether or not to apply the rule to the instant case. There are at least three instances of such discretion.

First, a judge is often required to choose between two or more conflicting precedents. This may require a single exercise of discretion to remove the conflict (and hence future choice). However, sometimes it may take a series of decisions over a long period of time before the conflict is conclusively resolved.[58] Second, legal rules exhibit a dynamic quality and might be changed or developed in response to changing social and economic conditions. Today, judicial creativity is openly recognised as essential to providing "justice relevant to the times".[59] Third, the application of a rule might result in a gross injustice. In these circumstances most legal systems contain devices to avoid

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Zakrzewski, *Remedies Reclassified* (2005), pp.85-102.

[55] K. Hawkins, "The Use of Legal Discretion: Perspectives From Law and Social Science" in *The Uses of Discretion* (1991, ed. K. Hawkins), p.11 at 12. The literature developing this idea is profligate. Most notably, see Schneider, n12 above; C. Sunstein, "Problems With Rules" (1995) 83 Calif L Rev 953.

[56] See Galligan, n19 above, at pp.33-37; Schneider, n12 above, at pp.66-67.

[57] Hart, n10 above, pp.121-132. As to open texture and constructive trusts, see Gardner, n42 above, at pp.193, 197-198.

[58] See, in particular, the discussion of the pre- and post- *Reid* authorities relating to the question of the nature of relief against the recipient of a bribe: Chapter 6, Sections III & IV.

[59] *Kleinwort Benson v Lincoln City Council* [1999] 2 AC 349 at 377 per Lord Goff. Thus, the constructive trust has a dynamic quality, changing as underpinning policies change: *Sen v Hedley* [1991] Ch 425 at 440 per Nourse LJ.

the rule's application.[60] The more sensitive the courts are to the fairness of the outcome, the more rules operate like "summary rules"[61] rather than reasons for a decision. Indeed, once an exception is permitted on the grounds of gross injustice, the difference between rules and discretion blurs considerably because every application of a rule involves judgment to the effect that its application is not grossly unjust.[62]

Recognising an element of discretion in rules poses problems for the institutional constructive trust theory. If in some instances a constructive trust involves the exercise of judicial discretion then - in those cases at least – the constructive trust cannot arise upon the facts, in the world beyond the court and before judicial choice is exercised. Rather, it must await the exercise of the judicial discretion.

(b) Dworkin's "Right Answer" Thesis

One way in which the institutional theorists might avoid the problem is to adopt a Dworkinian analysis. Dworkin suggests that there is in principle always one right answer to a legal question, even though judges and lawyers will frequently disagree over what it is.[63] Judges therefore recognise existing rights; they do not create new ones.[64] On this analysis a right to a constructive trust exists prior to and independently of the order of the court, even in a hard case. This analysis is, however, open to two criticisms.

First, the ideal that there is in principle always one right answer, even though there will be disagreement over what it is, is of limited assistance. A more realistic, useful and acceptable account would acknowledge discretion where "no practical procedure exists for determining if a result is correct, informed lawyers disagree about the proper result,

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[60] R. Summers & M. Taruffo, "Interpretation and Comparative Analysis" in *Interpreting Statutes* (1991, eds. N. MacCormick & R. Summers), p.461 at 485-6.
[61] J. Rawls, "Two Concepts of Rules" (1955) 64 Phil Rev 3 at pp.19-24.
[62] Sunstein, n55 above, at pp.986-988.
[63] R. Dworkin, "No Right Answer?" in *Law, Morality and Society: Essays in Honour of HLA Hart* (1977, eds. P. Hacker & J. Raz), p58. However, only Hercules, Dworkin's mythical judge of superhuman intellectual power and patience is able to identify the right answer in every case.
[64] R. Dworkin, n4 above, pp.84-86.

and a judge's decision either way will not widely be considered a failure to perform his judicial responsibilities."[65] To this extent, discretion cannot be eliminated entirely.

Second, Dworkin's account requires open normative reasoning of the sort that institutional theorists such as Birks are likely to eschew. Dworkin maintains that in hard cases judges select from the eligible interpretations of the law that which is the most normatively attractive.[66] This is achieved by applying the "best" theory of law, that is, the one which achieves the best mix of moral justification and descriptive fit.[67] By contrast, Birks cherishes the apparent certainty and demonstrability of "objectively ascertainable rules".[68]

(c) Birks' Analysis of "Weak" and "Strong" Discretion

Birks seeks to maintain a clear conceptual divide between the rule-based institutional constructive trust and discretionary remedial constructive trust, notwithstanding the element of discretion in rules, by appealing to the distinction between "weak, rule-based discretion"[69] and "strong discretion".[70] For Birks, remedies which are weakly or marginally discretionary can be aligned with non-discretionary remedies. In both cases, he maintains, it remains meaningful to speak of a pre-existing entitlement to a particular outcome.[71] Only if the discretion is "strong" does the court order become "a remedy which is not a right".[72] Such reasoning, however, is less than convincing.

First, by whatever name we call it - "technical", "marginal", "weak" or "rule-based" - to the extent there remains judicial choice in the application of a rule the claimant's entitlement cannot arise until the choice has been exercised.[73] Second, the simple two-fold division between "weak" and "strong" discretion obscures the subtle mixes of

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[65] K. Greenawalt, "Discretion and Judicial Decision: The Elusive Quest for the Fetters that Bind Judges" (1975) 75 Colum. L. Rev 359 at p.386.
[66] R. Dworkin, *Law's Empire* (1986), pp.225-258.
[67] *ibid.* at pp.52-54, 258-271.
[68] P.B.H. Birks, "Remedies for the Abuse of Confidential Information" [1990] LMCLQ 460 at p.465.
[69] P.B.H. Birks, "Three Kinds of Objection to Discretionary Remedialism" (2000) 29 WALR 1 at p.13.
[70] P.B.H. Birks, n30 above, at p.18. See also, Birks, n33 above, at p.217.
[71] Birks, n30 above, at pp.16-17.
[72] *ibid.* at p.17.
[73] Birks reasons that even equitable discretion has become "technical", in that it is so well settled "it is possible to describe the facts upon which a party will have a right to that remedy": n33 above, at p.217. However, this does not rule out the element of discretion in rules: see above, Section III.1(a).

rules and discretion that exist along an infinitely varied and finely shaded rules-discretion continuum.[74] Third and in light of the second criticism, there is no basis for identifying the precise point along the finely shaded rules-discretion continuum where "weak" discretion ends and "strong" discretion begins.

2. Discretion and Determinacy

(a) "Rules" in Discretion

Equally problematic is the claim that the constructive trust is always remedial because discretionary. Just as the use of rules involves an element of discretion, so too the use of discretion involves rules. The formal grant of discretion is therefore unlikely to lead to an effective choice in every case. As Hawkins notes, "to explore the use of discretion empirically reveals an orderly process at work".[75]

Even where the discretion conferred is permanent rather than of the transitory rule-building type, we might expect to find patterned outcomes as a result of social, organisational, economic and political forces.[76] While binding rules of law do not formally operate in such discretionary areas, it would be surprising if consistent outcomes reached in response to recurring fact patterns were not presented as normative propositions,[77] or if guidelines did not coalesce into doctrine.[78] It is likely that discretion will be exercised in "normal" ways in routine cases, with only "non-routine" cases requiring special consideration.[79] Equally, in a developed legal system judges are required to give reasons for their judgments and given that reasons

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[74] Below, Section III.3.
[75] Hawkins, n55 above, p.38. See also Schneider, n12 above, at pp.79-87.
[76] See *The Uses of Discretion* (1991, ed. K. Hawkins), Chapters 1-2 & 4-8.
[77] S. Gardner, "The Remedial Discretion in Proprietary Estoppel" (1999) 115 LQR 438 at p.468.
[78] A. Abddullah & T.T. Hang, "To Make the Remedy Fit the Wrong" (1999) 115 LQR 376 at p.378.
[79] For example, the remedial response in proprietary estoppel cases is formally portrayed as a discretionary determination, but where the facts are such that the parties' expectations are clear and it remains practical to give effect to those expectations, the remedy selected will be that which most effectively furthers them: see R. Smith, "How Proprietary is Proprietary Estoppel?" in *Consensus ad Idem* (1996, ed. F. Rose), p.235 at 239-242. Thus, only those cases not fulfilling simple criteria prompt special consideration.

are by their very nature general, they have the capacity to constrain future cases.[80] As Sunstein notes, "[f]ew if any judgments about particular cases are entirely particular".[81] It follows, therefore, that "enthusiasm for genuinely case-specific decisions makes no sense".[82]

(b) The Remedialists' Broader Commitments

It is evident from a broader survey of "discretionary remedialism" that, apart from some isolated statements relating to the constructive trust, few if any discretionary remedialists desire a system in which every determination is open for fresh consideration in each case. Isolated statements to the contrary are probably stimulated by a desire to gloss over the cracks in the rather uneasy distinction between rules and discretion. For the same reason, proponents of institutional constructive trust theory often mischaracterise the element of remedial discretion claimed for the remedial constructive trust. Birks, for example, speaks of a form of "inscrutable case-to-case empiricism"[83] or "free discretion"[84] that "must be kept fresh for each exercise".[85] This is not, in fact, what is generally claimed.

First, many discretionary remedialists explicitly reject the strong, unprincipled discretion that is often attributed to them.[86] They envisage that any remedial discretion conferred on judges will be constrained in at least two ways: it will be narrow, in that the range of permissible outcomes will be restricted; and it will be weak, in that articulated standards will apply, although the weight that they are accorded may vary with context.[87]

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[80] F. Schauer, "Giving Reasons" (1995) 47 Stan L Rev 633. Schauer argues that given a reason is logically prior to, and necessarily broader than, the outcome that it is a reason for, we might expect reasons for a decision to determine in advance future cases. If decision-makers aspire to exercise their discretion consistently, as they must in any Western legal system, reasons therefore have the capacity to determine the outcome of a future case in advance.

[81] Sunstein, n55 above, at p.957.

[82] *ibid.*

[83] P.B.H. Birks, "Civil Wrongs: A New World" in *Butterworths Lectures: 1990-91* (1992), p.92.

[84] Birks, n30 above, at p.18.

[85] Birks, n69 above, at p.13.

[86] See S. Evans, "Defending Discretionary Remedialism" (2001) 23 Syd L Rev 463; K. Barker, "Rescuing Remedialism in Unjust Enrichment Law: Why Remedies are Right" [1998] CLJ 301; P. Loughlan, "No Right to the Remedy? An Analysis of Judicial Discretion in the Imposition of Equitable Remedies" (1989) 17 MULR 132.

[87] Finn suggests that a range of constraints will orientate and "gird and guide" judicial discretion: Finn, n44 above, at p.266.

Second, remedialists recognise that precedent will continue to play an important role.[88] However, the precise role that precedent will play is not always made clear. It may be that it will primarily function as a means of identifying relevant standards that are to be taken into consideration rather than as a means of providing rules which dictate a particular outcome in the case at hand.[89] While there may be disagreement as to the precise role precedent should play there is general agreement that some mechanism is necessary to ensure that discretion is exercised regularly and judicially, not arbitrarily.[90]

Third, remedialists are against formalism and obfuscation. They emphasise the need for candour, clear articulation of the relevant factors and reasoned outcomes.[91] Broadly speaking, the remedialist methodology is similar to that which Frederick Schauer refers to as a "jurisprudence of reasons".[92] This is important because, as we have seen already, reasons are by their nature general. Thus, they may determine the outcome of future cases in advance.

Finally, it appears that even rules will have some role to play in a regime of discretionary remedialism. Indeed, some go so far as to recognise that the remedialist project is one of building appropriate and more refined rules rather than creating a sphere of continuing discretion. Thus, Waters notes that the "occasional rhetoric....of judicial discretion does not necessarily reflect anything more than the desire that formulae and rules shall not settle upon the law before the formative age is clearly over".[93] Similarly, in *Soulos v Korkontzilas* Justice McLachlin spoke of a desire for the "law of constructive trust to develop and for greater precision to be attained, as time and experience may dictate".[94]

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[88] In the context of the constructive trust, see Wright, n21 above, at pp.8-9, 180; Waters, n44 above, at p.184.
[89] D.M. Jensen, "The Rights and Wrongs of Discretionary Remedialism" [2003] Sing J Legal Stud 178 at pp.180-184.
[90] Evans, n86 above, at p.487.
[91] Evans, n86 above; G. Hamond, "Rethinking Remedies: The Changing Conception of the Relationship Between Legal and Equitable Remedies" in *Remedies: Issues and Perspectives* (1991, ed. J. Berryman), p.87 at 107.
[92] F. Schauer, "The Jurisprudence of Reasons" (1987) 85 Mich L Rev 847.
[93] Waters, n44 above, at p.184 . Evans similarly expects that discretion "will inevitably diminish over time as [it] becomes structured according to the decided cases": n86 above, at p.493, fn196.
[94] n36 above, at p.230. Although some of the earlier Canadian judgments arguably supported a

3. The Rules-Discretion Continuum

The idea that the use of rules involves discretion and the use of discretion involves rules is an important one. It reminds us that things are not as simple as is sometimes assumed. It also suggests that the distinction between "institutional" and "remedial", at least insofar as it is premised on rules and discretion, is anything but clean, simple and neat. As Gardner notes, in the end the "alleged difference between remedial and institutional constructive trusts is at least somewhat ephemeral".[95]

It is moreover, important to emphasise that we are not simply faced with a clear choice between rules *or* discretion. Rather, the choice is between infinitely varied mixes of rules *and* discretion. Rules and discretion are probably more accurately portrayed as points existing along a finely shaded and infinitely varied continuum, running from clear, precise rules to strong discretion. Points along that continuum include, but are not limited to: (a) rules with specific and precise empirical triggers; (b) rules with more or less open ended or evaluative empirical triggers; (c) rules with exceptions or escape routes in the event of gross injustice; (d) summary rules; (e) standards such as "reasonableness"; (f) use of analogy; (g) factors to be considered in making decisions; and (h) policy.[96]

The rules-discretion continuum can therefore be viewed as representing the broad repertoire of devices that the law has in its toolkit which are potentially available to "do the job" in a particular instance. The appropriate tool for the job depends on the context.[97] A well functioning legal system is likely to draw upon the continuum at various points and exhibit an excessive enthusiasm for neither rules nor discretion.[98]

The delineation of "institutional" and "remedial", to the extent that it is premised on a clear and stable separation between rules and discretion in practice, is therefore somewhat misleading and untenable.

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continuing discretion: see Gardner, n42 above, at p.199.

[95] Gardner, n42 above, at p.198. See also S. Nield, "Constructive Trusts and Estoppel" (2003) 23 LS 311 at p.328.

[96] For further discussion of various points along the continuum, see Sunstein, n55 above, at pp.960-968.

[97] See also below, Section IV.3.

IV. UNDERPINNING IDEALS

The choice between rules and discretion required by the dominant polemic might, however, assume importance even though neither can be achieved in an absolute form. It might tell us something about the ideals to which proponents of the "institutional" and "remedial" aspire, even though these ideals are practically unattainable. Proponents of the institutional constructive trust, we find, are often committed to the ideals of rules; proponents of the remedial constructive trust to the ideals of discretion. It is, however, important to recognise that an absolute commitment to these ideals may inhibit open discussion about the most appropriate point on the rules-discretion continuum that different types of case should lay. That point cannot be determined once and for all in the abstract. Rather, it depends on the context.

1. Institutional Constructive Trusts and the Ideals of Rules

Proponents of institutional constructive trust theory, most notably Professor Birks, cherish the values that we commonly associate with the ideas of formal justice and the rule of law: scepticism of judicial law making; a belief that rules and formal legal principles achieve the fundamental goal of certainty; and a belief that rules are essentially fair because they ensure that like cases are treated alike.[99]

(a) The Judicial Function

The rule-based institutional constructive trust is consistent with the idea that judges should find and apply the law; they should not make it. Their function is to determine the legal rights of the parties, not create new entitlements *ex post facto*. Making the law

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[98] Sunstein, n55 above; Schneider, n12 above.
[99] See, in particular, Birks, n69 above; Birks, n30 above, at pp.23-24; P.B.H. Birks, "Equity in the Modern Law: An Exercise in Taxonomy" (1996) 26 WALR 1 at pp.97-99.

is the function of Parliament.[100] Thus, Birks opines that "the law" determines the availability of a remedy, "not the judge".[101]

This looks like an alignment to the much criticised declaratory theory of law. The theory dominanted prior to the twentieth century,[102] although it was never an entirely accurate reflection of judicial practice.[103] Central to the theory was the idea that judges did not make law; rather they were entrusted with the task of finding and declaring the law that existed already. It is now broadly recognised that the theory is a "fiction"[104] or "fairy tale".[105] Judicial law making is universally accepted[106] and positively embraced as essential for "providing the citizens of this country with a system of practical justice relevant to the times at which they live".[107] The important task lies not in determining whether judges make law, but in identifying the essential limits of that law-making function and expounding judicial techniques to support it.

(b) Legal Certainty

It is often argued that, particularly in the context of determining property rights, rudimentary justice requires certainty; and that can be achieved only by clear, settled and objectively ascertainable rules.[108] Thus, one reason for rejecting the substitution of the "remedial" for the "institutional" is that the remedial would come "at the expense of absolute certainty".[109] This is to treat certainty as a supreme value or an unquestioned dogma.

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[100] *Polly Peck*, n27 above, at 832 per Nourse LJ.
[101] Birks, n69 above, at p.9.
[102] See G.J, Postema, "Classical Common Law Jurisprudence" (2002) 2 OUCLJ 155 at pp.166-167. Some contemporary theories of the common law come close to adopting a declaratory theory: e.g. A.W.B. Simpson, "The Common Law and Legal Theory" in *Oxford Essays in Jurisprudence* (Second Series, 1973, ed. A.W.B. Simpson), p.77 at 84-86.
[103] J. Baker, *An Introduction to English Legal History* (3rd edn, 1990), Chapter 12.
[104] *Kleinwort Benson v Lincoln City Council* [1999] 2 AC 349 at 377 per Lord Goff.
[105] Lord Reid, "The Judge as Law Maker" (1972) 12 JSPTL 22 at p.22.
[106] *O'Toole v Charles David Pty Ltd* (1991) 171 CLR 232 at 267 per Brennan J ("Nowadays nobody accepts that judges simply declare the law").
[107] *Kleinwort Benson*, n104 above, at 377 per Lord Goff. See also at 358 per Lord Browne-Wilkinson and *Alfred McAlpine Construction Ltd v Panatown Ltd.* [2001] 1 AC 518 at 553 per Lord Goff.
[108] P.B.H. Birks, "Establishing a Proprietary Base" [1995] RLR 83 at 84; Millett, n1 above; *Foskett v McKeown* [2000] 3 All ER 97 at 119-120 per Lord Millett.
[109] R. Pearce & J. Stevens, *The Law of Trusts and Equitable Obligations* (3rd edn, 2002), p.310.

Certainty is indeed valuable. It facilitates prediction and planning, allows people to know their entitlements, and can increase visibility and accountability of decision-making. However, absolute certainty is neither possible nor desirable. Rather, it is more appropriate to think in terms of securing a reasonable measure of practical certainty.[110] "Practical certainty" is the attainable element of certainty which is sufficient to meet the demands of the case.[111] It recognises that, as one of many potentially conflicting values that inform our perceptions of justice, certainty is not always paramount.

The relative importance of certainty varies over time. Sometimes the law becomes so sclerotic, or social and economic change so rapid, that notions of fairness and justice predominate to breathe new life into the law. As Lord Reid recognised, people "want two inconsistent things: that the law shall be certain, and that it shall be just and move with the times. It is our business to keep both objectives in view".[112] Lord Denning expressed a similar view.[113]

The relative importance of certainty also varies with context. In some contexts a greater degree of uncertainty might be tolerated because it is not possible to develop rules which achieve appropriate results in a sufficient number of cases. We have come across this problem already in the context of "rule failure" discretion.[114] In other contexts certainty may be simply less important than reaching a "just" outcome.[115] In still others certainty will be more important than individualised justice. In a commercial context, for example, certainty is often a highly prized commodity.[116] Equally, because effective planning requires a high degree of certainty, the certainty of rules is desirable

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[110] On the distinction between "absolute" or "theoretical" certainty and "practical" certainty, see J. Dewey, "Logical Method and Law" 10 Cornell LQ 17 at pp.24-25 (1924).
[111] See e.g. N. MacCormick, "Law as Institutional Fact" (1974) 90 LQR 102 at p.122.
[112] Lord Reid, n105 above, at p.26.
[113] A.T. Denning, "The Need for a New Equity" (1952) 5 CLP 1 at p.9.
[114] Above, Section II.1(c).
[115] E.g., family property disputes between M and F in which third parties are absent: see *Peter v Beblow* (1993) 101 DLR (4th) 621 at 640 per Cory J; *Rawluk v Rawluk* (1990) 65 DLR (4th) 161 at 181 per Cory J; Paciocco, n24 above, at pp.325-328.
[116] A particularly clear judicial application of this policy was in *Scandinavian Trading Tanker Co A.B. v Flota Petrolera Ecuatoriana (The "Scaptrade")* [1983] 1 Lloyd's Rep 146 at 153 per Goff LJ (CA), [1983] 2 AC 694 at 703-704 per Lord Diplock (HL). The House of Lords refused to accept a jurisdiction to grant equitable relief from forfeiture in the context of late payments under time charters. While it was recognised that the enforcement of strict legal rights might on occasion work capriciously, this was outweighed by the enormous virtues of predictability in a context where it was essential for owners to take irrevocable, far-reaching actions without delay.

where constructive trusts operate as facilitative devices (e.g., secret trusts).[117] At the end of the day, the extent to which the demands of certainty are to be preferred at the expense of other values is a matter of fact that must be determined in context rather than in the abstract.

(c) Treating Like Cases Alike

It is also often claimed that rules are essentially fair because they ensure that like cases are treated alike. It is however, a feature of rules that they are both over and under-inclusive when measured against their background justification.[118] Consequently, they may lead a decision-maker away from an outcome which would have been reached all things considered except the rule. As MacCormick points out, rules come "at the price of being morally blunt instruments".[119] Discretion rather than rules has the "potential to produce morally sensitive and morally nuanced decisions and to mediate effectively between competing values".[120]

A less objectionable argument is that rules rather than a discretionary "all things considered" approach are likely to produce a greater proportion of substantively just outcomes over the long run because rules can reduce decision-maker error and bias. This is the point Jensen makes when he argues that "rule-based decision making is the only means whereby we may be reasonably sure that decision-makers.....will decide similar cases in a similar way".[121] The point however, is overly simplistic. Whether rules are likely to be more successful at achieving substantively just outcomes in the long run will depend on the context. Sometimes, rules may not achieve appropriate outcomes in an adequate number of cases because the facts likely to come before the decision-maker may be so complex, varied or unpredictable that appropriate rules cannot be written in advance.[122] Moreover, the argument assumes a simple division between rules and discretion rather than a context sensitive choice between various

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[117] A point noted of facilitative laws some time ago by G.H. Trietal, *Doctrine and Discretion in the Law of Contract* (1981), pp.2-3. See also MacCormick, n111 above, at pp.122-123.
[118] Section II.1(a), above. The degree of over- and under-inclusiveness will, however, vary with the degree of precision, detail and complexity of the rule.
[119] N. MacCormick, "Discretion and Rights" (1989) 8 Law & Philosophy 23 at p.36.
[120] Evans, n86 above, at p.484.
[121] Jensen, n89 above, at p.179. See also Birks, n99 above, at pp.17, 27; *Cowcher*, n22 above, at 948 per Bagnall J.
[122] See the discussion of rule-failure discretion above, Section II.1.(c).

points on a finely shaded rules-discretion continuum. The idea that rules are essentially just by virtue of their general and uniform application therefore turns out to be somewhat misleading.

2. Remedial Theory and the Ideals of Discretion

Remedial theory by contrast, tends to reflect the ideals of substantive justice, emphasising the merits of the individual case, the need for flexibility and sensitivity to the particular and the pro-active role of the judge in securing justice.[123] The judicial function is thus perceived as involving a "thorough analysis of the facts followed by the application of the broad principles of conscience, fairness and reason".[124] The goal is to achieve an individually tailored outcome for the case at hand. Like cases really are treated alike as judicial discretion permits morally nuanced decisions that are attuned to all relevant aspects of the case.[125]

The pursuit of fine grained individualised justice is however myopic. We have already seen that there is a trade-off between the attainment of morally nuanced outcomes and the pursuit of other values. Thus, in some contexts sub-optimal results are tolerated out of necessity in return for the benefits brought about by the desired level of certainty.[126] Moreover, in practice the pursuit of individualised justice does not guarantee the treating of like cases alike. While a judge who is free to consider every relevant factor is theoretically empowered to reach the optimal outcome, he is increasingly prone to error.[127] The more information a judge is required to assimilate in a single instance, the greater the risk of miscalculation, confusion and misunderstanding or even bias. It is also plausible to believe that individualised justice would risk systematically favouring a particular class of litigant - namely those with adequate resources to argue that their case is relevantly different - and hence lead to substantive inequality in practice.[128]

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[123] See, for example, Waters, n45 above, at p.490, fn77 & p.499-503; Justice Paul Finn, n44 above, at pp.267ff.
[124] Finn, n44 above, at p.260.
[125] Thus, proponents of remedial theory often draw upon the historical jurisdiction of equity, the function of which was "to do justice most nearly in accordance with the requirements of each particular case": I.C.F. Spry, *Principles of Equitable Remedies* (6th edn, 2001), p.25.
[126] Above, Section IV.1.(b).
[127] Schauer, n2 above, pp.149-155.
[128] Sunstein, n55 above, at p.977.

Finally, the approach is likely to be politically unattractive. While judicial law-making is embraced, there is little consideration of the legitimate limits of that law-making function, nor of the development of effective techniques to adequately support it.[129]

3. The Rules-Discretion Continuum and Context Sensitivity

The ideals underpinning the institutional and remedial theories are therefore problematic. They often rest on overly simplistic vices-virtues approaches to rules and discretion. Proponents of the institutional theory tend to emphasise the general virtues of rules and the vices of discretion; proponents of the remedial theory tend to emphasise the general virtues of discretion and the vices of rules. What is in fact required is a more subtle analysis of which is the most appropriate in a given context. Rules are not always superior to discretion just as discretion is not always superior to rules.

It must also be remembered that the choice is not simply between polar opposites - between general rules and strong, untrammelled discretion. That would represent a gross oversimplification. The choice really involves a decision about at which point on the finely shaded rules-discretion continuum lays the most appropriate device (or judicial technique) to do the job. The appropriate choice between the numerous possibilities is a function of a number of context-sensitive factors: the required level of certainty to meet the needs of the case; the costs of devising adequate rules; the likelihood of bias and mistake; the expected risk and magnitude of over and under-inclusiveness; judicial resources; and the sheer number of expected cases, to name but a few.[130] Since the significance of these factors will vary with context it follows that the optimal point on the rules-discretion continuum will also vary. The subtlety of the normative choice is obscured rather than illuminated by the simplistic rules v. discretion debate that is encouraged by the dominant constructive trust polemic.

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[129] Although remedial theorists have now started to address this challenge: see, in particular Evans, n86 above.

[130] For detailed discussion of the criteria underpinning the choice, see L. Kaplow, "General Characteristics of Rules" in *Encyclopaedia of Law and Economics, Volume V: The Economics of Crime and Litigation* (2000, eds. B. Bouckaert & G. de Geest), p.502; L. Kaplow, "Rules Versus Standards: An Economic Analysis" (1992) 42 Duke LJ 557; M. O'Sullivan, "The Justices of Rules and Standards" (1992) 106 Harv L Rev 22 at pp.62-69 (1992); Sunstein, n55 above; Schneider, n12 above; Schauer, n2 above, Chapter 7.

V. Practical Consequences

In this final section we look at the problematic practical consequences that may follow from the respective constructive trust theories and the tendency to exaggerate the role of rules or the role of discretion. Again, these suggest that an extravagant pursuit of either rules or discretion is inappropriate and that the manner in which we conceptualise the constructive trust should encourage neither.

1. The Extravagant Pursuit of Rule-Based Institutional Theory

The rule-based institutional theory risks suffocating substantive justice between the parties and marginalising legitimate third party claims. The idea of "justice according to law" prematurely forecloses consideration of issues that might be otherwise considered relevant.[131] Justice simply requires that the claimant gets that to which the applicable rule says he is entitled, regardless of the extent to which the judge is animated by the justice of an alternative outcome. Moreover, the conceptualisation of the constructive trust as having an autonomous existence bolsters the appearance that the results generated by its application are natural, inevitable and beyond judicial control.[132] This is a particular concern in the context of the constructive trust given its potential impact on innocent third parties.

A second problematic consequence of the rule-based institutional theory concerns the idea that any development must be by "precedent out of principle".[133] This tends to lead to a particular brand of formal legal reasoning whereby the outcome is portrayed as the consequence of an exercise in logical deduction from authoritative premises.[134]

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[131] The more a rule is taken seriously, the more considerations that are germane to the circumstances are likely to be suppressed and the more over- and under-inclusiveness is either tolerated or passes by unnoticed: see L. Alexander & E. Sherwin, "The Deceptive Nature of Rules" (1994) 142 U Pa L Rev 1191; Schauer, n2 above, Chapter 5.

[132] See Chapter 3, Section II.2(a).

[133] n26 above.

[134] C. Rotherham, "Proprietary Relief for Enrichment by Wrongs: Some Realism About Property Talk" (1996) 19 UNSWLJ 378.

Decisions have bestowed upon them a false objectivity as already being law. The key in litigation is to characterise the facts so that they fall under the desired rule. Consequently, there is a danger that the relevant normative concerns are not fully examined or appreciated or are largely suppressed.[135] The rules take on a life of their own and lose touch with the justifications that lay behind them.

We see this process in the work of Professor Birks. Birks was at one time adamant that proprietary relief was unavailable where a defendant received property from a third party in breach of a legal or equitable duty because in such instances there was no "proprietary base".[136] There was a sound policy rationale for this too: property rights would create a danger of undeserved priorities on the defendant's insolvency.[137] However, *Attorney-General for Hong Kong v Reid*[138] compelled Birks' to revise his position. Birks interpreted the decision as generating a new rule to the effect that the receipt of a bribe is an event constitutive of a proprietary base.[139] Since there is nothing "structurally peculiar" about bribes, the reasoning in *Reid* must work for other acquisitive wrongs too.[140] Thus, of *Re Polly Peck (No2)*,[141] a case in which the claimant sought to recover the proceeds of profitable trespass and take priority in the defendant's insolvency, Birks reasoned that an institutional constructive trust might be legitimately found.[142] The legitimate policy concern that property rights should not be lightly conceded due to their impact on insolvency is quickly forgotten as rules creating proprietary interests proliferate without a frank and open policy check.

A third potential problem concerns the rigidity that is risked by an excessively rule-based approach. When rules are viewed as absolutes, they can apply to situations in which their application works a grave injustice or makes little sense. It was precisely because the common law caused such harm with its commitment to fixed rules and absolute rights that doctrines of equity were developed, to temper and mitigate the

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[135] Consider, for example, the artificial characterisation of a relationship as fiduciary, and the strain this has placed on the fiduciary concept, in order to provide access to proprietary remedies in "worthy" cases: see the critical comment by La Forest J in *Lac Minerals*, n43 above, at 29-32.
[136] P.B.H. Birks, *An Introduction to the Law of Restitution* (1989, rev'd paperback edn), p.388.
[137] *ibid.* at pp.388-389, 473.
[138] [1994] 1 All ER 1.
[139] Birks, n108 above, at pp.84-85.
[140] P.B.H. Birks, "Property in the Profits of Wrongdoing" (1994) 24 WALR 8 at p.14.
[141] [1998] 3 All ER 812.
[142] P.B.H. Birks, "The End of the Remedial Constructive Trust" (1998) 12 TLI 202 at pp.208-209.

rigour of law.[143] Equally, in more modern times, it has been recognised that notions of equity should also operate to mitigate the rigour of equity's own creations.[144]

2. The Extravagant Pursuit of Discretionary Remedial Theory

A slavish pursuit of a discretionary constructive trust is likely to fare no better. The ripple effects of a concept which determines that the claimant's equitable interest can exist only from the time of judicial declaration are likely to extend far and wide. It would for instance, risk inadequate protection of the claimant against third parties by upsetting statutory regimes in which the temporal requirement of a proprietary interest assumes significance.[145] Equally, as long as the constructive trust is portrayed as necessarily discretionary and unascertainable in advance, enforcement against third parties appears inconsistent with the traditional policy that third parties should not be bound by uncertain and inchoate rights.[146]

Exaggerated references to discretion are also likely to create further problems more commonly associated with discretionary decision-making. They may lead to the avoidance of questions about the degree of legitimate constraint within which judges should appropriately operate. There is also a danger that relief will be granted without consideration or explication of either the relevant criteria or of the appropriate weight to be accorded those criteria. In *Muschinski v Dodds*,[147] for example, the court felt it was appropriate for the constructive trust to operate prospectively rather than retrospectively in order to avoid prejudicing third parties. However, no reasons were provided as to why third parties should not be prejudiced. In such instances, it is difficult to ascertain what particular aspects of a case are taken into account, what particular criteria are considered, and how they affect determinations of the appropriate relief. Consequently, there is a lack of transparency, a risk that the real reasons for the decision operate without scrutiny, and a risk of confusion and uncertainty in later

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[143] T.F.T. Plucknett & J.L. Barton, "St German's Doctor and Student" (1974) 91 Selden Society 97.
[144] *Re Motorola New Zealand Superannuation Fund* [2001] 3 NZLR 50 at [63].
[145] See Chapter 3, Section V.3.
[146] *National Provincial Bank v Ainsworth* [1965] AC 1175 at 1248 per Lord Wilberforce.
[147] (1985) 160 CLR 583.

cases.[148] An undiscerning zeal to do justice in the instant case encourages a focus on the particular facts and the particular parties who happen to be on hand. Little guidance is provided for the future and important questions risk being ignored.

A commitment to fine grained individualised justice would also extend the range of admissible evidence, the applicability and weight of which could be determined only in the context of a concrete controversy.[149] Not only would this make the judicial process more cumbersome, but the consideration of diverse multiple criteria, and the high degree of individualisation, would require a judge to synthesise a large number of factors to determine the appropriate remedy. There comes a point at which this exceeds the limited capacity of our judges who, it should be remembered, do not possess the mythical qualities of Hercules.[150] The legal system would soon "break down under the weight of infinite bibliographical detail";[151] there would be a risk that irrelevant factors may be inadvertently included and relevant factors inadvertently excluded or not afforded the appropriate weight. The outcomes of cases would, to use Seldon's aphorism, vary with the length of the Chancellor's foot.[152]

V. Conclusion

The distinction between rules and discretion is fundamental to the distinction between the institutional and remedial constructive trust theories. We are presented with an apparently clear choice between a rule-based institution or a discretionary remedy. Either we prefer rules and all that they bring, hence adopt the institutional constructive trust, or we prefer discretion with all that it brings, hence adopt the remedial constructive trust. However, portraying the choice in this manner is, as we have seen, overly simplistic. There are four main reasons for this:

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[148] See, for example, the confusion in Australia over the court's power to mould the operation of the constructive trust post-*Muschinski*: Chapter 3, Sections IV.1 & IV.2. Consider also the uncertainty and lack of clearly defined goals in determining the appropriate remedy in recent cases of proprietary estoppel: see S. Gardner, "The Remedial Discretion in Proprietary Estoppel - Again" (2006) 122 LQR 492.

[149] *Perre v Apand* (1999) 164 ALR 606 at 625.

[150] See n63 above.

[151] Levontin, n11 above, at p.3.

[152] *Table Talk of John Selden* (1927, ed. F. Pollock), p.177.

1. *Rules involve discretion and discretion involves rules*. The application of rules may in practice involve choice while the exercise of discretion may be predictable and regular.

2. *A simple rules-discretion division is misleading*. It engenders the belief that the choice is between two legal forms. It is not. Rules and discretion are best viewed as points on a finely shaded and infinitely varied continuum of legal forms. A well functioning legal system is likely to draw upon the continuum at different points.

3. *The appropriate point on the continuum is dependent on context*. It cannot be determined once and for all, in the abstract, by reference to a simple vices-virtues test. The contingent nature of the appropriate legal form is not therefore illuminated by conceptual frameworks which demand a once and for all commitment to rules or discretion in the abstract.

4. *Excessive enthusiasm for rules or discretion is potentially damaging*. It is likely to generate a range of unwelcome practical consequences which may be avoided by a more realistic appreciation of the role and nature of rules and discretion.

This suggests that it would be unwise to adopt either the "institutional" or "remedial". If we are to develop a realistic and illuminating constructive trust concept it should demand neither an allegiance to rules nor to discretion.

CHAPTER 3: Timing and Operation*

I. INTRODUCTION

We have seen that the two different theories of constructive trust, which together comprise the dominant contemporary polemic, emphasise two main points of distinction: legal form - whether the constructive trust is rules-based or discretionary - and timing/operation. In Chapter 2 we focussed on the first point of distinction. We saw that there is good reason not to press the distinction of legal form too far. Indeed, we would do well to conceptualise the constructive trust in a manner that is "form-neutral". That is, the way in which we conceptualise the constructive trust should demand neither a once and for all commitment to rules or a once and for all commitment to discretion.

In this Chapter we turn to the second point of distinction: timing and operation. The choice initially and somewhat deceptively appears two-fold. The institutional constructive trust is characterised as a (rule-based) property entitlement that arises at the time of the facts giving rise to the claimant's cause of action. The remedial constructive trust is characterised as a (discretionary) remedy that confers on the claimant a proprietary interest only when declared by a court of competent jurisdiction. The choice, however, is not simply one of alternatives. Judges and jurists have not been uniform in the content they have given either abstraction. These numerous differences, not always appreciated, have potentially far reaching implications.

How, then, are we to choose between these possibilities? The constructive trust does not exist in nature. It is not capable of being simply tracked down in its natural environment and scientifically dissected to expose its essential anatomy. Rather, it is a construct developed in legal discourse to serve both normative and analytical

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* A large part of this Chapter appears as A.D. Hicks, "Conceptualising the Constructive Trust" (2005) 56 NILQ 521-550. The main additions to the present Chapter are Sections III.5 and III.6 dealing with the conceptualisation of the constructive trust by the United States Courts of Appeal, Sixth Circuit.

functions. [1] In assessing the utility of the proposed approaches at least four considerations therefore appear relevant. First, the chosen approach should permit adequate consideration and implementation of the appropriate normative concerns. In the context of specific relief such considerations must be considered in two different contexts: the justice of the claimant's entitlement as against the defendant; and the justice of that claim as against third parties claiming through the defendant. The latter consideration is relevant even where no third parties are apparent, not least because of the risk that important third party claims may not in fact be known by the court. Second, the chosen approach should facilitate the systematic organisation and presentation of the law, thereby enabling a reasonable measure of legal certainty, coherent development and synthesis. This requires the chosen approach to be logical and analytically sound. Third, the manner in which the constructive trust is portrayed should reflect realistically what the courts are doing in fact when they hold that the defendant is a constructive trustee of specific property. Care should be taken to avoid concepts which obscure more than they reveal. Finally, any conceptual revision, if required, should be the minimum necessary to achieve the desired results. This limitation, the principle of minimal conceptual disturbance, is necessary because the impact of a particular modification in one part of a legal system may effect changes to another, whether intended or not.[2]

In this Chapter we examine the various ways in which the constructive trust is conceptualised, drawing upon judicial decisions and academic comments from England, the United States and the Commonwealth. We find that existing approaches in these jurisdictions are, to varying degrees, found wanting when measured against the criteria identified above. The orthodox Anglo-American approach, examined in Section II, turns out to be incoherent, fits poorly with related doctrines, and obscures important and complex normative concerns. The reasons for its persistence are ideological and historical. By contrast, courts and commentators in the Commonwealth, and the United States Ninth Circuit Court of Appeals, have taken a

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[1] On the nature of such concepts generally, see H.L.A. Hart, "Definition and Theory in Jurisprudence" in *Essays in Jurisprudence and Philosophy* (1983) 21; D. Kelly, "Legal Concepts, Logical Functions and Statements of Fact" (1968) 3 U Tas L Rev 43; A. Ross, "Tu-Tu" (1957) 70 Harv L Rev 812.

[2] See J. Waldron, "'Transcendental Nonsense' and System in the Law" (2000) 100 Colum L Rev 16.

more functional approach to the constructive trust. However, none of the suggested alternatives to the Anglo-American orthodoxy are entirely satisfactory.

In Section III we see that a number of Canadian judges have attempted to develop a form of *in specie* relief that avoids unfair prejudice to third parties but, nevertheless, have continued to force such relief into the constructive trust mould. This, confusingly, gives us one concept with two distinct functions. Others have suggested that the constructive trust should allow the court to grant specific relief on whatever terms, and against whichever parties, that the court sees fit. This creates a range of problems that we might expect to find whenever judges are granted strong discretion. The United States Ninth Circuit Court of Appeals, meanwhile, has sought to avoid injustice to third parties, particularly creditors of a bankrupt defendant, by denying that a constructive trust can have any existence or effect until it has been imposed judicially. Until judicial imposition, the constructive trust claimant has merely a "claim", placing him in much the same position as any other unsecured creditor with a claim against the defendant. This approach, however, potentially creates as much injustice as it avoids and risks significant disturbance elsewhere in the legal system.

In Section IV we see that the Australian courts have blended a number of institutional and remedial features of the constructive trust, while some commentators have sought to reclassify the nature of the constructive trust claimant's interest. These approaches are either excessively illogical or are premised on wholesale changes that risk unintended interference elsewhere in the legal system. Moreover, the approaches do not deal effectively with the very problem that motivated them; namely, the creation of unwarranted and unintended priorities.

These findings suggest that a new analytical framework is required. A proposal for a new framework is outlined in Section V. The new framework recognises both the constructive trust and a purely personal order to transfer specific property. The constructive trust is conceptualised as a judicially imposed proprietary interest operating retrospectively, from the time of the facts giving rise to the claimant's cause of action. It would be imposed only where there is reason to grant the claimant the significant advantages that follow from the recognition or creation of an equitable proprietary interest. The purely personal order to transfer specific property, by

contrast, does not recognise or create an equitable interest; it simply confers on the claimant a purely personal right to the transfer of a particular asset. The claimant would be placed in a similar position to any other unsecured creditor and would not acquire an interest in the disputed asset until the defendant complied with the duty to transfer it. This would enable the courts to award a claimant a specific asset, rather than a money substitute, without the risk of creating unintended and unwarranted priorities. By reconceptualising the constructive trust and recognising a purely personal order to transfer specific property along these lines, normatively desirable results can be achieved within a framework that is coherent, rational and illuminating.

II. Conceptions of the Constructive Trust as an "Institution"

1. Anglo-American Orthodoxy: The Automatic Vesting Constructive Trust

It will be recalled that orthodox institutional theory conceptualises the constructive trust as arising by rule of law, independently of the court order, from the moment that the claimant's cause of action arises. The function of the court is simply to establish that the relevant facts did indeed occur and to recognise the claimant's pre-existing entitlement.[3] A claimant does not ask a court to *impose* an institutional constructive trust; rather he alleges that one "already has come into existence as a result of the way in which the defendants obtained possession of their property".[4] Facts occur upon which there is a simultaneous and automatic bifurcation of legal and equitable interest. The claimant's equitable proprietary interest arises once and for all, subject only to known modes of extinction, from this time.[5] This "classical"[6] conceptualisation predominates in English law.[7] More surprisingly it has also taken root in the United

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[3] See Chapter 1, Section IV.3(a) & Chapter 2, Section II.2(b).
[4] *Kuwait Oil Tanker Company SAK v Al Bader*, unreported, December 17, 1998, QBD (Moore-Bick J), reversed on other grounds [2003] UKHL 31. See also *Re Jarvis* [1958] 1 WLR 815 at 819 per Upjohn J.
[5] See e.g. *Grant v Edwards* [1986] Ch 638 at 652 per Mustill LJ; *Turton v Turton* [1988] Ch 542 at 552 per Nourse LJ, 554-555 per Kerr LJ; *Sen v Hedley* [1991] Ch 425 at 440 per Nourse LJ; *Attorney General for Hong Kong v Reid* [1994] 1 All ER 1.
[6] *French v Mason* [1999] FSR 597 at 603 per Pumfrey J.
[7] *Re Polly Peck International (in administration) (No2)* [1998] 3 All ER 812; *Metall und Rohstoff v Donaldson Lufkin Inc* [1989] 3 All ER 14 at 57 per Slade LJ. But compare *England v Guardian Insurance* [2000] Lloyd's Rep IR 404 (Thornton QC) (preparedness to consider a claim to a remedial constructive trust if the matter ultimately arose).

States, although the constructive trust in this jurisdiction is formally declared to be remedial.[8] Scott in particular is emphatic, arguing that "[t]he beneficial interest in the property is from the beginning in the person who has been wronged. The constructive trust arises from the situation in which he is entitled to the remedy of restitution, and it arises as soon as that situation is created".[9] The role of the court, therefore, involves nothing more than the specific enforcement of the claimant's pre-existing rights. The court order places property in the hands of the "proper and equitable owner".[10]

2. The Problematic Consequences of the Automatic Vesting Approach

(a) Obscuring the Relative Merits of Competing Claims

The conceptualisation of the constructive trust as autonomous, arising prior to the court's involvement and apparently existing separate from any judicial recognition, risks suffocating substantive justice and marginalising legitimate third party interests. It encourages judges to think that the court has no control over the outcome and obscures complex normative issues that require consideration.[11]

Where the relevant factual conditions are present, it is said, a trust arises automatically "in the world beyond the court",[12] creating in the claimant an equitable proprietary interest. It thus follows from the nature of the interest previously created that third parties are inevitably affected, with such consequences as priority on the defendant's insolvency appearing natural and self-evident. It is therefore easier for the court to deny responsibility for the impact that the constructive trust has on third

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[8] The presentation of the constructive trust as automatically vesting is found in the *Restatement* and the leading texts: A.W. Scott & W. Seavey (Reporters), *Restatement of the Law of Restitution: Quasi-Contracts and Constructive Trusts* (1937) §160; A.W. Scott & W. Fractcher, *The Law of Trusts* (4th edn, 1987 & Supplements), Vol. 5, §462; J.N. Pomeroy, *Equity Jurisprudence* (5th edn, 1941), Vol. 2, §375.

[9] Scott & Fratcher, n8 above, §462.4.

[10] *United States v Fontana* 528 F Supp 137 at 144-145 (SD. NY. 1981). See also *Restatement*, n8 above, §160, comment e.

[11] See e.g. the analysis of Browne-Wilkinson J, as he then was, in *Re Sharpe* [1980] 1 All ER 198.

[12] P.B.H. Birks, "Proprietary Rights as Remedies" in *Frontiers of Liability* (Birks ed., 1994), Vol. 2, 214 at p.215.

parties as a result of the suggestive power of the notion that something real has previously come into existence, with pre-determined consequences.[13]

The apparent inevitability of the outcome is also bolstered by the power of property: at the time the court adjudicates on the dispute the claimant already owns the asset. The court cannot therefore order an alternative form of relief and refuse to recognise the claimant's right, for to do so would be tantamount to an illegitimate judicial expropriation of property. The idea that something is already the property of the claimant thus exerts greater leverage than competing normative considerations that may suggest an alternative outcome.[14]

An unreflective acceptance of the idea that the constructive trust has an existence autonomous from its judicial recognition, particularly when coupled with axiomatic notions about property, therefore wields a powerful ideological force. Thus, some commentators suggest that priority on insolvency by way of constructive trust follows not because it is just, fair or merited but because "equity" has previously created a property right. Absent this pre-existing property right the award of priority on the defendant's insolvency would constitute an improper preference: [15] the role of the court is portrayed as one of enforcing pre-existing property rights rather than establishing priorities between the claimant and the defendant's creditors. The constructive trust claimant's priority is simply a necessary, if sometimes regrettable, by-product of the earlier rights creation.[16]

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[13] See e.g. M. Stone, "The Reification of Legal Concepts: *Muschinski v Dodds*" (1986) 9 UNSWLJ 63.

[14] See F. Cohen, "Transcendental Nonsense and the Functional Approach" (1935) 35 Col L Rev 809 at p.820 (identifying "property" as one of the "magic 'solving words' of traditional jurisprudence"); K. Gray, "Property in Thin Air" [1991] CLJ 252 at p.305 (noting the "powerful and yet wholly spurious moral leverage" generated by appeals to "property"). For an illustration, see P.B.H. Birks, "Trusts Raised to Reverse Unjust Enrichment: The *Westdeutsche* Case" [1996] RLR 3 at p.14 (suggesting that the only good reason for a court to order assets to be transferred to the claimant is if they already belong to him).

[15] See, in particular, E.G. Jennings & I.S. Shapiro, "The Minnesota Law of Constructive Trusts and Analogous Equitable Remedies" (1941) 25 Minn L Rev 667 at pp.675-676; Scott & Fratcher, n8 above, §462.4.

[16] While equity may have created the property right on the basis of existing precedent, the precedent may be the product of historical accident rather than a carefully reasoned solution to the problem of priority. Constructive trusts evolved historically to resolve two-party disputes with, it seems, little overt consideration of creditors' interests: F.W. Maitland, *Equity: A Course of Lectures* (1936), p.220; D.W.M. Waters, "The English Constructive Trust: A Look Into the Future" (1966) 19 Vanderbilt L Rev 1215 at pp.1216-1220. See also Chapter 1, Section III.1(b).

This reasoning tends to conceal rather than reveal the relative merits of competing claims while simultaneously explaining away the impact of the remedy on third parties.[17] To say that the claimant is entitled to an asset, with priority over unsecured creditors, because a constructive trust exists, is different to saying that a constructive trust exists because a court will order specific relief and confer priority over certain other interests.[18] The latter formulation makes it clear that the consequences require justification and recognises that "constructive trust is the name we give to that decision, not the reason for it".[19] It is therefore less likely to propagate constructive trusts that have unjust consequences on the defendant's insolvency. Thus, where judges are asked openly to *retrospectively* impose equitable title to assets in favour of the claimant, creditors and supervening interests are at the forefront of their minds. A constructive trust is imposed, if at all, cautiously.[20] By contrast, the first formulation appears to naturalise such consequences:[21] the disputed asset already belongs to the claimant, not the defendant, therefore ordering its transfer has no impact on the defendant's creditors.[22] It is therefore easier to lose sight of the essential policies that should limit the constructive trust's application.

(b) Logical Deficiencies

We also find that the automatic vesting constructive trust is a somewhat illogical judicial creation. For example, in some contexts an element of discretion is formally

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[17] J. Dawson, *Unjust Enrichment: A Comparative Analysis* (1951), pp.31-32; F. Lacy, "Constructive Trusts and Equitable Liens in Iowa" (1954) 40 Iowa L Rev 107 at pp.109-114; E. Sherwin, "Constructive Trusts in Bankruptcy" [1989] U Ill L Rev 297 at pp.311-313.
[18] Cohen, n14 above, pp.813-814.
[19] D. Dobbs, *Law of Remedies - Equity - Damages - Restitution* (1993), p399, n40.
[20] See e.g. *Fortex Group Ltd v MacIntosh* [1998] 3 NZLR 171 at 179-180 per Henry J; *Commonwealth Reserves I v Chodar* [2001] 2 NZLR 374 at [57] (interests of creditors and third parties are a "major and frequent obstacle to the grant of a proprietary remedy").
[21] For a useful account of the ways in which legal concepts can make particular conclusions appear self-evident while avoiding discussion about the desirability of those conclusions, see J. Cohen, "The Value of Value Symbols in Law" (1952) 52 Col L Rev 893.
[22] See, for example, Scott, who avoids any reference to the relevant policy concerns. Scott reasons that the constructive trust arises at the time of the unjust enrichment, and for this reason the claimant is awarded priority, before demonstrating that the claimant's interest under a constructive trust vests automatically because the claimant can recover property *in specie* even though the wrongdoer is insolvent: Scott & Fratcher, n8 above, §462.4, pp323, 325.

recognised as part of the decision to award a constructive trust,[23] even though this is inconsistent with the automatic vesting conceptualisation. It makes no sense to characterise the interest under the constructive trust as arising automatically at the time of the facts because, if the interest is dependent on how a court exercises its discretion, it cannot arise independently of and prior to the judicial decision that creates it.[24] Talk of discretion might, of course, be downplayed[25] or passed off as rhetoric.[26] But while a broad or strong discretion may not exist, it is not always possible or desirable to eliminate discretion entirely, even in the face of a formal commitment to rules.[27]

A further logical deficiency is evident when one considers the link between the time at which the equitable interest apparently arises under the constructive trust and the time of the events that determine the interest. A number of commentators suggest that logic requires the constructive trust to arise at the time of the events creating a cause of action in the claimant.[28] However, facts occurring after the cause of action arose

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[23] For example, where a constructive trust is imposed as the minimum equity to do justice in cases of proprietary estoppel, the determination of the minimum equity is formally portrayed as discretionary: see e.g. *Campbell v Griffin* [2001] EWCA Civ 990 at [36] per Walker LJ; *Griffiths v Williams* (1977) 248 EG 947.

[24] A broader conceptual inconsistency is also becoming apparent as some English courts resort to the separation of liability and remedy more generally in order to determine whether a constructive trust is appropriate. They recognise that remedy is not necessarily pre-determined by the nature of the obligation breached but rather follows from a search for what is factually the better solution to the facts before the court: see e.g. *Lord Napier & Ettrick v Hunter* [1993] AC 713 at 738 per Lord Templeman, 744 per Lord Goff (each providing reasons why a lien was a more appropriate remedy than a constructive trust, despite the existence of authority supporting the imposition of the latter). See also *Ocular Sciences Ltd v Aspect Vision Care Ltd* [1997] RPC 289 at 411-416 and *United Pan-Europe Communications v Deutsche Bank AG* [2000] 2 BCLC 461. In the former Laddie J rejected explicitly the existence of a direct link between profitable breach of fiduciary obligation and constructive trust, opining that "the court should consider whether it is the appropriate remedy in the circumstances of the case". In the latter Morritt LJ suggested that whether it is appropriate to impose a constructive trust over benefits acquired through the unauthorised use of confidential information is an issue which must be left "to the court to determine in the exercise of its discretion."

[25] See e.g. *Jennings v Rice* [2002] EWCA Civ 159 at [43]-[44] per Walker LJ; S. Gardner, "The Remedial Discretion in Proprietary Estoppel" (1999) 115 LQR 438. But compare S. Gardner, "The Remedial Discretion in Proprietary Estoppel - Again" (2006) 122 LQR 492, noting that the discretion in recent cases seems much more at large.

[26] See e.g. J. Edelman, "Remedial Certainty or Remedial Discretion in Estoppel After *Giumelli*" (1999) 15 JCL 179 (talk of discretion simply refers to rule-based discretion). For an alternative analysis, see D.M. Wright, "*Giumelli*, Estoppel and the New Law of Remedies" [1999] CLJ 476.

[27] See generally Chapter 2.

[28] See e.g. A. Kull, "Restitution in Bankruptcy: Reclamation and Constructive Trust" (1998) 72 American Bankruptcy LJ 265 at p.287; A. Black, "*Baumgartner v Baumgartner*, the Constructive Trust and the Expanding Role of Unconscionability" (1988) 11 UNSWLJ 117 at pp.128-129.

may be relevant to the decision to award or deny a constructive trust. [29] This is true of constructive trusts arising in the context of specifically enforceable contracts for sale,[30] even though the constructive trust is said to arise immediately upon completion of the contract.[31] It is also true of estoppel cases, where supervening events may lead the court to either withhold the required relief altogether or grant relief of a different form or on different terms than it would have done if asked at an earlier stage.[32] It now appears, moreover, that similar observations might be made in the context of quantifying parties' respective beneficial entitlements under a common intention constructive trust, at least in those cases where the parties' respective shares are not clear from what was done or said at the time the common intention was formed.[33] In these instances the court will grant a share "which, in light of all the material circumstances (including the acts and conduct of the parties after the acquisition) is shown to be fair".[34] Thus, each party will be:

> "entitled to that share which the court considers fair having regard to the whole course of dealing between them in relation to the property. And in that context, 'the whole course of dealing between them in relation to the property' includes the arrangements which they make from time to time in order to meet the outgoings (for example, mortgage contributions, council tax and utilities, repairs, insurance and housekeeping) which have to be met if they are to live in the property as their home."[35]

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[29] Although this is often denied: see e.g. *Turton v Turton* [1988] 1 Ch 542 at 552 per Nourse LJ.
[30] See e.g. *Price v Strange* [1978] 1 Ch 337.
[31] *Lysaght v Edwards* (1876) 2 Ch D 499 at 506-507 per Lord Jessel MR. As to the precise nature of the interest arising, see *Jerome v Kelly (Inspector of Taxes)* [2004] UKHL 25 at [30]-[32].
[32] *Crabb v Arun DC* [1976] Ch 179 at 189-190 per Denning MR, 199 per Scarman LJ; *Williams v Staite* [1979] Ch 291 at 298-299 per Goff LJ, 300-301 per Cumming-Bruce LJ; *Pascoe v Turner* [1979] 1 WLR 431; *Burrows v Sharp* (1989) 23 HLR 82; *Voyce v Voyce* (1991) 62 P & CR 290 at 296 per Nicholls LJ; *Sledmore v Dalby* (1996) P & CR 196.
[33] As Chadwick LJ noted recently, "there is no difference, in cases of this nature, between constructive trust and proprietary estoppel": *Oxley v Hiscock* [2004] EWCA Civ 546, [2004] 3 WLR 71 at [66]. See also *Grant v Edwards* [1986] Ch 638 at 656 per Browne-Wilkinson VC; *Yaxley v Gotts* [2000] Ch 162 at 176, 180 per Walker LJ; *Chan Pui Chun v Leung Kam Ho* [2002] EWCA Civ 1075 at [91]-[92] per Parker LJ. The apparent coalescence of constructive trust and proprietary estoppel in this context is not, however, universally accepted: see L.Fox, "Trusts of the Family Home: The Impact of *Oxley v Hiscock*" (2005) 56 NILQ 83 at pp.99-102. Lord Walker has recently back tracked on his earlier views, expressed in *Yaxley*, that the common intention constructive trust and estoppel are undergoing a process of assimilation: *Stack v Dowden* [2007] UKHL 17 at [37].
[34] *Oxley*, n34 above, at [66] per Chadwick LJ. Earlier cases had suggested that post-acquisition events were relevant because they served simply to demonstrate what shares must have been intended by the parties at the outset, but they did not themselves create or determine the entitlement: see *Midland Bank v Cooke* [1995] 4 All ER 562 at 574 per Waite LJ; *Stokes v Anderson* [1991] 1 FLR 391 at 400 per Nourse LJ.
[35] *ibid.* at [69] per Chadwick LJ. See also *Grant v Edwards* [1986] Ch 638 at 657-658 per Browne-Wilkinson VC; *Drake v Whipp* [1996] 1 FLR 826 at 831 per Gibson LJ; *Cox v Jones* [2004] EWHC

It follows that the claimant's beneficial entitlement will depend, in part at least, on facts occurring after the date on which the common intention was formed and detrimentally relied upon. It is, however, the date on which the common intention was detrimentally relied upon that the automatic vesting approach fixes the claimant's beneficial interest.[36]

We find, therefore, that in many cases facts which determine the availability or extent of the claimant's beneficial entitlement under a constructive trust can occur at a date later than its apparent date of birth. In these instances at least, logic suggests that the constructive trust must exist only from the date at which the factors determining the existence or extent of the beneficial interest crystallise; namely, at the date of court hearing. Any equitable proprietary interest "existing" from the time the claimant's cause of action accrued must be recognised as created retrospectively, notwithstanding increasingly creative judicial attempts to avoid this conclusion.[37]

We also find problems where the constructive trust is contingent on the exercise of a power of election by the claimant. Thus, where the claimant seeks a constructive trust pursuant to the successful tracing of an asset into a substitute, situations arise in which the original asset remains identifiable in the hands of a third party, who took with notice, while the substitute is identifiable in the hands of the defendant. The claimant must therefore elect against whom he wishes to proceed. He cannot simultaneously own both the original asset and the substitute.[38] Prior to the election, the claimant

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1486, [2004] 2 FLR 1010; *Hurst v Supperstone* [2005] EWHC 1309; *Dowden*, n.33 above, at [61]-[63] per Baroness Hale.

[36] In *Oxley* Chadwick LJ did not discuss the impact of his conclusions on the nature of the constructive trust, but recognised at [70] that "the courts have not found it easy to reconcile [the approach] with a traditional property-based approach." Elsewhere, it has been noted that an estoppel-based approach, involving the imposition of a constructive trust with retrospective effect, "is unlikely to find favour with English courts whose approach is to regard rights of property as fixed and ascertainable in advance and immutable": D. Hayton, *Commentary & Cases on the Law of Trusts and Equitable Remedies* (11th edn, 2001), p.352.

[37] E.g. the characterisation of the constructive trust in this context as being "of an ambulatory nature": *Dowden*, n33 above, at [138] per Lord Neuberger (referring to suggestions made by Lord Hoffmann during argument).

[38] P.B.H. Birks, "Mixing and Tracing" (1992) 45 CLP 69 at pp.89-98, developing more fully the views expressed in *An Introduction to the Law of Restitution* (1989), pp.91-93, 393-394. Smith suggests simultaneous ownership is possible: *The Law of Tracing* (1997), pp.380-383. But see the compelling criticism of this view by C. Rotherham, *Proprietary Remedies in Context* (2002), pp.95-96.

cannot therefore have a full equitable interest in the substitute asset. How, then, can a constructive trust "arise" prior to the date of election? The same question can be asked of cases where property passes pursuant to a voidable contract. Failure to rescind precludes a constructive trust claim, and the consequent equitable proprietary relief,[39] on the ground that despite the impediment affecting the transfer the transferor nonetheless intended full legal and beneficial ownership to pass.[40] The constructive trust cannot therefore "arise" at the time of the transfer[41] because its existence is contingent on the subsequent avoidance by the transferee. The transferee is only "potentially a constructive trustee".[42] If the equitable interest that arises pursuant to rescission is to have effect from the time of the initial transfer, this must be recognised as being retrospective.[43]

(c) Gross Artifice

Elsewhere, we find that explanations demanded by the automatic vesting approach, while logical, do not appear to reflect the reality. For example, where the defendant acquires a benefit from a third party in breach of fiduciary obligation, the principal may elect to adopt or reject the fiduciary's purchase.[44] This appears inconsistent with the idea of a beneficial interest vesting automatically in the claimant upon the defendant's receipt because the claimant's interest is contingent upon a positive election. We are, however, told by the authorities that, upon the defendant's acquisition, the claimant immediately acquires a full equitable interest. Where the election is positive the claimant simply takes that which, in equity, is already his; where the election is negative that act simply involves the making of a gift of the

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[39] *Twinsectra v Yardley* [1999] Lloyd's Rep Bank 438 at 461 per Potter LJ; *Halifax Building Society v Thomas* [1996] Ch 219 at 226 per Gibson LJ; *El Ajou v Dollar Land Holdings* [1993] 3 All ER 717 at 734 per Millet J; *Lonrho v Fayed (No 2)* [1992] 1 WLR 1 at 11-12 per Millett J.

[40] *Collings v Lee* [2001] 2 All ER 332 at 337 per Nourse LJ; *Halley v Law Society* [2003] EWCA Civ 97 at [53] per Carnwath LJ.

[41] As claimed in *Latec Investments v Hotel Terrigal Pty Ltd* (1965) 113 CLR 265 at 290-291 per Menzies J (in the event of successful rescission "the conveyee holds, and has always held, as trustee"); *Stump v Gaby* (1852) 2 De G M & G 623. See also M. Cope, *Constructive Trusts* (1992), pp.278-280.

[42] *Estates Realities v Wignall* [1992] 2 NZLR 615 at 632 (Tipping J).

[43] See *Lonrho v Fayed (No 2)*, n39 above, at 12. There, Millett J noted that it may well be "the beneficial interest in the property will be *treated* as having remained vested in him throughout" (emphasis added).

[44] *Dean v MacDowell* (1878) LR 8 Ch D 345 at 351 per James LJ. As a leading text puts the matter, in such cases the constructive trust is "a sword for the beneficiaries which may be sheathed if desired": J. Mowbray *et al.*, *Lewin on Trusts* (17th edn, 2000), p.447.

beneficial interest to the defaulting fiduciary.[45] This is surely a perversion of words, if not intellectually dishonest. The "gift" is really nothing of the sort; it is merely a condonation of a breach of fiduciary duty.

(d) Restricting the Availability of Relief in Specie

The automatic vesting approach may also impact negatively on the general availability of specific relief. An important feature of the constructive trust is that it allows the claimant to take the very property that is the subject matter of the dispute. He is not left with an equivalent monetary substitute. Another important feature is that the constructive trust confers priority over the defendant's creditors and later equitable interests. The result of this is that, on occasion, the courts may refuse to extend specific relief by way of constructive trust to encompass the case at hand, where third parties are absent, for fear of binding a court hearing a future case, where third party interests are present.[46] The problem arises because the constructive trust is assumed to create equitable property rights which arise necessarily at the time of the facts that fulfil the necessary conditions for its existence. Third parties claiming through the defendant are therefore bound of necessity whenever the relevant triggering facts are established. Consequently, the availability of specific relief outside the insolvency context may be limited, despite reasons other than priority for its award,[47] for fear of forcing future courts to recognise the existence of inappropriate rights. While the problem could be avoided if the courts were prepared to take a more discretionary approach to the constructive trust, retaining the power to deny its availability where it would create an injustice, this would be inconsistent with the orthodox rejection of discretionary constructive trusts in English law.[48] We thus find a lacuna in equity's remedial armoury.

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[45] For particularly strong reliance on this theory, see *Cook v Evatt (No 2)* [1991] 1 NZLR 676 at 696-697. The theory also appears in *Cook v Deeks* [1916] 1 AC 554 at 564, where the Privy Council established that the self-interested directors had no power to condone their breach and "make a present to themselves" of company property.

[46] See e.g. G. Klippert, *Unjust Enrichment* (1983), p.196 (priority advantage conferred by the constructive trust means that it cannot be made broadly available for fear of the incidental creation of unwarranted priorities).

[47] See Chapter 4, Section VI.

[48] See also the criticisms of the "limited flexibility" and "monolithic" remedial approaches below, Section III.2.

3. Why Has the Automatic Vesting Approach Persisted?

The automatic vesting conceptualisation has been rarely questioned in English law and, despite recent challenges,[49] continues to represent the orthodoxy in the United States. Given the logical and practical deficiencies of this conceptualisation its persistence appears puzzling. Three reasons might explain its longevity.

(a) Obscuring the Judicial Variation of Property Rights

One explanation for the persistence of the automatic vesting approach is its use in obscuring departures from classical liberal understandings of property. The proposition that the judiciary has no power to engage in the non-consensual redistribution of property rights permeates much of English law.[50] However, some constructive trusts are incompatible with this orthodoxy. For example, the constructive trust of the bribe in *Attorney General for Hong Kong v Reid*[51] was redistributive: it did not arise as a result of the consent of the parties and it did not function to protect a pre-existing property right of the claimant. However, rather than acknowledge this the Privy Council reasoned that the constructive trust arose automatically upon receipt of the bribe, prior to the involvement of the court, by virtue of the maxim "equity considers as done that which ought to be done". The court did no more than simply recognise the claimant's pre-existing right. It thereby formally maintained the appearance that orthodox notions of property were not being violated while creating in fact a property right in the claimant *de novo*.[52] The automatic vesting conceptualisation thus suppresses a reality that is subversive to the basic commitments of English law. Its function, as Rotherham points out, is "not so much practical as ideological".[53] It is, therefore, no coincidence to find movement away from the automatic vesting conceptualisation in those jurisdictions which have

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[49] See below, Sections III.5-III.6
[50] Rotherham, n38 above, pp.34-40
[51] [1994] 1 All ER 1.
[52] C. Rotherham, "Proprietary Relief for Enrichment by Wrongs: Some Realism About Property Talk" (1996) 19 UNSWLJ 378 at pp.396-397. See also *Cook v Deeks*, n45 above (opportunity acquired by directors from a third party in breach of fiduciary duty characterised as usurpation of the company's property).
[53] Rotherham, n38 above, p.29.

developed more instrumentalist understandings of property. In Canada, for example, it is now accepted that the courts can both recognise and create property rights by the imposition of a constructive trust. [54]

(b) The Ideal of Pre-Legal Rights

The portrayal of the constructive trust as an automatically vesting entitlement also maintains congruence with the classical idea of pre-legal rights that derive from some privileged source of legitimacy. These ideals underpin the work of Professor Birks: the role of the judge is to find and apply the law, changing nothing except that which comes from a better understanding of what is there already.[55] With such broader methodological commitments the automatic vesting conceptualisation of the constructive trust is perhaps inevitable. A constructive trust that arises automatically, prior to any judicial involvement, and which merely recognises the claimant's pre-existing entitlement, maintains congruence with the idea that the result follows from the application of a body of impartial universal principles established since time immemorial. It thus creates the impression that the court undertakes a passive declaratory role rather than an active and creative one.[56]

(c) The Distorting Influence of Scott and the Restatement

It would, however, appear that these reasons do not explain adequately the longevity of the automatic vesting approach in the United States. There, the realist onslaught of the late nineteenth and early twentieth centuries led to the emergence of an instrumental concept of law and property which make the persistence of the automatic vesting conceptualisation superficially puzzling.[57] But such persistence does not defy

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[54] See *Lac Minerals v International Corona Resources Ltd* (1989) 61 DLR (4th) 14 at 50-51 per La Forest J; *Semiahmoo Indian Band v Canada* (1997) 148 DLR (4th) 523 at 559-560 per Isaac CJ.

[55] See Chapter 1, Section IV.3(a). The similarities to the much criticised classical legal thought of the late nineteenth century are numerous: see T.C. Grey, "Langdell's Orthodoxy" (1983) 45 U Pitt L Rev 1.

[56] The declaratory theory of law has, however, been killed off judicially: *Kleinwort Benson v Lincoln City Council* [1999] 2 AC 349.

[57] On the emergence of an instrumental concept of law and its stimuli, see generally M.J. Horwitz, *The Transformation of American Law 1870-1960: The Crisis of Legal Orthodoxy* (1992). In outline, the instrumentalist approach involved: (i) a rejection of the belief that cases could be decided without controversy by reference to abstract legal principles and concepts; (ii) the recognition that judges made rather than discovered law; and (iii) the recognition that judge-made law was an instrument of social

all explanation. While classical visions of property and the role of the judiciary were historical stimuli for the conceptualisation, its persistence has for some time owed more to the powerful stabilising effect of the *Restatement of Restitution* and Scott's *Law of Trusts*, both of which have played a pivotal role in American understandings of the constructive trust.[58]

Scott was a joint reporter of the *Restatement*, published in 1937, and sole author of the first edition of his influential treatise.[59] Both works conceptualise the constructive trust as an automatically vesting entitlement, arising prior to the involvement of the court. This is partially explicable by Scott's classical orthodox background. Scott wrote towards the end of an era characterised by a firm belief in the inviolability of property, universal principles of common law and the felt need to reveal the law's hidden structure through conceptual ordering.[60] Moreover, the formative years of his legal education were spent at Harvard, the heartland of Langdellian casebook method which taught that the law could be discovered scientifically and arranged schematically as a set of logical propositions.[61] Equally, the early Restatements represented an instinctive reaction by the legal establishment to the realist movement and its criticism of Langdellian legal science. They attempted to refute claims about the legislative role of the judge while simultaneously reasserting the idea of impartial, self-executing laws.[62] A conceptualisation that bolstered these ideals was therefore understandable. The problem is that Scott's treatise and the *Restatement* have been perceived as authorities of timeless value, crystallising the cases into properly derived rules that are simply there to be applied. Thus, it has been noted that restatements of law were often treated in a similar way to legislative codes. So long as authority did

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policy, to be made and applied purposively in accordance with such policies. It was equally accepted that property rights were necessarily shaped and limited by judges balancing competing policies and interests, with each stick in the owner's bundle of rights necessarily imposing burdens on non-owners: see J. Singer, "Legal Realism Now" (1988) 76 Calif L Rev 467; M.J. Horwitz, *et al.*, *American Legal Realism* (1993); M. Cohen, "Property and Sovereignty" (1927) 13 Cornell LQ 8; W.N. Hohfeld, "Some Fundamental Legal Conceptions as Applied in Judicial Reasoning" (1913) 23 Yale LJ 16; W.N. Hohfeld, "Fundamental Legal Conceptions as Applied in Judicial Reasoning" (1917) 26 Yale LJ 710.

[58] Both have been cited heavily for the automatic vesting approach: see the cases cited in Scott & Fratcher, n8 above, §462.4. Scott in particular is often cited as authority where the effect of timing is to confer priority over the defendant's creditors or intervening lien holders: see e.g., *In re General Coffee Corp* 828 F 2d 699 (11th Cir. 1987) (bankruptcy); *United States v Fontana*, n10 above (federal tax lien).

[59] A.W. Scott, *The Law of Trusts* (1st edn., 1939).

[60] Rotherham, n38 above, pp.49-51, 57-59. See also Grey, n56 above.

[61] D.W.M. Waters, "The Role of the Trust Treatise in the 1990s" (1994) 59 Mo L Rev 121 at p.124.

[62] G. Gilmore, *The Death of Contract* (1974), pp.58-59.

not lie squarely against the rules they promulgated, they could be followed by judges "exactly as they would follow a statute".[63] Much the same might be said of Scott's treatise: it became almost too authoritative to challenge. Consequently, both authorities continued to exert an influence that retarded change in light of new understandings about the nature of property, the judicial function, and the efficacy and fairness of equitable property rights on insolvency.[64] In the United States, the persistence of the automatic vesting conceptualisation is therefore illustrative of a broader problem created by the treatise tradition and restatements of law.

4. The Constructive Trust as Automatically Retrospective in Effect

While rejecting the notion of the remedial constructive trust Anthony Oakley, author of the leading English text on the subject, has formulated an alternative conceptualisation that differs from the orthodoxy in at least one fundamental respect: a court order is necessary for the constructive trust to take effect.[65] He thus talks of the "imposition" rather than "recognition" of a constructive trust. This conceptualisation sits a little uneasily with the idea of institutional trusts. However, Oakley openly rejects discretionary remedial approaches[66] and views the consequences of the constructive trust as monolithic.[67] Moreover, he characterises the interest of a potential constructive trust claimant who has yet to secure a declaration of his interest as "a full equitable interest".[68] While consistent with the case law, this appears to be a restatement of the automatic vesting approach and inconsistent with the requirement of a court order before the constructive trust can take effect: a constructive trust that is judicially imposed surely cannot exist prior to its imposition.

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[63] G. Gilmore, "Legal Realism: Its Cause and Cure" (1961) 70 Yale LJ 1037 at p.1044.
[64] Although the American courts now increasingly view the constructive trust as a priority creating mechanism: see below, Section III.5.
[65] A.J. Oakley, *Constructive Trusts* (3rd edn, 1997), pp.5-6.
[66] Oakley also appears on occasion to suggest that the equitable interest arises automatically and a court order is simply a formality: see n68 below.
[67] Although this may be subject to limited exceptions: see n72 below.
[68] A.J. Oakley, "Proprietary Claims and Their Priority on Insolvency" [1995] CLJ 377 at p.424; A.J. Oakley, *Parker & Mellows: The Modern Law of Trusts* (8th edn, 2003), p.833.

The view that Oakley purports to adopt derives from Bogert's treatise on American trust law.[69] However, in this work Bogert flatly denies that the claimant holds the beneficial interest from the outset. He suggests that when constructive trust claimants seek the imposition of a constructive trust, "they may be treated as if they had been from the beginning the owners of such estate or interest."[70] Thus, the constructive trust is fully retrospective; for all practical purposes it is *deemed* to have arisen at the time of the facts giving rise to its imposition.[71] It follows that, while a court order is necessary for a constructive trust to take effect, this in no way affects the priorities between the constructive trust claimant and third parties.

5. The Utility of Automatic Retrospectivity in English Law

While the requirement of curial declaration for a constructive trust to operate avoids reifying the constructive trust in the sense of treating it as something that exists independently of the decision to impose it, the approach continues to treat the claimant's priority over general creditors as an inevitable incident of a constructive trust claim. Once the requisite operative facts are established the requirement of a court order is nothing more than a formality.[72] Oakley thus states that it is *because* the constructive trust takes effect at the moment of the conduct giving rise to its imposition, and hence creates an equitable proprietary interest at this time, that it is

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[69] G. Bogert & G.T. Bogert, *The Law of Trusts and Trustees* (2nd edn, 1978), §472.

[70] *ibid.* In the same section Bogert asserts that the court order decreeing the constructive trust establishes the defendant as constructive trustee "as of the date of his wrongful acquisition".

[71] This conceptualisation has received some judicial support in the United States: *Bly v Gensmer* 386 NW 2d 767 at 769 (Minn. App. 1986); *Healy v CIR* 345 US 273 at 282-283 (1952); *International Refugee Organization v Maryland Dry Dock Co* 179 F 2d 284 at 287 (4th Cir. 1950); *Stoehr v Miller* 296 F 414 at 426-427 (2nd Cir. 1924).

[72] Oakley does allude to the fact that the court has power to vary the general rule with respect to timing: A.J. Oakley, "The Precise Effects of the Imposition of a Constructive Trust" in *Equity and Contemporary Legal Developments* (1992, ed. S. Goldstein), p.427 at 437-438. This is difficult to reconcile with Oakley's rejection of the remedial constructive trust and his support for the institutional approach. However, Oakley views this power as of limited scope. For example, it is not deemed appropriate in the context of constructive trusts imposed on profiting fiduciaries. Indeed, it appears that Oakley envisages the power to be limited to family property disputes and novel cases. He thus appears to view it as consistent with institutional theory because the limited exceptions "merely re-emphasise the universality of the general rule": n65 above, p.6.

binding on the trustee in bankruptcy.[73] Priority over creditors is thus portrayed as natural, inevitable and apparently uncontroversial. That the constructive trust takes effect at the time of the conduct giving rise to its existence is, however, a conclusion, not a justification. Rather than enter into discussion of the merits of priority, Oakley thus adopts circuitous reasoning to explain away the impact of the constructive trust on the defendant's insolvency.

The dominant motive behind the conceptualisation appears to be a concern over taxation: if a constructive trust exists irrespective of whether the beneficiary ever seeks a court order to compel the defendant to convey the property, the claimant may be subject to tax liability for property which he has never claimed and never enjoyed.[74]However, to this extent the emphasis on timing of creation appears an unnecessary complexity and only partially successful. While the approach may prevent the liability to tax of an unsuspecting claimant who has not sought to enforce a potential constructive trust claim, it appears that the constructive beneficiary who does enforce will become liable to tax for the period in which he has not enjoyed the property: once enforced the constructive trust is effective from the date of the relevant conduct. The claimant is therefore deemed to have owned the property in the interim and, as the beneficial owner, is liable to tax. The only way around this would be to make a sensible policy decision not to tax the claimant for such a period. This does not depend on the precise conceptualisation adopted.[75] In the United States, for example, the identification of money as taxable income has been held to turn on whether the recipient has "such control over it that, as a practical matter, he derives readily realizable economic value from it".[76] The constructive trust theory adopted by the court therefore "in no way determines the allowability of the claim".[77] A similar approach was adopted in Canada at a time when the automatic vesting approach

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[73] Oakley, n65 above, p.5. Presumably, for this reason, a constructive beneficiary who seeks to enforce his claim to the property will also become liable to tax as of that date, even though he has not enjoyed the benefit of the property in the interim.

[74] See Oakley, n72 above, p.437; Oakley, n65 above, p.6.

[75] See, e.g., J. Glover, "Taxing the Constructive Trustee: Should a Revenue Statute Address Itself to Fictions?" in *Trends in Contemporary Trust Law* (1997, ed. A.J. Oakley), p.315.

[76] *James v US* 81 S Ct 1052 at 1055 (1960); *Rutkin v US* 343 US 130 at 137 (1952).

[77] *In the Matter of Diversified Brokers* 355 F Supp 79 at 89 (ED, Miss. 1973). See also *Wood v US* 863 F 2d 417 at 419 (5th Cir. 1989). Constructive trustees have therefore been liable to tax for the period in which they had dominion and control over the property, regardless of the constructive trust theory adopted: see *Healy v CIR* 345 US 278 at 282-283 (1952) (automatic retrospectivity); *First National Bank of Miami v US* 235 F Sup 331 (SD. Fla. 1964) (automatic vesting theory).

dominated.[78] More recently, it was established that where the developing remedial constructive trust would frustrate statutory provisions or create practical problems it would be treated as not within the legislative intent of the relevant taxation provision.[79]

Oakley's willingness to adapt the constructive trust in light of the apparent injustices that would otherwise be created in the context of taxation is telling. The most pressing, important and directly relevant concern for the constructive trust is not taxation but the extent to which its imposition justifiably affects innocent third parties. However, it is this very issue that Oakley strains to avoid, reflecting the traditional reluctance of English law to engage openly in this question.[80]

III. Conceptions of the Constructive Trust as a "Remedy"

1. Judicial Conceptions of the Constructive Trust as a Remedy in Canada

Consideration of the remedial constructive trust in Canada takes place in the context of two general developments. First, the courts have increasingly recognised that the constructive trust is "both blunt and powerful with the result that important third party interests can be too easily compromised".[81] In particular, there has arisen considerable disquiet over the impact of the constructive trust on creditors[82] and purchasers of the disputed property or an interest therein.[83] Second, following the development of a general cause action in unjust enrichment, the courts have separated the consideration

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[78] *R v Poynton* (1972) DTC 6329.
[79] *Karavos v Canada* (1995) 57 ACWS (3d) 876; *Nelson v NMR* (1991) DTC 37 at 43.
[80] See e.g. Sir Peter Millett, "Remedies: The Error in *Lister & Co v Stubbs*" in *Frontiers of Liability* (1994, ed. Birks), Vol. 1, p.51 at 52 ("Either the plaintiff is entitled to a proprietary remedy or he is not. If he is then the insolvency of the defendant is not a sufficient reason for withholding it from him.")
[81] *Re 512760 Ontario Inc* (1992) 91 DLR (4th) 719 at 731 (Adams J). See also *LeClair v LeClair* (1998) 159 DLR (4th) 638 at 651 per Ryan JA.
[82] See, e.g., *Soulos v Korkontzilas* (1997) 146 DLR (4th) 214 at 227, 230 per McLachlin J; *Bedard v Schell* (1987) Sask R 71 at 74-75 (Gerein J); *CDIC v Principal Savings & Trust Co* (1998) 224 AR 331 at 337-341 (Belzil J).
[83] See, e.g. *Rawluk v Rawluk* (1990) 65 DLR (4th) 161 at 188, 191 per McLachlin J, exhibiting particular concern over the creation of invisible and unregistered or unregistrable interests in land.

of liability from that of remedy.[84] Once liability is established, the court is required to make a context specific evaluation of the most appropriate response to the unjust enrichment in question, taking into account the precise facts of the case as they present themselves at the date of the court hearing.[85] Following these developments there has been a lack of unanimity about the most appropriate way to conceptualise the constructive trust.

In *Rawluk v Rawluk* Cory J, speaking for the majority of the Supreme Court of Canada, expressed complete agreement with Scott's automatic vesting approach and opined that "a property interest arising under a constructive trust can be recognised as having come into existence not when the trust is judicially declared but from the time when the unjust enrichment first arose". [86] However, as we will see, Cory J appears to contradict this statement later in his judgment. Moreover, a continuing commitment to the automatic vesting approach is difficult to reconcile with the increased concern for subsequent third party interests. This concern appears to require a power to deny a constructive trust where, all other things being equal except the appearance of third party interests, a constructive trust would have been awarded.[87] According to the automatic vesting approach, however, the subsequent appearance of third party interests is an irrelevant consideration; third parties are bound necessarily by the earlier equitable interest created by the constructive trust.[88] The approach is also difficult to reconcile with the separation of liability and remedy: how can the constructive trust arise concurrently with liability if factors that determine its appropriateness, including those arising in the interim, are the subject of discretionary consideration as at the date of trial?

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[84] *Sorochan v Sorochan* (1986) 29 DLR (4th) 1 at 7 per Dickson CJ. See D.W.M. Waters, "Liability and Remedy: An Adjustable Relationship" (2001) 64 Sask L Rev 429.

[85] A similar remedial approach is adopted for wrongs: see *Cadbury Schweppes v FBI Foods* [1999] SCR 142; *Lac Minerals*, n54 above, at 50-52 per La Forest J.

[86] n83 above, at 176, citing Oosterhoff & Gillese, *Text, Commentary and Cases on Trusts* (3rd edn, 1987), p.579 and Scott & Fratcher, n8 above, §462.4. This conceptualisation does not appear to have been entirely ruled out in later cases: see *Ellingsen v Hallmark Ford Sales Ltd* (2000) 190 DLR (4th) 47 at 70 per Lambert JA.

[87] See e.g. *Peter v Beblow* (1993) 101 DLR (4th) 621 at 640, where Cory J noted that where the constructive trust would unfairly affect *bona fide* third party interests it would not be awarded.

[88] It might be argued that the constructive trust can vest automatically but the court may not enforce the trust if to do so would create an inequitable result, such as the creation of unwarranted priorities: *Shearer v Barnes* 118 Minn 179 at 188 (1912). For criticism of such an approach, see the discussion of the merits of *Muschinski v Dodds* (1985) 160 CLR 583, below, Section IV.

Further interpretations of *Rawluk*, consistent with remedial thinking, are possible.[89] Following his apparent agreement with Scott, Cory J quoted with approval the dictum of Lord Denning MR that a constructive trust "may arise at the outset, when the property is acquired, or later on, as the circumstances may require".[90] In light of this, he suggested that "even if it is declared by a court after the parties have already separated, a constructive trust can be *deemed* to have arisen when the duty to make restitution arose".[91] This appears to suggest that the constructive trust arises only when declared but the date from which it operates is a different matter. Two possible alternatives have emerged.

(a) Limited Flexibility: Prospective or Retrospective Operation

We might interpret the words of Cory J in *Rawluk* as indicating that, once a constructive trust is identified as the most appropriate remedy, it may be given either retrospective or prospective effect.[92] Where a constructive trust is declared to operate retrospectively it will take effect from the moment that the claimant's cause of action accrued, and the consequences that follow from the creation of an equitable proprietary interest will run from this time. Where the constructive trust is declared to operate prospectively the claimant's equitable proprietary interest will take effect only from the date of judgment. This interpretation appears consistent with the influential dissent in *Rawluk* by McLachlin J, who commented:

> "When the court declares a constructive trust, at that point the beneficiary obtains an interest in the property subject to the trust. That property interest, it appears, may be taken as extending back to the date when the trust was 'earned' or perfected. In *Hussey v Palmer*....Lord Denning postulated that the interest

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[89] For a further inconsistent interpretation, see *Stirling v Buck* (1993) ACWS 1293, where Murphy J interpreted Cory J's comments as meaning that the constructive trust "arises at the time the unjust enrichment arises but the court, in declaring such a trust, can declare it effective either from the date it arose or from the date of the court order". This continues to vest the constructive trust with institutional characteristics and is similar to the approach in *Muschinski v Dodds*, below, Section IV.

[90] *Hussey v Palmer* [1972] 3 All ER 744 at 747. On the mistaken interpretation of this *dicta*, see below, Section III.1(a).

[91] n83 above, at 176 (emphasis added).

[92] The words of Cory J were that the constructive trust "*can* be deemed to have arisen when the duty to make restitution arose". They were not that it *will* be deemed to have arisen when that duty arose.

> may arise at the time of declaration or from the outset, as the case may require."[93]

In fact, all that Lord Denning postulated in *Hussey*[94] was that the relevant conduct which makes it unconscionable for a defendant to retain property may occur post-acquisition as well as pre-acquisition.[95] He made no suggestion that the Court could vary the time at which the interest arises. However, for present purposes the correct interpretation of *Hussey* is not as important as the meaning to which McLachlin J attributed it. She was clearly of the opinion that *Hussey* supported the inference that an unjust enrichment constructive trust[96] would arise only if and when declared, and then operate either retrospectively or prospectively.

(b) Monolithic Operation: Deemed Existence From Time of Unjust Enrichment

Some courts view *Rawluk* as establishing the narrower proposition that, while the court must first determine whether the imposition of a constructive trust is appropriate, once imposed it operates *as if* it had arisen at the time the claimant's cause of action arose.[97] Thus, in *Rawluk* Cory J said:

> "If the court is asked to grant such a remedy and determines that a declaration of constructive trust is warranted, then the proprietary interest awarded pursuant to that remedy will be deemed to have arisen at the time when the unjust enrichment first occurs."[98]

This conceptualisation was adopted by Ryan JA in *LeClair v LeClair*.[99] By his will J devised his estate equally between his wife, T, and his son, R. An apartment held solely by J but maintained and improved by T comprised 90% of the value of the estate. After J's death T claimed that her financial and non-financial contributions

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[93] n83 above, at 185.
[94] [1972] 3 All ER 744.
[95] A view consistent with the judgment of Lord Diplock in *Gissing v Gissing* [1971] AC 886 at 905-906. Elsewhere, Lord Denning was of the opinion that the constructive trust arose upon the facts that so affected the defendant's conscience that he could not take free of the claimant's rights. See, for example, *Binions v Evans* [1972] Ch 359 at 368.
[96] Her comments were explicitly limited to the constructive trust developed as a response to unjust enrichment: n83 above, at 185.
[97] See e.g. *King v Harris* (1995) NBR (2d) 161; *Barnebe v Touhey* (1994) OR (3d) 370.
[98] n83 above, at 177.
[99] (1998) 159 DLR (4^{th}) 638.

entitled her to an interest in half of the apartment by way of constructive trust and that this share did not therefore form part of J's estate at his death. It was, however, accepted that J would have drawn his will differently had he been aware of T's claim. If, at his death, J was therefore found to have held a half share in the apartment on constructive trust for T, T would have received an unintended windfall to the detriment of the innocent R. Ryan JA held that, while an unjust enrichment claim was established, the apartment was not automatically subject to a constructive trust prior to J's death. The court first had to determine that a constructive trust was appropriate and in this case it was not, both for the reasons stated and because the unjust enrichment had been appropriately remedied by the terms of the will which conferred on T a half share in the estate. Ryan JA stated:

> "Cory J [in *Rawluk*] addressed the question whether, once a court declares a constructive trust, the interest arises at the time of judicial declaration, or as of the time of the unjust enrichment. His answer was that it arises at the time of the unjust enrichment. However, contrary to the appellant's argument in this case, this passage does not negate the need for a court to first determine whether an unjust enrichment occurred and whether the appropriate remedy would be a constructive trust."[100]

The conceptualisation is therefore similar to Bogert's, although the separation of liability and remedy and general judicial awareness of the position of third parties permits greater emphasis on the justice of the outcome.[101] The developing approach in New Zealand is also comparable. There, a finding of unjust enrichment or unconscionability triggers the court's discretionary determination of the most appropriate remedy.[102] A constructive trust resulting from the exercise of this discretion can arise only when declared but will be backdated to the time the cause of action arose, to the detriment of creditors and those with later equitable interests.[103] It will be imposed, therefore, only where such detriment is warranted or such creditors and later interests are absent.[104]

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[100] *ibid.* at 648

[101] See e.g. *LeClair*, n99 above, at 651 and contrast to the treatment of the automatic retrospective approach by Oakley, who continues to view priority as an inevitable incident of the constructive trust.

[102] See *Chodar,* n20 above, at [42]

[103] *Fortex*, n20 above, at 175-177 per Tipping J, 179-180 per Henry J (referring to the creation of a "backdated proprietary interest").

[104] For an illustration of the latter, see *Chodar*, n20 above.

2. The Utility of the Approaches

Both the "limited flexibility" and "monolithic" approaches are clearly of some merit, not least because they create a remedial framework within which specific relief can be granted without necessarily prejudicing third parties. It is recognised that the constructive trust does not simply enforce pre-existing property rights but rather operates to establish priorities between the claimant and other parties.[105] Thus, claimants are conferred priority over the defendant's creditors "by means of (and not by reason of) their having a proprietary interest".[106] Moreover, the approach makes it difficult for a court to ignore other potential injustices created by the operation of the constructive trust because its portrayal as arising only when declared emphasises judicial responsibility for the justice of the outcome. This is more consistent with contemporary judicial attitudes in those Commonwealth jurisdictions which embrace the creative nature of the judicial function.[107] Indeed, without this change in legal culture it is difficult to see how the constructive trust could develop along these lines.

One might, however, question the extent to which either approach would effectively safeguard third party interests. The monolithic approach recognises that in some instances specific relief conferring general priority is warranted while in others it is warranted only to the extent third parties are not affected. In the former class of case the imposition of a constructive trust, with its retrospective effect, naturally achieves the required result. In the latter class of case the court must ensure that no third party interests are present before the constructive trust is imposed. At this point difficulties emerge because subsequent interests in or over the disputed property may not always be apparent and the solvency of the defendant may be unknown or difficult to

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[105] See, in particular, *Barnabe v Touhey*, n97 above, at 378-379.

[106] S. Evans, "Property, Proprietary Remedies and Insolvency: Conceptualism or Candour?" (2000) 5 Deakin L Rev 31 at p.44.

[107] See, e.g. the extra-judicial writings of M. Kirby, *Judicial Activism* (2004); A. Mason, "Equity's Role in the Twentieth Century" (1997-8) 8 KCLJ 1; B. McLachlin, "The Role of Judges in Modern Commonwealth Society" (1994) 110 LQR 260; M.H. McHugh, "The Law-Making Function of the Judicial Process" (1988) 62 ALJ 16; G. La Forest, "Some Impressions on Judging" (1986) 35 U of New Brunswick LJ 145. Justices La Forest and McLachlin in particular have been influential in the development of the constructive trust in Canada, as has Mason J in Australia: see *Lac Minerals*, n54 above, at 44-52; *Rawluk*, n93 above and accompanying text; *Soulos*, n82 above, at 221-232; *Hospital Products v USSC* (1984-5) 156 CLR 41 at 110-115.

ascertain. The defendant is the person most likely to hold the relevant information about the state of his solvency, yet least likely to make it available to the court: [108] it is irrelevant to his liability and there may be legitimate business reasons for his not wanting to disclose such information publicly. To avoid unintended priorities it might be suggested that it will be inappropriate to award a constructive trust without "complete information".[109] However, this requirement may do no more than simply provide further incentive to the defendant to withhold relevant information in order to avoid being called upon to account for his gain *in specie*.

A prospectively ordered constructive trust which takes effect from the date of judgment would not confer priority over earlier equitable proprietary interests, including those created in the interim between the time at which the claimant's cause of action accrued and the date of judgment. However, prospective effect would not necessarily prevent the creation of unintended priorities over unsecured creditors. This may occur because a prospective constructive trust would confer priority over general creditors in those presumably not uncommon situations in which the defendant is made insolvent by the court finding against him.

One might also question the appropriateness of forcing into the constructive trust mould specific relief that does not bind third parties. By interposing discretion between the facts creating liability and the decision to impose the constructive trust the constructive trust appears a unitary concept: certain facts create a discretionary determination of its availability and, once available, it confers on the claimant a property right. However, in those situations in which relief will be awarded only to the extent third parties are not affected, the imposition of a constructive trust appears nothing more than a misleading label to denote what is akin to a personal order to transfer property. This appears distinct from the idea of the constructive trust – a "proprietary concept" by which the claimant "is found to have an interest in

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[108] See, in particular, *Chodar*, n20 above, where the defendant refused to submit information regarding his solvency. Glazebrook J imposed a remedial constructive trust - something she would not have done had the defendant been insolvent - having considered evidence on the matter that was "vague and unparticularised".

[109] *CDIC v Principal Savings & Trust Co* (1998) 224 AR 331 at 341.

property".[110] Were the personal nature of the obligation created by the order openly recognised, there would be no risk of the creation of unintended priorities. Being a personal obligation, the claimant would be left to enforce judgment in the same way as other creditors with personal claims against the bankrupt. The constructive trust, as a proprietary concept, could then be left intact to refer only to those situations where it is appropriate for the claimant to take the advantages which follow from the recognition or creation of an equitable proprietary interest.

Acknowledging this may bring with it a number of benefits. First, it may contribute to the rational development of the law because it assists the schematic or taxonomic presentation of the subject, whether that taxonomy is a taxonomy of rights[111] or a taxonomy or remedies.[112] Second, we avoid the confusion that follows from the use of one term to refer to two distinct remedies with different intended consequences. Third, it enables us to remove confusing trust nomenclature in those instances where a defining element of a trust - enforcement of interest against third parties - is absent. Fourth, the recognition that one species of "constructive trust" does not affect third parties resolves the difficulties created by the need to inquire into the state of the defendant's solvency before awarding relief.

3. The Constructive Trust of Tomorrow: The Pure Remedial Approach.

Some go further than the Canadian courts and suggest that greater flexibility is required to achieve justice. Most notably Professor Waters champions a "pure remedial constructive trust",[113] the court retaining maximal flexibility as to its operation and content. Its precise effects will thus vary with the circumstances of each

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[110] These being the characteristics of the constructive trust in Canada, as stated in *Peter v Beblow*, n87 above, at 649 per McLachlin J

[111] As propounded by e.g. P.B.H. Birks, "Rights, Wrongs, and Remedies" (2000) 20 OJLS 1, in which case the constructive trust and the personal order would reflect two different responses in the second measure of restitution.

[112] As propounded by e.g. D.M. Wright, "Wrong and Remedy: A Sticky Relationship" [2001] SJLS 300, in which case the personal order would represent a new remedy and take its place alongside the constructive trust and other potentially available remedies, to be selected according to criteria of appropriateness once liability is established. See also V. Waye & D.M. Wright "Trial Strategy When Selecting a Remedy From the Remedial Smorgasbord" (1998) 17 Australian Bar Rev 263.

[113] D.W.M. Waters, "The Constructive Trust in Evolution: Substantive and Remedial" in *Equity and Contemporary Legal Developments* (1992, ed. S. Goldstein), p.457 at 499.

case and the conduct of each creditor:[114] the order may give effect to a constructive trust from the time of the unjust enrichment, the time of the court order, some interim date, or some future date; and the order may be granted on whatever terms that the court sees fit.[115]

> "[The courts could] ensure that only particular third parties are affected by the *in rem* restitution. A[n] order might be given as against one defendant, but not against another, or it might be given as against both but with the content of the order varied at the discretion of the court to meet the equities of the situation, as far as each defendant is concerned. It would affect third parties not before the court by creating such priorities as the court states in the order….As there is no reason in my opinion why every chargee or lienholder of the assets in dispute who has acquired his charge or lien between enrichment and court order should automatically be relegated to a priority behind the claimant of the assets for unjust enrichment, so in my opinion there is no reason why every unsecured creditor of the enriched party should be so relegated."[116]

The merits of the claim of each individual potentially affected by the *in rem* relief granted are therefore considered.

4. The Utility of Pure Remedial Theory

The concern for greater individualised justice and fairness to third parties is laudable. In theory, the model permits the award of specific relief on terms that are always fair and just to the defendant, the claimant, and any third parties. The approach is not open to the criticism that it represents an illegitimate erosion of the *parri passu* principle where the defendant is insolvent. This principle does nothing more than affirm that which is self-evident: parties standing in positions of relative equality are to be treated equally.[117] The pure remedial approach simply rests on a more refined analysis of relative equality. It is, however, problematic for other reasons.

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[114] *ibid.* at pp.490, fn77 and 499-505. See also D.W.M. Waters, "Trusts in the Setting of Business, Commerce and Bankruptcy" (1983) 21 Alta L Rev 395 at p.434.
[115] n113 above, at p.502.
[116] Waters, n113 above, at p.503. See also Waters, n16 above, at pp.1216-1217.
[117] G. McCormack, *Proprietary Claims and Insolvency* (1997), p.1; F. Oditah, "Assets and the Treatment of Claims in Insolvency" (1992) 108 LQR 459 at p.463 (noting the principle "explains remarkably little"); R.J. Mokal, "Priority as Pathology: The *Pari Passu* Myth" [2001] C.L.J. 581.

First, it is difficult to imagine circumstances in which such a broad discretion to discriminate between individual creditors is necessary. And even were we to accept in principle that such circumstances might arise, it would be irrational to revise our concepts presently in the hope that they adequately accommodate that which we cannot foresee with any real precision.[118]

Second, legal forms that sit at either end of the finely shaded rules-discretion continuum are less workable in practice than in theory.[119] While a highly individualised approach theoretically optimises the chance of reaching the most appropriate outcome, the reality is somewhat different. Doctrines that seek high degrees of individualised justice increase the risk of arbitrariness and mistake, lack certainty and predictability, and require the inefficient and time-consuming application of background policies.[120]

Certainty, predictability and efficiency are of particular significance in the context of *in rem* relief due to the potential for detriment to third parties. The more uncertain the position of third parties who deal with the disputed property, the greater the transaction costs of property dealings and the more difficult it is for individuals to take *ex ante* measures to protect their interests and rationally determine the risks involved in their dealings. Moreover, it is a primary concern of insolvency law to minimise the cost of determining priorities: the greater those costs the less remains of the already insufficient assets to meet the claims of creditors. Efficiency rather than finely tuned justice between each affected individual therefore assumes greater significance. The pure remedial approach is antithetical to these concerns. An elaborate, time-consuming and finely tuned balancing of the merits of individuals'

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[118] Birks forcefully reminded us of this, warning "against change which outstrips the intellect, and loses touch with the demand for stability and consistency": P.B.H. Birks, "Equity in the Modern Law: An Exercise in Taxonomy" (1996) 26 UWALR 1 at p.4.

[119] See Chapter 2, Section V.

[120] Waters appears to inconsistently suggest that his discretionary model does not lie in tension with these requirements: see Waters, n113 above, at p.504. More recently, he has emphasised the rule-building nature of the discretion and suggested a need for the principled resolution of disputes: D.W.M. Waters, "The Nature of the Remedial Constructive Trust" in *Frontiers of Liability* (Birks ed., 1994), Vol. 2, 165 at pp.184-185.

claims increases the role, and hence costs, of the liquidator or trustee in bankruptcy.[121] Moreover, uncertainty and unpredictability may encourage litigiousness in the desperate creditor: "scarcity begets innovation in the hungry creditor's quest to get a little more than the next fellow".[122] The clearer the stated priorities the less hope there is for the desperate creditor to argue that his case is relevantly different from others in the queue, hence the less incentive to resort to litigation.

5. Challenging the American Orthodoxy: The Sixth Circuit Court of Appeals Approach

(a) Background and Context

The long established orthodoxy in the United States is that a constructive trust vests automatically in the claimant at the time the cause of action arises. That trust interest is then recognised by the court at a later date, the court exercising a purely declaratory function.[123] In recent years however, this position has been increasingly challenged. The context that has provided the impetus for this challenge is bankruptcy.

According to the orthodox approach the extent to which a constructive trust operates to withdraw property from the bankrupt's estate turns on the relationship between Sections 541 and 544 of the Bankruptcy Code.[124] By virtue of Section 541(a)(1) property of the debtor distributable in bankruptcy includes "all legal or equitable interests of the debtor in property at the commencement of the case". Section 541(d) clarifies that this does not include property "in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest". The debtor's estate does however, include any interest in property that the trustee in bankruptcy can recover through use of the Code's "strong arm" powers contained in

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[121] The approach also raises the possibility of conflict between separate court orders in favour of different claimants, each creating conflicting rights against the insolvent and other specified third parties.

[122] *In re Omegas Group Inc* 16 F 3d 1443 at 1445 (6th Cir. 1994). See also *In re Haber Oil Co Inc* 12 F 3d 426 at 431 (5th Cir. 1994).

[123] Above, Section II.1.

[124] For historical background, see J. Davis, "Equitable Liens and Constructive Trusts in Bankruptcy: Judicial Values and the Limits of Bankruptcy Distribution Policy" (1989) 41 Fla L Rev 1 at pp.3-19.

Section 544.[125] Through the exercise of these powers the trustee in bankruptcy can avoid transfers of the debtor's property to the extent that such transfers would be defeated by the claim of a hypothetical lien creditor or a hypothetical *bona fide* purchaser.[126]

Applying the orthodox approach, the constructive trust is an equitable interest in property and therefore does not form part of the debtor's estate at the commencement of the case. Whether a constructive trust claimant is granted priority turns on whether the strong arm provisions in Section 544 take priority over Section 541(d). Some courts have suggested that Section 541(d) prevails; others that Section 541(d) is trumped by the strong arm provisions.[127] The Sixth Circuit Court of Appeals, however, has taken a radically different approach. It has reasoned that to ask which section prevails – Section 541(d) or Section 544 – is to ask the wrong question. The proper and logically prior question is whether or to what extent a constructive trust is an "equitable interest".

(b) The Decision in Re Omegas

In *Re Omegas*[128] the debtor, Omegas, was a "middleman" between Datacomp and IBM. Datacomp sent payments totalling $1.1m to Omegas for IBM computers. At the time that some or all of the payments were made Omegas knew it would be unable to meet the order because of its precarious financial state and because IBM had refused to supply further computers. Datacomp claimed that Omegas' failure to notify it of the impending disaster while continuing to accept payments for obligations it knew it could not meet amounted to fraud and therefore gave rise to a constructive trust of the payments. Consequently Datacomp claimed, the monies were caught by Section

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[125] 11 USC §541(a)(3), §550(a).
[126] 11 USC §544(a).
[127] See R. Keach, "The Continued Unsettled State of Constructive Trusts in Bankruptcy: Of *Butner*, Federal Interests and the Need for Uniformity" (1998) 103 Commercial LJ 411; C.J. Cuevas, "Bankruptcy Code Section 544(a) and Constructive Trusts: The Trustee's Strong Arm Powers Should Prevail" (1991) 21 Seton Hall L Rev 678.
[128] *XL/Datacomp Inc v Wilson (In re Omegas Group Inc)* 16 F 3d 1443 (6th Cir. 1994). See R.F. Suhrheinrich & P. Carrier-Hamilton, "The Sixth Circuit Year in Review – Leading Cases of 1994" (1994) 26 U Mem L Rev 365 at pp.379-383; H. Dagan, "Restitution in Bankruptcy: Why All Involuntary Creditors Should Be Preferred" (2004) 78 Am Bankr LJ 247 at pp.257-261.

541(d), Section 541(d) trumped the strong arm powers, and the monies did not therefore form part of the bankrupt's estate.

Rather than resolve the apparent conflict between Sections 541(d) and 544, however, the court asked whether a constructive trust transformed the claimant into the beneficiary of an equitable interest. It concluded that it did not. The relationship between Sections 541(d) and 544 did not therefore need to be addressed. The court reasoned that the problem with the orthodox approach is that it fails to recognise that "a constructive trust is not really a trust. A constructive trust is a legal fiction, a common-law remedy in equity that may only exist by grace of judicial action."[129] It continued:

> "a claim filed in bankruptcy court asserting rights to certain assets 'held' in 'constructive trust' for the claimant is nothing more than that: a claim. Unless a court has already impressed a constructive trust upon certain assets or a legislature has created a specific statutory right to have particular kinds of funds held as if in trust, the claimant cannot properly represent to the bankruptcy court that he was, at the time of commencement of the case, a beneficiary of a constructive trust [of property] held by the debtor."[130]

The implications of this are clear. As the court noted explicitly later in its judgment:

> "Because a constructive trust, unlike an express trust, is a remedy, it does not exist until a [claimant] obtains a judicial decision finding him to be entitled to a judgment "impressing" defendant's property or assets with a constructive trust. Therefore, a creditor's claim or entitlement to a constructive trust is not an 'equitable interest' in the debtor's estate existing pre-petition, excluded from the estate under §541(d)."[131]

In the absence of a pre-petition judicial order impressing the disputed property with a constructive trust the claimant therefore has no equitable interest. The property forms part of the bankrupt estate and the claimant ranks equally with other unsecured creditors. The constructive trust arises and takes effect from the date of judicial declaration only. Any post-bankruptcy imposition of constructive trust cannot help the

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[129] n128 above, at 1449.
[130] *ibid.*
[131] *ibid.* at 1451.

claimant because it does not retrospectively alter the position at the time bankruptcy commenced.

(c) The Reception of Re Omegas

The decision in *Re Omegas* has been reaffirmed on a number of occasions by the Sixth Circuit.[132] Not surprisingly, these decisions have been followed by courts bound by Sixth Circuit precedent,[133] although sometimes reluctantly and not without criticism.[134] The *Omegas* view of the constructive trust and its role in Bankruptcy has also taken root in the Ninth Circuit.[135] This is also not surprising given the Ninth Circuit's earlier pronouncement that:

> "A constructive trust is not the same kind of interest in property as a joint tenancy or a remainder. It is a remedy, flexibly fashioned in equity to provide relief where a balancing of interests in the context of a particular case seems to call for it…..in the case presented here it is an inchoate remedy; we are not dealing with property that a State court decree has in the past placed under a constructive trust."[136]

Additionally, the *Omegas* approach has been adopted in the bankruptcy divisions of some other States.[137] A similar conceptualisation of the constructive trust has also been adopted outside the bankruptcy context by the DC Circuit. Thus, in *United States v BCCI Holdings (Luxembourg) SA* it was said that a "constructive trust is a remedy that a court devises after litigation. It is, as we have noted, a fictional trust - not a real one."[138] On the application of that theory it was held that the claimant had

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[132] *In re McCafferty* 96 F 3d 192 (6th Cir. 1996); *In re Newpower* 233 F 3d 922 (6th Cir. 2000); *Blachy v Butcher* 221 F 3d 896 (6th Cir. 2000); *In re Morris* 260 F 3d 654 (6th Cir. 2001).

[133] See e.g. *In re Richardson* 216 BR 206 (Bankr. SD. Ohio. 1997).

[134] *In re Dow Corning* 192 BR 428 (Bankr. ED. Mich. 1996)

[135] *In re Advent Management Corp.* 178 BR 480 at 488 (BAP. 9th Cir. 1995), aff'd, 104 F 3d 293 (9th Cir. 1997).

[136] *In re North American Coin & Currency Ltd* 767 F 2d 1573 at 1575 (9th Cir. 1985). A further notable pre-*Omegas* decision is *In re Independent Clearing House Co.* 41 BR 985 at 989 (Bankr. D. Utah, 1984) (constructive trusts "are created by courts of equity and do not come into existence until declared by a court as a means of affording relief").

[137] *In re Paul J Paradise & Associates, Inc* 217 BR 452 at 456 (Bankr. D. Del 1997) aff'd, 249 BR 360 (D. Del. 2000); *In re Nova Tool & Engineering, Inc.* 228 BR 678 (Bankr. ND. Ind. 1998); *In re Foos* 183 BR 149 (Bankr. ND. Ill. 1995); *In re Morken* 182 BR 1007 (Bankr. D. Minn. 1995).

[138] 46 F 3d 1185 at 1190-1191 (D.C. Cir. 1995).

no equitable interest in the disputed property until a court of competent jurisdiction impressed the property with a constructive trust.

The revolt against the orthodoxy has not however, been entirely successful. In other Circuits and State bankruptcy courts the reasoning in *Re Omegas* has been flatly rejected.[139] In rejecting the approach the majority have vigorously defended the orthodox view of the constructive trust and its role in bankruptcy. The orthodox view, they claim, is supported by authority and consistent with legislative intent. The sweeping statements in *Omegas* by contrast, "contradicted a century of bankruptcy law, including Supreme Court authority, legislative history and the standard commentary."[140]

6. An Assessment of the *Omegas* Doctrine

Like other remedial approaches, an enlightening aspect of *Omegas* is that it demonstrates "constructive trust" is not a magic formula for identifying which claims are appropriately accorded priority over the claims of competing creditors. History has, to use Dawson's colourful phrase, "created a monster".[141] That monster needs taming, not least because of its impact in bankruptcy. Conceptualising the constructive trust as existing only "by grace of judicial action"[142] emphasises judicial responsibility for the outcome. Unlike the orthodox approach, the interests of innocent third parties who may be affected by the imposition of a constructive trust are a primary consideration; they are not obscured or marginalised. While the orthodox view suggests that constructive trusts have no impact on the defendant's creditors because the property subject to the constructive trust does not belong beneficially to

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[139] See e.g. *In re Dameron* 206 BR 394 (Bank. ED. Va. 1997), aff'd 155 F 3d 718 (4th Cir. 1998),
[140] A. Kull, "Restitution in Bankruptcy: Reclamation and Constructive Trust" (1998) 72 Am Bankr LJ 265 at pp.272-273. See also T.H. Jackson, "Statutory Liens and Constructive Trusts in Bankruptcy: Undoing the Confusion" (1987) 61 Am Bankr LJ 287. In *In re CRS Steam* 225 BR 833 at 841-842 (Bankr. D. Mass. 1998) Judge Queenan reasoned that *Re Omegas* comprised "off-hand statements of law" and in some instances was "simply wrong". Ironically Judge Queenan went on to adopt an even more radical approach, reasoning that under the Bankruptcy Code even a constructive trust declared pre-petition by a court of competent jurisdiction was nothing more than a claim. For critical analysis, see A.S. Hohimer, "Constructive Trusts in Bankruptcy: Is an Equitable Interest in Property More Than Just A 'Claim'?" (2003) 19 Bank Dev J 499.
[141] J.P. Dawson, *Unjust Enrichment: A Comparative Analysis* (1951), p.30.
[142] *Omegas*, n128 above.

the bankrupt estate, *Omegas* recognises the reality that constructive trusts do in fact "take from the estate and thus directly from competing creditors".[143] The approach does not, however, ensure normatively desirable or principled outcomes any more than the orthodox approach.

(a) Unjust Enrichment of Creditors

In some instances a constructive trust claimant's priority is undoubtedly justified. Yet in its rush to avoid the unjust enrichment of the constructive trust claimant at the expense of the defendant's creditors, *Re Omegas* risks the unjust enrichment of the defendant's creditors at the expense of the constructive trust claimant.[144] In an attempt to avoid this, at least in cases where priority is most clearly merited, the Sixth Circuit has interpreted *Omegas* creatively. It has for instance, distinguished cases such as *Omegas*, in which the debtor obtained property from the creditor in the ordinary course of business, from cases in which the debtor never acquired an equitable interest.[145] It has also enlarged the pre-petition exception: a bankruptcy court may give effect to a post-petition judgment impressing property with a constructive trust if the action was initiated pre-petition.[146] These limitations however, do not necessarily operate to discriminate between cases in which priority is merited and cases in which it is not.

(b) Arbitrariness

As well as preventing recovery by deserving claimants, the *Omegas* doctrine may permit recovery by less deserving claimants if they happen to commence a State court action pre-petition. This is because the pre-petition exception is unrelated to the merits of the constructive trust claim. The decision to expand the pre-petition exception to include not only State court judgments obtained pre-petition but also

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[143] *ibid.* at 1452.

[144] The extent to which this criticism would apply to the adoption of the approach in English law turns on the nature of the constructive trust "claim" prior to declaration. If classified as an "equity" the claimant would continue to take priority over other unsecured creditors by virtue of the English bankruptcy principle that a trustee in bankruptcy is bound by all of the equities affecting the bankrupt: see below, n.171.

[145] *Newpower*, n132 above, at 936 (property purchased with embezzled funds).

[146] *Morris*, n132 above, at 668.

State court actions initiated pre-petition simply enlarges the class of case in which priority will be determined by something which has no bearing on the merits. Dagan thus notes that the expansion "vividly brings to light the arbitrariness of allowing or dismissing claims for preferential treatment in bankruptcy solely on the basis of timing and sequence of events that have nothing to do with the equities of the parties."[147]

(c) The Consequences of Wholesale Conceptual Disturbance

The wholesale change of the constructive trust claimant's interest may have undesirable and unforeseen practical consequences, or cause confusion outside the bankruptcy context. For example, denying the status of "equitable interest" to a constructive trust claim is likely to disturb the application of statutory regimes in which the temporal requirement of a proprietary interest assumes significance. An illustration of some currency is the temporal requirement of an interest in property under the Racketeering Influenced Corrupt Organization Act (RICO).[148] This legislation allows the government to seize assets that belong to the wrongdoer at the time of any illegal action falling within the Act. Thus, in those Circuits adopting the "automatic vesting" or "automatic retrospectivity" conceptualisations, the constructive trust claimant is not subordinated to the government's RICO claim: the disputed property either belonged or is deemed to have belonged to the claimant not the defendant, at the time the illegal act was committed.[149] However, changing the conceptualisation changes the priorities. Where the courts have accepted the view that the constructive trust, properly conceived, is a remedy that can arise and operate only when declared, it follows that the defendant and not the claimant owned the disputed asset at the time the illegal act was committed. The government is therefore able to seize the asset as an asset of the wrongdoer at the relevant time.[150] This creates a

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[147] Dagan, n129 above, at p.260.
[148] 18 USC 1963.
[149] See *US v Schwimmer* 968 F 2d 1570 at 1582 (2d Cir. 1992); *US v Lavin* 942 F 2d 177 at 187 (3d Cir. 1991); *US v Campos* 859 F 2d 1233 (6th Cir. 1988); *US v Marx* 844 F 2d 1303 (7th Cir. 1988).
[150] *US v BCCI Holdings* 46 F 3d 1185 (DC Cir 1995).

result that is arguably contrary to the legislative intent of Congress.[151] Similar problems may occur closer to home, if constructive trusts were to create an equitable interest from the time of declaration only.[152]

IV. THE INSTITUTIONAL-REMEDIAL HYBRID: *MUSCHINSKI V DODDS* AND ITS PROGENY.

1. *Muschinski v Dodds* and Subsequent Interpretations

Similarly stimulated by a desire to avoid prejudice to third party interests, the Australian courts have developed an approach that appears to blend inconsistently both institutional and remedial characteristics of the constructive trust. Institutional elements are evidenced by the characterisation of the trust as arising at the date of the operative facts and pre-existing judicial declaration. Remedial characteristics take the form of flexibility within the operation of the constructive trust, permitting the courts to tailor the consequences to meet with the demands of the case. The conceptualisation follows the influential judgment of Deane J in *Muschinski v Dodds*.[153] Drawing on Scott,[154] Deane J noted:

> "....notwithstanding that the constructive trust is remedial in both origin and nature, there does not need to have been a curial declaration or order before equity will recognise the prior existence of a constructive trust....Where an equity court would retrospectively impose a constructive trust by way of equitable remedy, its availability as such a remedy provides the basis for, and governs the content of, its imposition *inter partes* independently of any formal order declaring or enforcing it."[155]

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[151] See W.D. Sorrell, "Recent Decisions of the United States Court of Appeals for the District of Columbia Circuit: Racketeering Influenced Corrupt Organization Act" (1996) 64 Geo Wash L Rev 1441.

[152] A subsisting equitable interest may be of importance in England for taking otherwise relevant property outside the operation of similar confiscation regimes, which respect third party rights in property subsisting at the time of confiscation order: see *HM Customs & Excise Commissioners and Long v A* [2002] EWHC 611 at [171], affirmed [2002] EWCA Civ 1309 at [23]-[24], [50]-[54]. discussing the Drug Trafficking Act 1994, s31(4). See now Proceeds of Crime Act 2002, s69(3).

[153] (1985) 160 CLR 583.

[154] A.W. Scott, *The Law of Trusts* (1967, 3rd edn), Vol 5, §462.2.

[155] n153 above, at 615.

However, later in his judgment his Honour further noted that "the constructive trust may be moulded and adjusted to give effect to the interplay of equitable principles in the circumstances of the particular case" and an order "can properly be so framed that the consequences of its imposition are operative only from the date of judgment or formal court order or from some other specified date."[156] In this particular instance, his Honour held "[l]est the legitimate claims of third parties be adversely affected, the constructive trust should be imposed only from the date of publication of reasons for judgment". [157] On this reasoning, the constructive trust comes into existence automatically upon the facts, prior to curial declaration but the court retains the power to vary the date from which the trust's consequences are operative.[158]

Two interpretations of the case have followed. The broad interpretation suggests there is maximal flexibility: a constructive trust may operate from the moment of the unconscionable conduct, from the date of judgment or from any intermediate or later date, as the justice of the case demands. Deane J appears to have supported such an expansive power when he commented that the constructive trust may operate "from the date of judgment or formal court order or from *some other specified date*".[159] A narrow interpretation permits a more restrictive choice: the constructive trust arises prior to curial declaration, but the court has the power to determine whether its consequences take effect from the moment of the conduct giving rise to its imposition or, alternatively, from the date of judgment. This interpretation more accurately reflects the actual outcomes of the cases,[160] although more recently any flexibility as to the operative date of the constructive trust has been doubted, at least in relation to common intention constructive trusts. [161]

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[156] *ibid.* at 623.
[157] *ibid.*
[158] The approach has been applauded by many: e.g. Oakley, n72 above, at pp.437-438, 455.
[159] n156 above (emphasis added). See D.M. Wright, *The Remedial Constructive Trust* (1998), pp.263-270; D.M. Wright, "The Statutory Trust, The Remedial Constructive Trust and Remedial Flexibility" (1999) 14 JCL 221.
[160] Compare *Re Sabri* (1996) 21 Fam LR 213, *Kidner v Secretary, Department of Social Security* (1993) 31 ALD 63 and *Re Jonton Pty Ltd* [1992] 2 Qd R 105 (interest operative from time cause of action accrued) with *Re Osborne* (1989) 91 ALR 135 (common intention constructive trust not operative prior to husband's insolvency).
[161] *Parsons v McBain* (2001) 192 ALR 772 (interest under constructive trust effective from the date the cause of action accrues but, as a matter of priorities rather than timing of operation, may be deferred to later claims where the parties' conduct warrants it).

2. The Merits of *Muschinski* and its Progeny

While both narrow and broad interpretations of *Muschinski* display a legitimate concern about the problematic effects of proprietary relief on third parties, they also raise a number of problems. To the extent that the broad interpretation represents a plea for individualised justice, it is susceptible to the same criticisms as are levelled against the pure remedial approach and contrary to the rejection by Deane J elsewhere in his judgment of abstract notions of justice and fairness when determining the appropriate relief.[162] Both narrow and broad approaches also risk failing to avoid unwarranted and unintended priorities due to the court's necessary dependence on accurate information about the defendant's solvency.

With its emphasis on moulding, the approach has also created confusion and uncertainty because the extent to which the court can legitimately mould and manipulate the operation of the constructive trust remains unclear. Some lower courts have established a constructive trust by recourse to existing equitable doctrine but then, rather than consider timing of imposition, have proceeded to award a quite different form of relief.[163] Other courts have further suggested that the constructive trust may be stripped of all of its consequences and no relief granted at all.[164] This is needless circumlocution. Where a constructive trust "arises" but an alternative remedy is granted there is in fact no constructive trust. The facts simply create the grounds for the imposition of a different remedy. Talk of the constructive trust can drop out of the picture. Constructive trust terminology serves to designate a series of legal

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[162] n153 above, at 615.

[163] For discussion and critical evaluation of these cases, see P. O'Connor, "Happy Partners or Strange Bedfellows: The Blending of Remedial and Institutional Features in the Evolving Constructive Trust" (1996) 20 MULR 735 at pp.745-751; R.P. Austin, "The Melting Down of the Remedial Trust" (1988) 11 UNSWLJ 66.

[164] *Australian National Industries v Greater Pacific Investments Pty Ltd (in liquidation) (No3)* (1992) 7 ACSR 176 at 190 per Cole J. The view is reminiscent of the *Restatement*, which conceptualises the constructive trust as arising automatically but being unenforceable where the legal remedy is adequate: see n8 above, §160, comments e & f.

consequences attaching to particular facts.[165] If such consequences do not follow, there is no constructive trust.[166] Talk of the constructive trust can similarly drop out of the picture where its operation is apparently "suspended" and no remedy granted at all. Indeed, in such circumstances it is meaningless to talk of the claimant as having a cause of action: without a remedy there is no right.[167]

3. The Interim Equity Model

In an attempt to avoid injustice to intervening third party interests, while avoiding the inconsistencies of *Muschinksi*, some have argued that the constructive trust claimant neither has, nor is deemed to have, an equitable interest in the disputed property prior to the court order.[168] Rather, the potential constructive beneficiary's interest is simply an "equity" which is transformed into an equitable interest upon curial declaration.[169] The constructive trust claimant will therefore not take priority over any equitable interest created in the interim, between the date of the facts giving rise to the constructive trust claim and the date of curial declaration, such as interests of purchasers under specifically enforceable contracts and equitable mortgages.[170] The potential beneficiary will however, continue to enjoy priority over the constructive trustee's unsecured creditors by virtue of the general principle that a trustee in bankruptcy is bound by all of the equities affecting the bankrupt.[171]

There is, however, little support for the interim equity model in the authorities of any Commonwealth jurisdiction. Indeed, there exists contrary authority on the very issue in question. Thus, in *Re Jonton Pty Ltd*[172] it was held that, although a common

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[165] Dobbs, n19 above, at p.398.
[166] It is for this reason that Dobbs brands the analogous US orthodoxy "a fling with esoteric metaphysics": n19 above, §4(3)(2), n1. See also G. Palmer, *Law of Restitution* (1978), §1.4.
[167] Chapter 1, Section IV.2(b).
[168] Most notably, J. Glover, "Bankruptcy and Constructive Trusts" (1991) 19 Aus Bus L Rev 98.
[169] *ibid.* at pp.109-110.
[170] *Latec Investments Ltd v Hotel Terrigal Pty Ltd* (1965) 113 CLR 265; *Re Papaloizou* (1980) [1999] BPIR 106 (Browne-Wilkinson J); *Phillips v Phillips* (1861) 4 De GF & J 208.
[171] *Ex parte Holthausen* (1874) LR 9 Ch App 722 at 726 per James LJ; *Re Clark, ex parte Beardmore* [1894] 2 QB 393 at 410 per Davey LJ. Similar principles apply upon corporate insolvency: see H. Anderson, "The Treatment of Trust Assets in English Insolvency Law" in *Commercial Aspects of Trusts and Fiduciary Obligations* (1992, ed. McKendrick), p.167 at 172.
[172] [1992] 1 Qd R 105.

intention constructive trust was not declared judicially until 1991 the claimant's equitable proprietary interest existed from the time of the events giving rise to the claim. Since these occurred in the 1970s the claimant took priority over the equitable interest of a mortgagee whose claim dated from the 1980s.[173]

The approach also fails to develop a form of specific relief that does not bind unsecured creditors. It simply addresses the problem of priority between competing equitable interests, reversing the existing rules of priority. Is this really necessary? While there may be justification to subordinate a constructive trust claim to a later equitable interest, this will not always be so. Exceptions will therefore be required just as there is presently a perceived need for exceptions to the "first in time" rule that presumptively favours the constructive trust claimant. A sensitive and effective solution to this problem may be already within our grasp, without widespread conceptual change. We might keep the existing approach, classifying the unclaimed constructive trust interest as an equitable interest but where required conclude that the merits are unequal so that the equity first in time (the constructive trust claimant) does not prevail.[174] Dealing with the matter by reference to more flexible priority rules is also likely to avoid the significant confusion that would follow the classification of a claim as an "equity", given the protean and indeterminate nature of the term.[175]

Undesirable and unforeseen practical consequences may also follow such wholesale change of the constructive trust claimant's interest prior to curial declaration, thus conflicting with the principle of minimal conceptual disturbance. For example, the blanket classification of the potential constructive trust claimant's interest as an "equity" may disturb the application of various statutory regimes in which the

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[173] See also *Re Sabri* (1996) 21 Fam LR 213. Priorities between constructive trust claimant and competing interests are determined in English law in the same manner: see, e.g. *Re Morgan* (1881) LR 18 Ch D 93, discussed in Chapter 5, Section III.1(a).

[174] *Heid v Reliance Finance Corporation Pty* (1983) 154 CLR 326 at 341-342 per Mason & Deane JJ. Such flexibility may not exist in English law, although see *MacMillan v Bishopgate Investment Management (No3)* [1995] 3 All ER 747 at 768 per Millett J (order of priority may be reversed in "special circumstances"); *Rice v Rice* (1854) 2 Drew 73 per Kindersley VC (explaining the maxim *qui prior est tempore, potior est jure* operates as a tie-breaker, to be applied only where there is no other ground for choosing between the competing claims).

[175] As to which, see A. Everton, "'Equitable Interests' and 'Equities' - In Search of a Pattern" [1976] Conv 209; R. Smith, *Property Law* (5th ed, 2006), pp.27-29; Skapinker, "Equitable Interests, Mere Equities, 'Personal' Equities and 'Personal Equities' - Distinctions With a Difference" (1994) 68 ALJ 593.

temporal requirement of a proprietary interest assumes significance. We have seen already an example of this in the United States relating to the temporal requirement of an interest in property under the RICO legislation.[176] Closer to home, we might consider the potential problems that would have arisen when a potential constructive trust claimant sought to assert their interest against a third party by virtue of the Land Registration Act 1925, s70(1)(g).[177] If the claimant's interest was classified as a mere equity the temporal requirement that the appropriate proprietary interest be in existence at the time of the actual occupation would not be satisfied.[178] The blanket classification of the constructive trust claimant's interest as an "equity" is also likely to upset the application of Section 21 of the Limitation Act 1980 to constructive trust claims.[179]

V. Towards A New Analytical Framework

1. Institutional and Remedial Theories: Lessons to Learn

What then might we learn from the various institutional, remedial and hybrid conceptualisations considered in this chapter? We have seen that the automatic vesting approach persists in English law for reasons of ideology, not utility. It avoids consideration of crucially important normative concerns and potentially perpetuates unjust and largely unintended judicially created priorities. Its operation and interplay with related doctrine lacks logic and often depends on reasoning that is at best grossly artificial. Oakley's automatically retrospective conceptualisation avoids some of these difficulties but similarly portrays priority over third parties as an inevitable and natural consequence of the constructive trust, reflecting the traditional reluctance of

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[176] Above, Section III.6.(c).
[177] See now Land Registration Act 2002, schedule 3, para 2.
[178] See now Land Registration Act 2002, s116, by which a mere equity is capable of binding successors in title. Note, however, that the language of "mere equity" may not be taken literally: Smith, n175 above, at p.29.
[179] Section 21 requires a trust and then a breach of trust or the retention of trust property. If a constructive trust is an equity and never a trust interest until declared, the constructive trust will be taken outside the operation of the section notwithstanding the Act's explicit inclusion of constructive trusts: see M. Hemsworth, "'Constructive Trusts' and 'Constructive Trustees' – What's in a Name" (2000) 19 CJQ 154, esp. pp.164-165.

English judges and jurists to engage openly in critical normative issues affecting priorities.

A major weakness of institutional constructive trust theories generally is they tend to engender the belief that we need to "look downward" at the cases, and understand better or rationalise what is there already. This fails to acknowledge that that which is there already is in fact part of the problem. The constructive trust has developed under diverse influences. It is somewhat naïve to believe that the cases governing its availability can be reduced to some coherent or logical structure that is fit for purpose in the modern world. There is an urgent need to re-evaluate when the constructive trust should be available to respond to particular events and whether alternative remedies may be more appropriately developed. The institutional theory does, however, remind us that the pursuit of substantive justice is not the only matter with which we should be concerned.

Remedial and hybrid approaches developed against the background of more progressive judicial cultures. They have been motivated largely by the desire to address openly the very issue that the institutional constructive trust avoids: the justice of the constructive trust claim against innocent third parties. The theories tell us two important things. First, we must accept that there is a need to re-evaluate the availability of the constructive trust if we are to achieve acceptable results in concrete cases. This requires us to address head-on an enormously important and difficult normative question: when is proprietary relief justified? Second, if we are to achieve acceptable results it is necessary to refine the remedial framework of which the constructive trust is part. In particular it is necessary to develop a form of specific relief that does not risk generating priorities over third parties. The flaws of the remedial approaches lie not necessarily in this agenda but in its execution.

In Canada it is recognised that in some cases the constructive trust binds third parties legitimately; in others it operates simply to do justice between claimant and defendant. The problem is that the latter cases continue to be dealt with via the language of constructive trust. This makes "constructive trust" do too much and obscures the individuality of what is in substance a different remedy with different intended consequences. It also fails to avoid the risk of unintended and unwarranted priorities

because it places such a heavy reliance on the availability of information about the defendant's solvency. There is reason to believe that the quality of such information will often be poor, leaving a court to second guess the appropriateness of the imposition of a constructive trust. The hybrid approaches developed in Australia post-*Muschinski* also fail to avoid the risk of unwarranted or unintended priorities.

In the United States the Ninth Circuit has similarly sought to revise the constructive trust to facilitate just outcomes as between constructive trust claimant and innocent third parties. However, in doing so it has risked injustice to constructive trust claimants, arbitrariness and disturbance in other areas. These problems arose because the Sixth Circuit made sweeping changes without considering the full field to which its revised doctrine would apply.

2. Proposals for a New Framework

The problems experienced by institutional and remedial theories are avoided, and justice and clarity enhanced, by the recognition of two conceptually distinct remedies: the constructive trust and the personal order to transfer specific property. The constructive trust is more appropriately conceptualised as a judicially imposed interest in property operating retrospectively from the time the claimant's cause of action accrued. It should be given a reduced sphere of operation and imposed only where there is reason to grant the claimant the significant benefits that follow from the recognition or creation of equitable property rights, particularly priority over creditors and supervening interests. By this approach, judicial responsibility for the outcome is emphasised. Moreover, the gross artifice and logical deficiencies of the automatic vesting approach are avoided.

The purely personal order to transfer specific property would exist alongside the constructive trust.[180] It would operate in those cases previously dealt with by the

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[180] Professor Goode alludes to the need for specific relief that does not prejudice creditors. However, he limits the operation of the device to "deemed agency gains", would continue to recognise an automatic vesting constructive trust, and is ambivalent as to whether such a remedial order should confer on the claimant a prospective proprietary interest or a purely personal right to the transfer of specific property:

constructive trust in which specific relief is desirable but general enforcement against third parties is not. It is by its nature purely personal. Thus, it is enforceable only against an individual or specific class of individuals; it is not, like a property right, enforceable against an indefinite class of person or, as it is generally put, against "the whole world". A claimant must therefore enforce his rights in the same way as any other party with a personal claim against the defendant. The claimant acquires full beneficial ownership only when the asset is transferred by the defendant.

There is a pressing need for the development of such *in personam* specific relief in the fiduciary context, a context which will be examined in detail in Part II of this thesis. This is because it is necessary to strip the fiduciary of his gains but it will not be always appropriate to confer priority. Some argue that in such circumstances a discretionary remedial constructive trust is adequate: the discretion to award a constructive trust will not be exercised positively in such cases. This, however, does not sound like proprietary relief, nor does it sound like discretion. It is a call for the imposition or recognition of an *in personam* obligation to surrender a gain *in specie*. The notion of a purely personal order (or obligation) to transfer specific property more faithfully represents what is being sought. It also affords a way of avoiding unintended priorities and the expense and difficulty of an inquiry into the defendant's solvency.

This of course leaves much unsaid about any reclassification. Which cases should remain within the scope of the constructive trust? Which are more appropriately dealt with by the personal order to transfer specific property? These questions may require difficult normative questions to be answered and may generate controversy. However, those questions and controversies are there already; avoiding or obscuring them will not make them go away. The benefit of the framework for analysis proposed here is that it clarifies the choices to be made and illuminates what is at stake in making them. It is to such issues that we now turn in Part II of this thesis.

R.M. Goode, "Property and Unjust Enrichment" in *Essays on the Law of Restitution* (1991, ed. A. Burrows), p.215; R.M. Goode, "The Recovery of a Director's Improper Gains: Proprietary Remedies for Infringement of Non-Proprietary Rights" in *Commercial Aspects of Trusts and Fiduciary Obligations* (1992, ed. E. McKendrick), p.137 at pp.146-148.

PART II: APPLICATION: ACQUISITIVE BREACHES OF FIDUCIARY OBLIGATION

CHAPTER 4: Fiduciary Obligations, Remedies and the Justifications for Proprietary Relief

I. INTRODUCTION

The suggestion in Part I was that neither the institutional nor remedial approaches offer satisfactory means of developing the constructive trust. Rather the pursuit of normatively desirable outcomes within a coherent, logical and organised framework is best promoted by the recognition of two discrete concepts: (1) the constructive trust, which is more appropriately viewed as the judicial grant of a proprietary interest which operates retrospectively from the time of the facts which gave rise to its imposition; and (2) a personal order to transfer specific property, which confers on the claimant a purely personal right to have transferred specific property in the hands of the defendant.

In Part II the benefits of the framework proposed in Chapter 3 are further demonstrated. This is achieved by the detailed application of the framework to cases involving acquisitive breaches of the fiduciary obligation of loyalty. Three specific fact situations are considered: the renewal of leases and the purchase of reversions; the receipt of bribes and secret commissions; and the wrongful exploitation of fiduciary opportunities. In each of these three categories of case it is demonstrated, to varying degrees, that the proposed framework provides a more satisfactory way forward than continued adherence to the institutional constructive trust or the development of a remedial model.

This Chapter deals with two general issues. First, it examines the nature of fiduciary relationships and identifies the function of fiduciary obligation. Second, it examines the justifications for imposing a constructive trust in cases of acquisitive breach of fiduciary obligation. It suggests that subject to limited exceptions, a constructive trust is appropriate in, and should be limited to, cases where the fiduciary (F) either misappropriates benefits from his principal (P) or intercepts benefits on their way to his principal from a third party. In these circumstances a proprietary claim is appropriate

because it preserves the efficient and effective utilisation of the fiduciary form. Absent misappropriation or interception priority over third parties cannot be justified. Specific relief may be nevertheless desirable, primarily to maximise the deterrence of fiduciary wrongdoing and thereby preserve confidence in the fiduciary form. A personal order to transfer specific property is generally appropriate in these cases.

II. Fiduciary Relationships and the Fiduciary Obligation

An understanding of fiduciary relationships and the obligations they attract is a necessary pre-requisite to the determination of the appropriate remedial responses. As a leading American remedies scholar notes, "the remedy should reflect the right or the policy behind the right as precisely as possible".[1] This section therefore examines the nature of fiduciary relationships and the fiduciary obligation.

1. The Identification of Fiduciary Relationships

(a) The Elusiveness of Comprehensive Definition

Numerous attempts have been made to identify those aspects or qualities of a relationship that justify its characterisation as "fiduciary". However, the articulation of a coherent general theory remains elusive. As Justice La Forest of the Supreme Court of Canada noted:

> "There are few legal concepts more frequently invoked but less conceptually certain than that of the fiduciary relationship.....courts have no difficulty in imposing fiduciary obligations, but at a more fundamental level, the principle on which that obligation is based is unclear."[2]

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[1] D. Dobbs, *Law of Remedies* (1993), §1.7.

[2] *Lac Minerals v International Corona Resources Ltd* (1989) 61 DLR (4th) 14 at 26 per La Forest J. See also D. DeMott, "Beyond Metaphor: An Analysis of Fiduciary Obligation" [1988] Duke LJ 879.

Early attempts to provide a theory, most notably by Sealy,[3] sought to categorise and rationalise relationships that had been found to be fiduciary in the past. The main problem with this methodology was that it offered a static picture of traditional fiduciary relationships.[4] However, the categories of fiduciary relationship are "no more closed than the categories of negligence at common law."[5] New kinds of relationship which are fiduciary in nature might be developed and fiduciary relationships might arise as a matter of fact out of the peculiar circumstances of relationships not ordinarily regarded as such.[6]

Another early attempt to provide a comprehensive account of the fiduciary relationship was Austin Scott's "undertaking" or "assumed responsibility" theory.[7] According to this theory, adopted more recently by Lord Browne-Wilkinson in *White v Jones*,[8] a fiduciary relationship arises "where one party, A, has assumed to act in relation to the property or affairs of another, B."[9] The problem with this definition is that it is over-inclusive and applies to a number of relationships that are clearly non-fiduciary in nature. For example, a garage mechanic undertakes to fix and look after my car and to return it safely and I trust him to do so, but there is no fiduciary relationship between us.

In other jurisdictions, most notably Canada, the courts have focussed on the identification of general characteristics or indicators of fiduciary relationships.[10] Some have identified the defining element as discretion or power vested in F coupled with a corresponding vulnerability of P.[11] Others prefer to rely on the identification of a reasonable or legitimate expectation of P that F will act in P's interests and for the

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[3] L.S. Sealy, "Fiduciary Relationships" [1962] CLJ 69.
[4] E.g. trustee and beneficiary (*Keech v Sandford* (1726) Sel Cas Ch 61); solicitor-client (*Re Hallet's Estate* (1880) 13 Ch D 696); partner and co-partners (*Bentley v Craven* (1853) 18 Beav 75); director and company (*Regal (Hastings) v Gulliver* [1967] 2 AC 134n); agent and principal (*De Bussche v Alt* (1878) 8 Ch D 286; *Lamb v Evans* [1893] 1 Ch 218).
[5] *Laskin v Backe & Co* (1971) 23 DLR (3d) 385 at 392 per Arnup J. See also *English v Dedham Vale Properties Ltd* [1978] 1 WLR 93 at 110; P.D. Finn, "The Fiduciary Principle" in *Equity, Fiduciaries and Trusts* (1989, ed. T.G. Youdan), p.1 at 4.
[6] *Lac Minerals*, n2 above, at 16 per Wilson J; A.J. Oakley, "The Liberalising Nature of Remedies for Breach of Trust" in *Trends in Contemporary Trust Law* (1996, ed. A.J. Oakley), p.217 at 230-233.
[7] A.W. Scott, "The Fiduciary Principle" (1949) 37 Calif L Rev 539 at p.540.
[8] [1995] 2 A.C. 206.
[9] *ibid.* at 274. See also J. McGhee *et al*, *Snell's Equity* (30th edn, 2000), ¶6-05.
[10] For the seminal Canadian cases, see L. Hoyano, "The Flight to the Fiduciary Haven" in *Privacy and Loyalty* (1997, ed. P.B.H. Birks), p.169.
[11] *Frame v Smith* (1987) 42 DLR (4th) 81 at 98-99 per Wilson J; *Lac Minerals*, n2 above, at 63 per Sopinka J; *Hodkinson v Simms* (1994) 117 DLR (4th) 161 at 222 per Sopinka J; E.J. Weinrib, "The Fiduciary Obligation" (1975) 25 UTLJ 1.

purposes of the relationship.[12] However, the application of such open-textured criteria catch non-fiduciary relationships, lack precision and are uncertain in application.[13]

A number of further competing theories have been developed in recent years.[14] However, consensus remains elusive and none have gained a foothold in the courts. Indeed, the volume of competing theories, each emphasising different elements or criteria, appears to have done little more than increase the conceptual uncertainty of the fiduciary concept.

(b) The Functional Approach to Fiduciary Identification

The difficulty of developing a comprehensive and accurate definition of fiduciary relationship has led English and Australian courts to adopt a functional approach to fiduciary identification.[15] This approach seeks a deeper understanding of the function of fiduciary obligation to assist with the identification of when such obligations are appropriately imposed.[16]

The functional approach recognises that not every duty owed by a fiduciary is fiduciary in nature. Consequently, "not every breach of duty by a fiduciary is a breach of

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[12] Finn, n5 above, at p.46; *Arklow Investments Ltd v McLean* [2000] 1 WLR 594 at 598 (PC); *Lac Minerals*, n2 above, at 26 per La Forest J; *Hodkinson*, n11 above, at 176 per La Forest J.

[13] R. Flannigan, "The Boundaries of Fiduciary Accountability" [2004] NZLR 214 at pp.233-240; S. Worthington, *Equity* (2003), pp.129-131.

[14] E.g. D.G. Smith, "The Critical Resource Theory of Fiduciary Duty" (2002) 55 Vand L Rev 1399 (relationship is fiduciary when A acts on behalf of B while exercising discretion with respect to a critical resource belonging to B); J. Glover, "The Identification of Fiduciaries" in *Privacy and Loyalty* (1997, ed. P.B.H. Birks), p.269 (fiduciary relationships determined by reference to three "family resemblances": property, reliance and power); F. Easterbrook & D. Fischel, "Contract and Fiduciary Duty" (1993) 36 Jnl of Law & Econ 425 (fiduciary relationship is a contractual relationship with unusually high costs of specification and monitoring); T. Frankel, "Fiduciary Law" (1983) 71 Calif L Rev 795 (fiduciary relationship arises where A serves as a substitute for B and is entrusted with the power to act for B); J.C. Shepherd, "Towards a Unified Concept of Fiduciary Relationships" (1981) 97 LQR 51 (fiduciary relationship arises whenever A receives a power subject to a duty to utilise it in the best interests of B).

[15] *Bristol & West Building Society v Mothew* [1998] Ch 1; *Pilmer v Duke Group Ltd* (2001) 207 CLR 165; *Breen v Williams* (1996) 186 CLR 71. See G. Dempsey & A. Greinke, "Proscriptive Fiduciary Duties in Australia" (2004) 25 Aus Bar Rev 1.

[16] For discussion and development, see M. Conaglen, "The Nature and Function of Fiduciary Loyalty" (2005) 121 LQR 452; P.B.H. Birks, "The Content of Fiduciary Obligation" (2000) 34 Isr L Rev 3; S. Worthington, "Fiduciaries: When is Self-Denial Obligatory" [1999] CLJ 500. See also D. DeMott, "Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences" (2006) 48 Ariz L Rev 925.

fiduciary duty."[17] For instance, a fiduciary might fail to exercise reasonable skill and care in the execution of his office or he might otherwise breach a term in his contract of engagement. These are not breaches of *fiduciary* obligation.[18] Contractual obligations and duties of care and skill are owed by fiduciaries and non-fiduciaries alike.[19] Thus, in *AG v Blake*[20] Lord Woolf MR held that while the defendant's acts amounted to a breach of his contract of employment they did not, even if the defendant was correctly identified as a fiduciary, amount to a breach of *fiduciary* obligation.

The same reasoning applies with respect to obligations designed for, and peculiarly applicable to, specific fiduciary relationships. An example is the trustee's duty to treat beneficiaries with an even hand. While the duty is owed by a fiduciary (a trustee) it is not a duty to which other fiduciaries are subject and is not, therefore, essentially fiduciary in nature.[21]

Once we remove such non-fiduciary content from the fiduciary relationship we are left with that which is universally and peculiarly fiduciary: the obligation of undivided loyalty. [22] This obligation distinguishes fiduciary relationships from other relationships.[23] It is found in all relationships that are fiduciary but never in those that are not. A relationship is therefore fiduciary when it attracts the obligation of loyalty. As Worthington explains, this will be in those circumstances where:

> "the very *function* or *purpose* or *reason* for one party's role in the relationship *demands* that the party operate on the basis of self-denial..... Imposition of an obligation of self-denial affords ultimate protection, but it operates as a sledgehammer: it ought to be used only when absolutely necessary. Arguably, it is needed only if, without it, the subject would be left with no effective legal means of monitoring the relationship; if, without it, obligations imposed in contract and tort, or by a duty to act for proper purposes, would be insufficient for the task."[24]

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[17] *Mothew*, n15 above, at 16 per Millett LJ. See also *Hilton v Baker, Booth & Eastwood (a firm)* [2005] UKHL 8, [2005] 1 WLR 567 at [29].
[18] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 at 200 per Lord Browne-Wilkinson.
[19] The same is true of other duties, such as the duties to act in good faith or for proper purposes, which are also often identified, incorrectly, as "fiduciary": see Conaglen, n16 above, at pp.455-460.
[20] [1998] Ch 439 at 455.
[21] Flannigan, n13 above, at pp.219-220. See also R. Flannigan, "Fiduciary Duties of Shareholders and Directors" [2004] JBL 277.
[22] See Conaglen, n16 above; C. Harpum, "Fiduciary Obligations and Fiduciary Powers" in *Privacy and Loyalty* (1997, ed. P.B.H. Birks), p.145 at 146-149.
[23] *Mothew*, n15 above, at 18 per Millett LJ. See also the works cited in n16 above.
[24] Worthington, n16 above, at p.506 (emphasis original).

In short, a relationship will be fiduciary when it is necessary and appropriate to impose on one party (F) an obligation of self denial when acting for another party (P).

2. The Content of the Fiduciary Obligation of Loyalty

(a) The Two Strands of Fiduciary Loyalty: "No-Profit" and "No-Conflict"

There are two strands to the fiduciary obligation of loyalty. These were stated by Deane J in a passage in *Chan v Zacharia*,[25] later quoted with approval in *Don King v Warran*:[26]

> "The first is that which appropriates for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest. The second is that which requires the fiduciary to account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it: the objective is to preclude the fiduciary from actually misusing his position for his personal advantage."[27]

This is a statement of what are conveniently termed the "no-conflict" and "no-profit" rules. The latter rule appears to have grown out of the former.[28] Thus, while the two rules are usually treated as separate, there is considerable overlap between them in terms of application and coverage. It is important to emphasise that both rules are *proscriptive* rather than prescriptive. They do not tell the fiduciary what he must do; they tell him what he must not do.

The leading formulation of the no-conflict rule was enunciated by Lord Cranworth in *Aberdeen Rly Co v Blaikie Brothers*:

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[25] (1984) 154 CLR 178.
[26] [2000] Ch 291 at [40]-[43].
[27] n25 above, at 198
[28] A.J. McLean, "The Theoretical Basis of the Trustee's Duty of Loyalty" (1969) 7 Alta L Rev 218.

> "it is a rule of universal application that no one having [fiduciary] duties to discharge shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which may possibly conflict, with the interests of those whom he is bound to protect." [29]

The "possibility of conflict" to which Lord Cranworth referred must be a "real sensible possibility of conflict" [30] rather than a "theoretical or rhetorical" conflict. [31] Nevertheless, Lord Cranworth's statement remains "the clearest and most direct statement of the rule".[32] Its object is to prevent the fiduciary from being swayed by considerations of personal interest (or by the pursuit of an inconsistent duty)[33] in the exercise of those powers which are his to exercise in a fiduciary capacity.

At other times the no-profit rather than the no-conflict rule is emphasised.[34] Thus, in *Boardman v Phipps*[35] Lord Hodson stated that a fiduciary will be liable "to account for profits acquired by him by reason of his fiduciary position and by reason of the opportunity and the knowledge, or either, resulting from it".[36] Similarly, in *Regal (Hastings) v Gulliver*[37] the directors of a company made incidental profits while pursuing an opportunity on its behalf. While they acted honestly and *bona fide* throughout they were nevertheless held liable to account for their profits, such liability arising "from the mere fact of a profit having, in the stated circumstances, been made".[38]

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[29] (1854) 1 Macq 461 at 471. Earlier important applications of the no-conflict principle include *Whelpdale v Cookson* (1747) 1 Ves 9; *Whichcote v Lawrence* (1798) 3 Ves 740 at 750; *Ex parte Lacey* (1802) 6 Ves Jun 625 at 626; *Thompson v Havelock* (1808) 1 Camp 527.
[30] *Boardman v Phipps* [1967] 2 AC 46 at 124 per Lord Upjohn. See also *Bhullar v Bhullar* [2003] EWCA Civ 424 at [30], [42]; *Lapthorn v Eurofi Ltd* [2001] EWCA Civ 993 at [41], [53].
[31] *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 1 All ER 716 at 730 per Upjohn LJ.
[32] *Newgate Stud Company v Penfold Bloodstock Ltd* [2004] EWHC 2993, at [218]-[235] (Richards J).
[33] As where F acts for two principals with potentially conflicting interests without the informed consent of both: *Mothew*, n15 above, at 18 per Millett LJ.
[34] See e.g. *Parker v McKenna* (1874) LR 10 Ch App 96 at 118 per Lord Cairns LC; *Regal*, n4 above, at 149 per Lord Russell, 153 per Lord MacMillan, 156 per Lord Wright, 157-158 per Lord Porter.
[35] n30 above..
[36] *ibid.* at 105.
[37] n4 above.
[38] *ibid.* at 149 per Lord Russell. See also Chapter 7, Section II.1.

(b) The Stringent and Unbending Application of the Rules

It is fundamental to both proscriptions that they are applied strictly and inflexibly. The importance of this was emphasised by Lord Russell in *Regal (Hastings) v Gulliver*:

> "The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account."[39]

The courts will not therefore look to the broader justice of the case. Both proscriptions stand "much more upon general principle than upon the circumstances of any individual case".[40] It is of no concern to the court that F did what he considered *bona fide* to be in the best interests of P,[41] or indeed benefited P by his actions.[42] It is also irrelevant that P suffered no loss[43] or could not anyway have acquired the benefit in question.[44] As Lord Justice James remarked, the no-conflict and no-profit rules are "inflexible" and "must be applied inexorably".[45] While such stringency has been criticised on the ground that it simply preserves "the appearance of justice regardless of the facts"[46] it nevertheless remains the law in England.[47]

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[39] *ibid* at 144.
[40] *Ex parte James* (1803) 8 Ves Jun 337 at 345 per Lord Eldon. See also *Hatch v Hatch* (1804) 9 Ves 292 at 297; *Bray v Ford* [1896] AC 46 at 51; *IDC v Cooley* [1972] 1 WLR 443 at 452; *In re Drexel Lambert UK Pension Plan* [1995] 1 WLR 32 at 38-39. For recent judicial discussion, see *Murad v Al-Saraj* [2005] EWCA Civ 959 at [60]-[79] per Arden LJ, [101]-[112] per Parker LJ.
[41] See e.g. *Blewett v Millett* (1774) 1 Bro PC 367.
[42] See, most notably, *Boardman*, n30 above; *Regal*, n4 above.
[43] *Hamilton v Wright* (1842) 9 Cl & Fin 111 at 123 per Lord Brougham; *Parker v McKenna*, n34 above, at 124-125 per James LJ; *Regal*, n4 above, at 154 per Lord Wright; *A-G v Blake* [2001] 1 AC 268 at 280 per Lord Nicholls; *Al-Saraj*, n40 above, at [59]-[67] per Arden LJ.
[44] See e.g. *Cooley*, n40 above; *Boardman*, n30 above; *Regal*, n4 above.
[45] *Parker v McKenna*, n34 above, at 124.
[46] R. Teele, "The Necessary Reformulation of the Classic Fiduciary Duty to Avoid a Conflict of Interest or Duties" (1994) 22 Aus Bus L Rev 99 at p.102. See also P.L. Davies, *Gower & Davies' Principles of Modern Company Law* (7th edn, 2003), pp.417-418; G. Jones, "Unjust Enrichment and the Fiduciary Duty of Loyalty" (1968) 84 LQR 472.
[47] *John Taylors v Masons* [2001] EWCA Civ 2106 at [46] per Arden LJ. Although Arden LJ has more recently accepted that in principle a softening of the rules may be appropriate in narrowly defined and exceptional circumstances: *Al-Saraj*, n40 above, at [82]-[83]. See also *Foster Bryant Surveying Limited v Bryant, Savernake Property Consultants* [2007] EWCA Civ 200 at [76] per Rix LJ (whether it remains

3. The Role of Loyalty in Protecting the Objectives of Fiduciary Relationships

(a) The Objectives of Fiduciary Relationships

In a fiduciary relationship F is granted access to or control over P's assets, interests or affairs in order to pursue a defined objective or objectives on behalf of P – for example, the pursuit of a reasonable return on an investment at an acceptable level of risk. The objectives may be defined broadly or narrowly. An example of a broadly defined objective is the pursuit of profit through the development and exploitation of opportunities within a company's line of business, the company having a general objects clause. A narrowly defined objective might be to negotiate the acquisition of a particular plot of land desired by P for no more than a stated price.[48] However, even where F's objectives are defined in relatively narrow terms it is not possible to dictate and specify the precise behaviour of F in advance. As Cooter & Freedman point out:

> "In fiduciary relationships…..the parties are unable to foresee the conditions under which one act produces better results than another. Rather, chance events and unanticipated contingencies require continual recalculation to determine which course of action will be the most productive…Thus, in the constantly changing environment of a fiduciary relationship, the agent's obligations must be articulated in general and open-ended terms."[49]

The impossibility of specifying precisely what F is to do creates the risk that the objectives of the relationship will be frustrated by inappropriate or ineffective fiduciary conduct. This risk is increased by a combination of two additional factors.

First, because benefit and control are in two different people there is the "unavoidable fact that the interests of the principal and fiduciary are not perfectly aligned".[50] In the absence of effective controls (legal or otherwise) the impulse of F will be to favour his personal interests rather than those of P. This risk is increasingly apparent given the

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true that the rules are inflexible and must be applied inexorably "may be in doubt").

[48] E.g. *Soulos v Korkontzilas* (1997) 146 DLR (4th) 214.

[49] R. Cooter & B.J. Freedman, "The Fiduciary Relationship: Its Economic Character and Legal Consequences" (1991) 66 NYULR 1045 at pp.1048-1049.

[50] K.B. Davis, "Judicial Review of Fiduciary Decisionmaking - Some Theoretical Perspectives" (1985) 80 Nw U L Rev 1 at p.4. See also W. Bishop & D.D. Prentice, "Some Legal and Economic Aspects of Fiduciary Remuneration" (1983) 46 MLR 289.

significant "moral distance" [51] that is an invariable feature of most fiduciary relationships in the modern world.

Second, the structural peculiarities of the relationship are such that the principal, "being on the outside, cannot know everything that is going on."[52] This is because the effective monitoring of F is likely to be difficult, impractical or inefficient. Importantly P will often lack the necessary knowledge or expertise to monitor F's behaviour, or he may simply not have the time.[53] As Weinrib notes, "[t]he control of the principal is necessarily attenuated, for the exercise of that control would necessitate his intervention in the details of the transaction and would stultify the very reason for which the agency was instituted."[54] Moreover, where F acts for multiple common principals the cost of an individual's monitoring may exceed the expected benefit (which is shared by all) and therefore be unattractive.[55] Where monitoring is attempted it is likely to be inefficient because un-coordinated and duplicative. Thus, P can "seldom eliminate the entire risk of opportunism by any cost-justified level of monitoring".[55a]

The impossibility of specifying in advance precisely what F is to do, F's non-aligned personal interest, the barriers to effective monitoring and the simple fact that wrongdoing may be difficult to detect combine to provide F with significant incentive and opportunity to cheat. That is, to act in a way that is harmful to the objectives of the relationship.

(b) Harmful Fiduciary Behaviour: Mismanagement and the Appropriation of Value

The objectives of the relationship may be frustrated by the fiduciary's mismanagement. Mismanagement involves shirking, mistakes and poor decision-making. The legal

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[51] R. Cotterrell, "Trusting in Law: Legal and Moral Concepts of Trust" (1993) 46 CLP 75.
[52] E.R. Hoover "Basic Principles Underlying Duty of Loyalty" (1956) 5 Clev Mar L Rev 7 at p.11.
[53] A.G. Anderson, "Conflicts of Interest: Efficiency, Fairness and Corporate Structure" (1978) 25 UCLA L Rev 738 at pp.744, 749-750; Frankel, n14 above, at pp.812-815.
[54] n11 above, at p.4
[55] The point is often made in relation to, but is not necessarily limited to, companies with dispersed shareholdings: R. Clark, "Agency Costs Versus Fiduciary Duties" in *Principals and Agents: The Structure of Business* (1986, eds. J. Pratt & R. Zeckhauser), p.55 at p.77; Anderson, n53 above, at pp.774-775, 779; *Al-Saraj*, n40 above, at [74] per Arden LJ.
[55a] Davis, n50 above, at p.6.

control of mismanagement is provided by the duty of skill and care and the application of other prescriptive norms specifically developed or tailored for the individual relationship. These are supplemented by a number of extra-legal controls, such as product competition, the threat of take-over (in a corporate setting) and incentive payments. Proper management by F is also made more likely by the duty of loyalty, which seeks to avoid situations in which F may act in such a way as to harm P's interests.

The objectives of the relationship may be also frustrated by F's appropriation of value. This covers two different acts, both of which divert value away from P and into the hands of F. These are simple misappropriation and the interception of benefits. Misappropriation occurs where F simply takes that which already belongs to P – as where a director embezzles company money. Interception occurs when F prevents a benefit arriving at P by channelling it his own way. A number of corporate opportunity cases illustrate this kind of appropriation of value.[56] The obligation of loyalty is designed to avoid both of these kinds of appropriation of value and thereby make the successful pursuit of the objectives of the relationship more likely. In order to achieve this it is necessary to proscribe a broader range of activity than is in fact harmful to P.

(c) The Prophylactic Function of Fiduciary Loyalty

We have noted already that actual harm to P and bad faith on the part of F are not necessary ingredients of a breach of fiduciary obligation. In order to minimise the risk of F appropriating value and neglecting P's interests the duty of loyalty prohibits the fiduciary from acquiring value in some circumstances where such acquisition does not in fact harm P.

First, by casting liability broadly to capture those situations in which there is no harm to P in fact and in which F is guilty of no moral wrongdoing, the obligation of loyalty functions "to make a wrong less likely, by attempting to avoid situations in which that wrong is more likely to occur".[57] This rationale for strict loyalty can be traced back over two centuries. Thus, it was recognised by Lord Kames in 1800 that however

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[56] E.g. *Cook v Deeks* [1916] 1 AC 554. See Chapter 7, Section V.1(b).

innocent a trustee's profit it remains "poisonous with respect to consequences; for if a trustee be permitted, even in the most plausible circumstances, to make a profit, he will soon lose sight of his duty, and direct his management chiefly for making profit for himself".[58] For this reason equity "by absolute interdiction.....puts temptation beyond the reach of the fiduciary".[59] The stringent rule operates as a prophylactic: it prevents harmful situations from arising and thereby makes the successful pursuit of the objectives of the relationship more likely.

It is also arguably necessary to apply the no-profit and no-conflict rules stringently to avoid evidential difficulties. [60] The fiduciary will usually control the relevant information. He is therefore in a position to conceal actual wrongdoing.[61] Wrongdoing may be also difficult to detect because P lacks the ability to monitor F's activities effectively.[62] Establishing actual fiduciary wrongdoing will be therefore difficult. To avoid this evidential difficulty equity assumes the worst of a fiduciary whenever there is a risk or mere appearance of wrongdoing. This is deemed necessary if "cases deserving of no sympathy are not to escape".[63] By giving the fiduciary less opportunity to wriggle out of liability through placing significant evidential barriers in front of P, fiduciary wrongdoing is deterred. Again, this makes the pursuit of the objectives of the relationship more likely. However, the evidence problem has been question in recent times: evidential difficulties facing P are not as great as they once were as a result of modern civil courts' enhanced fact-finding powers.[64]

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[57]Conaglen, n16 above, at p.469. See also S. Worthington, n13 above, p118.
[58] H.H. Kames, *Principles of Equity* (4th edn, 1800), p.375. See also *Bentley v Craven* (1853) 18 Beav 75 at 76-77 per Romilley MR; *Benson v Heathorn* (1842) 1 Y & CCC 326 at 340 per Knight-Bruce VC.
[59]*Midcon Oil & Gas Ltd v New British Dominion Oil Co* (1958) 12 DLR (2d) 705 at 716 per Rand J.
[60] Cooter & Freedman, n49 above.
[61] Thus, it is said of F that it is in his "own power to conceal" his wrongdoing: *Whelpdale v Cookson* 1 Ves Sen 9 at 27 per Lord Hardwicke. To similar effect, see also the much cited *Ex parte James* 8 Ves 337 at 345 per Eldon LC; *Ex parte Bennett* 32 ER 893 at 900 per Eldon LC; *Lagunas Nitrate Co v Lagunas* [1899] 2 Ch 392 at 462 per Rigby LJ; *Regal* n4 above, at 154 per Lord Wright.
[62] Above, Section II.3(a).
[63] *Boardman v Phipps* [1965] Ch 992 at 1032 per Russell LJ (CA).
[64] *Al-Saraj*, n40 above, at [82] per Arden LJ, [156] per Clarke LJ; *Holder v Holder* [1968] 1 Ch 353 at 398 per Danckwerts LJ, 402 per Sachs LJ. See also D. Paling, "Trustees: Profits and Remuneration" [1974] Conv 330. For the transformation in the fact-finding powers of courts exercising equitable jurisdiction, see J. Langbein, "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?" (2005) 114 Yale LJ 929 at pp.945-947. A rejection of the evidence problem does not invalidate the prophylactic function of loyalty in avoiding situations in which wrongdoing is more likely.

4. The Utility of Fiduciary Organisation

(a) The Fiduciary Relationship as an Efficient Organisational Form

The protection of fiduciary relationships is important. They are a ubiquitous organisational form in developed economic societies. Indeed, writing almost a quarter of a century ago Tamar Frankel went so far as to suggest that "society is evolving into one based predominantly on fiduciary relations." [65] Fiduciary organisation is increasingly adopted because under certain conditions it can allow people to pursue their objectives efficiently and effectively, maximizing both personal and societal wealth.

Society is increasingly organised around highly specialised divisions of labour. The primary advantage of fiduciary organisation is that it can help to maximise the benefits of these specialised divisions.[66] In many instances P's objectives can be pursued more efficiently and effectively by employing a specialist rather than by undertaking the task personally. Employing a specialist also allows P to devote more time to other activities he can do better. By concentrating on activities in which he has a comparative advantage, P also maximises the benefits of his own labour.[67]

Fiduciary organisation also facilitates the efficient pooling of resources and the creation of economies of scale. Aggregating the resources of two or more people allows parties to exploit opportunities that could not have been exploited efficiently (or at all) when acting in isolation. For example, pooling investment funds in the hands of a third party facilitates diversification, allowing returns to be maximised and risks to be minimised. Equally, centralised management of projects or resources by a specialist is likely to produce economies of scale in the use of information and avoid additional running costs that would be incurred if each principal tinkered in day to day management.[67a]

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[65] Frankel, n14 above, at p.798, and see also at pp.801-802.
[66] Frankel, n14 above, at p.803; E.F. Fama & M.C. Jensen, "Separation of Ownership and Control" (1983) 26 Jnl Law & Econ 301; V. Brudney & R. Clark, "A New Look at Corporate Opportunities" (1981) 94 Harv L Rev 997 at p.999; Anderson, n53 above, at p.740ff.
[67] R. Cooter & T. Ulen, *Law and Economics* (2000, 3rd edn), p.30.
[67a] See Anderson, n53 above, at pp.774-775; K. Arrow, *The Limits of Organisation* (1974), pp.69-70.

In short, fiduciary organisation allows resources (including labour) to be channelled to their most productive uses. Individual and societal wealth is thereby maximised. The corporate form is perhaps the most widely documented illustration of these benefits.[68] As Easterbrook & Fischel observe:

> "Those who have wealth can employ it productively even if they are not good managers; those who can manage but lack wealth can hire capital in the market; and the existence of claims that can be traded separately from employment allows investors to diversify their investment interests. Diversification makes investment as a whole less risky…..and therefore makes investment both more attractive and more efficient."[69]

The corporate form is but one illustration. Specialisation, efficient decision-making structures, the pooling of resources and the generation of economies of scale are, to differing degrees, features of other fiduciary forms: partnerships, joint ventures, agency arrangements, express trusts and the like. The social and economic benefits of fiduciary organisation, while difficult to measure precisely, are therefore significant.

(b) Implications for Fiduciary Law

If the benefits of fiduciary organisation are to be maximised individuals must be encouraged to adopt that organisational form, notwithstanding the risk of F's mismanagement or appropriation of value. This requires the law to provide assurances that overcome principals' concerns for the safety of their assets and interests.[70] It also requires the costs of adopting and utilising the relationship to be minimised. Reducing the need or incentive of P to monitor F is particularly important. The relationship would be of little practical or economic benefit if P was required to watch F's every move. Fiduciaries are engaged typically where P does not have the time or expertise to undertake the task personally.

Frankel thus identifies the "main purpose of fiduciary law" as being to "reduce entrustors' risk from embezzlement of their property or interests and to reduce the costs

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[68] See Fama & Jensen, n66 above (emphasising specialisation and decision-making efficiencies); E.F. Fama, "Agency Problems and the Theory of the Firm" (1980) 88 J Pol Econ 288.
[69] F.H. Easterbrook & D.R. Fischel, "The Corporate Contract" (1989) 89 Colum L Rev 1416 at p.1425. See also Anderson, n53 above, at pp.775-776.
[70] T. Frankel, "Fiduciary Duties as Default Rules" (1995) 74 Or L Rev 1209 at p.1223.

of monitoring fiduciaries."[71] The duty of loyalty plays a fundamental role in this respect. More importantly for present purposes, although less recognised in the academic literature, the remedies available for a breach of fiduciary obligation may also impact upon whether and how a party will utilise the fiduciary form. We return to this issue in Section V.

III. Remedial Consequences of a Breach of Fiduciary Obligation

1. The Reach of the Constructive Trust

(a) The Broad English Orthodoxy

The orthodox view of English law is that constructive trust is the "virtually inevitable consequence" of an acquisitive breach of fiduciary obligation.[72] A constructive trust is created immediately upon the receipt of the benefit by F; the role of the court is to simply recognise and enforce P's equitable property right. Acquisitive breach of fiduciary obligation is simply an event constitutive of equitable property in the claimant. It appears that this general principle was developed in the trust and equity treatises of the mid- to late-nineteenth century.[73] One of the clearest statements of it is in the first English edition of Joseph Story's *Equity Jurisprudence*:

> "....where a trustee, or other person, standing in a fiduciary relation, makes a profit out of any transactions within the scope of his agency or authority, that profit will belong to his *cestui que trust*.....and by operation of equity, the profit is immediately converted into a constructive trust in favour of the party entitled to the benefit."[74]

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[71] *ibid.*

[72] Oakley, n6 above, at p.233. See also A.J. Oakley, *Constructive Trusts* (3rd edn, 1997), p.178 (constructive trust arises "more or less automatically" following breach of fiduciary obligation). A limited exception is where the terms of the relationship do not oblige F to keep money separate from his own or to apply it for the exclusive benefit of P: *Paragon Finance v D.B. Thakerar* [1999] 1 All ER 400 at 416 per Millett LJ; *Coulthard v Disco Mix Club Ltd* [2000] 1 WLR 707 (Jules Sher, QC).

[73] See Chapter 5, Section IV.2(b).

[74] W.R. Grigsby (ed) *Commentaries on Equity Jurisprudence* (1st English ed, 1884), §1261.

The views of most commentators have changed little since, except to further emphasise that the trust is, in modern parlance, "institutional" rather than "remedial".[75] However, typically this conclusion is reached with little explicit discussion of the appropriateness of proprietary relief or scrutiny of the authorities on which the claimant's equitable proprietary claim apparently rests. Cases inconsistent with the broad orthodoxy are often dismissed as anomalous or simply wrong;[76] alternative remedies are considered "only when the imposition of a constructive trust is actually impossible".[77]

(b) The Emerging Commonwealth Consensus

A quite different approach is taken in other Commonwealth jurisdictions. In these jurisdictions the mere fact of profitable breach of fiduciary obligation is not in itself sufficient to entitle the claimant to a constructive trust. Rather the court has the power to impose the most appropriate remedy, or determine the most appropriate remedies from which the claimant may elect, following a separate, flexible and contextualised remedial inquiry. This inquiry is "relatively unfettered by legal rules" and involves a search for what is "factually the better solution".[78] Before imposing a constructive trust the court will consider a wide range of factors, including the just claims of third parties,[79] the context in which the fiduciary obligation was breached,[80] and the nature of the breach.[81] In *Maquire v Makaronis*[82] Kirby J was thus keen to emphasise the "wide variety of equitable remedies available to a court of equity following proof of breach of fiduciary duty [which] permit the court to exercise very large powers to

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[75] See e.g. F.M.B. Reynolds, *Bowstead & Reynolds on Agency* (17th edn, 2001), p.174 ("profits made by the agent in breach of his fiduciary obligations are regarded as held for the principal on a full (i.e. non-remedial) constructive trust with proprietary implications"). The clearest recent judicial statement to this effect is *Attorney General for Hong Kong v Reid* [1994] 1 All ER 1.

[76] See the treatment of *Lister & Co v Stubbs* (1980) 45 Ch D 1 in *Reid* and by Oakley, n72 above, pp.134-137.

[77] Oakley, n72 above, p.178. See also P. Hood, "What is so Special About Being a Fiduciary?" (2000) 4 Edinburgh L Rev 308 at p.316. Note, however, the more flexible approach in *Ocular Sciences Ltd v Aspect Vision Care Ltd* [1997] RPC 289 at 416 (Laddie J).

[78] J.J. Doyle, "Commentary" in *Equity and Commercial Relationships* (1987, ed. P.D. Finn), p.211 at 213.

[79] *Katingal Pty Ltd v Amor* (1999) 162 ALR 287; *Soulos v Korkontzilas* (1997) 146 DLR (4th) 214 at 230-232 per McLachlin J.

[80] E.g. domestic or commercial, proprietary relief being more cautiously awarded in the latter: *Hospital Products v USSC* (1984) 156 CLR 41 at 108, 114 per Mason J.

[81] E.g. proprietary relief is often less appropriate when the breach relates to the development of a business rather than the acquisition of specific asset: *Warman International v Dwyer* (1995) 69 ALJR 362 at 369.

[82] (1997) 71 ALJR 781.

fashion orders apt to a full consideration of all the facts".[83] The remedy can be "fashioned according to the exigencies of the particular case so as to do what is 'practically just' as between the parties".[84]

The benefit of this approach is that unlike the English orthodoxy, which fails to openly consider the normative underpinnings of proprietary relief, it reminds us that a constructive trust is not always the appropriate response to an acquisitive breach of fiduciary obligation. However, the desire to achieve "just" outcomes in each case must be balanced with other important goals.[85] More precise guidance as to when it is appropriate to recognise a constructive must be developed if some "formless void if individual moral opinion"[86] is to be avoided.

It appears that this has been recognised in Canada, judicial references to the continued need for discretion and flexibility notwithstanding. In *Soulos v Korkontzilas*,[87] McLachlin J spoke of the need for the "law of constructive trust to develop and for greater precision to be attained, as time and experience may dictate."[88] This suggests that talk of discretion may refer to "rule failure" discretion and a transient "rule-building" discretion.[89] Discretion may be appropriately retained in those circumstances and contexts in which it is unlikely that rules can be developed to achieve appropriate results in a sufficient number of cases. However, for the most part, discretion will exist only until such time as more specific guidance can be provided. Such guidance, particularly in the shape of firm rules, will not be possible until the courts have reviewed a sufficient number of cases to have a sense of the full field of situations to which the guidance will apply. We see below in the context of acquisitive breaches of fiduciary obligation that relatively firm and general remedial guidance is possible for most types of case.

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[83] *ibid.* at 804-805. See D. Wright, "Fiduciaries, Rescission and the Recent Change to the High Court's Equity Jurisprudence" (1998) 13 JCL 166. See also *Lac Minerals*, n2 above; *Cadbury Schweppes v FBI Foods Inc.* [1999] SCR 142.
[84] n82 above, at 806.
[85] As to which, see Chapter 2, Section IV.
[86] *Muschinski v Dodds* (1985) 160 CLR 583 at 615-616 per Deane J.
[87] n79 above.
[88] n79 above, at 230 per McLachlin J.
[89] As to these typologies, see Chapter2, Section II.1(c).

2. Other Available Remedies

The appropriate reach of a particular remedy depends in part on the existence and availability of other remedies. The constructive trust is no different. For example, were constructive trust the only way of stripping F of his gains, we may be prepared to make it more broadly available than if other gain-based remedies were available, such as an account of profits. When determining the circumstances in which a constructive trust is appropriate it is therefore important to keep in mind the alternative remedies that are potentially available. Some breaches of fiduciary obligation attract a greater range of remedial responses than others.[90] However, in addition to the constructive trust the main remedies are an account of profits, the equitable lien and equitable compensation.[91] It is submitted that things would be improved if we added to this list the personal order to transfer specific property.

(a) Account of Profits

An order for an account of profits has long been available to compel a profiting fiduciary to pay over his wrongful gain.[92] It provides the principal with a purely personal claim for the monetary value of F's net gains. Unlike the beneficiary of a constructive trust, the claimant has no entitlement to a particular asset or fund. An order of an account of profits "gives rise to a liability, even in a case of a fiduciary, which is personal".[93] This was recently confirmed in *Ultraframe v Fielding*,[94] where Lewison J confidently pronounced that liability to account "does not carry with it the conclusion that the accounting party is a trustee, or that the person to whom he is liable to account has a proprietary remedy. His liability to account is personal." F is simply an equitable debtor of the sum due.[95] P's claim will therefore rank *parri passu* with the claims of F's general creditors.

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[90] Most notably the receipt of a bribe or secret commission: Chapter 6, Section II.2.

[91] Interim and final injunctions are available as independent or supplemental remedies to prevent threatened breaches or the continuation of a breach: *Normalec Ltd v Britton* [1983] FSR 318 (final injunction); *Hunter Kane v Watkins* [2003] EWHC 186, [2004] EWHC 841 (interim injunction).

[92] See e.g. *Somerville v Mackay* [1810] 16 Ves Jun 382; *Russell v Austwick* [1826] 1 Sim 52.

[93] *Warman*, n81 above, at 367.

[94] [2005] EWHC 1638 at [1517].

[95] This distinction is not, however, always accepted or made clear in the cases: see e.g. the observations of Fisher J in *Cook v Evatt (No 2)* [1991] 1 NZLR 676 at 692 ("a remedy requiring a fiduciary to disgorge profit is a proprietary remedy, not a compensatory one").

(b) Equitable Lien

An equitable lien is a right to a charge upon the property of another until specified claims have been satisfied. It arises "by operation of law"[96] and places the lien holder in the position of secured creditor for the sum due.[97] Like the constructive trust, there appears to be no theme or unifying principle behind the recognition or creation of equitable liens.[98] It is nevertheless increasingly recognised, particularly in the Commonwealth, that the equitable lien may play an important role in cutting back the constructive trust.[99] For example, in the present context a lien may be appropriate to secure an account of profits where P's claim to F's gain is sufficiently strong to justify being insulated from the risk of F's bankruptcy but other factors render specific relief inappropriate.[100]

(c) *Equitable Compensation*

A claim for equitable compensation focuses on the claimant's loss rather than on the defendant's improper gains.[101] The defendant will be personally liable to pay such as will put the claimant financially in the position he would have occupied had the breach not occurred.[102] The remedy functions "to make good a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach."[103] The Courts of Equity have always been willing to award equitable compensation for breach of an exclusively equitable obligation,[104] including

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[96] *Re Welsh Irish Ferries Ltd* [1986] Ch 471 at 477 per Nourse J. See also *Re Bond Worth Ltd* [1980] 1 Ch 228 at 250 (Slade J).
[97] *Combe v Lord Swaythling* [1947] Ch 625 at 628 per Wynn-Parry J. See also *Hewett v Court* (1983) 149 CLR 639.
[98] J. Phillips, "Equitable Liens - A Search for a Unifying Principle" in *Interests in Goods* (1993, eds. N. Palmer & E. McKendrick), p.621.
[99] See P.D. Finn, "Modern Equity" in *The Struggle for Simplicity in the Law: Essays for Lord Cooke of Thorndon* (1997, ed. P. Rishworth), p.89. See also Justice W.M.C. Gummow, "Unjust Enrichment, Restitution and Proprietary Remedies" in *Essays on Restitution* (1990, ed. P.D. Finn), p.47 at 85 (noting that the "modern fascination with the constructive trust" tends to obscure the full range of available proprietary remedies).
[100] Chapter 7, Section V.2.
[101] Talk in the cases of F's liability to pay compensation as being "restitutionary" should not be confused with the modern meaning of the term as giving up or giving back a gain: *Swindle v Harrison* [1997] PNLR 641 at 651 per Evans LJ.
[102] *Target Holdings v Redferns* [1996] AC 421 at 434, 437 per Lord Browne-Wilkinson.
[103] *ibid.* at 438-9 per Lord Browne-Wilkinson.
[104] *Nocton v Lord Ashburton* [1914] AC 932.

breach of fiduciary obligation.[105] However, given that F's gains are often greater than P's loss[106] or that the benefit acquired by F may be specific property subjectively desired by P,[107] P is more likely to seek a gain-based remedy, being an account of profits or delivery of the benefit *in specie* by way of constructive trust.

(d) The Personal Order to Transfer Specific Property

The personal order to transfer specific property would fill a lacuna in English fiduciary law. A constructive trust is specific and proprietary; it gives P the disputed asset and confers priority over F's unsecured creditors and later equitable interests. An account of profits is personal and substitutional; it confers no priority and awards the claimant an equivalent money value rather than the actual disputed benefit. The existing remedial framework does not therefore allow for the surrender of a gain *in specie* without the simultaneous creation of priority. What is necessary is a purely personal form of specific relief. It is demonstrated below that the development of such relief would be of great advantage to English fiduciary law because it would allow the court to award P a specific asset free of the fear of unwarranted priorities.

IV. Justifying Priority: The Problems

Determining the appropriate remedy as between P and F poses few problems in most cases.[108] However, matters are not so simple where F is bankrupt or the gain is received by F's corporate vehicle which becomes insolvent. In this Section we examine the special considerations that make the constructive trust in bankruptcy or insolvency so

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[105] See C.E.F. Rickett, "Where are we Going With Equitable Compensation?" in *Trends in Contemporary Trust Law* (1996, ed. A.J. Oakley), p177; J. Berryman, "Equitable Compensation for Breach by Fact-Based Fiduciaries: Tentative Thoughts on Clarifying Remedial Goals" (1999) 37 Alta L Rev 95; J. Getzler, "Equitable Compensation and the Regulation of Fiduciary Relationships" in *Restitution and Equity* (2000, eds. P.B.H. Birks & F.D. Rose), Vol 1, p235.

[106] See, e.g. *Cooley*, n40 above, where P's chance of acquiring the opportunity appropriated by F was put at just 10%. A claim to compensation would have been discounted to reflect P's rather remote chance of exploiting the opportunity successfully.

[107] E.g. *Soulos*, n79 above.

[108] Below, Section VI.

controversial. We also examine the general justification for priority and its problematic application in the fiduciary context.

1. The Special Considerations in Bankruptcy and Insolvency

(a) The Competitors for the Gain: Principal Versus Creditor

When motivated by the desire to secure priority, claimants often state their case in terms of breach of fiduciary obligation.[109] This is because establishing a breach of fiduciary obligation is generally assumed to provide an automatic gateway to the constructive trust. The constructive trust claimant, as beneficial owner of the disputed gain, can withdraw that property from the pool of assets available for distribution among F's creditors.

In a bankruptcy or insolvency situation the debtor's assets are invariably insufficient to satisfy the claims of all creditors in full. Granting P a priority claim therefore means there will be less to distribute to other creditors, who will as a consequence receive fewer pence for every pound they are owed. Competition for F's gain is not therefore between P and F; it is between P and innocent third parties – F's creditors. It follows that any satisfactory justification for the imposition of a constructive trust must demonstrate why one creditor (P) should have his claim satisfied in full when this increases the losses of others.

(b) The Potential Costs of Equitable Proprietary Claims

It is also necessary to factor into any decision to grant a claimant priority by way of constructive trust the broader costs of such claims.[110] Importantly, equitable proprietary claims increase the risks of unsecured creditors by reducing their expected value in bankruptcy. Proprietary claims may therefore impact negatively on the price and

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[109] See e.g. *Liggett v Kensington* [1993] 1 NZLR 257, reversed in *Re Goldcorp* [1995] 1 AC 74; *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd (in administrative receivership)* [2005] EWCA Civ 722, [2006] 1 BCLC 60.

[110] The need for caution in granting equitable property rights due to their unsettling effects on insolvency is increasingly recognised by the judiciary: see e.g. *Re Stapylton Fletcher Ltd* [1995] 1 All ER 192 at

supply of unsecured credit. Moreover, as the risks of lending on an unsecured basis increase creditors are likely to be drawn to ways of reducing the risk such as taking security. This may increase the cost of credit transactions. Encouraging creditors to encumber their debtors' estates by the early taking of security also leaves debtors with less borrowing capacity in times of need, when credit is usually only available on a secured basis. Cutting off access to credit at such times may deny businesses the opportunity of trading their way out of what may be nothing more than short term financial difficulty.[111]

Secured lenders are also not free from the risks of equitable proprietary claims. This is because equitable proprietary claims, although invisible, take priority over equities and later equitable interests.[112] As McCormack notes:

> "These third parties may have advanced credit on the assumption that they would achieve priority. If this assumption proves to be unfounded the source of loans may dry up to the detriment of the mainsprings of commercial life. Alternatively, the rate of interest chargeable on loans may be increased and again this may have a deleterious effect on commercial activity."[113]

Equitable proprietary claims may also create practical problems for the administration of a bankrupt's estate (or analogous corporate insolvency procedure) or increase the costs of the trustee in bankruptcy (or liquidator/administrator). This is particularly likely where such claims are ill-defined or the triggering facts are such as to make the identification or quantification of an equitable interest less than simple.[114]

213-214.

[111] The lack of credit would thus generate further social and economic costs, namely those that follow from business failure: S.L. Schwarcz, "The Easy Case for the Priority of Secured Claims in Bankruptcy" (1997) 47 Duke LJ 425 at pp.446-449.

[112] G. McCormack, *Proprietary Claims and Insolvency* (1997), pp.14-15, 43-49; J. Ulph, "Equitable Proprietary Rights in Insolvency: The Ebbing Tide?" [1996] JBL 482; A. Belcher & W. Beglan, "Jumping the Queue" [1997] JBL 1.

[113] G. McCormack, "Proprietary Claims and Insolvency in the Wake of *Westdeutsche*" [1997] JBL 48 at p.67.

[114] See the concerns of Pincus J in *Re Osborne* (1989) 91 ALR 135 at 141 (dealing with a claim under the doctrine espoused in *Baumgartner v Baumgartner* (1987) 164 CLR 137, which "no one could pretend.....is likely to lead, in the ordinary case, to a simple resolution").

(c) The Difficulty of Securing Just Priorities in Practice

Even if we can identify good reasons in theory for awarding P a priority claim it is necessary to consider the ability of judges to achieve justice in practice. Justice in theory does not necessarily equate to justice in practice.[115] The difficulty of realising just priorities in practice may count against the recognition of proprietary claims, particularly where the justification for the claimant's priority is weak or marginal.

Perhaps the most significant barrier to practical justice in bankruptcy relates to the identification of assets which are appropriately subject to a constructive trust. Equitable tracing rules identify the assets that the law recognises as belonging to P and which are therefore excluded from distribution to F's creditors. However, tracing rules may operate to grant arbitrary preferences. It is difficult to see the justice of awarding P a priority claim to property in F's hands which is not causally linked to an asset in which P had a proprietary interest.[116] However, a causal connection is not required by equitable tracing.[117] To require such would often prove impractical if not impossible.[118] Equitable tracing therefore requires a "transactional link" (or series of such links) between the original property and that which P claims. This provides a workable "second-best" solution to the problem of identifying causally relevant assets. It is a necessarily "blunt instrument with which to implement legitimate policy objectives."[119] In practice, however, it may result in the granting of an arbitrary preference in that P will be granted a proprietary interest in causally unconnected property.

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[115] C. Rotherham, "The Recovery of the Profits of Wrongdoing and Insolvency: When is Proprietary Relief Justified?" (1997) 1 CFILR 43 at p.48.

[116] C. Rotherham, *Proprietary Remedies in Context* (2002), p.111.

[117] See S. Walt & E. Sherwin "Contribution Arguments in Commercial Law" (1993) 42 Emory LJ 897 at pp.926-928; D.A. Oesterle, "Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC §9-306" (1983) Cornell L Rev 172 at pp.195-208.

[118] Rotherham, n116 above, at p.113. Although this view is not universal: see S. Evans, "Rethinking Tracing and the Law of Restitution" (1999) 115 LQR 469; P. Jaffey, *The Nature and Scope of Restitution* (2000), p.298.

[119] C. Rotherham, "Tracing and Justice in Bankruptcy" in *Restitution and Insolvency* (2000, ed. F. Rose), p.113 at 130. See also A. Kull, "Rationalizing Restitution" (1995) 83 Cal L Rev 1191 at p.1217 (tracing is a "rule of thumb" for the identification of assets that are most likely to be causally related).

2. The General Theory of Priority: Corrective Justice and Involuntariness

As the last in the statutory line of priorities unsecured creditors are most likely to be affected by the imposition of a constructive trust. It is priority over these creditors that a convincing theory of priority must primarily explain. Two requirements are generally regarded as necessary and sufficient to justify priority: (a) a correlation between the defendant's material gain and the claimant's material loss; and (b) that the claimant has not voluntarily assumed the risk of the defendant's bankruptcy.

(a) Correlation of Material Gain and Loss and the Argument of Corrective Justice

Private law claims are viewed as most compelling where the claimant's material loss is the defendant's material gain.[120] Unjust enrichment claims, which involve a reversible transfer of wealth from claimant to defendant, provide the central illustration. The requirement that the defendant give back the enrichment reverses the transfer and returns the parties to their original positions. Unjust enrichment claims therefore have "strong appeal in terms of fairness and corrective justice".[121]

The equation of material gain and loss in unjust enrichment claims is said to strengthen the claimant's case for priority over the defendant's unsecured creditors. On the assumption that the enrichment continues to augment the defendant's estate,[122] a constructive trust effects corrective justice between the claimant and the defendant's creditors by placing each of the affected parties in the positions they would have occupied had the unjust enrichment never occurred.[123] This of course begs the question why is corrective justice between the parties desirable? The answer, Rotherham explains, rests on arguments of autonomy: "to allow creditors to have recourse to assets

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[120] Such claims are "twice as strong" as claims based on loss alone because "if A not only causes B to lose one unit but appropriates that unit to himself, the resulting discrepancy between A and B is not one unit but two": L.L. Fuller & W.R Perdue, "The Reliance Interest in Contract Damages" (1936) 46 Yale LJ 52 at p.56. Dawson suggests that the resulting discrepancy means P suffers twice the anguish of one whose claim is based on loss alone: J.P. Dawson, *Unjust Enrichment: A Comparative Analysis* (1951), p.5. For an evaluation of the normative appeal of these reasons, see C.T. Wonnell, "Replacing the Unitary Principle of Unjust Enrichment" (1996) 45 Emory LJ 153 at pp.177-184. The language of "material gain" and "material loss" is adopted here to clearly distinguish the situations under discussion from those involving a "normative" or "notional" correlation of gain and loss of the sort that connects all private law claimants to particular defendants: see E.J. Weinrib, *The Idea of Private Law* (1995).

[121] E.L. Sherwin "Constructive Trusts in Bankruptcy" [1989] U Ill L Rev 297 at p.330.

[122] As determined by the law of tracing: see above, Section IV.1(c).

gained without plaintiffs' real consent would show a lack of respect for the autonomy of such plaintiffs and so would result in the unjust enrichment of the defendant's creditors".[124]

(b) The Voluntary Assumption of Risk Rationale

The corrective justice argument might explain the priority of unjust enrichment claims over claims based on loss alone – for example a claim for compensation in tort for negligently inflicted harm.[125] But it cannot explain priority over all of the defendant's contract creditors. Ordinary contract creditors are not afforded priority even though they may have advanced money or goods which continue to swell the defendant's estate. However, unlike unjust enrichment claimants, contract creditors are said to have voluntarily assumed the risk that their debtor may become bankrupt.[126]

Since ordinary contract creditors deal with their debtor on a voluntary basis they might be reasonably expected to protect themselves through such means as contracted for security. If they do not it is plausible to assume that they chose to run the risk of becoming an unsecured creditor. By contrast, where a claimant's disposition of wealth is involuntary there is no intention to enrich the defendant and the claimant has "no opportunity to demand compensation for the risk of insolvency in the form of price or

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[123]Sherwin, n121 above, at pp.329-333; Rotherham, n116 above, at pp.80-81.
[124] Rotherham, n116 above, at p.81.
[125] Although see Hanoch Dagan's critique in "Restitution in Bankruptcy: Why All Involuntary Creditors Should be Preferred" (2004) 78 Am Bankr LJ 247.
[126] P.D. Maddaugh & J.D. McCamus, *The Law of Restitution* (2nd edn, 2003), pp.119-121; A Burrows, "Proprietary Restitution: Unmasking Unjust Enrichment" (2001) 117 LQR 412 at pp.425-428; Rotherham, n116 above, pp.81-86; Rotherham, n119 above, at 126-130; G. McMeel, *The Modern Law of Restitution* (2000), pp.405-406; D. Friedmann, "Payment Under Mistake: Tracing and Subrogation" (1999) 115 LQR 195 at p.198; R. Goff & G. Jones, *Law of Restitution* (5th edn., 1998), p90; D. Wright, *The Remedial Constructive Trust* (1998), pp.144-145; K. Heuston, "Constructive Trusts: Are They Unfair to Creditors?" [1995-6] RALQ 159 at pp.176-183; S.R. Scott, "The Remedial Constructive Trust in Commercial Transactions" [1993] LMCLQ 330 at pp.341-349; J. Glover, "Bankruptcy and Constructive Trusts" (1991) 19 Aust Bus L Rev 98 at pp.121-122; D. Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priority Over Creditors" (1989) 69 Can Bar Rev 315 at pp.324-325, 340-347; Sherwin, n121 above, at pp.335-337, 350-360; G. Palmer, *The Law of Restitution* (1978) §2.14, pp185-186; F.R. Lacy, "Constructive Trusts and Equitable Liens in Iowa" (1954) 40 Iowa L Rev 107 at pp.139-140. For judicial recognition of the rationale, see *Re Hallet*, n4 above, at 730 per Lord Jessel MR; *Space Investments v Canadian Imperial Bank of Commerce Trust Co* [1986] 3 All ER 75 at 77 per Lord Templeman; *Stephenson Nominees Pty Ltd v Official Receiver* (1987) 16 FCR 536 at 556 per Gummow J; *Liggett v Kensington* [1992] 1 NZLR 257 at 274 per Cooke P: *Lord Napier & Ettrick v Hunter* [1993] 1 AC 713 at 737 per Lord Templeman; *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669 at 684 per Lord Goff.

interest, or protection by means of collateral."[127] The risk of the defendant's bankruptcy is not assumed voluntarily.

3. The Fiduciary's Gains and the Argument of Corrective Justice

It has been noted already that F's gain may be one of three kinds: it may be misappropriated directly from P; it may be acquired from a third party in circumstances where such act does not in fact harm P; or it may be acquired from a third party and such acquisition prevents it arriving at P. The argument of corrective justice applies clearly to the first category but not to the second. Its application to the third category is uncertain.

(a) Direct Misappropriation From P

In some instances F simply misappropriates P's property. For example, a company director embezzles the company's funds or a trustee purchases a trust asset at a gross undervalue. Such cases fall squarely within the corrective justice framework noted above. It is easy to see why a remedy that is specific and confers priority is appropriate. Priority protects P against involuntary transfers of wealth to creditors via F. Delivery-up of that which P owned previously rather than a money substitute is important where the property itself rather than its simple economic value is what is important to P. This might be because P has formed a psychological attachment to the property.[128] When such attachments are formed the loss of the asset causes "pain that cannot be relieved by the object's replacement".[129] In other instances P may desire the asset because it is rare, unique or difficult to replace.[130] In cases of misappropriation of P's property a constructive trust is therefore autonomy-enhancing.

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[127] Sherwin, n121 above, at p.336.
[128] J.J. Rachlinski & F. Jourden, "Remedies and the Psychology of Ownership" (1998) Vand L Rev 1541 at pp.1551-1559.
[129] M.J. Radin, "Property and Personhood" (1984) 32 Stan L Rev 957 at p.959.
[130] The inadequacy of a money remedy has long been recognised for this reason: see the cases on the delivery-up of unique chattels: *Pusey v Pusey* (1684) 1 Vern 273; *Duke of Somerset v Cookson* (1735) 3 P Wms 390; *Lowther v Lord Lowther* (1806) 13 Ves 95.

(b) Pure Disgorgement/Windfall Cases

F's gain is often acquired from a third party rather than misappropriated directly from P. In some cases F's wrongful acquisition causes P no harm or loss and P has no prior connection to the benefit in question.[131] P's claim in these three party cases is for disgorgement (giving up); it is not for restitution (giving back).[132] The requirement that F give up his gain to P makes P better off than he was prior to the breach and better off than he would have been had no breach occurred. Such cases clearly fall outside the corrective justice framework.

(c) Factual Interception Cases

In other three party cases F's wrongful acquisition causes a correlative loss to P in the sense that it is F's acquisitive breach which is the event that prevents the benefit arriving at P. These, in Birksian terminology, are cases of "interceptive" or "anticipatory" subtraction.[133] Birks reasoned that before there could be an interceptive subtraction it must be shown the benefit was "indubitably *en route*" to and would "certainly have arrived" at P but for the interception. Where this burden is met Birks reasoned it is true to say that F's gain is made by subtracting wealth from P.[134]

It is not clear why Birks required such a high burden of proof.[135] The conclusion that F's gain is P's loss would seem to follow equally where it is established that but for the acquisitive breach the gain would, on the balance of probabilities, have gone to P in the

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[131] A notable exception is the renewal of a lease, in which case F's renewal for his personal benefit may not be the reason for its non-arrival at P but P may have a connection to the property in that he previously enjoyed the benefit of the lease.

[132] L.D. Smith, "The Province of the Law of Restitution" (1992) 71 Can Bar Rev 672; G. Virgo, *The Principles of the Law of Restitution* (2nd edn, 2006), pp.4-5.

[133] P.B.H. Birks, *An Introduction to the Law of Restitution* (1989), pp.133-138, 142-145. Although Birks did not develop the idea with the identification of proprietary relief in mind, he did acknowledge that such claims warranted a proprietary response: P.B.H. Birks, "Personal restitution in Equity" [1988] LMCLQ 128 at p.134.

[134] This was important for Birks since his dominant motivation for the idea was to facilitate the correct classification of the claimant's cause of action: interception cases belonged to restitution, not wrongs, therefore "there is a claim available without reliance on the breach of duty": n133 above, at p.137. The classification has been subject to widespread criticism: Virgo, n132 above, pp.108-112; M. McInnes, "Interceptive Subtraction, Unjust Enrichment and Wrongs – A Reply to Professor Birks" [2003] CLJ 697; L.D. Smith, "Three Party Restitution: A Critique of Birks's Theory of Interceptive Subtraction" (1991) 11 OJLS 481.

[135] For further discussion, see Chapter 7, Section V.1(d).

ordinary course of events. Such cases are referred to below as cases of "factual interception", to avoid confusion with Birks' narrower conception of interceptive subtraction.

In cases of factual interception a constructive trust does not return the gain whence it came: F "gives up" rather than "gives back" the gain. This is disgorgement and therefore does not seem to fall within the corrective justice framework.[136] However, ordering F to give-up the benefit to P simultaneously erases F's wrongful gain and P's wrongfully caused loss, as measured by reference to the circumstances that would have pertained in the ordinary course of events had F not breached. A constructive trust simply "redirects the title of the [disputed] property to its original course".[137] The parties are placed in the positions they would have occupied.

We might conclude that the constructive trust in such cases is corrective. However, in the end the important question is not whether we can force the case into a corrective justice framework but whether there is good reason to place the parties in the positions they would have occupied in the ordinary course of events had the breach not occurred. We return to this question in Section V where it is argued that placing the parties in the positions they would have occupied is justified by reference to the argument of utility.

4. Is the Principal an Involuntary Creditor?

Even if we assume that the acceptance of risk rationale offers a satisfactory basis for prioritising unjust enrichment claims over contract claims[138] its application in the fiduciary context remains problematic. It was famously remarked in the American case of *Re Kountze Bros* that "the fiduciary's creditors have accepted the risk of his

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[136] L.D. Smith, *The Law of Tracing* (1997), pp.297-298.

[137] *Lac Minerals*, n2 above, at 51 per La Forest. See also *Soulos*, n79 above, at 231 per McLachlin J.

[138] The rationale is not without its critics. The most common objection is that the theory lacks explanatory force in practice because not all contract creditors are well placed to assess their debtor's solvency or bargain for security: *Hewett v Court* (1983) 149 CLR 639 at 651 per Murphy J (consumers "unlike trade creditors, cannot be expected to inquire into the insolvency of the person with whom they are dealing"); D.W.M. Waters, "Trusts in the Setting of Business, Commerce and Bankruptcy" (1983) 21 Alta L Rev 395 at p.433 (unrealistic to expect creditors to bargain for security in contexts where it is not customarily sought and the market is competitive); F.H. Lawson, *Remedies of English Law* (2nd edn, 1980), p.300 (unrealistic to assume unsecured creditors voluntarily accept their position); *Liggett v*

insolvency, while his *cestuis* have accepted only the risk of his honesty".[139] More recently Youdan remarked that P never intentionally puts his rights to misappropriated or intercepted property "at the risk of his fiduciary's personal dealing with it or at the risk of his insolvency."[140] However, such comments arguably overstate the case. In many instances P voluntarily places his property or interests in F's hands. Like ordinary contractual arrangements, many fiduciary arrangements are therefore consensual. This point is illustrated graphically by recent contractarian analyses of fiduciary relationships.[141] By voluntarily entering the relationship without taking further precautions surely P accepts a cognisable risk that F might not only behave dishonestly but also become bankrupt.

A common response is that, while P may be aware of the possibility that F might become bankrupt, he nevertheless does not assume the risk of becoming an unsecured creditor because he arranges his affairs with one eye on the legal consequences of the relationship – including the priority advantage. The problem with this reasoning is that it can be used to explain away whatever risks the positive law allocates. As Rotherham observes, "it is circular to use the prevailing risks to justify the law that imposes those risks. The very matter at issue is precisely what risks the law should impose on different classes of creditors."[142] Thus, by voluntarily entering the relationship P can be said to accept whatever risks are imposed by the law, but those risks must be justified on other grounds. The suggestion in the next section is that the risks are most appropriately allocated in the fiduciary context by considerations of utility.

Kensington [1992] 1 NZLR 257 at 294 per McKay J (same).

[139] 79 F 2d 98 at 102 (2nd Cir 1935).

[140] T.G. Youdan, "The Fiduciary Principle: The Applicability of Proprietary Remedies" in *Equity, Fiduciaries and Trusts* (1989, ed. T.G. Youdan), p.93 at 106.

[141] E.g. Easterbrooke & Fischel, n14 above; J. Langbein, "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale LJ 625. Although an express trust is a consensually created relationship the beneficiary will not have voluntarily placed his interests or property in the hands of the trustee, unless he is also the settlor. Nevertheless, beneficiaries may be viewed as voluntary if they could call for the transfer of the trust property outright but fail to do so. In such cases they voluntarily leave their interests in the hands of the trustee.

V. JUSTIFYING PRIORITY BY THE ARGUMENT OF UTILITY

1. The Basic Idea

We saw above that fiduciary organisation facilitates the maximisation of personal and societal wealth. It is therefore important to both encourage its use and minimise its costs. Use is encouraged by maximising the attractiveness of the fiduciary form. This can be most easily achieved by minimising the risk that the objectives of the relationship will be frustrated. A significant risk of frustration is F's appropriation of value – by either direct misappropriation or factual interception of benefits on their way to P. A right to recover such benefits *in specie* reduces this risk. But unless that right is proprietary P remains subject to the risk that the objectives of the relationship will be frustrated by F's bankruptcy. In the face of such risk we might expect to find parties:

1. avoiding the relationship and forgoing potentially profitable projects or activities altogether;

2. avoiding such relationships and adopting less efficient organisational forms, such as undertaking projects or activities personally; or

3. continuing to adopt the fiduciary form but taking increased precautions, such as monitoring or bargaining for increased protection and hence incurring additional costs.

We see below that by reducing the appreciable risks of fiduciary organisation, a proprietary claim to misappropriated or intercepted benefits encourages the use of this important organisational form and reduces overall monitoring and transaction costs. It follows that it is incorrect to suggest that "it would create better incentives for the proper regulation of these relationships if only personal relief were available and beneficiaries were thereby encouraged to protect themselves against the actions of dishonest fiduciaries".[143]

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[142] Rotherham, n116 above, at p82.

2. Priority Over Unsecured Creditors

The insolvency risk is likely to be a significant concern of many principals. Absent a priority claim to misappropriated or intercepted benefits F's bankruptcy potentially frustrates the relationship by (1) reducing P's actual or anticipated level of wealth; and (2) depriving P of specific assets which may be desired for reasons other than their simple economic value. Whether P is insulated against the insolvency risk is therefore likely to impact upon the extent to which and manner in which fiduciary organisation is utilised.

(a) Straightforward Misappropriation Cases

The utility of insulating from F's bankruptcy assets beneficially owned by P at the outset of the relationship and assets properly acquired for P during the conduct of the relationship is broadly recognised. Thus, having noted the social and economic benefits of fiduciary relationships, and having recognised that such arrangements would be less effective if principals faced the risk of losing their property upon fiduciary bankruptcy, Sherwin reasons:

> "The protection the beneficiary receives from a constructive trust remedy is not absolute; it depends on tracing and is lost upon dissipation of the products. But the assurance of a restitutionary remedy that will give the beneficiary a prior right to recover the property or its traceable products (in effect, a right of equitable ownership) may have a real impact on her initial decision to enter the arrangement. Therefore, a constructive trust remedy, applicable in bankruptcy, is necessary to preserve the utility of the relationship."[144]

Others point out that F's creditors are often better placed than P to monitor their debtor and can look after their own interests at a lower cost than P through express bargaining. A pattern of creditors' rights that prefers P thus economises on total transaction and monitoring costs of all the relevant parties – principal, fiduciary and the creditors of both.[145]

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[143] *ibid.* at p.84.
[144] Sherwin, n121 above, at p.356.
[145] H.Hansmann & R. Kraakman, "The Essential Role of Organisational Law" (2000) 100 Yale LJ 387; H.Hansmann & R. Kraakman, "Organisational Law as Asset Partitioning" (2000) 44 Eur Econ Rev 807.

(b) Factual Interception Cases

Analogous arguments apply to priority claims for intercepted benefits. The objectives of a fiduciary relationship might be frustrated as much by the non-arrival of benefits as by the misappropriation of P's existing wealth. This is particularly apparent in relationships where F's primary function is acquisitive or developmental (purchasing agents, directors etc.) rather than simply property-holding (e.g. trustee of family assets). A constructive trust of intercepted benefits appreciably reduces the risk of frustration of the relationship through F's interception and bankruptcy. Fiduciary organisation is thereby made more appealing. A constructive trust is also likely to minimise transaction and monitoring costs.

Absent a priority claim to intercepted benefits P and F would have an incentive to bargain to insulate P from the bankruptcy risk: it makes fulfilment of P's objectives more likely and makes F's services more marketable. A default priority rule therefore avoids transaction costs by giving the parties the rules of organisation that they are likely to prefer. Indeed, in many instances it is difficult to see how it would be practicable or feasible for P and F to arrange their relationship to avoid frustration of its objectives through F's interception and bankruptcy.[146]

Absent a default priority rule P would also have a greater incentive to monitor F's conduct and financial affairs. However, principals are typically poorly placed and inefficient monitors.[147] Encouraging such monitoring is also inconsistent with specialisation: time spent monitoring F could be more productively devoted to the pursuit of activities in which P has a comparative advantage.[148] Encouraging close scrutiny of F by P therefore makes little sense and is costly.

Prioritising P transfers risk to F's other creditors. However, F's contract creditors are

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For specific application to express trusts, see H. Hansmann & U. Mattei, "The Functions of Trust Law: A Comparative Legal and Economic Analysis" (1998) 73 NYUL Rev 434 at pp.451-463.

[146] See especially Chapter 7, Section V.1(b).

[147] See above, Section II.3(a).

[148] See above, Section II.4(a).

generally better placed to avoid the bankruptcy risk at lower cost.[149] First, they are likely to be better placed and lower cost monitors of their debtor.[150] For example, repeat trade creditors who deal frequently with their debtor and extend credit over relatively short periods of time are well placed to detect signs of incipient financial decline.[151] Creditors who are less efficient monitors might reduce their monitoring costs and the risks to which they are exposed by taking security.[152] Second, F's contract creditors are also likely to have relatively accessible and low cost means of responding to the bankruptcy risk: taking security; shortening the term of credit; inducing early voluntary repayment through prompt payment discounts; refusing to extend credit; or demanding better terms for bearing the risk.[153] Granting P priority to the extent necessary to preserve the objectives of the relationship is therefore likely to economise on the total transaction and monitoring costs of P, F and F's creditors.

(c) Pure Disgorgement/Windfall Cases

In the absence of misappropriation or interception F's acquisitive breach does not in fact frustrate the objectives of the fiduciary relationship. A refusal to grant a proprietary claim to such benefits would therefore provide P with little incentive to avoid the relationship or to incur additional costs monitoring F or bargaining for priority to such benefits. However, granting a proprietary claim to such benefits would transfer additional risk to creditors by further reducing their expected value in bankruptcy. This provides additional incentive for creditor monitoring and the taking of security. A priority claim to such benefits may therefore increase total transaction and monitoring costs.

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[149] Tort claimants are generally poorly placed to avoid the risk, but the impact on such claimants should not be overstated. In England legislation allows the victim to recover compensation directly from the bankrupt tortfeasor's insurer: Third Parties (Rights Against Insurers) Act 1930 and Road Traffic Act 1988, s.151.

[150] Hansmann & Kraakman, n145 above, at p.425 (emphasising the different types of information available to contract creditors).

[151] T.H. Jackson & A.T. Kronman, "Secured Financing and Priorities Among Creditors" (1979) 88 Yale LJ 1143 at pp.1160-1161.

[152] *ibid.*

[153] Where the creditor is a consumer making advanced payments for goods and services (the class of creditor generally viewed as the most helpless) the insolvency risk can be significantly reduced at low cost by paying by credit card: see Consumer Credit Act 1974, s75.

That conclusion assumes that evidential difficulties facing P (given the requirement to demonstrate an equation of gain and loss) will have minimal impact on P's decision-making. However, the evidence problem means in reality P may not be insulated from the risk of frustration of the objectives of the relationship through fiduciary bankruptcy because an actual interception may be impossible to prove. Confidence in fiduciary relationships may be reduced and additional monitoring and contracting encouraged. The proposed remedial inquiry will be also more costly to administer because P is required to prove an additional element to gain access to priority. If these costs are significant then there may be no net gain to limiting P to priority in cases of interception.

However, the impact of the evidence problem on P's conduct is likely to be negligible, as are the increased administrative costs of the remedial inquiry. The evidence problem carries less weight than it once did and the additional element in the remedial inquiry assumes relevance only on the few occasions in which P seeks to be insulated from the bankruptcy risk. Taking into account the increased costs associated with extensions of proprietary claims and the additional risk that would be transferred to creditors under an automatic priority rule, an approach limiting priority to interception cases, coupled with the availability of a purely personal order to transfer property in other cases, is likely to generate the greater net benefits.

3. Utility and Other Priority Disputes

(a) Principal Versus Secured Creditors

The principal's objectives are also at risk of frustration from F wrongfully holding out misappropriated or intercepted assets to third parties as security. The protection afforded to P by an equitable proprietary claim significantly reduces this risk, though it does not eliminate it entirely.

Equitable proprietary claims are usually defeated by the holder of a legal charge, who is likely to be a *bona fide* purchaser of the legal interest for value without notice.[154] The doctrine applies where the charge holder makes such investigations of F's title that are in the circumstances reasonable. A degree of protection is therefore afforded to P. Indeed, it is arguable that the doctrine functions to allocate the risk of loss to the party who could have avoided it at the least cost. It therefore encourages an efficient level of precaution.[155]

A constructive trust ranks P ahead of later equitable security interests, notwithstanding that the later interest was acquired for value and without notice of P's rights, under the first in time principle.[156] Even here, it is plausible to assume that such a rule will in most circumstances allocate risk to the party best placed to avoid it.[157] Assuming the risks from invisible proprietary claims remain relatively stable (which would be unlikely under strongly discretionary remedial approaches) creditors can price the cost of the credit they extend to reflect the average level of risk inherent in the form of security they have selected. They are therefore able to effectively and expeditiously compensate themselves for the risks. Moreover, some secured creditors, particularly those holding floating charges, will be relatively well placed to monitor their debtor's conduct and solvency.[158]

(b) Principal Versus Remote Recipient

Priority disputes can also arise outside the bankruptcy and insolvency contexts when F transfers assets to a third party (T).[159] In such cases causally relevant gain may remain in F's hands (i.e. the exchange product). However, if F is bankrupt and has dissipated the exchange product or the intercepted or misappropriated asset is intrinsically

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[154] McCormack, n112 above, pp.43-44.
[155] Section V.3(b).
[156] *Cave v Cave* (1880) 15 Ch D 639.
[157] Hansmann & Mattei, n145 above, at p.456. Moreover, the principle is applied somewhat flexibly and may be reversed where necessary: *Rice v Rice* (1854) 2 Drew 73. Thus, where P is considered responsible for the priority dispute (as he may well be where he fails to take least cost measures to avoid the dispute) the priorities may be reversed.
[158] They are therefore appropriately encouraged to monitor by a rule conferring priority on less able monitors: *Liggett v Kensington* [1992] 1 NZLR 257 at 274 per Cooke P.
[159] See M. Mautner, "'The Eternal Triangles of the Law': Towards a Theory of Priorities in Conflicts Involving Remote Third Parties" (1991) 90 Mich L Rev 95; D. Fox, "Constructive Notice and Knowing Receipt: An Economic Analysis" [1998] CLJ 391.

valuable, the transfer to T will frustrate the objectives of the relationship. Granting a right of recovery from T thus reduces the risk that the objectives of the relationship will be frustrated by F's misappropriation or interception and subsequent dealings with third parties.

By lowering the risk a proprietary claim reduces the incentive for P to incur costs monitoring F and makes fiduciary organisation more attractive because it is more secure. However, the risk of loss from such priority disputes is transferred to T. It is well documented that equitable proprietary claims risk upsetting the smooth functioning of commerce by requiring costly and lengthy investigations of title by cautious recipients.[160] The benefits to P must be therefore weighed against the costs of increasing T's incentive to investigate title. This is arguably achieved by the context sensitive application of the notice standard found in the *bona fide* purchaser rule.[161] It is arguable that the rule reduces total monitoring costs by imposing liability on T to the extent he could have taken precautions to avoid the conflict at less cost than P. [162]

4. The Doctrinal Appropriateness of the Suggested Remedial Inquiry

One potential objection is that determining the nature of relief by reference to an inquiry into P's loss is doctrinally incoherent. The courts have not entertained inquiries into loss when determining F's liability. Equally, such inquiries are not a legitimate remedial consideration. Matters "which on grounds of policy are rejected as irrelevant to liability cannot, without some sacrifice of consistency, be reintroduced as determinative of the nature of the relief to be granted."[163] With respect, it is difficult to see the force of this objection.

Loss is irrelevant to liability for reasons of deterrence and to avoid evidential

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[160] W. Goodhart & G. Jones, "The Infiltration of Equitable Doctrine into English Commercial Law" (1980) 43 MLR 489; R.M. Goode, "The Right to Trace and its Impact in Commercial Transactions - II" (1976) 92 LQR 528 at p.568.

[161] For evidence of the development of a context sensitive standard, see e.g. *Cowan de Groot Properties v Eagle Trust* [1992] 1 All ER 700.

[162] Optimal monitoring is thereby encouraged as the loss is borne by the party who could have avoided it at least cost: Fox, n159 above; Hansmann & Mattei, n145 above, at p.464; Mautner, n159 above.

[163] P.J. Millett, "Remedies: The Error in *Lister v Stubbs*" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 1, p.51 at 54.

difficulties, which may arise because F controls the relevant information. Deterrence is furthered by the high probability that F will be stripped of his wrongful gain. The proposed remedial framework does not affect this probability. Where F is bankrupt the gain will, in the absence of a demonstrable equation of gain and loss, be distributed to innocent creditors rather than to F personally; where F is solvent the presumptively available personal order to transfer specific property ensures F is stripped of the benefit by its transfer to P. Evidential difficulties afford no reason to give P the advantage of presumptions where their effect is to facilitate recovery against innocent third parties. The fiduciary's creditors are "no more likely than the principal (perhaps less) to have access to the facts that bear on the question".[164]

VI. The Appropriate Relief As between Principal and Fiduciary

In most cases competition for F's gain will be between P and F rather than P and third parties. Clearly P's claim to the gain has merit where the benefit in F's hands is either misappropriated from P or intercepted on its way to P. Awarding P the gain *in specie* avoids frustration of the objectives of the relationship. However, F is liable to disgorge wrongful gain even if its acquisition caused P no harm.[165] The justification for such disgorgement and the extent to which it demands specific relief and priority are examined in this section.

1. The Underpinnings of Pure Disgorgement

(a) The Deserts of the Unworthy Defendant

The disgorgement of wrongfully acquired gains may inflict on the unworthy fiduciary his "just deserts". This rationale has intuitive appeal in the case of the consciously disloyal fiduciary who, motivated by greed, engages in the cold and calculated

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[164] Youdan, n140 above, at p.108.

[165] Or caused harm but such harm bears no connection to F's gain, as where F's pursuit of private gain leads him to direct his time and energy elsewhere and to the neglect of the management of P's affairs:

exploitation of P's reliance and trust for personal gain. However, a desert-based rationale dictates that only morally blameworthy acts are punished and that the punishment meted out must be proportionate to the wrongdoing.[166] It therefore has less appeal when applied to good faith fiduciaries, such as Mr Boardman[167] or the directors in *Regal*,[168] who commit innocent but profitable breaches.

(b) Deterring Disloyal Conduct

We have seen already that the fiduciary obligation of loyalty is designed to prevent misconduct occurring in the first place.[169] The theory of deterrence posits that where the costs of wrongdoing are sufficiently high to outweigh the likely benefits, individuals are deterred from pursuing the proscribed activity. Thus, requiring disgorgement of F's profits "is so to speak good for discipline: there is a penal element calculated to deter agents from behaving in that way".[170]

However, critics note that simply stripping the wrongdoer of his gain "is not much of a deterrent".[171] The effectiveness of deterrence depends not only on the price of the sanction but also on the probability that the sanction will be applied. The problem is that detection and enforcement rates are not perfect. If successful enforcement occurs in, say, fifty *per cent* of all cases the fiduciary can expect to keep, on average, half of his wrongful gains. A calculating fiduciary would therefore realise that wrongdoing is on average profitable. This suggests that the deterrent rationale requires the sanction for wrongdoing to be set at a level higher than F's wrongful gain.[172] There are two reasons why this criticism is not compelling.

Dean v Macdowell (1878) LR 8 Ch D 345 at 348 per Lord Jessell MR.

[166] H.L.A. Hart, *Punishment and Responsibility* (1968), pp.1-27, 210-237.

[167] *Boardman*, n30 above.

[168] n4 above.

[169] Above, Section II.3.(c).

[170] *Boardman v Phipps* [1965] Ch 992 at 1030 per Pearson LJ (CA).

[171] L. Smith, "The Motive, Not the Deed" in *Rationalizing Property, Equity and Trusts* (2003, ed. J. Getzler), p.53 at 60.

[172] J. Glover, *Commercial Equity: Fiduciary Relationships* (1995), ¶6.129 (pressing the case for exemplary damages on this basis). For critical analysis, see A. Duggan, "Exemplary Damages in Equity: A Law and Economics Perspective" (2006) 26 OJLS 303.

First, as a matter of history equity has not pursued a purely punitive function.[173] At both common law and equity the courts have been wary of too readily blurring civil with criminal law functions and thereby leaving the defendant facing a penal liability without the safeguards afforded by the criminal law.[174] Simple disgorgement is not punitive since it does not place F in a worse position than he occupied prior to the breach or a worse position than he would have occupied had he not breached.[175] Equity's compromise solution to the detection and enforcement problem is to increase the probability of successful enforcement by making proof of breach easier. Disgorgement of gain therefore furthers deterrence "perhaps imperfectly but as fully as possible while remaining within the constraints of traditional fiduciary doctrine".[176]

Second, the deterrent value of stripping the fiduciary of his gain must be considered in conjunction with the other remedies and sanctions potentially available against the disloyal fiduciary. As well as losing his profit F may face dismissal, tarnished reputation, loss of confidence in his services and even criminal liability.[177] The calculating fiduciary is likely to factor these consequences into his assessment of risk and return before deciding whether to pursue wrongful gain.

2. The Limits of the Principal's Claim

(a) Should P be Granted a Windfall?

The deterrence and (to a lesser extent) desert-based rationales explain why a wrongdoer should be stripped of his gain. They do not explain why it should be awarded to a claimant who has not suffered a loss.[178] Allowing recovery may be viewed as less objectionable than leaving the gain with F.[179] But this does not explain why the

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[173] For recent discussion of the relevant English and Commonwealth authorities, see *Harris v Digital Pulse* (2003) 197 ALR 626.
[174] See, e.g. *Atcheson v Everitt* 98 ER 1142 at 1147 (1775) per Lord Mansfield; *Rookes v Barnard* [1964] AC 1129 at 1226 per Lord Devlin.
[175] However, a punitive element arguably enters via the back door on some occasions, as where an allowance for skill and labour is withheld from the bad faith fiduciary.
[176] Conaglen, n16 above, at p.464.
[177] See Chapter 6, Section II.1 & II.2.
[178] See the observations of Gibson LJ in *Halifax Building Society v Thomas* [1996] Ch 217 at 229.
[179] Palmer, n126 above, §2.11.

claimant of all people is made an "accidental beneficiary of a rule of law based on public policy".[180] Weinrib thus questions the explanatory power of the deterrence rationale on the ground that:

> "the injustice or social inexpediency of the defendant's retention of the gain indicates only the party from whom the gain should be taken, not the party to whom it should be awarded. Thus, such accounts fail to provide a reason for the law to transfer the defendant's gain to the plaintiff of all people."[181]

However, in the fiduciary context there is good reason to transfer the gain to P. P is the person most likely to learn of a breach due to his proximate relationship with F. But in the absence of significant quantifiable loss he is unlikely to institute proceedings without the prospect of recovering F's gain. If F's wrongful gain was expropriated by a third party, such as the State, there is an incentive for P to bargain with F for a share in the profits rather than report the breach.[182] Leaving part of the gain in F's hands would, however, undermine the deterrent and desert rationales.[183]

(b) Do the Rationales Justify In Specie Disgorgement?

Stripping F of his gains *in specie* avoids the problem of subjective value. This problem arises where F values an asset more than the market does. In such cases a money award measured by reference to market value would leave F with a consumer surplus. This would increase the incentive to breach, even in a world with perfect enforcement rates. Specific relief also avoids valuation difficulties. Ascertaining the market value of an asset may be difficult because there is an absence of a suitable comparator or because the valuation turns on a number of factors that are uncertain. In *Lac Minerals v International Corona Resources*,[184] for example, the value of a money award turned on such variables as the reserves of the gold mine that was wrongfully acquired by the defendant, future gold prices, inflationary trends, exchange rates and a "myriad of other matters" all of which were "virtually impossible to predict".[185] Such "insurmountable

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[180] *McCarey v Associated Newspapers Ltd (No 2)* [1965] 2 QB 86 at 107.
[181] E.J. Weinrib, "Restitutionary Damages as Corrective Justice" (2000) 1 Theoretical Inq L 1 at p.2.
[182] E. Kades, "Windfalls" (1999) 108 Yale LJ 1489 at pp.1526-1528.
[183] Deterrence and deserts aside, allowing recovery by P in the absence of demonstrable loss also avoids evidential difficulties: see below, Section VI.3.
[184] n2 above..
[185] (1987) 62 OR (2d) 1 at 58-59 (Ont. CA). These reasons were accepted by La Forest J on appeal to the

difficulties" were avoided by ordering the defendant to transfer the asset itself rather than pay a monetary substitute.[186] Disgorgement *in specie* may therefore avoid potentially expensive inquiries and judicial guesswork in valuing the gain.

Disgorgement *in specie* also ensures that the defendant does not retain a specific indicia of his wrong, something that would bring the law into disrepute. As La Forest J commented in *Lac Minerals*:

> "The moral quality of the defendants' act may also be another consideration in determining whether a proprietary remedy is appropriate. Allowing the defendant to retain a specific asset when it was obtained through conscious wrongdoing may so offend a court that it would deny to the defendant the right to retain the property."[187]

Specific relief thus allows the court to express fully its moral condemnation of F's improper act and reinforce the high standards expected of the fiduciary community.

(c) Can the Rationales Justify Priority?

Judges and jurists often resort to deterrence and desert-based rationales to justify or bolster a decision to award proprietary relief.[188] However, it is difficult to see how a constructive trust that is premised on these rationales can have any application where F is bankrupt.[189] F will not benefit personally from his gains and it is difficult to see how awarding P priority over other creditors punishes or deters F.

One superficially attractive explanation for P's priority is that creditors should not receive a windfall from an asset which should never have formed part of their debtor's estate.[190] However, one might ask equally why P should be awarded, in preference to

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Supreme Court: n2 above, at 49.

[186] n2 above, at 48-49 per La Forest J.

[187] *ibid.* at 51-52. See also *Soulos*, n79 above at 231 per McLachlin J (property acquired in "flagrant and inexcusable" breach of the obligation of loyalty will typically lead to the imposition of a constructive trust); R. Goode, "Property and Unjust Enrichment" in *Essays on the Law of Restitution* (1991, ed. A. Burrows), p.215 at 244.

[188] See e.g. *Reid*, n75 above, at 4; Weinrib, n11 above, at pp.20-21 (constructive trust should be reserved for the "most heinous" breaches of fiduciary obligation).

[189] Except in the relatively rare case that F's assets are sufficient to meet all of his liabilities or where F's gain is represented by property otherwise exempt from bankruptcy distribution under the Insolvency Act 1986, s283(2). In either case F would retain the asset were it not awarded to P.

[190] *Reid*, n75 above, at 5; Millett, n163 above, at p.52; R.H. Maudsley, "Proprietary Remedies for the

innocent third parties, benefits that he would not otherwise have acquired? Indeed, a closer analysis suggests that the claims of contract creditors may be more meritorious. Just as the profit made in breach of fiduciary obligation has swelled F's estate so too has the receipt of goods for which F has not paid and the receipt money paid for obligations which he has not discharged.[191] Moreover, the unsecured creditors have behaved honestly, in all likelihood could not have prevented F's wrongful gain and, perhaps most importantly, have given value. The real issue for these creditors is not how much of a windfall they will receive but how much of their losses will be made good. Some commentators therefore suggest that pure disgorgement claimants should not only be denied priority but also deferred to the defendant's contract and tort creditors.[192]

A more sophisticated defence of deterrence-based priority is offered by Duggan in his contractarian analysis of the constructive trust.[193] Duggan suggests that if *ex ante* bargaining were possible F's creditors would agree to P's constructive trust, even in the absence of a demonstrable loss. The reasoning behind this ostensibly counter-intuitive conclusion is as follows. P is likely to desire a constructive trust because effective deterrence requires the capture of all causally relevant gains, and the "only sure-fire way of extracting all [of F's] gains is to impose a constructive trust".[194] The fiduciary is also likely to prefer a constructive trust because effective deterrence "increases the value of [F's] services to P and presumably also the price P is prepared to pay for them".[195] It follows that F's creditors are "probably better off because the availability of the remedy affects [F's] income-earning potential by improving the marketability of his services".[196] Thus, had F's unsecured creditors been party to negotiations between P and F at the outset of the relationship they would have agreed to a constructive trust. A constructive trust therefore gives all of the affected parties what they would have have

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Recovery of Money" (1959) 75 LQR 234 at p.243; A.W. Scott & W.A. Seavey (reporters), *Restatement of the Law of Restitution* (1937), §202, comment e.

[191] A. Burrows, *Remedies for Breach of Tort and Breach of Contract* (3rd edn, 2004), p.619; A. Tettenborn, "Remedies for the Recovery of Money Paid by Mistake" [1980] CLJ 272 at pp.274-275; R.M. Goode, 'Ownership and Obligation in Commercial Transactions' (1987) 103 LQR 433 at pp.444-445.

[192] P. Jaffey, "Disgorgement and Confiscation" [1996] RLR 92 at p.97; S. Worthington, "Property, Obligation and Insolvency Policy: Cutting the Gordian Knot" [2005] JIBFL 100. The downside of this is that principals may be less likely to enforce against solvent fiduciaries (thus leaving a gain with F) for fear of recovering nothing should F turn out to be insolvent.

[193] A. Duggan, "Constructive Trusts From A Law and Economics Perspective" (2005) 55 UTLJ 217.

[194] *ibid.* at p.229.

[195] *ibid.* at p.230.

[196] *ibid.* at p.230.

agreed.

To assert that a constructive trust will make creditors better off is rather speculative. It assumes (a) that the availability of the constructive trust will in fact allow F to charge more; (b) that at least some of that increase will be available to pay F's creditors; and (c) that recovery by creditors will as a consequence be greater than recovery under a rule capturing a *parri passu* share of F's wrongful gains. Such assumptions are questionable. The greater a person's disposable income, the more we might expect them to spend on holidays, dining out and other consumables. Rather than significantly increasing the size of F's distributable estate, any apparent increase in F's income that is attributable to his enhanced marketability may be off-set by increases in expenditure and additionally assumed liabilities. Moreover, even if we assume that *in specie* disgorgement improves the security of the fiduciary relationship and therefore allows F to charge more for his services, the same result can be achieved by specific relief that does not confer priority. This is what F's creditors would want because it would allow them to recover most should F become bankrupt. The interests of P, F and F's creditors are therefore less aligned than Duggan suggests.

3. The Avoidance of Difficult Evidential Hurdles

Where the benefit in F's hands is either misappropriated from P or intercepted on its way to P, *in specie* relief avoids frustration of the objectives of the relationship. Specific relief is also appropriate as between P and F in the absence of demonstrable loss. There are two reasons for this. First, loss is not a necessary ingredient in determining F's liability to P. To introduce it as a determinant of the appropriate remedy (or outcome) as between F and P (as opposed to between third parties and P) would be incongruous. Second, because F is likely to control the relevant information requiring P to demonstrate that F's gain is his loss as a pre-requisite of specific recovery from F may provide an incentive for F to conceal or manipulate the evidence.

However, the evidence problem is not a reason to favour P over innocent third parties, such as creditors. Such parties are no more likely than P (perhaps less so given their arm's length dealings) to have access to the facts that bear on the question. Absent a

demonstrable correlation of gain and loss a personal order to transfer specific property will therefore secure the appropriate result between P and F without the risk of creating potentially unwarranted priorities. Moreover, if the outcome that F faces is that he must give up his gain to P or to his own creditors he is unlikely to have an incentive to exploit the evidence problem by concealing or manipulating information since he does not stand to benefit either way and is likely to be indifferent as to whether the gain goes to his principal or creditors.

VII. Limits to Specific Relief

On occasion there may be factors which render specific relief inappropriate. A remedy which requires the defendant to surrender specific property will, like a money award, inflict a loss on the defendant. However, taking specific things may be a "more erratic instrument of justice".[197] Taking a specific asset, or granting someone an interest in such, may create practical problems that are avoided by monetary remedies. Awarding an asset to the claimant may be also inconsistent with the parties' conduct or dealings. Finally, requiring the surrender of a specific asset may cost more than an alternative remedy. One remedy may be more efficient than another at vindicating the claimant's rights or furthering the underlying policy objectives of the rule that has been transgressed. Although the courts tend not to consider efficiency directly, such concerns lurk behind the developing concept of remedial proportionality.[198]

In the context of the constructive trust these considerations may be crucial but are often neglected.[199] We see below, particularly in the context of the wrongful exploitation of commercial opportunities, that if we are to keep the constructive trust (and personal order to transfer specific property) within appropriate limits it is necessary to address such considerations frankly and openly. On occasion, they may lead to the conclusion

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[197] P.B.H. Birks, "Proprietary Rights as Remedies" in *Frontiers of Liability* (1994), Vol 2, p.214 at 218.
[198] Arden LJ thus observed recently that the courts increasingly demand "remedies are proportionate to the justice of the case where this does not conflict with some other overriding policy objectives of the rule in question": *Murad*, n40 above, at [83]. Elsewhere, proportionality has been described as a "long standing principle of both moral and legal force": *Butler v Countrywide Finance Ltd* [1993] 3 NZLR 623 (Hammond J).
[199] A rare illustration of such factors being afforded weight in the context of a constructive trust claim is *Ocular Sciences*, n77 above, at 407, 416. There Laddie J refused to impose a constructive trust on the ground that it would generate disproportionate costs.

that a money remedy (e.g. account of profits, which may or may not be secured by way of charge) is more appropriate than the transfer of the gain *in specie*.[200]

VIII. CONCLUSION

The implications of what has been said above for the appropriate remedy in cases involving acquisitive breaches of fiduciary obligation can be stated clearly and briefly by way of the following three propositions:

1. A constructive trust is generally justified in cases in which F misappropriates an asset directly from P or intercepts an asset on its way to P. In both instances a constructive trust reduces the risk that the objectives of the relationship will be frustrated and, consequently, encourages the productive use of fiduciary organisation.

2. Where F's gain is not misappropriated from P or intercepted on its way to P a personal order to transfer specific property is generally appropriate. This furthers the policy of deterring fiduciary breaches, may allow the court to express fully its moral condemnation of a conscious and dishonest breach, and avoids evidential difficulties as between P and F. None of these reasons justify priority over creditors or other third parties.

3. Propositions (1) and (2) cannot be made in absolute terms because in limited circumstances it may be inappropriate to impose a remedy which requires F to give up his gain *in specie*. In such cases it will be usually appropriate to grant (a) an account of profits, secured by a charge over the relevant asset, in lieu of a constructive trust; or (b) a simple account of profits in lieu of a personal order to transfer specific property.

These propositions are applied and developed more fully in the remaining chapters of this thesis.

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[200] Chapter 7, Section V.2.

CHAPTER 5: Leases and the Rule in *Keech v Sandford*

I. INTRODUCTION

Keech v Sandford[1] is perhaps the most famous case in equity, notwithstanding that it is an "obscurely reported decision of one of the less distinguished holders of the Great Seal".[2] The case established that a trustee who renews a lease for his own benefit will be liable to assign the same to those beneficially entitled to the original, even though his actions cause no loss. The influence of *Keech* on the development of fiduciary obligations has been considerable.[3] However, in this chapter we focus on the rule from the perspective of remedy.

It is suggested below that although it is not easy to justify, a constructive trust of the renewal should not cause too many concerns because it is unlikely to significantly prejudice third parties. However, the extension of the rule to include a constructive trust of the freehold reversion is a different matter. Here, there is some scope for unfair prejudice to third parties. At most, a personal rather than proprietary claim to the freehold might be thought desirable.

Of greater concern is that the "rule" in *Keech* has been interpreted as either creating or illustrating the broader principle that any benefit acquired by a fiduciary in breach of fiduciary obligation is held on constructive trust for the principal. This would have far reaching implications. The nature and evolution of the principle is therefore examined in detail. It is concluded that it has no firm jurisprudential basis and does not operate as a strong determinant of cases. This finding is important for the arguments made in subsequent chapters.

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[1] (1726) Sel Cas Ch 61.
[2] S. Cretney, "The Rationale of *Keech v Sandford*" (1969) 33 Conv 161 at 162.
[3] See J. Getzler, "Rumford Market and the Genesis of Fiduciary Obligations" in *Mapping the Law: Essays in Honour of Peter Birks* (2006, eds. A. Burrows & A. Rodger), p.577.

II. THE RULE IN *KEECH V SANDFORD* AND ITS DEVELOPMENT

1. The Rule in *Keech v Sandford* and its Rationale

(a) Keech v Sandford

Keech v Sandford was not the first case to apply the rule that a trustee who renews a lease for his own benefit holds it subject to the same equitable obligations as he held the original.[4] However, it is certainly the most enduring.[5] It also marks the point at which the rule hardened into a strict and absolute form.[6]

The case concerned the lease of a market devised to a trustee for the benefit of an infant. Prior to the expiration of the lease the trustee sought a renewal on behalf of the infant. The landlord refused because he was dissatisfied with the security for the rent. Being a lease of the profits of the market there could be no distress for rent and the infant lacked the capacity to enter into an enforceable covenant. Having failed to renew for the *cestui que trust* the trustee took the renewal in his personal capacity.[7] The infant sought an assignment of the lease and an account of profits. In granting the relief the Lord Chancellor said:

> "I must consider this as a trust for the infant, for I very well see that if a trustee, on refusal to renew, might have a lease to himself, few trust estates would be renewed to *cestui que use*. Although I do not say there is a fraud in this case, yet the trustee should rather have let the lease run out, than to have had it himself. It may seem hard that the trustee is the only person of all mankind who might not have the lease, but it is very proper that rules should be strictly pursued, and not

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[4] Earlier examples include *Holt v Holt* (1670) 1 Ch Cas 190; *Rushworth's Case* (1676) 2 Freem 13; *Walley v Walley* (1687) 1 Vern 484. See generally D.E.C. Yale, (ed) *Lord Nottingham's Chancery Cases, Volume II* (79 Seldon Society, 1961), pp.124-128

[5] See J. Mowbray, *et al.*, *Lewin on Trusts* (17th edn, 2000), pp.438-447; A.J. Oakley, *Constructive Trusts* (3rd edn, 1997), pp.156-160; A.W. Scott & W. Fratcher, *Law of Trusts* (4th edn, 1989 & supps), §170.21; F. Spearing, "*Keech v Sandford*: The Case and its Ramification" (1987) 1 Tr L & P 171; J.G. Stark, "The Durability of the Rule in *Keech v Sandford*" (1984) 58 Aus LJ 660; Cretney, n2 above; W.G. Hart, "The Development of the Rule in *Keech v Sandford*" [1905] LQR 258.

[6] Thus, during Lord Nottingham's time the rule was qualified by a "reluctance to construe a trust unless there were some clear equity against the alleged trustee": Yale, n4 above, at p.126.

[7] These are the stated facts in (1726) Sel Cas Ch 61 and 2 Eq Cas Abr 741 but the reports may not be entirely accurate. Although Lord King made no finding of fraud in the case it is not entirely apparent from the original pleadings that all was above board. The defendant trustee may have been preferred because he had previously performed some services for the leasor and may have paid a secret premium for the lease: see lines 55-58 of the pleadings, reproduced in D.R. Paling, "The Pleadings in *Keech v Sandford* [1972] Conv 159.

> in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease on refusal to renew to *cestui que use*."

As these words make clear, the application of the rule is strict and cannot be rebutted by submission of evidence demonstrating that it was not possible to renew for the beneficiary. It is also irrelevant that the trustee did not renew for the trust for *bona fide* reasons or because his co-trustees refused to agree to a renewal.[8] *Blewett v Millett*[9] is illustrative. The trustees held a leasehold interest in a mine for an infant beneficiary. The mining business was risky and likely to prove unprofitable. To relieve the beneficiary of what the trustees reasonably considered to be an unacceptable risk, and with the concurrence of his co-trustees, one of the trustees acquired the interest. Upon reaching the age of 21 the infant successfully sought an assignment of the interest and an account of profits, the mine having turned out to be unexpectedly profitable.

(b) The Rationale for the Rule

It has been often said that the rule in *Keech* is explicable by reference to the no-profit rule: it is founded on the trustee's access to the landlord afforded by his position. Thus, in *Re Knowles* it was said that the rule reflects the fundamental principle that a trustee "cannot be allowed to derive a personal benefit from his position of trustee and the opportunities that that position gives him."[10] Others suggest that the rule is underpinned by the need to avoid potential conflicts between the trustee and the trust interest.[11] Whether either of these rationales was considered by Lord King in *Keech* is debateable. They are probably a subsequent rationalisation. However, what is clear is that Lord King's primary motive for adopting a strict rule was prophylactic. It avoided the possibility of harm to trusts of leaseholds generally if in the instant case, where

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[8] It was also irrelevant that: the old lease had expired (*Edwards v Lewis* (1747) 3 Atk 538); the lease had not customarily been renewed (*Killick v Flexney* (1792) 4 Bro Ch 161); the interest was a tenancy at will or sufferance (*James v Dean* (1805) 11 Ves Jr 383 at 391, (1808) 15 Ves Jr 236 at 240); or that the renewal was for a different term or at a different rent (*Mulvany v Dillon* (1810) 1 B & B 409).

[9] (1774) 7 Bro PC 367.

[10] [1948] 1 All ER 866 at 868. See also *Re Biss* [1903] 2 Ch 40 at 57 per Collins MR, 60 per Romer LJ; *Blewett v Millett*, n9 above, at 373; *Pickering v Vowles* (1783) 1 Bro CC 197 at 199, fn1; *James v Dean*, n8 above, at 391-392. The same principle explains F's liability for the purchase of the reversion: *Thompson's Trustee v Heaton* [1974] 1 WLR 605 at 612.

[11] E.g. M. Cope, *Constructive Trusts* (1992), p.312; Mowbray, n5 above, at p.448; A.W. Scott & W. Seavey (reporters), *Restatement of the Law of Restitution* (1937), §195, cmt a (conflict arises from illegitimate competition for the lease with the trust).

there was no fraud, the trustee was not permitted to take the lease.[12] The development of a stringent prophylactic was no doubt conditioned by the social, legal and economic conditions of the time.

At the time charitable, ecclesiastical and some public bodies were prohibited from granting leases for more than 21 years or three lives. There nevertheless developed a practice that such bodies would invariably grant a renewal to the sitting tenant.[13] While there was no legal obligation to do so, the practice had considerable value.[14] Provisions for future family generations were made on the basis of the "renewal right" and leases were purchased on the expectation that they would continue to be renewed so long as the fines and rents were paid.[15] These circumstances created a significant risk that a trustee could, by exploiting his position, cut off the beneficiaries' access to the continued enjoyment of a lease.

A further factor influencing the strict approach in *Keech* was that many leases were held on trust for infant beneficiaries, being persons under twenty-one years of age. Infant beneficiaries were peculiarly vulnerable not least because, as demonstrated by the facts of *Keech* itself, they were incapable of providing enforceable covenants. For this reason landlords might all too easily have been persuaded to grant a renewal to the trustee personally rather than for the benefit of an infant.

Another factor that probably influenced the decision in *Keech* was that it came in the immediate aftermath of the South Sea debacle, during which loss was occasioned on a grand scale to those who had speculated with the money of others. Chancery masters, who were at liberty to speculate with funds paid into Court so long as they repaid the amounts, were notable (and mostly bankrupt) culprits.[16] Lord King, whose predecessor Lord Macclesfield had been impeached in 1726 following discovery of

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[12] As to the prophylactic rationale generally, see Chapter 4, Section II.3(c).
[13] Cretney, n2 above, at pp.163-168.
[14] *ibid.* at pp.165-167.
[15] Many estates derived their value from the unenforceable renewal right and were practically inalienable without it: see *Pickering v Vowles* (1783) 1 Bro CC 197 at 198.
[16] Control over trustees' uses of trust property was uncertain and relatively weak at the time. Indeed, although there was contrary earlier authority, in the decade before *Keech* it had been declared that executors or trustees could invest trust property and retain the profits personally so long as they repaid the capital (*Bromfiled v Wytherley* (1718) Prec Ch 505): see M.R. Chesterman, "Family Settlements on Trust: Landowners and the Rising Bourgeoisie" in *Law, Economy and Society, 1750-1914: Essays in the History of English Law* (1984, eds. G.R.Rubin & D.Sugarman), p.124 at 157-158.

the large deficiency in the masters' accounts, was charged with overseeing restoration of the monies.[17] The environment of the time was undoubtedly and understandably protectionist.

A final factor influencing a strict rule is what has since been called the "evidence problem". In the eighteenth century Chancery procedure did not permit oral evidence except in very limited circumstances. Most evidence was collected by way of written interrogatories and affidavits.[18] The courts thus lacked the basic machinery to undertake a detailed examination of the facts of a case. Establishing wrongdoing and resolving inconsistencies in the evidence of the parties would have been extremely difficult. Protection of the beneficiary required a presumption of wrongdoing from its mere possibility.

However, it is important to remember that while these factors were undoubtedly influential at the time of *Keech* and may well have justified a stringent penal rule they are not applicable in modern conditions. Trustees are now strictly regulated, long term leases can be granted, we are in a world far removed from the speculative and volatile business environment of the early eighteenth century, and the civil courts have well developed fact-finding powers. Nevertheless, there is "absolutely no doubt"[19] that the rule in *Keech* remains English law.

2. The Extension of the Rule

Keech itself established a narrow rule *viz.* a trustee who renews a lease in his own name holds it on constructive trust for those beneficially interested in the original term. The new lease is simply an extension of the old.[20] However, the rule has been extended over the years into wider areas and applied to significantly different facts.[21]

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[17] Chapter 1, Section III.1(b).
[18] D. Paling, "Trustees: Profits and Remuneration" [1974] 38 Conv 330 at pp.331-332.
[19] Oakley, n5 above, at p.159.
[20] *Bevan v Webb* [1905] 1 Ch 620 at 625; *Griffith v Owen* [1907] 1 Ch 195 at 204.
[21] The expansion has been likened to the extension of the "neighbour" principle following *Donoghue v Stevenson* [1932] AC 562: Stark, n5 above, at p.660.

(a) The Classes of Person to Which the Rule Applies

The rule in *Keech* has been extended to apply in its strict form to others who occupy a fiduciary position.[22] This includes executors and executors *de son tort*,[23] agents,[24] tenants for life of settled land[25] and directors.[26] In relation to such persons the application of the rule is absolute and irrebuttable. However, the rule has also been applied in a rebuttable form to non-fiduciaries who occupy a special position by virtue of their having a partial interest in the lease.[27] Such parties can avoid being caught by the rule by demonstrating they did not abuse their position or intercept a benefit that would have otherwise accrued to the claimant.[28] Somewhat strangely, the rule appears to apply in this rebuttable form to partners who renew a partnership lease in their own name at any time before the partnership is fully wound up.[29] This is generally considered anomalous given that partners occupy a fiduciary position.[30]

(b) The Subject Matter to Which the Rule Applies

The rule in *Keech* has also been expanded to encompass the fiduciary's acquisition of subject matter other than leases. For example, it has been held to cover the renewal of licenses,[31] the renewal of agency agreements[32] and the renewal of promotion contracts.[33]

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[22] For discussion of the full range of person subject to the rule see Cope, n11 above, pp.318-322.
[23] *Fosbrooke v Balguy* (1833) 1 My & K 226; *Mulvany v Dillon* (1810) 1 B & B 409.
[24] *Mulhallen v Marum* 3 Dr & W 317.
[25] *Taster v Marriot* (1768) Amb 668; *Re Biss,* n10 above, at 56, 61. Since 1925 statute has declared that a tenant for life is an express trustee of his power: Settled Land Act 1925, s.107(1).
[26] *Hurley v BGH Nominees* (1984) 10 ACLR 197 (purchase by a director, through his own corporate vehicle, of the reversion of premises leased by the company).
[27] See *Re Biss*, n10 above (tenant in common); *Nesbitt v Tredennick* (1808) 1 B & B 29 (mortgagee); *Hughes v Howard* (1858) 25 Beav 575 (mortgagor).
[28] *Re Biss*, n10 above, at 57-58 per Collins MR, 61 per Romer LJ.
[29] *ibid.* at 61-62 per Romer LJ; *Clegg v Edmondson* (1857) 8 D M & G 787 at 807 per Turner LJ. However, in *Thompson's Trustee*, n10 above, *Keech* was applied strictly to the purchase of the freehold reversion by a partner.
[30] For fuller discussion, see R.C. Banks, *Lindley & Banks on Partnership* (17th edn, 1995), ¶¶16-15 – 16-21.
[31] *John Taylors v Masons* [2001] EWCA Civ 2106 (market licence); *G.E. Smith v Smith* [1952] NZLR 470 (import licence).
[32] *Bennett v Gaslight & Coke Co* (1882) 52 LJ Ch 98.
[33] *Don King Productions v Warren* [2000] Ch 291.

However, perhaps the most notable extension of the rule has been its application to the purchase by a trustee or other fiduciary of the reversion expectant on the lease.[34] At one time it was thought that the fiduciary would be caught by the rule only where he had acquired the reversion by use of his position[35] or if the lease was renewable by custom[36] or by contract,[37] in which case purchase of the reversion would intercept and cut-off the chance of further renewals or destroy the renewal right.[38] However, the distinction, which many have criticised as being without foundation,[39] does not appear to have survived in later cases.[40] More recent authorities suggest F's liability will turn on whether he derived improper advantage from his position.[41]

(c) The Broad Principle

Some courts and commentators attribute even greater significance to *Keech* and suggest that it either created or evidenced a fundamental principle of equity: a constructive trust attaches to any benefit acquired in breach of fiduciary obligation. Thus, in *Re Edwards' Will Trusts*[42] Buckley LJ cited *Keech* as the seminal authority for the

> "well established law that a trustee cannot use his position or his powers as a trustee to acquire property for his own benefit. If he purports to do so, however innocently, he is held to be a constructive trustee of that property for the persons beneficially interested under the trust of which he is a trustee."[43]

The recognition of such a broad principle has potentially far reaching consequences. If accepted, it would demand the automatic recognition of a constructive trust in a

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[34] See generally, Oakley, n5 above, pp.158-160; Cope, n11 above, pp.329-339.
[35] *Griffith v Owen*, n20 above, at 205, where Parker J assumed this was the only reason to hold the fiduciary liable, regardless of whether or not the lease was renewable by custom or right.
[36] *Phillips v Phillips* (1885) 29 Ch D 873; *Longton v Wilsby* (1897) 76 LT 770.
[37] *Trumper v Trumper* (1872) LR 14 Eq 295 at 309 per Bacon VC; *Re Lord Ranelagh's Will* (1884) 26 Ch D 390.
[38] *Bevan v Webb*, n20 above, at 626.
[39] Cretney, n2 above, at pp.171-175; P. Jackson, "Trustees Purchasing Reversions" (1968) 31 MLR 707.
[40] *Protheroe v Protheroe* [1968] 1 WLR 519; *Thompson's Trustee*, n10 above.
[41] Mowbray, n5 above, at p.441; P. Jackson, "Further Extensions to the Rule in *Keech v Sandford*" (1975) 38 MLR 226 at p.227. Note also *Ward v Brunt* [2000] WTLR 731. Here, a partner purchased the reversion of a partnership lease but was not accountable because the purchase was made by exercise of an option granted to the partner personally under the former freeholder's will and not as a result of her fiduciary position or in the course of the execution of her fiduciary office.
[42] [1982] 1 Ch 30.
[43] *ibid.* at 40. See also Oakley, n5 above, p.157.

broad range of case, such as the receipt of a bribe,[44] the wrongful exploitation of a fiduciary opportunity[45] and the receipt of fees by trustee directors.[46] In short, any acquisitive breach of fiduciary obligation would be an event constitutive of an equitable property right in the gain for the benefit of the principal. Given its potential significance, the apparent principle derived from *Keech* is the subject of detailed analysis in Section IV below.

III. The Constructive Trust of Leaseholds and Reversions: Nature and Justification

1. The Nature of the Constructive Trust and its Consequences

(a) The Constructive Trust as Automatically Vesting

Numerous cases are explicit that where the rule in *Keech* applies the person who has renewed the lease or purchased the reversion holds the same on trust for the persons beneficially interested in the original lease. The report of *Keech* states that Lord King decreed "the lease should be assigned to the infant".[47] There is no mention of the lease being held on trust. This has caused some to suggest that the case is "perfectly explicable on a right *ad rem* analysis":[48] the order was a purely personal order to transfer the lease and it neither recognised nor created a proprietary interest. If correct it would follow that the order in *Keech*, being personal rather than proprietary in nature, would not bind third parties.

With respect this suggestion is unconvincing. There are at least four reasons for this. First, the view that dominated Chancery thinking in the 18th and 19th centuries was the trust, and without a trust interest there could be no justification for transferring

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[44] *Attorney General for Hong Kong v Reid* [1994] 1 All ER 1.
[45] *Boardman v Phipps* [1967] 2 AC 46.
[46] *Re Francis* (1905) 92 LT 77; *Re Macadam* [1946] Ch 73.
[47] n1 above, at 62.
[48] G. McCormack, *Proprietary Claims and Insolvency* (1997), p.101. Goode makes a similar claim about no-conflict cases derived from the rule in *Keech* but seems to prefer the imposition of a constructive trust with prospective effect: R.M. Goode, "Property and Unjust Enrichment" in *Essays on the Law of Restitution* (1991), p215. See also Chapter 3, Section V2, fn180.

property from one party to another.[49] "Upon what ground is a Court of Equity ever called upon to direct one man to convey a real estate to another, except upon the ground of a trust, either actual or constructive?"[50]

Second, it is clear from the language in the cases developing the rule in *Keech* if not from the language in *Keech* itself that the new lease is deemed to belong, from the moment of renewal, to those beneficially entitled to the original. Warrington J thus explained in *Bevan v Webb* that the "renewed lease is treated as a graft or addition to the trust property and itself forms part of the trust property".[51] This follows the earlier authorities in which it was held that the new lease is "merely an extension or continuation of the other".[52] The lease never belongs beneficially to the defendant.

Third, it is clear that both before and after *Keech* the claimant's interest had proprietary character in that the entitlement to the lease was enforceable against volunteers and purchasers with notice.[53] Thus, in *Walley v Walley*,[54] decided four decades before *Keech*, an executor in trust for an infant legatee renewed a lease which he mortgaged and sold the equity of redemption for payment of his own debts. Upon establishing that the purchaser had notice of the infant's interest the Court decreed "the plaintiff should be let into possession and have the benefit of the new lease, and an assignment thereof from the defendants".[55]

Fourth, the proprietary character of the claimant's interest in the renewed lease has been recognised explicitly in later cases dealing with the competing claims of the beneficiary and the fiduciary's creditors. Thus, in *ex parte Grace*,[56] a trustee took a renewal in his own name before he was declared bankrupt. The lease was sold by the assignees in bankruptcy and the infant beneficiary held entitled to the proceeds of sale in proportion to his interest in the lease.

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[49] See Chapter 1, Section III.1.
[50] *Beckford v Wade* (1805) 17 Ves 87 at 96 per Sir William Grant MR.
[51] n20 above, at 625.
[52] *Randall v Russell* (1817) 3 Mer 190. See also *Rakestraw v Brewer* (1728) 2 P Wms 511 at 513 ("The additional term comes from the old root and is of the same nature"); *Rawe v Chichester* (1773) Amb 715 at 719 (even where the lessor is not bound to renew, the new lease "is a continuation of the old lease").
[53] *Eyre v Dolphin* (1813) 2 B & B 290; *Walley v Walley* (1687) 1 Vern 485.
[54] *ibid.*
[55] *ibid.* at 487. See also *Coppin v Fernyhaugh* (1788) 2 Bro CC 292 (mortgagee with notice).
[56] (1799) 1 Bos & P 379.

The nature of the interest in the renewal was also considered in *Re Morgan*.[57] There, an executor was appointed with directions to continue the testator's business and account for the profits to the estate. He took a new lease of the same premises and two adjoining cottages before depositing the lease as security for a loan which he applied for his own benefit. The mortgagee was not aware of the executorship or of the equities affecting the lease. Justice Fry held:

> "the equity of the estate attached the moment the renewed lease was granted; the equity of the depositee attached only when the deposit was made; the equity of the estate, therefore, is prior in time to that of a depositee. And it appears to me that the rule applies, *Que prior est tempore potier est jure*, for there is no superiority in one equity over the other which would make me displace the preceding right."[58]

Whatever the true nature of the order decreed by Lord King in *Keech v Sandford* – and there is reason to believe it was proprietary although we can never be sure – the position is now beyond doubt. Upon renewal a constructive trust of the lease arises vesting the equitable interest in those beneficially entitled under the original term.

The authorities on the purchase of the reversion are similarly unequivocal as to the availability and nature of the constructive trust, although none of the cases have involved third parties. Lord Denning MR was both succinct and clear in *Protheroe v Protheroe*, albeit without citing any relevant authority: "There is a long established rule of equity from *Keech v Sandford* downwards that if a trustee, who owns the leasehold, gets the freehold, that freehold belongs to the trust and he cannot take the property for himself."[59]

(b) The Artifice of the Automatic Vesting Approach in This Context

The application of the automatic vesting theory to renewals and reversions seems somewhat artificial. As numerous cases make clear the beneficiary cannot be compelled to accept a renewal that is wrongfully acquired by the trustee; he can elect

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[57] (1881) 18 Ch D 93.
[58] *ibid* at 101-102. See also at 103-104 per Lord Jessel MR.
[59] *Protheroe v Protheroe* [1968] 1 WLR 519 at 521. See also *Griffith v Owen*, n20 above. See also *Hurley*, n26 above.

to take it or leave it. *Clements v Norris*[60] is a rare reported example of negative election. However, usually litigation arises because the beneficiary wants the lease. Thus, in *ex parte Grace* it was held:

> "Grace took the lease at his own peril; if it had not turned out beneficial he must have sustained the loss, but as it is a beneficial lease it must be for the benefit of the trust....In the present case it has clearly proved a beneficial lease, or this application would not have been made to the Court".[61]

It is therefore the privilege of the beneficiary to choose whether or not to take the lease even though the lease has apparently belonged to him from the moment of renewal.[61a] This leads to the conclusion that a negative election must be treated as a gift of the equitable interest to the trustee, albeit a gift that must be accepted. The artifice of treating as a gift what is really a strategic remedial decision to condone a breach of duty has been noted already.[62] If the reality of this situation is to be reflected, the interest under the constructive trust must be viewed as operating retrospectively.

(c) The Consequences of a Constructive Trust of the Renewal

In most cases the practical effects of the constructive trust of the lease will be felt only by trustee and beneficiary. Where the beneficiary is entitled absolutely the constructive trustee will be liable to assign the lease. This will be subject to the beneficiary making appropriate counter restitution[63] and indemnifying the trustee against personal covenants that he has entered into with the leassor.[64] Where the interest of those entitled is not absolute "a declaration combined with suitable orders concerning the vesting of property will suffice."[65] If the renewal has been sold, the constructive trust will attach to the traceable proceeds of sale.[66]

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[60] (1878) 8 Ch D 129.
[61] (1799) 1 Bos & P 376 at 377 (Eyre CJ).
[61a] Equally, where F acquires the reversion P "cannot be compelled to accept and pay for the reversion": *Thompson's Trustee*, n10 above, at 612.
[62] Chapter 3, Section II.2(c).
[63] In the case of an executor or trustee reimbursement of the costs and expenses of renewal can be secured by a lien over the trust estate: *Lawrence v Maggs* (1959) 1 Eden 453.
[64] *Keech*, n1 above; *Giddings v Giddings* (1826-1827) 3 Russ 241.
[65] Mowbray, n5 above, p.445.
[66] *Ex parte Grace* (1799) 1 Bos & P 379.

Given the proprietary nature of the remedy there remains the risk that third parties will be prejudiced. Where the fiduciary is bankrupt the benefit of the lease will not form part of the bankrupt estate. However, the impact on F's unsecured creditors is likely to be neutral. As noted, it is a condition precedent of the transfer of the lease that P makes appropriate counter restitution. The value that P injects into the estate is therefore likely to be broadly equivalent to the value of that which he takes out.[67]

A different issue concerns the potential for conflicts to arise between P and third parties who have taken security in the lease. For example, equitable mortgages of leases created by the deposit of documents were at one time common. The mortgagee's interest would rank behind the earlier equitable interest of the constructive beneficiary of the lease.[68] However, this and similar priority problems are much less likely to occur as a result of the modern system of land registration. Another potential conflict arises between the interest of the beneficiary and a third party who has taken a sub-lease from the trustee. However, in such cases the assignment of the lease to the constructive beneficiary is subject to sub-tenancies granted at the market rate.[69]

(d) The Consequences of a Constructive Trust of the Reversion

Where P is entitled absolutely the constructive trustee will be liable to assign the reversion subject to P's payment of the purchase price and reasonable expenses. If the freehold has been sold the constructive trust will attach to the proceeds of sale.[70] Perhaps the most significant concern relates to the potential impact of the constructive trust on the trustee's creditors. Although P is required to reimburse F's acquisition costs the value of the freehold may have increased in value in the meantime. This problem would not have arisen historically since land prices were relatively stable. However, in more recent times high short term property inflation means that P's injection of value may be significantly less than the realisable value of the freehold. This raises issues of fairness between the beneficiary's and the constructive trustee's

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[67] This position might be contrasted usefully with the exploitation of fiduciary opportunities, where the inflated value of the opportunity may be significant: see Chapter 7, Section II.2.
[68] *Re Morgan*, n57 above.
[69] *Bowles v Stewart* (1803) 1 Sch & Lef 209 at 230. See also Mowbray, n5 above, at p.446.
[70] *Thompson's Trustee*, n10 above.

creditors' entitlements to the appreciated value. There may be also problems of the kind we see generally when a legal owner deals with third parties in relation to land in which another has an equitable interest.[71]

2. The Foundations of the Constructive Trust

In the previous Chapter it was suggested that a constructive trust is generally justified in cases of factual interception. In such cases the fiduciary's acquisitive breach is responsible for frustrating the objective of the relationship. A constructive trust insulates those objectives from the risk of fiduciary wrongdoing and bankruptcy or improper dealings with third parties.

However, in many of the renewal cases F's acquisition causes P no harm. In *Keech* itself the leasor refused to renew for the benefit of the infant and in *Millett v Blewett*[72] the defendant's co-trustees refused to renew for the trust. Similar observations of the reversion cases are possible. For example, in *Hurley v BHG Nominees Pty Ltd*[73] the corporate beneficiary of the original lease could not itself have purchased the freehold at the relevant time due to a lack of funds and anyway appeared disinterested in doing so. In such cases is there any other satisfactory explanation or justification for the automatic recognition of a constructive trust of the lease or reversion?

(a) Renewals

In cases such as *Keech* it is clear that the primary reason for holding the defendant liable and imposing a constructive trust is to deter wrongdoing. The trustee is not criticised for failing to secure the lease for the beneficiary. He is reproached for taking a benefit that in the circumstances he should have let pass him by. However, the policy of deterrence demands only that the trustee be compelled to give up the lease; it does not necessarily require it to be surrendered to the trust beneficiary.[74]

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[71] Although again this problem may not be significant given the protection afforded to third parties by the modern land registration system.
[72] n9 above.
[73] n26 above.
[74] Chapter 4, Section VI.

A stronger reason for the general recognition of a constructive trust might nevertheless have operated historically. It has been noted already that ecclesiastical, charitable and public bodies were restricted as to the duration of lease they could grant. In response to this there developed a strong customary practice of renewing a lease to the sitting tenant. The practice became so entrenched that the trustee who renewed for his own benefit was viewed as misappropriating trust property.[75] The constructive trust simply preserved what had come to be seen as a trust asset.[76] However, this explanation lost its force as soon as the link to customarily renewable leases was lost.[77]

A further historical argument for the automatic recognition of the constructive trust relates to the evidence problem noted above. The automatic recognition of a constructive trust without proof of loss was probably necessary to effectively insulate the beneficiary from the risk of trustee wrongdoing at a time when trusts of leases were widespread and wrongdoing was difficult to prove. However, these arguments are of limited application today.

It is therefore difficult to identify a clear and satisfactory justification for the automatic recognition of a constructive trust of the renewal. Nevertheless, it will be recalled that in this context the impact of the constructive trust on third parties is likely to be minimal.[78] The automatic recognition of a constructive trust is therefore less of a concern than it is in others contexts.[79]

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[75] See also the language adopted in the cases cited in n52 above and the discussion below, Section IV.2(a).

[76] Thus, when reviewing the leasehold renewal cases in *Boardman v Phipps* [1964] 2 All ER 187 at 202 Wilberforce J explained that the trustee who renews on his own behalf "is in effect buying a part of the trust property".

[77] T.G. Youdan, "The Fiduciary Principle: The Applicability of Proprietary Remedies" in *Equity, Fiduciaries and Trusts* (1989, ed. T.G. Youdan), p.93 at 96.

[78] This finding may influence the utility equation developed in Chapter 4. Indeed. it may even justify automatic proprietary relief: the less risk of harm to third parties and the lower the costs of priority conferred by a constructive trust, the more likely it is that such costs will be off-set by savings in the administrative costs of a rule that does not require an inquiry into loss: see Chapter 4, Section V.2(c).

[79] See especially Chapter 7, Section II.2.

(b) Reversions

Compelling F to surrender the reversion may be necessary for prophylactic reasons: it discourages a course of conduct that is potentially harmful to P. However, it is difficult to see the justification for a remedy that confers a priority claim to the freehold. In particular, unsecured creditors may lose out where F is bankrupt since P's injection of value by way of counter restitution may be significantly less than the current value of the freehold. This was unlikely to be a problem historically since land prices were relatively stable.

The historical explanation that applied to leases – that the lease was viewed as part of the trust property due to the renewal right – can hardly apply to the reversion. The reversion is "a separate item altogether".[80] At best delivery of the reversion might be viewed as an indirect way of protecting the continued enjoyment of the property that the beneficiary would have enjoyed under a customarily renewable lease. In *Randall v Russell* Sir William Grant put the matter thus:

> "The ground commonly stated, on which the renewed lease becomes subject to the trusts of a will disposing of the original lease, is, that the one is merely an extension or continuation of the other. But the fee is a totally different subject, which the testator had it not in his contemplation to acquire or dispose of. Yet, if [the trustee] had purchased from the [landlord], it might be said, that she thereby intercepted and cut off the chance of future renewals, and, consequently, made use of her situation to prejudice the interests of those who stood behind her; and there might be some sort of equity in their claim *to have the reversion considered as a substitution for those interests....*"[81]

In other cases Sir William Grant seems to have more firmly equated the reversion with a customary renewal,[82] this suggesting that the freehold was viewed as some form of imperfect substitute or sufficient equivalent to protect the beneficiaries' continued enjoyment of the property. However, the argument can hardly apply unless a lease is renewable by custom or contract. Moreover, it is difficult to see how it justifies a priority claim to the freehold in competition with innocent third parties, at least in more modern times of rapid inflation of real property prices.

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[80] *Boardman*, n76 above
[81] (1817) 3 Mer 190 at 197 (emphasis added).
[82] *Hardman v Johnson* (1815) 3 Mer 347 at 352.

IV. BROAD EQUITABLE PRINCIPLE

1. The Broad Principle Attributed to *Keech*

The impact of *Keech v Sandford* has extended far beyond cases of leases and the purchase of reversions. One reason for this is that some view the case as either creating or recognising an equitable principle much broader than is immediately apparent on its face. The principle was expressed as follows in the High Court of Australia:

> "a trustee must not use his position as trustee to make a gain for himself: any property acquired, or profit made, by him in breach of this rule is held by him in trust for his *cestui que trust*. The rule is not confined to cases of express trusts. It applies to all cases in which one person stands in a fiduciary relation to another."[83]

The opinion of Deane J in *Chan v Zachariah*,[84] is similarly emphatic:

> "Stated comprehensively….the principle of equity is that a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain; or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it. Any such benefit or gain is held by the fiduciary as constructive trustee".[85]

This passage has been endorsed in England,[86] where similar broad statements have also been made. Thus, in a recent corporate opportunities case Lewison J said of *Keech*:

> "The new lease had not formed part of the original trust property; the minor could not have acquired the new lease from the landlord; and the trustee acted innocently, believing that he committed no breach of trust and that the new lease did not belong in equity to his *cestui que trust*. Nevertheless, Lord King L.C. held that 'the trustee is the only person of all mankind who might not have the

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[83] *Keith Henry & Co Pty Ltd v Stuart Walker & Co Pty Ltd* [1958] 100 CLR 342 at 350.
[84] (1984) 154 CLR 178.
[85] *ibid.* at 199.
[86] *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 at [16]; *Don King Productions*, n33 above, at 341.

> lease.' The trustee was obliged to assign the new lease to the minor and account for the profits he had received. The result is only explicable on the basis that the trustee held the lease on the terms of the trust. Thus the rule is that property which a trustee obtains by use of his position as trustee becomes trust property."[87]

If these statements are correct the consequences of *Keech* would be far reaching indeed. The statements suggest that property which has neither been once held by or on behalf of P, nor paid for by P, will be held on constructive trust if acquired in breach of fiduciary obligation.[88] It also follows that, as in *Keech* itself, it is irrelevant to the recognition of a constructive trust whether P could or would have acquired the benefit in F's hands. Thus, in *Normalec v Britton*[89] Walton J opined that a competing business established in breach of fiduciary obligation belonged in equity to P and it was "*nihil ad rem* that that business may itself have dealt in a large number of matters with which the plaintiff itself did not deal. If authority is wanted for that it is *Keech v Sandford*".[90] Similarly, in *Chan v Zachariah* Deane J emphasised, following the passage quoted above,[91] that where a fiduciary breaches the no-profit or no-conflict rule the "constructive trust arises from the fact that a personal benefit or gain has been so obtained or received and it is immaterial that there was no absence of good faith or damage to the person to whom the fiduciary obligation was owed."[92]

According to the broad principle of *Keech*, acquisitive breaches of fiduciary obligation and constructive trust are therefore coterminous. An acquisitive breach of fiduciary obligation is, effectively, an event constitutive of an equitable proprietary interest in the claimant. There is little room for non-proprietary remedies, except where the claimant elects to pursue them or where proprietary relief is impossible – for example, because property or its traceable proceeds have ceased to be identifiable. This gives the constructive trust a much broader role than it is possible to justify.[93]

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[87] *Ultraframe v Fielding* [2005] EWHC 1638 at [1489]. See also *Reid* n44 above (the rule in *Keech* "must be that property which a trustee obtains by use of knowledge acquired as trustee becomes trust property."); *Swain v Law Society* [1981] 3 All ER 797 at 813 per Oliver LJ ("that which is the fruit of trust property or of the trusteeship is itself trust property").

[88] See e.g. *News International plc v Clinger* HC Transcript, 17th November 1998, para 276. See also the interpretation and application of *Keech* in *Reid*, n44 above.

[89] [1983] FSR 318

[90] *ibid.* at 322-323. However, rather than enforce the constructive trust the claimant sought an injunction to restrain the competition.

[91] n85 above.

[92] *ibid.* at 199.

[93] See Chapter 4, Sections V & VI.

2. Context, Origins and the Weight Accorded to the Principle

Acceptance of the broad principle attributed to *Keech* suggests that there is little room for a more discriminatory approach to the recognition of constructive trusts in cases involving a breach of fiduciary obligation. The principle is clear: an acquisitive breach generates a constructive trust. The consequences of this would be far reaching. It would risk unwarranted priority over F's creditors and may compel outcomes which are impractical or disproportionate as between F and P.[94]

However, neither the legal basis nor the weight of the principle is clear. First, when considering the nature of relief granted, it is important to place *Keech* in its peculiar historical context. This raises questions about whether the case can in fact be viewed as establishing or illustrating the principle attributed to it. Second, closer examination reveals that the broad principle owes its existence not to the Chancery courts but to the treatise writers of the nineteenth century and their pursuit of an agenda which to most modern eyes looks somewhat ill conceived. Third, the broad principle has at no time been fully reflected in the decided cases. While it has been invoked to bolster decisions to grant proprietary relief, it has not operated to constrain judges who have considered proprietary relief inappropriate on the facts of the case before them.

(a) The Principle in Historical Context

At first blush *Keech* appears structurally similar to other cases involving the wrongful acquisition of a benefit from a third party in breach of fiduciary obligation. It therefore appears to follow that whether the benefit acquired is a bribe, secret commission, opportunity or a lease the same remedial consequences must follow: F holds the benefit on constructive trust for P.

This illustrates one of the dangers of inductively deriving general rules and abstract principles from decided cases, especially where the cases are of some antiquity. The danger is that the importance of the context in which a case arose or the principle was

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[94] See Chapters 4, Section VI & Chapter 7, Section V.2.

developed is forgotten. As Baroness Hale emphasised recently, "[i]n law, 'context is everything'".[95] Similarly, Lord Browne-Wilkinson has warned that it is dangerous to "lift wholesale the detailed rules developed in the context of traditional trusts and then seek to apply them to trusts of a quite different kind".[96] Rules and principles must be understood in their social, economic and historical contexts. As social and economic conditions change, so the law moves on.[97]

We must not forget that *Keech v Sandford* arose in a social, legal and economic environment that was radically different to that of today. As noted already, the case was decided at a time when there were restrictions as to the duration of leases that could be granted by some bodies. This led to the development of a customary practice of renewal without which short-term leases would have been of limited value to either landlord or tenant.[98] The custom of renewal became so entrenched that the leasehold was "considered almost equal freehold".[99] A trustee who renewed the lease for his own benefit "would, in effect, be appropriating trust property for his own benefit".[100]

The renewal of a customarily renewable lease for the trustee's personal benefit was therefore viewed as analogous to a simple misappropriation of trust property. At the very least it involved the frustration of a reasonable expectation of the beneficiary.[101] Placed in its historical context, *Keech* does not therefore support a necessary link between acquisitive breach and constructive trust. In particular, it does not demand a constructive trust where P has no realistic expectation of acquiring the disputed property and has no prior connection to it.[102]

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[95] *Stack v Dowden* [2007] UKHL 17 at [69].
[96] *Target Holdings v Redferns* [1996] 1 AC 421.
[97] *Stack*, n95 above, at [46], [60] per Baroness Hale.
[98] Cretney, n2 above.
[99] *ibid.* at p.165.
[100] *ibid.* at p.168.
[101] G. Virgo, *Principles of the Law of Restitution* (2nd edn, 2006), p.520; A.J. Oakley, "The Liberalising Nature of Remedies for Breach of Trust" in *Trends in Contemporary Trust Law* (1996, ed. A.J. Oakley), p.217 at 235.
[102] E.g. *Boardman v Phipps* [1967] 2 AC 46; *Regal (Hastings) v Gulliver* [1967] 2 AC 134n; *Reid*, n44 above.

(b) The Origins of the Broad Principle

The broad principle attributed to *Keech* has its origins in the trust and equity treatises of the 19th century. Perhaps the most widely known statement of the principle in that era is to be found in *White & Tudor's Leading Cases in Equity*: [103]

> "Whenever a person clothed with a fiduciary or quasi-fiduciary character or position gains some personal advantage by availing himself of such character or position, a constructive trust is raised by courts of equity, such person becomes a constructive trustee, and the advantage gained must be held by him for the benefit of his *cestui que trust*."

The earliest statement of the principle appears in the American treatise on equity jurisprudence by Story, [104] although Story cited *Fawcett v Whitehouse* [105] and not *Keech* as illustrative of the principle. [106] Story was clearly influential in England [107] and his work provided the foundations for later equity manuals. [108] As the broad principle spread through the texts it thereby entered the mainstream of legal thought and conditioned the minds of future generations of judges and jurists. [109] By the turn of the twentieth century W.G. Hart described the principle as "well established", although he pointed to no judicial statement of it. He simply relied on the formulation of the principle in *White & Tudor*. [110] The influence of these nineteenth century developments is still seen today in the texts. [111] However, it is important to remember

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[103] F.T. White & O.D. Tudor, *A Selection of Leading Cases in Equity* (7th edn, 1897), p.695. See also A. Underhill, *A Concise Guide to Modern Equity* (1885), p69.

[104] J. Story, *Commentaries on Equity Jurisprudence as Administered in England and America* (1836), Vol 2, §1261. See also G. Spence, *The Equitable Jurisdiction of the Court of Chancery* (1850), Vol 2, p.944

[105] [1929] 1 Russ & M 132 at 149.

[106] This is not surprising. Story and other writers saw their role as uncovering natural principles that were simply illustrated by the decided cases. *Fawcett* simply provided a more recent illustration of the fundamental principle. However, like *Keech*, *Fawcett* offers rather weak support for the imposition of a constructive trust: see Chapter 6, Section IV.1(a).

[107] A first English edition was published in 1884: J. Story, *Commentaries on Equity Jurisprudence* (1884, ed. W.E. Grigsby).

[108] E.g. J.W. Smith, *A Manual of Equity Jurisprudence, Founded on Story's Commentaries and Spence's Equitable Jurisdiction* (3rd edition).

[109] In at least two twentieth century cases *White & Tudor* is either cited alongside *Keech* as authority for the broad principle or is otherwise a clear influential: *Midcon Oil & Gas Ltd v New British Dominion Oil Co Ltd* ((1958) 12 DLR 2d 705 at 712-713 per Rand J (quoting the above passage from the 7th edition); *Wicks v Bennett* (1928) ALR 30, where the language closely tracks the passage in *White & Tudor* quoted above.

[110] Hart, n5 above, at p.259.

[111] Thus, acquisitive breaches of fiduciary obligation are usually considered in chapters on constructive trust, and equity's response to the profiting fiduciary is presumed to be the recognition of a constructive

that nowhere in *Keech* (or *Fawcett v Whitehouse* for that matter) - indeed, nowhere prior to the twentieth century - was such a broad principle developed or acknowledged judicially. The principle attributed to *Keech* is a product of the treatises. Its exposition in the cases came much later.

To understand why the broad principle was developed in the nineteenth century treatises it is necessary to understand the influences under which these works were written.[112] The influences were both practical and theoretical.

On the practical side the writers of the time were faced with a disorderly law that needed to be tidied up and systematically stated if it was to be respectable and intelligible. The trust in particular was relatively new and peculiarly English. It had been tied to land and viewed as little more than a conveyancing device for many of its formative years.[113] Until the mid-eighteenth century almost all of the treatises relating to trusts therefore focussed upon the effects of the Statute of Uses on conveyances.[114] If it was to form its own independent category, the subject had to be given order and conceptual shape.

Equity scholars were also keen to demonstrate that clear and certain doctrines of equity had developed and that decisions of Chancellors amounted to more than a reflection of the individual's conscience. "Conscience" was the primary principle of decision in the Court of Chancery in the fifteenth and sixteenth centuries.[115] However, the displacement of common law rules by the exercise of the Chancellor's discretion was increasingly attacked from the mid-seventeenth century. The most famous critic

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trust: see e.g. G. Thomas & A. Hudson, *The Law of Trusts* (2004), Chapter 29; A.J. Oakley, *Parker & Mellows: The Modern Law of Trusts* (8th edn, 2003), pp.330-370; D.J. Hayton, *Underhill & Hayton: Law of Trusts and Trustees* (16th edn, 2003), pp382-398. The result is that time and energy is spent not on evaluating the recognition of a constructive trust but on defining who is a fiduciary, analysing the no-conflict and no-profit rules, and considering their application in different contexts.

[112] The leading general account of the underlying influences on eighteenth and nineteenth century treatise writers remains the illuminating essay by A.W.B. Simpson, "The Rise and Fall of the Legal Treatise: Legal Principles and the Forms of Legal Literature" (1981) 48 U Chi L Rev 632.

[113] Thus, the trustee was often viewed as "merely an instrument of conveyance": *Burgess v Wheate* (1759) 1 Eden 177.

[114] G. Alexander, "The Transformation of Trusts as a Legal Category, 1800-1914" (1987) 5 Law & Hist Rev 303 at pp.336-337.

[115] T.S. Haskett, "The Medieval English Court of Chancery" (1996) 14 Law & History Rev 247 at p.267.

was John Seldon. As a product of the conscience of the individual Chancellor Seldon branded equity "A Roguish thing."[116]

> "Tis all one as if they should make the Standard for the measure we call A foot, to be the Chancellor's foot; what an uncertain measure would this be; One Chancellor has a long foot another A short foot a third an indifferent foot; tis the same thing in the Chancellor's conscience."[117]

Seldon's criticism, and his powerful metaphorical expression of it, was influential in the settlement of "principles of equity". [118] It was echoed subsequently by Chancellor's such as Lord Nottingham, whose efforts to systematise equity are well documented,[119] and Lord Eldon. As the latter stated famously:

> "The doctrines of this Court ought to be as well settled and as uniform almost as those of the common law, laying down fixed principles, but taking care that they are to be applied according to the circumstances of each case. I cannot agree that the doctrines of this Court are to be changed with every succeeding judge. Nothing would inflict on me greater pain, in quitting this place, than the recollection that I had done any thing to justify the reproach that the equity of this Court varies like the Chancellor's foot." [120]

Against this backdrop the move to develop general rules and deduce broad principles from decided cases was understandable; almost inevitable.

However, perhaps more important were the broader theoretical underpinnings of jurists that dominated in the eighteenth and nineteenth centuries. Law was a science; and equity should be law-like. Treatise writers generally identified their role as being not the organisation of authoritative judgments but the discovery of natural principles on which decided cases were based. As Simpson explains, the writers embraced the belief

> "that private law consisted essentially of a latent scheme of principles whose workings could be seen in and illustrated by the decisions of the courts, where

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[116] F. Pollock (ed) *Table Talk of John Seldon* (1927), p.43.
[117] *ibid.*
[118] See W. Holdsworth, *Some Makers of English Law* (1938), p.198.
[119] See D.R. Klinck, "Lord Nottingham and the Conscience of Equity" (2006) 67 Journal of the History of Ideas 123 at pp.124-125.
[120] *Gee v Pritchard* 36 ER 670 (Chan. 1818).

> they were developed and applied. The text writer set out to expound these principles in a rational, coherent manner, as was appropriate to a science."[121]

It followed that the role of the treatise writer was to uncover and expound the law's hidden structure and principles. The idea was that "in the beginning there were principles, and that in the end those principles were found to cover a large multitude of cases deducible from them".[122] General principles were the basis of decided cases, not the reverse. Of the authors of the early equity and trust treatises Austin thus observes:

> "Disguised by the fictitious apparatus of 'legal science' and fidelity to judicial law, the textwriters were able to pour the shapeless materials of the case law into a sharp and rigid mould, inventing along the way the legal propositions needed to give definition to their creature."[123]

It does not take a fervent realist to identify the flaws of such an approach. Abstract legal principles are not timeless and inherent in the nature of things. They are constructs developed by people in particular contexts for particular reasons. An understanding of the context of the early leasehold cases and the reasons for the development of the general principle by the treatise writers suggests that there is good reason to treat the principle attributed to *Keech* as of limited application in the modern world.

(c) To What Extent Does the Principle Decide Concrete Cases?

Notwithstanding its occasional forceful pronouncement in twentieth century cases, it is fair to say that the broad principle has never enjoyed universal appeal. Its enunciation by the jurists puts a thick gloss on a less than decisive case law. Thus, while in 1905 Hart described the principle as "well established"[124] it was flatly contradicted by a number of then recent authorities. The application of the principle would generate a constructive trust in all cases of acquisitive breach of fiduciary obligation. Yet *Lister v Stubbs*[125] and *Metropolitan Bank v Heiron*[126] had only

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[121] Simpson, n112 above, at p.666.
[122] T.F.T. Plucknett, *Early English Legal Literature* (1958), p.19.
[123] R.P. Austin, "The Melting Down of the Remedial Trust" (1988) 11 UNSWLJ 66 at p.68.
[124] n5 above.
[125] (1890) 45 LR Ch D 1.

recently confirmed that the recipient of a secret commission did not hold the commission on trust for his principal. Indeed in *Lister* Lindley LJ sought to maintain a sharp conceptual distinction between ownership and obligation – between property that was owned by but misappropriated from P and property that was acquired from a third party in breach of an obligation owed to P.[127] Only in the former instance would a constructive trust be available.[128] The *Lister* line of authority was followed in the context of bribes and secret commissions for most of the twentieth century until the decision of the Privy Council in *Attorney-General for Hong Kong v Reid*.[129] Ironically, the Privy Council disapproved of *Lister* partially on the ground that it was inconsistent with the principle of *Keech v Sandford*.

Moreover there is recent evidence that, contrary to the result dictated by application of the broad principle, a constructive trust need not be the automatic consequence of a breach of fiduciary obligation. Thus, in *Ocular Sciences v Aspect Vision Care Ltd*[130] the claimant sought a constructive trust over a fraction of a company's assets. Laddie J refused to found a constructive trust because its imposition would generate significant practical problems. In reaching this eminently sensible conclusion he rejected emphatically the proposition that there is an ineluctable link between breach of fiduciary obligation and constructive trust.[131] Thus, while the broad principle is often used to bolster a decision to impose a constructive trust, it can be hardly considered determinative. In the wise words of Justice Holmes, "general principles do not decide concrete cases".[132]

V. Conclusion

It is important to put *Keech v Sandford* and other renewal cases into historical context. Doing so suggests that there is little justification for the constructive trust of a renewal absent evidence that F's renewal prevented it arriving at P. However, the authorities

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[126] (1880) 5 Ex D 319.
[127] n125 above, at 15.
[128] *ibid.* at 4-5, 9-10 (Sterling J), 12 per Cotton LJ.
[129] n44 above. See Chapter 6, Section II.3.
[130] [1997] RPC 289.
[131] *ibid.* at 413. See further Chapter 7, Section V.2(b).
[132] *Lochner v New York* (1905) 198 US 45 at 76.

are clear and to the contrary. There is even less justification for a constructive trust of the freehold reversion. A purely personal claim to the freehold by way of personal order to transfer specific property might be thought particularly desirable in this context. Finally, and perhaps most importantly, the broad principle attributed to *Keech* should not and, it seems, does not determine the outcome in concrete cases. This is particularly significant. If the broad principle operated strongly it would leave no room to develop the personal order to transfer specific property in cases where a constructive trust cannot be justified and is not demanded by clear authority. It is to such cases that we now turn.

CHAPTER 6: Bribes and Secret Commissions

I. INTRODUCTION

This chapter deals with F's receipt of bribes and secret commissions. In this context there remains significant disagreement over whether F is a constructive trustee of his gain or simply personally liable to account for its value. For some, *Attorney General for Hong Kong v Reid*[1] conclusively settled the issue – in England at least - in favour of the automatically vesting constructive trust.[2] Others, however, remain sceptical and question the reasoning and subsequent authoritative value of this Privy Council decision.

This chapter suggests that the position adopted by the Privy Council in *Reid* is difficult to support. An analysis of the pre-*Reid* cases demonstrates considerable confusion relating to the nature of relief granted. Some courts seemed to adopt the view that the bribe belonged to P, others that F was simply liable in debt for the amount of the bribe. Still others appeared to suggest that P might acquire a beneficial interest in the bribe, but only from the time the Court found in his favour. The result of such confusion is that, remedially, much remains up for grabs.

This chapter demonstrates that normatively desirable outcomes can be achieved within a clear and illuminating framework if we recognise that the personal order to transfer specific property has a role to play. Recognising its availability will help ensure that wrongdoing fiduciaries do not benefit from their corrupt activities. However, unlike the constructive trust it achieves this without the risk of creating unwarranted priorities. Recognising the personal order allows the constructive trust to be more narrowly confined and limited to those situations in which bribe taking effects a transfer of wealth from P to F. In these cases insulating P from the risk of F's insolvency by the imposition of a constructive trust is necessary to secure P's wealth and encourage the efficient utilisation of fiduciary relationships.

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[1] [1994] 1 All ER 1.
[2] E.g. A.J. Oakley, "Proprietary Claims and Their Priority in Insolvency" [1995] CLJ 377 at p.389.

II. LIABILITY AND REMEDIES

1. The Fiduciary's Liability for Bribes and Secret Commissions

A fiduciary takes a bribe[3] when he receives a benefit from a third party with whom he is dealing on P's behalf,[4] the benefit potentially influences his dealings and it is received without the knowledge or consent of P and was not contemplated at the outset when the relationship was created.[5] There is no requirement that P be caused loss as a result of the bribe taking[6] and for the purpose of the civil law,[7] a corrupt motive on the part of F is unnecessary.[8] The court will thus not inquire into whether F was in fact influenced to act in a way prejudicial to P's interests.[9] It is sufficient that a secret benefit has been received in circumstances that are such as to put the fiduciary in a position where his duty and interest conflict.[10]

While this Chapter focuses on the receipt of bribes by fiduciaries it is generally agreed that bribes can be also received by non-fiduciaries, although the extent to which this is so depends ultimately on how far we expand the fiduciary concept. In the context of bribe taking it has been given a particularly wide meaning and includes those

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[3] "Bribe", "secret commission" and "surreptitious payment" are used interchangeably in the case law: *Industries & General Mortgage Co v Lewis* [1949] 2 All ER 573 at 575 (Slade J). On the general definition of a bribe, see also *Hovenden & Sons v Millhoff* (1900) 83 LT 41 at 43 per Romer LJ; *Taylor v Walker* [1958] 1 Lloyd's Rep 490; M. Cope, "Ownership, Obligation, Bribes and the Constructive Trust" in *Equity Issues and Trends* (1995, ed. M. Cope), p.91 at 99-104; P.D. Finn, *Fiduciary Obligations* (1977), pp.214-220.

[4] Although a promised benefit that is not in fact received is sufficient: "A bribe remains a bribe even if it is eventually unpaid and irrespective of whether its purpose is achieved": *News International plc v Clinger* (unreported, Chancery Division, 17th November 1998) (Lindsay J).

[5] Usual and customary commissions are permitted notwithstanding that P may be unaware of the amount: *Fyfees v Templeman* [2000] 2 Lloyd's Rep 643.

[6] *Hovenden*, n3 above, at 48 per Romer LJ.

[7] Proof of the bribee's corruptness is generally required for the purpose of criminal sanction under common law conspiracy or anti-corruption legislation: see *R v Whitaker* [1914] 3 KB 1283 (conspiracy); Prevention of Corruption Act 1906, s1. Corruption is presumed in some cases, namely those defined in the Prevention of Corruption Act 1916, s2.

[8] Or, as is often said in the alternative, there is an irrebuttable presumption of corruption: *In re a Debtor* [1927] 2 Ch 367 at 376 per Scrutton LJ. The presumption does not meet with universal approval: see e.g. J.C. Shepherd, *The Law of Fiduciaries* (1981), pp.260-262, 264-266.

[9] *Harrington v Victoria Graving Dock Co* (1878) 3 QBD 549; *Shipway v Broadwood* [1899] 1 QB 369 at 373 (Chitty J).

[10] *Meadow Schama & Co v Mitchell & Co* (1973) 228 EG 1511 at 1512 per Lord Denning MR; *Anagel Atlas Compania Naviera SA v Ishikawajima-Harima Heavy Industries* [1990] 1 Lloyd's Rep 167 at 171 (Leggatt J); *The Parkdale* [1897] P 53 at 58-59 (Barnes J).

relationships which would not ordinarily be classified as such.[11] Lord Porter thus noted in *AG v Reading* that in this context the "fiduciary relationship" is used "in a wide and broad sense".[12] However, while he found a fiduciary relationship existed between an army sergeant and the Crown he acknowledged that this was not necessary to found relief but merely afforded an alternative way of formulating the cause of action.[13]

2. Remedial Options

The consequences of establishing the receipt of a bribe are as far reaching as they are varied.[14] Transactions affected by the bribe may be treated by P as void *ab initio*,[15] while payment and indemnification of F can be refused.[16] P may also recover from either briber or fiduciary the amount of the bribe[17] or if specific property, the value of the property received,[18] with interest payable from the date of receipt by F.[19] Full recovery from both briber and fiduciary is not permitted.[20] Where the fiduciary or briber have profited from the bribe, an account of profits from either party also lies.[21]

As an alternative to gain-based recovery P may claim damages for any loss caused, both

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[11] A.J. Oakley, *Constructive trusts* (3rd edn, 1997), pp.131-132; C. Harpum, "The Uses and Abuses of Constructive Trust: The Experience of England and Wales" (1997) 1 Edinburgh L Rev 437 at pp.460-461, noting that often the "exigous fiduciary relationship serves merely to identify who should receive the money stripped from the recipient of the bribe."

[12] [1951] 1 All ER 617 at 620..

[13] At first instance Denning J refused to found a fiduciary relationship but grounded liability in unjust enrichment: [1948] 2 All ER 27 at 29.

[14] For discussion, see A. Tettenborn, "Bribery, Corruption and Restitution - The Strange Case of Mr Mahesan" (1979) 95 LQR 68 at pp.69-71; A. Berg, "Bribery – Transaction Validity and Other Civil Law Implications" [2001] LMCLQ 27; H. Johnson, "Dealing With Bribes" (1994) 12 Int BFL 94.

[15] See *Logicrose v Southend United FC Ltd* [1988] 1 WLR 1256; *Taylor v Walker*, n3 above; *Panama & South Pacific Telegraph Co v India Rubber, Gutta Percha & Telegraph Works Co* (1875) 10 Ch App 515.

[16] *Nicholson v J Mansfield & Co* (1901) 17 TLR 259. Receipt of a bribe is also grounds for summary dismissal of the fiduciary: *Swale v Ipswich Tannery Ltd* (1906) 11 Com Cas 88.

[17] *Reading v Attorney General* [1951] 1 All ER 617 at 620; *Industries & General Mortgage Co*, n3 above.

[18] *Nat-y-glo and Blaina Ironworks Co v Grave* (1878) 12 Ch D 738. There is some authority for the proposition that in such instances liability is measured by reference to the highest value that the property might have fetched while in F's hands: see e.g. *Re Morvah Consuls Tin Mining Co* (1875) 2 Ch D 1.

[19] *Boston Deep Sea Fishing & Ice Co v Ansell* (1888) 39 Ch D 339 at 372.

[20] *Mahesan v Malaysian Government Officer's Co-Operative Housing Society Ltd* [1979] AC 374.

[21] The availability of an account of profits from F conflicts with the views of Lindley LJ in *Lister & Co v Stubbs* (1890) 45 Ch D 1 at 15, but was nevertheless assumed to be available at the election of P even prior to *Reid*: P.B.H. Birks, *Introduction to the Law of Restitution* (1989 Rev'd ed), p.389; A. Burrows, *The Law of Restitution* (1993), p.411. For an account from the briber, see *Fyfees*, n5 above, at 668, 672.

fiduciary and briber being jointly and severally liable.[22] Double recovery for both the amount of the bribe and compensatory damages is not permitted and would fly "in the face of a long line of authority".[23] The exclusion of double recovery has nevertheless been questioned on the ground that there may not be any inconsistency between the two measures.[24] It is well settled that P may recover F's profit even where he has suffered no loss. The aim is to deter corruption rather than compensate loss.[25] The recovery of damages, by contrast, aims to repair loss rather than prevent corruption. Disgorgement and compensation are therefore different in nature and, consequently, it is unclear why they should not be available cumulatively.[26] Friedman suggests that treating the measures as alternatives is more consistent with "true principle".[27] That position is, however, weakened if *Reid*[28] is accepted as authority for the proposition that a bribe is held on trust by F from the moment of receipt. Seeking compensation for loss caused to P is a different matter to the recovery of P's property from F. The true nature of P's claim to the bribe, however, remains uncertain.

3. The Claim to the Bribe: Personal or Proprietary?

Prior to 1993 the leading case on the nature of relief that could be claimed by the victim of a bribe was the widely disputed Court of Appeal decision in *Lister & Co v Stubbs*.[29] In this case it was held that an agent receiving a secret commission was liable in debt to pay his principal the value of the commission; the relationship between the parties being one of debtor and creditor, not trustee and beneficiary. While the case was subject to much criticism[30] and only limited support,[31] it was consistently followed over the

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[22] *Morgan v Elford* (1876) 4 Ch D 352.
[23] *Mahesan*, n20 above, at 410 per Lord Diplock.
[24] See P.B.H. Birks, "Inconsistency Between Compensation and Restitution" (1996) 112 LQR 375 at p.378. The Law Commission did not recommend any legislative changes to the area, reservations notwithstanding: *Aggravated, Exemplary and Restitutionary Damages* (Law Com 247, 1997), ¶¶1.64-1.72.
[25] See Section IV.1, below.
[26] Tettenborn, n14 above, at pp.73-74.
[27] G.H.L. Friedman, *The Law of Agency* (6th edn, 1990), p.168.
[28] n1 above.
[29] (1890) 45 Ch D 1.
[30] D. Hayton, "Constructive Trusts: Is the Remedying of Unjust Enrichment a Satisfactory Approach?" in *Equity, Fiduciaries and Trusts* (1989, ed. T.G. Youdan), p.205 at pp.222-223; R. Goff & G. Jones, *The Law of Restitution* (4th edn), chapters 2 & 32; Shepherd, n8 above, pp.268-269; C. Needham, "Recovering the Profits of Bribery" (1979) 95 LQR 536 at pp.540-545; Sir Peter Millett, "Bribes and Secret Commissions" [1993] RLR 7, reprinted as "Remedies: The Error in *Lister v Stubbs*" in *Frontiers*

course of a century in both English[32] and Commonwealth[33] courts.

However, in *Attorney General for Hong Kong v Reid*[34] the Privy Council refused to follow *Lister*. Reid, a public prosecutor in Hong Kong, was convicted of accepting bribes as an inducement to obstruct the prosecution of certain criminals. It was alleged that three properties in New Zealand were purchased with the bribe monies. The Attorney General for Hong Kong consequently registered caveats against the relevant titles to prevent any dealings with them. To renew the caveats he was required to show an arguable case that the Hong Kong Government had a proprietary interest in the respective properties. This depended on whether the bribe monies were held on trust by Reid when they were received and so could be traced into the properties.

Following *Lister* both the High Court and New Zealand Court of Appeal held that the Hong Kong government had no such interest in the bribe; the relationship between the parties was simply that of debtor and creditor, not trustee and beneficiary.[35] However, the decision was reversed on appeal to the Privy Council. Placing emphasis on authorities of some antiquity and the equitable maxim "equity considers as done that which ought to be done", a strong Privy Council determined that from the moment Reid received the bribe, it was held on constructive trust. The Attorney-General could therefore trace the bribe monies into, and claim a constructive trust over, the three properties.

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of Liability (1994, ed. P.B.H. Birks), Vol 1, p.51; R.P. Meagher, W.M.C. Gummow & J.R.F. Lehane, *Equity Doctrines & Remedies* (3rd edn, 1992), pp.155-156; J.R.F. Lehane, "Fiduciaries in a Commercial Context" in *Essays in Equity* (1985, ed. P.D. Finn), p.107.

[31] See R.M. Goode, "Ownership and Obligation in Commercial Transactions" (1987) 103 LQR 433 at pp.441-445; Birks, n21 above, at pp.387-389, 473-474; J. Evans & P.Watts, "Constructive Trusts and the Authority of English Decisions in Other Commonwealth Jurisdictions: A Comment on *Attorney-General for Hong Kong v Reid*" [1992] NZ Recent Law Rev 302.

[32] *Powell & Thomas v Evan Jones & Co* [1905] 1 KB 11 at 19 per Collins MR; *Wilsons & Furness-Leyland Line Ltd v British & Continental Shipping Co Ktd* (1907) 23 TLR 397; *Attorney General v Goddard* (1929) 98 LJKB 743; *Regal (Hastings) v Gulliver* [1942] 1 All ER 378 at 393 per Lord Wright; *Attorney General's Reference (No 1 of 1985)* [1986] QB 491; *Islamic Republic of Iran Shipping Lines v Denby* [1987] 1 Lloyd's Rep 367.

[33] *Ardlethan Options Ltd v Easdown* (1915) 20 CLR 285 at 292 per Isaacs J; *Westpac v Markovic* (1985) 82 FLR 7 at 10 per Zelling J; *Daly v Sydney Stock Exchange* (1986) 160 CLR 371 at 379 per Gibbs CJ; *Police v Leaming* [1975] 1 NZLR 471. The decision was questioned judicially only rarely: e.g. *DPC Estates Pty Ltd v Grey & Consul Developments Ltd* [1974] 1 NSWLR 443 at 470, reversed on other grounds (1975) 49 ALJR 74 (*Lister* interpreted restrictively)..

[34] n1 above.

[35] [1992] 2 NZLR 385.

III. JUDICIAL REACTION TO *REID*

The conclusion reached by the Privy Council in *Reid* has been congratulated by some commentators as removing an anomaly from the law[36] but criticised by many others.[37] The reaction of the judiciary has been similarly mixed.

1. Judicial Support for *Reid*

In *Kleinwort Benson v Lincoln City Council*[38] Lord Lloyd considered *Reid* to be illustrative of a Privy Council decision effectively overturning a long established Court of Appeal authority. A number of later High Court cases apparently support a similar view. It is however, submitted that these cases fail to kill off *Lister* entirely.

In *Crown Resources v Vinogradsky*[39] secret commissions were received by two defendants and subsequently paid into, and moved around, various off-shore companies of which they were beneficial owners. The claimant sought to trace the monies and hold the companies liable to account for money that represented the secret payments. Justice Garland noted of *Reid*:

> "This decision effectively overruled (although I am conscious that a decision of the Privy Council is persuasive only) the earlier decision of the Court of Appeal in *Lister v Stubbs*, by regarding money improperly received by a person in a fiduciary position as subject to a constructive trust in equity although in law the fiduciary was a debtor."[40]

Consequently, he was "fully persuaded" to follow *Reid* on the grounds that it

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[36] A.J. Oakley, n11 above, p.137; D.J. Hayton & C. Mitchell, *Hayton & Marshall: The Law of Trusts and Equitable Remedies* (12th edn, 2005), pp.360-361; R. Goff & G. Jones, *The Law of Restitution* (5th edn, 1998), p.87; J. Beatson, "Proprietary Claims in the Law of Restitution" (1995) 25 Can Bus LJ 66 at pp.71-77.

[37] P.B.H. Birks, "Property in the Profits of Wrongdoing" (1994) 24 WALR 8; D. Crilley, "A Case of Proprietary Overkill" [1994] RLR 57; A. Jones, "Bribing the DPP: Should he Profit from Abusing his Position?" [1994] Conv. 157; R. Pearce, "Personal and Proprietary Claims Against Bribees" [1994] LMCLQ 189; S. Gardner, "Two Maxims of Equity" [1995] CLJ 60 at pp.60-63.

[38] [1999] 2 AC 349 at 393.

[39] 14th November 2001, High Court, Queen's Bench Division (unreported).

[40] *ibid.* at [21].

demonstrated *Lister* was decided *per incuriam*.[41] Thus, the secret commissions received by the corporate defendants "are, or were, held on constructive trusts in favour of the Claimant and therefore traceable".[42]

Reid was also followed by Smith J in *Tesco Stores v Pook*,[43] without any reference to the conflicting authority of *Lister*.[44] Pook, a grocery development manager at Tesco, was paid a bribe by a third party for the purpose of securing further business from Tesco. He then used this money to purchase real estate. Upon establishing that the facts surrounding the making of the payment were such as to constitute a bribe, Smith J simply concluded "Mr Pook is obliged to account. He holds the payment on trust for Tesco".[45]

In both *Pook* and *Vinogradsky* however, no third party interests were evident. The most unpalatable consequences of applying *Reid* did not therefore have to be confronted directly in the case at hand. In *Pook* moreover, the underlying proprietary position was not essential to the outcome because it appears, an *in personam* account of profits is all that was sought.

The decision of Toulson J in *Fyfees v Templeman*[46] also fails to squeeze all of the life from *Lister*. The issue in this case was whether an account of profits was available against the briber. Toulson J held that it was and in doing so opined that *Lister* represented a "wrong turning" which was rectified by *Reid*. *Reid* therefore opened up a previously closed door: it would have made no sense to allow an account against the briber if gain-based recovery was not permitted against the bribee. This however, does not demand a complete rejection of *Lister*. It simply demands the uncontroversial step of rejecting *Lister* to the extent it prevents an account of profits from F. The decision in

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[41] *Ibid*. As to whether *Lister* should be considered *per incuriam*, see Section IV, below.
[42] *Ibid* at [26].
[43] [2003] EWHC 823.
[44] See also the observations of Rimer J in *Sinclair Investment Holdings SA v Versailles Trade Finance Limited (inAdministration)* [2007] EWHC 915 at [105] (*Reid* cited in support of the proposition that benefits acquired in breach of fiduciary obligation are held by the fiduciary on constructive trust for P, "who thereby obtains an immediate proprietary interest in them"). See further *Corporacion Nacional del Cobre de Chile v Interglobal Inc* (2002-03) 5 I.T.E.L.R. 744 (Grand Court (CI)) (applying *Reid*); *Polymer Systems (1999) Ltd v Montgomerie* [2002] 3 NZLR 383 (*Reid* cited as authority for constructive trust in cases of acquisitive breach of fiduciary obligation); *Secretary for Justice v Hon Kam Wing* [2003] 147 HKCU 1 (Hong Kong High Court) (applying *Reid* to substantially similar facts).
[45] n43 above, at [45].

Fyfees did not therefore depend on establishing that the bribee is a constructive trustee of the bribe.

The leading post-*Reid* authority is the decision of Collins J in *Daraydan Holdings v Solland*.[47] In this case proprietary relief was directly in issue, the claimant wishing to trace secret commissions into substitute assets and seek an order for their delivery up.[48] Justice Collins noted that *Reid* "is regarded as black-letter law"[49] by leading texts. In his own opinion *Reid* was good authority which would be followed by the House of Lords.[50] As a matter of precedent he expressed the opinion that a High Court judge is at liberty to depart from Court of Appeal authority to follow a Privy Council decision,[51] and he would do this in the instant.case (if required) for "powerful policy reasons".[52] However, Collins J's "powerful" policy analysis left much to be desired.[53] Moreover, notwithstanding the forceful rejection of *Lister*, the case was ultimately decided in a manner that was consistent with it.

The secret commission in *Daraydan* was in fact subtracted from the claimants. K was engaged to negotiate the best price for refurbishments to the claimants' properties. S was awarded the contracts but agreed to inflate the prices by 10%, amounting to £1.8m. That amount was to be and indeed was, paid to K upon receipt of payment by S from the claimants. S was simply a conduit through which the £1.8m passed from the claimant to K. The case was therefore one in which "the bribe was paid out of the money paid by the claimants for what they thought was the price. These factors make the claim one for the restitution of money extracted from the claimants."[54] Proprietary relief in such circumstances is entirely consistent with pronouncements in *Lister*.

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[46] n5 above.
[47] [2004] EWHC 622. See M. Halliwell, "The Ghost of *Lister & Co v Stubbs*" [2005] Conv 88.
[48] *ibid.* at [20].
[49] *ibid.* at [80].
[50] *ibid.* at [85]. See also *Pakistan v Zardari* [2006] EWHC 2411 (Comm) at [164]-165], [168], an interim hearing in which it was claimed the defendants had received vast secret commissions or bribes in relation to government contracts. On the back of *Reid* and his own decision in *Daraydan*, Collins J opined that *if* the monies in question were bribes (this had not yet been established) they and their proceeds would be held on constructive trust and were capable of being "knowingly received".
[51] This is doubtful: see below, nn60-64 and accompany text.
[52] n47 above, at [86].
[53] The argument he took to justify proprietary relief was deterrence, while the potential for injustice to creditors upon a defendant's bankruptcy he dismissed on the basis that the defendant should never have received the benefit. The flaws of such an argument were discussed in Chapter 4, Section VI.2(c). See also below, Section V.
[54] n47 above, at [87].

2. Judicial Scepticism of *Reid*

Reid has been received with less enthusiasm in other cases. In *Attorney General v Blake*[55] Sir Richard Scott VC stated of *Lister* that the decision in *Reid* "does not relieve me from the obligation in this jurisdiction of accepting [the] authority." *Reid* was also distinguished and regarded with some suspicion by a strong Court of Appeal in *Halifax Building Society v Thomas*.[56] Here, the Halifax sought a declaration that it was entitled to the surplus funds from the sale of property financed by a fraudulently obtained mortgage. It argued *inter alia*, that the trial judge had erred by following the reasoning of *Lister* rather than *Reid*, thereby rejecting its claim to be beneficially entitled to the surplus funds by way of constructive trust. The Court of Appeal, however, followed *Lister* and held that there could be no constructive trust claim because having affirmed the mortgage, the building society simply stood in a debtor-creditor relationship with the defendant:[57] "ownership must not be confused with obligation, nor must the relationship of debtor and creditor be converted into one of trustee and cestui que trust".[58] *Lister* was also regarded as good law by Laddie J in *Ocular Sciences v Aspect Vision Care Ltd*, although it was narrowly confined to its facts. [59]

The High Court cases purporting to follow *Reid* must be now also considered in light of recent pronouncements relating to the obligation of the Court of Appeal (and, by necessary implication, the High Court) to follow previous Court of Appeal decisions in the face of disapproval from the Privy Council. It was for some time assumed that, while not formally binding, Privy Council authority could be followed and previous Court of Appeal decisions departed from.[60] Thus, in *Dayadan* Collins J indicated a

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[55] [1996] Ch 84 at 96.
[56] [1996] Ch 217.
[57] *ibid* at 228-229 per Gibson LJ (Brown and Glidewell LJJ concurring).
[58] *Snell's Equity* (29th edn, 1990), p.197, quoted with approval by Gibson LJ, *ibid.* at 229.
[59] [1997] RPC 289 at 413 (*Lister* distinguishable from cases in which there is a pre-existing fiduciary relationship).
[60] See e.g. *Port Line Ltd v Ben Line Steamers Ltd* [1958] 1 All ER 787, where Diplock J refused to follow *Lord Strathcona Steamship Co v Dominion Coal Co Ltd* [1926] AC 108 because he felt that it was wrongly decided. However, equally there are numerous instances in which the courts have chosen not to follow the Privy Council. For a recent illustration, see *Luc Thiet Thuan v R* [1997] AC 131 (definition of provocation), not followed by the Court of Appeal in *R v Campbell* [1997] 1 Cr App R 199, 207; *R v Parker* [1997] Crim LR 759; *R v Smith* [1998] 4 All ER 387, affirmed [2000] 4 All ER 289 (HL).

willingness to follow Privy Council authority "where the decision of the Privy Council is recent, where it was a decision on the English common law, where the Board consisted mainly of serving Law Lords, and where the decision had been made after full argument on the correctness of the earlier decision". [61] However, in *National Westminster Bank v Spectrum Plus Ltd*[62] the Court of Appeal held that, even in the face of a contrary Privy Council decision, its own decisions remain binding on it and (except in narrowly defined circumstances) [63] must be followed until overruled by the House of Lords. On appeal, the House of Lords overturned the decision of the Court of Appeal on the point of substantive law and followed the Privy Council's approach. However, three of the four members of the House who expressed an opinion on the point of precedent stated that the Court of Appeal had been correct to treat itself as bound by the earlier English authority until it was overruled (as it was) by the House.[64]

The availability of constructive trust relief in bribe cases cannot therefore be regarded as settled on the authority of *Reid* alone. Much will continue to depend on the interpretation of pre-*Reid* authorities and a careful evaluation of the underpinning policy concerns. It is to these matters that we now turn in Sections IV and V.

IV. The Pre-Reid Precedents

Pre-*Reid* arguments over precedent were generally divided into two polarised interpretations of the authorities. On the one hand there were those who argued that the weight of authority favoured proprietary relief by way of institutional (that is, automatically vesting) constructive trusts. On the other hand there were those who argued that authority showed the claimant was simply entitled to purely personal relief

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[61] n47 above, at [85].
[62] [2004] EWCA Civ 670, [2004] 3 WLR 503.
[63] Namely, those identified in *Young v Bristol Aeroplane Co Ltd* [1944] KB 718. *Lister* does not fall into any of these exceptions.
[64] [2005] UKHL 41, [2005] 2 A.C. 680 at [93], [120] per Lord Scott, and [153] per Lord Walker. Lord Steyn concurred with both Lord Scott and Lord Walker. While the wisdom of the decision may be questioned in relation to the Court of Appeal's ability to break from its own decision to follow the Privy Council, the argument that the High Court should continue to follow the Court of Appeal is far more persuasive: see H.N. Bennett, "Precedent and the Privy Council" (2005) 121 LQR 23. See further, M. Conaglen & R. Nolan "Precedent from the Privy Council" (2006) 122 LQR 349

by way of equitable debt or (comments in *Lister* notwithstanding) an account of profits. Also evident was a less noticed strand of authority suggesting that a constructive trust was available but would not arise until declared by the Court.

1. Property in Bribes

It is hard to agree with those who suggest there are "countless cases"[65] supporting the recognition of an institutional constructive trust of bribes. The argument is that there are cases in which a constructive trust has been granted and cases in which, while only a personal remedy was awarded, *obiter* statements suggest that the claimant owned the bribe or had an equitable interest in it. These arguments are also bolstered by appeal to an equitable maxim of some antiquity: "equity considers as done that which ought to be done".

(a) Cases Involving the Apparent Imposition of a Constructive Trust

Those cases in which the court apparently recognised a constructive trust number just two and remain less than convincing. In *Fawcett v. Whitehouse*[66] the defendant, when negotiating the assignment of a lease for himself and his two co-partners, took a £12,000 payment from the assignors. Lyndhurst LC held that "as to two thirds of the sum of £12,000, the defendant must be considered a trustee for the partnership".[67] Similarly, in *Sugden v. Crossland*,[68] where an executor retired in order to appoint another in consideration of £75, Stuart VC held:

> "It is a well settled principle that, if a trustee makes a profit of his trusteeship, it shall enure to the benefit of his *cestui que trusts*….there does not seem to be any difference in principle whether the trustee derived the profit by means of the trust property, or from the office itself. I shall therefore direct that the £75 be….dealt with as part of the assets…"[69]

Both of these decisions can be criticised on the ground of brevity. In *Sugden* the whole

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[65] Millett, n30 above, at pp.53-54.
[66] [1829] 1 Russ & M 132.
[67] *ibid.* at 148.
[68] (1856) 3 S.M. & Giff. 192.

judgment comprised three short paragraphs and no authority was cited for the "well settled" propositions advanced. Similarly, in *Fawcett*, the previous order of the Vice Chancellor was merely affirmed when directing just three lines of the judgment to the nature of the remedy. Furthermore, in neither case did anything appear to turn on the nature of relief granted: the claims were for money and both defendants, it appears, were solvent. Given the pervasiveness of trust thinking and trust language in nineteenth century Chancery courts, even when a simple money judgment was all that was being sought, we should not read too much into these decisions.[70] At best, they provide tenuous support for the property in bribes theory.

There are, however, further cases such as *Keech v. Sandford*[71] and *Boardman v. Phipps*[72] that are commonly cited in support of the imposition of a constructive trust. These cases apparently held that, where an honest fiduciary makes a profit by virtue of his position, he holds the resulting benefit on constructive trust for his principal.[73] It is inconsistent to hold that an honest fiduciary is a constructive trustee of benefits acquired in breach of fiduciary obligation while a dishonest fiduciary merely faces personal liability.[74] In *Reid*, Lord Templemen therefore took the view that *Keech* must establish "that property which a trustee obtains by use of knowledge acquired as trustee becomes trust property."[75]

The support offered by these cases to the property in bribes theory is, however, relatively weak. We saw in Chapter 5 that *Keech* must be understood in its peculiar historical context, which makes the case analogous to the misappropriation of trust property. We also saw that the broad principle attributed to *Keech* – that an acquisitive breach of fiduciary obligation is an event constitutive of equitable ownership in the principal – stands on weak foundations. *Boardman* is an equally weak authority, not

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[69] *ibid.* at 194.
[70] See Chapter 1, Section III.1.
[71] (1726) Sel Cas T King 61.
[72] [1967] 2 AC 46.
[73] See also *Williams v Barton* [1927] 2 Ch 9, where an honest trustee received a secret commission and was held liable to account for the commission as "constructive trustee". While lending some support to the property in bribes school the proprietary nature of relief was not an issue.
[74] The issue was most forcefully argued by R. Goff & G. Jones, *The Law of Restitution* (4th edn, 1993), pp.668-669. Of course, the obvious response is why should the *Lister* line of authority be assumed to give way rather than the *Boardman* line of authority: D.J. Hayton, "Developing the Law of Trusts for the Twenty-First Century" (1990) 106 LQR 87 at pp.102-103.
[75] n1 above, at 5.

least because the nature of relief granted in the case is, in fact, wholly uncertain.[76] To regard *Boardman* as a clear illustration of "the extent to which equity is willing to impose a constructive trust on property obtained by a fiduciary"[77] is to assert certainty where none exists.

(b) Cases in Which a Personal Remedy Was Granted

The property in bribes theorists also rely on a number of cases in which purely personal relief was granted against the recipient of a bribe or secret commission, but *obiter* statements suggest the claimant had a proprietary interest. Two commonly cited examples are *Pearson's Case*[78] and *McKay's Case*.[79] Both cases concerned secret commissions taken by fiduciaries of companies and were decided on the narrow issue of the payment of damages under the Companies Act 1862, s.165.[80] However, statements were made by both courts that went further. Thus, in *McKay's Case* it was said that

> "it is clear that all the shares transferred [to McKay]….belong to the company. The company are entitled to say to McKay, "Either those shares ought never to have had any existence, or else you hold them only as a trustee for the company."[81]

Similarly, in *Pearson's Case* the recipient of a bribe was said to be

> "liable, at the option of the *cestui que trust*, to account either for the value at the time of the present he was receiving, or to account for the thing itself and its proceeds if it had increased in value."[82]

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[76] See Chapter 7, Section III.2(b).

[77] *Reid*, n1 above, at 10. See also Millet, n30 above, at p.54, where *Boardman* is assumed to be a case of constructive trust without discussion. A similar assumption is found in *Islamic Republic of Iran Shipping Lines v. Denby* [1987] 1 Lloyds Rep 367 at 371.

[78] *In re Caerphilly Colliery Company (Pearson's Case)* (1877) 5 Ch D 336

[79] *In re Morvah Consols Tin Mining Company (McKay's Case)* (1875) 2 Ch D 1

[80] This section conferred on the court discretion to award such compensation as it thought just in respect of any misfeasance or breach of trust committed by a past or present company director. The fact that such cases were pleaded under the Companies Act 1862, s.165 was assumed to make no difference to the general principles of law applied: see *Nant-y-Glo and Blaina Ironworks Company v. Grave* (1878) 12 Ch D 738 at 746-7 (Bacon V-C).

[81] (1875) 2 Ch D 1 at 6 per Mellish LJ. It was also suggested in the case that the defendant may be liable to account for the highest value of the property in his hands. This measure might evidence a proprietary foundation because it may have been premised on the theory that, as the true owner, the claimant could have sold his property at the highest value had it not been taken from his possession by the defendant, who should be therefore liable to pay this amount.

[82] (1877) 5 Ch D 336 at 341 per Jessel MR. The language is ambiguous. To account for the thing itself

Similar comments as to the underlying proprietary position were made in cases where the remedy imposed to recover the bribe was an *in personam* common law claim for money had and received. Thus, the Court of Appeal has said that as soon as money representing a secret commission found its way into the hands of the agent of a company, "it became their money in his hands, and they were entitled to take it and keep it".[83]

Again however, it would be a mistake to take these *obiter* statements as strong support for the constructive trust. In none of these cases was a proprietary remedy sought, nor was a finding of property in the bribe or secret commission essential to the outcome.[84] Consequently, these courts heard no argument on the issue of proprietary relief and provided no clear authority for such a proposition. There also exist contrary obiter statements, suggesting that references to secret commissions as belonging to, or being property of, the principal were not meant in the usual sense of those words.[85] It is therefore a mistake to take literally the language used in these cases as authority for the availability of constructive trust relief.[86]

Finally, there is the judgment of Denning J (as he then was) in *Reading v The King*.[87] There, Denning J explained the recovery of the bribe in terms of unjust enrichment, stating:

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and its proceeds does not necessarily imply a constructive trust.

[83] *Grant v. The Gold Exploration and Development Syndicate Ltd.* [1900] 1 QB 233 at 251 per Collins LJ. While there are terminological differences between the judges as to the precise nature of the liability of the defendant in this case, it is clear that all three judges imposed purely personal relief. For similar statements as to the underlying proprietary position, see *Morison v. Thompson* (1874) 9 QB 480 at 486 (Cockburn CJ).

[84] Although in *Grant* it may have been necessary to reason by the fiction that the claimant had a pre-existing proprietary base because the court was unsure whether it could award disgorgement for wrongs: see Crilley, n37 above, at p.63.

[85] See *In re North Australian Territory Co* [1892] 1 Ch 322 at 338 per Lindley LJ, noting that while the company was entitled to recover the money it was not entitled to priority on insolvency nor to trace the money into substitute assets. The case concerned the Companies (Winding Up) Act 1890, s10, which replaced the Companies Act 1862, s165.

[86] An even weaker authority cited for the property in bribes theory is *Phosphate Sewage Co. v. Hartmond* (1877) 5 Ch D 394, where F was held liable to "restore" (at 441-442 per Malins V-C) or "refund" (at 457 per James LJ) to P a £15,000 bribe. In *Sumitomo Bank Ltd. v. Kartika Ratna Thahir* [1993] 1 SLR 735 (cited with approval in *Reid*, n1 above, at 10), Lai Kew Chai J reasoned that this meant P had a right to compel specific restitution of any property received by an agent in breach of his duty, hence supported the property in bribes theory. This is clutching at straws. Restitution need not be specific or proprietary, and nothing in *Hartmond* points to either.

[87] [1948] 2 All ER 27

> "There are many cases in the books where a master has been held entitled to the unauthorised gains of his servant or agent. At law the action took the form of money had and received. In equity there was said to be a constructive trust due to a fiduciary relationship. Nowadays it is unnecessary to draw a distinction between law and equity ….The claim here is for restitution of money which in justice ought to be paid over."[88]

The cases in which "there was said to be a constructive trust" were not, however, cited. Moreover, the basis of the constructive trust was identified as the existence of a fiduciary relationship. This is unsound. We have seen already that there is no firm foundation in law for the proposition that there is a necessary link between an acquisitive breach of fiduciary obligation and constructive trust.[89]

(c) The Equitable Maxim

In *Reid* Lord Templeman employed the equitable maxim "equity considers as done that which ought to be done" to demonstrate the apparent correctness of his conclusion that the defendant held the bribe on constructive trust from the moment it was received. Yet, as Gardner notes, such maxims "sound both more determinate and more authoritative than they necessarily are."[90]

The maxim is traditionally adopted to give effect to consensual transactions, as with the specific performance of contracts for the sale of land. Here it is said, "Equity looks upon things agreed to be done as actually performed".[91] While it can hardly be said that a fiduciary and his principal agree that the former should receive a bribe for the benefit of the latter,[92] this did not prevent Lord Templeman applying the maxim in *Reid.* He reasoned:

> "The false fiduciary who received the bribe in breach of duty must pay and account for the bribe to the person to whom that duty was owed. In the present case, as soon as Mr Reid received a bribe in breach of the duties he owed to the Government of Hong Kong, he became a debtor in equity to the Crown for the amount of the

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[88] *ibid.* at 29.
[89] Chapter 5, Section IV.
[90] S. Gardner, "Two Maxims of Equity" [1995] CLJ 60.
[91] *Re Cary Elwes' Contract* [1906] 2 Ch 143 at 149 per Swifen Eady J.
[92] This is discussed further below in section V.3.

> bribe.....As soon as the bribe was received it should have been paid or transferred instanter to the person who suffered from the breach of duty. Equity considers as done that which ought to have been done. As soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on a constructive trust for the person injured."[93]

The suggestion is that the liability to account for the bribe, when coupled with the maxim, creates a constructive trust. Without more it is however, difficult to see how this might be so. The anticipation of the execution of an obligation to account cannot itself change the nature of that obligation and create an equitable proprietary interest in P. F's obligation to account is simply one to pay over the value of the bribe from whatever part of his funds he chooses; it does not attach to specific property.[94] There is thus nothing on which the equitable maxim can "bite".[95] As Birks notes, if the only obligation of the defendant is to account, "the maxim could only yield the quaint result that an account due was an account given."[96] Were it otherwise and the maxim could operate to transform a debt into a proprietary interest, the legal landscape would be radically different to what we currently believe it to be.

Sir Peter Millett has defended the use of the maxim on the ground that equity simply treats the defendant as having acted in accordance with his fiduciary obligations. The bribe is therefore treated as received legitimately for the benefit of the principal rather than as part of the fiduciary's own funds.[97] However, this is a *non sequitur*: it is the duty of the fiduciary not to accept the bribe in the first place.[98]

It might be asked why resort to the maxim is so pervasive. [99] Rotherham suggests that the judiciary are attracted to the maxim because of its capacity to obscure departures from the conventional paradigm of inviolable property rights.[100] Thus, the fiction that F

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[93] n1 above, at 4-5.
[94] A.J. Oakley, "The Bribed Fiduciary as Constructive Trustee" [1994] CLJ 31 at pp.32-33; Pearce, n37 above, at p.192.
[95] Crilley, n37 above, at p.66.
[96]P.B.H. Birks, "Obligation and Property in Equity: *Lister & Co v Stubbs* in the Limelight" [1993] LMCLQ 30 at p.32.
[97] P.J. Millett, "Restitution and Constructive Trusts" (1998) 114 LQR 399 at p.407. See also Millett, n30 above, at pp.57-58.
[98] Gardner, n90 above, at p.62.
[99] For general discussion of the use of the maxim to found a constructive trust, see C. Harpum, "The Uses and Abuses of Constructive Trusts: The Experience of England and Wales" (1997) 1 Edinburgh L Rev 437 at pp.452-462.
[100] C. Rotherham, *Proprietary Remedies in Context* (2002), pp.44-47, 191-195.

intended to hold the bribe for P, when coupled with the maxim, gives the appearance that the court is engaged in "the observance of existing entitlements, rather than a redistribution of the parties' rights and obligations."[101] However, as a result the maxim tends to obscure the relevant considerations - such as deterrence and third party interests - in an "impenetrable cloak".[102] As Waters notes, resort to the maxim is "scholastic, shorn of visible contact with the relevant policy considerations that one would expect to find".[103] Rather than support the imposition of a constructive trust, this suggests that results apparently generated by the application of the maxim should be treated with a good deal of suspicion.[104]

2. The Property in Bribes Sceptics

For over one hundred years *Lister & Co. v. Stubbs*[105] stood as authority for the proposition that the relationship between the bribed fiduciary and principal was that of debtor and creditor. Lindley LJ stated of proprietary relief in the case:

> "One consequence, of course, would be that, if Stubbs were to become bankrupt, this property acquired by him [with the bribe money] would be withdrawn from the mass of his general creditors and be handed over bodily to Lister & Co. Can that be right? Another consequence would be that....Lister & Co. could compel Stubbs to account to them, not only for the money with interest, but for all the profits which he might have made by embarking in trade with it. Can that be right? It appears to me that those consequences shew that there is some flaw in the argument....the unsoundness consisting in confounding ownership with obligation."[106]

Lister has been followed on numerous occasions,[107] while a number of cases preceding

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[101] *ibid.* at p.46.
[102] Gardner, n90 above, at p.62.
[103] D.W.M. Waters, "Proprietary Relief: Two Privy Council Decisions - A Canadian Perspective" (1995) 25 Can Bus LJ 90 at p.92. Others have referred to the use of the maxim as "silly" and "incomprehensible": E. McKendrick, "Unascertained Goods: Ownership and Obligation Distinguished" (1994) 100 LQR 509; G.L. Gretton, "Constructive Trusts" (1997) 1 Edinburgh L Rev 281 at p.283.
[104] See further the result generated by the application of the maxim in *Lord Napier & Ettrick v Hunter* [1993] AC 713 at 752 per Lord Browne-Wilkinson. For critical analysis, see Rotherham, n100 above, at pp.279-280.
[105] n29 above.
[106] *ibid.* at 15. See also Cotton LJ at 12, stating that "the moneys which under this corrupt bargain were paid....to the Defendant cannot be said to be money of the Plaintiffs".
[107] See the authorities cited above, n32.

the decision also support a similar view.[108] Thus, in *Metropolitan Bank v. Heiron,*[109] criticised in *Reid* on the erroneous grounds that it was decided "perilously close to the long vacation without citation of any of the relevant authorities,"[110] James LJ said of a fiduciary who received a bribe that:

> 'he is liable to have that money taken from him by his principal or cestui que trust. But it must be borne in mind that that liability is a *debt only differing from ordinary debts in the fact that it is merely equitable*.'[111]

A problem commonly associated with the *Lister* line of authority however, is that it appears to only allow recovery in equity by way of action for equitable debt.[112] Any profit made by use of the bribe therefore remains with the wrongdoer. This is an unpalatable situation and has been the major catalyst behind the development of the property in bribes theory.[113] The belief is misguided however, and unsupported by precedent or policy. While in *Lister* Lindley LJ objected to the recovery of secondary profits, the majority of opinion supports a gain-based measure.[114]

3. Prospective Constructive Trust Theory

In *Metropolitan Bank v Heiron,*[115] a company brought an action against one of its former directors claiming that he had received a bribe from a debtor of the company to induce him to use his influence to secure more favourable terms for the debtor. These

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[108] *Mills v Northern Rly Of Buenos Ayres Co.* (1870) 5 Ch App 621; *Metropolitan Bank v Heiron* (1880) 5 Ex D 319.
[109] *ibid.*
[110] n1 above, at 7. By contrast, the lack of citation of any authority whatsoever did not prevent the Privy Council in *Reid* from deeming *Sugden v. Crossland* (1856) 3 Sm & G 192 to be "of importance because it disposes succinctly of the argument which appears in later cases….that there is a distinction between a profit which a trustee takes out of a trust and a profit such as a bribe which a trustee receives from a third party."
[111] (1880) 5 Ex D 319 at 323 (emphasis added). See also the similar statements made by Brett LJ at 324 and Cotton LJ at 325.
[112] See *Reading v. The King* [1949] 2 KB 232 at 237 per Asquith LJ, approved by Lord Porter [1951] AC 507 at 517. An action may also lie at common law for money had and received. However, recovery is limited to the initial value of the bribe: *Mahesan*, n20 above. For critique, see Needham, n30 above, at pp.548-552.
[113] See, for example, *Reid*, n1 above, at 10-11; Shepherd, n8 above, at pp.95 & 116 (noting that a restitutionary measure of relief must be supported by a proprietary interest or property rights).
[114] See Crilley, n37 above, at pp.66-67. The view that an account does not lie is also untenable in light of broader developments in the law of restitution (or disgorgement) for wrongs.
[115] (1880) 5 Ex D 319.

allegations were brought before the board of directors more than seven years previously, the board taking no action. The Court of Appeal held that the claim of the company was barred by analogy to the Statute of Limitations, the period of limitation running from the moment the company learnt of the fraud. Furthermore, the claim was not protected by the principle that no time runs against a breach of trust since this was not a case where the principal received or held property subject to a trust. Brett LJ said:

> "Neither at law nor in equity could this sum of 250*l.* be treated as the money of the company, *until a Court, in an action by the company, had decreed it to belong to them* on the ground that it had been received fraudulently as against them by the defendant. In such a case….the money is to be considered *as held adversely to the plaintiffs, the company, until the decree*; and where the suit is founded upon fraud so that there is *no trust until the decree*….Courts of Equity will follow the analogy of the [Statute of Limitations] and apply it to such a case."[116]

Cotton LJ then followed in a similar vein, stating:

> "Here the money sought to be recovered was in no sense the money of the company, *unless it was made so by a decree* founded on the act by which the trustee got the money into his hands. It is a suit founded on breach of duty or fraud by a person who was in the position of trustee, his position making the receipt of the money a breach of duty or fraud. It is very different from the case of a cestui que trust seeking to recover money which was his own before any act wrongfully done by the trustee. *The whole title depends on its being established by a decree of a competent Court that the fraud of the trustee has given the cestui que trust a right to the money*."[117]

Ten years later in *Lister* Cotton LJ took his opinion in *Heiron* to be a correct view of the law: while the facts of the case were not such as to automatically make the defendant a trustee, "the moneys which under this corrupt bargain were paid….to the Defendant cannot be said to be the money of the Plaintiffs *before any judgement or decree in some such action has been made*."[118] Almost a decade later in *Kingston Cotton Mills v Mouat*,[119] Sterling J, who decided *Lister* at first instance, opined that "the basis of that decision was that until judgment was given money which had come to the hands of the defendant could not be treated as money of the plaintiff."[120]

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[116] *ibid.* at 324 (emphasis added).
[117] *ibid.* at 325-326 (emphasis added).
[118] n29 above, at 12-13 (emphasis added). See also the judgment of Sterling J at 10.
[119] [1899] 1 Ch 831.
[120] *ibid* at 835.

Three interpretations of these statements are plausible. First, that there is no trust until decreed, but once decreed the defendant is treated as having held trust property from the outset. This is the idea of automatic retrospectivity noted in Chapter 3 and seems the least likely interpretation. Second, there is the interpretation provided in *Reid*. While the Privy Council found the passages in *Heiron* "puzzling" they were taken to mean "that a proprietary interest in the bribe arises as soon as a court has found that a bribe has been accepted".[121] The constructive trust in other words, is automatic once wrongdoing is established but it exists and, presumably, operates from the date of decree only. Third, it may be that the claimant in *Heiron* had no interest in the bribe *unless and until* it was specifically decreed by the court upon its finding for the claimant. The decree may rest "on the ground that [the money] had been received fraudulently" - that is, the cause of action on which the decree rests is the fraudulent or wrongful receipt of money - but it does not mean that a decree granting constructive trust relief follows automatically from a finding of a wrongful receipt. In other words, the court has the power to establish a trust relationship to facilitate *in specie* recovery but it will not necessarily do so simply because the claimant has established a cause of action.[122]

The third interpretation would lead to results more consistent with the policy consideration of insolvency that so bothered the courts and particularly Lindley LJ. However, it would not avoid the risk of unintended priorities entirely because the court would be reliant on F for information about his solvency. F would have no reason to disclose his financial circumstances and indeed, may have positive reasons for not doing so. The gathering of relevant information on which to base a judgment as to the availability or non-availability of the constructive trust is therefore likely to prove time consuming, costly and unreliable.[123]

The first and second interpretations are incompatible with the desire to avoid priority.

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[121] n1 above, at 8. See also [1992] 2 NZLR 385 at 391 per Richardson J (New Zealand Court of Appeal) and the analysis of *Heiron* by D.W.M. Waters, "The English Constructive Trust: A Look Into the Future`` (1966) 19 Vanderbilt Law Rev 1215 at p.1248.

[122] A proprietary interest would not be found where this would confer priority over creditors, for example: see, most notably, Lindley LJ in *In re North Australian Territory Co* [1890] 1 Ch 322 at 338.

[123] These issues were explored in Chapter 3, Section III.2

Were the constructive trust to arise automatically once the court found that the wrong had indeed occurred, there would still be an automatic creation of equitable property rights. Assuming the court found that certain wrongful conduct took place, it would be compelled to recognise the wrong, hence retrospectively recognise (or create) proprietary rights (first interpretation) or prospectively recognise (or create) proprietary rights (second interpretation). Such rights would confer priority over F's unsecured creditors. Retrospective proprietary rights would also risk prejudicing supervening equitable interests. These are precisely the consequences that the court in *Lister* was keen to avoid.

V. A Question of Policy

It follows from what has been said above that we cannot progress matters very far by simply stating and re-stating the authorities. They are both confused and contradictory. If we are to move forward a careful assessment and application of the relevant normative considerations that arise in this context is necessary.[124]

The fiduciary's bankruptcy, it should be noted at the outset, is a crucial consideration. A constructive trust of the bribe will confer priority over the fiduciary's general creditors as well as later equitable interests. This is significant because as Watts notes, "the dishonest, once discovered, are likely candidates for insolvency".[125] The appropriateness of the constructive trust must therefore be examined in the larger context of the potential priorities it creates. Judicial considerations of this matter are polemic. In *Lister & Co. v. Stubbs*, Lindley LJ found it a startling proposition that the bribe should be handed over by the insolvent fiduciary to P, thus withdrawing it from the pool of assets available to F's general creditors.[126] In *Attorney-General for Hong Kong v. Reid*, however, the Privy Council were of the opinion that "the unsecured

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[124] See generally D. Cowan *et al.*, "*Lister & Co v Stubbs*: Who Profits?" [1996] JBL 22 at pp.32-37; Crilley, n37 above, at pp.65-70; D.J. Campbell, "Commentary" in *Equity Issues and Trends* (1995, ed. M. Cope), p.126 at 128-130; Pearce, n37 above, at pp.192-196; R.M. Goode, "Proprietary Restitutionary Claims" in *Restitution Past, Present, and Future* (1998, eds. W. Cornish *et al*) p.63 at 71-73.
[125] P. Watts, "Bribes and Constructive Trusts" (1994) 110 LQR 178 at p.179.
[126] n29 above, at 15.

creditors cannot be in a better position than their debtor".[127]

Two different justifications underpin the principal's recovery in cases of bribes and secret commissions.[128] First, it is important that F is stripped of the benefit which accrues to him from taking the bribe or commission for reasons of deterrence and deserts. This may require specific relief but not priority over F's creditors. Second, it is important to the efficient functioning of fiduciary relationships that P's wealth is insulated from the risk of F's wrongful dealings and bankruptcy. This requires a constructive trust where the receipt of the bribe effects a corresponding subtraction from P's wealth.

1. The Policy of Profit Stripping

(a) Deterrence

In the bribes context the policy of deterrence operates at two levels. First, at the broad institutional level: the fiduciary relationship is an important facilitative institution and confidence in it must be maintained.[129] Second, deterrence is important because of the nature of bribe taking: the act of bribery is an "evil practice which threatens the foundations of any civilised society".[130]

If we are attempting to prevent breaches of fiduciary obligation and bribe scenarios from ever arising it is difficult to justify a remedy that allows the bribee to retain any benefit from the bribe: the incentive of benefit reduces the deterrent effect of the fiduciary obligation. The view suggested by Lindley LJ in *Lister*, that P's recovery

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[127] n1 above, at 5.
[128] A further argument for constructive trust relief appeared in *Reid*, n1 above, at 12. Lord Templeman suggested that a constructive trust would prevent the dissipation of the assets by Mr Reid, which would frustrate the entering of judgment against. However, this is a problem faced by all creditors, not just the Government in *Reid*. The claimant can, moreover, apply for a Freezing Order, which ensures that the defendant cannot remove assets from the jurisdiction but does not elevate P to the position of secured creditor: see P.B.H. Birks, "Personal Restitution in Equity" [1988] LMCLQ 128 at p.135; Crilley, n37 above, at pp.67-68.
[129] I. Jackman, "Restitution for Wrongs" [1989] CLJ 302.
[130] n1 above, at 4.

ought not to extend to profits made from investing the bribe, is therefore untenable.[131] Indeed, effective deterrence may require F to surrender the bribe or its proceeds *in specie*. Where the bribe or its proceeds are non-fungible they may be valued subjectively by the bribee. If the bribee has sufficient funds to pay the value of the property without selling it, a personal money remedy will not remove the entire benefit attributable to the bribe. The only way to remove all of the benefit is to transfer the asset representing the bribe to the victim, or to otherwise expropriate it.[131a]

The rationale does not however, justify priority. Profit from wrongdoing is not an incentive unless the wrongdoer will in fact realise the benefit. This will not happen where F is bankrupt because the bribe will be shared by F's innocent creditors. The deterrent rationale is therefore implemented effectively by a purely personal claim to specific assets which abates on F's bankruptcy.

(b) The Retributive Rationale

This requires the bribed fiduciary to be stripped of any benefit derived from his wrongdoing because the moral quality of his act is such that to hold otherwise would be repugnant and contrary to justice and good sense.[132] F will usually have victimised P for profit with a high degree of cold calculation. The moral quality of this act makes it appropriate to focus the inquiry on stripping the benefit obtained.[133] The quantum and type of recovery should be determined by considerations of how best to implement this benefit-stripping policy. Where there is a risk that F may benefit despite a money award against him – as there is where the bribe is non-fungible - the most appropriate remedy is one that strips the defendant of the asset itself. However, the retributive rationale does not warrant recovery where its effect is to reduce the amount payable to innocent creditors. That would punish innocent third parties rather than the bribed fiduciary. The retributive rationale is therefore appropriately implemented by a personal order to transfer the bribe property *in specie*.

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[131] n29 above, at 15.

[131a] Removing the benefit through expropriation by another party such as the State is, however, likely to prove less effective and less efficient than recovery by P: see Chapter 4, Section VI.2(a).

[132] Chapter 4, Section VI.2(b).

[133] This consideration was clearly apparent in *Reid*, n1 above, at 4. See also *Fyfees*, n5 above, (the law "should not assist a party to retain the profits of such a vice").

The retributive rationale is an important cumulative ground justifying specific recovery. It may well be that in most cases any benefit resulting from a bribe that is not removed by an account of profits will be so minimal or remote that it will not in practice undermine the deterrent function of the law.[134] This weakens the case for developing a purely personal form of specific relief – an account of the value of the property will be good enough. However, taken together the deterrence and retributive rationales provide a plausible justification for the development and recognition of a form of specific relief that does not bind third parties.

2. Protecting Wealth Placed in the Hands of or Under the Control of F

(a) When Will Payment of a Bribe or Secret Commission Transfer Wealth From P to F?

It is essential to the efficient and effective functioning of fiduciary relationships that the law protects property and wealth which P places in the hands, or under the control, of F. This requires P's wealth to be insulated from the risk of F's wrongdoing and bankruptcy.[135] This is important because sometimes bribe taking effects a transfer of wealth from P to F. In such cases, a constructive trust is arguably appropriate.

The payment of a bribe or secret commission may serve to transfer wealth from P to F either directly or indirectly. A direct transfer occurs where P pays the briber (X) via F and F appropriates part of the money which he is given to apply as payment to X. The commission in F's hands is wealth subtracted from P directly. An indirect transfer of P's wealth occurs where payment by P reaches X but X pays part of the same to F. Such cases may be usefully divided into three different types.

1. F is paid out of P's money via X. That is, P pays the agreed price to X and X pays the bribe to F out of the same. The only difference between this case

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[134] It should be remembered that other legal deterrents will impact on F's calculation of whether wrongdoing is worthwhile. Thus, bribe taking may give rise to criminal sanctions, although the requirements of bribe taking for the purpose of the criminal law are much narrower than the requirements sufficient to found a cause of action under civil law. Other civil sanctions, such as summary dismissal, will also have a deterrent effect.

and cases of direct transfer is that the money passes through a third party conduit (X) before arriving at F.

2. F is paid by X from money which is the traceable proceed of the money paid by P. For example, P pays X £1000 by cheque. X banks the cheque and withdraws £100 to pay F. *Daraydan v Solland*[136] is a notable illustration of such a case. F was engaged to negotiate refurbishment contracts for P. F agreed with X that when preparing prices X should add 10% commission that was to be paid back to F. A company (SI) was formed to secretly pay F the commissions. P transferred money representing the amounts invoiced to the Swiss bank account of SI and 10% (totalling £1.8m) was immediately paid out to F. The claimants' money could be traced into and through SI's bank account and into the hands of F.[137] The overall and intended effect of the transactions was to transfer £1.8m from P to F via X.

3. F is paid by X from money that is causally connected to the money paid by P to X but there is no transactional link between the two as required by the law of tracing. For example, F and X agree that X is to inflate the prices he charges P by 10% and is to pay that amount to F. X is paid £1,100, which he pays into Account A and pays F £100 which he withdraws from Account B. *Madrid Bank v Pelly*[138] may be a case of this kind if not the second. Four directors paid £5,000 to the promoters of a company, the latter paying immediately upon receipt of that sum £500 to each of the directors. The court, it appears, did not suggest that each of the £500 payments was a kick-back paid directly out of the £5,000 advanced by the directors or was otherwise traceable from that amount. However, the "combination and simultaneousness of the acts afford[ed] evidence that the whole matter was one transaction between them".[139] The important point was that the transactions were structured in such a way as to take wealth totalling £2000 from P and enrich the defendants collectively by a correlative amount.

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[135] Chapter 4, Section V.
[136] n47 above
[137] *ibid.* at [20], [93].
[138] (1869) 7 LR Eq 442. See also *Morison v Thompson*, n83 above.
[139] *ibid.* at 447 per Romilly MR.

Although there are differences between each of the three types of case, they are similar in one important respect. Like cases involving the involuntary transfer of wealth directly from P to F the actions of F and X diminish P's wealth by the amount which F gains. A constructive trust furthers the policy of protecting P's assets and wealth from fiduciary wrongdoing and bankruptcy.[140]

(b) Is the Distinction Likely to Prove Workable in Practice?

It might be suggested that this is all very well in theory, but in practice identifying and distinguishing cases in which there is a causal link between the receipt of a bribe or secret commission and a diminution of P's wealth would be difficult, perhaps impossible. However, the normative arguments considered above may still prove a useful basis for limiting the constructive trust. A correlation between P's loss and F's gain is unlikely in cases of general bribes paid for non-pecuniary benefits.[141] In these cases at least we might deny a constructive trust, even if we retain its availability in other cases where F's taking of a secret commission is likely to result in a loss to P. It is also noteworthy that in general bribes cases, such as *Reid* and *Reading*, the fiduciary concept is used in an expansive sense[142] and the relationships are not primarily concerned with dealings in, or securing, P's wealth.

VI. Three Poor Counter Arguments Supporting Property in Bribes and Secret Commissions Generally

Proponents of property in bribes provide three further arguments to support the general recognition of a constructive trust. First, they suggest that the bribe received by F creates a corresponding loss to P in a broader range of cases than those noted above.

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[140] It might be suggested that this may not justify a constructive trust of the entire proceeds or profits. If the policy is to ensure P does not suffer a diminution of wealth a lien for the amount of the bribe would appear adequate. However, proceeds and profits may represent a useful default value representing the loss caused by P being unable to exploit his wealth in the interim.

[141] See below, Section V.1.(b).

[142] See above, nn11-13 and accompanying text.

Second, it has been argued that F's powers are a species of property owned beneficially by P therefore any benefit secured from their exercise belongs to P as the fruit of trust property. Third, it has been suggested that the bribe is held on trust by F because this is the outcome that is intended by the parties. These arguments are not compelling.

1. A Corresponding Loss to the Principal in All Cases?

It is often posited that the briber, as a rational economic actor, does not give a bribe or agree to pay a secret commission for nothing. Rather, he must expect to receive an advantage that is at least equal to the value of the bribe or commission paid.[143] Where F receives a bribe or commission P must therefore suffer a corresponding loss.[144] If this is correct then P's claim to the bribe and its proceeds seems more compelling as against third parties. P is not simply the lucky recipient of a windfall; he is seeking the return of that which he has been deprived. However, except with the aid of grossly artificial presumptions, it is not possible to identify a diminution in P's wealth in all cases.

(a) Direct and Indirect Misappropriation

A loss correlate to the bribe or commission received by F is evident where F is paid either directly or indirectly from P's property. We have looked at these cases above. Proprietary relief in these cases is consistent with the policy of securing P's assets and wealth. However, not all cases involve direct or indirect subtraction. Bribes for non-pecuniary benefits provide an obvious example.

(b) Bribes for Non-Pecuniary Benefits

The economic theory noted above is demonstrably false when applied to bribes for non-pecuniary advantages. A policeman paid to turn a blind eye to a gaming house,[145] an army sergeant bribed to assist the smuggling of contraband past checkpoints,[146] and

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[143] See Shepherd, n8 above, at p.267; Pearce, n37 above, at pp.190-191.
[144] Hayton & Mitchell, n36 above, at p.361 (taking the assumption to justify proprietary relief in *Reid*, n1 above).
[145] *Attorney General v Goddard* (1929) 98 LJKB 743.
[146] *Reading v Attorney-General* [1951] AC 507.

the Crown prosecutor paid to pervert the course of justice,[147] all involve payments which cause no equivalent economic loss to the claimant. The harm to the claimant is either not quantifiable[148] or bears no necessary or logical correlation to the amount of the bribe. Indeed, in some cases the only quantifiable economic loss resulting from the bribe is suffered by an innocent third party. In *Reading*, for example, a Sergeant was paid to use his position to assist in the smuggling of contraband past army check points. While the Sergeant's regiment, the army generally and the British government may have suffered embarrassment or loss of confidence, the economic consequence of the bribe was most directly felt by that the Egyptian government, which lost the excise duties payable on the goods that were smuggled.

(c) Commissions Paid to Purchasing Agents

A narrower economic approach limits the presumption of loss to cases of secret commissions received by purchasing agents. In such cases:

> "the court will assume as against the briber that the true price of the goods as between him and the purchaser must be taken to be less than the price paid to, or charged by, the vendor by, at any rate, the amount or value of the bribe."[149]

There is thus a presumption that the price paid by the bribed fiduciary is "loaded as against the purchaser at least by the amount of the bribe".[150] This presumption is generally regarded as non-rebuttable.[151]

While the presumption did not develop as a means of justifying proprietary relief it has been utilised by a number of commentators for this purpose. Hayton for example, suggests that the incontrovertible assumption of loss in such cases justifies the imposition of a constructive trust, since, in the eyes of the law, P has lost by what F has

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[147] *Reid*, n1 above.
[148] *ibid.* at 4.
[149] *Hovenden*, n3 above, at 48 per Romer LJ.
[150] *Industries & General Mortgage Co*, n3 above, at 577. See also *Grant*, n83 above, at 247 per Collins LJ (the purchase price "is made large enough" to include the bribe).
[151] See, most recently, the comments of Lawrence Collins J in *Konamaneni v Rolls Royce Industrial Power (India) Ltd* [2002] 1 All ER 1 at [158]; *Mahesan*, n20 at 411 per Lord Diplock.

gained.[152] However, this measure of loss will often bear no correlation to the loss caused in fact.

Cases such as *Williams v Barton*[153] demonstrate that the price paid by P may in fact represent a fair market rate. In this case the defendant trustee was employed by a firm of stockbrokers, the terms of his employment being such that his salary comprised half of the commission earned by the firm on business introduced by him. The defendant recommended that the trust employ the firm to value the trust securities, the firm being paid by the trust and in turn paying the defendant the corresponding commission. While this gave rise to a conflict between the defendant's duty to give the trust the benefit of his unfettered advice in choosing a stockbroker and his interest in increasing his own remuneration, it is difficult to identify any loss to the trust. The fee charged by the stockbroker was a competitive market rate, the defendant took no part in fixing the fees charged by the firm, the second trustee accepted the terms of engagement, and the employment of a stockbroker was a necessary trust expense. While recovery of the commission was justified on the grounds that it removed the source of the conflict, it is difficult to see any loss to the trust. It would therefore be difficult to justify the trust's recovery ahead of the competing claims of innocent third parties with claims against the defendant.

A further problem with the theory is that the payment of a commission by a briber will not always have the intended effect of corrupting the apparent bribee.[154] Moreover, the commission may not relate to a specific transaction. Rather, it may take the form of a general commission relating to a number of transactions over time[155] or its purpose might be to secure F's favour in future transactions but not the present one. Where this is the case the presumption cannot justify recovery of the full amount of the bribe unless all of the transactions envisaged when the commission was paid have been completed.

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[152] Hayton, n30 above, at p.224; T.G. Youdan, "The Fiduciary Principle: The Applicability of Proprietary Remedies" in *Equity, Fiduciaries and Trusts* (1989 ed. T.G. Youdan), p.93 at 107-108. Hayton has since applied this incontrovertible assumption to bribes generally: n144 above.
[153] [1927] 2 Ch 9.
[154] Shepherd, n8 above, at pp.261-262.
[155] See Finn, n3 above, at p.219; *London School of Economics v Pearson* (1998, QBD, unreported).

These problems are not surprising given the origins of the presumption. The presumption of loss developed in the case law as a roundabout way of stating that loss was not a requirement of liability. This was viewed as desirable because it served the evidential end of preventing dishonest agents placing potentially difficult hurdles in front of P and thereby wriggling out of liability. For similar evidential reasons a presumption of loss equivalent to the value of the bribe was viewed as a convenient means by which to measure damages recoverable from the briber.[156] However, there is no reason why the same presumption should operate to determine the allocation of F's gains between P and F's creditors.[157]

To avoid potentially difficult, time-consuming and expensive evidential inquiries we may of course be content to presume a loss correlate to the amount of the commission for remedial purposes. However, such a decision must be made with both eyes on the policy implications: would the potential costs of making proprietary relief more broadly available than is strictly justified be off-set by the benefits of evidential simplicity?[158]

2. The Theory of Encumbered Powers

Shepherd argues that bribes should be held on trust for the principal as a result of the theory of encumbered powers.[159] Drawing on Hohfeld's theory of property as a bundle of relationships[160] he suggests that, because a fiduciary is duty-bound to exercise a power transferred to him by the principal in his principal's best interest, the fiduciary can be treated as holding the legal title to the exercise of that power on trust.[161] Since a bribe is received by the fiduciary in relation to the exercise of his fiduciary powers, all

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[156] *Grant*, n83 above, where Smith and Vaughn-Williams LJJ permitted recovery of damages for fraud, with loss measured by the amount of the bribes. See also *Hovenden* n3 above; *Salford Corp v Lever* [1891] 1 QB 168.

[157] See Chapter 4, Section V.4.

[158] Another possibility would be to deny proprietary relief altogether on the ground that not all commissions involve a correlative loss to P. We would here need to consider the potential costs of failing to insulate principals from the risk of fiduciary wrongdoing and insolvency where transactions are structured so as to direct wealth from P to F.

[159] n8 above, at pp.267-268.

[160] W.N. Hohfeld, "Some Fundamental Legal Conceptions as Applied in Judicial Reasoning" in *Fundamental Legal Conceptions* (1923, ed. W.W. Cook), p23.

[161] n8 above, Chapter 6.

bribes are held on constructive trust. Shepherd explains:

> "The basic idea is that, where A transfers an encumbered power to B, B in no sense receives anything of his own. It is A's power, and he has only really given B a technical use of it, such that, at least in equity, the use of this power by B is really use by A. If A used the power, he would receive all of the profits, and so should receive all of the profits when B uses it as well. In simplest terms, A is the beneficial owner of an asset (the power), and, like the owner of any other asset, he owns the fruits of its use. The fact that B is the person using it makes no difference to the ownership of the profits generated there from."[162]

The constructive trust over a bribe therefore simply recognises the principal's existing beneficial interest in the profit and is "remedial only in the sense that it is a technique to recognize that property right."[163] It follows that the courts do not decide who should own the property representing the bribe; rather they decide who *does* own it.[164]

There are, however, two problems with this theory. The first is that Shepherd aims to offer a descriptive theory that "fits" with existing fiduciary law. That approach lies in tension with the normative approach adopted in this thesis. This thesis suggests that, at least in the context of proprietary relief for acquisitive breaches of fiduciary obligation, the existing case law, founded on historical accidents and unwarranted assumptions, forms part of the problem. The second problem is that Shepherd's theory prematurely forecloses discussion about the nature of the appropriate relief. To argue that the power exercised by F is held on trust for P, so that any profit made by the exercise of that power is beneficially owned by P, is to state a conclusion. To say that the bribe is held on trust because it represents the fruits of the exercise of a power that is held on trust simply begs the question why classify the power, for this purpose, as trust property?

3. The Actual or Presumed Intentions of the Parties

A third counter-argument can be found in the work of Rickett. Rickett suggests that the event which brings an institutional constructive trust into being is a real or actual

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[162] *ibid.* at p.116.
[163] *ibid.* at p.117.
[164] *ibid.* at p.118.

consent.[165] While the consent cannot be effectuated by an express trust due to the existence of an impediment, such as lack of compliance with a necessary formality, equity is persuaded "to treat, or deem, the consent which was present in fact to be effective in law".[166] To hold otherwise would permit the defendant unconscionably to assert title to the property and deny the consensual position established between himself and the claimant.

Surprisingly Rickett extends this reasoning to include constructive trusts over profits made in breach of fiduciary obligation, explicitly supporting *Attorney General for Hong Kong v Reid* on this basis. He suggests that it followed from Reid's voluntarily assumed fiduciary undertaking to the Crown that he would account for any property received as a result of his position. While this intention could not create an express trust in the bribe money because the relevant property had not been received at the time of the undertaking,[167] equity would, by way of constructive trust, "give effect to the intention of the parties, as expressed in Reid's fiduciary status".[168]

A similar approach was adopted in a Hong Kong case with facts substantially similar to *Reid*. *Secretary for Justice v Hon Kam Wing*[169] concerned a corrupt police officer who had accepted a number of bribes between 1940 and 1971 which were traceable into cars, investments and land. Judge Barma reasoned that an element of volition was evident on the part of the defendant because he acted "voluntarily in taking the bribes which he was offered" and "voluntarily placed himself in a situation in which equity created a trust in respect of the bribes which he received."[170] He went on to note that the constructive trust in such cases is a "real trust" and the defendant is "a trustee in the true sense of the word".[171] He continued:

> "…the transaction impeached was not the receipt by [the defendant] of the bribes,

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[165] C.E.F. Rickett, "The Classification of Trusts" (1999) 18 NZULR 305 at pp.325-326; C.E.F. Rickett, "Of Constructive Trusts and Insolvency" in *Restitution and Insolvency* (2000, ed. F. Rose), p.188 at 192-196; C.E.F. Rickett & R. Grantham, *Enrichment and Restitution in New Zealand* (2000), Chapter 18.
[166] C.E.F. Rickett, "The Classification of Trusts" (1999) 18 NZULR 305 at p.326.
[167] Equity will not create a trust of future property: *Re Ellenborough* [1903] 1 Ch 697.
[168] Rickett & Grantham, n165 above, at p.409.
[169] [2003] 147 HKCU 1.
[170] *ibid.* at [35]. This suggestion is rather odd: at the time the bribes were received *Lister* was regarded as good law throughout the Commonwealth. It is therefore difficult to see how a constructive trust arose at the moment in time that the bribes were received when that was not in fact the effect of the then law.
[171] *ibid.* at [62].

> but the failure to hand them over……the Government's claim involves an acceptance that the bribes have been received, rather than a complaint about that fact. Its complaint is…..that having been received in circumstances in which they became its property under a constructive trust, the bribes were not handed over to it, and were instead applied by [the defendant] for his own purposes."[172]

Others reach similar results by the invocation of a presumed intention rather than a real one. Thus, Sir Peter Millett reasons that a fiduciary "must not accept a bribe. If he has done so, equity insists on treating it as a legitimate payment intended for the benefit of the principal; he will not be able to say it was a bribe".[173] The theory is otherwise the same: the failure to account rather than the initial receipt (which is presumed legitimate) is the conduct of which P complains.

There are significant problems with both the "real" and "presumed" intention theories. First, the intention attributed to the parties is inconsistent with F's initial undertaking. Rather than intending F to accept and account for illicit payments made in breach of fiduciary obligation (which *ipso facto* would then not be illicit or acquired in breach of fiduciary obligation), P engages F on the understanding that he will *not* seek such benefits. Second, at the time the bribe or commission is received, it is clear that the recipient does not intend to receive it for the benefit of P. Closing one's eyes to this fact and presuming otherwise begs the question why presume? Third, both strands of reasoning require us to accept the absurd proposition that P does not in fact complain about the receipt of the bribe; the complaint is simply that the bribe has not been handed over. Yet the act of receiving a bribe is grounds for summary dismissal[174] or, worse still, may amount to an indictable criminal offence. When the Hong Kong Government brought a criminal prosecution against Warwick Reid it most certainly objected to his bribe taking. It would surely then object to being told that if it wanted a constructive trust it must applaud Reid's profitable perversions of justice.

The fiction that the constructive trust arises out of the agreement of the parties also serves to prematurely foreclose consideration of relevant policy concerns, such as the potential effect on third parties. This is because the trust is portrayed as taking effect at

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[172] *ibid.* at [63].

[173] Millett, n30 above, at p.58. In *Re Smith* [1906] 1 Ch 71 at 77, Kekewich J noted that equity treats a trustee receiving a bribe as receiving it "not on his own behalf, but on behalf of and as agent for the trust estate."

the moment the bribe was received, this being the time at which the trust was completely constituted. As Rickett notes:

> "The trust arises because of the parties' intentions, and thus it dates from a point in time well before the trial at which the court acknowledges the existence of that trust. At the time of trial, therefore, the property rights are already, as a matter of doctrine, in existence, and all the court is required to do is to give effect to those rights by ending the defendant's interference with them."[175]

VII. The Appropriate Remedy Revisited

It follows from what has been said above that a constructive trust is necessary and appropriate in some cases but not in all. Sometimes, specific relief is desirable but only to the extent that it does not operate to the detriment of innocent third parties. The new remedial framework provides a means by which these outcomes might be effectively pursued.

1. Traditional Choice: Institutional Constructive Trust or Account of Profits

The normative concerns identified above are poorly handled by the traditional remedial choice: either F is personally liable to account for the value derived from the bribe or he holds the bribe and its proceeds on constructive trust. Even if we recognised that the constructive trust could be available on a more flexible basis and is not simply the automatic consequence of the receipt of a bribe, the remedial choice does not adequately accommodate the normative demands.

Some view a constructive trust as necessary to ensure that the fiduciary disgorges the whole of the benefit derived from the bribe.[176] However, where P's claim rests on the justice engendered by the twin policies of deterrence and deserts a claim to specific relief loses its force on F's bankruptcy. The institutional constructive trust therefore

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[174] *Swale v Ipswich Tannery Ltd* (1906) 11 Com Cas 88.
[175] n165 above, at 194, fn32.

goes too far. It delivers the necessary *in specie* relief outside bankruptcy but confers an unwarranted priority inside bankruptcy. Others suggest that an account of profits is sufficient to strip F of the benefit of the bribe without the risk of unwarranted priorities.[177] However, an account will not necessarily remove the benefit where the bribe or its proceeds are non-fungible. It avoids the creation of unwarranted priorities but does not supply the required specific relief.

The traditional choice - account of profits or institutional constructive trust - is therefore less than ideal. One risks the creation of unwarranted priorities; the other avoids that risk but may leave a benefit in F's hands. Given the appeal of stripping a conscious wrongdoer of his gains *in specie* this is a significant remedial deficiency. Either we risk leaving a benefit in the hands of a conscious wrongdoer or we risk unwarranted priorities.

2. Constructive Trust with Prospective Operation

One interpretation of *Metropolitan Bank v Heiron*[178] is that the constructive trust of bribes or secret commissions does not arise until the date that the court establishes the breach of duty and orders for the claimant but once it does so the constructive trust is automatic with prospective effect. This, however, is not much of an advance over the automatic vesting approach because it would continue to confer priority over F's unsecured creditors. This is not justified where the sole rationale for P's recovery is deterrence and desert.

An equally plausible interpretation of *Heiron* is that a constructive trust would be imposed, if at all, by the decree of the court hearing the dispute. At the time of decree the court would determine whether a constructive trust is appropriately imposed. Following what has been said above, this would be where F was solvent or where there was a correlation between the bribe and a loss to P. Where F is bankrupt and the rationale for relief is deterrence or deserts the court would decline to exercise its power

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[176] Millett, n30 above, at p.56.
[177] Birks, n21 above, at p.389; Burrows, n21 above, p.411.
[178] Above, Section IV.3.

to impose a constructive trust. The court would thus have the power to award specific relief upon establishing that a bribe had been received but it would not exercise its power positively where third parties would be unjustifiably prejudiced. This is similar to the approach developed by some Canadian courts.[179] The problem with such approaches is the difficulty in accessing accurate information about F's solvency and the subsequent risk of creating unintended and accidental priorities.[180]

3. The Purely Remedial Constructive Trust

A number of commentators suggest that ensuring the appropriate relief in bribes cases requires the development of a purely remedial constructive trust, available at the discretion of the court.[181] The nature and degree of the discretion envisaged varies between commentators, although the primary motivation of all is to ensure fairness to creditors and other third parties.

For some, the envisaged discretion is simply one which allows the courts to refuse a constructive trust where F is bankrupt but grant a constructive trust where F is solvent.[182] The success of such approaches depends largely on the quality of information before the court about F's solvency. Consequently, they risk generating unintended priorities. We might also question the nature of the response. A response which aims to award P an asset *in specie* but only where third parties will not be prejudiced is more faithfully represented as personal rather than proprietary relief. "Constructive trust" nomenclature is misleading, regardless of whether it is prefixed with "remedial". Re-conceptualising this type of "constructive trust" as a personal order to transfer specific property would remove the misleading trust language and avoid unintended priorities.

Cope and Allen envisage a broader discretion and place greater emphasis on the pursuit

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[179] See Chapter 3, Section III.1(b)
[180] See Chapter 3, Section III.2 and further criticisms therein.
[181] T. Allen, "Bribes and Constructive Trusts: *A-G of Hong Kong v* Reid" (1995) 58 MLR 87; Cope, n3 above; Campbell, n124 above; W.R. Cornish, "The Principal Question" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 1, p.77 at 80; Jones, n37 above, at p.164.
[182] Cornish, n181 above; Campbell, n124 above.

of finely tuned individualised justice. Thus, Cope, suggests that "each case should be examined on its merits with a view to deciding whether relief in the form of a constructive trust is warranted."[183] Similarly, Allen supports the development of a discretionary proprietary remedy to be imposed by the courts "where it appears just to do so" and which "would have the merit of achieving justice in the case at hand, while still leaving the courts free to do justice" as the circumstances demand in future cases.[184] A constructive trust, he goes on, may be appropriate, notwithstanding F's bankruptcy but this can only be determined on the facts of each case after considering such factors as P's conduct.[185]

It is however, difficult to see why a broad discretion is necessary or desirable. The important distinction is between cases in which the receipt of the bribe or commission amounts to a direct or indirect transfer of wealth from P to F and those in which it does not. In the former cases proprietary relief is justified notwithstanding F may be bankrupt. In the latter cases there is no reason to grant priority. The idea that it may be relevant to look at other factors before awarding priority, such as P's conduct in order to ascertain whether he took steps to minimise the risk of F's bribe-taking, seems to add an unnecessary layer of complexity.[186] The approach also brings the exercise of discretion to the fore upon F's bankruptcy. This is precisely the context in which certainty, predictability and efficiency assume importance.[187]

4. The New Framework

The new framework developed in Chapter 3, recognising both the constructive trust and personal order to transfer specific property, provides the most satisfactory way forward. It facilitates the reaching of normatively desirable outcomes in a clear, coherent and ordered fashion.

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[183] n3 above, at p.124.
[184] n181 above, at p.93.
[185] Thus, Allen suggests that the competing merits of other creditors' claims should be assessed and it will be relevant whether P attempted to minimise the risk of bribe taking by F: n181 above, at pp.92-94.
[186] The conduct of P does not appear to have been an issue in any of the decided cases and encouraging P to take more precautionary steps to guard against bribe taking is questionable: an important role of fiduciary law is minimising P's transaction and monitoring costs: Chapter 4, Sections II.3(a) & II.4(b).

The constructive trust – a retrospective proprietary interest operating from the time the bribe was received – will play a narrower role than envisaged by *Reid* but a potentially broader (and certainly different) role than was envisaged in *Lister*. In *Reid* the receipt of a bribe was viewed as an event constitutive of equitable property in P. In *Lister* it was held that a constructive trust was available only where P was seeking to recover money which was his own before the breach of fiduciary obligation (or the traceable product of such).[188]

The suggestion above was that there is justification for granting proprietary relief where the receipt of the bribe or secret commission by F generates a correlative diminution in P. However, this requirement may prove too complex, expensive and uncertain in practice. If this turns out to be the case we might opt for a second best solution, such as permitting constructive trust relief in cases of commissions paid to purchasing agents (such cases being more likely to involve a corresponding diminution of P's wealth) but denying constructive trust relief in cases of general bribes for non-pecuniary benefits (in which P is unlikely to suffer a corresponding loss of wealth).

Where there is no correlation between the bribe received by F and a diminution of P's wealth a priority claim is not necessary and the focus is simply on effectively stripping F of the benefit of the bribe. An account of profits will be sufficient in most cases to strip F of the benefit of the bribe. However, where the bribe or its proceeds are non-fungible and F is solvent specific relief is appropriate. This can be effected safely, without risk of prejudice to third parties, by a personal order to transfer the gain *in specie*. The personal order to transfer specific property reduces the pressure on the constructive trust. As long as the constructive trust remains the only mechanism by which F may be stripped of his gain *in specie*, notwithstanding the risk of creating unfair priorities, judges are likely to be drawn to it. The personal order therefore enhances equity's vital profit stripping abilities without risking unintended and undeserved priorities. Unlike the remedial approaches it also avoids the need to inquire into the solvency of F before determining the appropriate relief: where if F is bankrupt the remedy, by its nature, will not confer priority.

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[187] Chapter 3, Section III.4.

VIII. CONCLUSION

The controversy over the nature of the appropriate relief in cases of bribes and secret commissions cannot be regarded as settled. The courts have grappled with a concern for the fiduciary's creditors and a desire to ensure that the bribed fiduciary does not benefit from his wrong. Given the limited remedial apparatus that the courts have had available to them – constructive trust and account of profits – these policies have proved difficult to reconcile and to pursue effectively. It is perhaps not therefore surprising to find a contradictory and confused case law.

Careful analysis suggests that, except where the receipt of a bribe or commission results in a corresponding diminution of P's wealth, specific relief without binding effect on third party interests is all that is required. This demands no more than the recognition of a personal right to the transfer of specific property. This right will need to be enforced only in those cases where the fiduciary holds non-fungible property (in other cases an account of profits is likely to be sufficient), it will abate on F's insolvency and it will not bind third parties who have acquired an interest in the disputed asset. Where receipt of the bribe or commission results in a corresponding diminution of P's wealth a constructive trust, conferring priority over F's creditors, is appropriate. Such situations are most likely to occur in the context of commissions paid to purchasing agents but are unlikely in cases involving the receipt of a general bribe. At the very least a constructive trust should therefore be excluded in the latter class of case.

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[188] n29 above, at 4-5, 9-10 (Sterling J), 12 per Cotton LJ.

CHAPTER 7: Fiduciary Opportunities

I. INTRODUCTION

This Chapter considers the constructive trust in cases where F exploits for his own advantage a proscribed opportunity to the exclusion of P and without P's fully informed consent. In general terms, an opportunity will be proscribed when it falls within the scope and ambit of the fiduciary obligation that F owes to P. F is legally disabled from pursuing these opportunities because they are or might possibly be of benefit to P. Placing them off limits to F encourages F to pass on to P information about potentially suitable opportunities. It also allows F to consider the suitability of opportunities on P's behalf free of the distorting influence of self interest.

In recent years a good deal of attention has focused on the identification of those opportunities which are "fiduciary" in nature and therefore properly placed off-limits to F.[1] By contrast, determination of the appropriate remedy following the wrongful exploitation of a fiduciary opportunity is a subject that has been somewhat neglected. The orthodox understanding is that a constructive trust arises automatically upon the wrongful exploitation of the fiduciary opportunity. From that time P acquires a beneficial interest in F's gain. That beneficial interest is simply recognised and enforced by the court at a later date. The descriptive accuracy and normative desirability of this understanding is questioned in this Chapter.

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[1] In particular, attention has focused on the most appropriate framework for considering corporate opportunities and whether the range of proscribed opportunities should be defined broadly or narrowly: see B. Clark, "UK Company Law Reform and Directors' Exploitation of Corporate Opportunities" (2006) 17 ICCLR 231; D. Kershaw, "Does it Matter How the Law Thinks About Corporate Opportunities?" (2005) 25 LS 533; S.R. Scott, "The Corporate Opportunity Doctrine and Impossibility Arguments" (2003) 66 MLR 852; J. Lowry & R. Edmunds, "The No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolutism" [2000] JBL 122; J. Lowry, "*Regal (Hastings)* Fifty Years On: Breaking the Bonds of the Ancient Regime" (1994) 45 NILQ 1; Law Commission Consultation Paper, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (1998) ¶¶3.19-3.31. A good deal of debate has centred on whether the UK should adopt a US-style corporate opportunities doctrine, as to which see E. Talley, "Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunity Doctrine" (1998) 108 Yale LJ 279; P.K. Chew, "Competing Interests in the Corporate Opportunity Doctrine" (1989) 67 NCL Rev 435; V. Brudney & R. Clark, "A New Look at Corporate Opportunities" (1981) 94 Harv L Rev 998. As to the desirability of a US style corporate opportunity doctrine in the UK, see D. Kershaw, "Lost in Translation: Corporate Opportunities in Comparative Perspective" (2005) 25 OJLS 603.

II. The Scope of Fiduciary Liability and the Constructive Trust

1. The Boundaries of Fiduciary Liability

A fiduciary opportunity is defined in sweeping terms and captures a broad range of activity. The precise scope of the opportunities placed off-limits to F is determined in one of four ways:

(a) By direct application of the no-conflict rule: equity will prohibit F from pursuing or exploiting an opportunity where there exists a real sensible possibility of a conflict between his personal interest and duty to P;[2]

(b) By direct application of the no-profit rule: F is prohibited from pursuing for his personal benefit an opportunity which arose by reason of and in the course of his fiduciary office or by reason of knowledge or information gained there from;[3]

(c) By application of the "line of business" test: in the case of a corporate fiduciary it is suggested that F is prohibited from pursuing opportunities which fall within the company's existing or potential line of business.[4] The extent to which this test forms part of English law is somewhat uncertain. The courts have not expressly adopted line of business terminology but have been quick to place off-limits to corporate fiduciaries opportunities that are "commercially attractive" to the company or "relevant", "of concern" or "closely related" to its business.[5] To the extent that the "line of business" test *is* recognised in English law it is probably better viewed as a means of facilitating the clearer and more precise application of the

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[2] *Boardman v Phipps* [1967] 2 AC 46 at 123-124 per Lord Upjohn ; *Queensland Mines v Hudson* (1978) 18 ALR 1 at 3 (PC); *Bhullar v Bhullar* [2003] EWCA Civ 424 at [42] per Parker LJ; *Crown Dilmun v Sutton* [2004] EWHC 52.

[3] *Regal (Hastings) v Gulliver* [1967] 2 AC 134n.

[4] See R.P. Austin, "Fiduciary Accountability for Business Opportunities" in *Equity and Commercial Relationships* (1987, ed. P.D. Finn) p.141; D.D. Prentice, "The Corporate Opportunity Doctrine" (1972) 50 Can Bar Rev 623 at pp.629-630; S. Beck, "The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered" (1971) 49 Can Bar Rev 80 at pp.92-93.

[5] *Bhullar*, n2 above, at [41]; *IDC v Cooley* [1972] 1 WLR 443 at 451; *General Nutrition Ltd v Yates* (Unreported, 12th May 1981).

no-profit and no-conflict rules in a corporate setting rather than as a doctrine establishing an independent source of liability.[6]

(d) By application of the "maturing business opportunities" test: a corporate fiduciary acting post-resignation is prohibited from pursuing "maturing business opportunities" that the company was "actively pursuing" at the time of F's resignation.[7] Under this approach the prohibited opportunities are more narrowly circumscribed. The test will not capture the more uncertain, embryonic or speculative projects that would be caught by the traditional no-profit and no-conflict rules, even where they fall within the company's line of business.[8]

It is generally regarded as irrelevant to the application of these doctrines that F acted honestly or that his actions in some way benefited P.[9] At least in relation to serving fiduciaries it remains irrelevant that the opportunity was not one which P could have pursued, wanted to pursue or would have succeeded in pursuing.[10] The stringency of equity in this area is illustrated graphically in the leading cases of *Boardman v Phipps*[11] and *Regal (Hastings) v Gulliver*.[12] As Rix LJ noted of the latter:

> "It would thus seem that even though the directors had in fact been proved to have been acting honestly, and even though it had been in fact proved that the company had suffered no loss, the position must in law be regarded, for the safety of

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[6] R.P. Austin, "Moulding the Content of Fiduciary Duties" in *Trends in Contemporary Trust Law* (1996, ed. A.J. Oakley), p.153 at 161.

[7] *Canadian Aero Services v O'Malley* (1973) 40 DLR (3d) 371 at 382. Although see the cautionary note of Rix LJ in *Foster Bryant Surveying Ltd v Bryant, Savernake Property Consultants Ltd* [2007] EWCA Civ 200 at [76] that it is "difficult accurately to encapsulate the circumstances in which a retiring director may or may not be found to have breached his fiduciary duty".

[8] *Hunter Kane v Watkins* [2004] EWHC 841, [2003] EWHC 186 at [56]-[58]; *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704; *Balston Ltd v Headline Filters Ltd* [1990] FSR 385; *Island Export Finance v Umunna* [1986] BCLC 460. For analysis of the cases and the policy concerns that demand the range of opportunities placed off limits to the former director to be more narrowly circumscribed, see P. Koe, "Once a Director, Always a Fiduciary?" [2003] CLJ 403.

[9] The classic illustrations remain *Boardman*, n2 above, and *Regal*, n3 above.

[10] *Wrexham Football Club Ltd (in administration) v Crucialmove Ltd* [2006] EWCA Civ 237, [2007] BCC 139 at [40]; *Re Quarter Master UK Ltd* [2004] EWHC 1815 at [70]; *Crown Dilmun*, n2 above, at [178]-[182]; *Bhullar*, n2 above, at [41]; *In Plus Group Ltd v Pyke* [2002] EWCA Civ 370 at [71]; *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 at [15]-[17]; *Abbey Glen Properties v Sumborg* (1978) 65 DLR (3d) 253; *Cooley*, n5 above.

[11] n2 above..

[12] n3 above.

> mankind,[13] as though they had been acting secretly and dishonestly, to the loss of their company, and no inquiry otherwise was to be permitted."[14]

The harsh treatment of F is deemed necessary as a prophylactic: it avoids situations in which the fiduciary may be tempted to act for his own benefit and thereby maximises the chances that opportunities will be channelled to P. It also avoids giving fiduciaries the opportunity to conceal their wrongdoing by exploiting the imbalance of information between the parties.[15]

2. The Constructive Trust and its Consequences

In England it is generally accepted that a constructive trust follows the wrongful exploitation of a fiduciary opportunity "more or less automatically".[16] It is the "standard equitable remedy"[17] which will be denied only where its recognition is impossible - for example because the wrongfully acquired benefit is no longer identifiable by orthodox tracing principles.[18] The receipt of benefit through the wrongful exploitation of a fiduciary opportunity is simply an event that is constitutive of equitable property in P. Thus, in the corporate context it is said that an "undisclosed profit which a director so derives from the execution of his fiduciary duties belongs in equity to the company."[19] The role of the court is to simply identify the relevant property by application of equity's identification rules and to enforce P's right to it.[20]

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[13] A reference to the evidence problem identified by James LJ in *Parker v McKenna* (1874) LR 10 Ch App 96 at 124-125 (the court should not inquire into whether P "did or did not suffer any injury in fact by reason of the dealing of the agent; for the safety of mankind requires that no agent shall be able to put his principal to the danger of such an inquiry as that").

[14] *Foster Bryant*, n7 above, at [50].

[15] Chapter 4, Section II.3(c).

[16] A.J. Oakley, *Constructive Trusts* (3rd edn), p178. For similar sentiments, see S. Worthington, "Corporate Governance: Remedying and Ratifying Directors' Breaches" (2000) 116 LQR 638 at p.671; P.H.Pettit, *Equity and the Law of Trusts* (10th edn, 2006), pp139-150; J. Mowbray *et al, Lewin on Trusts* (17th edn, 2001), p.450; F.M.B. Reynolds, *Reynolds & Bowstead on Agency* (17th edn, 2001), p.173

[17] *Ocular Sciences Ltd v Aspect Vision Care Ltd* [1997] RPC 288 at 411 per Laddie J (referring to submission of Counsel).

[18] See *Sinclair Investment Holdings SA v Versailles Trade Finance Limited (inAdministration)* [2007] EWHC 915 at [105] (Rimer J); *Ultraframe (UK) v Fielding* [2005] EWHC 1638 at [1465], [1533]-[1547] (Lewison J).

[19] *Furs v Tomkies* (1936) 54 CLR 583 at 592. The paragraph of which this sentence was part was quoted with approval in *Gwembe Valley Development v Koshy* [2003] EWCA Civ 1048 at [48], although the nature of relief was not the focus of the discussion.

[20] *Re Jarvis* [1958] 1 WLR 815 at 819 per Upjohn J.

The consequences of the automatic vesting approach are significant and potentially far-reaching in terms of their impact on F and innocent third parties. Perhaps the most important consequence is that P's claim will rank ahead of F's unsecured creditors. Although P will be required to reimburse F for acquisition and development costs as a condition precedent of enforcing the constructive trust[21] P will benefit from the appreciated value of the opportunity. The appreciated value is likely to be significant since the motivation for pursuing opportunities is usually profit. P's injection of value into F's estate by way of reimbursement of development costs is therefore likely to be significantly less than the realisable value of the opportunity. This raises issues of fairness between competing claims to the enhanced value. Notably, in some cases, F's breach will have caused P no loss because P would not or could not have exploited the opportunity. Nevertheless, the orthodox approach automatically favours conferring the whole of the benefit on P to the exclusion of F's creditors.

It is also a consequence of the automatically vesting constructive trust that P will rank ahead of those with later equitable interests, such as lenders with floating charges.[22] Secured lenders may therefore be left to face an unexpectedly high degree of risk, having extended credit in reliance on assets to which P was not entitled and the true beneficial ownership of which it was impossible to discover. Again, it is not always clear why P should be preferred to such creditors, particularly in those cases where P has suffered no loss.

The constructive trust may also impact significantly on F personally. A claimant who is successful in establishing a constructive trust will be entitled to the transfer of "his" property or its identifiable substitute. This may cause significant hardship, inconvenience or expense for F, particularly where the property has been used in the conduct of his business or is bound up with his future plans. For example, a good faith fiduciary might exploit an opportunity in breach of fiduciary obligation and with the proceeds acquire vital plant and equipment for use in the conduct of his legitimate business. The orthodox approach recognises that, from the outset, P has a continuing beneficial interest in the benefit of the opportunity and its traceable substitutes. P is

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[21] *Carlton v Halestrap* (1988) 4 BCC 538 at 540; *Wrexham Football Club*, n10 above.

[22] Priority over floating charge holders is a particular concern because opportunities are often diverted to companies that F owns or controls: see e.g. *CMS Dolphin*, n8 above (where the recipient company

therefore entitled to call for the transfer of the plant and equipment regardless of the consequences that this may have for F or his business. The court has no discretion to order otherwise. As Lord Browne-Wilkinson made clear in *Foskett v McKeown*,[23] the outcome does "not depend on whether it is fair, just and reasonable"[24] to grant proprietary relief. "It is a case of hard-nosed property rights."[25]

The recognition of an automatically vesting constructive trust which confers on P a proprietary interest in the benefit or its traceable substitute thus places P in a highly advantageous position, to the potential detriment of F and innocent third parties. That position should not be conceded lightly, without clear authority and compelling justification or explanation.

III. The Authorities

Notwithstanding the many forceful pronouncements in the texts[26] there is surprisingly little clear and unambiguous authority supporting the automatic recognition of a constructive trust in opportunity cases.[27] Simple use of the language of constructive trust to describe F's liability is not necessarily conclusive because of the various and inconsistent meanings attributed to that term. Moreover, the leading cases are indeterminate on the issue because either the nature of the remedy granted is ambiguous or the facts and reasoning are capable of supporting a much narrower role for the constructive trust. Finally, statements of broader principle proclaiming that any profitable breach of fiduciary obligation generates an equitable interest in the resulting benefit have no firm foundation.

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became insolvent); *Gencor*, n10 above; *Cook v Deeks* [1916] 1 AC 554.

[23] *Foskett v McKeown* [2001] 1 AC 102.

[24] *ibid.*

[25] *ibid.*

[26] See n16 above.

[27] In the recent *Wrexham Football Club* case, n10 above, the Court of Appeal affirmed a decision of Norris J imposing a constructive trust over freehold property acquired in breach of fiduciary obligation notwithstanding that the claimant company could not have exploited the opportunity itself. However, rather than providing a firm foundation for proprietary relief the case illustrates the problems in this area: (1) the focus was on liability rather than remedy; (2) the latter was dealt with in cursory fashion and was simply assumed; (3) no third parties were present therefore the most unpalatable consequences of proprietary relief did not have to be confronted directly.

1. The Indeterminate Use of Constructive Trust Language

The case law must be interpreted in light of a somewhat confused terminological background which has seen parties described as "constructive trustees" in a variety of senses. These different senses have been noted already.[28] First, constructive trust language has been adopted to describe the position of a defendant who is personally liable to account for the net value of a gain, as equitable debtor of the sum due.[29] Second, constructive trust language has been adopted to denote that a person stands in a position analogous to a trustee and is therefore subject to fiduciary obligations. At least one member of the House of Lords in *Boardman v Phipps* seemed to use the language of constructive trust in this sense.[30] Third, a person who is subject to some of the remedies available against an express trustee is often described as a "constructive trustee" notwithstanding that their liability is purely personal.[31] As a result of such inconsistent and indiscriminate invocations of the language of constructive trust and constructive trusteeship the true nature of a fiduciary's liability in a given case is often difficult to ascertain.[32]

2. Remedial Ambiguity in the Leading Cases

(a) Lack of Explicit Consideration of the Nature of Relief Granted

Confusion as to the true nature of F's accountability is compounded by an almost complete lack of discussion in the cases of the nature of relief granted. In just about every reported case the focus has been on whether the opportunity exploited by F was in fact proscribed. The remedy issue is invariably neglected or dealt with by assertion and without the benefit of argument. The recent corporate opportunity case of *Bhullar v*

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[28] Chapter 1, Section II.3(b).
[29] *Ultraframe*, n18 above, at [1513]-[1517].
[30] n2 above, at 105 per Lord Hodson.
[31] E.g. cases of dishonest assistance: see L. Smith, "Constructive Trusts and Constructive Trustees" [1999] CLJ 294.
[32] See the cautionary words of Gibbs J in *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 at 395.

Bhullar[33] is illustrative. In the Court of Appeal Parker LJ noted that the trial judge "declared that Silvercrest [the defendants' corporate vehicle] holds the property on trust for the company".[34] However, Silvercrest was not in fact a party to the proceedings and in his judgment the trial judge stated that he was prepared to grant relief "in the form of an enquiry as to loss or an account of profits".[35] There was no further discussion of the issue in either court.

Similarly, in *IDC v Cooley*,[36] the reported order stated that the defendant was "trustee for plaintiffs of profits of his contracts".[37] However, Roskill J spoke throughout his judgement in terms of the defendant's "liability to account", did not discuss the nature of relief and did not seek evidence that the profits from completed contracts remained identifiable. This would have been essential to a constructive trust: without identifiable property there is nothing to which a proprietary claim can attach. Despite these shortcomings, the case is regularly cited as authority for the general recognition of a constructive trust in cases of acquisitive breach of fiduciary obligation.[38]

(b) Boardman v Phipps

Central to the claim that P obtains an immediate proprietary interest in the benefit of a wrongfully exploited fiduciary opportunity is *Boardman v Phipps*.[39] In *Attorney General for Hong Kong v Reid*, *Boardman* was taken to demonstrate "the extent to which equity is willing to impose a constructive trust on property obtained by a fiduciary by virtue of his office".[40] More recently, Rimer J accepted *Boardman* as authority for "the proposition that any identifiable assets acquired by fiduciaries in breach of their fiduciary duty are, and can be declared to be, held upon constructive trust for the principal" and the principal "thereby obtains an immediate proprietary

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[33] n2 above.
[34] *ibid.* at [4].
[35] [2002] WL 1654842 at [272], [302].
[36] n5 above.
[37] *ibid.* at 454
[38] E.g. *Islamic Republic of Iran Shipping Lines v Denby* [1987] 1 Lloyd's Rep 367 at 371; M. Cope, *Constructive Trusts* (1990), p.217.
[39] n.2 above.
[40] [1994] 1 All ER 1 at 10. See also *Normalec Ltd v Britton* [1983] FSR 318 at 322; *Islamic Republic of Iran Shipping Lines v Denby* [1987] 1 Lloyd's Rep 367 at 371; *Carlton v Halestrap*, n21 above, at 540.

interest".[41] Yet judges in other cases have been equally forceful in their rejection of *Boardman* as authority for such a proposition. In *Ultraframe*, for example, Lewison J was quick to dismiss counsel's submission that *Boardman* was a case of constructive trust.[42]

Academic opinion is equally divided. Most notably Professor Birks viewed *Boardman* as involving nothing more than a purely personal liability to account for profit.[43] By contrast, professor Burrows views it as a clear case of constructive trust and criticises Birks' "startling re-interpretation" of the case.[44] Such strong disagreement stems from the remedial ambiguity of *Boardman*, the result of which is that the case cannot in fact stand safely for either proposition.

The well known facts of the case are that a trust solicitor (Boardman) and a trust beneficiary (Phipps) acquired shares in a company in which the trust had a substantial shareholding. The purchase of the shares by the trust was prohibited by the trust instrument and the trustees were not prepared to countenance the acquisition "under any circumstances".[45] Having gained control Boardman restructured the company and sold some of its assets before causing substantial distributions of capital to be made to shareholders. Notwithstanding that their actions were of considerable benefit to the trust, Boardman and Phipps were held liable to account in equity for breach of fiduciary obligation. However, the nature of their obligation to account is uncertain.

That uncertainty stems from the ambiguously reported order of Wilberforce J at first instance. The order was reported in the Weekly Law Reports as an account of profits, with consideration of the transfer of the shares being adjourned.[46] However, according to the All England Reports the defendants were constructive trustees of the shares and liable to account for the profits made thereon.[47] The bare majority of the House of Lords that found Boardman and Phipps liable all agreed in substance with the judgment and declaration of Wilberforce J but failed to clarify the remedial position.

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[41] *Sinclair Investment*, n18 above, at [105] per Rimer J.
[42] n18 above, at [1546].
[43] P.B.H. Birks, *An Introduction to the Law of Restitution* (1989), p.388.
[44] A. Burrows, *Remedies for Torts and Breach of Contract* (3rd edn, 2004), pp.619-620.
[45] n2 above, at 95 per Lord Cohen.
[46] [1964] 1 WLR 993 at 1018.
[47] [1964] 2 All ER 187 at 188 (head note) and 208.

Lord Hodson spoke for the most part in terms of the defendants' liability to account. At one point he described them as "constructive trustees", but the label appears to have been adopted to denote that the defendants occupied positions analogous to express trustees at the time they were negotiating for the shares on their own behalf.[48] Lord Cohen concluded that each defendant was "accountable to the respondent for his share of the net profits they derived from the transaction."[49] The reference to "net profits" indicates that the obligation to account was purely personal. A "net profit" is not a physically identifiable asset or fund; it is an accounting concept which balances income and expenditure against each other. It follows that there can be no proprietary claim to net profits. Were the claim to the proceeds proprietary the defendants would have held the shares and capital distributions (or their traceable proceeds) for the benefit of the claimant, subject to the making of appropriate counter restitution.

By contrast Lord Guest noted that "the only question before this House is whether the appellants are constructive trustees of these shares".[50] Having quoted from the speeches of Lords Russell and Wright in *Regal* he concluded, "[a]pplying these principles to the present case I have no hesitation in coming to the conclusion that the appellants hold the shares as constructive trustees and are bound to account to the respondent".[51] However, there is no indication that the shares were transferred. Nor was a proprietary claim to the shares necessary to a finding that Boardman and Phipps were personally liable to account for the capital distributions that they received as a result of their share holdings. It is also important to note that Lord Guest's views as to the underlying proprietary position appeared to be premised on the flawed understanding that information acquired by Boardman while representing the trust was trust property in the normal sense of that term and could be traced into the shares.[52] The case was therefore one in which the claimant could point to a pre-existing proprietary base. The lack of merit in such reasoning is considered further below.[53]

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[48] n30 above.
[49] n.2 above at 104.
[50] *ibid.* at 114. See also at p.112.
[51] *ibid.* at 117.
[52] *ibid.* at 115.

(c) Reading Too Much Into Regal

All three of the majority in *Boardman* relied heavily on *Regal (Hastings) v Gulliver*.[54] The directors in *Regal* were held personally liable to account for their profits as equitable debtors of the sum due, the shares having been sold and the directors being good for the money. Nevertheless, some academics suggest that there also existed a co-extensive proprietary claim: had the matter been pressed the House of Lords would have been prepared to grant the company a proprietary claim to the traceable proceeds of the shares.[55]

The existence of a co-extensive proprietary claim is doubtful. In *Regal* itself Lord Wright referred favourably to *Lister & Co v Stubbs*[56] as authority for the proposition that the relationship between claimant and defendant in secret profit cases "is that of debtor and creditor, not trustee and *cestui que trust*."[57] The cases, he said, established the general rule that a fiduciary "must account for *net* profits" secretly acquired.[58] Like Lord Russell,[59] he also noted that the directors could have ratified their conduct at a general meeting.[60] Assuming that the directors controlled the majority,[61] this would not have been possible if the shares were held on constructive trust.[62] A careful reading thus suggests that *Regal* is inconsistent with the remedial position purportedly adopted by the majority in *Boardman*, who relied heavily on the case.

3. *Cook v Deeks* and Other Cases of Factual Interception

In other leading cases the underlying proprietary position is indisputable: the benefit in

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[53] Section IV.2(b).
[54] n.3 above.
[55] D. Hayton, *Underhill & Hayton: The Law Relating to Trusts and Trustees* (15th edn, 1995), p.536; Cope, n38 above, at p.216.
[56] (1890) 45 Ch D 1.
[57] n3 above, at 156.
[58] *ibid.* at 154 (emphasis added). As to the significance of the reference to "net profits" see n49 above and accompanying text.
[59] n3 above, at 150.
[60] *ibid.* at 154.
[61] The head note to the original report in the All England Reports states that the directors "doubtless controlled" the majority: [1942] 1 All ER 378 at 379. However, this has been questioned: Law Commission Consultation Paper, *Shareholder Remedies* (1996), ¶5.12; *Prudential Assurance Co v Newman (No.2)* [1981] Ch 257 at 308.

F's hands is held on constructive trust for P from the moment it is received. However, in these cases F diverts his own way a benefit that would otherwise have gone to P in the ordinary course of events. The claim to proprietary relief therefore has strong normative appeal.[63]

Cook v Deeks[64] is the leading illustration. Three director-shareholders negotiated to secure a construction contract on behalf of their company but at the last minute diverted it their own way. An account of profits was all that was sought by the minority shareholder. However, the Privy Council held that the contract "belonged in equity to the company and ought to have been dealt with as an asset of the company".[65] This was important because it meant that the wrongdoing directors could not exploit their majority shareholding to ratify their conduct.[66] That would have amounted to fraud on the minority; it would have involved the directors making "a present to them selves" of company property.[67] In such cases a constructive trust is clearly appropriate: the fact that the benefit would have otherwise accrued for the benefit of the company gave the claim strong normative bite. Nothing said in the case suggests that a constructive trust is more broadly available than that.

In a different kind of case F purchases property that falls within the scope and ambit of his fiduciary obligations before selling it on to P at a higher price. Cases such as *Benson v Heathorn*[68] establish that F is from the outset a trustee of the property so acquired.[69] This is why P can retain the property *and* claim F's profit on the sale. As Lord Justice Cotton explained in a leading company law case, by selling on the property to his company a director is simply "putting into his own pocket a sum of money by way of purchase money paid by the company for that which was already their own."[70] Deeming the property to belong to P at the time of F's acquisition is justified by the fact that the asset was quickly sold on by F to P. This suggests that in the ordinary course of

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[62] See the discussion of *Cook v Deeks* below, Section III.3.
[63] Chapter 4, Section V.
[64] n22 above.
[65] *ibid.* at 564.
[66] *ibid.* at 563-564.
[67] *ibid.* at 564.
[68] (1842) 1 Y & CCC 326
[69] *ibid.* at 340 per Knight-Bruce VC. See also the discussion in *Re Cape Bretton Company* (1885) LR 29 Ch D 795 at 803-806 per Cotton LJ, 811 per Fry LJ; *Jacobus Marler v Marler* (1916) 85 LJPC 167n.
[70] *Cape Bretton, ibid* at 804, 806 per Cotton LJ.

events and but for F's initial diversion the property would have arrived at P directly from the third party at the price paid by F.[71] By appropriating and then selling-on, F simply returns the property to its original course but at a higher price. A constructive trust operating from the time of F's initial acquisition serves to protect P's purchasing machinery by delivering specific property at the price that would have been paid had F not breached.[72]

4. Fundamental Equitable Principle

In Chapter 5 we saw that some courts have identified a general equitable principle which determines that a fiduciary is a trustee of any benefit acquired in breach of fiduciary obligation. A constructive trust of the benefit of a proscribed opportunity might be considered nothing more than a specific application of this general principle. However, to the extent the principle does exist in English law its influence is somewhat weak. While it might be used to bolster a decision reached on other grounds, it does not appear to be sufficiently strong to dictate an outcome where a court determines a constructive trust is inappropriate.[73]

It is also difficult to put this apparent principle on a satisfactory jurisprudential footing. One theory is the principle follows from the seminal case of *Keech v Sandford*.[74] We have seen already that this theory cannot withstand close scrutiny.[75] Another suggestion is that a constructive trust automatically follows because of the equitable pedigree of the wrong.[76] However, this proposition is contradicted by a number of cases. It is also entirely unsatisfactory to explain away the potentially far reaching consequences of a constructive trust by "incanting the spell of an equitable pedigree or by waving the wand of the word 'fiduciary'".[77]

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[71] See, e.g. the facts of *Benson*, n68 above.
[72] Some cases, most notably *Burland v Earle* [1902] AC 83 at 98, suggest an even narrower roll for the constructive trust; namely, no constructive trust without a specific mandate to purchase the asset for P.
[73] See, in particular, Chapter 5, Section IV.2(c).
[74] (1726) Sel Cas T King 61. See *Ultraframe*, n18 above, at [1489].
[75] Chapter 5, Section IV.
[76] Cope, n38 above, p.279.
[77] P.B.H. Birks, "The End of the Remedial Constructive Trust?" (1998) 12 TLI 202 at p.209.

IV Other Explanations

Section III demonstrates that the authorities do not provide strong support for the orthodox view that a constructive trust automatically follows the wrongful exploitation of a fiduciary opportunity. Nevertheless, many have sought to bolster that position by constructing alternative rationales and justifications. The most significant are (1) that a constructive trust furthers the presumed or actual intentions of the parties; (2) that a constructive trust follows from the proprietary status of fiduciary opportunities or information used to exploit such opportunities; (3) that a constructive trust is necessary to further the legitimate policy of deterring fiduciary wrongdoing; and (4) that a constructive trust operates to direct the benefit to the party who is most deserving.

1. Evidential Presumptions and Intention

P's automatic access to proprietary relief is sometimes rationalised by denying that F can act for his own benefit and contrary to his duty.[78] Thus, in the partnership case of *Dean v MacDowell*,[79] Cotton LJ opined that if "profit is made by business within the scope of the partnership business, then the partner who is engaged in that secretly cannot say that it is not the partnership business."[80] James LJ explained in the same case that F does the act "nominally" for himself "but really for the partnership".[81] However, this seems both artificial and question-begging. In most cases F's demonstrable intention before, during and after the acquisition is to benefit himself, not P. Why are we to shut our eyes to the reality and presume that F acted for P when we know he did not?

Others look to the "real" intentions of the parties at the time they entered into the fiduciary relationship.[82] At that time F apparently binds himself by acceptance of the

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[78] See P.J. Millett, "Remedies: The Error in *Lister & Co v Stubbs*" in *Frontiers of Liability* (1994, ed. P.B.H. Birks), Vol 1, p.51 at 59.
[79] (1878) 8 Ch D 345.
[80] *ibid.* at 354 (emphasis added).
[81] *ibid.* at 351.
[82] E.g. C.E.F. Rickett, "Of Constructive Trusts and Insolvency" in *Restitution and Insolvency* (2000, ed. Rose), p.188 at 192-196; D. Hayton & C. Mitchell, *The Law of Trusts and Equitable Remedies* (12th edn,

duty of loyalty to hand over to P any benefit received by virtue of his office or a conflicted transaction. The constructive trust simply does what an express trust cannot do:[83] it "perfects" the parties' original intentions that F will hold such benefits for P as and when they are received. Once the subject matter becomes certain (upon receipt by F) a constructive trust arises. The property never belongs beneficially to F therefore the enforcement of the trust apparently has no impact on F's creditors. [84]

A constructive trust might indeed operate to place the parties in the positions they intended at the outset, or at least in the positions they would have intended had they foreseen the situation.[85] To this extent it is quite appropriate to emphasise the intentions or objectives of the parties to the relationship. However, the perfection theory remains problematic.

First, the intention of the parties does not explain why an initial bargain between P and F relating to future and even unspecified property should be enforced, especially against third parties. This is after all something that equity refused to do by way of express trust. Moreover, it is equally the case that ordinary contract creditors enter into arrangements with F under which it is intended that F will provide goods or make payments. Bankruptcy therefore equally frustrates the intentions of other parties.

Second, it is difficult to see how the parties could intend F to commit P to some opportunities – namely those where, at the time the opportunity was live and available, P did not have the resources to pursue it, its risks were too great for P to bear, P was otherwise disabled from pursuing it, or P did not in fact wish to pursue it. Were F to commit P to such opportunities he would probably breach his duty of skill and care.[86] How could equity presume, let alone find a genuine intention at the outset, that these opportunities are to be pursued for P? One possibility might be that rational parties would agree P should have the power to elect to adopt such opportunities when F's

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2005), pp.352-353.

[83] Because equity will not create an express trust of future property: *Re Ellenborough* [1903] 1 Ch 697.

[84] C.E.F. Rickett & R. Grantham, "Towards a More Constructive Classification of Trusts" [1999] LMCLQ 111 at p.121.

[85] Good examples are *Crown Dilmun*, n2 above (appropriation of lucrative business opportunity within P's investment plans and risk tolerances); *Soulos v Korkontzilas* (1997) 146 DLR (4th) 214 (appropriation of specific property subjectively desired by P).

[86] *Regal*, n3 above, at 139 per Viscount Sankey.

wrongdoing is eventually discovered, regardless of the position in fact when the opportunity was live. Stacking the cards against F in this way is good for deterrence. However this is inconsistent with the view that the constructive trust arises automatically upon acquisition of the benefit, at a time before P elects whether or not to take the opportunity with the benefit of hindsight. Moreover, it continues to fall short of explaining why a bargain between P and F should be enforced against third parties, such as F's creditors. While a rational principal and fiduciary might agree *ex ante* to such a position it is unlikely that F's creditors would. The position cannot be therefore justified on the basis of contractarian theories.[87]

2. The Proprietary Status of Opportunity and Information

Equity will generate proprietary rights in an asset which P did not previously own where (a) the new asset is the "fruit" of an asset owned by P;[88] or (b) that which was owned by P can be traced into the new asset.[89] In each case P has a "proprietary base".[90] It is sometimes suggested that in opportunity cases P has a requisite proprietary base because opportunity and information used to exploit the opportunity are themselves the property of P.

(a) Opportunity as Property

An increasing number of judges treat the opportunity to acquire an asset or to make a profit as intangible property that belongs to P.[91] It is therefore assumed to follow that benefits acquired through the exploitation of the opportunity also belong to P as the fruit of trust property. Lawrence Collins J thus explained that by seeking to exploit a corporate opportunity for his own advantage a former director is "just as accountable as

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[87] Although see the rather speculative argument by A. Duggan, "Constructive Trusts From a Law and Economics Perspective" (2005) 55 UTLJ 217 at pp.229-230, criticised in Chapter 4, Section VI.2(c).
[88] *Re EVTR* [1987] BCLC 646 at 651 per Dillon LJ (it is a "long established principle of equity" that the fruits are held by F "as a constructive trustee on the trusts of the original property").
[89] L.D. Smith, *The Law of Tracing* (1997), Chapter 8.
[90] Birks, n43 above, at pp.378-385.
[91] *Foster Bryant*, n7 above, at [77] per Rix LJ; *Lindsley v Woodfull* [2004] EWCA Civ 165 at [26], [30] per Arden LJ; *In Plus Group Ltd v Pyke* [2002] EWCA Civ 370, [2003] BCC 332, at [71] per Brooke LJ; *Don King Promotions v Warren* [2000] Ch 291 at 342 per Morritt LJ. It is, however, doubted whether the classification of opportunity as property will be appropriate in all cases in which F is liable: *Bhullar*, n2

a trustee who retires without properly accounting for trust property. In the case of the director he becomes a constructive trustee of the fruits of his abuse of the company's property."[92] Similarly, Morritt LJ has stated of corporate opportunity cases:

> "Those are cases in which a beneficial commercial opportunity comes the company's way and forms knowledge owned or possessed by the directors as agents for the company. Those directors then seek to use that knowledge or opportunity for themselves and are subsequently held to be constructive trustees of it and of its fruits for the company whence they took it."[93]

Such reasoning is problematic. Most significantly it lies in tension with the modern consensus against deducing outcomes by classifying something as property. Weinrib summarises the point well: "Property is itself merely the label for that crystallized bundle of economic interests which the law deems worthy of protection." [94] Accordingly, "when intangibles such as information and opportunity are at stake affixing the label of property constitutes a conclusion not a reason. The difficulty is not to supply a label but to identify the protected interest."[95]

Moreover, when it is said that an opportunity is the "property" of P, that label must be understood in a special sense.[96] "Property" is used simply to denote who has the better right to the exploitation of the opportunity as between P and F.[97] It says nothing about third parties, who do not stand in a fiduciary relationship to P and who remain free to compete with P for the same opportunity. This is scarcely an appropriate use of the property concept. In essence, P has nothing more than a personal right to exclude from the opportunity an individual or a closed list of individuals, being the person or persons owing fiduciary obligations. And even if we accept that the property label is appropriate in this limited sense it does not necessarily follow from such classification that P owns the fruit of the "property". The term is too indeterminate to generate that conclusion. As Hanoch Dagan explains:

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above, at [27]-[28] per Parker LJ; *Ultraframe*, n18 above, at [1360].

[92] *CMS Dolphin*, n8 above, at [96]. See also *Shepherd Investments Ltd v Walters & Others* [2006] EWHC 836 at [133].

[93] *Brown v Bennett* [1999] BCC 525 at 531 per Morritt LJ.

[94] E.J. Weinrib, "The Fiduciary Obligation" (1975) 25 UTLJ 1 at p.10

[95] *ibid.* at p.11.

[96] See *Ultraframe*, n18 above, at [1473]-[1474] (accepting that judges use "property" in many different ways and its use in the opportunities context is broad and ambiguous).

"The concept of property is too controversial and has too many manifestations and configurations in our own law to be able to answer the specific type of questions our doctrine needs to resolve. Property is an artefact, a human creation that can be, and has been, modified in accordance with human needs and values. Property is an essentially contested concept that is open to competing interpretations and permutations. There is neither an *a priori* list of entitlements that the owner of a given resource inevitably enjoys, nor an exhaustive list of resources that enjoys the status of property. Thus, there is no reason to presuppose that any gains derived from property are necessarily within the entitlement of the property owner."[98]

In short, particular consequences do not necessarily follow from the classification of something as property.[99]

(b) Information as Property[100]

Others reason that information is a species of property and as such is traceable into benefits acquired through its use.[101] Thus, when a director uses company information to secure a contract for his own benefit some American courts hold that a corporate asset (information) is traceable into substitute property (a chose in action, being the benefit of a contract with a third party).[102] Lord Guest may have established a constructive trust on a similar basis in *Boardman v Phipps*:[103] Boardman acquired the shares by utilising information that belonged to the trust and therefore benefited from a transaction into which he entered with trust property.[104]

Such reasoning is beset with difficulties. First, like the classification of opportunity as property the classification of information as such lies in tension with the modern consensus against deducing outcomes by classifying something as property. It is also

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[97] Kershaw, n1 above, at p.553.
[98] H. Dagan, "The Distributive Foundations of Corrective Justice" (1999) 98 Mich L Rev 138 at pp.147-148. As to different judicial conceptions of property, see C. Rotherham, "Conceptions of Property in Common Law Discourse" (1998) 18 LS 41.
[99] See further, C. Rotherham, "Property and Unjust Enrichment: A Misunderstood Relationship" in *New Perspectives on Property Law, Obligations and Restitution* (2003, ed. A. Hudson), p.187.
[100] The distinction between information about an opportunity and an opportunity is a rather uneasy one since a known opportunity forms part of F's knowledge. However, the two are often treated as distinct and will be treated as distinct for the purpose of this analysis.
[101] For the debate over property in information and citations to the relevant literature, see N. Palmer & P. Kholer, "Information as Property" in *Interests in Goods* (1998, eds. N. Palmer & E. McKendrick), p.1 and A.S. Weinrib, "Information and Property" (1988) 39 UTLJ 117.
[102] Brudney & Clark, n1 above, at pp.1006-1007.
[103] n2 above.
[104] *ibid.* at 115.

subject to the other theoretical objections raised in the previous section. Second, concentrating on abstract questions about the extent to which information is property directs attention away from more illuminating normative inquiries as to what the situation demands.[105] As a consequence the classification is likely to lead to disproportionate and ill-fitting results.[106]

Finally, the notion that the information is traced into the wrongfully acquired benefit raises a conceptual difficulty: there is no nexus of exchange.[107] Thus, where a director utilises corporate information to secure a contract we might classify the information as corporate property but even then "there may be difficulties in tracing the information or opportunity into the resulting chose in action for the purposes of a proprietary remedy."[108] An alternative might be to argue that the contract is the "fruit" of the information, but whether there is a sufficient link between the two turns on a complex causal inquiry. It is not inevitable.[109] A causal investigation and whether it warrants the imposition of a constructive trust is not in any way facilitated by the classification of information as property.

3. Deterring Disloyal Conduct

The disgorgement of benefits acquired within the scope and ambit of F's fiduciary obligations has a prophylactic function: it makes wrongdoing less likely.[110] It is sometimes argued that a constructive trust maximises deterrence because it is the only way to ensure full disgorgement of F's gains. However, it must be remembered that what is important to the deterrence rationale is not that P receives the benefit but that F does not. Thus, where P loses nothing by F's wrongful exploitation of a fiduciary

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[105] For judicial recognition of the obfuscatory potential of property in this context, see *Cadbury Schweppes v FBI Foods* [2000] FSR 491 at 513 (SC, Canada).

[106] See Oakley, n16 above, at p.170; R.P. Austin, "Constructive Trusts" in *Essays in Equity* (1985, ed. P.D. Finn), p.196 at 225; G. Jones, "Restitution of Benefits Obtained in Breach of Another's Confidence" (1970) 86 LQR 463 at pp.475, 479.

[107] That is, the property acquired by F is not the exchange product of the information: see *Satnam Investments v Dunlop Heywood* [1999] FSR 722 at 743 per Nourse LJ; *Ultraframe*, n18 above, at [1365]-[1366]. For recent exploration of the issues, see D. Sheehan, "Information, Tracing Remedies and the Remedial Constructive Trust" [2005] RLR 82.

[108] *Ultraframe*, n18 above, at [1491].

[109] *United Pan-Europe Communications NV v Deutsche Bank* [2000] 2 BCLC 461 at 482; *Satnam*, n107 above, at 743.

opportunity it has been pointed out that P is a "fortunate man in that the rigour of equity enables him to participate in the profits".[111] P's claim to the benefit is rather weak. It rests solely on the need to remove the gain from F. Since F will not benefit personally from his gain upon bankruptcy the deterrence rationale does not justify a constructive trust in that context.

4. The Deserts of the Parties

A constructive trust is also supported on the ground that P is the most deserving recipient of the wrongfully acquired benefit in F's hands. This argument has the most force where competition for the gain is between P and F and F is a conscious wrongdoer. It has less force where F has committed an innocent or technical breach or has benefited P by his actions. Its merits are still less clear where the competition for the gain is between P and F's creditors. In particular where P seeks to recover the benefit of an opportunity that he would not have received had F not breached F's creditors, who are doing no more than seeking to have their losses made good, are arguably more deserving than P.[112]

V. The Limits of Constructive Trust

The previous sections lead us to two important conclusions. The first is that the authorities do not provide strong support for the orthodox view that a constructive trust is the inevitable consequence of the wrongful exploitation of a fiduciary opportunity. The second is that attempts to explain, rationalise or justify the orthodox position are ultimately found wanting. In particular it has proved difficult to find a satisfactory rationale for preferring P over F's creditors, at least where F's breach is not responsible for frustrating the objectives of the fiduciary relationship.

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[110] Chapter 4, Section VI.
[111] *Boardman*, n2 above, at 104 per Lord Cohen.
[112] Chapter 4, Section VI.2(c).

In this Section the appropriate limits to the constructive trust are examined. Drawing upon the normative considerations discussed in Chapter 4 it is suggested that the constructive trust is appropriately limited to instances in which the benefit of the wrongfully exploited opportunity is intercepted on its way to P. In other cases a personal order to transfer specific property is generally warranted. However, neither remedy should be available in absolute terms. In some circumstances factors may render inappropriate a remedy which leads to the recognition or creation of a beneficial interest in property or its transfer.

1. Justifying Priority

(a) Excluding the Constructive Trust in Pure Disgorgement Cases

Perhaps the most important reason for keeping the constructive trust of opportunities within reasonable limits is the potential impact on F's creditors. A failing of the orthodox approach is that in some cases it confers on P a windfall by capturing benefits that P would not have enjoyed had F acted properly and not breached. While this may further the aim of deterring wrongdoing where F is solvent the same justification cannot explain a constructive trust on F's bankruptcy.[113] Goode argues that in such cases F's creditors:

> "have no ground for complaint, even if the value of the asset exceeds the acquisition costs, for the effect….is to put D's estate back into the position in which it would have been if D had not acted in breach of duty to P in the first place. Just as D's creditors ought not to be prejudiced by an unfair preference of P, so also they ought not to be allowed to profit from a net gain resulting from D's breach of duty to P."[114]

However, this puts a rather thick gloss on the picture. F's estate will not necessarily be put in the position it would have occupied had the breach not occurred since F may have expended considerable effort and skill in developing the opportunity. Equitable allowances are awarded sparingly and rarely on a full *quantum meruit* basis, especially

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[113] Chapter 4, Section VI.
[114] R.M. Goode, "Property and Unjust Enrichment" in *Essays in the Law of Restitution* (1991, ed. A. Burrows), p.215 at 226.

to a conscious wrongdoer.[115] Where F is bankrupt the opportunity cost of F's development of the benefit transferred to P will be therefore borne by F's creditors, at least in part. Additionally, it is unclear why F's creditors should not be permitted to share in a gain that should never have formed part of F's estate while, at the same time, it is permissible to grant P a priority claim to value he would not have received had F not breached.[116]

(b) Opportunities and Intercepted Benefits

In this section we deal with cases of factual interception. There is some judicial and academic support for limiting the constructive trust to such cases,[117] although the justification for such limitation is not clearly stated.[118] This section develops the justification introduced in Chapter 4: granting a priority claim to the very asset or value of which P is deprived by F's breach (or to the traceable proceeds of such) is appropriate because it insulates P from the risk that the objectives of the relationship will be frustrated by F's opportunism and bankruptcy. Insulating P from such risk facilitates the efficient and productive use of fiduciary organisation.

The justification has particular force when applied to relationships in which F's role is primarily acquisitive or developmental, such as company directors. It is broadly acknowledged that an important feature of a well functioning company law is that it eliminates or reduces the risk of diversions of value through directorial machinations.[119] The usual focus is on avoiding direct misappropriation of company property. However, securing the benefit of opportunities for the company is just as important.

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[115] *Badfinger Music v Evans* [2002] EMLR 35 at 58; *Guinness plc v Saunders* [1990] 2 AC 663 at 694; *Re Worthington* [1954] 1 All ER 677 at 679.

[116] Chapter 4, Section VI.2.(c).

[117] *Ocular Science*, n17 above, at 416 (Laddie J); *Ontex Resources v Metalore Resources* (1993) 103 DLR (4th) 158 at 189-192 (Morden ACJO, Robins & Finlayson JJA); *Lac Minerals Ltd v International Corona Resources Ltd* (1989) 61 DLR (4th) 14 at 44, 51 per La Forest J; G. McCormack, *Proprietary Claims and Insolvency* (1997), p95 and "Restitution, Policy, and Insolvency" in *Restitution and Insolvency* (2000, ed. F. Rose), p.261 at 268-269; T.G. Youdan, "The Fiduciary Principle: The Applicability of Proprietary Remedies" in *Equity, Fiduciaries and Trusts* (1989, ed. T.G. Youdan), p.93 at 107-108.

[118] There are clues in some cases, most notably *Lac Minerals*, *ibid.*, at 51: "it is justified to grant a right of property since the concurrent findings below are that the defendant intercepted the plaintiff *and thereby frustrated its efforts* to obtain a specific and unique property that the courts below held would *otherwise have been acquired.*" (emphasis added).

A company is dependant on the opportunities that its directors channel to it. It can be destroyed or otherwise damaged as much by cutting off its access to profitable opportunities as by the misappropriation of assets that it owns already.[120] Moreover, directors can divert from a company as much as (or more than) they can steal from it.[121] One reason for this is that the wrongful interception of benefits on their way to the company is more difficult to detect than the taking of assets which appear on the company's balance sheet. The importance of opportunities on their way to the company explains why such benefits are often treated by the courts as belonging to the company before they are received.[122] Granting what is in effect a right of ownership of the benefit reduces the risk that the company's objectives will be frustrated by directorial opportunism and bankruptcy. This has a number of advantages.[123]

First, by reducing the risk that the profit maximising objectives of shareholders will be frustrated shareholder investment and utilisation of the corporate form is encouraged. The benefits that flow from the separation of ownership and control via the corporate form (specialised divisions of labour, informational economies of scale etc.) are thereby maximised.[124]

Second, priority is what shareholders would want because it reduces a cognisable risk to the profit maximising objective. It is also what directors are likely to want because it increases confidence in, and the value of, their services. However, in the absence of default priority bargaining around the risk of directorial interception and bankruptcy is likely to be difficult and expensive. One option would be for the company to contract for security over the directors' personal assets, in effect providing the company with a secured claim for the value of diverted opportunities. However, determining the

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[119] M. Roe, "Corporate Law's Limits" (2002) 31 J Legal Stud 233 at p.235.
[120] A diverted opportunity may well be critical to the company's immediate future: see e.g. the disputed contract in *Kingsley IT Consulting Ltd v McIntosh* [2006] EWHC 1288.
[121] Consider the multi-million pound investment property diverted by the defendant in *Crown Dilmun* n2 above.
[122] E.g. *Cook v Deeks*, n22 above, at 558-560.
[123] These were introduced in Chapter 4, Sections II.4 & V.2.
[124] As to the relationship between protective legal environments, the reduction in agency costs, and the increased utilisation of organisational forms in which ownership and control are separated, see J.C. Coffee, "The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control" (2001) 111 Yale LJ 1; R. La Porta *et al.*, "Law and Finance" (1998) 106 J Pol Econ 1113.

amount of security may be difficult given that the value of future opportunities will be uncertain. Directors are also unlikely to have sufficient unencumbered assets given that the potential value of opportunities may be high. They are also unlikely to agree to have their hands tied in this way because it would restrict their own personal borrowing. Moreover, in some cases it will be the specific benefit rather than its immediately realisable economic value that is important to the company.[125] Another option would be the purchase of insurance to cover the risk that value will be diverted from the company to a bankrupt director. However, this is unlikely to be attractive or practicable given the uncertain value of future opportunities, the importance attached to some opportunities *in specie* and the costs of arrangement. Finally, the company might seek to avoid the risk by a web of express contracts which secure a claim to the specific benefit of any wrongfully exploited opportunity ahead of the directors' personal creditors. However this would be prohibitively expensive, if possible at all.[126] A default priority rule to intercepted benefits is thereby likely to reduce transaction costs of company and director.

Third, a constructive trust of benefits intercepted on their way to the company is likely to economise on monitoring costs. The greater the risk to the company's objectives the greater the incentive of shareholders to monitor, notwithstanding that they are typically poorly placed monitors. The shareholders may be widely dispersed and uncoordinated, and there is also a free-rider problem in that the benefits of monitoring by one shareholder will be shared by others. Individual shareholder monitoring may be therefore duplicative or not worthwhile for any individual to undertake.[127]

Fourth, since they are unlikely to be able to bargain for adequate security or monitor efficiently, shareholders are poorly placed to control the extent to which benefits important to the objectives of the company are exposed to the risk of directorial

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[125] For example, the opportunity and its successful exploitation may provide a gateway to further opportunities and ventures.

[126] For example, Company and Director could agree that Director enter into contracts with all personal creditors on terms providing that they forgo any claim to the benefits of wrongfully exploited opportunities. However, the transaction costs would be prohibitive and there is no guarantee that Director would insert the required term into contracts or that creditors would accept them: see H. Hansmann & U. Mattei, "The Functions of Trust Law: A Comparative Legal and Economic Analysis" (1998) 73 NYULR 434 at p.457.

[127] A.G. Anderson, "Conflicts of Interest: Efficiency, Fairness and Corporate Structure" (1978) 25 UCLA L Rev 738 at pp.778-780.

appropriation and bankruptcy. While conferring priority on the company increases the risks of the director's creditors by reducing their expected value in bankruptcy, creditors are arguably better placed to contract around the risk and monitor their debtor at lower cost. It is therefore arguable that the priority rule economises on total monitoring and transacting costs.

In short, insulating the company against a cognisable risk to its objectives is an important part of a protective environment that facilitates separation of ownership and control and reduces overall monitoring and transaction costs. These benefits are likely to be sufficient to outweigh the costs generated by the creation of an invisible proprietary claim.[128] The same rationale cannot justify priority in pure disgorgement cases. Denying a priority claim in such cases is unlikely to encourage additional monitoring or transacting, or reduce the attractiveness of the corporate form, because in such cases the director's wrongful acquisition does not in fact frustrate the company's objectives.

Similar arguments apply to other fiduciaries. For example, consider agents entrusted with acquiring[129] or otherwise facilitating the acquisition of[130] benefits on behalf of P. In these cases the acquisition of a particular asset or interest is the *raison d'être* of the relationship and therefore great emphasis will be placed on avoiding the risk of its non-arrival.[131] By reducing this risk, a constructive trust makes such relationships more attractive, avoids encouraging additional monitoring by P and avoids the additional transaction costs that would be encouraged were the parties required to bargain around the risks themselves. Giving P the very asset that he would have received facilitates the smooth and efficient functioning of an important part of the every day machinery of commerce.

(c) Difficult Cases of Factual Interception

That the benefit in F's hands is P's loss provides a strong reason for proprietary relief.

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[128] These costs were considered in Chapter 4, Section IV.
[129] See e.g. the "selling-on" cases discussed above, Section III.3.
[130] E.g. *Lees v Nuttall* 1 Russ & M 53, aff'd 2 My & K 819.

However, such a finding - and the extent to which proprietary relief is appropriate - may be less than straightforward in some cases. For example, the correlation between F's gain and P's loss may be partial only: had F not breached, P would have received some but not the whole of the gain.

Imperfect correlation may exist because only part of the opportunity exploited by F would have been open to P, or F may have developed the opportunity in a significantly different way to how it would or could have been developed by P.[132] The lack of correlation may be relatively small or significant. In most cases it may be unrealistic to expect exact correlation. Nevertheless, there will come a point at which a priority claim to the entire gain is difficult to accept. However, such difficulties should not obscure the overall benefits of the factual interception analysis and its simple application in the run of the cases.

Cases in which F engages in competition with P in breach of fiduciary obligation present particular problems.[133] Some justify the imposition of a constructive trust over F's gain on the ground that absent competition by F the gains would have gone to P.[134] However, this must be considered the exception rather than the rule. In the run of the cases any correlation is at best partial. *Re Thompson*[135] demonstrates the point nicely. An executor was directed to continue the testator's yacht brokering business but established a competing brokerage. Yachts for sale typically appeared on the books of all of the brokers in the area. However, only the successful broker received a commission. While F's competition might have therefore resulted in the interception of some commissions, it is likely that F also received commissions that would otherwise have gone to those who competed with P legitimately. In the absence of P identifying and tracing specific commissions that were intercepted the reasons for granting a constructive trust are weak. An account of profits is arguably more appropriate.

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[131] A particularly clear illustration is *Soulos*, n85 above.
[132] See e.g. *Edmunds v Donovan* [2005] VSCA 27 and *Warman (International) v Dwyer* (1995) 69 ALJR 362.
[133] See e.g. *Re Thompson* [1930] 1 Ch 203; *Moore v M'Glynn* [1894] 1 IR 74. The cases are silent, but it is generally assumed that F will be liable for his gains as a constructive trustee: Oakley, n16 above, p.154 *et seq*; J. Mowbray *et al*, *Lewin on Trusts* (17th edn, 2000), p.457.
[134] Cope, n38 above, at p.244; P.D. Maddaugh & J. McCamus, *Law of Restitution* (2nd edn, 2003), pp.860-862.
[135] n133 above.

(d) The Competing Approaches of Birks and Goode

Not all who reject the orthodox approach would recognise a constructive trust in cases of factual interception. Influenced by its potential impact on fiduciary bankruptcy, some are prepared to limit the constructive trust more narrowly. However, convincing justifications for these narrower approaches are not provided.

At least prior to *Attorney General for Hong Kong v Reid*,[136] Birks viewed a simple breach of fiduciary obligation as insufficient to found a proprietary claim.[137] Rather, he required a "proprietary base". At the time Birks assumed a proprietary base existed only where there was a direct subtraction from P or an interceptive subtraction of assets on their way to P.[138] However, Birks' notion of interceptive subtraction is narrow: the benefit must have been indubitably *en route* to P, so that it could be said with certainty that F's acquisitive breach prevented its arrival. *Cook v Deeks*[139] is illustrative: the directors had effectively negotiated the contract on behalf of the company by the time they diverted it their own way.[140]

Birks offered no reason why the interception must be certain. His approach may have been influenced by his desire to minimise any conceptual blurring of the boundary between ownership and obligation. However, by excluding cases of probable interception and limiting proprietary claims so narrowly, the requirement would increase the risk that the objectives of the fiduciary relationship would be frustrated by F's opportunism and bankruptcy. Moreover, in the absence of certainty of interception Birks would limit P to an account of profits. If P desired specific relief, even outside bankruptcy, he would therefore face a high evidential barrier. This would do little for deterrence or to reduce administrative costs.

Professor Goode would draw the line at a different point and limit the "institutional" constructive trust to cases in which F intercepts a benefit to which P had an existing

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[136] [1994] 1 All ER 1. Post-*Reid* Birks has felt compelled to accept, with some scepticism, the view that an acquisitive wrong is an event constitutive of equitable property rights in the victim: P.B.H. Birks, "Property in the Profits of Wrongdoing" (1994) 24 WALR 8 at 14.
[137] Birks, n43 above, at p.388.
[138] P.B.H. Birks, "Personal Restitution in Equity" [1988] LMCLQ 128 at p.134
[139] n22 above.
[140] See the discussion in Birks, n43 above, at pp.137-138, 144-145.

contractual right against T.[141] The Argos contract in *CMS Dolphin v Simonet*[142] is illustrative. Simonet was the director of CMS. He negotiated with a third party (Argos) for CMS to undertake advertising work in return for the payment of a monthly retainer plus fees. Simonet left CMS in acrimonious circumstances and informed Argos that, while CMS would be unable to undertake the work, he would conduct it through his own corporate vehicle, to which retainers and fees for work undertaken were subsequently paid.

In cases of factual interception, where P has no pre-existing contractual right to the benefit, Goode would limit P to a "remedial" constructive trust. This would be discretionary and, if granted, prospective.[143] It would not therefore grant protection against those with supervening equitable interests. Moreover, it would not be awarded unless P could show good reason for its grant. The simple fact of F's actual or impending bankruptcy would not, of itself, be a sufficient reason.[144] Thus, a priority claim to intercepted benefits would not be guaranteed.

In Goode's view there is "all the difference in the world" between a benefit to which P has a contractual right and a probable augmentation of P's estate.[145] However, distinguishing between such cases for the purpose of determining proprietary relief is difficult to support.[146] The important point is that in both cases the end result is the same: benefits essential to the pursuit of P's objectives are diverted by F's wrongful conduct. Absent recovery against F (or his creditors) P's objectives will be frustrated. Moreover, whether a contract is or is not negotiated on behalf of P prior to the wrongful diversion of a benefit may be fortuitous and a matter entirely within the hands of F. Thus, in *Cook v Deeks*[147] the directors who diverted the contract their own way were the very ones charged with negotiating it on behalf of the company. The negotiations

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[141] R.M. Goode, "Proprietary Restitutionary Claims" in *Restitution: Past, Present and Future* (1998, eds. Cornish *et al.*), p.63 at 73-74; Goode, n114 above, at pp.225-226.
[142] n8 above.
[143] R.M. Goode, "The Recovery of a Director's Improper Gains: Proprietary Remedies for Infringement of Non-Proprietary Rights" in *Commercial Aspects of Trusts and Fiduciary Obligations* (1992, ed. E. McKendrick), p.137 at p.148.
[144] Goode, n114 above, at p.236.
[145] n141 above, at p.74.
[146] For more general criticisms of Goode's theory, see D. Wright, "The Remedial Constructive Trust and Insolvency" in *Restitution and Insolvency* (2000, ed. F. Rose), p.206 at pp.212-216; S. Worthington, "Three Questions on Proprietary Restitutionary Claims" in *Restitution Past, Present and Future* (1998, eds. W. Cornish *et al.*), p.79.

proceeded initially on behalf of the company but at the last minute the directors signed the contract for their own benefit. It is difficult to see any rationale for treating the case differently from one in which the directors put pen to paper on behalf of the company before tearing it up and writing out a new contract for themselves.

2. Circumstances in Which Specific Relief is Rendered Inappropriate

It follows from what has been said that it will be usually appropriate to impose a constructive trust where F's wrongful exploitation of a fiduciary opportunity results in the interception of a benefit that would otherwise have gone to P. In other cases, at least where the gain in F's hands is non-fungible, specific relief without priority is usually desirable and can be achieved by way of personal order to transfer specific property. However, these propositions are limited by the adverb "usually" since in some circumstances specific relief might be rendered inappropriate, at least to the extent it would lead to the transfer of a particular asset or the creation of an ownership interest therein.

(a) Where Specific Relief is Inefficient

Sometimes requiring F to surrender a specific asset or granting P a beneficial interest therein may cost more than an alternative remedy.[148] A constructive trust or personal order might be therefore considered an inefficient or disproportionate response. Consideration of this issue requires a comparison of the costs and benefits of the alternatives.

Specific relief with priority is often beneficial where assets or value are diverted from P because it avoids frustration of P's objectives. However where the gain in F's hands is fungible, or the traceable proceed of the intercepted benefit, specific relief has limited utility. Insulating P from the insolvency risk can be achieved by an account of profits secured by way of charge over the property.[149] Specific relief without priority may be

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[147] n22 above.
[148] Chapter 4, Section VII.
[149] Indeed, where the benefit is a traceable proceed it would seem that P is protected adequately by a lien

necessary in non-interception cases for reasons of deterrence. However, the deterrent value of specific relief vanishes where the gain is fungible. Even where F's gain is non-fungible the deterrent value of specific relief over an account of profits is unlikely to be significant and may be off-set by modest and more direct costs.

The costs of ordering F to surrender specific assets may be significant. In a commercial setting the disputed asset (or its traceable proceeds) may be quickly woven into the fabric of F's business, or become bound up with F's present or future plans.[150] Removing the asset might cause significant frustration, inconvenience and expense, particularly if F has committed an innocent or technical breach and has dealt with the asset in ignorance of P's claim. In some instances the opportunity is an integral foundation on which F builds a new business. Compelling F to surrender the opportunity *in specie* may handicap or effectively terminate F's business and lead to further indirect costs, such as the general costs associated with unemployment and the dilution of legitimate competition.[151] Where such factors are present a constructive trust is likely to be inappropriate, particularly if F's breach is technical and there is no significant quantifiable loss to P.[152]

(b) Where Specific Relief is Impractical

On other occasions specific relief may be an impractical means of doing justice between the parties. One example is where the disputed assets are used in an on-going business and are only partially attributable to a breach of fiduciary obligation. In that case a constructive trust would extend over a fraction of the assets only. This is likely to raise a host of potential practical problems that make a constructive trust wholly inappropriate. In *Ocular Science*, for example, Laddie J refused to impose a constructive trust over a fraction of some of the assets of a company because of the

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securing the value of the original: C. Rotherham, *Proprietary Remedies in Context* (2002), p.113.

[150] Considerable hardship or expanse may be also generated where the gain is applied outside a commercial setting. For example, suppose the wealthy Mr Boardman used his gain to purchase a house for occupancy by an infirm relative in an area in which she could receive support from family and friends. It is difficult to see how a court could justify the imposition of a constructive trust over the home for the sake of giving the trust an asset that it could never have acquired and which was purchased with value gained from an activity which was in fact beneficial to it. Compare *Patel v Ali* [1984] Ch 283.

[151] The destruction of legitimate competition rather than more admirable goals often motivates a claim to a constructive trust over business assets: see e.g. *Ocular Sciences*, n17 above, 415-416.

[152] As in *Ocular Sciences*, *ibid.*, where such factors were considered primarily in relation to the refusal of

problem of determining "[w]ho should decide what repairs or modifications would be carried out to equipment, who should pay for them, who should decide what to do with obsolete equipment and if [the company] was to be floated on the stock exchange, who would decide on what price and on what terms?"[153]

Practical problems of a different nature arise where P claims a share in a business. Specific relief may result in joint ownership of the business between P and F or P and a third party. This potentially thrusts the parties into a continuing business relationship when there is no trust or confidence between them. Further disputes and litigation may result. A remedy fashioned to permit a clean break may be therefore best. Thus, in *Warman International v Dwyer*[154] F negotiated a joint venture agreement with Bonfiglioli to distribute its gearboxes in Australia. At the time F worked for Warman, the then Australian distributor of Bonfiglioli products, although Bonfiglioli was increasingly dissatisfied with the way Warman operated. The High Court of Australia held that it would be inappropriate to impose a constructive trust over F's 50% shareholding in BTA, the company through which the joint venture was run, because this would introduce Warman as an equal shareholder with Bonfiglioli. It would therefore force Bonfiglioli back into business with the very company that it had only recently terminated its relationship with as a result of its restrictive and inefficient practices.[155]

(c) Where Specific Relief is Rendered Inappropriate by the Claimant's Conduct

Specific relief may be inappropriate as a result of P's conduct. Particularly relevant in the context of fiduciary opportunities is delay. This may be a significant factor for at least three reasons. First, the longer an asset is in the hands of the defendant the more likely it is that the defendant will rely upon his or her possession of that asset, particularly if the breach was innocent or technical. Second, third parties who deal with F may rely on F's apparent entitlement to an asset or freedom to exploit an

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an injunction, but were also considered relevant to the decision to refuse a constructive trust.

[153] *ibid.*

[154] n132 above.

[155] *ibid.* at 365, 371. But compare *Visagie v TVX Gold Inc* (1998) ACWS (3d) 100, where an objection on this ground in a joint venture case was dismissed because the parties could agree a buy out and disagreements over the terms of buy-outs were commonplace in joint-ventures.

opportunity.[156] Third, where profits are uncertain or take time to materialise, delay in the absence of any other factor suggests opportunistic behaviour by P, who simply waits to see whether a venture proves profitable before electing to claim the benefit without being exposed to any of the risks. In these circumstances equity favours the risk taker:

> "....a man having an adverse claim in equity on the ground of constructive trust should pursue it promptly, and not by empty words merely. He should shew himself in good time willing to participate in possible loss as well as profit, not play a game in which he alone risks nothing."[157]

In such cases delay will usually make any form of gain-based relief inappropriate, but will not necessarily bar a claim to equitable compensation for the loss of opportunity.[158]

VI. Development of a Business in Breach of Fiduciary Obligation

Special problems arise where a fiduciary develops and operates a business in breach of fiduciary obligation. In this context the identification of F's gain and the remedy appropriate to achieve an effective accounting of it are matters of some complexity. A constructive trust will not be always appropriate and a degree of remedial flexibility is arguably necessary. It follows that there are significant problems with the application of the orthodox institutional constructive trust approach in this context.

1. The Nature of "Gain" in This Context

Unlike simple assets such as land or shares a business is a complex entity composed of an aggregate of assets (plant and machinery, goodwill, intellectual property etc.) and liabilities. The gain which is delivered to P must reflect both elements. This is

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[156] *Edmunds v Donovan*, n132 above, at [64]-[67].
[157] *Clegg v Edmondson* (1857) 8 De GM &G 787 at 814 per Knight-Bruce LJ. See also *Re Jarvis* [1958] 1 WLR 815 at 820-821.
[158] *Edmunds v Donovan*, n132 above.

necessary to achieve fairness between P and the business' creditors. As one Australian judge explained:

> "Where the fiduciary's disloyalty has led to the establishment of a business, the gain is plainly not its gross assets without any allowance for the debts it has incurred; the gain must be the net worth of the business. That is what the fiduciary has disloyally obtained for himself....At any rate, any gain achieved through the business has been so achieved, at least in part, as a result of the business receiving the benefit of its dealings with innocent third parties.....the beneficiary should not be permitted to reap the rewards of the business done with those third parties, except upon the footing of meeting the claims arising out of their transactions entered into in the course of the business without notice of his rights." [159]

The gain, therefore, is the business understood as a complex whole – its assets and liabilities – and it is this for which F must account.

2. Identifying the Gain and the Appropriate Remedy

There are a number of ways in which a business may be acquired, developed or conducted, either in whole or in part, in breach of fiduciary obligation. However, in each case the overarching aim is to identify a fair and realistic measure of the benefit that is wrongfully acquired by F.[160] It is that benefit for which F must account and a constructive trust is simply one means of achieving such accounting. It is not the only means.[161] Whether it is appropriate or practical will depend on the precise nature and identification of the gain.

(a) Entire Business Developed Through Breaches of Fiduciary Obligation

In extreme cases F's entire business might be carved out of P's. In such cases the gain is appropriately identified as the whole of F's business. *Timber Engineering v Anderson*[162] provides a graphic illustration. The claimant ("TECO") manufactured and sold timber frames to the building industry. Its manager (Anderson) sold TECO

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[159] *Katingal Pty Ltd v Amor* [1999] FCA 317 at [9]. See also J.B. Kearney, "Accounting for a Fiduciary's Gains in A Commercial Context" in *Equity and Commercial Relationships* (1987, ed. P.D. Finn), p.186 at 201.

[160] *Hospital Products v USSC* (1984-5) 156 CLR 41 at 110 per Mason J; *Re Jarvis*, n157 above, at 820.

[161] Kearney, n159 above, at p.201.

products on his own account, conducting this business through a corporate vehicle (Mallory Trading). He was later joined by the TECO sales representative (Toy). Toy resigned from TECO in July 1977 to work for Mallory Trading full time; Anderson was dismissed from TECO four months later and similarly also went to work for Mallory. The business of Mallory Trading was then transferred to another of the defendants' corporate vehicles, Mallory Timber, before the fraudulent activity was uncovered. Kearney J established:

> "the business had its genesis in the resources and facilities of TECO which were available to Anderson and Toy. It is also clear that they did take advantage of such resources and facilities so as to cause life to be breathed into the mere shell of Mallory Trading, bearing in mind that the business of Mallory Trading was built upon cash flow and sales. The whole substance of Mallory Trading as a viable business enterprise stemmed from the resources of TECO which were utilized in Mallory Trading. The outstanding features of the nurturing of Mallory Trading are that its executives were being paid by TECO, its customers were TECO customers, and its products were significantly derived from TECO products ... the whole of the TECO business (including, not only physical facilities such as telephones, motor cars and expense accounts) were used; but also its intangible elements such as marketing methods, knowledge of customers and goodwill were also resorted to in building up Mallory Trading."[163]

Kearney J went on to conclude:

> "Every opportunity which Mallory Trading has received is directly traceable to resources and benefits provided by TECO, even of time and efforts expended by Anderson and Toy for which TECO was paying. Every advance made by Mallory Trading was also due to the advantages of the tangible and intangible resources and facilities provided from TECO. In truth, the business of Mallory Trading was carved out of the business of TECO."[164]

Similarly in *McInstry v Thomas*[165] the defendant, the general manager of a lumber company, used the company's facilities (e.g. offices and work time) and resources (e.g. funds to pay expenses) to establish a competing partnership. He then diverted to the partnership lumber contracts in which the company had an interest or expectancy. At least in its early stages, the partnership was nothing more than the sum total of benefits derived from company resources and, it appears, intercepted contracts. However, such

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[162] [1980] 2 NSWLR 488.
[163] *ibid.* at [16].
[164] *ibid.* at [17].
[165] 64 So 2d 808 (1953).

cases are exceptional. It is much more likely that part of the business will have been developed legitimately by F[166] or derived from the exploitation of opportunities that were not open to P.

A constructive trust is arguably appropriate in cases such as *Timber Engineering*. In that case, giving TECO the business would broadly place it in the position it would have occupied but for the breach. The company's profit maximising objectives would be thereby insulated from the risk of fiduciary appropriation and bankruptcy. The constructive trust would appropriately attach to the shares in Mallory Timber. This would transfer the business (which was owned entirely by the wrongdoers or their nominees) as a complex whole – its assets and its liabilities. It would therefore avoid leaving Mallory Timber creditors with an empty shell of a company from which they could recover little or nothing. If the wrongdoers had contributed skill, capital or other resources the transfer could be made subject to the payment of an allowance, F's reclamation of specific assets, a charge over such assets, or to a charge over the business as a whole.[167]

It is important to note that in such circumstances the constructive trust is a means by which an effective accounting is achieved; the initial acquisition of the company need not, and often will not, have arisen through any wrongdoing. It may have occurred legitimately before the breach but the company is then used as a vehicle through which to run the business. In such circumstances a constructive trust creates an interest in the shares *de novo*. The acquisition of the shares was not tainted by wrongdoing, but their transfer is an effective mechanism by which to secure an appropriate accounting.[168]

Where the business is unincorporated, as in *McKinstry*, it cannot be transferred in this way. Any transfer of the business undertaking, being essentially the business' assets and liabilities, would need to be made on terms so that P takes subject to existing equitable security interests and indemnifies the claims of the business' general creditors.

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[166] Although there is strong authority for the proposition that F's liability should extend to the benefits of legitimate business which could not have been undertaken without the cash flow or other benefits derived from the breach of fiduciary obligation: *Hospital Products*, n160 above, at 114 per Mason J; *CMS Dolphin*, n8 above, at [97].
[167] *Timber Engineering*, n162 above at [27].
[168] Goode, n114 above, at p.243.

The latter can be secured by way of charge over the assets transferred.[169] However, transfer of the business as a whole in this way would surely rarely prove feasible. It may be difficult to identify and separate F's own assets from business assets, and complex investigations would be necessary to mould the order in such a way as to cater adequately for competing interest.

(b) The Business as a Partial Product of Breaches of Fiduciary Obligation

In many cases it is not possible to say that the gain derived from the breach is the whole of F's business. This may be because part of the business was developed by way of activities which did not amount to a breach of fiduciary obligation. In other cases F will contribute significant skill, labour and capital in the development of the business. There will be a point at which the business must be considered as partially or wholly a product of those independent inputs. A business is an organic asset that grows and develops only with nurture. In this respect, it is different to simple assets such as land or money in a bank account. In many cases, as time passes, "the benefit flowing from the breach of fiduciary duty becomes less significant".[170]

Where F's contributions are not substantial they are unlikely to be considered sufficient to displace a finding that the entire business is the appropriate measure of the gain. Thus, in *Timber Engineering* Toy and Anderson worked full time for Mallory after they left the employment of TECO. They submitted that they were liable to account only for the profits made until that time; thereafter the continuation of the business was attributable to one or both of their own independent skill and effort. That submission was rejected because the essence of the business remained, even though its value may have been enhanced. The defendants' contributions could be recognised by the award of an equitable allowance.

In extreme cases, F's inputs will be more substantial. Indeed, the nature of those contributions may be such that, over time, the business cannot be considered as derived from or tainted by F's breach. It is therefore important to treat a business developed in breach of fiduciary obligation differently from specific assets acquired in breach of

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[169] *ibid.* at p.242.

fiduciary obligation. Thus, in *Warman International v Dwyer*[171] the High Court of Australia recognised that in the case of a business developed in breach of fiduciary obligation it may be appropriate to identify the gain as something less than the whole business and its profits:

> "That may well be the case when it appears that a significant proportion of an increase in profits has been generated by the skill, efforts, property and resources of the fiduciary, the capital which he has introduced and the risks he has taken, so long as they are not risks to which the principal's property has been exposed. Then it may be said that the relevant proportion of the increased profits is not the product or consequence of the plaintiff's property but the product of the fiduciary's skill, efforts, property and resources. This is not to say that the liability of a fiduciary to account should be governed by the doctrine of unjust enrichment, though that doctrine may well have a useful part to play; it is simply to say that the stringent rule requiring a fiduciary to account for profits can be carried to extremes and that in cases outside the realm of specific assets, the liability of the fiduciary should not be transformed into a vehicle for the unjust enrichment of the plaintiff."[172]

Where the business is the partial product of the breach of fiduciary obligation the gain for which F is liable is that part. It is therefore inappropriate to transfer the whole of the business. An accounting might be achieved by the granting of a proportionate share in the business. However, the result of this may be to force F, or his partners or co-venturers, into a continuing business relationship with P. This may generate further problems and disputes. In such circumstances non-specific relief may be a more practical and efficient way forward.[173]

(b) The Business as Independent of Breaches of Fiduciary Obligation

It may be that the elements of a business attributable to a breach have tapered off over time in consequence of F's independent efforts and resources, so that there is no reasonable connection between the business and breach. The transfer of the business or an interest therein is thus inappropriate. The appropriate remedy is an account of the profits generated by the breach of fiduciary obligation, limited by considerations of

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[170] Kearney, n159 above, at p.205.
[171] n132 above.
[172] *ibid.*
[173] See above, Section V.2(b).

causation and remoteness.[174]

3. Problems with the Orthodox Property-Based Approach of English Law

What has been said above is underpinned by the desire to seek a realistic measure of F's gain and to secure a practical, accurate and fair accounting of that gain. It recognises that in the context of businesses developed and operated in breach of fiduciary obligation special considerations arise and it is therefore appropriate to deal with the matter in a different manner to F's acquisition of simple assets. The approach recognises and seeks to be responsive to a number of different policies. Most prominent are: (1) the need to preserve the integrity of fiduciary organisation by deterring wrongdoing and protecting P's objectives; (2) the importance of encouraging and permitting legitimate competition; (3) the public interest in encouraging entrepreneurial activity; and (4) the public interest in the efficient exploitation of opportunities by those best placed and most able to exploit them. These policies are not effectively accommodated by the traditional property based approach of English law. At least three problems might be identified.

The first problem relates to the identification of the subject matter for which F is liable to account. The property-based approach proceeds in two stages. At the first stage it identifies property belonging to P (whether that property belonged to P prior to the wrong or automatically vested in P as a result of the wrong). At the second stage it locates that property or its value by applying the ordinary rules of following and tracing. In the context of a business developed in breach of fiduciary obligation the application of such rules are likely to be difficult or costly. For example, consider the difficulties that would have arisen in *Timber Engineering* had it been necessary to take each input of the business that was misappropriated from or intercepted on its way to the claimant company and then follow or trace each individual input to its present location in the

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[174] *Warman*, n132 above. The case applied principles of causation and remoteness but without explicit reference. The lesser recognised remoteness principle recognises that it may be inappropriate or excessively harsh, given the nature of a business, to require F to account for the whole of the factually caused gain: see *Koo Lee & Yip v Koo Hoi Yan Donald* [2003] 2 HKC 113 at 158-164; *Murad v Al-Saraj* [2005] EWCA Civ 959 at [79] per Arden LJ, [115]-[116] per Parker LJ; P. Jaffey, "Accounting for Wrongful Profits" [1995] LMCLQ 462; M. McInnes, "Account of Profits for Breach of Fiduciary Duty" (2006) 122 LQR 11 at pp.13-15.

business. Kearney J avoided these difficulties by taking a broad brush and flexible approach to identifying the connection between the existing business and the benefits acquired in breach of fiduciary obligation.

The property approach, based on "hard-nosed property rights",[175] is also likely to generate harsh or artificial results. Tracing is not dependant on considerations of causation or remoteness. Yet in the absence of such considerations it is likely that at least part of a business or its assets will remain related by transactional link to a breach of fiduciary obligation, even though it cannot be said in any realistic sense that there is a connection between the two.

Second, the property approach is also inconsistent with the recognition that the most effective and practical way of rendering an account may be to create an interest in property *de novo*. We have seen that an example of this occurs where a constructive trust is imposed on F's shares as an effective device to transfer the gain (an entire business) to P. This secures an accurate accounting of the gain and protects business creditors, notwithstanding that the shares themselves were not acquired in breach of fiduciary obligation and are not the traceable product of such property. The constructive trust is simply a vehicle to transfer the appropriate gain.

Third, identifying the gain and implementing such relief as will secure an accurate and fair accounting is necessarily a flexible process that is likely to depend on a range of factors. In this context we might recognise that a guided, rule-failure discretion is necessary because the diverse and complex circumstances that are likely to arise make it difficult to write clear rules that will achieve appropriate results in a sufficient number of cases. Recognising this lies in tension with the orthodox mantra that proprietary remedies in English law are not and ought not to be discretionary.[176]

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[175] n23 above.

VII. The Appropriate Remedial Framework Re-visited

1. Automatic Recognition of an "Institutional" Constructive Trust

It will be apparent from what has been said above that the orthodox view – that benefits acquired through the wrongful exploitation of fiduciary opportunities necessarily and automatically vest in P - is particularly problematic. We saw in the previous section that this approach is likely to prove inadequate in the context of businesses developed in breach of fiduciary obligation. We have also seen that there are strong reasons – most notably the avoidance of costly and unfair priorities – for restricting the availability of the constructive trust more generally. The claim to a constructive trust should not be, and in fact never has been, an absolute and inevitable consequence of the wrongful exploitation of a fiduciary opportunity.

One way forward might be to simply limit the availability of the constructive trust.[177] However, because specific relief without priority is often desirable simply cutting back on the constructive trust and leaving P with an account of profits is not a promising way forward. Such an approach fails to address the need for a device by which the wrongfully acquired benefit can be delivered to P without creating a risk of unwarranted priorities. This is necessary for reasons of deterrence and for the sake of avoiding difficult evidential hurdles as between P and F.[178]

The portrayal of the constructive trust as automatically vesting in P, and from that time creating a beneficial interest in the disputed gain that the court simply recognises at a later date, is also problematic. It creates the impression that the court is simply granting P "his" property rather than redistributing benefits and creating priorities. Relevant normative considerations are thereby marginalised or obscured as the outcome is made to sound natural and inevitable. Thus, it is said that ordering F to surrender property that he never owned (because it was trust property from the moment of receipt) cannot harm F's creditors. Windfall recovery by P is equally explained away in similar terms.

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[176] See e.g. *Ultraframe*, n18 above, at [1542].
[177] E.g. Youdan, n117 above (limiting the constructive trust to cases of factual subtraction but otherwise leaving P with an account of profits).

In *Abbey Glen v Stumborg*,[179] for example, two director-shareholders sold their company on a net asset basis after diverting a corporate opportunity their own way. The new controllers then caused the company to recover the benefit of the opportunity from the directors. Since any harm to the company caused by the directors' misconduct was reflected in the price of the shares[180] the company's recovery indirectly conferred on the new shareholders a windfall proportionate to their shareholding. They recovered benefits for which they gave nothing and thereby enhance the value of their bargain *ex post*.[181] However, Clement JA avoided the entire windfall issue by reasoning that, since a constructive trust in favour of the company arose automatically upon the directors' wrongful receipt of the benefit, the company was claiming (and the court was granting) nothing to which the company and its shareholders were not already entitled.[182] The opportunity belonged to the company from the outset. Ordering the directors to hand over assets that already belonged to the company could not be considered a windfall.

The property approach is also inconsistent with the recognition of the need to sometimes refuse specific relief because impractical, disproportionate or inconsistent with the parties' later conduct. Such determinations will depend on facts that occur after the breach. The court responds to the circumstances as they stand before it. The availability of a constructive trust is not determined by reference to the facts as they existed at the time of the breach. Indeed, factors which render specific relief inappropriate may fluctuate between the breach and court order. A court may ultimately refuse specific relief even though it would not have done so on the facts as they stood at an earlier stage, and vice-versa. Acknowledging this makes it difficult to see how the constructive trust can arise automatically, once and for all, at the time of the breach.

Finally, it is worth noting that the recognition of such considerations as practicality and proportionality make it more appropriate to align the constructive trust with equitable remedies like the injunction and specific performance rather than the express trust and

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[178] See Chapter 4, Section VI.3.
[179] n10 above. For discussion and critique see W.J. Braithwaite, "Unjust Enrichment and Directors' Duties" (1979) 3 Can Bus LJ 210; D.D. Prentice, "Corporate Opportunity - Windfall Profits" (1979) 42 MLR 215.
[180] In fact it was unlikely that the directors' actions caused the company harm since the opportunity was probably not open to the company as a result of the third party's refusal to deal with it.
[181] *Regal*, n3 above, is a similar case, although only Lord Porter (at 156) dealt with this issue.
[182] n10 above, at 63.

other substantive property interests. [183] These equitable remedies, unlike the institutional constructive trust, are not available in absolute terms.[184]

2. The "Remedial" Constructive Trust

In many respects the development of a remedial conception, such as that developed in Canadian fiduciary law,[185] would represent an improvement. It would allow the constructive trust to be limited so as to avoid unwarranted priorities but would facilitate specific recovery by P outside insolvency. The emphasis on context and establishing what is factually the better solution also accommodates the need to deny specific relief in some circumstances when it is rendered inappropriate by other factors. The open recognition of a discretionary element also provides the flexibility that is sometimes necessary – for example, to tailor appropriate relief to do justice between P, F, F's personal creditors and F's business creditors when a business is developed in breach of fiduciary obligation.

However, the element of discretion should not be over-exaggerated. While a greater degree of flexibility is necessary in some instances in others it is possible to define with greater clarity the circumstances in which a constructive trust is appropriately imposed. One determinant of whether legal form is more or less discretionary or more or less rule-based is context.[186] In the opportunities context it is necessary to draw upon different points of the rules-discretion continuum at different times. A further difficulty with remedial approaches, as was noted in Chapter 3, is that they do not necessarily avoid the creation of unintended priorities and require a potentially costly and difficult inquiry into the state of F's solvency. Moreover, the recognition that a "constructive trust" will be imposed in some circumstances only to the extent third parties are absent seems a misnomer. What is envisaged is nothing more than the imposition of a personal

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[183] As recognised by Laddie J in *Ocular Sciences*, n17 above, at 411-416. Laddie J acknowledged that if (as was sensible) proprietary relief was to be refused on the grounds of practicality and proportionality the institutional constructive trust conceptualisation was inappropriate. He therefore drew upon Canadian remedial constructive trust jurisprudence.

[184] Thus, a claimant seeking an injunction is said to have "no absolute right": *Jaggard v Sawyer* [1995] 2 All ER 189 at 207, 208 per Millett LJ.

[185] E.g. *Soulos*, n85 above (discretion to deny constructive trust in order to protect third parties) and Chapter 4, Section III.1(b).

[186] Chapter 2, Section IV.3.

obligation on F to transfer specific property to P.

3. The New Framework

It will be recalled that the newly proposed remedial framework would comprise the constructive trust – a retrospectively granted proprietary interest – and the personal order to transfer specific property. Subject to the existence of factors rendering specific relief inappropriate a constructive trust is appropriate where F's wrongful exploitation of a fiduciary opportunity results in his interception of a benefit on its way to P. Absent interception, the personal order to transfer specific property is generally appropriate. Not only does this framework keep the constructive trust within appropriate limits, it has a number of further benefits in terms of transparency, clarity and utility.

Conceptualising the constructive trust as the judicial creation of a proprietary interest with retrospective effect emphasises judicial responsibility for the outcome. This reduces the likelihood that the concept will be utilised to uncritically explain away windfalls or priority. It is also consistent with the recognition that whether or not a constructive trust should be imposed is a question to be answered by reference to the facts as they stand at the time of determination, not on the facts as they stood when the breach of fiduciary obligation occurred.

The personal order to transfer specific property responds to the need for non-priority conferring specific relief and provides for this in a manner that does not risk unintended priorities. This takes pressure off the constructive trust, which might be otherwise asked to do the job notwithstanding the risk of unfair priorities that it would generate. The notion of a personal order to transfer specific property is also more transparent and descriptively accurate than the notion of a remedial "constructive trust" that will be imposed only where third parties are absent.

Finally, the need to maintain a strict deterrent approach in order to preserve the integrity of fiduciary organisation may be facilitated rather than frustrated by the more flexible remedial approach envisaged here. We have seen that a constructive trust might operate to destroy a legitimate business, prevent legitimate competition, create unjust priorities,

or generate disproportionate hardship for F or those dealing with him. If constructive trust is the automatic consequence of the wrongful exploitation of fiduciary opportunities, the desire to avoid such consequences may encourage a general relaxation or case-specific avoidance of the liability rules.[187] This would cut off some of the more draconian aspects of the remedy. A more flexible remedial regime allows the courts to ameliorate some of the more unpalatable remedial consequences while maintaining a strict fiduciary obligation.

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[187] Chew, n1 above, at 444-445.

PART III: CONCLUSIONS

CHAPTER 8: Conclusions

I. THE REJECTION OF INSTITUTIONAL AND REMEDIAL THEORIES

This thesis has sought to offer a compelling critique of contemporary constructive trust theories and to push the case for a new approach. That endeavour has been conditioned by the desire that our doctrine and legal concepts should promote fairness, facilitate systematic organisation and operate transparently. To demand this of our concepts and doctrines can be hardly considered radical. It is, nevertheless, something that has proved difficult to achieve.

It English law the constructive trust is viewed as "institutional" in nature. The dominant conception is the automatic vesting constructive trust. This conception is illogical and requires grossly artificial explanations.[1] Judges and jurists in other jurisdictions have developed "remedial" conceptions of the constructive trust. For a variety of reasons these have not proved a fruitful alternative.[2] The most promising development of the remedial theory has been in the Supreme Court of Canada. There it has been suggested that the court might retain discretion to refuse a constructive trust in order to avoid prejudice to third parties, but award a constructive trust all other things being equal except the appearance of third parties. However, apart from continuing to risk unwarranted priorities – a point to which we return below - the approach is less than transparent. It seems to envisage circumstances in which specific relief is desirable as between claimant and defendant, but not claimant and third parties. This is a call for a specific personal remedy, not a proprietary remedy. Elsewhere, we have seen the development of hybrid approaches. These seek to blend, somewhat inconsistently, institutional and remedial features. Not surprisingly they turn out to be incoherent and generate confusion.[3]

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[1] Chapter 3.II.2 and Chapter 5, Section III.1(b)
[2] See Chapter 3, Section III.1 – III.6.
[3] See especially the approach derived from *Muschinski v Dodds* (1986) 160 CLR 583, evaluated in Chapter 3, Section IV.2.

Perhaps the most significant criticism that might be levelled against the "institutional", "remedial" and "hybrid" approaches is that to varying degrees they fail to further appropriate normative concerns. This is an important theme that has run throughout this thesis. Traditionally, fairness was not a significant concern of the constructive trust in English law. The constructive trust developed somewhat haphazardly by way of ill-conceived analogy with the express trust. The resulting doctrine was and remains out of touch with relevant normative considerations.[4] The conservatism of the institutional constructive trust theory – its emphasis on seeking to rationalise and work with that which is there already – fails to address this problem. Indeed, the automatic vesting approach of English law works to obscure important normative issues. Most significantly it marginalises legitimate third party interests as a result of the suggestive power that a trust (and therefore the claimant's beneficial entitlement to property) arises in the world beyond the court. The court simply recognises and protects the claimant's pre-existing property right.[5]

By contrast remedial theories have been motivated by the desire to consider the relevant normative issues openly in order to secure "just" outcomes. In particular they have sought to address that which institutional approaches strain to avoid: the fairness of constructive trust claims as against the constructive trustee's creditors. However, the remedial approaches have only achieved partial success. Most remedial approaches rely on judicial discretion to grant or withhold a constructive trust in order to protect deserving creditors: a constructive trust can be withheld where (i) the putative constructive trustee is bankrupt, or will be made bankrupt by the order against him; and (ii) priority is unwarranted. However, this continues to risk the creation of unintended and unwarranted priorities because the decision whether or not to impose a constructive trust depends on the court's access to information about the defendant's solvency. There is every reason to believe that the quality of such information will be often poor. An alternative, adopted in *Re Omegas*,[6] modifies the timing of the claimant's beneficial interest so as to reduce the incidents of equitable proprietary claims on bankruptcy. However this simply grants or

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[4] Chapter 1, Section III.
[5] Chapter 3, Section II.2(a).
[6] See Chapter 3, Section III.5.

denies priority on an arbitrary basis, by reference to events that have no connection to the relevant normative concerns.[7]

There is also another aspect of fairness which neither institutional nor remedial approaches effectively further. This is fairness of legal form. The institutional-remedial distinction is usually premised on a clear division of rules and discretion and a strong preference for one over the other. Either we prefer the virtues of rules and reject the vices of discretion, hence adopt an institutional conceptualisation, or we prefer the virtues of discretion and reject rules for their vices, hence adopt a remedial conceptualisation.

We saw in Chapter 2 that there are problems with portraying the choice of legal form in such dichotomised and absolute terms. Rules and discretion are best viewed as points on a finely shaded and infinitely varied continuum of legal forms. A well functioning legal system will draw upon the continuum at different points at different times and in different contexts. Thus, in Chapter 6 we saw in the context of bribes and secret commissions that it may be necessary to formulate the availability of the constructive trust in terms of a relatively general rule notwithstanding the risk of over-inclusiveness.[8] By contrast, in the context of a business developed in breach of fiduciary obligation we saw that greater flexibility may be necessary in determining the most appropriate way of holding the fiduciary accountable for his gain.[9] We cannot simply prefer rules to discretion, or discretion to rules, in the abstract. Choice of appropriate legal form is itself a complex normative issue. This is obscured by conceptualisations that demand either a general preference for rules or a general preference for discretion.

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[7] Chapter 3, Section III.6(a)-III.6(b).
[8] Chapter 6, Section V.2(b).
[9] Chapter 7, Section VI.

II. THE NEW FRAMEWORK

1. The Retrospective Proprietary Interest and Personal Order

The suggestion in this thesis is that if we are to secure normatively desirable outcomes within a framework that is coherent, rational and illuminating a new approach is required. That new approach would recognise two conceptually distinct remedies: the constructive trust and the personal order to transfer specific property.

The constructive trust would be re-conceptualised as the judicial grant of an interest in property that operates retrospectively from the time of the facts giving rise to the claimant's cause of action. The personal order to transfer specific property would confer on the claimant a right to the transfer of a specific asset; it would not recognise or create a proprietary interest. The claimant would acquire a proprietary interest only once the defendant had complied with the order and executed a transfer of the property. Professor Goode alluded to such a remedy some time ago and suggested that it may be an appropriate remedy for some acquisitive breaches of fiduciary obligation.[10] However, his views as to its application were somewhat vague,[11] he did not clearly identify the normative underpinnings that would control its application, and he severely curtailed its role.[12] The idea was therefore left undeveloped.

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[10] R.M. Goode, "Property and Unjust Enrichment" in *Essays on the Law of Restitution* (1991, ed. A. Burrows), p.215.

[11] In the end, he seems to have preferred a remedial constructive trust operating prospectively from the time of curial declaration: R.M. Goode, "The Recovery of a Director's Improper Gains: Proprietary Remedies for Infringement of Non-Proprietary Rights" in *Commercial Aspects of Trusts and Fiduciary Obligations* (1992. ed. E.McKendrick), p.137 at 148.

[12] Most significantly he would not extend the order to the recovery of bribes: R.M. Goode, "Proprietary Restitutionary Claims" in *Restitution: Past, Present and Future: Essays in Honour of Gareth Jones* (1998, eds. W. Cornish, *et al.*), p.63.

2. The Benefits of the New Framework

The proposal for a new framework grew out of the critique of the institutional and remedial theories. Like that critique its development was moderated by considerations of fairness, system and transparency.

The new framework maximises the law's ability to achieve fairness. Recognition of the personal order to transfer specific property allows the constructive trust to be reserved for those circumstances in which the significant benefits of proprietary relief – most notably priority – are justified. The development of the personal order is therefore important to cutting back the constructive trust and keeping it within appropriate bounds: it reduces pressure on the courts to recognise a constructive trust in order to do justice between claimant and defendant notwithstanding the risk of unwarranted priorities.

The new framework is also more likely to facilitate fairness of legal form. This is because it is form neutral; unlike the dominant institutional and remedial theories it demands neither a commitment to rules nor a commitment to discretion. It acknowledges that at different times and in different contexts it will be appropriate to draw upon the finely shaded and infinitely varied continuum of legal forms at different points.

The new remedial framework also has benefits in terms of coherence, transparency and system. The constructive trust is conceptualised as a judicially imposed proprietary interest that operates retrospectively from the time the claimant's cause of action accrued. This is intended to recognise that whether a constructive trust is appropriate will often turn on facts that occur between the date of the claimant's cause of action and the date of curial declaration. The retrospective operation of the constructive trust simply expresses the idea that a fair solution to the problem can be achieved by granting the claimant the advantages that flow from a proprietary interest that is deemed to operate from the time the cause of action arose. Emphasising that the constructive trust is a judicially imposed remedy also emphasises judicial responsibility for the outcome. This is not to suggest that the constructive trust is imposed in each case at the discretion of the court.. It is simply to

emphasise that the courts have a role to play in shaping the remedial framework, and to do that the justifications for proprietary relief must be known and addressed openly.

The personal order to transfer specific property also brings with it the benefits of transparency and clarity in that it is a more descriptively accurate label. Its intended function is not obscured by the language of constructive trust and discretion.[13] By giving the constructive trust and personal order such clear and distinct functions the systematic organisation of legal norms is facilitated. This, we might expect, will facilitate the clear and rational development of the law.

3. Prospects for the New Framework in English Law

(a) Neutralising Equity's Maxim

The personal order to transfer specific property is fundamental to cutting back on the constructive trust. But can such an order ever exist in English law? The maxim equity considers as done that which ought to be done apparently transforms any specifically enforceable obligation to transfer property into an immediate proprietary interest.[14] If the maxim cannot be neutralised then equity can never deal in purely personal rights to identifiable property. Indeed, such is the pull of the maxim that it was applied recently in *Moutney v Treharne*[15] to give proprietary effect to a property adjustment order made under statutory authority. In light of this decision Hayton & Mitchell assert:

> "a court order to convey a specific asset can lead to the imposition of a constructive trust on the property even though the order itself is not couched in these terms, and here it seems that the order is itself the event to which the constructive trust responds."[16]

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[13] Compare the Canadian approach which relies on discretion to deny a constructive trust in cases where third parties would be prejudiced: Chapter 3, Section III.2.

[14] R. Calnan, "Imposing Proprietary Rights" [2004] RLR 1; S. Worthington, *Proprietary Interests in Commercial Transactions* (1998).

[15] [2002] EWCA Civ 1174, [2003] Ch 135. See also *Treharne v Forrester* [2003] EWHC 2784 at [20]-[22]; *In re Flint (a bankrupt)* [1993] Ch 319 at 326.

[16] D. Hayton & C. Mitchell, *The Law of Trusts and Equitable Remedies* (12th edn, 2005), p.350.

In *Moutney* a district judge made a property adjustment order pursuant to section 24(1)(a) of the Matrimonial Causes Act 1973 directing a husband to transfer his interest in the matrimonial home. The order took effect when the divorce decree was made absolute. The day after the decree absolute was granted, and before he complied with the order, the husband was made bankrupt. Did the property form part of the bankrupt estate? The Court of Appeal held it did not. Parker LJ reasoned that the order had the effect of conferring on Mrs Mountney an equitable interest in the property from the time of the decree absolute. That result followed "on the basis that the maxim that equity treats as done that which ought to be done applied, so as to vest the beneficial ownership of the property in the party in whose favour a property adjustment order had been made".[17] It followed that the property did not form part of the bankrupt estate.

The fact that the equitable maxim was called in aid of an order made under statute demonstrates its seductive and beguiling qualities.[18] The real issue – somewhat obscured by involvement of the maxim - was whether as a matter of construction the proprietary interest contended for by the claimant could be got out of the words of the relevant statutory provisions or the property adjustment order itself. If it could, there would seem to be no need to involve the maxim; if it could not then the application of the maxim seems spurious. In this respect, it is notable that Parker LJ refused to hold the property was held on constructive trust by the husband because:

> "Mrs Mountney's rights under the order cannot have effect beyond that which the order itself gives them. Either the order gives Mrs Mountney a right which is binding on the trustee under section 283(5) [of the Insolvency Act 1986] or it does not. If it does there is no need to impose a constructive trust: if it does not there is no justification for doing so."[19]

This is clearly correct, but surely the same reasoning applies to the use of the equitable maxim to establish a proprietary right. We might question the logic and consistency of

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[17] n15 above, at [77].
[18] This was recognised by Laws LJ who was critical of the application of the maxim to a statutory order: n15 above, at [83]-[87].
[19] n15 above, at [40].

rejecting one equitable creation on this ground only to found proprietary rights by recourse to another. The beguiling qualities of the maxim again triumph over logic and the frank and open consideration of what impact the Order should have in the event of an intervening bankruptcy.

The same can be said of the application of the maxim to a non-statutory order to transfer (or judicially created personal right to) specific property. There are strong policy reasons for recognising a purely claim to the transfer of specific property. If such a personal order or right is both appropriate and intended by the court that grants or creates it then it is difficult to see why it should be rendered impossible by an arcane maxim.[20]

(b) The Variation of Property Rights and the Judicial Function

It is often suggested that, in English law, judges do not engage in the non-consensual redistribution of property rights. It is also notable that some judges express a reluctance to engage in the frank and open consideration of normative issues – or as they are often labelled, "policy" issues.[20a]

The development of the new approach lies in tension with these observations. The function of the personal order to transfer specific property is to coerce the defendant to transfer specific property to the claimant. The re-conceptualisation of the constructive trust equally acknowledges the judicial role in redistributing property rights and, potentially, establishing priorities between claimant and third parties. It also requires a degree of revision and judicial creativity: the personal order to transfer specific property will need to be developed and the appropriate role of that order, and the constructive trust, will need to be determined. How does this affect the prospects of the proposed new framework?

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[20] See also the criticisms of the use of the maxim in *Attorney General for Hong Kong v Reid* [1994] 1 All ER 1: Chapter 6, Section IV.1(c).

[20a] See G. McCormack, "Restitution, Policy and Insolvency" in *Restitution and Insolvency* (2000, ed. F Rose), p.261.

The cold hard truth is that judicial doctrines non-consensually vary property rights. This is demonstrated in Rotherham's illuminating study of proprietary remedies.[21] Indeed, it is difficult to accept that most judicial concern about the variation of property rights really relates to the redistributive nature of judge-made doctrines *per se*. As Birks makes clear in his review of Rotherham's work:

> "Nobody doubts that property can in certain circumstances be won and lost non-consensually, or that the interpretation of those circumstances lies with the judges, and nobody thinks that that interpretative function could be static or should belong only to the legislature."[22]

The real objection is to *discretionary* judicial variations of property rights, in contrast to judicial variations "where nothing is going on beyond the legitimate interpretation of the events which trigger non-consensual acquisition".[23] The distinction between legitimate interpretation and illegitimate discretion is unclear. One is reminded of the equally problematic distinction drawn by Birks between "weak" and "strong" discretion.[24] We need not reopen that debate here. This is because the constructive trust and personal order to transfer specific property are form-neutral. Their acceptance does not demand an on-going commitment to discretion any more than it demands a commitment to rules or traditional interpretive techniques. The point on the continuum of legal forms by which the availability of the constructive trust and personal order are appropriately determined is a separate matter and contingent on context.

That said, a degree of judicial activism would be necessary in order to develop the personal order to transfer specific property and to determine the appropriate role of that order and the constructive trust. That can be done only by engaging in normative analysis. Two points might be made. First, the normative issues with which the judiciary must grapple are there already. Ignoring them does not make them disappear. The

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[21] C. Rotherham, *Proprietary Remedies in Context: A Study in the Judicial Redistribution of Property Rights* (2002). See also C. Rotherham, "Restitution and Property Rites: Reason and Ritual in the Law of Proprietary Remedies" (2000) 1 Theoretical Inq L 205.
[22] P.B.H. Birks, (Publication Review) (2003) 119 LQR 156 at p.158.
[23] *ibid.*
[24] Chapter 2, Section III.1(c).

suggested framework allows for their open consideration and effective implementation. Second, regardless of the historical position it is now openly recognised that judges – in the appellate courts at least – have a role in shaping and developing the law. If the merits of the new framework are sufficiently strong, there is no necessary reason against its judicial development.

III. Application to Acquisitive breaches of Fiduciary Obligation

In Part II the institutional and remedial theories and the development and application of the new framework were considered in the specific context of acquisitive breaches of fiduciary obligation. The deficiencies of the institutional and remedial theories were further highlighted and the benefits of the new framework in this context were emphasised. This required detailed consideration of the justifications for specific relief as between the principal and fiduciary and the principal and third parties. It was demonstrated that a constructive trust is not always appropriate and the personal order has an important role to play in the avoidance of unfair priorities.

In this context the benefits of the new approach are particularly apparent when compared to the orthodox approach. The English orthodoxy is that the automatically vesting constructive trust is an inevitable consequence of a breach of fiduciary obligation. A number of attempts have been made to gloss over the incoherence and normative deficiencies of that approach. They include resorting to silly maxims, the finding of a fictional common intention, evidential presumptions and conclusory property reasoning. These obscure and add to the deficiencies rather than resolve them. Part of the reason for their widespread appeal is probably that it is easier to avoid rational justification in this area. But that will not do.

Finding compelling justifications for specific relief and priority over third parties is undoubtedly difficult and certainly controversial. That is as true in the fiduciary context

as any other. Reasonable minds are likely to disagree over when priority is appropriate and when one person should be compelled to surrender property to another. Those minds may disagree still further in determining the appropriate legal form; the choice is not simply between rules and strong discretion. However, issues such as these will not go away. A significant benefit of the framework proposed in this thesis is that it clarifies the choices to be made and illuminates what is at stake in making them.

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