

# THE CONSTRUCTIVE TRUST AS A REMEDY FOR MISTAKE, FRAUD, DURESS AND UNDUE INFLUENCE

By  
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## Introduction

The constructive trust is gradually emerging in Anglo-Australian law as a very effective remedy for the specific restitution of property acquired by fraudulent, unconscionable or inequitable conduct. It is therefore appropriate to consider in more detail the general principles which are applied by the courts to determine whether a person holding title to property can be charged as a constructive trustee of the property because the property was acquired by fraudulent, unconscionable or inequitable conduct. It is also necessary to examine particular applications of these general principles. In this article the use of the constructive trust as a remedial device for restoring property acquired by mistake, fraud, duress and undue influence is considered as a specific category in which these general principles are applied as a justification for charging the holder of title to property as a constructive trustee of the property.

### 1. Fraudulent, Unconscionable or Inequitable Conduct

(a) *The General Principles* of what equity regards as fraudulent, unconscionable or inequitable conduct as the rationale for the imposition of a constructive trust must be considered before examining in detail particular illustrations of the application of the general principles. Equity is always prepared to grant relief from fraudulent, unconscionable or inequitable conduct and the constructive trust as a remedy is one of the ways whereby this object is achieved. Where property is acquired by one person by way of a fraud upon another, the fraudulent party can be held to be a constructive trustee.<sup>1</sup> The concept of fraud in equity includes a wide variety of conduct not classified as fraud at common law. For the purposes of an action at law, fraud has to be established on the basis of a fraudulent misrepresentation that consists of a false statement of fact made by the defendant to the plaintiff, knowingly or without belief in its truth or a statement made recklessly, with the intent that it should be acted upon and when in fact it is acted upon by the plaintiff. In contrast fraud in equity is formulated so as to include both actual and constructive fraud. It extends to any conduct which a court of equity was prepared to designate as unfair, unconscionable and unjust. This appellation is readily used in many instances other than fraudulent misrepresentation.<sup>2</sup>

A number of very significant categories of fraud are represented in Anglo-Australian applications of the constructive trust. One writer has correctly observed that the idea of fraud pervades virtually the whole field of constructive trusts.<sup>3</sup> There exists a group of cases in which the constructive trust is used to provide relief from fraud, duress, undue influence and other forms of unconscionable dealing. There is also another group of cases in which

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1. H.G. Hanbury & R.H. Maudsley, *Modern Equity*, (1981) at 391.

2. J.L. Dewar, 'The Development of the Constructive Trust', (1982) 60 *Canadian Bar Rev.* 265 at 282.

3. *Ibid.*

the courts are primarily concerned with preventing one party from fraudulently or unconscionably taking advantage of statutory provisions. Most of the cases in this category have arisen in the context of *inter-vivos* conveyances, and most of the cases involve oral agreements concerning land. The constructive trust is here usually used as a remedy to give relief to a party that is at a disadvantage because of the operation and application of statutory provisions. There is a further category in which the constructive trust is applied in disputes concerning benefits that have arisen upon the death of another person. For example the courts have used the constructive trust to prevent a criminal from profiting from his crime by taking advantage of established legal principles such as the passing of property upon the death of one joint tenant to another. The court will prevent a murderer of the other joint tenant benefiting from this legal principle and the constructive trust provides the mechanism for restitution of the property to the party disadvantaged by the application of this legal principle. Other examples of this kind are in the main concerned with the creation and operation of wills as for example wills that have been fraudulently revoked, where someone has been fraudulently prevented from making a will and where someone has been fraudulently induced to leave property to a legatee or devisee. In addition there are other examples in which the constructive trust is used to prevent a transferee or devisee of property passing under a will or upon an intestacy, from setting up the absolute nature of the transfer in order to defeat the claims of a beneficiary of a secret trust.

Both English and Australian courts are also extending and developing the concept of fraudulent conduct as a ground for imposing a constructive trust and in doing so the judges have begun to develop the constructive trust as a general equitable remedy.<sup>4</sup> A so called category of 'new model' constructive trusts has emerged in Anglo-Australian law. In some cases the judges have formulated the concept of fraud in a way which allows the imposition of a constructive trust whenever justice and good conscience require it and when as a matter of good conscience the defendant ought to acknowledge the claim of others to the property or a share in it. The conduct of one party is designated as inequitable or unconscionable rather than as fraudulent or unconscionable.<sup>5</sup> Many of the reported cases are concerned with matrimonial property claims and claims to an interest in property made by one *de facto* spouse against the other.

It must be stressed at this point that the remedy of rescission rather than the constructive trust often provides adequate relief from fraud, and restitution of the property in much the same way as the constructive trust. For example a purchaser of land who acquires the property by fraud takes a voidable title. Rescission of the purchase has the effect of returning the land to the defrauded party if *restitutio in integrum* is possible. While the conveyance remains on foot, the title holder can pass title to a bona fide purchaser just as a constructive trustee can pass title to a bona fide purchaser. All of this is consistent with the fraudulent owner holding the property as a constructive trustee for the defrauded party so that in an appropriate case the court may effect restitution of land by way of a constructive trust rather than by way of rescission. If the property is a chattel, title to which has been procured under a contract induced by fraud, the operation of these legal principles is more complicated. The defrauded party is accorded the option of affirming the contract and suing for damages for deceit or the defrauded party may elect to rescind the contract and sue for damages for any loss suffered.<sup>6</sup> Here rescission does not usually lead to the

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4. *Ibid*, at 281.

5. A.J. Oakley, *Constructive Trusts*, (1978) at 12.

6. Hanbury, *supra* n. 1, at 391-2.

restitution of the chattel. However it is suggested that when the chattel is unique or when the perpetrator of the fraud is insolvent, specific restitution ought to be available by way of a constructive trust. The purchaser of a chattel under a contract induced by fraud also takes a voidable title which may be passed to a bona fide purchaser for value without notice and this is also consistent with the fraudulent title holder as a constructive trustee of the chattel.

All of the above instances and categories of fraudulent, unconscionable and inequitable conduct as well as the general principles determining whether the conduct is fraudulent are very similar to the general principles which guide the imposition of a constructive trust in the law of the United States. There any transaction may provide the basis for the imposition of a constructive trust and the courts may impose the trust whenever as a matter of equity and good conscience property held by the defendant should be possessed by the plaintiff. Each case is determined on the basis of its own facts and circumstances and no limitations are placed upon the instances in which a constructive trust may be imposed. The courts are prepared to impose a constructive trust whenever it is necessary to prevent an injustice.<sup>7</sup> Despite this absence of limitation upon the doctrine, the courts nevertheless apply the doctrine with caution. Usually it is not applied so as to increase the jurisdiction of equity or to extend established rules to new situations. Particular instances which do not give rise to a constructive trust in the United States include amounts received under contracts, attorney's fees, improvements on real property, insurance policies, leases and rights to rent; breaches of written contracts and failure to perform an agreement or to carry out a promise; prior oral contracts superseded by a written contract; mere failure to pay a debt and refunding or repaying part of the purchase price for a transfer of property after title has vested in the named grantee.<sup>8</sup>

Fraud is also a necessary element in the American remedial theory of the constructive trust. Fraud in this context means frauds or wrongs for which courts in the exercise of their legal powers may give damages as compensation and the fraud may be actual or constructive. In the United States, a constructive trust may be found to arise from any act or omission which is contrary to a legal or equitable duty or trust or confidence and which is contrary to good conscience and operates to the injury of another.<sup>9</sup> It is generally accepted that a person who acquires land or other property by fraud, misrepresentation, imposition or concealment or under any other such circumstances as to render it inequitable to retain the property is in equity regarded as a constructive trustee of the property for the person who has suffered by reason of the fraud or other wrong and who is entitled to the property.<sup>10</sup> Statutory provisions in some states of the United States also provide that one who gains a thing by fraud, accident, mistake, undue influence, the violation of a trust, or other wrongful act is unless he has some other and better right thereto, an involuntary trustee of the thing gained for the benefit of the person who would otherwise have had it.<sup>11</sup>

A proper understanding and appreciation of the operation of the constructive trust as a remedy for relief from fraudulent, unconscionable or inequitable conduct requires a detailed consideration of the specific categories which exemplify such conduct. The rest of this article is therefore given over to an analysis of mistake, fraud, duress and undue influence as a basis for charging the title holder of property as a constructive trustee. Throughout this article a comparative approach is adopted in that the development of the constructive trust in Anglo-Australian law is compared with the American remedial theory

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7. 89 C.J.S. S.142.

8. *Ibid.*

9. 89 C.J.S. S.145.

10. 89 C.J.S. S.146.

11. *Ibid.*

of the constructive trust whenever that theory has been applied to the particular matter under discussion.

## 2. Mistake, Fraud, Duress and Undue Influence

(a) *Mistake* as the basis for the imposition of a constructive trust remains the least well developed of the specific matters under consideration in this article. It is only in recent years that the courts have begun to grant relief by way of a constructive trust rather than relief in the form of other remedies such as rescission, rectification and re-opening of accounts.<sup>12</sup> English courts in particular have begun to acknowledge that the existing remedies provided by both law and equity may be inadequate in the event of money or property passing by mistake. This change has so far only occurred in relation to money paid under a mistake of fact so that it has been recognized that the remedies available at law through the action for money had and received are inadequate when the payee is insolvent. The constructive trust has already been used to give the payer priority over the general creditors of an insolvent payee in the English case of *Chase Manhattan Bank N.A. v. Israel-British Bank (London) Ltd.*<sup>13</sup>

The plaintiff bank in *Chase Manhattan Bank (N.A.) v. Israel British (Bank) (London)* sought to trace a mistaken payment into property which represented the money and in so doing the judge was compelled to decide what no previous English court had decided, namely whether the plaintiff was entitled to a declaration of a constructive trust on the basis of mistaken payment. The plaintiff by mistake paid two million dollars into the account of the defendant bank which two months later filed a petition for bankruptcy. Goulding J. found that the defendants had learned of the mistaken payment or at least had been put on inquiry by facts which should have indicated to a reasonable person that it might have been a mistake and he went on to hold that a person who pays money to another under a factual mistake retains an equitable proprietary interest in it so that the conscience of the recipient is subjected to a fiduciary duty to respect the payer's proprietary right. The judge also held that the equitable remedy of tracing was in principle available on the ground of a continuing proprietary interest in the payer.<sup>14</sup> In order for the payer to trace the fund it was not necessary in the opinion of the judge, to show that the money was the subject of a fiduciary obligation before it got into the wrong hands. The pre-requisite of a fiduciary relationship for a tracing claim was held to be satisfied by deciding that the payment into the wrong hands itself gave rise to a fiduciary relationship. In effect the wrong or the event itself created an *ad hoc* fiduciary relationship. The result of so holding was that the assets (if any) in the defendant's hands which properly represented the plaintiff's money at the commencement of the winding up did not belong to the defendant beneficially and did not form part of the property available to the liquidator for division amongst the creditors. In summary then it was held that under English law a party who pays money under a mistake of fact may claim to trace in equity and this right stems from a continuing right of property recognized in equity.<sup>15</sup> The judge declared that the defendant upon receipt of the money had become a trustee for the plaintiff of the sum of money and he directed an inquiry as to what had become of the money and what assets if any in the possession or power of the defendant now represented the money.

Although the judge in *Chase Manhattan Bank (N.A.) v. Israel British (Bank) (London)*

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12. A detailed discussion of these remedies in cases of mistake is outside the scope of this article. For a detailed treatment of these matters, see Chapter 8 of R. Goff and G. Jones, *The Law of Restitution*, 1986.

13. [1981] Ch. 105.

14. *Ibid.* at 119-120.

15. *Ibid.* at 128.

allowed the constructive trust to be used as a remedy in a case where money was paid under a mistake of fact, some criticisms can be made of the reasoning used to reach this result. Goulding J, as a judge sitting at first instance, was constrained by the decision in *Re Diplock*<sup>16</sup> which required the judge to find a fiduciary relationship before allowing a tracing claim. The judge was able to do so by relying on *Sinclair v. Brougham*,<sup>17</sup> an authority which permitted him to find that the required relationship had arisen from the very fact of the payment itself and that it was unnecessary to show that the property was subject to a fiduciary relationship before it got into the wrong hands. This reasoning is based on the fiction or construction of a fiduciary relationship by the court and it continues to create the impression that a fiduciary relationship is necessary for the imposition of a constructive trust as well as for a tracing claim. It is surely the mistake or the event and the unjust enrichment which results from the mistake that provides the rationale for a continuing equitable interest in the property and not a fiduciary relationship for clearly there is no such relationship. The important and determining question is whether it is just to impose a constructive trust. It is the equities of the particular case which the court must assess and not the construction of a fiduciary relationship where none in fact exists. Goff and Jones in their work on *The Law of Restitution* find it regrettable that Goulding J. was not able to deal with these critical questions because of the binding precedent of *Re Diplock*. In the opinion of Goff and Jones an approach based on the equities of the case would favour the plaintiff because the defendant discovered the mistake two days after the payment was made yet they continued trading without any attempt to return the money. In contrast the plaintiffs had not, like other creditors, advanced credit to the defendants and taken the risk of the defendant's insolvency.<sup>18</sup> In the absence therefore of the imposition of a constructive trust, the defendant's general creditors would have received a windfall, in other words the creditors would have been unjustly enriched at the expense of creditors. In other circumstances there may not be such an unjust enrichment as for example where the general creditors are subsequently induced to grant or extend credit because the defendant's assets were materially swollen by the mistaken payment.<sup>19</sup>

The tracing rules for ascertaining what property represented the money paid under a mistake of fact were not proved or debated in *Chase Manhattan Bank N.A. v. Israel - British Bank (London)*. All Goulding J. had to say on this issue was that the courts would not necessarily apply the same tracing rules or arrive at the same final result as that reached in some American cases which had applied *Re Hallett's Estate*<sup>20</sup> in order to determine what was the lowest intermediate balance in the defendant's hands.<sup>21</sup> The refusal of Goulding J. to categorically endorse the American approach provides support for the arguments of Goff and Jones that the existing tracing rules for the identification of property may not be appropriate in cases such as the *Chase Manhattan Bank* case. The existing tracing rules were formulated in the context of beneficiaries of a trust seeking priority over the general creditors of a bankrupt trustee in circumstances where relatively small amounts of money were involved. In these circumstances the 'identification of the plaintiff's assets in the mixed fund did not present insurmountable problems and could be solved through the application of artificial presumptions'.<sup>22</sup> Further in the American case which adopted *Re*

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16. [1948] Ch. 465.

17. [1914] A.C. 398.

18. Goff and Jones, *supra* n. 12 at 115.

19. *Ibid.*

20. (1880) 13 Ch.D. 696.

21. *Re Berry* (1906) 147 F. 696.

22. Goff and Jones, *supra* n. 12 at 116.

*Hallet's Estate*,<sup>23</sup> the lowest intermediate balance in the account never fell below the amount of money placed in the defendant's bank account before the mistake whereas the amount of money paid under mistake in the *Chase Manhattan Bank* case was much larger and it was paid into an account in which very large sums of money passed day by day over a much longer period of time following the receipt of mistaken payment. The identification of the money by application of the traditional tracing rules was not possible and the judge in the *Chase Manhattan Bank* Case has left it to judges in future cases, to work out the appropriate rules for the identification of funds paid under a mistake of fact. The sort of rules that will be developed will depend upon the extent to which the courts are prepared to accord the plaintiff priority over the defendant's creditors in the event of the defendant's insolvency.<sup>24</sup> In some American jurisdictions the courts have adopted the approach of allowing the plaintiff priority if it can be demonstrated that the mistaken payment went to swell the defendant's assets. This approach allows the payer to gain preference through the imposition of a constructive trust over any of the unencumbered assets held by the defendant. The justification for this approach is that the plaintiff's claim is more deserving than that of the general creditors.<sup>25</sup>

The imposition of a constructive trust in cases of mistake other than money paid under a mistake of fact has not as yet been the subject of any judicial decision in England or Australia. Money paid under a mistake of law is not usually recoverable although there are scholars who argue that similar principles should apply as those which enable the recovery of money paid under a mistake of fact. It has been argued also by Goff and Jones that restitutionary proprietary claims by way of a constructive trust and tracing should be allowed for money paid under a mistake of law as well as for money paid under a mistake of fact. There is also no authority which as yet permits the recovery of property transferred under a mistake of law. Here again there are cogent arguments in favour of allowing recovery *in specie* by imposition of a constructive trust on the property held by the transferee. In Canada there is some authority for the proposition that a person who makes a payment to another or transfers property to another under a mistake of fact or law can in equity recover it and that a court may impose a constructive trust upon the transferee.<sup>26</sup> In *Re Wayne Coal Co*,<sup>27</sup> the judge made some *obiter* remarks to the effect that if the identical money paid in error is preserved *in specie* or is earmarked so as to retain its identity the court can impose a constructive trust irrespective of whether the mistake is one of fact or law. A constructive trust was not imposed by the judge because the plaintiff prior to bringing the action had already elected to claim as a creditor for the money rather than claiming specific restitution of the moneys.

There is therefore a clear absence of adequate and appropriate authority in England and Australia, establishing guidelines and rules for the imposition of a constructive trust in cases of mistake other than money paid under a mistake of fact. This is not true of the United States where academic and judicial authorities have worked out a coherent scheme for specific restitution of property received under a mistake. It is therefore suggested that English and Australian courts should in future cases be guided by the more well developed American rules. Goulding J. in the *Chase Manhattan Bank* case provided some encouragement for doing this when he expressed the opinion that the constructive trust and

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23. *Re Berry supra* n. 21.

24. Goff and Jones, *supra* n. 12 at 116.

25. For further information on what is known as the swollen assets theory see Goff and Jones, *ibid.*

26. D.W.M. Waters, *Law of Trusts in Canada*, (1974) at 36.

27. [1920] 3 WWR 642, 55 D.L.R. 327.

its application to cases of mistake as set out in the American text on *Trusts* by Scott, is in accord with the general principles of equity as they apply in England and furthermore in the absence of English authority, he was prepared to follow the law as stated in Scott's text.<sup>28</sup> A brief resume of the law governing the imposition of a constructive trust for mistake in the law of the United States is therefore appropriate at this point so as to provide a possible framework for English and Australian judges who may in the future be called upon to decide claims for the imposition of constructive trust because of mistake.<sup>29</sup>

In the United States a transferee of property is chargeable as a constructive trustee of the property where the owner of the property transfers the property as a result of a mistake of such a character that the former owner is entitled to restitution.<sup>30</sup> Restitution of chattels and money as well as real property is permitted. Before outlining in more detail the character of the mistake which entitles the transferor or payer to restitution, it is necessary to note some general limitations which govern the imposition of a constructive trust upon a transferee or payee. In the case of property which has been transferred the constructive trust only arises where there is property upon which the constructive trust can be fastened and the property must be held by the person who is to be charged as a constructive trustee. A constructive trust cannot be imposed when services have been rendered as the result of a mistake and nor does a constructive trust arise if a creditor by mistake releases a debt.<sup>31</sup> The constructive trust does not arise when the transferor or payer has other adequate remedies available to him. Thus where a transfer of property is voidable for mistake, a judgment for the return of the property or its value may be an adequate remedy. Where chattels or money is involved the remedy at law may be adequate in that the transferor or payer may be entitled to a judgment for the value of the chattels or a judgment for the amount of money paid. The availability of other adequate remedies may therefore entitle a court of equity to refuse specific restitution but such a refusal does not mean that the transferor has no beneficial interest in the property and nor does it mean that there is no constructive trust because a holding that the legal remedy is adequate is merely personal and it is not a substantive determination of rights.<sup>32</sup>

The remedy at law may in some cases be inadequate and the transferor or payer may be entitled to specific restitution of the property. A transferor of property may be entitled to specific restitution of property that has been transferred under a transaction that is voidable for mistake. Specific restitution is available if the property transferred is land or a unique chattel and it is also available when the transferee of the property is insolvent even although the property is of such a character that in the absence of insolvency, the remedy at law would be adequate so as to prevent the transferor or payer from obtaining specific restitution. Specific restitution of chattels and money can therefore be awarded when the person holding title to the property or money is insolvent and this is so irrespective of whether the transferee or payee was insolvent at the time the transfer was made or subsequently became insolvent. Specific restitution is also allowed when the person to whom the property is transferred by mistake is ready and willing to reconvey the property *in specie* and in these circumstances it does not matter whether the transferor or payer can compel the return of the property *in specie*. A transferor or payer entitled to specific

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28. *Supra* n. 13 at 118.

29. A brief summary of the American law is to be found in the judgment of Goulding J, *ibid* at 126.

30. Restatement of Restitution, S.163.

31. Other remedies may be available in such cases, such as a personal judgment for services rendered. In the case of a release of a debt the court may revive the debt and any security subject to the rights of a bona fide purchaser, See Restatement of Restitution, S.163.

32. *Ibid*.

restitution must as a condition of restitution be prepared to restore to the transferee or payee any property that the transferor or payer received in exchange for the property transferred.<sup>33</sup>

The character of the mistake that will entitle a party to specific restitution must usually take the form of a mistake of fact in the law of the United States. Ordinarily a constructive trust will arise in favour of the rightful owner of the property when through a mistake of fact title to and apparent ownership of property rightfully belonging to the transferor is obtained by another person. A payee who received money through a mistake of fact may be charged as a constructive trustee of the money for the rightful owner but usually this is not necessary as the remedy at law will be adequate. If however the payee is adjudicated bankrupt the money may be traceable to a bank account if it has not been withdrawn and so the bankrupt payee may then be chargeable as a constructive trustee of the money.<sup>34</sup> Where the character of the mistake is a mistake of law, property or money is not usually recoverable in the United States just as it is not recoverable in England and Australia.<sup>35</sup> Ordinarily no constructive trust can arise. This refusal to allow recovery and specific restitution by way of a constructive trust is criticised by Scott and in his opinion a person who makes a payment or who conveys property under a mistake of law should in an appropriate case be entitled to specific restitution.<sup>36</sup> Some exceptions to this rule have emerged in the United States cases. A beneficiary entitled to property held on trust is entitled to restitution where his trustee by mistake transfers the property through a mistake of law to one who is not entitled to the property.<sup>37</sup> A third party transferee or payee can rely on the defence of a bona fide purchaser and the defence of change of position.

In Anglo-Australian law the rectification and rescission of conveyances ineffective for mistake as well as the use of the constructive trust to provide relief in the event of a conveyance of property following a mistake, is a matter of a great deal of dispute and confusion. Here again the American approach to the constructive trust provides a more coherent framework. When land is conveyed under a mutual mistake, that is a mistake of which the grantee knows, the grantor can set the transaction aside even though value was given for the transfer. The mistake may take the form of a conveyance of a piece of land which was not intended by the parties to be conveyed so that where the title to the land has passed to the grantee, the grantee can be compelled to return the property to the grantor so long as the grantee has not passed title to the land to a bona fide purchaser for value without notice of the mistake. In these circumstances the grantee is chargeable as a constructive trustee of the land for the grantor because the retention of the property would constitute an unjust enrichment to the grantee. Where the grantee has sold the land to a bona fide purchaser, the grantor can charge the grantee as a constructive trustee of the proceeds of sale in the hands of the grantee.<sup>38</sup>

Specific restitution is not available where the property is transferred to another under a unilateral mistake, that is under a mistake not shared and not known to the grantee. Rescission is not available where the grantee gave consideration and was without notice of the mistake at the time when he made the bargain. This is so even where the promise is made to give something for value and the promisor learns of the mistake before he is able to perform his promise. The promisee is entitled to the benefit of the bargain and may keep

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33. *Ibid.*

34. A.W. Scott, 'Constructive Trusts' (1955) 71 *L.Q.R.* 39 at 42.

35. *Bilbie v. Lumley* (1802) 2 East 469, 102 E.R. 448.

36. A.W. Scott, *The Law of Trusts* (1967) at 3429-3420.

37. *Ibid.*

38. *Ibid* at 3427.



the property transferred so long as the transferee has no notice of the mistake. This also applies when the transferee has learned of the mistake before performing his side of the bargain. The promise in such a case is sufficient to support the contract. As a corollary of this there can be no specific restitution except where a person has transferred the property under a unilateral mistake of fact which was caused or induced by a misrepresentation of the transferee including an innocent misrepresentation. Where there is no mistake in the bargain but one of the parties by mistake has paid money or conveyed property which he was not by the bargain duty bound to pay or convey, the transferor is entitled to restitution. Further, when a transfer of property whether land or chattels is made by way of gift the transferor is entitled to restitution where the gift was made under a mistake that was not known to the donee and of which the donee had no notice.<sup>39</sup>

The issue of whether restitution is available may also arise where the owner of property has not, as the result of a mistake, conveyed property to another person. Where the property is conveyed for a consideration and the conveyance is ineffective to transfer the whole of the property because of a mistake, specific restitution is available and the transferor may be charged as a constructive trustee of the property that he contracted to convey to the transferee. This has the effect of imposing a duty on the transferor to complete the transaction for which he has received the consideration. Where however the conveyance is a gratuitous conveyance which is ineffective to transfer the property, the donor is not chargeable as a constructive trustee so that the donor can continue to hold the property for his own benefit. A court of equity in the United States will not compel the donor to complete the gift when the donor has failed to comply with the legal requirements necessary to pass title to the property. There is no duty to perfect the gift and no express trust arises because the owner did not intend to create a trust. It is thought that there is no justification for charging the donor as a constructive trustee because there is no unjust enrichment that results from the donor's retention of the property. In the absence of consideration, a court will not compel the donor to fulfill his generous intention. An exception is made where the donee has so changed his position in the belief that the conveyance was effective to such an extent that it would be inequitable to preclude the donee from obtaining the property. The courts will then compel the donor to transfer the property to the intended donee and may effect this by charging the donor as a constructive trustee of the property. An exception is also made where a conveyance is ineffective because of the death of the donor, whenever the donee is the natural object of the donor's bounty and the donor has died believing that the donor has made an effective conveyance. The inheritors of the property can be compelled to transfer the property to the donee and as such are chargeable as constructive trustees of the property for the donee. The court must also be satisfied that it is not inequitable to permit the donee to have the property. If therefore it is unfair to the heir, the next of kin, the residuary devisees or legatees, the court will not compel the transfer of the property to the donee.<sup>40</sup>

The owner of property may intend to transfer the property to one person but by mistake transfer it to another person. In the United States the courts can compel the grantee to restore the property to either the grantor or to the intended grantee except where the grantee is a bona fide purchaser. The grantee is therefore chargeable as a constructive trustee of the property for either the grantor or the intended grantee. Where the circumstances are such that a third person is entitled to restitution from the grantee or transferee, the grantee or transferee is chargeable as a constructive trustee of the property

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39. Restatement of Restitution, S.163.

40. Scott, *The Law of Trusts*, *supra* n. 36 at 3431-3432.

for the third person.<sup>41</sup> This will be so when the grantor or transferor in making the conveyance intended to discharge an obligation which he owed to the intended grantee or transferee. If therefore the grantor or transferor prior to the conveyance is under a specifically enforceable duty to convey the property to an intended grantee or transferee, the grantee or transferee holds the property upon a constructive trust for the intended grantee or transferee as for example where there is a contract to sell land or a unique chattel to the intended grantee or transferee. Therefore when a person is under a contract duty to convey property to one person and by mistake has made a conveyance of the property to another, the transferee is chargeable as a constructive trustee of the property for the other party to the contract and the justification for this is that prior to the transfer, the other party to the contract has an equitable interest which can only be cut off by a transfer to a bona fide purchaser.

Where a debtor, intending to pay his creditor, by mistake makes a payment to a third person, the matter is more complicated. The payee cannot retain the money unless the payee is a bona fide purchaser and the payee is regarded as a bona fide purchaser when the money received was paid to the payee in discharge of a debt owed to him. Where the payee is not a bona fide purchaser the debtor can rescind the transaction and the debt is not discharged. Where the debtor does not rescind the transaction the payee who is not a bona fide purchaser is chargeable as a constructive trustee of the money for the creditor intended to be paid and when the creditor receives the money from the payee the debt is discharged. When the creditor receives payment from the debtor, the payee of the mistaken payment is under a duty to repay the money to the debtor and is a constructive trustee of the money for the debtor. The effect of all this is that a debtor who is solvent can rescind the transaction with the payee except where the creditor has received payment from the payee or has elected to surrender his claim against the debtor and to accept a claim against the payee in lieu of the claim against the debtor. However where the debtor is insolvent before the creditor has recovered from the payee, the creditor is entitled to recover the payment from the payee and to charge the payee as a constructive trustee of the money. The debtor's trustee in bankruptcy does not acquire the creditor's right to rescind the mistaken payment and this prevents other creditors from sharing in the money that would be recovered if the trustee in bankruptcy had the right to rescind the payment. The trustee is denied this right in order to prevent the unjust enrichment of other creditors that would arise from rescission of the payment by the trustee in bankruptcy. The creditor who because of the mistake was not paid is therefore allowed to recover the full amount from the payee.<sup>42</sup>

In some circumstances a payment by a debtor to a person other than the creditor will discharge the debt and the payee will only be chargeable as a constructive trustee of the money for the creditor. For example where a creditor has assigned his claim to a third person and the debtor in ignorance of the assignment has paid the assignor. The payee is then chargeable as a constructive trustee for the assignee. A similar problem arises when the original creditor has made successive assignments and the debtor pays the second assignee.<sup>43</sup> The second assignee can be compelled to pay what he has received to the prior assignee except when the second assignee is a bona fide purchaser. The second assignee is chargeable as a constructive trustee of the money for the first assignee. Usually payment

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41. Restatement of Restitution, S.165.

42. *Ibid.*

43. The American authorities are divided as to whether the rights of the assignees depend upon the order of the assignments or the order in which the assignees notify the debtor of the assignments. See Restatement of Restitution, S.165.

made to the second assignee without notice of the prior assignment discharges the debt even though the prior assignee is entitled to recover from the payee. It must again be stressed that in many of the above instances the constructive trust is not always specifically enforceable by the debtor who has paid a third party by mistake and nor is the constructive trust necessarily enforceable by the creditor who has not been paid because of the mistake. Specific enforcement of the constructive trust depends upon the adequacy of any remedy at law and where the payee is solvent, the remedy at law is usually adequate. Conversely the remedy will not be adequate if the payee is insolvent and this applies in cases where the remedy would otherwise be adequate but for the insolvency of the payee.

A further instance in which the constructive trust may be used to provide relief from a mistaken transfer of property is where a person intending to make a gift by mistake transfers the property to a person other than the intended donee. The donee can compel the transferee to return the property except when the transferee is a bona fide purchaser of the property. The transferee is chargeable as a constructive trustee of the property for the donor. The intended donee cannot compel the transferee of the property to surrender the property to him and nor can the intended donee compel the donor to complete the gift. Where the donor has died before learning of the mistake the intended donee may be able to recover the property from the transferee by satisfying a court that the intended donee is a natural object of the donee's affection and that the retention of the property by the transferee is inequitable.<sup>44</sup>

(b) *Fraud, Duress and Undue Influence* as well as other forms of wrongful conduct such as misrepresentation and unconscientious (unconscionable) dealing may entitle a court to charge a person holding title to property as a constructive trustee. Most of the cases are examples of equitable fraud such as undue influence and unconscientious dealing which has occurred at the time of disposing of the property. Other instances such as duress are examples of conduct considered to be wrongful as a matter of law rather than equity. The transactions which result from such wrongful conduct are voidable and the most frequently used remedy for relief is that of rescission. As previously noted the effect of this remedy is to require the recipient of the property to restore the property to the victim. Increasingly, English and Australian courts are also prepared to charge the recipient of the property as a constructive trustee of the property. There is general agreement that the party holding the property is a constructive trustee of the property and that the courts can make declarations to that effect with or without orders for the reconveyance or retransfer of the property. It is therefore appropriate at this point to illustrate the operation of the constructive trust in this context through a discussion of two instances of wrongful conduct, one of which, duress, is a legal doctrine and the other, undue influence, is an equitable doctrine.

Whether a person who pays money or confers some benefit under duress can be compelled to make specific restitution is not yet the subject of any judicial decision in England and Australia. Like mistake, the use of the constructive trust in cases of duress is still unclear and undeveloped. However Goff and Jones submit the courts should be willing to grant the coerced party a restitutionary proprietary remedy in the event of the insolvency of the party that has exercised the illegitimate pressure. Such relief is required as a matter of equity in order to prevent the unjust enrichment of the creditors which would otherwise arise if the creditors are allowed to share in a fund or property obtained by the insolvent debtor through the exertion of illegitimate pressure upon the claimant.<sup>45</sup> Once this view is

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44. *Ibid.*

45. Goff and Jones, *supra* n. 12 at 247.

accepted it will be clear that the party in receipt of property acquired through duress will be chargeable as a constructive trustee of the property.

Where the party who has exerted undue influence retains the property transferred to him, the court will usually set the transaction aside and require the transferee to reconvey the property and if the transferee has obtained some security for the liabilities of a third party the security is unenforceable. It would seem that the transferee of the property who is liable to restore the property because it was acquired through undue influence is chargeable as a constructive trustee of the property. Sometimes the exertion of undue influence can result in a transfer of property to or a benefit conferred on a third party, that is to a person other than the party who has exercised the undue influence. The third party may also be required on occasions to restore the property, particularly where the third party is a volunteer or has notice of the undue influence.<sup>46</sup> Again it would seem that where the third party is liable to restore the property, the third party is chargeable as a constructive trustee of the property.

Since the immediate transferee of the property is chargeable as a constructive trustee of the property, the transferor may wish to pursue a restitutionary proprietary claim and to trace the property into other property, as against the transferee as well as tracing the property into the hands of a third party transferee who has received the property from the initial transferee. The transferor will particularly want to assert a restitutionary proprietary claim when the initial transferee or the taker from the initial transferee of the property has gone bankrupt before the transferor has been able to bring an action to establish that the property was acquired by undue influence. A definitive answer as to whether a restitutionary proprietary claim is available in these circumstances is not to be found in the cases because the authorities provide confusing and conflicting statements as to whether the transferor of the property has an equitable interest in the property before the court has made any order avoiding the transfer sufficient to entitle the transferor to a restitutionary proprietary claim. It is therefore necessary to examine how the existing authorities classify the victim's interest in property that has been conveyed under circumstances which give rise to a right in equity to have the conveyance set aside.

In *Stump v. Gaby*<sup>47</sup>, the court decided that a person entitled to set aside a conveyance remained the equitable owner of the property and could devise the equitable interest in the property.<sup>48</sup> This proposition was again asserted in *Dickinson v. Burrell*<sup>49</sup> when the court was asked to determine whether the right to set aside a conveyance on equitable grounds had passed to the grantee under a voluntary settlement of the property in trust for the grantee for life with remainder to children of the children as he should appoint and in default of appointment to all his children who should attain 21 (or being) daughters should marry in equal shares. Lord Romilly M.R. held that the voluntary settlement carried with it all the same incidents and rights attached to the property conveyed as are carried by a deed executed for value.<sup>50</sup> It carried with it the right to set aside the conveyance as a right incidental to the property and this right was also incidental to each interest carved out of the property. However where the original grantor has merely sold or conveyed the right to

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46. *Bainbridge v. Browne* (1881) 18 Ch.D. 188; *Chaplin & Co. Ltd. v. Brammall* [1908] 1 K.B. 233; *Avon Finance Co. Ltd. v. Bridger* [1985] 2 All E.R. 281; *Coldunell Ltd v. Gallon* [1986] Q.B. 1184; *Kings North Trust Ltd. v. Bell* [1986] 1 W.L.R. 199; *Bank of N.S.W. v. Rogers* (1941) 65 C.L.R. 42; see also M. Cope, *Duress, Undue Influence and Unconscientious Bargains*, (1985) Chapter 8.

47. (1852) 2 De. G.M. & G. 623, 42 E.R. 1015.

48. The court also held that the equitable owner had confirmed the voidable conveyance by devising the property to the defendants who claimed through the original transferee of the conveyance.

49. [1866] 1 L.R. Eq. 337.

50. *Ibid.* at 342.

sue to set aside the conveyance without a grant of the property or his interest in the property, the grantee does not acquire any right to maintain an action for the recovery of the property.

The authorities cited in the previous paragraph therefore support the contention that a person entitled to set aside a conveyance on equitable grounds retains an equitable interest in the property and can pass that equitable interest together with the right to sue for the recovery of the property to a devisee. This right can also pass by way of a contract for valuable consideration and by a voluntary conveyance. Unfortunately these authorities have not been followed by English and Australian courts when deciding issues of priority between the original owner of the property entitled to bring an action in equity for the recovery of the property and a subsequent transferee from the original grantee. The courts have not in this context accorded the original transferor an equitable interest in the property. In *Phillips v. Phillips*<sup>51</sup> the court held that where the circumstances give rise to an equity as distinct from an equitable estate, a purchaser of an equitable interest can maintain a defence of a bona fide purchaser for value without notice. Usually this defence is only available to a purchaser of a legal estate without notice. The court expressed the view that where the grantor has a right to set aside a deed for fraud or to correct it for mistake, the grantor has an equity and not an equitable interest.<sup>52</sup>

In Australia, the High Court of Australia, in *Latec Investments Limited v. Hotel Terrigal Pty. Ltd.*<sup>53</sup> followed *Phillips v. Phillips*.<sup>54</sup> The High Court did so in circumstances where a mortgagor had a right to set aside a contract and a transfer of land to a purchaser on the equitable ground that the exercise of a power of sale by a mortgagee was fraudulent. The mortgagor sought to obtain priority as against a subsequent purchaser of an equitable interest in the property without notice of the mortgagor's right to set aside the contract. The judges were all agreed that the mortgagor was not entitled to priority but in the course of reaching this conclusion a variety of conflicting reasons were expressed in their judgments. One Judge, Kitto J, reached this result through an application of the established rules for determining priority between competing equitable interests. This approach does not deny that the grantor has an equitable interest.<sup>55</sup> Taylor J. also said that there was '... abundant authority for the proposition that the owner of land a transfer of which has been obtained by fraud retains an equitable interest'<sup>56</sup> and that therefore the transferor has a right that can be assigned *inter vivos* or devised and '... that the grantor's interest in the property does not come into existence only if and when the conveyance is set aside.'<sup>57</sup> Despite these statements, his Honour also conceded that the cases provided no guidance as to how to determine priority between competing equitable interests when the first in time has an equitable interest that arises from a right to set aside a conveyance for fraud. According to Taylor J. the person entitled to set aside the conveyance 'has in every sense of the term an equitable interest in the land and if he is to be postponed to an equitable interest acquired without notice at some later time it is not because... that he has a mere equity as distinguished from an equitable estate; if he is to be postponed then there must be some other reason.'<sup>58</sup> His Honour criticised the argument that a plaintiff seeking to set aside a

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51. (1861) 4 De G. F. & J. 208, 45 E.R. 1164.

52. *Ibid.* at 1169.

53. (1965) 113 C.L.R. 265.

54. *Supra* n. 51.

55. *Supra* n. 53 at 276.

56. *Ibid.* at 282.

57. *Ibid.* at 284.

58. *Ibid.* at 284-5.

deed for fraud or to reform it for mistake has only an equity as distinguished from an equitable estate before the transaction is set aside. The judge was able to find other reasons for postponing the equitable interest first in time to the later equitable interest and one of the reasons that he thought justified this result was the fact that the holder of the earlier equitable interest required the assistance of a court of equity to remove an impediment to his title as a preliminary step to the assertion of his equitable interest and that assistance had not been sought before an equitable interest in the property had passed to a purchaser for value without notice.<sup>59</sup> With respect, the effect of this reasoning is to deny the first claimant an equitable interest in the property for the purpose of deciding priority in any case where the court has not at the time the issue is raised, set the transaction aside. Taylor J. in the end still determines the issue not by an application of the usual rules applicable for determining priority between competing equitable interests but instead allows the holder of an equitable interest to rely upon the defence of a bona fide purchaser for value without notice so as to defeat the claim of the earlier claimant who has not yet obtained a judgment from a court setting aside the earlier conveyance.

In the other judgments the same result is said to be justified by the decision in *Phillips v. Phillips*<sup>60</sup> Kitto J. apart from applying the usual equitable rules for resolving priority also applied *Phillips v. Phillips* and held that the reasoning in that case applied where the claim to an earlier equitable interest was dependent for its success upon the setting aside or rectification of an instrument. He however also thought that it was applicable where the earlier claim was an equity unaccompanied by an equitable interest. Similar justification for the application of *Phillips v. Phillips* is to be found in the judgment of Menzies J. who held that the reasoning applied where the subsequent holder of the equitable interest had acquired the interest without notice of the equity to set aside a conveyance. Unlike Taylor J., Menzies J., for the purpose of priorities classified the right of the earlier claimant to set aside the conveyance as a mere equity and in doing so emphasized that the right to have the conveyance set aside was a right which must be exercised as a necessary condition if there is to be a relation back of the equitable interest.<sup>61</sup> His Honour also conceded that in contexts other than priorities, the holder of the right to have the conveyance set aside could be regarded as retaining an equitable estate and that this result is achieved by focusing on the result of the eventual avoidance of the conveyance. His Honour said that this is the approach in cases in which it has been held that the holder of the right to avoid the conveyance has an equitable interest which may be devised or conveyed.<sup>62</sup>

The application of the reasoning in *Latec* would have the effect that for the purposes of priority, the right to set aside a transaction for undue influence would not be accorded the full incidents of an equitable interest.<sup>63</sup> The right will only bind a third party transferee who is a purchaser who has notice of the circumstances which give rise to the right. It does not bind a bona fide purchaser of a legal or an equitable interest when the purchaser is without such notice. All of this still leaves unanswered the question of whether this ought to be the law in cases of mistake, and undue influence as well as for other kinds of wrongful conduct which may give rise to a right to avoid a conveyance. The alternative would be to accord the defrauded party the full incidents of an equitable interest and this would mean that prior to avoidance of the conveyance, the right would bind not only volunteers and those with notice but also bona fide purchasers of an equitable interest with or without notice. Priority

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59. *Ibid.* at 286.

60. *Supra* n. 51.

61. (1965) 113 C.L.R. 265 at 291.

62. *Ibid.*

63. D.J. Hayton, *Underhill's Law Relating to Trusts and Trustees* (1979) (13th ed), at 329.

would be determined by application of the established rules that determine priority in competition between two competing equitable interests. Usually the holder of an equitable interest later in time as distinct from the holder of a legal interest, cannot rely on the defence of a bona fide purchaser for value without notice.

The change to the law advocated in the previous paragraph would follow as a consequence of accepting the American remedial theory of the constructive trust. Under this theory the constructive trust arises as soon as the circumstances have arisen which give rise to the equitable right to set the transaction aside so that even before the conveyance is set aside the victim has a full equitable interest and not a mere equity.<sup>64</sup> The adoption of the remedial theory of the constructive trust leads inevitably to the conclusion that the constructive trust arises when the wrongful conduct takes place. The interest of the victim in the property should therefore be classified as an interest arising under a constructive trust<sup>65</sup> and the victim should be allowed to trace or follow the property in equity into its product. It should have the full incidents of an equitable interest and it should not be regarded as a mere equity. Goff and Jones support this approach and they argue that a person who has transferred property under undue influence should be allowed a restitutionary proprietary claim whenever the property is identifiable in equity. This approach means that the general creditors of an insolvent transferee cannot benefit from the undue influence of the insolvent transferee. This approach would also allow specific restitution irrespective of whether or not the undue influence arises out of a fiduciary relationship<sup>66</sup> and even if a fiduciary relationship is required, the courts will find, as has already occurred in cases of mistake, that the equitable title remains in the transferor.<sup>67</sup>

Finally it remains to consider briefly what effect the Torrens System of Land Registration has upon the imposition of a constructive trust where the property has been transferred under a conveyance procured by fraud, duress or undue influence. Where the legal title has vested in the wrongdoer and the rights of other third parties have not intervened, the victim is entitled to maintain an action in equity for rectification of the register and for specific restitution of the property. In *Loke Yew v. Port Swettenham Rubber Company Limited*,<sup>68</sup> a case in which the appellant obtained registration free of the plaintiff's unregistered interest by false and fraudulent statements, it was held that 'so long as the rights of third persons are not implicated the wrongdoer cannot shelter himself under the registration as against the man who suffered the wrong.'<sup>69</sup> In *Breskvar v. Wall*<sup>70</sup> the High Court of Australia had to consider the effect of registration procured by actual fraud and in circumstances where registration was obtained under a void instrument. The legal title was held to have been acquired by registration despite the fact that the instrument through which it was acquired was void. Although legal title was acquired, it was a defeasible title because the registration was procured by fraud. The Chief Justice, Justice Barwick held that the registered proprietor held the estate subject to the appellant's right to sue to recover the land and have the register rectified. The appellants' right was described by the Chief Justice as an equitable claim but the appellants did not hold the land on trust for the appellants.<sup>71</sup> Menzies J. also agreed that the appellants did not hold the land in trust

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64. Oakley, *Constructive Trusts*, *supra* n. 5 at 13-14. Oakley states that the courts seem to regard the interest of the transferor as analogous to an interest arising under a trust.

65. *Ibid.*

66. Goff and Jones, *supra* n. 12 at 256.

67. *Ibid.*

68. [1913] A.C. 491.

69. *Ibid.* at 504-5.

70. (1971) 126 C.L.R. 376.

for the appellants<sup>72</sup> while Walsh J. described the appellants right as 'in the nature of an equitable right.'<sup>73</sup> However Gibbs J. went further and assumed in favour of the appellants that after registration by the fraudulent transferee, the appellants 'continued to have an equitable interest in the land rather than a mere equity to set the transfer aside.'<sup>74</sup>

The approach of Gibbs J. in *Breskvar v. Wall*<sup>75</sup> if followed generally would entitle the court to charge the wrongdoer who has become the registered proprietor of the land as a constructive trustee of the land for the victim both before and after a successful claim is brought for rectification or restitution of the property. It would also follow from this that in the event of the bankruptcy of the wrongdoer the victim could enforce the constructive trust and remove the property from the creditors of a bankrupt registered proprietor. Where the wrongdoer has transferred the property to a third party the right of the victim to recover the property as against the third party is not as clear cut. If the third party remains unregistered the usual rules for determining priority between competing equitable interests would apply but where the third party has become the registered proprietor of the land, the third party can rely on statutory provisions which accord to the registered proprietor an indefeasible title whether the third party is with or without notice of the victims prior equitable claim to the property.

The use of the constructive trust as a remedy for the recovery of property procured through fraud, duress and undue influence as well as for other forms of wrongful conduct is well established in the law of the United States and a very comprehensive and clearly established framework for restitution of property thus procured is to be found in the American remedial theory of the constructive trust. By application of this theory recovery is available as follows:

(i) *A wrong by the transferee to a transferor of the property* may give rise to a constructive trust. Where an owner of property is induced to transfer it by fraud, duress or undue influence of the transferee, the transferee holds the property upon a constructive trust for the transferor.<sup>76</sup> Where a person by fraud, duress or undue influence acquires title to property, including land, chattels or money the wrongdoer can be charged as a constructive trustee. If the fraud, duress or undue influence is of such a character that no title has passed to the wrongdoer, the wrongdoer is not regarded as a constructive trustee and no title can pass to a bona fide purchaser. This applies not only where a person wrongfully takes possession of the chattel of another without the consent of another and thereby converts the chattel, but it also applies where the wrongdoer obtains possession without title by fraud or duress. In these situations the wrongdoer is not in American law, a constructive trustee. The legal title to the property remains with the owner and ordinarily the legal title of the owner continues notwithstanding a transfer by the wrongdoer to a bona fide purchaser. Legal remedies rather than a suit in equity for specific restitution are usually adequate in these situations.

Where title to property is acquired by fraud, duress or undue influence from another, the victim is entitled to rescind the transaction and recover the property or its value from the wrongdoer and the wrongdoer holds the property upon a constructive trust for the person from whom he obtained it. However a suit in equity for specific restitution cannot be maintained if the remedies at law such as damages for deceit, conversion or in

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71. *Ibid.* at 387.

72. *Ibid.* at 397-398.

73. *Ibid.* at 406.

74. *Ibid.* at 413.

75. *Ibid.*

76. Restatement of Restitution, S.166, Scott *supra* n. 36 at 3438-3439.



*quasi-contract* are adequate. These remedies can of course be sought whether or not the chattels or money are still held by the wrongdoer. Thus where chattels which are not unique are obtained by the wrongdoer or money is obtained by the wrongdoer, the remedies at law will usually be adequate and hence a suit in equity for specific restitution cannot be maintained. There are also a number of clearly established situations in which the remedies at law are not adequate and a suit for specific restitution is allowed. Where land is obtained by fraud, duress or undue influence the victim has the option of a suit in equity to compel the wrongdoer to convey the land to him and the wrongdoer is chargeable as a constructive trustee of the land for the victim. The wrongdoer is also chargeable as a constructive trustee where the wrongdoer has obtained unique chattels. Where the wrongdoer is insolvent, the victim can maintain a suit in equity to compel specific restitution even where the chattels are not unique and also in cases of money paid to the wrongdoer. Where there is another basis for a suit in equity, specific restitution is also available as for example where the wrongdoer is a trustee or other fiduciary. Many instances of title to property acquired by undue influence involve an abuse of a confidential or fiduciary relationship and hence the basis for a suit for specific restitution will exist even 'although no relief would be given in equity because of the adequacy of the remedy at law if the property had been acquired by fraud or duress by one not in a fiduciary relation.'<sup>77</sup>

Where the wrongdoer has paid value for the property and the victim has elected to rescind the transaction, the wrongdoer is entitled to receive back the consideration which he gave for the property. The victim has the option of either keeping the consideration and allowing the wrongdoer to keep the property or the victim can rescind the transaction and recover the property but when rescission is sought by the victim, he must restore the consideration. Where the victim has received property from the wrongdoer in exchange for the property transferred, the victim when seeking the return of the property transferred must restore to the wrongdoer the property that he received in exchange from the victim. The wrongdoer does not forfeit the property given in exchange merely because he obtained the property transferred to him wrongfully.

A wrongdoer who has acquired title to the property by fraud, duress or undue influence may transfer the property to a third person and the third person may be chargeable as a constructive trustee of the property for the victim if the third person has notice of the wrong or does not pay value for the property. Where the third person is a bona fide purchaser, the third person is entitled to take the property free of the constructive trust. In summary then the victim can trace the property into the hands of a third party to whom the fraudulent transferee has transferred it so long as the third party is not a bona fide purchaser.

In order to maintain a suit for specific restitution of the property acquired by fraud, duress, or undue influence, the property must remain *in specie* in the hands of the wrongdoer or in some other converted form. Where the property so obtained has been converted into or exchanged for other property, the constructive trust can still attach to such property and the property into which the original property has been converted or exchanged can be followed except where the property has passed to a bona fide purchaser for value without notice.

It is not clear whether the principles outlined above also apply where a thief has stolen or misappropriated property and it is not clear whether the holder of the proceeds of stolen property or property purchased out of the stolen property is chargeable as a constructive trustee. A suit to recover the property by way of a constructive trust could be defeated on the ground that the thief has not acquired title to the property and also for reason that there

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77. Restatement of Restitution, S.166.

are other available and adequate remedies at law. For these reasons some American courts have held that a thief is not chargeable as a constructive trustee of the property for the owner of the stolen property or of the proceeds therefor of the property into which it has been converted, when no fiduciary relation exists between the owner of the property and the thief. Where a fiduciary relation exists between the owner of the property or money, the American courts have been prepared to charge the thief as a constructive trustee of the money or property. Some courts have also charged the thief as a constructive trustee of stolen property or money even when there is no fiduciary or confidential relationship between the owner of the property and the thief or embezzler.<sup>78</sup>

(ii) *A wrong by a third person to a transferor of property* may give rise to a constructive trust. Where an owner of property transfers the property to another and has been induced by fraud, duress or undue influence of a third party, the transferee is chargeable as a constructive trustee of the property for the transferor except where the transferee is a bona fide purchaser for value who has given or promised to give value for the property and has done so before receiving notice of the fraud duress or undue influence.<sup>79</sup> A transferee who is a donee will hold the property upon a constructive trust irrespective of whether the donee is with or without notice that the transfer was induced by the fraud, duress or undue influence of a third party. This is in no way altered by the fact that the third party wrongdoer has paid value for the transfer to the transferor. A court is not precluded from charging a gratuitous transferee as a constructive trustee when the transferee has no notice of the fraud, duress or undue influence of the third person. This situation is considered to be in substance the same as if the third person had by fraud, duress or undue influence obtained the transfer of the property and then gratuitously transferred the property to another.

Where the transferee of the property has notice of the wrongful conduct of the third person prior to giving or promising to give value for the property, the transferor may rescind the transaction and charge the transferee as a constructive trustee of the property. Where the transferee has received the property as a bona fide purchaser for value without notice of the fraud, duress or undue influence, by the third party, the transferee cannot be held to be a constructive trustee of the property. This defence can be relied upon where the transferee pays value to the transferor under a bargain between the transferor and the transferee in circumstances where the transfer is induced by the fraud, duress or undue influence of a third party. The transferee can also claim to be a bona fide purchase even if the transferee has not paid value but has only made a promise which is sufficient consideration to support a contract. The transferee is therefore protected if the transferee has promised to pay a consideration for the promise and is at the time of entering the bargain, without notice of the fraud, duress or undue influence exerted by the third person.

The transferee may be able to claim the property as a bona fide purchaser for value without notice where the transferee has entered into a bargain with the third party who by fraud, duress or undue influence has induced the transferor to transfer the property directly to the transferee. A transferee must have paid value in order to be entitled to the property and a mere promise of something of value made to the third person is not sufficient to satisfy this requirement even although the transferee has received the property directly from the transferor. This situation is regarded as in substance the same as though the third person had by fraud, duress or undue influence obtained a transfer of the property and then subsequently transferred it to a bona fide purchaser for value without notice. It does not matter whether the transaction between the transferor and the third party wrongdoer is gratuitous or for value.

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78. 89 C.J.S. S.146

79. Restatement of Restitution S.167; Scott *supra* n. 36 at 3442-3444.

(iii) *A transferee of property may also be chargeable as a constructive trustee of the property for a third person* when the transferee has acquired the property from another by fraud, duress or undue influence. It is necessary to establish that the circumstances are such as to entitle the third person to restitution from the transferee. This will arise when the transferee has acquired the property from a transferor by fraud duress or undue influence in circumstances which prevent the transferor from transferring the property to a third person to whom the transferor would have transferred the property but for the fraud, duress or undue influence of the transferee. This will be the case where the transferor is under a specifically enforceable duty to a third party to transfer the property to a third party.<sup>80</sup> In these circumstances the third party has an equitable interest in the property and the transferee who has obtained the property by fraud, duress, or undue influence is chargeable as a constructive trustee of the property for the third party except where the transferee holds the property as a bona fide purchaser for value without notice. Even where the third party has no equitable interest in the property the transferee may still be chargeable as a constructive trustee for the third party where the third party has a personal claim against the transferor as for example where a debtor is induced by fraud, duress or undue influence to pay the debt to someone other than the creditor entitled to the money. The payee is chargeable as a constructive trustee for the creditor unless the debtor has rescinded the transaction. A solvent debtor can rescind the transaction if the creditor has not received payment from the payee or the creditor has not elected to surrender his claim to the debtor and to accept his claim against payee in lieu thereof. A debtor cannot rescind after insolvency and thereafter the creditor is entitled to recover the money from the payee and to charge the payee as the constructive trustee of the money, just as a creditor in the event of the insolvency of a debtor can charge the payee as a constructive trustee of money that a debtor has by mistake paid to the payee.

A transferee of property may also be required to make restitution to a third party when the transferee has obtained the property from the transferor by fraud, duress or undue influence and the transferee knows that but for the fraud, duress or undue influence, the transferor would have made a gift of the property to the third party. The transferee can be charged as a constructive trustee of the property for the third party (the intended donee) and the court can compel the transferee to make specific restitution to the third party so long as the transferor has not rescinded the transaction. The transferor's right to rescind the transaction terminates when the transferor dies and in that event the third party as the intended donee is entitled to restitution of the property from the transferee.<sup>81</sup> In addition where a person intending to dispose of property by will to a third party is prevented from disposing of the property by will to the third party, by fraud, duress or undue influence and the property instead goes to the wrongdoer by will, the wrongdoer can be charged as a constructive trustee of the property for the third party.

In all of the above instances where the transferee is required to restore the property to a third party, the underlying principle is that where a person had acquired property by fraud, duress or undue influence, the transferee can be compelled to surrender the property to the person who would have received the property but for the fraud, duress or undue influence. Statutory provisions in some states of the United States have expressly recognized this principle by providing that a transferee who has gained property by fraud or other wrongful

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80. Restatement of Restitution, S.169; Scott, *supra* n. 36 at 3447-3450.

81. As previously noted when the transferor has by mistake transferred property to a person other than the intended donee the transfer can be rescinded even after the death of the transferor except where the third party as the intended donee is the natural object of the transferor's bounty.

act holds the property as an involuntary trustee for the benefit of the person who would otherwise have had it.

(iv) *A wrong by a transferor of property to a third person* may give rise to a constructive trust. The transferee of the property may be chargeable as a constructive trustee of the property for the third party. Where a person holds property in which another has a beneficial interest transfers title to the property to a transferee in violation of his duty to the third party who is entitled to the beneficial interest in the property, the transferee is chargeable as a constructive trustee of the property for the third party except where the transferee is a bona fide purchaser for value without notice. The transferee is not chargeable as a constructive trustee where the transferee has only received possession of the property but not title to the property. The beneficial interest of the third party which entitles the third party to charge the transferee as a constructive trustee may arise in a variety of ways including as an interest under a trust, as an equitable mortgage, and as an equitable interest of a purchaser under an executory contract which is specifically enforceable. The effect of regarding the transferee as a constructive trustee is that the equitable interest of the third party can only be cut off by a transfer to a bona fide purchaser for value without notice.

A wrong to a third party by a transferor may also arise from a transfer of property in fraud of a third party in circumstances where the third party does not have an equitable interest in the party prior to the transfer. The transferee can be charged as a constructive trustee of the property for the third party so long as the transferee is not a bona fide purchaser. A fraud upon a third party sufficient to charge the transferee as a constructive trustee can include a fraud upon creditor, a fraud upon a spouse, or a fraudulent exercise of a power of appointment.

(v) *A mistake or wrong that induces improvements to the property of another and thereby increases the value of the property* may give rise to an *equitable lien* over the property but not a constructive trust.<sup>82</sup> The equitable lien can be used to provide relief whenever a person has made improvements upon the property of another or otherwise increased the value of the property and the person who has made the improvements has done so as the result of fraud, duress or undue influence or as the result of a mistake which is of such a character as to entitle the person who made the improvements or increased the value of the property, to specific restitution of the improvements or increase in value so conferred. An equitable lien rather than a constructive trust is used as the remedy because the improvements cannot be severed from the land or chattels and hence it is not possible to effect restitution by ordering the owner to surrender the land or chattels. Therefore instead of using the constructive trust, the courts can effect restitution by way of an equitable lien upon the property and the equitable lien operates as a security which entitles the holder of the lien to priority over the general creditors of the owner of the property. The general creditors are not regarded as bona fide purchasers and they are not permitted to benefit from the wrongful conduct of the owner of the property or from the mistake. Where the improvements or the provision of services, are induced by fraud, duress, or undue influence, the party induced to make the improvements or to provide the services, can enforce the equitable lien and recover the value of the improvements or any services rendered. The amount that is recoverable is not limited to the amount of the increase in the value of the property that results from the expenditure or services provided. Where the improvements are made under a mistake and the owner of the property is not at fault, the person who has made the improvements in circumstances that entitle him to restitution,

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82. Restatement of Restitution, S.170; Scott, *supra* n. 36 at 3451-3452.

can only recover the amount by which the value of the property has increased and is therefore not necessarily entitled to the full amount of his expenditure. The security obtained through the imposition of an equitable lien would be limited to the amount of the increase in value of the property which is the result of the mistake.

(vi) *A mistake or wrong which induces another to discharge an obligation or lien* may entitle the person discharging the obligation or lien, to be *subrogated to the position of the obligee or lien-holder*<sup>83</sup> Subrogation is available as a form of relief where a person has discharged an obligation owed by another or a lien upon the property of another and has been induced to do so by fraud, duress or undue influence of the obligor or owner of the property. It may also arise where a person has discharged an obligation or a lien as the result of a mistake of such a character that the person discharging the obligation is entitled to restitution. Relief by way of subrogation is not available where a person officiously discharges the debt of another without any inducement by way of fraud, duress, or undue influence or by mistake in circumstances where the person is not under an obligation as a surety or in some other way, to discharge the debt and does not have any interest of his own to preserve by the discharge of the debt. Whether the person who discharges the obligation or who has any right to restitution from the obligee or lien holder depends upon whether the obligee or lien holder is a bona fide purchaser

### Conclusion

There seems to be no doubt that in England and Australia, the constructive trust can be used as a remedy for effecting the specific restitution of property acquired by mistake, fraud, duress or undue influence. However a coherent and detailed framework for the use and application of the constructive trust in the event of property passing in such an event still has to be worked out. In particular the function of a fiduciary relationship in such cases remains unclear, in the case of mistake there are no detailed principles with respect to the character of the mistake which will give rise to a constructive trust, confusion still exists as to the time at which the constructive trust arises, no detailed principles have been laid down in relation to the effect of a wrong by a third party or as to the effect of a wrong to a third party and nor has any attempt been made to work out in any detail the circumstances which will entitle a third party to restitution. In addition the elaboration of a detailed framework to deal with these and other matters will also require the introduction of the equitable lien as a remedy for improvements made to another's property as the result of a mistake or wrong, and it will also require the introduction of a right of subrogation where the mistake or wrong results in the discharge of an obligation or lien. These shortcomings have been highlighted in this article through a comparison with the American remedial theory of the constructive trust, which provides a detailed framework of principle in relation to the matters just mentioned. It is therefore suggested that English and Australian judges and academics should turn to American cases and academic writings on Restitution for guidance as they embark upon the development of the constructive trust as remedy for the restitution of property acquired by mistake, fraud, duress or undue influence.

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83. Restatement of Restitution, S.171; Scott, *supra* n. 36 op.cit. at 3453.