Introduction

The courts have often been concerned with the issue of the circumstances in which the law allows a plaintiff's claim to rank in priority to the general creditors of an insolvent defendant by awarding a proprietary remedy.¹

Where a court awards a proprietary remedy against a solvent defendant, there is little significance, as far as third parties are concerned, in the fact that the remedy is proprietary rather than personal in nature.² For, in that case, even if the defendant was not required to meet the claim out of specific property in his or her hands (or, even if the plaintiff was not given a claim attaching to specific property in the defendant's hands), the defendant would be able to meet the amount of the claim out of his or her general assets.

Where, however, the court awards a proprietary remedy against an insolvent defendant, a number of consequences relevant to third parties follow. The remedy attaches to specific property in the defendant's hands so that the plaintiff is either entitled to a transfer of the property, or the plaintiff's claim must be met out of that specific property. Consequently, to that extent, the property to which the remedy attaches is not available for the general creditors in the insolvency. That is, in the case of an insolvent defendant, an award of a proprietary claim prefers the plaintiff to the general unsecured creditors of the defendant.

It is clear that the circumstances in which the courts will award a proprietary remedy are very significant in the case of an insolvent defendant. Consequently, the boundaries of such a claim are also important.

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¹ Eg Barclays Bank Ltd v Quistclose Investments Ltd [1970] AC 567.
² As between the plaintiff and the defendant, of course, whether the remedy awarded is personal or proprietary can be very important. It can determine whether the plaintiff recovers the increase in value of particular property or, as shall be seen below, whether compound interest can be awarded.
The boundaries of a proprietary claim have been examined by the House of Lords in the case of Westdeutsche Landesbank Girozentrale v Islington London Borough Council. This case comes 10 years after our High Court awarded proprietary remedies in the case of unconscionability. It is an appropriate time to consider the boundaries of the bases for proprietary claims following consideration by the highest courts in two common law jurisdictions.

Although the principles discussed in this paper are generally applicable to all proprietary claims, this paper concentrates on the constructive trust.

This paper examines the existing bases of proprietary claims, a pre-existing connection with property and a pre-existing fiduciary relationship, before looking at whether those requirements are properly expanded by other bases. It then suggests that the existing bases are appropriate for a traditional institutional constructive trust, but that it may be appropriate to award a remedial constructive trust on the basis of unconscionability. However, the paper suggests that such an order is not appropriate between commercial parties dealing at arms' length where there is no pre-existing equitable obligations on either party with respect to the relationship with the other.

**Traditional Bases of Proprietary Claims**

The traditional bases of proprietary claims are well established. This paper does not propose to trace the development of the principles.

It is clear from such decisions as Westdeutsche and Hospital Products Ltd v United States Surgical Corporation, and academic writing such as that by Glover that the traditional requirements for the establishment of a proprietary claim are the existence of pre-existing connection with property established by showing that there is a pre-existing fiduciary relationship between the plaintiff and the defendant.

This has been thought by the courts to be a sufficient basis for preferring a plaintiff over the general unsecured creditors of a defendant because there has been some interest in the property other than the insolvent defendant's interest since it was in the hands of the defendant.

However, it is clear that the courts have sometimes struggled with this basis in circumstances where the courts have clearly wanted to award a proprietary remedy and yet have had difficulty in establishing that a pre-existing fiduciary relationship existed. Two cases which illustrate this are Sinclair v Brougham and Chase Manhattan Bank NA v Israel-British Bank (London) Ltd.

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4 See Muschinski v Dodds (1985) 160 CLR 583; Baumgartner v Baumgartner (1987) 164 CLR 137.
7 [1914] AC 398.
8 [1981] 1 Ch 105.
In Sinclair v Brougham, the court held that the deposits to a company which did not have the power to carry on a banking business were held in such a way that gave rise to a proprietary claim in equity. However, the judges did not agree on the reasons for allowing such a claim. On any view, the court had a great deal of difficulty in fitting the case within the traditional bases of proprietary claims.

The Lord Chancellor, Viscount Haldane considered that in the circumstances there arose a resulting trust in favour of the depositors. With respect, it is difficult to see how a resulting trust could arise in circumstances where there appeared to be no intention on the part of the depositors to reserve any beneficial interest to themselves. Indeed, why should the depositors have considered the issue? When the money was deposited it was the intention of the depositors that full legal and beneficial title (or at least absolute legal title since the beneficial interest was not separated out) be transferred to the corporation immediately in return for a chose in action. The fact that the chose in action was ultra vires and therefore void ab initio only became known later. It seems impossible to believe that, in anticipation of such a situation, the depositors reserved some beneficial interest to themselves or established a Quistclose trust.

Lord Parker, it is suggested, tried to fit the case within the established principles for awarding proprietary claims by holding that the money had been received by the directors of the corporation as fiduciaries. Again, with respect, it is difficult to see how the facts of the case could be interpreted in this way. First, it seems quite clear that the money was in fact paid to and received by the corporation itself and not the directors. Secondly, it is hard to see that the relationship between the depositors and the directors was sufficiently redolent of trust confidence such that a fiduciary relationship arose.

The other judgments dealt with the issues in ways that are not directly relevant here.

In Re Diplock, the Master of the Rolls, Lord Greene, interpreted Sinclair v Brougham to decide that sufficient fiduciary relationship had been found to exist between the people who had deposited money and the directors of the company because the purpose for which they had given their money to the directors was incapable of being fulfilled. With respect, this view is subject to the same objections as Lord Parker's view. Also, why should the subsequent failure of a purpose give rise to a fiduciary relationship if the parties did not consider that eventuality?

In Chase Manhattan, the court held that a payment made under a mistake of fact gave rise to fiduciary relationship between the payer and payee. One need not look far to see the difficulty with this proposition. To suggest that a fiduciary relationship should exist because of an event of which both parties were ignorant is stretching

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9 [1914] AC 398 at 421.
10 Ibid at 441.
11 In re Diplock [1948] Ch 465 at 540-541.
12 Compare Barclays Bank Ltd v Quistclose Investments Ltd [1970] AC 567 where the parties did consider that eventuality.
equity's jurisdiction over the conscience to include the subconscience. It is impossible, in my view, to say that a relationship sufficiently redolent of trust and confidence can exist when neither party knew of the circumstances said to bring them into that relationship. Further, the case clearly does not fall into any established category of fiduciary relationship such that there might have been some presumption or habitual bias in finding that a fiduciary relationship exists. On the other hand, it is clear that the plaintiff bank had a personal restitutary claim for moneys had and received. But this claim should not have preferred that plaintiff bank to other creditors of the defendant.

If those two cases did not establish the traditional principles by establishing a fiduciary relationship, should the traditional bases be expanded to include those circumstances? This was considered by the House of Lords in Westdeutsche.

In Westdeutsche, the Islington London Borough Council entered into a financing arrangement called an interest rate swap. Essentially, this is a derivatives contract whereby the financier pays a lump sum at the start of the agreement equivalent to interest at a fixed rate on a notional capital sum (that is never paid). The borrower agrees to pay interest payments, in this case every six months, according to a particular prevailing interest rate taken at a particular time for each six months. In this sense, the borrower is taking a "bet" that the interest rates at the times the payments are made will be less than the fixed rate amount, or at least that the cost of the finance will be no more than at prevailing commercial rates.

The parties entered into the arrangement in June 1987. As part of that arrangement, the bank initially paid, £2.5M to the council. However, in November 1989, a separate case held that local authorities did not have the power to enter into interest swap transactions. At that time, the council had made four six monthly payments, totalling approximately, £1.35M. The bank commenced an action for the balance of the, £2.5M as well as compound interest from the date of the agreement in June 1987.

At first instance, Hobhouse J\textsuperscript{13} gave judgment for the bank for the balance of the, £2.5M and compound interest from 1 April 1990.

In the Court of Appeal, Dillon, Leggatt and Kennedy LJJ dismissed the council's appeal and allowed the bank's cross-appeal that compound interest should run from the date of the agreement and not the later date awarded by the trial judge.

The Court of Appeal held that the bank had a claim on two bases. First, it had a claim for moneys had and received in restitution founded on quasi contract or unjust enrichment. Secondly, since the purpose for which the money was paid by the bank to the Council had wholly failed, the Council had held the money from the time it had received it on resulting trust for the bank.

The Council's argument that, since it had made some interest repayments to the bank, the consideration for the payment of the, £2.5M by the bank had not wholly failed was considered by Dillon LJ to be "repugnant to common sense".\textsuperscript{14}

\textsuperscript{13} (1993) 91 LGR 323.

\textsuperscript{14} [1994] 1 WLR 938 at 943.
The trial judge considered that, as the agreement was *ultra vires* and therefore void, there was no consideration for the payment of the, 2.5M by the bank. In that sense, the consideration had wholly failed. However, as Dillon LJ points out,\(^{15}\) that type of case is better described as a case where there has been no consideration rather than where the consideration has wholly failed.

The alternative, equitable basis of the claim was that:

contrary to the expectation of the parties, the swap transaction and contract are... *ultra vires* and void... and the, £2.5M has, from the time the Council received it, been held on resulting trust for the bank.\(^{16}\)

In this regard, Dillon LJ relied on the speech of the Lord Chancellor, Viscount Haldane, in *Sinclair v Brougham.*\(^{17}\)

In the House of Lords,\(^{18}\) the leading judgment was delivered by Lord Browne-Wilkinson.\(^{19}\) The issue on the appeal revolved around the fact that:

In the absence of fraud, courts of equity have never awarded compound interest except as against a trustee or other person owing fiduciary duties who is accountable for profits made from his position.\(^{20}\)

As no fraud was suggested, the plaintiff bank had to show that the council was a trustee or otherwise a fiduciary in respect of the payment to it by the bank.

His Lordship pointed out that the bank’s arguments had important practical consequences if correct:

However, the creation of an equitable proprietary interest in moneys received under a void contract is capable of having adverse effects quite apart from insolvency. The proprietary interest under the unknown trust will, quite apart from insolvency, be enforceable against any recipient of the property other than the purchaser for value of a legal interest without notice.\(^{21}\)

His Lordship also pointed out the significance of the arguments of the bank in the case of an insolvent defendant. However, this case was not one of insolvency, the council having ample funds to meet the claim.

His Lordship pointed out that there is need for caution when applying equitable principles to the commercial world:

\(^{15}\) *Ibid* at 945.
\(^{16}\) *Ibid* at 947.
\(^{17}\) [1914] AC 398 at 418.
\(^{18}\) [1996] 2 WLR 802.
\(^{19}\) *Ibid* at 822.
\(^{20}\) *Ibid* at 825.
\(^{21}\) *Ibid* at 827.
... wise judges have often warned against the wholesale importation into commercial law of equitable principles inconsistent with the certainty and speed which are essential requirements for the orderly conduct of business affairs.22

This caution should, in my view, be at the forefront of the minds of the courts developing the boundaries of proprietary claims. This point is discussed later in the paper.

The bank’s argument that, because it only intended to part with its beneficial ownership of the moneys in performance of a valid contract, the beneficial ownership did not pass in this case, was disposed of in the following way. The bank, having the absolute legal title to the money held one undivided title and no separate legal interest existed when payment was made to the council. Further, at that time, it was clear that the bank intended that the council receive the absolute use of the money and that the money formed part of the general assets of the council.

The further submission that the equitable interest in the money was still held by the bank and, because there was a separation of the legal and beneficial interests, the council must have held the beneficial interest on trust with the bank, was also rejected. Lord Browne-Wilkinson pointed out that there are cases where there is separation of legal and beneficial interest without the existence of a trust. In any event, the council could not have held the money on trust at least until it knew that the contract was void. By this time, the money was already mixed with other money of the council and indeed had been dissipated.

The bank’s argument that the payment to the council created a resulting trust was rejected on the basis that there was no express trust that had failed or been capable of being wholly carried out such that a resulting trust arose.

The attempt by Professor Birks to expand the role of resulting trusts to cover remedies for unjust enrichment in circumstances where traditional principles of resulting trusts would have meant that they would not have been awarded was firmly rejected by Lord Browne-Wilkinson who pointed out that such a development would have the capacity to affect adversely third parties who had dealt with defendants on the basis that they owned the property in their hands in circumstances where all concerned were ignorant of the mistake or other vitiation which, according to Birks, would later render the property held on resulting trust, and so outside the general assets of the defendant available for general creditors.

It seems clear that any development of proprietary claims will not be made via an expansion of the circumstances in which resulting trusts will be awarded. That fact should be welcomed.

The bank’s case was primarily founded on Sinclair v Brougham. However, as pointed out above, the reason the Court in that case felt the need to find an equitable proprietary claim in the circumstances was that the law of restitution was not sufficiently developed to cope with the facts of the case. It is clear that, now, on the facts

22 Ibid at 828.
of *Sinclair v Brougham* a personal restitutionary claim at common law for moneys had and received would be available to the depositors. The perceived limitation of restitutionary claims to where there was an implied contract, in my view, lead the Court to stretch their reasoning on equitable proprietary claims in such a way that has not withstood the scrutiny of time.

Lord Goff decided the case on a different basis, but did discuss *Sinclair v Brougham*:

> For present purposes, I approach this case in the following way. First, it is clear that the problem which arose in *Sinclair v Brougham*, viz. that a personal remedy in restitution was excluded on grounds of public policy, does not arise in the present case, which is not of course concerned with a borrowing contract. Second, I regard the decision in *Sinclair v Brougham* as being a response to that problem in the case of ultra vires borrowing contracts, and as not intended to create a principle of general application. From this it follows, in my opinion, that *Sinclair v Brougham* is not relevant to the decision in the present case. In particular it cannot be relied upon as a precedent that a trust arises on the facts of the present case, justifying on that basis an award of compound interest against the council.23

With respect, the view Lord Goff took of *Sinclair v Brougham* is a little too convenient and fails to deal with the issue of whether any of the principles laid down in that case are correct. However, to my mind, his Lordship is not trying to defend the principles in that case and could not be taken to be seriously opposing the view of the majority on this point. Apart from the passage quoted above, support for this is found in the difficulties his Lordship identifies in following the approach suggested by Birks that the role of resulting trusts should be expanded to cater for the situation at hand.

> There is no general rule that the property in money paid under a void contract does not pass to the payee; and it is difficult to escape the conclusion that, as a general rule, the beneficial interest to the money likewise passes to the payee. This must certainly be the case where the consideration for the payment fails after the payment is made, as in cases of frustration or breach of contract; and there appears to be no good reason why the same should not apply in cases where, as in the present case, the contract under which the payment is made is void ab initio and the consideration for the payment therefore fails at the time of payment.24

In any event, it is clear that his Lordship decided that the bank did not have a proprietary interest in the circumstances of the case.25 Indeed, none of the law lords suggested otherwise. Consequently, in my view, the House of Lords has definitively established that an institutional constructive trust does not lie where

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23 *Ibid* at 812 to 813.
24 *Ibid* at 814.
25 *Ibid* at 815.
money has been paid under an ultra vires transaction. That is, such a payment does not give rise to a fiduciary relationship or any other relationship sufficient to found a proprietary claim, and the boundaries of the bases for awarding institutional constructive trusts will not be extended to include such a situation. I think it must also follow from the majority’s approach to *Chase Manhattan* that the same two points are good in relation to money paid under a mistake.

Despite the fact that, in *Westdeutsche*, the House of Lords was unable to find a basis for the award of compound interest, in my view there is no cause for the law to stretch itself unduly to accommodate such a claim. It is open to the legislature to give the courts power to award compound interest or, in cases like *Westdeutsche*, is open to the parties, specifically financiers, to protect their interests by a side agreement or deed to the effect that, if a borrower does not have the power to enter into the transaction, it will repay the money and pay compound interest. It may be considered that such a document would involve an unrealistic expectation of far sightedness, but such provisions are not uncommon. For example, many agreements commonly entered into by trustees have provision that the trustee has power to enter into transaction.

So it seems that the constructive trust will not be called in aid of a restitutionary claim without more. That is clearly a divergence from the United States position and also the Canadian position. However, in my view it is the correct approach to the issue under Australian law. There is clear support for this proposition in the judgment of Gummow J (in the Full Federal Court) in *Re Stephenson Nominees Pty Ltd.* After warning that a constructive trust is not always the appropriate remedy to express a right to restitution and against too readily confounding ownership (constructive trust) with obligation (eg to account), his Honour says:

Care is called for against overemphasising the role of the constructive trust in this area. Whilst the constructive trust may readily, in many cases, be seen as a restitutionary remedy for an unjust enrichment at the expense of the plaintiff, this by no means always will be the case. The constructive trust may be imposed as a cautionary or deterrent remedy even where there has been no unjust enrichment at the expense of the plaintiff. For example, leading cases have made it plain that it is no answer to the application to company directors of the rule forbidding fiduciaries placing their interest in conflict with their duty, that the profits they have made are of a kind the company itself could not have obtained or that no loss to the company is caused by their gain ..... In such situations the constructive trust operates not to restore to the company that of which it was deprived by the conduct complained of, but to enforce observance of the fiduciary duty not to prefer personal interest to duty to the plaintiff.

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Indeed, if a constructive trust were awarded as a matter of course for restitutionary claims, one is entitled to ask why should restitutionary claimants be preferred over claimants in contract or tort?

I think that the following principles can be distilled from the cases regarding when an institutional constructive trust (or other proprietary claim) will be awarded.

In order to establish a proprietary claim, it will generally need to be established by the plaintiff that there is some pre-existing equitable obligations owed by the defendant to the plaintiff (for example, fiduciary duties or obligations of confidence) founding some connection with property in the defendant’s hands.\textsuperscript{30}

The only area that warrants specific mention here is that this general principle now extends to the award of proprietary claims against fiduciaries who have accepted bribes. The recent Privy Council case of \textit{A-G (Hong Kong) v Reid}\textsuperscript{31} established this, overruling the old authority of \textit{Lister v Stubbs}.\textsuperscript{32}

This paper now turns to consider the categorisation of constructive trusts before considering the alternative bases and the types of constructive trusts they relate.

\section*{Categorisation of Constructive Trusts}

There are three ways in which the term constructive trust is used. It is important to understand the context in which the term is used in a given case to properly understand the consequences that flow from its award. In any case, it is essential to recognise the discretionary nature of the remedy in the hands of a court of equity.

The first is what is generally referred to as the traditional or institutional approach. That is, where a constructive trust is considered to be like an express trust in that it attaches to property and arose at some time when the fiduciary obligations owed by a particular party were later to be considered by the court to be such that the fiduciary was constructive trustee of the property. What distinguishes the institutional constructive trust from express and implied or resulting trusts is that, in the case of constructive trusts, the parties do not have the intention of creating a trust relationship.

Secondly, constructive trust is used as the term to describe a remedy awarded by a court of equity in the circumstances where there has been no pre-existing fiduciary relationship between the parties or other equitable obligations owed by the defendant to the plaintiff. Examples of this are the Australian High Court cases of \textit{Muschinski v Dodds}\textsuperscript{33} and \textit{Baumgartner v. Baumgartner}.\textsuperscript{34} In this context, the court has decided that a remedy should attach to property because of the conduct of

\begin{itemize}
\item \textsuperscript{30} Gummow makes it clear that proprietary claims are available for any violation of equitable duty, not just for a breach of fiduciary relationship: "Unjust Enrichment, Restitution and Property Rights" in PD Finn (ed) \textit{Essays on Restitution} Law Book Co Sydney 1990, p 74.
\item \textsuperscript{31} [1993] 3 WLR 1143.
\item \textsuperscript{32} (1890) 45 Ch D 1.
\item \textsuperscript{33} (1985) 160 CLR 583.
\item \textsuperscript{34} (1987) 164 CLR 137.
\end{itemize}
the defendant and perhaps the respective positions of the plaintiff and defendant. This leads Goode to describe it as a wrong based remedy.\textsuperscript{35} In this case the remedy is not akin to a trust, but is merely a remedy attaching to specific property. The other fundamental difference for this type of remedy is that it will normally not backdate to a time before the order of the court. However, once again, it is discretionary and the courts would have the discretion to allow it to operate so as to prefer the plaintiff to the unsecured creditors of the defendant by declaring it to have existed at some date prior to insolvency.

There is clear support for this analysis in the judgment of Lord Browne-Wilkinson in \textit{Westdeutsche}:

Under an institutional constructive trust, the trust arises by operation of law as from the date of the circumstances which 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 possibly unfair consequences to third parties who in the interim have received the 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.\textsuperscript{36}

The only comment that need be made is that insofar as his Lordship may be taken to be suggesting that a court has no discretion whether or not to award an institutional constructive trust, such a view is not the law in Australia. A recent example of this is the High Court decision of \textit{Warman International Ltd v Dwyer}.\textsuperscript{37} For my part I do not think that he is suggesting that. In my view, his Lordship is saying that, once awarded, the consequences of an institutional constructive trust flow without discretion, not that the award itself is not discretionary.

Of these two types it can be said, as Glover puts it that \textit{"in proprietary terms, this remedy performs a generalised restitutionary function"}.\textsuperscript{38}

Thirdly, the liability of a third party for knowing assistance in a breach of fiduciary duty is sometimes referred to as that of a constructive trustee. In my view, this is a misnomer. There is no property to which the remedy attaches in that case. It is simply an equitable remedy to account as if the defendant were a constructive trustee. Fundamentally, it is a personal liability not relating to any specific property. For these reasons, it should not be considered in a discussion of proprietary claims.


\textsuperscript{36} \textit{Ibid} at 837.

\textsuperscript{37} (1995) 128 ALR 201.

\textsuperscript{38} "Equity, Restitution and the Proprietary Recovery of Value" (1991) \textit{UNSWLJ} 14 (2) 247 at 258.
Alternative Bases for Proprietary Claims

There has been some criticism of the traditional bases as being arbitrary and not relating to the merits of each claim.\(^{39}\) Perhaps it is for this reason that academics have sought an alternative basis founded more on the justice of each case. The possibilities raised in the cases and some of those by academic writers are discussed briefly below. In \textit{Sinclair v Brougham} it was argued that payment of money which was ultra vires the recipient to receive in that capacity gave rise to an equitable proprietary claim.

In \textit{Chase Manhattan Bank NA v Israel-British Bank (London) Ltd} \(^{40}\) a payment made under mistake was held to give rise to an equitable proprietary claim.

It would seem that, following \textit{Westdeutsche}, neither of those bases can be sustained as bases for an equitable proprietary claim.

However, in \textit{Westdeutsche} the House of Lords left open the possibility of a proprietary claim being awarded on the basis of unconscionability. This approach has already been adopted by the High Court.

In \textit{Muschinski v Dodds},\(^{41}\) the High Court awarded a constructive trust in respect of a part interest in land on the basis that it would be unconscionable for a legal title holder to assert his legal title without recognising a contribution from his de facto spouse. This was clearly not based on any pre-existing equitable relationship or proprietary interest. It was a case of the court creating an equitable interest where none had existed before. Yet the court was careful to disavow any free ranging jurisdiction to award a constructive trust whenever justice and good conscience require it.\(^{42}\) It is important to note, in my view, that this was a case of adjusting rights in a domestic situation. In my view, the court is entitled to take a more flexible approach in such cases. Paciocco sees many good reasons for a different approach in domestic and commercial cases.\(^{43}\) Further, it was not a case of insolvency and so the court had no cause to consider the issues which, in my view, are very influential in deciding the best course of the development of this area of the law.

\textit{Muschinski v Dodds} was applied by the High Court in \textit{Baumgartner v Baumgartner}.\(^{44}\) In that case, a de facto couple contributed to the cost of a house in which they lived. It was held that the man who held legal title, held the house for them both in proportion to their contributions with a charge in his favour for the amount of a capital contribution made by him out of the proceeds of sale of his previous dwelling. Once again, in the context of a non-insolvency, domestic situation, the court created equitable rights where none had existed on the basis of

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39 See eg Glover \textit{supra} n 6.
42 In Canada, La Forest J in \textit{Lac Minerals Ltd v International Corona Resources Ltd} (1989) 61 DLR (4th) 14, referred to Deane J's judgment in \textit{Muschinski v Dodds} and said he did not agree with the view that a proprietary remedy can be imposed when it is "just" to do so without further guidance.
43 \textit{Supra} n 27 at 325.
44 (1987) 164 CLR 137.
unconscionable conduct.

The consequences of expanding the bases of proprietary claims must be considered carefully before the courts take any steps in that direction. Any adoption of an alternative basis of the types mentioned above must face at least two problems.

First, if greater flexibility is to be allowed to award proprietary remedies where justice requires it (in whatever intellectually satisfying costume that is put) it merely begs the question what the limits of such a principle are. In the most discretionary areas of the law the courts and certainly litigants search for principles underlying the exercise of the discretion.

Secondly, and a related point is that such an approach clearly goes against the warnings of the need for certainty of property ownership especially in commercial dealings recently echoed by Lord Browne-Wilkinson in *Westdeutsche*. This is especially important in cases of commercial parties dealing at arms' length.

That is not to say that proprietary remedies should not be allowed in other than the traditional cases, but that those issues must be satisfactorily addressed before they are.

For the reasons mentioned above, unconscionability is the only possible new basis for a proprietary claim. In my view, unconscionability is a sufficient basis for awarding proprietary claims, but only in some circumstances and subject to the courts' careful use of its discretion such that the award is only backdated in appropriate circumstances.

The paper now turns to consider this possible basis.

**Unconscionability as the Basis of a Proprietary Claim**

Where a court awards a constructive trust as a remedy on the basis of the unconscionability of the defendant, it is imposing obligations where none existed before. This is in contrast to where a constructive trust is awarded on the basis of a pre-existing fiduciary or other equitable relationship. That is, unconscionability of itself does not give rise to an equitable proprietary interest unless and until a court of equity in its discretion awards such an interest.45

Because there has been no pre-existing relationship giving rise to obligations on the part of the defendant, at least before the judgment, the court will usually only award that remedy dating from the date of the judgment. Again, this is in contrast to an institutional constructive trust where the remedy can backdate to the date of particular conduct or such other date as the court, in its discretion, considers appropriate. However, in my view, the court retains the discretion to backdate the award of the constructive trust. It is the situation where it does so that is potentially prejudicial to other creditors of the defendant.

45 However, Glover suggests otherwise: “Equity, Restitution and the Proprietary Recovery of Value” *supra* n 6 at 267.
At present, in Australia, such a remedial constructive trust has only been awarded in cases of non-commercial dealings by parties in a domestic setting. It has not been applied to commercial parties dealing at arms' length. Nor has it yet been applied in circumstances of an insolvency. In that case, it would be interesting to see if the court would allow the remedial constructive trust to prefer the plaintiff to the general creditors of the defendant. In general, I think the court would not allow that to occur. All those factors point to the remedial constructive trust being merely a remedy awarded by the court and not any pre-existing substantive right.

It would be difficult to see the justification for a court interfering with the rights of the general creditors to the assets of the defendant in the case of an insolvency on the basis merely of unconscionability where there is no pre-existing fiduciary relationship. Why should the plaintiff get a benefit over and above the general creditors who have lent their money to the defendant?

In essence, a proprietary claim is really only such where it does rank ahead of any general creditors. Consequently, if a remedial constructive trust does not rank ahead of general creditors, it really is not a proprietary claim strictly so called at all, but a general remedy of equity to deal with particular circumstances of unconscionability.

**Alternative Bases in Commercial Cases**

Although the traditional bases of proprietary claims are criticised as being arbitrary and not being dependent on the justice of the case, they have much to commend themselves in the cases of commercial parties dealing at arms' length where one later becomes insolvent. In these cases, the courts have, rightly in my view, placed the needs of the speedy transactions of commerce to have certainty of ownership of property at the fore. This approach is entirely consistent with the House of Lords in Westdeutsche and the Australian courts in cases such as *Diversified Mineral Resources NL v CRA Exploration Pty Ltd.*

Many commentators have also identified this issue. As Gopde put it: “In commercial situations the need to protect the free flow of assets in the stream of trade overrides the principle that proprietary rights should be protected”.

Glover, when discussing the differences between personal and commercial situations observed:

> Parties to commercial dealings are often taken to address expectations differently. Commercial parties are more distant from one another and can be expected to protect their expectations by bargaining for them.

There is also support for this view by Paciocco noting that, in Canada:

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46 (1995) ATPR 41-381.
48 “Equity, Restitution and the Proprietary Recovery of Value” *supra* n 6 at 279.
In those family cases where there has been a finding of unjust enrichment the constructive trust is all but the automatic remedy. This tendency must be avoided in the commercial sphere. In my view, to achieve appropriate results, courts must apply different principles, or at least apply the same principles differently, in these distinguishable settings. In short, courts should be much more inclined to order specific relief in the context of spousal disputes, and much less inclined to do so in commercial cases.”

Here Paciocco is discussing only the award of a remedial constructive trust, to use the language of this paper.

Similar indications have been made by the High Court in cases such as Hospital Products Ltd v United States Surgical Corporation. In my view, the courts consistently guard against the intrusion of uncertain equitable principles into arms’ length commercial dealings. They will do so even more vigilantly when it comes to insolvency.

If commerce must wait for a court to determine where, in the exercise of its discretion, it thinks justice lies, the uncertainty and delay would inevitably lead to greater cost which would in the end be borne by the entire community. Further, the traditional bases, if arbitrary, still, in my view, provide a logical foundation for depriving the general creditors of assets of and insolvent and adjusting legal proprietary rights. If, as is suggested, that is the true function of proprietary claims especially in commercial dealings, the traditional approach is far from objectionable. By requiring some identifiability and a pre-existing equitable relationship, creditors arriving on the scene later in time are given a reasonable opportunity to discover that some of the property legally held by the debtor may later be used to satisfy another’s claim. In the same way, proprietary rights are more easily able to be identified in day to day commercial transactions.

Further, in commercial cases, it is open to the parties to bargain for the protection of their interests by requiring security or taking advantage of other means.

Having said that, I do not suggest that the law does or should preclude a court from having the capacity to, in its discretion, award a proprietary claim in the case of insolvency where only commercial parties are involved. However, I do suggest that a court should only make such an award that backdates and affects third parties in the most extreme of circumstances where commercial parties are involved. A statement to that effect at the highest level would be a welcome boost to gaining the necessary certainty in commercial dealings.

Some commentators do not give sufficient weight to this discretion. For example, Glover speaks of an “insolvency constructive trust”. It is not that it is a different type of remedy in the case of insolvency or that different principles apply to decide

49 Supra n 27 at 325-326.
51 Such as the Quistclose trust or Romalpa clause. Paciocco makes this general point (although without specific reference to those two mechanisms), supra n 27 at 327.
52 “Bankruptcy and Constructive Trusts”(1991) 19 ABLR 98 at 121.
whether it is established, but different consequences flow from its award in insolvency and so different factors are relevant to the court when deciding how to exercise its discretion.

Turning now to unconscionability itself, it is suggested that it should only very rarely be available in commercial cases as the basis of any claim whether proprietary or not. Although unconscionability is necessarily difficult to define and still developing, it usually involves some inequality of bargaining position or misuse of strict legal rights. Those elements will rarely be present in commercial arms’ length dealings. It would be even rarer for circumstances to exist which justified deferring the interests of creditors to such a claim in an insolvency.

Before leaving this topic, I should say something about the so called “risk of insolvency test”. It suggests that some (particularly unsecured creditors) accept the risk of insolvency by not taking security and that such creditors cannot expect preference over others who may have a moral claim to property in the insolvent’s hands. This is a useful point if put a little differently. More than that some accept the risk, the point is that some specifically do not accept the risk by taking measures to protect themselves in one way or another. The means open to such forward thinking or cautious creditors are flexible and varied in the era of Quistclose trusts and Romalpa clauses. Such creditors can expect some preference. Others cannot whether they actively accepted the risk of insolvency or did not turn their minds to it. Paciocco makes some useful observations which support this view:

...not all general creditors have accepted the risk of the defendant’s insolvency. It is not true of judgment creditors who have been victims of tortious conduct by the defendant, or of employees for whom the taking of security is not an option.  

Measure of Remedial Constructive Trust in Cases of Insolvency

Any discussion of this topic should consider an element which has not been emphasised in the Australian cases (because it has not been in issue) or in the Anglo-Australian commentaries - if a remedial constructive trust (based on unconscionability) is to be awarded in cases of insolvency, what should be the measure of the award?

Again, the courts would need to consider the competing claims of the general creditors. To allow any appreciation in value or profits derived (akin to the remedy of an institutional constructive trust) would, in my view, unfairly benefit the plaintiff at the expense of the unsecured creditors. My use of restitutionary language here is intentional because restitution lawyers would, I suspect, immediately cry that the plaintiff should have restored to him or her the full value of the benefit in the

53 Supra n 27 at 325.
54 Paciocco comes to the same conclusion, ibid at 351.
hands of the defendant (assuming, for the moment, that the circumstances giving rise to the remedial constructive trust also gave rise to a claim in restitution). The fundamental basis of the restitutionary claim, that the defendant would be unjustly enriched if allowed to keep the benefit, is not applicable where it is the general creditors of the defendant and not the defendant himself or herself that would get any part of the "benefit" (in restitutionary terms) not returned to the plaintiff.

It follows, to my mind, not that the plaintiff should always be limited to the loss suffered, or some minimum equity to do justice as the measure of his or her claim, but that the measure should be left to the discretion of the courts as part of the discretion that goes along with whether or not to award the remedial constructive trust and if so its terms. It should be clear from what I have said that I think the courts should be careful not to allow a claim greater than the loss to the plaintiff too readily in cases of insolvency.

Insofar as this discussion indicates that I do not think that the remedial constructive trust is or should be the plaything of restitution, I make no apologies. It is a creature of equity which may often be employed by those seeking restitution, but it has its own principles that must be established before it is to be awarded. Those principles are equitable and not restitutionary.

Conclusion

The decision of the House of Lords that payments pursuant to an ultra vires agreement or because of a mistake do not, without more, give rise to a proprietary claim is correct and clears up two anomalous cases on proprietary claims. Consequently, the case clearly establishes that at present, at least in the United Kingdom, the traditional bases will need to be established in order to be awarded a proprietary claim. If there is to be a development to allow proprietary remedies in other cases, it is clear that it will not be by way of resulting trusts, and that the needs of commerce will be borne firmly in mind by the courts. In my view, that position is the correct approach to the development of this area of the law.

Consequently, the courts in this country should use the development of awarding constructive trusts based on unconscionability carefully. In particular, in cases of the insolvency of commercial parties, unconscionability should only be used as the basis of a constructive trust in the most exceptional of circumstances. Otherwise, a plaintiff in such a case should be required to establish a pre-existing fiduciary relationship or that other equitable obligations were owed by the defendant to it. Judicial statement to this effect would be most welcome.