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Equity in the 21st Century: Problems and Perspectives

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Equity in the 21st Century: Problems and Perspectives

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The front cover depicts the main stairwell that leads to the atrium of Thompson Rivers University, Faculty of Law. The back cover depicts the distinct exterior of the Faculty of Law. The curved design of the roof was inspired by the natural beauty of the mountains visible from the building.

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Foreword

Justice Russell Brown
Supreme Court of Canada

After last year's successful inaugural issue of the *Canadian Journal of Comparative and Contemporary Law* (CJCCL) dedicated to "Health Law and Human Rights", I am honoured to provide this brief foreword to the CJCCL's second issue, containing papers exploring the theme of "Equity in the 21st Century: Problems and Perspectives".

As a theme, "equity in the 21st century" is intriguing. At first glance, one might suppose that "equity" and "21st century" are as suitably juxtaposed as "Thomas Aquinas" and "emoji". While its origins are murky, we know that equity emerged long ago from the administrative power of the mediaeval Chancellor, to whom the King had delegated the task of hearing pleas from his subjects concerning injustices at the common law courts. As most law students also know, the Chancellor, as an ecclesiastic, was concerned with conscience (wherein lay the path to the immortal soul). It was therefore on the basis of "conscience" that he exercised this delegated remedial power by ordering respondents to act according to good conscience, notwithstanding their legal rights to do otherwise.

This account — while accurate — risks, however, descending into caricature in several respects. First, common law courts were not amoral wastelands. Still, their limited forms of action could work injustice. Clear rules were preferred over avoiding hardship. John H Baker's famous example of the paid debt that must be paid a second time (owing to the debtor's failure to ensure the debt was cancelled after it was paid the first time) illustrates the sort of problem that typically arose.[1] Secondly, while the Chancellor's jurisdiction ultimately widened from the "wide

1. John H Baker, *An Introduction to Legal History*, 3d (London: Butterworths, 1990) at 118.

but vague"[2] powers wielded during the Middle Ages, the Chancellor's conscience-based jurisdiction soon narrowed, as the stream of *ad hoc* decisions were inevitably reduced to rules or principles of equity which, by the late 18th century, were as inflexible and prone to working injustice as the common law itself. By the mid 20th century, the English Court of Appeal could unashamedly proclaim in *Re Diplock* that it lacked jurisdiction to do equity on the mere basis that "we may think that the 'justice' of the present case requires it".[3]

As the latter half of the 20th century showed, however, equity had not rolled over and died. As Leonard I Rotman argues in his article on the Supreme Court of Canada's understanding of the fusion of law and equity, in recent decades equity has brought the positive law "closer to the human condition". Longstanding devices such as resulting and constructive trusts, injunctions and estoppel were extended, and the action in unjust enrichment (assuming it can truly be understood as "equitable") was pulled from its post-*Moses v Macferlan*[4] obscurity. Courts have breathed new life into equity's concern for the conscientious exercise of legal rights in property and under terms of contracts. Concerns for "fairness" and "justice" have predominated.

A more muscular equitable doctrine to quell "unfairness" and "injustice", however, raises its own set of concerns, none of which are new. Is equity really nothing more than a body of sentimental goo to be haphazardly applied when the spirit of fairness and justice moves us? Or should the conditions calling for its intervention be stated (if they can be stated) precisely and exhaustively? The obvious criticism is that a purely "I-know-unconscionability-when-I-see-it" approach is nothing more than palm tree justice. Equity would lack intelligibility, clarity and predictability in application, thereby implicating basic norms of the rule of law.[5] Little wonder Professor Donovan Waters used to warn his trust law

2. Paul Vivian Baker & Peter St John Hevey Langan, *Snell's Equity*, 29d (London: Sweet & Maxwell,1982) at 8.
3. *Re Diplock*, [1948] Ch 465 at 481 (CA (Eng)), aff'd *sub nom Ministry of Health v Simpson*, [1951] AC 251 (HL).
4. (1760), 97 ER 676 (KB).
5. Tom Bingham, *The Rule of Law* (London: Penguin Group, 2010) at 37.

students against distorting the remedial constructive trust's conscience-based origins by taking it "too far". That seems fair. Nobody committed to equity's public repute wants to see a new maxim proclaiming equity (or the remedial constructive trust) to be the last refuge of a scoundrel. At the same time, there has been no expressed appetite for a return to the rigid systematization that made *Re Diplock* possible.

This tension is never far from the surface in this splendid collection of essays. For example, Alastair Hudson maintains that we err by treating the organizing principle of "conscience" as an entirely subjective phenomenon, as opposed to the product of objectively constituted sources of normative behaviours. And, although not directly addressed to the subjective-vs.-objective dichotomy, Sarah Worthington's paper seeks, by way of analysis of the proscriptive rules which equity imposes upon fiduciaries, to bring principle to determining who is a fiduciary (fellow Canadians, please pay attention![6]), the obligations they owe, and the remedies which flow from a breach. In contrast, Hila Keren, in lamenting "the fall of equity", strikes a more subjective note by celebrating (or, more accurately from her standpoint, commemorating) equity's "non-economic" priorities of "morality, fairness, justice or equality". The other papers implicitly presume that conscience is either an objective reference point, or that — if it has a subjective dimension — such subjectivity need not defeat clear thinking and rational rule-making in equity. Richard C Nolan's article demonstrating the importance of inherent jurisdiction to the administration of trusts celebrates the innovative judicial extension of that jurisdiction, for example, to give directions where the trustee is caught between competing groups of holders of notes issued under the terms of a trust deed. At the same time, though, he calls for greater attention to identifying a theoretical basis for deciding when a court can or cannot exercise inherent jurisdiction in this fashion. Mark Gillen espouses more radical reform of trust law by providing for enforcement of certain non-charitable purposes trusts — not, however, by way of a subjective act of judicial discretion, but by way of legislative intervention.

Nolan and Gillen's papers are also representative of a distinctly

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6. *CA v Critchley* (1998), 60 BCLR (3d) 92 (CA) at para 75.

pioneering flavour to the collection — not inappropriately, given the 21th century theme. They are joined in this respect by Irit Samet's consideration of whether the law should abandon *caveat emptor* to permit rescission for unilateral mistakes in contract formation, and of whether equity is the appropriate vehicle to effect such a reform; Matthew Harding's deep reflection about discriminatory public trusts, whether judges should prefer the threshold of "public benefit" over "public interest", and the place of the value of freedom of disposition under each threshold; Kathryn Chan's argument for reinvigorating the Federal Court of Appeal's equitable jurisdiction over registered charities by invoking certain curative principles oriented towards effectuating imperfect charitable gifts; Paul Davies' consideration of whether the rules of equitable compensation should follow those available for breach of contract, for negligence, or for other torts; and David Wiseman's account for the possibility that equity might prefer a beneficiary-protection power over a beneficiary-direction rule in the context of joint bank account resulting trusts. And, appropriately enough (given this Journal's dedication to comparative law), Graham Virgo seeks to harmonize the Australian and Canadian remedial constructive trust with the institutional (substantive) constructive trust in England, while Margaret Hall considers the applicability to Canadian law of a recent English judicial innovation, rooted in the equitable doctrine of undue influence, for disrupting relationships that exploit children and mentally incapable adults. At a more general level, Justice Mark Leeming shows why equity is especially suited to comparative analysis, comprising themes which are familiar to jurists throughout the common law world.

Breaking new ground can, however, be difficult work, and the results are not always universally embraced. Robert Chambers shows how, over several decades of debate about liability for knowing receipt of assets transferred in breach of trust or fiduciary duty, various accounts for such liability have been advanced — from unjust enrichment, to failure to perform a duty to restore the misapplied trust property, to Chambers' admirably plain-spoken and persuasive argument that knowing receipt is itself a breach of trust. Any resort to "waiver of tort", once hoped to be equity's elixir for overcoming indeterminate causation in mass tort

claims,[7] must now account for Craig Jones' account of its limits. Stephen Watterson explores the residual uncertainties in the wake of the House of Lords' decision in *Banque Financière de la Cité v Park (Battersea) Ltd*,[8] following which English law has had to sort out what it means to say that subrogation to extinguished rights (usually held by a disappointed unsecured creditor or by a lender whose funds were misappropriated to discharge another's liabilities) is not only a remedy, but one that is also equitable and restitutionary. And as Mitchell McInnes' essay on beneficial services in respect of land shows, the implications of expanding the scope for equitable relief — in that particular case for relief under proprietary estoppel — are often insufficiently examined, both before and after the fact.

Our legal community, howsoever one chooses to define it (Western Canadian, Canadian, Anglo-American, common law), owes a debt of appreciation to Thompson Rivers University's Faculty of Law on this initiative — the CJCCL, with its worthwhile themes and its first-rate content. The essays contained in its second issue deserve wide circulation among practicing and academic lawyers and, of course, among judges charged with doing equity. As one who has profited from reading them, I offer my thanks and congratulations to all concerned and, in particular, to the authors and to the CJCCL's editorial team.

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7. *Serhan (Estate Trustee) v Johnson & Johnson* (2004), 132 ACWS (3d) 221 (Ont Sup Ct).
8. [1999] 1 AC 221 (HL).

The Comparative Distinctiveness of Equity

Justice Mark Leeming
Judge of Appeal of the Supreme Court of New South Wales*

Comparative law is difficult and controversial. One reason for the difficulty is the complexity of legal systems and the need for more than a merely superficial knowledge of the foreign legal system in order to profit from recourse to it. One way in which it is controversial is that it has been suggested that the use of comparative law conceals the reasons for decisions reached on other grounds. This paper maintains that equity is distinctive, and that one of the ways in which equity is different from other bodies of law is that there is greater scope for the development of equitable principle by reference to foreign jurisdictions. That difference is a product of equity's distinctive history, underlying themes and approach to law-making. Those matters are illustrated by a series of recent examples drawn from appellate courts throughout the Commonwealth.

* I am grateful for the assistance provided by Kate Lindeman and Hannah Vieira in the preparation of this article. All errors are mine.

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I. Introduction

This paper is about the ways in which courts within the Commonwealth look to each others' decisions for guidance. It considers whether that occurs in ways that turn on the nature of the litigation, and, especially, when courts are dealing with equitable principles. Its principal contention is that courts use comparative law in a distinctive way when developing and applying principles of equity. It seeks to give a series of examples and thereby to identify plausible reasons for that contention.

II. The Problem of Generality

One problem with many statements as to the use of comparative law is that they are too general. It is worth reiterating Professor Nelson's observation that "[c]ommon-law decisionmaking is extraordinarily complex, and it may not lend itself to a unitary description".[1] The ways in which foreign law is used by courts in the common law tradition are quite nuanced. Much may be lost in generalities.

It is one thing for a court to have regard to foreign law when an issue of general policy is to be determined, particularly when the court

1. Caleb Nelson, "The Legitimacy of (Some) Federal Common Law" (2015) 101:1 Virginia Law Review 1 at 8.

is an ultimate appellate court.[2] For example, should advocates have an absolute immunity for negligence? Should a plaintiff harmed by exposure to asbestos fail because he or she cannot prove precisely when the exposure occurred? Should a legal system recognise a claim for wrongful birth? Examples could readily be multiplied. Courts faced with such questions will regularly seek to gain assistance from the experience in a comparable legal system. This is a perfectly legitimate (and recurrent) approach to assist in the resolution of common legal issues. Sir Basil Markesinis and Dr. Fedtke have observed that "[t]he similarity of the problem, coupled with the growing similarity in socio-economic environments (at any rate among developed nations), may call for a similarity in legal outcome notwithstanding undoubted differences in language and legal techniques".[3] Many or most readers will be familiar with the Australian, Canadian, New Zealand and United Kingdom solutions to the particular questions — all tortious — mentioned above.[4]

The fact that courts — especially ultimate appellate courts — employ a comparative approach on such issues is unquestionably true, but it is *not* the sort of use of foreign decisions addressed in this paper. Indeed,

2. See *e.g. Jones v Kaney*, [2011] UKSC 13 ("[i]t is highly desirable that at this appellate level, in cases where issues of legal policy are concerned, the Court should be informed about the position in other common law countries" at para 76) and, conversely, as a strand of the reasoning rejecting a submission, in *Commissioner of Customs and Excise v Barclays Bank*, [2006] UKHL 28 ("it is a notable feature of this appeal that the Commissioners adduce no comparative jurisprudence to support their argument" at para 20).
3. Sir Basil Markesinis & Jörg Fedtke, *Judicial Recourse to Foreign Law: A New Source of Inspiration?* (Abingdon, UK: Routledge, 2006) at 125.
4. In relation to advocates' immunity from suit see *e.g. D'Orta-Ekenaike v Victoria Legal Aid*, [2005] HCA 12 at para 61 and see now *Attwells v Jackson Lalic Lawyers Pty Ltd*, [2016] HCA 16 (immunity reformulated, by reference to principles of finality); *Lai v Chamberlains*, [2006] NZSC 70; *Arthur J S Hall v Simons*, [2002] 1 AC 615 (HL)(immunity abrogated). In Canada, barristers' immunity from suit was never part of the common law: see *Demarco v Ungaro* (1979), 21 OR (2d) 673 (Ont Ct J (Gen Div)); *Henderson v Hagblom*, 2003 SKCA 40, leave to appeal to SCC refused [2004] 1 SCR ix.

it is open to criticisms which are not without force. Writing of the use of comparative law (ancient and modern) in the *Fairchild v Glenhaven*[5] appeal — ironically, itself much lauded as exemplary[6] — Lord Hoffmann observed: "[t]he foreign authorities were cited in the way courts always use comparative law; as a rhetorical flourish, to lend support to a conclusion reached on independent grounds".[7] In a similar vein, Justice Scalia said that to "invoke alien law when it agrees with one's own thinking, and ignore it otherwise, is not reasoned decisionmaking, but sophistry".[8] There is a measure of rhetorical overstatement in both those passages. However, it is tolerably clear that ultimate appellate courts are not likely to determine issues of general policy by reason of foreign decisions. Local conditions are apt to prevail. The divergent solutions to the examples given above well illustrate this.[9]

Now consider the other extreme. It is perfectly clear that comparative law has a large and often determinative role to play in cases turning on international conventions.[10] A notable example is aviation litigation

5. [2002] UKHL 22.
6. See *e.g.* Markesinis & Fedtke, *supra* note 3 ("the House of Lords decision in *Fairchild v Glenhaven*, [2002] 1 AC 32 (HL) comes closer to the ideal we are advocating" at 48).
7. Lord Hoffmann, "*Fairchild* and After" in Andrew Burrows, David Johnston & Reinhard Zimmermann, eds, *Judge and Jurist: Essays in Memory of Lord Rodger of Earlsferry* (Oxford: Oxford University Press, 2013) 63 ("the reasoning in *Fairchild* was simply that we thought it very unfair that an employer should be able to escape any liability for mesothelioma suffered by a worker whom he had negligently exposed to asbestos simply because the worker had also been (negligently or otherwise) exposed to asbestos by someone else" at 64). The antipathy between the two on this topic is evident from Lord Rodger's dissent in *Barker v Corus (UK)*, [2006] UKHL 20 and, especially, what is disclosed in Alan Paterson, *Final Judgment: The Last Law Lords and the Supreme Court* (Oxford: Hart Publishing, 2013) at 189-90.
8. Dissenting, in *Roper v Simmons* (2005), 125 S Ct 1183 (US) at 1228.
9. *Supra* note 4.
10. See Jonathan Mance, "Foreign and Comparative Law in the Courts" (2001) 36:3 Texas International Law Journal 415 at 420-24 (this has long been the case, as his Lordship has observed).

involving the Warsaw Convention[11] and its successors, whose self-evident purpose was to harmonise the laws of all contracting States on the liability of carriers for the commercial carriage of passengers and cargo by air. It is trite that it is desirable that decisions in different jurisdictions should, so far as possible, be kept in line with each other in such cases; otherwise the purpose for entering into and implementing the treaty would be frustrated.[12] This sort of use of foreign law, where a uniform legislative text is imposed from without, is once again, *not* what this paper addresses.

Between those two extremes, there lies an intermediate area, to which this paper is directed. The essential idea is found in the following passage from Lord Wilberforce's speech in *Buttes Gas & Oil Co v Hammer (Nos 2 & 3)*:[13]

> [w]hen the judicial approach to an identical problem between the same parties has been spelt out with such articulation in a country, one not only so closely akin to ours in legal approach, the fabric of whose legal doctrine in this area is so closely interwoven with ours, but that to which all the parties before us belong, spelt out moreover in convincing language and reasoning, we should be unwise not to take the benefit of it.[14]

This paper focuses upon what his Lordship said of legal approaches being akin, of the closely interwoven fabric of legal doctrine, and of

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11. *Convention for the Unification of Certain Rules Relating to International Carriage by Air*, 12 October 1929, 261 UNTS 423.
12. See *e.g. Stott v Thomas Cook Tour Operators Ltd*, [2014] UKSC 15 at paras 34-44; *Povey v Qantas Airways Ltd*, [2005] HCA 33 ("[i]mportantly, international treaties should be interpreted uniformly by contracting states" at para 25); *Emery Air Freight Corporation v Nerine Nurseries Ltd*, [1997] 3 NZLR 723 (CA); *Thibodeau v Air Canada*, 2014 SCC 67 at paras 52-57 ("[t]o sum up, the text and purpose of the *Montreal Convention* and a strong current of international jurisprudence show that actions for damages in relation to matters falling within the scope of the *Montreal Convention* may only be pursued if they are the types of actions specifically permitted under its provisions. As the Supreme Court of the United Kingdom put it very recently, '[t]he Convention is intended to deal comprehensively with the carrier's liability for whatever may physically happen to passengers between embarkation and disembarkation': *Stott*, at para 61" at para 57).
13. [1982] AC 888 (HL) [*Buttes Gas & Oil Co*].
14. *Ibid* at 936-37.

the language and reasoning being convincing.[15] Equity decisions in the Commonwealth are capable of answering that description.

III. The Use of Foreign Equity Decisions

The use of foreign law, and in particular foreign decisions when developing and applying equitable principle, is illustrated by two recent judgments of the UK Supreme Court, both written by Lord Neuberger for a unanimous Court. Both decisions expressly employed a comparative approach. In 2014, the Court noted how other courts in other leading common law jurisdictions had departed from the United Kingdom in relation to whether a bribe received by a fiduciary was held on trust, overturned the English decision, *Sinclair Investments Ltd v Versailles Trade Finance Ltd*,[16] and instead chose to follow principles adopted elsewhere in the Commonwealth.[17] Lord Neuberger stated:

> [a]s overseas countries secede from the jurisdiction of the Privy Council, it is inevitable that inconsistencies in the common law will develop between different jurisdictions. However, it seems to us highly desirable for all those jurisdictions to learn from each other, and at least to lean in favour of harmonising the development of the common law round the world.[18]

In 2015, in an appeal in proceedings alleging passing-off, having considered Australian, Canadian, Irish and New Zealand authorities,[19] his Lordship reiterated the point:

> it is both important and helpful to consider how the law has developed in other common law jurisdictions – important because it is desirable that the common law jurisdictions have a consistent approach, and helpful because every national common law judiciary can benefit from the experiences and thoughts of other common law judges.[20]

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15. *Ibid.*
16. [2011] EWCA Civ 347.
17. *FHR European Ventures LLP v Cedar Capital Partners LLC*, [2014] UKSC 45 at para 45 [*FHR*]. See also the consideration of Australian, New Zealand and North American decisions in *Lawrence v Fen Tigers Ltd*, [2014] UKSC 13 at paras 241-43.
18. *FHR*, *ibid.*
19. *Starbucks (HK) Ltd v British Sky Broadcasting Group*, [2015] UKSC 31 at paras 38-43.
20. *Ibid* at para 50.

Those statements were not, as I read them, merely supportive of conclusions already reached.[21] Indeed, a remarkable aspect of the first appeal is that the decision overturned a previous decision written by its author.[22] Moreover, in the second appeal, the Supreme Court departed from Australian and Canadian authorities.

Both appeals concerned questions of equitable principle. Here there is greater scope for harmonisation than in most mainstream areas of judge-made law.[23] There are at least three reasons why. First, equity enjoys a longer readily comprehensible history than most areas of private law. There is simply more material to work with articulating a coherent legal tradition. Second, parts of equity are either unaffected by statute, or have been influenced by statute so long ago that the original statutory text has become unimportant, such that there is greater scope for, and ease of, the harmonisation process.[24] Third, the underlying principles and maxims of equity tend to enhance a mode of reasoning apt to support a comparative approach. A foreign judgment is apt to be "spelt out in convincing language and reasoning" (to use Lord Wilberforce's language) when its reasoning involves familiar themes and motivating principles common to equitable jurisprudence.

For the purposes of this paper, by "equity" and "equitable principle" I mean merely the doctrines and remedies deriving from Chancery. Professor (now Lord Justice) Beatson said, of "the unenacted law made up of common law and equity" that "[e]ach comes from a separate source with its own bundle of traditions. Each functions somewhat differently".[25] I appreciate that to some that historical definition may seem old-fashioned, unhelpful, or indeed one which distorts a more

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21. *Cf. supra* notes 7, 8.
22. *Supra* note 16.
23. Admiralty law is another such area, with a historical background in some respects resembling that of equity, but this is a matter beyond the scope of this paper.
24. See Mark Leeming, "Theories and Principles Underlying the Development of the Common Law: The Statutory Elephant in the Room" (2013) 36:3 University of New South Wales Law Journal 1002 at 1004-05.
25. Jack Beatson, "Has the Common Law a Future?" (1997) 56:2 Cambridge Law Journal 291 at 298.

coherent analysis of the legal system. I have elsewhere sought to explain why considering equity as a separate body of law within the legal system is a helpful approach.[26] For present purposes, I observe merely that it is unquestionably the law of Australia,[27] that the theme chosen by the Editors-in-Chief of this volume presupposes the continued utility of the term and that considerations of historical continuity are central to the thesis that foreign equity decisions are used in a distinctive manner. That said, as the passing-off appeal mentioned above illustrates, there are numerous differences at the level of detail within the Commonwealth. But that is no new thing, nor is it unhealthy. I turn to this immediately.

IV. The Variegated Common Law of the Commonwealth

There is a firmly established comparative law tradition in courts throughout the Commonwealth. In part that reflected the idea that there was a single common law (including equity). Appellate judges in England long sat in the Privy Council hearing appeals throughout the Empire and Commonwealth (as well as the substantial quantity of Scottish appeals to the House of Lords and the Supreme Court). Moreover, although originally the idea was that there was a single "common law of England" uniform throughout the British Empire, it became clear by the second half of the twentieth century that there were distinctive local varieties. Two tort appeals from Australia and New Zealand to the Privy Council

26. See Mark Leeming, "Subrogation, Equity and Unjust Enrichment" in Jamie Glister & Pauline Ridge, eds, *Fault Lines in Equity* (Oxford: Hart Publishing, 2012) 27 at 39-43; Mark Leeming, "Equity: Ageless in an Age of Statutes" (2015) 9 Journal of Equity 108.

27. *Bankstown City Council v Alamdo Holdings Pty Ltd*, [2005] HCA 46 (the normative complexity of the Australian legal system derives from "the interaction between the rules of law, principles of equity, requirements of statute, and between legal, equitable and statutory remedies" at para 27).

illustrate the point.[28] In the first, the Privy Council recognised that the Australian law of libel might diverge from that established in England, saying that it was a question for the High Court to decide whether the decision of the House of Lords in *Rookes v Barnard*[29] compelled a change in the law of libel in Australia.[30] In the second, the Privy Council concluded that the New Zealand Court of Appeal was entitled to depart from English decisions on the grounds that conditions in New Zealand were different. The Court of Appeal of New Zealand "should not be deflected from developing the common law of New Zealand … by the consideration that the House of Lords … have not regarded an identical development as appropriate in the English setting".[31]

Those statements are remarkable for at least three matters which may be underappreciated. The first is that they were decisions when appeals lay as of right to the Privy Council, yet the men who constituted it also sat in the House of Lords and would in that capacity decide the same question of law differently. The second is that in both instances regard was expressly had to policy and different local conditions. The third is that the measure of deference accorded by the Judicial Committee is inconsistent with there being a single, monolithic body of common law throughout the Commonwealth.

28. See also Andrew Burrows, "The Influence of Comparative Law on the English Law of Obligations" in Andrew Robertson & Michael Tilbury, eds, *The Common Law of Obligations: Divergence and Unity* (Oxford: Hart Publishing, 2015); William Gummow, "The Australian Constitution and the End of Empire – A Century of Legal History" (2015) 33:1 Law in Context 74 at 84; Mark Leeming, "Farah and Its Progeny: Comity among Intermediate Appellate Courts" (2015) 12:2 The Judicial Review 165 at 168-69.
29. [1964] UKHL 1.
30. *Australian Consolidated Press Ltd v Uren* (1967), 17 CLR 221 (PC (Austl)) at 241.
31. *Invercargill City Council v Hamlin*, [1996] 2 WLR 367 (PC (NZ)) at 376. Note the consideration of divergent Australian and Canadian developments in reaching that conclusion.

V. Three Examples of Equitable Principle in Ultimate Appellate Courts

Below, I examine some of divergent workings-out of the same equitable principle by three ultimate appellate courts.

A. *Barnes v Addy*: Liability for Knowing Assistance in Australia, Canada, and the United Kingdom

An area which is wholly equitable but where there are divergent views in Australia, Canada and the United Kingdom is the liability of those who assist in a breach of fiduciary duty, even though liability in all places may be traced to Lord Selborne's words in *Barnes v Addy*[32] that "strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, … unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees".[33]

The Australian approach still requires there to have been a "dishonest and fraudulent design" by the fiduciary, as to which the third party assisted and had sufficient notice. Here, notice includes knowledge of the circumstances which would indicate the facts to an honest and reasonable person, but mere constructive notice is insufficient.[34] Moreover, the High Court of Australia has emphasised that the formulation by Lord Selborne was not an exhaustive statement of the circumstances in which a person who was not a recipient of trust property and had not acted as a trustee *de son tort* might be liable.[35] In particular, a person who induces or procures a trustee to commit a breach of trust will be liable irrespective of the

32. (1874), LR 9 Ch App 144 (CA (Eng)).
33. *Ibid* at 251-52.
34. *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975), 132 CLR 373 (HCA); *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007), 230 CLR 89 (HCA) [*Farah Constructions*]; *Hasler v Singtel Optus Pty Ltd*, [2014] NSWCA 266 (Austl) [*Hasler*]; *FTV Holdings Cairns Pty Ltd v Smith*, [2014] QCA 217 (Austl) at paras 58-62; *cf. Westpac Banking Corporation v Bell Group Ltd (No 3)*, [2012] WASCA 157 (Austl) at paras 2112-25 (on a more relaxed test of "dishonest and fraudulent design").
35. *Farah Constructions*, *ibid* at para 161.

quality of the breach. A person who participates in the breach but falls short of inducing or procuring it will only be liable if the breach amounts to a dishonest and fraudulent design.[36] That is a relatively nuanced formulation of accessorial liability, which reflects a close adherence to Lord Selborne's words.

The approach in the United Kingdom was reformulated in *Royal Brunei Airlines v Tan*[37] ("*Royal Brunei*"), where it was held that a third party could be liable, even for a wholly innocent breach by the fiduciary, if the third party had the requisite state of mind. There has been some fluctuation in *Twinsectra v Yardley*[38] and *Barlow Clowes International Ltd v Eurotrust International Ltd*[39] on the question of the third party's state of mind.[40] But whatever be the position on knowledge, the English test appears to subsume the distinction made in the Australian authorities.

It seems that an intermediate position obtains in Canada. In the Supreme Court's decision in *Air Canada v M & L Travel Ltd*,[41] a more relaxed view appears to have been taken of the quality of the fiduciary's breach. It was stated (*obiter dicta*) that equity would regard "the taking of a knowingly wrongful risk resulting in prejudice to the beneficiary" as "dishonest or fraudulent" such as to be "sufficient to ground personal liability".[42] Subsequently, as Professor Waters has observed, leave to appeal has been refused in a case where the trustee's breach was not dishonest

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36. See *Farah Constructions*, *ibid* at para 164; *Hasler*, *supra* note 34 at paras 77-78; Charles Harpum, "The Stranger as Constructive Trustee: Part 1" (1986) 102:1 Law Quarterly Review 114 at 144.
37. [1995] 2 AC 378 (PC (Brunei)).
38. [2002] UKHL 12.
39. [2005] UKPC 37 (Isle of Man).
40. For insight into the differing formulations, see Paterson, *supra* note 7 at 183-84.
41. [1993] 3 SCR 787 [*Air Canada*]. See also *Citadel General Assurance Co v Lloyds Bank Canada*, [1997] 3 SCR 805; *Gold v Rosenberg*, [1997] 3 SCR 767.
42. *Air Canada*, *ibid* at 826; McLachlin J expressly declined to decide this issue at 830.

or fraudulent.[43] It would appear that a settled position has not yet been reached.

It is not the purpose of this paper to criticise or to express a preference for any of the formulations as a matter of policy. Instead, it may be noted that close regard was given in each of the Australian and Canadian decisions to earlier United Kingdom authority. Indeed, prior to 2007, it was widely thought that the reformulation of liability in *Royal Brunei* reflected the Australian law.[44] To use Lord Wilberforce's words, "it is plain that this is an area where the jurisprudential fabric is closely interwoven".[45] Of course, that is largely a consequence of history. Each of the Australian colonies, and most of the Canadian colonies, inherited the law of England including equity. Each participated for many decades in a judicial system which culminated in appeals to the Privy Council. And in each case, liability exists at general law, relatively unaffected by statute. Although there are local divergences, it remains easy to compare and contrast those divergences. It is right to do so. Indeed, the High Court has reserved to itself the right to consider, in a future case, whether to adopt aspects of *Royal Brunei* as a matter of Australian law.[46] The differences which presently exist result in large measure from decisions to relax the precedential weight accorded to much earlier English decisions — which is to say, precisely the phenomenon seen in the Privy Council tort appeals referred to above.[47] Those differences do not deny either the shared historical basis for these forms of liability, nor the ability of courts readily to have regard — and at the level of fine-grained detail — to the reasoning processes of foreign courts. The common historical background makes it easier to undertake comparative analyses, and to do so not merely at the crude level of arguing that the *outcome* is preferable,

43. *Gordon v Winnipeg Canoe Club* (1999), 134 Man R (2d) 213 (CA) leave to appeal to SCC refused, (2000) 153 Man R (2d) 160 (SCC); see Donovan WM Waters, Mark Gillen & Lionel Smith, *Waters' Law of Trusts in Canada*, 4d (Toronto: Carswell, 2012) at 517.
44. See *Hasler*, *supra* note 34 at para 47.
45. *Buttes Gas & Oil Co*, *supra* note 13 at 936-37.
46. *Farah Constructions*, *supra* note 34 at paras 163-64.
47. See Part IV, above.

but at a more sophisticated level, of assessing the extent to which there has been a distortion in a coherent body of law.

B. Qualifications to the Rule in *Saunders v Vautier*

In some circumstances, in accordance with one aspect of the "rule"[48] in *Saunders v Vautier*,[49] fewer than all of a number of absolutely entitled adult beneficiaries can bring a trust to an end *pro rata*, by calling for the transfer of their shares of the trust property. May that occur where the trustee holds shares in a private company and the result is that there is a change of control in the company (*e.g.* by breaking up a blocking stake)?

The "rule" may readily be seen in eighteenth century decisions,[50] as well as in the first edition of *Lewin on Trusts*,[51] all of which predated *Saunders v Vautier.* A different path was taken by United States decisions, influenced by early New York and Michigan statutes.[52] In Australia, much of Canada and England, one beneficiary can bring to an end a trust of divisible property *pro rata*, subject to there not being "special circumstances". A continuous line of authority holds that the mere breaking up of a parcel of shares is insufficient to constitute special circumstances.[53] However, if it is shown that the consequence is a loss in value, then there will be special circumstances. In *Beck v Henley*[54] ("*Beck*"),

48. The "rule" is better seen as a power on the part of the beneficiaries, with a correlative liability on the part of the trustee. See *e.g. CPT Custodian Pty Ltd v Commissioner of State Revenue*, [2005] HCA 53 at para 44.
49. (1841), 41 ER 482 (Ch).
50. See *e.g. Love v L'Estrange* (1727), 2 ER 532 (HL); *Barnes v Rowley* (1797), 30 ER 1024 (Ch).
51. See Thomas Lewin, *A Practical Treatise on the Law of Trusts and Trustees* (London: A Maxwell, 1837) at 496.
52. See Paul Matthews, "The Comparative Importance of the Rule in *Saunders v Vautier*" (2006) 122:2 Law Quarterly Review 266 at 282-87; see also *Re Barton*, [2002] EWHC 264 (Ch).
53. See *In re Marshall*, [1914] 1 Ch 192 (CA (Eng)); *Re Sandeman's Will Trusts*, [1937] 1 All ER 368 (Ch); *Re Weiner's Will Trusts*, [1956] 1 WLR 579 (Ch (Eng)) and *Lloyds Bank Ltd v Duker*, [1987] 1 WLR 1324 (Ch (Eng)).
54. [2014] NSWCA 201 (Austl) [*Beck*].

the New South Wales Court of Appeal was asked to depart from that line of authority.[55] After considering the English decisions from which the "special circumstances" exception was derived, the Court held that it should not lightly depart from judicial authority that was "long standing and consistent", and which had been applied and followed in other jurisdictions.[56] Further, the Court considered the potential consequences of deviating, stating that "[i]t is not possible to quantify the costs — in terms of certainty, and upsetting the considered and informed desires of settlors, testators and beneficiaries, of the change in the law for which [the appellant] contends. All that can be said is that those costs would be real".[57] This was not a case where comparative law was cited merely to lend support to a conclusion reached on independent grounds.[58]

The same decision illustrates another distinctive equitable phenomenon: the antiquity of equitable doctrine. In areas such as tort and contract, which were radically reformulated from the second half of the nineteenth century,[59] it is very hard to go back to the early nineteenth century (or earlier) in a way that assists legal analysis. Justice Windeyer once said — coincidentally, in an appeal linked to the divergence between the common law of Australia and the United Kingdom — that "like any attempt to trace the lineage of an idea, much depends on how far you wish to go back and how much certainty you demand in the connecting links".[60] But it is much easier to consider the more distant legal past in equity, where (at least in the British Commonwealth) there was no occasion for such a reformulation as occurred at common law. The "rule" in *Saunders v Vautier* is one instance. Another striking example is *Pearne v Lisle*,[61] whose abhorrent subject matter nonetheless discloses principles pursuant to which specific performance will be refused where damages are

55. *Ibid.*
56. *Ibid* at para 81 (the words are mine, with the agreement of Beazley P and Sackville AJA).
57. *Ibid.*
58. *Cf. supra* note 7.
59. Neil Duxbury, *Frederick Pollock and the English Juristic Tradition* (Oxford: Oxford University Press, 2007) at 187.
60. *Uren v John Fairfax & Sons Pty Ltd*, [1966] HCA 40.
61. (1749), 27 ER 47 (Ch).

an adequate remedy which have changed little in 260 years.[62] As Justice Gummow has written, extra-judicially: "[i]n equity, the lineage of an idea may be quite clear and its persistence through changing circumstances all the more readily explicable".[63]

It is as well to recall another signal historical difference between the two main branches of English law. As stated in *Re Hallett's Estate*,[64] "the rules of Courts of Equity are not, like the rules of the Common Law, supposed to have been established from time immemorial. It is … well known that they have been … from time to time — altered, improved, and refined. In many cases we know the names of the Chancellors who invented them".[65] The same point was made a century later by Sir Anthony Mason, stating that equity "made no secret of its evolutionary development".[66] That there can more or less readily be a direct link to the Chancellors who first formulated equitable doctrine can but enhance the capacity for fruitful and insightful use of foreign law.

C. Judicial Advice

The ability to bring a trust to an end is largely unregulated by statute in Australia and the United Kingdom, although the same is not true in many North American jurisdictions.[67] But even in areas where statute has intruded (which are numerous), it can remain straightforward to apply a comparative approach to the development of equitable principle. Take for example judicial advice to trustees. Statute authorises a trustee to obtain the benefit of a statutory defence if the trustee follows advice

62. *Ibid* (contract for the sale of slaves).

63. William Gummow, *Change and Continuity: Statute, Equity and Federalism* (Oxford: Oxford University Press, 1999) at 42.

64. (1880), 13 Ch D 696 (CA (Eng)).

65. *Ibid* at 710.

66. Anthony Mason, "The Impact of Equitable Doctrine on the Law of Contract" (1998) 27:1 Anglo-American Law Review 1 at 3.

67. In Canada, provincial statutes in Alberta and Manitoba have qualified the "rule" in *Saunders v Vautier*, *supra* note 49, by making the termination of the trust subject to judicial consent, thereby conferring a discretion upon the court to approve directions overriding the settlor's or testator's intention. See Waters, Gillen & Smith, *supra* note 43 at 1258-62.

given after full disclosure. It makes sense — given the character of the application and the nature of the defence — to regard this as essentially equitable. The subject was considered at length in *Macedonian Orthodox Community Church St Petka Incorporated v His Eminence Petar*.[68] The High Court of Australia there observed that where the New South Wales legislation "reflected and even copied laws enacted, or made, for identical or analogous circumstances in England, it was permissible and helpful to construe the New South Wales legislation with the benefit of the experience expressed in judicial observations on the English analogues".[69]

Despite very significant differences in legislative history, the High Court pointed to what Lord St. Leonards had said in 1857 when introducing the Trustee Relief Bill as to its being a "cheap and simple process of determining questions".[70] Nevertheless, the High Court had regard to the significantly altered (and expanded) provisions in section 63 of the New South Wales *Trustee Act 1925*[71] as warranting the result that there should be no limitation confining the availability of advice to non-adversarial proceedings. Thus, with or without the intrusion of local statute, bodies of law which remain unmistakably "equitable" recur throughout the British Commonwealth. Assistance is gained by having regard to decisions throughout the Commonwealth, as well as from works of legal scholarship on equity and trusts in applying and developing equitable principle.

I am most familiar with Australian decisions. However, even a superficial examination of recent Canadian decisions tends to bear out the themes in this paper. For example, irrespective of the relative merits of the majority and the minority judgments, one cannot fail to be struck by the fact that in a recent decision of the British Columbia Court of Appeal on equitable estoppel, extensive regard was given to recent English decisions,[72] or that Justice Barrett's decision from my own court in *Re*

68. [2008] HCA 42 [*Petar*].
69. *Ibid* at para 53. See also *Beck*, *supra* note 54 at paras 48-54.
70. *Petar*, *supra* note 68 at para 67.
71. No 14 (NSW)(Austl).
72. *Sabey v von Hopffgarten Estate*, 2014 BCCA 360.

Gaydon[73] has been applied in a series of decisions in Ontario and British Columbia.[74] Conversely, the New South Wales decision *Beck* relied on a 1949 Canadian decision, *In re the Trustee Act; In re Burger Estate*,[75] in support of issuing judicial advice in mandatory form.

The Chief Justice of the Federal Court of Australia has recently observed that "[e]quity, as a reflection of underlying norms and values (and often expressed thus rather than by rules that are precisely linguistically expressed) required, necessarily, a form of judicial technique different to the common law".[76]

Those norms transcend national boundaries, and the judicial technique likewise straddles temporal and geographic limits. In short there is, as Lord Wilberforce said, a common legal approach, a closely interwoven fabric of legal doctrine, which permits regard to be had to the convincing language and reasoning in different countries' courts in the Commonwealth.[77]

VI. Conclusion

One danger in any use of comparative law was identified by Justice Kriegler of the South African Constitutional Court:

> because of the subtleties of foreign jurisdictions, their practices and terminology require more intensive study ... Even on a superficial view, there seem to me to be differences of substance between the statutory, jurisprudential and societal contexts prevailing in those countries and in South Africa as to render ostensible analogies dangerous without a thorough understanding of the foreign systems.[78]

This paper has sought to explain why those difficulties — which are undoubtedly real — are less significant in the case of equity throughout

73. [2001] NSWSC 473.
74. See *Lomas v Rio Algom Limited*, 2010 ONCA 175, which in turn was applied in *Mayer v Mayer*, 2014 BCCA 293.
75. [1949] 1 WWR 280 (Alta (SC)).
76. *Paciocco v Australia and New Zealand Banking Group Ltd*, [2015] FCAFC 50 at para 271 (Allsop CJ, Besanko and Middleton JJ agreeing).
77. *Buttes Gas & Oil Co*, *supra* note 13 at 936-37.
78. *Bernstein v Bester NO*, [1996] ZACC 2 (SA), cited by Markesinis & Fedtke, *supra* note 3 at 159.

the Commonwealth. The result is that the use of comparative equity decisions is distinctive.

In advancing that argument, this paper has necessarily relied on a number of generalised propositions, illustrated by recent examples. It has not been possible within the confinement of this paper to undertake an empirical analysis[79] (and which would also present large definitional issues).[80] I do not mean to underplay those difficulties, although I do not regard them as insuperable. Although I have emphasised what is lost by generalisations as to the role of comparative law, I acknowledge that this paper unavoidably suffers from a similar vice. It may therefore best be seen as an overview of an attractive and plausible thesis. Those qualifications notwithstanding, it should be recalled that on any view the majority of civil litigation — contract, tort and statutory claims — does *not* involve the principled development or application of equitable principle. There is a distinctive character to the minority that *does*, which is shared throughout the Commonwealth and affects the ways in which a comparative approach is taken.

79. Contrast Keith Stanton, "Comparative Law in the House of Lords and Supreme Court" (2013) 42:3 Common Law World Review 269.

80. I am conscious that the metes and bounds of "equity" and "equitable principle" are contestable and that whatever they be, much litigation has elements of both common law and equity.

Improvements to Land, Equity, Proprietary Estoppel, and Unjust Enrichment

Mitchell McInnes*

Due to the high value that it placed upon the ownership of land, the common law traditionally was wary of intervening if the plaintiff non-contractually improved the defendant's land. For the most part, liability was imposed only if the landowner acted unconscionably according to the doctrine of proprietary estoppel. Recently, however, Canadian courts have expanded the scope of relief in two respects. First, the test for proprietary estoppel has been revised and relaxed. Second, the cause of action in unjust enrichment is now widely employed as an alternative source of liability. While neither development is necessarily wrong, the implications of those changes have received too little attention. A sensitive balance must be struck between the interests of worthy claimants and the interests of innocent landowners.

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I. Introduction

If the plaintiff improves the defendant's land, will the owner be held liable? From a historical perspective, that question was unlikely to receive a robust response. The defendant obviously was obliged to pay if the plaintiff acted pursuant to a contract between the parties. Absent an agreement, however, the improver's prospects were slim. That was particularly true in law. Active claims were refused recognition and the passive right of set-off was severely restricted. *Montreuil v Ontario Asphalt Co.*[1] provides a dramatic illustration. Believing that it had acquired a lease and an option to purchase from a landowner, a company spent a small fortune building a dock and a factory on the property. Unfortunately, the purported holder of the *fee simple* then discovered that he held a mere life estate, and, worse yet, died a few years later. The company was anxious to reach some agreement, but the gentleman's children, as the remaindermen, were uncooperative. Proceeding in law, they recovered possession through an action in ejectment and they were awarded *mesne*

1. (1922), 63 SCR 401 [*Montreuil*].

profits, representing reasonable rental value, with respect to the trespass that the company committed following the expiration of the lease. The company was not so fortunate. As both of the original parties had been mistaken as to the nature of the lessor's interest, the equitable doctrine of proprietary estoppel was inapplicable. Further, because the children had proceeded entirely in law, the company could not, by pleading that "[h]e who seeks equity must do equity", invoke the equitable doctrine of set-off, which would have encompassed the full value of the improvements.[2] The company, instead, was limited to its legal remedies, which consisted exclusively of law's miserly right of set-off. Having made permanent improvements to the property in the *bona fide* belief that it was in lawful occupation, it was entitled to compensation, but only "to the extent of the rents and profits claimed" by the children.[3] Since the trespass was worth a small fraction of the $100,000 that the company had spent on the improvements, the children came away with a substantial windfall.[4]

The situation in equity was better, but far from generous. While proprietary estoppel (or the doctrine of acquiescence) has long provided relief, it historically was formulated narrowly. The claimant was required to satisfy the "five probanda" articulated in *Wilmott v Barber*[5] ("*Wilmott*"):

> [i]n the first place the plaintiff must have made a *mistake as to his legal rights*. Secondly, the plaintiff must have *expended some money or must have done some act* (not necessarily upon the defendant's land) on the faith of his mistaken belief. Thirdly, the defendant, the possessor of the legal right, must k*now of the existence of his own right* which is inconsistent with the right claimed by the plaintiff. … Fourthly, the defendant … must know *of the plaintiff's mistaken belief* of his rights. … Lastly, the defendant … must have *encouraged the plaintiff* in his expenditure of money or in the other acts which he has done, either directly or by abstaining from asserting his legal right.[6]

Proof of the five probanda demonstrated a form of fraud that led equity

2. *Neesom v Clarkson* (1845), 67 ER 576 (Ch); *Richards v Collins*, 9 DLR 249 (Ont Div Ct).
3. *Montreuil, supra* note 1 at 439. See also *Geldhof v Bakai* (1982), 139 DLR (3d) 527 (Ont HC); *Farquhar v Sherk*, (1979), 14 RPR 18 (Ont Dist Ct).
4. The case was remitted to trial for a determination of precise values.
5. (1880), 15 Ch D 96 at (Eng) 105-106 [*Wilmott*].
6. *Ibid.* See also *Ramsden v Dyson and Thornton* (1866), LR 1 HL 129 [emphasis added].

to "restrain the possessor of the legal right from exercising it".[7] The precise means by which it did so was a function of an unusually broad discretion aimed at identifying "the minimum equity [required] to do justice between the parties".[8] The possibilities, which were virtually unlimited, included the transfer of title.[9] By definition, however, proprietary estoppel traditionally was confined to a narrow band of cases. If the defendant did not, actively or passively, improperly induce the plaintiff to act, then there was no basis for judicial intervention and the landowner's windfall was left to lie where it fell.[10]

The explanation for the historical reluctance to award relief for improvements to land is reasonably clear. Rights in real property were all but sacrosanct. Land, a scarce resource in a relatively small country, was the main repository of wealth and source of power prior to the industrial revolution. That fact, coupled with a fierce conception of personal autonomy, understandably resulted in an unwillingness to impose liability upon landowners. The danger was twofold. By its very nature, land is susceptible to services to an extent that other forms of property are not. It was easy to imagine a house mistakenly built on the wrong side of a boundary line, but impossible to conceive of a similarly substantial undertaking affecting a chattel. And even if liability was *in personam*, it might well entail a debt so large as to be satisfied only with the proceeds

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7. *Wilmott, supra* note 5 at 106.
8. *Crabb v Arun District Council*, [1976] Ch 179 at 189 (CA (Eng)) [*Crabb*].
9. *Dillwyn v Llewelyn* (1862), 45 ER 1285 (QB); *Pascoe v Turner*, [1979] 1 WLR 431 (CA (Civ)(Eng)); *Brogden v Brogden*, (1920), 53 DLR 362 (ABCA); *Cowderoy v Sorkos Estate*, 2012 ONSC 1921 [*Cowderoy*].
10. It is occasionally said that proprietary estoppel may apply regardless of context: *Amalgamated Investment and Property Co Ltd v Texas Commerce International Bank Ltd*, [1982] QB 84 (CA (Civ)(Eng))(enforcement of loan guarantee); *Moorgate Mercantile Co Ltd v Twitchings*, [1977] AC 890 (HL)(existence of competing interest in vehicle). Canadian courts, however, have generally confined the equitable doctrine to interests in land, as Justice Crawford held in *Silverstone Trucking Ltd v Pacific Dispatch Ltd*, 2015 BCSC 533 ("[a]s this case does not relate to real property, any claim of proprietary estoppel fails" at para 68). See also *Maritime Telegraph and Telephone Co v Château Lafleur Development Corp*, 2001 NSCA 167 at paras 37, 50; *Sabey v Beardsley*, 2014 BCCA 360 at para 32 [*Sabey*].

from the sale of land.

Circumstances, of course, have changed. Land is not so scarce in a country the size of Canada. Moreover, while a home frequently remains a person's most valuable asset, wealth increasingly is held in other forms. Real property may be a single part of a diversified portfolio. Wealthy individuals in the twenty-first century are just as likely to trace their privileged positions to copyrights and patents as to land. Highly valuable services may be rendered with respect to chattels and intangible assets as easily as they may be conferred upon real property.

To some extent, the legal system has evolved in step with modern perspectives on land. The Supreme Court of Canada, for instance, has broken with the past by rejecting the presumption that every parcel is unique and hence capable of supporting an order for specific performance of a contract. "Residential, business, and industrial properties", it explained, are "mass produced much in the same way as other consumer products" and therefore do not warrant special protection.[11] The court has also recognized that traditional attitudes regarding title to land are no longer appropriate within the context of "joint family ventures".[12] The redistribution of property rights upon the dissolution of marriage historically was unthinkable not only because courts tended to denigrate the nature of female domestic labour,[13] but also because they believed

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11. *Semelhago v Paramadevan*, [1996] 2 SCR 415 ("[t]his approach may appear to be overly generous to the respondent in this case and other like cases and may be seen as a windfall. In my opinion, this criticism is valid if the property agreed to be purchased is not unique. While at one time the common law regarded every piece of real estate to be unique, with the progress of modern real estate development this is no longer the case. Residential, business, and industrial properties are all mass produced much in the same way as other consumer products. If a deal falls through for one property, another is frequently, though not always, readily available" at para 20) [*Semelhago*].
12. *Kerr v Baranow*, 2011 SCC 10 [*Kerr*].
13. *Murdoch v Murdoch*, [1975] 1 SCR 423 (dismissing the claim of a woman who had laboured on the family property for twenty years because she merely had performed "the work done by any ranch wife" at 436).

that title to Blackacre was too important to be varied by judicial fiat.[14] While English courts continue to resist the remedial constructive trust,[15] Canadian judges no longer recoil at the prospect of awarding proprietary relief.[16]

Similarly, some provinces have adopted non-traditional attitudes towards land.[17] If a structure or fence encroaches upon a neighbouring property in British Columbia[18] or Manitoba,[19] a judge is entitled to order its removal, grant an easement, or, most dramatically, vest title in the encroaching party upon payment of an appropriate price. Likewise, if, as a result of a mistaken belief that the land was the plaintiff's own, a "lasting improvement" is made to the defendant's property, betterment

14. *Pettkus v Becker*, [1980] 2 SCR 834, Justice Martland ("[i]n my opinion, the adoption of this concept involves an extension of the law as so far determined in this Court. Such an extension is, in my view, undesirable. It would clothe judges with a very wide power to apply what has been described as 'palm tree justice' without the benefit of any guidelines. By what test is a judge to determine what constitutes unjust enrichment? The only test would be his individual perception of what he considered to be unjust" at 859) [*Pettkus*].
15. *Chapman v Chapman*, [1954] AC 429 (HL) at 444; *Re Polly Peck International (No 2)*, [1998] 3 All ER 812 (CA (Civ)) at 830.
16. *Pettkus*, *supra* note 14. Matrimonial property legislation similarly rejects the traditional view. For constructive trusts outside of family law, see *Soulos v Korkontzilas*, [1997] 2 SCR 217.
17. Mitchell McInnes, *The Canadian Law of Unjust Enrichment and Restitution* (Toronto: LexisNexis, 2014) at 327-31 [McInnes].
18. *Property Law Act*, RSBC 1996, c 377, s 36.
19. *The Law of Property Act*, CCSM 1997, c L90, s 28 [*Law of Property Act*].

statutes in Alberta,[20] Saskatchewan,[21] Manitoba,[22] and Ontario[23] allow a court to either award the claimant a lien for the value of the improvement or require the claimant to retain the affected portion of the property and compensate the defendant's resulting loss.

In deciding to override the protection traditionally enjoyed by landowners, the Supreme Court of Canada and the provincial legislatures act upon policies formulated following careful consideration of competing interests. These decisions typically receive considerable attention among their target audience. As a result, there are normally opportunities, before or after the fact, for experts and affected parties to assess the situation and to comment on the wisdom of moving in one direction or another.

In other instances, however, the legal system's attitude regarding non-contractual improvements to land has evolved piecemeal and without broad oversight. In a sense, that is the genius of the common law. The "heap of good learning"[24] is forever changing, incrementally, one case at a time. That approach nevertheless provides pause for thought insofar as significant developments may occur largely unnoticed. That is true, to a lesser or greater degree, in the current context.

The reformulation of the proprietary estoppel doctrine has been

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20. *Law of Property Act*, RSA 2000, c L-7, s 69.
21. *Improvements Under Mistake of Title Act*, RSS 1978, c I-1, s 2. See *St Pierre v St Pierre*, 2010 SKCA 20 ("[t]he claims he was entitled to statutory relief under *The Improvements Under Mistake of Title Act* and *The Frustrated Contracts Act* are without merit. The purpose of the former Act is to overcome the common law proposition that the true owner of land is entitled to everything attached to the land. It is intended to compensate someone who has an honest but mistaken belief that he or she was making lasting improvements to their own land. As the appellant was a wrongdoer, having induced someone to sell her home, he cannot expect to be compensated for his own wrongdoing" at para 18).
22. *Law of Property Act*, *supra* note 19, s 27.
23. *Conveyancing and Law of Property Act*, RSO 1990, c C-34, s 37(1).
24. Thomas Wood, *An Institute of the Laws of England in Their Natural Order According to Their Common Use* (1722), cited in Peter Birks, ed, *English Private Law*, 2d ed (Oxford: Oxford University Press, 2000) at xliv.

comparatively high profile.[25] For too long, the "five probanda" that Justice Fry articulated in *Wilmott*[26] had been treated like "a Procrustean bed constructed from some unalterable criteria",[27] rather than simply a "valuable guide".[28] The doctrine's usefulness had been unnecessarily cramped by a test that supported redress only if the defendant had knowingly duped the plaintiff into action. As a result, while traditions die hard, a number of Canadian courts have expressly redesigned proprietary estoppel.[29]

Idle-O Apartments Inc v Charlyn Investments Ltd[30] ("*Idle-O*") is a prime example. Idle-O purportedly leased part of a parcel to Charlyn for a term of 998 years. That lease, in fact, was void because it constituted an informal subdivision lasting more than three years.[31] Nevertheless, because neither party appreciated the problem, Charlyn greatly improved the property over the next two decades. When the defect finally came

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25. A great deal of commentary has arisen in response to recent English cases that have revisited the scope of proprietary estoppel: *Yeoman's Row Management Ltd v Cobbe*, [2008] UKHL 55; *Thorner v Major*, [2009] UKHL 18; *cf. Blue Haven Enterprises v Tully and another*, [2006] UKPC 17 (Jam); David Neuberger, "The Stuffing of Minerva's Owl? Taxonomy and Taxidermy in Equity" (2009) 68:3 Cambridge Law Journal 537; Martin Dixon, "Confining and Defining Proprietary Estoppel: The Role of Unconscionability" (2010) 30:3 Legal Studies 408; Ben McFarlane & Andrew Robertson, "Apocalypse Averted: Proprietary Estoppel in the House of Lords" (2009) 125:3 Law Quarterly Review 535.
26. *Wilmott, supra* note 5.
27. *Taylor Fashions Ltd v Liverpool Victoria Trustees Co Ltd*, [1981] 1 All ER 897 (Ch) at 918.
28. *Crabb, supra* note 8 at 194.
29. *Murphy v MacDonald*, 2009 PESC 30 (applying traditional criteria and denying relief because the defendant was not aware of the plaintiff's mistake) [*Murphy*]; *Dutertre Manufacturing Inc v Palliser Regional Park Authority*, 2012 SKQB 335 [*Dutertre*].
30. 2013 BCSC 2158 [*Idle-0*].
31. *Land Title Act*, RSBC 1996, c 250, s 73 (1)(b) provides: "[e]xcept on compliance with this Part, a person must not subdivide land into smaller parcels than those of which the person is the owner for the purpose of [...] (b) leasing it, or agreeing to lease it, for life or for a term exceeding 3 years".

to light and Idle-O asserted exclusive possession under a declaration of invalidity, Charlyn sought protection in the doctrine of proprietary estoppel. The traditional test, of course, could not be satisfied. While Charlyn had acted in the mistaken belief that it held a long-term interest in the land, Idle-O was oblivious to that error, as well as its own rights. The title-holder certainly had not engaged in the sort of cynical fraud contemplated in *Wilmott*. Charlyn's plea was nevertheless successful. As Justice Newbury explained in an excellent judgment, the "five probanda" have been "overtaken by a broader and less literal approach to proprietary estoppel".[32] An "equity" will arise in the improver's favour if:

i. "There was an assurance or representation, attributable to the owner, that the claimant has or will have some right to the property", and
ii. "The claimant relied on this assurance to his or her detriment so that it would be unconscionable for the owner to go back on that assurance".[33]

If both hurdles are cleared, "the court must [then] determine the extent of the equity and the remedy appropriate to satisfy the equity".[34] All of that was true on the facts of *Idle-O* even though both parties had laboured under the same mistake. While the invalid lease itself could not constitute an actionable representation, Idle-O's conduct certainly encouraged Charlyn in the belief that it would enjoy the fruit of its own labour. Moreover, once Charlyn detrimentally relied on that inducement by spending a great deal of time and money on the property, it became unconscionable for Idle-O to strictly enforce its legal rights. Accordingly, Charlyn's existing directors, as well as their children, were entitled to use the premises for recreational purposes for the remainder of their lives. Once the last member of that class has died, the cloud on Idle-O's title will disappear.

The specific manner in which the court reformulated proprietary

32. *Idle-0, supra* note 30 at para 134, quoting *Trethewey-Edge Diking District v Coniagas Ranches Ltd*, 2003 BCCA 197 at para 64. See also *Erickson v Jones*, 2008 BCCA 379; *Sabey*, *supra* note 10; *The Owners, Strata Plan VR 10 v EE Management Corp*, 2015 BCSC 473; *Hawes v Dave Weinrauch and Sons Trucking Ltd*, 2015 BCSC 540.

33. *Sabey v Rommel*, 2014 BCCA 360 at para 30.

34. *Ibid*.

estoppel obviously is important, but the fundamental reorientation of the doctrine is even more significant. Liability does not necessarily require proof that the defendant was culpably complicit in the plaintiff's decision to act.[35] The doctrine now responds, much more broadly, to the fact that it would simply be inequitable for the defendant to assert its legal rights to the plaintiff's detriment. The essential element of unconscientiousness, which justifies equity in overriding the landowner's legal rights, may be entirely *ex post*.

In that sense, the modern Canadian conception of proprietary estoppel strongly resembles the action in unjust enrichment. The defendant may be held liable with respect to unrequested services even though it neither knew, nor ought to have known, that the plaintiff

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35. Whereas British Columbia's Court of Appeal has adopted a two-stage test, its counterpart in Ontario has adopted a three-fold inquiry. See *Clarke v Johnson*, 2014 ONCA 237 (Peppal JA warned against rigid criteria, but said that proprietary estoppel occurs when "(i) the owner of the land induces, encourages or allows the claimant to believe that he has or will enjoy some right or benefit over the property; (ii) in reliance upon his belief, the claimant acts to his detriment to the knowledge of the owner; and (iii) the owner then seeks to take unconscionable advantage of the claimant by denying him the right or benefit which he expected to receive" at para 52) [*Clarke*]. See also *Eberts v Carleton Condominium Corporation No 396* (2000), 136 OAC 317 (Ont CA) at para 23; *Love v Schumacher Estate*, 2014 ONSC 4080 at para 36 [*Schumacher Estate*]; *Gold v Chronas*, 2014 ONSC 6763; *Brownlee v Kashin*, 2015 ONSC 1035 at para 69 [*Brownlee*]; *Alexander James Wright v Candice Holmstrom*, 2015 ONSC 1906 at para 50; *Servello v Servello*, 2014 ONSC 5035 at para 103, per Justice Koke [*Servello*]. The same approach now prevails in Alberta: *Parkdale Nifty Fifties Seniors Association v Calgary (City)*, 2012 ABCA 301 at para 12; *Rocky Mountain House (Town of) v Alberta Municipal Insurance Exchange*, 2007 ABQB 548 at para 22; *Nelson v 1153696 Alberta Ltd*, 2009 ABQB 732 at para 235, appealed on other grounds in *Nelson v 1153696 Alberta Ltd*, 2011 ABCA 203. Some judges proceed more cautiously. In *Cowderoy*, *supra* note 9 at para 84, Justice Tausendfreund observed that proprietary estoppel traditionally encompassed two categories of cases – depending upon whether the defendant *encouraged* or merely *acquiesced* in the plaintiff's acts – and held that the "five probanda" are not necessarily apposite in the former.

did not truly intend to confer a benefit. As a result, unjust enrichment, like the re-formulated model of proprietary estoppel, has the capacity to substantially undermine the courts' traditional reluctance to impose liability for non-contractual improvements to land.

II. The Risk of Restitution

Although the label is used ambiguously too often, "unjust enrichment" properly refers to the cause of action that governs unwarranted transfers between parties.[36] As authoritatively framed by the Supreme Court of Canada, it requires proof that (i) the defendant received an *enrichment*; (ii) the plaintiff suffered a *corresponding deprivation*; and (iii) there was an *absence of juristic reason* for the transfer. Reference sometimes is made to a final stage of inquiry, consisting of four *bars and defences*.[37] If the cause

36. Canadian courts sometimes use "unjust enrichment" to refer to a situation in which the plaintiff proves that the defendant committed some form of civil wrong (*e.g.* breach of confidence, trespass to land, "exceptional" breach of contract), but instead of seeking compensation for losses suffered, demands "restitution" (or, more precisely, disgorgement) of the defendant's ill-gotten gain. Critically, whereas true unjust enrichment and restitution require no breach and are confined to benefits that the defendant received *from* the plaintiff, the alternative model of liability typically is invoked to capture benefits that the defendant obtained from a third party as a result of violating the plaintiff's rights. That is true, for instance, if a Crown prosecutor abuses the fiduciary position by accepting bribes from criminals. The government does not recover money that it previously possessed. As the victim of the operative breach, it strips away the enrichment that its dishonest agent obtained from the third parties: *Attorney General of Hong Kong v Reid*, [1994] 1 AC 324 (PC (NZ)); *cf. Can Aero v O'Malley*, [1974] SCR 592.
37. *Pettkus*, *supra* note 14; *Garland v Consumers' Gas Co*, 2004 SCC 25 [*Garland*]. The underlying principle was first recognized in *Deglman v Guaranty Trust Co of Canada and Constantineau*, [1954] SCR 725 [*Deglman*].

of action is made out, restitution is the only possible response.[38] The transfer between the parties is reversed and the *status quo ante* is restored. The plaintiff cannot get back more than was lost; the defendant cannot give back more than was gained.

The roots of the modern action in unjust enrichment date back hundreds of years, but it was only during the second half of the twentieth century that the subject came into its own.[39] It was even longer before the simple three-part claim was allowed to unfold naturally in the current context. Writing in 1992, Professor Fridman objected to the application of unjust enrichment as a "broad general principle" and insisted, in the event of non-contractual improvements to land, that "no claim will succeed where the defendant was given no opportunity to object to what was being done, *i.e.* did not actively acquiesce".[40] To impose liability against an "entirely innocent" landowner "on a restitutionary basis", he said, "would result in an injustice".[41] Similarly, in 2004, Professors Maddaugh and McCamus wrote that "the full implications of the unjust enrichment principle have not been adopted" and said that relief for improvements to land has been "narrowly restricted to mistakes of ownership in the traditional sense".[42]

Significantly, as Fridman reported, while case-law was sparse, there was "no congruence between the law relating to improvements to land

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38. McInnes, *supra* note 17 at chs 32, 34, 35 (While the *measure* of relief is always the same, the *form* of restitution depends upon the circumstances. It is usually *personal*, but it exceptionally is *proprietary*. There is growing recognition that many traditional proprietary doctrines are best understood as restitution for unjust enrichment. That is true, for instance, of resulting trusts, rescission, and subrogation).
39. By 1760, Lord Mansfield was able to draw a generalized principle from a rich body of case law: *Moses v Macferlan* (1760), 97 ER 676 (KB).
40. GHL Fridman, *Restitution*, 2d ed (Scarborough: Carswell, 1992) at 334, 336 [*Fridman*].
41. *Ibid*.
42. Peter D Maddaugh & John D McCamus, *The Law of Restitution*, 2d (Aurora, Ontario: Canada Law Book Inc, 2004)(Loose-leaf) at § 12:400.20 [Maddaugh & McCamus].

and that pertaining to improvements to chattels".[43] The action in unjust enrichment was available to one who, for instance, repaired a vehicle following an apparently valid purchase.[44] *Goff & Jones*, the pioneering English text, explained the essential difference:

> It may seem odd to allow a bona fide improver of a chattel a claim for improvements and to deny a bona fide improver of land a comparable claim. But no English lawyer should be surprised that our law should treat chattels differently than land. Most chattels are not unique; they are fungible and replaceable. It may be unreasonable to require the owner of land to sell or mortgage in order to recompense the improver for unsolicited improvements. But it will not generally be unreasonable to require the owner of a chattel, who has obtained an unsolicited but incontrovertible benefit from another's improvements, to sell his chattel to make restitution for the benefit, if that is the only way he can do so.[45]

As the preceding quotation suggests, restitution carries a substantial risk insofar as it may impose an unfair burden upon an innocent recipient. The explanation lies in unjust enrichment's unique nature.[46] Most causes of action turn on the breach of an obligation. Once it has been determined that the defendant is a wrongdoer, a court will be justified in disrupting the *status quo ante*. It may strip away ill-gotten gains (*i.e.*

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43. Fridman, *supra* note 40 at 345. See also *Gidney v Shank*, [1995] 5 WWR 385 (Man QB), reversed in *Gxqidney v Shank*, [1996] 2 WWR 383 (Man CA) [*Gidney*]; *Thomas v Robinson*, [1977] 1 NZLR 385 (SC) [*Robinson*].

44. *Greenwood v Bennett*, [1973] QB 195 (CA (Civ)(Eng)) [*Greenwood*]; *Webb v Ireland*, [1988] IR 353 (HC) [*Webb*].

45. Robert Goff & Gareth Jones, *The Law of Restitution*, 3d (London: Sweet & Maxwell, 1986) at 147-48 [Goff & Jones].

46. McInnes, *supra* note 17 at 24-31 ("Strict liability" is an ambiguous phrase. It typically means that the defendant may be held liable for having breached an obligation even though the breach was neither deliberate nor negligent. That is true, for instance, under the actions for breach of fiduciary duty, breach of confidence, and trespass. In such circumstances, the defendant's breach of that primary obligation triggers the imposition of a secondary (remedial) obligation. Unjust enrichment, in contrast, entails *true* strict liability. The defendant incurs liability, without any breach at all, simply by receiving a benefit from the plaintiff in the absence of any legal explanation. And since there is no breach, there is never any question of a secondary obligation. The duty to make restitution is a primary obligation that arises from the transfer itself).

disgorgement), extract reparation of losses (*i.e.* compensation), or even impose deliberate pain (*i.e.* punitive damages).[47] The breach warrants the mistreatment. In other instances, the court's justification lies in a prior agreement. While it is human nature to grumble, the defendant has no real complaint if a court demands performance of a contractual undertaking. Judicial intervention merely reflects a choice that the defendant previously exercised.

Unjust enrichment, however, requires neither a wrong nor an agreement. The plaintiff may seek restitution for improvements to land even though the defendant was entirely innocent and unaware of those services at the time of conferral. If that claim is upheld, then there is a very real risk that the landowner will bear the burden of a benefit that was unnecessary, unwanted, and unaffordable. In the worst case scenario, as *Goff & Jones* contemplated, the defendant may be able to satisfy judgment only by liquidating the land. As a result of the plaintiff's mistaken decision to act, the defendant may be compelled to sacrifice a long-cherished family home. That is not an attractive prospect.[48]

III. Enrichment and Autonomy

Broadly speaking, the risk that restitution may create injustice may be managed at either the first stage or the third stage of the action in unjust enrichment.

Enrichment is a deceptively simple concept. It serves at least three functions.[49] To begin, it obviously demonstrates that the defendant

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47. Disgorgement almost always disrupts the *status quo ante* insofar as it leaves the plaintiff with a benefit that it never possessed and never would have obtained in the normal course of events. Punitive damages have the opposite effect insofar as they require the defendant to deplete untainted resources in order to satisfy judgment. Though the point occasionally is overlooked, the same is true of compensation. Unless the defendant coincidentally received a wrongful gain corresponding to the plaintiff's wrongful loss, the payment of reparations necessarily will draw upon pre-existing funds. Compensatory damages hurt, albeit not as much as punitive damages.
48. Goff & Jones, *supra* note 45.
49. McInnes, *supra* note 17 at ch 2.

received an objective benefit, which, when coupled with other elements, may support liability.[50] Moreover, assuming that liability has been established, the measure of relief is governed by the value of the transfer between the parties; this is a function of the defendant's gain and the plaintiff's corresponding loss.[51] And, most importantly for present purposes, the concept of enrichment provides the primary means by which the courts protect innocent recipients from hardship. It does so by ensuring that the risk of liability is consistent with the defendant's autonomy.

It is not enough for the plaintiff to prove the transfer of an objective benefit. The common law "was founded on a philosophy of robust individualism which expected every person to look out after his or her own interests and which place[d] a premium on the right to choose how to spend one's money".[52] The recipient of an objective benefit consequently enjoys the right of *subjective devaluation*.[53] That label is a bit misleading. The defendant may be personally delighted to have a benefit, but still escape liability. The explanation lies in the fact that subjective

50. *Peel (Regional Municipality) v Canada*, [1992] 3 SCR 762 ("[t]he word 'enrichment' ... connotes a tangible benefit" at para 45) [*Peel*]; *Peter v Beblow*, [1993] 1 SCR 980 ("[t]his court has consistently taken a straightforward economic approach to the first two elements of the test for unjust enrichment" at 990) [*Beblow*].

51. *Air Canada v British Columbia*, [1989] 1 SCR 1161 (restitution "is not intended to provide windfalls to plaintiffs who have suffered no loss. Its function is to ensure that where a plaintiff has been deprived of wealth … it is restored to him" at 1202); *Kerr, supra* note 12 (unjust enrichment means "not simply that the defendant has been enriched, but also that the enrichment corresponds to a deprivation which the plaintiff has suffered" at para 39); *Quebec (Attorney General) v A*, 2013 SCC 5 (liability in unjust enrichment "will be allowed in the lesser of the following two amounts: that of the enrichment of [the defendant] and that of [the plaintiff's] own impoverishment" at para 119); *cf. Kingstreet Investments Ltd v New Brunswick (Finance)*, 2007 SCC 1.

52. *Peel, supra* note 50 at 785-86.

53. *Stevested Machinery & Engineering Ltd v Metso Paper Ltd*, 2014 BCCA 91 at para 60; *Valley v McLeod Valley Casing Services Ltd*, 2004 ABQB 302 at para 145 [*McLeod*]; *Sherbeth v Sherbeth*, 2007 MBQB 50 at para 22 [*Sherbeth*].

devaluation is a test of autonomy. It allows the defendant to turn to the plaintiff and say, "it is not your job to make my choices".[54] Suppose, for example, that a landscaping company, erroneously arriving at the wrong address, artistically sculpts the landowners' hedges into fantastical shapes. That service has market value. Some people pay good money for it. Nevertheless, whether they are amused or horrified to discover the topiary on their front yard, the owners presumptively never chose to expend resources on such whimsy.

A. Request and Free Acceptance

Given the doctrine of subjective devaluation, recognition of a legal enrichment is premised upon proof that restitution would not intolerably override the recipient's autonomy. There are two possibilities. First, the plaintiff may prove that the defendant actually chose to accept the risk of liability, either actively through a request[55] or passively through free

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54. *Magical Waters Fountain Ltd v Sarnia* (1990), 74 OR (2d) 682 (Ont Ct J (Gen Div)) at 691, per Justice Gautreau, appealed on other grounds in *Magical Waters Fountains Ltd v Sarnia* (1992), 8 OR (3d) 689 (CA). See also JRM Gautreau, "When Are Enrichments Unjust?" (1989) 10:3 Advocates' Quarterly 258 ("[t]he choice of how to invest one's time, effort and money should not be forced on one. Freedom of choice is the dominant consideration in these cases" at at 261).

55. Of course, a request that elicits performance may support recognition of a contract: *St John Tug Boat Co Ltd v Irving Refinery Ltd*, [1964] SCR 614. If so, unjust enrichment generally is a non-issue.

acceptance.[56] A request normally[57] demonstrates both a desire to receive and a willingness to pay.[58] Accordingly, if the plaintiff duly performs, the defendant cannot complain if the court compels payment. Much the same is true, under the doctrine of free acceptance, if the defendant chooses to accept a proffered benefit despite knowing that the plaintiff expects payment and despite a reasonable opportunity to reject.[59] In effect, silent acquiescence is deemed to constitute a decision to assume

56. As of 2004, a transfer is reversible not because of the presence of an unjust factor, but rather because of the absence of juristic reason: *Garland*, *supra* note 37 discussed below at Part V.B. As a result, free acceptance has "now been overtaken" as a test of *injustice*: *Kerr, supra* note 12 at para 121. It nevertheless continues to serve, more narrowly, as a test of *enrichment*.
57. Exceptions do arise. Within a family unit, in which benefits are routinely conferred gratuitously, one may genuinely request a service without any expectation of subsequently being provided with a demand for payment. Much the same may be true even in a commercial context. For instance, an injured worker may seek out a psychologist's services in the mistaken belief that the psychologist would look to the employer for payment: *Tang v Jarrett*, [2009] OJ No 1282 (Sup Ct J)(QL). So too, a homeowner may ask for a realtor's help in selling a property in the mistaken belief that the agent expected payment only in the event of a sale: *Seale & Associates Inc v Vector Aerospace Corp*, [2009] OJ No 1456 (Sup Ct J)(QL); *Sugar v Kim Orr Barristers Professional Corp*, 2012 ONSC 6668 (firm requested lawyer's assistance in drafting pleadings in belief that services were offered on a contingency basis).
58. The request doctrine is extended slightly if, for example, a benefit is either demanded at gunpoint or taken without permission. The courts will not allow a person to improperly frustrate the normal operation of the marketplace. One who demands or takes is treated as the same as one who requests: *720654 Alberta Ltd v El Hajj*, 2011 ABPC 64.
59. *Pettkus*, *supra* note 14; *Binichakis v Smitherman*, 2009 BCPC 131; *Park Georgia Realty Ltd v Mayfair Lanes Canada Ltd*, 2009 BCSC 1322 at para 73.

the risk of liability.[60]

B. Incontrovertible Benefit

The second category of enrichment is more controversial. Instead of turning upon the nature of the defendant's conduct, it turns upon the nature of the enrichment itself. As Justice McLachlin explained, normally, it "would be wrong to make the defendant pay" for an unsolicited benefit "since he or she might well have preferred to decline the benefit if given a choice".[61] An *incontrovertible benefit*, however, is "demonstrably apparent and not subject to debate or conjecture". It is "not the antithesis of freedom of choice" — it "exists when freedom of choice as a problem is absent".[62]

Money is an incontrovertible benefit.[63] As the very means by which value is recognized and expressed, it cannot be subjectively devalued. It is always valuable and it is equally valuable regardless of who holds it. If the recipient does not wish to be held liable, money can always be given back. Even if the specific notes and coins received from the plaintiff no longer are on hand, others can be returned in their place. Money, after all, is fungible. One $20 bill is as good as the next.

Services, in contrast, can never be restored *in specie*. As Baron Pollock famously said, "[o]ne cleans another's shoes; what can that other do

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60. That proposition is somewhat controversial. A person who requests a benefit outside of a social setting is indeed normally prepared to pay. In contrast, a non-solicited benefit may be freely accepted not because one intends to pay, but rather because one cares too little to even voice an opinion. In that sense, the doctrine constitutes a rare positive obligation in private law.
61. *Peel*, *supra* note 50 at 795.
62. *Ibid.*
63. *BP Exploration Co (Libya) Ltd v Hunt (No 2)*, [1979] 1 WLR 783 (QB (Eng)), per Justice Goff ("[m]oney has the peculiar character of a universal medium of exchange. By its receipt the recipient inevitably is benefitted" at 799). See also *Sharwood & Co v Municipal Financial Corp* (2001), 197 DLR (4th) 477 (Ont CA) at 485; *Halifax (City) v Nova Scotia (Attorney General)*(1997), 163 NSR (2d) 360 (SC) at 370.

but put them on"?[64] The courts consequently must exercise great care in recognizing non-monetary incontrovertible benefits. In effect, the court must be satisfied that, given the impugned transfer, it is *as if* the defendant received money. This will be true in two circumstances.

A benefit may arise *positively* through an accretion to pre-existing resources or *negatively* through the discharge of an obligation.[65] And if an obligation represents a *necessary expense*, either legally or factually, then its satisfaction creates an incontrovertible benefit.[66] Suppose, for instance, that each landowner bears a statutory obligation to upgrade a sewer line on its property. As a result of an error, the plaintiff upgrades the defendants' line rather than its own, at a cost of $25,000. Assuming that the expense would have been the same in either event, the defendants necessarily are enriched.[67] It is as if they received money. The pre-existing resources that they necessarily would have used to discharge their statutory duty can be directed to the claimant instead. And while they have no choice about reversing the unjust enrichment, they similarly had

64. *Taylor v Laird* (1856), 25 LJ Ex 329 (Eng) at 332. The same observations apply, *mutatis mutandis*, with respect to goods that have been consumed.
65. *Peel*, *supra* note 50 at 790; *Carleton (County) v Ottawa (City)*, [1965] SCR 663.
66. A legally necessary expense is relatively simple because the operative obligation usually admits little, if any, scope for dissent. A tax demand, for instance, normally dictates the amount and the timing of the required payment. In contrast, because a factually necessary expense may be a function of personal circumstance, a court must take care to ensure that the defendant had no real choice in the matter. For instance, does the installation of an air conditioning unit represent a factually *necessary* expense? What if the defendant lives in Arizona or the Yukon? What if the defendant is fabulously wealthy or desperately poor? As the category of factually necessary expense expands, the defendant's autonomy contracts.
67. The incontrovertible benefit exists insofar as a necessary expense has been anticipated. Consequently, if the defendants could have satisfied their statutory obligation at a cost of $20,000, then that is the value of their enrichment even if it cost the plaintiff $25,000 to upgrade the sewer line. By the same token, restitution will be limited to the lesser amount, under the second element of the action in unjust enrichment, if the plaintiff spends only $20,000 in order to discharge an obligation that would have cost the defendants $25,000.

no choice about upgrading their sewer line. Restitution leaves them none the worse for wear.

The same is true if the defendants receive a benefit from which they *realize a financial gain*. Suppose, for instance, that the defendants own an empty parcel that they intend to sell for $50,000. Before they do so, the plaintiff acts in error and builds a house on the property at a cost of $150,000. The defendants then sell the improved lot for a price of $200,000. They are in the same position they would have enjoyed if they had sold the land in its original state for $50,000 and received $150,000 cash from the claimant. By the same token, liability will restore the *status quo ante* on both sides. Restitution, again, will leave the defendants none the worse for wear.

The analysis, however, may be more contentious. Assume that while the plaintiff mistakenly built a house on the defendants' property and thereby raised its value from $50,000 to $200,000, the landowners never intended to sell and, indeed, still hold title. Should an incontrovertible benefit be recognized on the basis of a *realizable* financial gain? The defendants *could* sell the improved parcel for $200,000, pay $150,000 as restitution to the plaintiff, and use the remaining $50,000 to buy a replacement for their original asset. And, if they wish to retain the improved property, they could satisfy judgment from other resources. While rearranged, the totality of their wealth would be unchanged relative to the *status quo ante*. Instead of holding land worth $50,000 and other assets worth $150,000, they would hold land worth $200,000.

For many years, case-law was sparse, the law was unsettled, and academic analysis provided the primary point of discussion. As might be expected, scholarly opinions vary. At one extreme, the interest in autonomy is said to permit recognition of an enrichment only if and when a profit *has been realized* from a non-monetary benefit.[68] That approach, of course, puts the plaintiff at the defendant's mercy. A landowner may escape liability simply by holding onto the improved property until the limitation period has passed or perhaps until the improvement has

68. Peter Birks, *Unjust Enrichment*, 2d (Oxford: Oxford University Press, 2005) at 61-62; Peter Birks, *An Introduction to the Law of Restitution* revised ed (Oxford: Clarendon Press, 1985) at 121-24.

sufficiently depreciated. At the other extreme, the defendant may be considered enriched as long as a financial gain *can be realized* from the claimant's efforts. Most commentators, however, prefer to soften that position through the addition of qualifiers. A beneficial service is said to be incontrovertible if a financial gain is *readily realizable*[69] or *readily realizable without undue hardship*.[70] Depending upon its precise formulation, that test may allow a landowner to escape liability if, for instance, the affected property is not marketable or genuinely treasured. Accordingly, while the underlying premise no longer holds in Canada,[71] landowners previously were thought to be protected from the risk of restitution by the belief that every parcel of land is unique and irreplaceable.[72]

Courts elsewhere in the Commonwealth continue to proceed cautiously in this area. As will be seen, however, Canadian judges have adopted a surprisingly broad test of incontrovertible benefit. While the issue has never received the attention that it deserves, an enrichment is commonly recognized as long as the plaintiff's services have increased the market value of the defendant's property. A realizable financial gain, it seems, may be sufficient.

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69. Andrew Burrows, *The Law of Restitution*, 3d (Oxford: Oxford University Press, 2011) at 47-49.
70. A variation on the same theme holds that if recognition of an incontrovertible benefit would expose a landowner to intolerable hardship, liability may take the form of an equitable lien that is exercisable only if and when the defendant sells the relevant asset for an enhanced price: Maddaugh & McCamus, *supra* note 42 at § 3:200.10, § 5:300; *Gareau Estate (Re)*(1995), 9 ETR (2d) 25 (Ont Ct J (Gen Div)).
71. While each parcel of land historically was considered unique and irreplaceable, the Supreme Court of Canada has adopted a more flexible test: *Semelhago, supra* note 11; *Southcott Estates Inc v Toronto Catholic District School Board*, 2012 SCC 51.
72. Goff & Jones traditionally endorsed that view: Goff & Jones, *supra* note 45 at 147. The most recent edition of that text, under new authorship, now supports a very different approach: C Mitchell, P Mitchell & S Watterson, eds, *Goff & Jones: The Law of Unjust Enrichment*, 8d (London: Sweet & Maxwell, 2011) c 5.

C. Change of Position: Autonomy Front and Back

The test of enrichment protects a recipient's autonomy at the time of transfer. In order to satisfy the first element of the action in unjust enrichment, the plaintiff must prove that the defendant either chose to accept the risk of financial responsibility (request, free acceptance) or received a benefit for which responsibility cannot be denied (incontrovertible benefit). Without more, however, the risk of restitution remains. Having been unjustly enriched, entirely innocent recipients may, in good faith, become disenriched prior to trial. Suppose, for instance, that the defendants, finding their property improved and honestly believing that the windfall is theirs to keep, sell the land and distribute the additional proceeds to charities that no longer can be identified. If the plaintiff then steps forward and the court awards full recovery, the defendants will be justifiably aggrieved. Liability will be contrary to their freedom of choice. If they had known that they would have to restore the value of the claimant's services, they never would have given to charity. Additionally, they will have to deplete other resources (*e.g.* children's education fund) in order to satisfy a judgment. Restitution will hurt. It will leave the defendants with less than they had before the unjust enrichment occurred. This cannot be right.

That problem is solved by protecting the defendants' autonomy front and back. Just as the tests of enrichment respect freedom of choice at the moment of receipt, the change of position defence performs the same function at the time of trial.[73] Liability, ultimately, is reduced to the extent that dis-enrichment occurs in good faith before judgment.[74] Consequently, if the defendants donated the full value of their enrichment to charity, the plaintiff would recover nothing. Alternatively, if the defendants gave away forty per cent of their apparent windfall, the plaintiff's claim would be reduced accordingly. In contrast, the defendants would have no defence at all if they spent their enrichment

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73. McInnes, *supra* note 17 at ch 36.

74. *Mobil Oil Canada Ltd v Storthoaks (Rural Minicipality)*, [1976] 2 SCR 147; *RBC Dominion Securities Inc v Dawson* (1994), 111 DLR (4th) 230 (NFCA).

on rent and groceries; those expenditures would have occurred regardless of the unjust enrichment and they do not implicate the defendants' autonomy. The funds that the defendants would have otherwise spent on their home can be directed toward the plaintiff instead. The defence similarly would be denied if the defendants knew of the plaintiff's claim when they experienced their dis-enrichment. That would be true if they gave to charity *after* being served with a statement of claim. Having made an informed decision, they cannot reasonably expect the plaintiff to bear the cost of their charitable donation.

IV. Injustice and Autonomy

For the purposes of unjust enrichment, it would be difficult to overstate the significance of the preceding analysis. The tests of enrichment, supported by the change of position defence, ensure that restitution never hurts relative to the *status quo ante*. They do so by allowing liability only insofar as it is consistent with the defendant's freedom of choice. That proposition also carries an important corollary. Because the recipient's autonomy is protected at the first and fourth stages of inquiry, it need not dominate the third. The issue of injustice can — and indeed, must — be resolved primarily be reference to considerations other than the recipient's freedom of choice.

Granted, freedom of choice could be protected in terms of injustice rather than enrichment. Liability could be premised upon proof that, within a pre-existing relationship, the defendant requested or acquiesced in the receipt of a benefit despite knowing that the plaintiff expected payment in return. Significantly, however, whereas the nuanced test of enrichment sensitively provides protection only to the extent that it is required, an injustice-based approach broadly operates on an all-or-nothing basis.

Consider a simple situation in which the parties have no relationship at the time of transfer. The plaintiff mistakenly improves the defendant's property and thereby raises its value from $10,000 to $15,000. Oblivious to the claimant's mistaken services, the defendant incurs transaction costs of $1,000 while selling the improved asset for $15,000, purchases a non-improved replacement for $10,000, and pockets the remaining $4,000.

The plaintiff then discovers the error and sues for restitution.

The defendant's autonomy will receive all the protection it requires under the enrichment-based approach. Regardless of the fact that the parties remained strangers throughout the episode, the defendant incontrovertibly is enriched as a result of realizing a $4,000 profit from the plaintiff's services. Liability will very nearly restore the *status quo ante*. The defendant once again will have property worth $10,000; the plaintiff will recoup $4,000. Of course, the claimant would prefer to recover $5,000, but the additional $1,000 would run contrary to freedom of choice. Judgment could be satisfied only if, for instance, the defendant used funds that had been earmarked for a brief holiday in the mountains. Despite doing nothing wrong, the defendant would be adversely affected. Restitution would hurt.

Now consider the outcome under an injustice-based approach. Since the defendant was unaware of the plaintiff throughout, and therefore neither requested nor freely accepted the services, liability must be denied altogether. The plaintiff will have no means of reversing any part of the $5,000 transfer; the defendant will retain both an asset worth $10,000 and $4,000 in cash. It is difficult to imagine a clearer case of unjust enrichment. And yet, for many years, that is precisely the analysis that Canadian courts employed.

A. The Rise in Special Relationships

The modern Canadian law of unjust enrichment began in 1954 when *Deglman v Guaranty Trust Co*[75] recognized an independent restitutionary claim.[76] Understandably, early judgments were somewhat unsophisticated and results were decidedly mixed. In cases involving improvements to land, it seems that the issues of enrichment and injustice were often resolved through unreasoned intuition.

Estok v Heguy[77] is a notorious example. Having apparently purchased

75. *Deglman, supra* note 37.

76. *Ibid.*

77. (1963), 40 DLR (2d) 88 (BCSC). See also *T & E Development Ltd v Hoornaert* (1978), 78 DLR (3d) 606 (BCSC); *Reeve v Abraham* (1957), 22 WWR 429 (ABSC); *Phipps v Pickering* (1978), 8 BCLR 101 (BCSC).

a rural property, the plaintiff spread a great deal of manure in preparation for planting crops. The purported agreement was then determined to be void for lack of a *consensus* and the land was returned to the defendant. Against the ensuing claim for restitution, the defendant insisted that since he intended to resume using the parcel for pasture, he had no need for the fertilizer. The court nevertheless imposed liability for the value of the service. The error in that decision is now easy to see. There was no enrichment. Although the manure deposit was an objective benefit with market value, the plaintiff could not overcome the plea of subjective devaluation. The defendant never chose to bear responsibility. He had not requested the service and, because he never had an opportunity to reject the manure, there was no question of free acceptance. Nor did the fertilizer constitute an incontrovertible benefit. Given the defendant's intended use of the property, he had not been saved a necessary expense, and there was no evidence that he was in a position to realize a financial gain.

Republic Resources Ltd v Ballem[78] ("*Republic Resources*") stands on firmer ground. The plaintiff entered onto the defendant's land under a natural gas lease but, as a result of an error, successfully drilled a well only after the term had expired. Since it was no longer able to exploit the well, the plaintiff sued the defendant in unjust enrichment. It claimed that it had conferred an incontrovertible benefit because the defendant was either saved the expense of drilling a well or able to realize a financial gain whenever the well was put into production. Justice Holmes disagreed. In the circumstances, he said, there was no need to drill a well and it was impossible to know if or when the capped well might be put into profitable production. Thirteen other wells in the area had been shut down and the market for natural gas was in precipitous decline. Consequently, since the plaintiff had created, at most, an "unascertained benefit",[79] restitution was unavailable because it would unfairly override the defendant's autonomy.

78. [1982] 1 WWR 692 (ABQB) [*Republic Resources*]. See also *Ross Cromarty Developments Inc v Arthur Bell Holdings Ltd*, [1994] 3 WWR 142 (BCCA).

79. *Republic Resources*, *supra* note 78 at 708.

1. The Misinterpretation of *Nicholson v St Denis*

Despite denying liability on the facts, the court in *Republic Resources* observed that restitution may be awarded, on the basis of an incontrovertible benefit, even if the defendant was unaware of the plaintiff's services at the time of performance.[80] In that sense, *Republic Resources* closely resembles *Nicholson v St Denis*[81] ("*Nicholson*"). Unfortunately, the latter case came to be misinterpreted with occasionally disastrous results.

Nicholson itself is an innocuous decision. It began when the defendant agreed to sell a property, which contained a building, to Labelle. Though the purchaser would not receive title until the price was paid in full, he took possession immediately and hired the plaintiff to place siding on the building. The job was completed, but as Labelle had become insolvent, he could not pay. The plaintiff therefore demanded restitution from the defendant who had resumed possession of the parcel. Justice MacKinnon rightly dismissed that claim; there was no enrichment. The defendant had neither requested nor freely accepted the plaintiff's services despite knowing that he expected payment. Nor did the siding constitute an incontrovertible benefit. It did not anticipate a necessary expense and there was no evidence to suggest that it raised the property's market value so as to create a realizable financial gain. Moreover, as a Canadian court would say today, there was a juristic reason for any enrichment that might exist. By entering into a contract and extending credit, the plaintiff took the chance that Labelle might not be able to pay.[82] Unjust enrichment cannot be used to circumvent a contractual allocation of risk.[83]

All of this is entirely orthodox. *Nicholson*'s enduring legacy is found instead in Justice MacKinnon's *dicta*.[84] After surveying cases in which restitution had been awarded, he offered a general observation.

> [I]n *almost all of the cases* the facts established that there was a *special relationship*

80. *Ibid.*
81. (1975), 57 DLR (3d) 699 (Ont CA) [*Nicholson*].
82. The plaintiff similarly became the author of his own misfortune when he neglected to secure his rights under the *Mechanics' Lien Act*, RSO 1970, c 267.
83. McInnes, *supra* note 17 at ch 12.
84. *Nicholson*, *supra* note 81.

> between the parties, *frequently contractual* at the outset, which relationship would have made it unjust for the defendant to retain the benefit conferred on him by the plaintiff ... This relationship in turn is *usually, but not always,* marked by two characteristics, firstly, *knowledge of the benefit* on the part of the defendant, and secondly, either an express or an implied *request* by the defendant for the benefit, or *acquiescence* in its performance.[85]

As long as it is confined to situations involving services, rather than money or property, that statement is absolutely true. The explanation pertains to the element of enrichment. As previously discussed, services are problematic because they can never be restored and because they are not equally valued by everyone. There consequently is a danger that liability will hurt. The court may effectively dictate an innocent party's allocation of resources. The defendant may have to pay money for a service that, while objectively beneficial, was not a spending priority.

To combat that danger, the law normally requires the plaintiff to prove the defendant either requested or freely accepted services with knowledge that payment was expected. Significantly, however, MacKinnon J qualified his statement. He referred to "almost all of the cases" and said that a special relationship "is usually, but not always", required.[86] Exceptions do exist. Even if the defendant did not actually choose (actively or passively) to bear responsibility for a benefit, the autonomy interest may be overcome by the nature of the services themselves. That is true if the plaintiff provided the defendant with an incontrovertible benefit.

MacKinnon J supported his position by citing *Greenwood v Bennett*.[87] The plaintiff purchased a badly damaged Jaguar and spent considerable time and money on repairs. In fact, although the claimant had acted in good faith, the car previously had been stolen from the defendant and run into the ground. After the police intervened and returned the vehicle to its rightful owner, the plaintiff sued for the value of the mistaken improvements. Although the other members of the Court of

85. *Ibid* at 701-702 [emphasis added].
86. *Nicholson*, *supra* note 81 at para 8.
87. *Greenwood*, *supra* note 44. See now *Benedetti v Sawiris*, [2013] UKSC 50 ("there are circumstances in which the receipt of a service may call for restitution of its monetary value even if the receipt was involuntary" at para 113).

Appeal recognized a passive claim of equitable set-off, Lord Denning held that the mistaken improver was entitled to restitution of an unjust enrichment. Stated in more modern language, the defendant obtained an enrichment when he sold the Jaguar, in its improved state, for an increased price. By realizing a financial gain from the plaintiff's efforts, the defendant incontrovertibly was benefitted.[88]

A careful reading of the *dicta* in *Nicholson* reveals a sound proposition: in the absence of a "special relationship" that involves either request or free acceptance, the defendant is not enriched, and consequently cannot be held liable, unless the plaintiff conferred a benefit that, by its very nature, is incontrovertible. Soon enough, however, the case was misinterpreted as support for a very different proposition: a mistaken improver of property must demonstrate a pre-existing "special relationship" with the defendant in order to prove that the impugned transfer was unjust, and hence, reversible. A misplaced desire to protect innocent recipients from unwanted obligations elevated the concept of a "special relationship" to the status of an "essential nexus", the "*sine qua non* of success",[89] without which a restitutionary claim for services rendered must fail.

Because it effectively insists that the autonomy interest can be satisfied only through an actual exercise of choice, the purported "special relationship" rule precludes recovery any time the plaintiff must prove an incontrovertible benefit in order to overcome the defendant's plea of subjective devaluation. An entire category of legitimate claims is placed beyond the reach of the action in unjust enrichment. The result, predictably, is injustice. Undeserved windfalls are left where they fall.

Olchowy v McKay[90] ("*Olchowy*") perfectly illustrates that possibility. Mistakenly believing that he had purchased a parcel of land, the plaintiff spent $3,889 clearing it of rocks and planting canola seed. The defendants,

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88. Canadian courts have applied the same reasoning in cases dealing with land: *Salna v Awad*, 2011 ABCA 20; *Sanderson v Campsall*, 2000 BCSC 583; *Maggio Flooring Ltd v Gipson*, [2011] OJ No 1751 (Sup Ct J)(QL); *Park Lane Ranch Ltd v Fleetwood Village Holdings (Phase II) Ltd* (1980), 17 RPR 35 (BCSC).
89. *McLaren v The Queen*, [1984] 2 FC 899 at 905 (FCTD).
90. [1996] 1 WWR 36 (SKQB) [*Olchowy*].

who were aware of the claimant's error from the outset, cynically sat silent until the work was done. They then purchased the property for a price that did not account for the crop and harvested 600 bushels of canola worth $4,386. The court agreed that the plaintiff had conferred an incontrovertible benefit to the extent that the defendants realized a financial gain from the plaintiff's services. Restitution nevertheless was denied on the grounds that the defendants had not requested the enrichment, and, because they did not own the property when the services were provided, they were not subject to the obligations inherent in the doctrines of free acceptance or proprietary estoppel.[91] In the end, they were literally allowed to reap what the plaintiff had sown.[92]

Olchowy was a remarkable case, but the court's analysis was anything but. Beginning in 1975, restitution claimants routinely were required to

91. *Ibid*. Though harsh, *Olchowy* might be defended on the basis that, by virtue of their purchase, the defendants acquired an absolute right to both the land and the crop growing on it. The judgment, in fact, contains reasons along those lines. Significantly, however, the plaintiff did not dispute *ownership* of the canola. His claim pertained to its *value*. And, in any event, Justice McLellan's reasoning is mirrored in countless other decisions that are not complicated by questions of title. For a discussion of the intersection of unjust enrichment and Torrens indefeasibility, see McInnes, *supra* note 17 at ch 26.

92. The plaintiff's only relief, for $428, stemmed from the fact that the clearing of rocks constituted a "lasting improvement" under Saskatchewan's betterment legislation. See *Improvements Under Mistake of Title Act*, RSS 1978, c I-1, s 2.

establish “special relationships”.[93] And as long as that practice continued, the action in unjust enrichment very often would deny relief to those who improved land.

V. Restitution for Improvements

Late into the twentieth century, liability was unlikely if one improved another’s land. Leaving aside betterment statutes and passive rights of set-off, proprietary estoppel and unjust enrichment provided the best hope of relief, but both were subject to very similar limitations. Even though Canadian courts have distanced themselves from the “five probanda” in favour of more relaxed criteria, proprietary estoppel continues to require proof that services were rendered in reliance upon the landowner’s active or passive representation that the claimant enjoyed, or would acquire, some interest in the affected property. The action in unjust enrichment was doubly restricted. As courts refused to recognize incontrovertible benefits in connection with land, an enrichment could be established only by means of a request or free acceptance. And on the issue of injustice, liability was said to depend upon the existence of a “special relationship”.

The situation today is dramatically different. Proprietary estoppel has

93. *Jones v Craig*, [2009] OJ No 2365 (Sup Ct J)(QL); *Grant Design Group Inc v Neustaedter* 2008 MBQB 336; *Litemor Distributors (Edmonton) Ltd v Midwest Furnishings and Supplies Ltd*, 2007 ABQB 23; *Agrium Inc v Chubb Insurance Co of Canada*, 2002 ABQB 495; *Nu-Way Kitchens Ltd v Smallwood* (2000), 187 Nfld & PEIR 251 (SC); *Elmford Construction Co v South Winston Properties Inc* (1999), 45 OR (3d) 588 (Sup Ct J); *JE Weaver Enterprises Ltd v Hardy* (1998), 44 CLR (2d) 243 (NSSC); *Turf Masters Landscaping Ltd v TAG Developments Ltd* (1995), 143 NSR (2d) 275 (CA); *Robert D Sutherland Architects Ltd v Montykola Investments Inc* (1995), 142 NSR (2d) 137 (SC); *Alyea v South Waterloo Edgar Insurance Brokers Ltd*, (1993) 50 CCEL 266 (Ont Ct J (Gen Div)); *cf. MacLellan v Morash*, 2006 NSSC 101 (lack of “special relationship” fatal to legal claim for *quantum meruit*, but irrelevant to equitable claim in unjust enrichment for “compensation”) [*Morash*].

lost its traditional status as the primary source of liability.[94] Of course, that claim remains relevant if the plaintiff seeks to do something other than reverse a transfer, or if the facts do not fall within the restitutionary action. In the majority of cases, however, the focus falls upon unjust enrichment. Even those situations that historically would have triggered a plea of proprietary estoppel are now commonly addressed exclusively in terms of unwarranted transfers.[95] That change is a function of two fundamental developments within the Canadian law of unjust enrichment. Together, they facilitate liability, even if, prior to performance, the plaintiff had no contact with the defendant.

A. Readily Realizable Gains

The first development is the remarkable expansion of incontrovertible benefits. If the landowner did not actually choose to accept the risk of financial responsibility, the plaintiff must prove that the benefit itself was undeniable. And unless the services anticipated a necessary expense, that benefit must pertain to the realization of a financial gain.

There should be little scope for debate if the defendant actually did turn the plaintiff's contributions into cash.[96] That was true in *Sanderson*

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94. In practice, the detrimental act that lies at the heart of proprietary estoppel often entails an enrichment to the landowner, such that the claimant can satisfy both heads of liability as they are now formulated. See *Idle-0, supra* note 30; *Clarke*, *supra* note 35; *Schumacher Estate*, *supra* note 35. Nevertheless, because it does not require a beneficial transfer, proprietary estoppel may provide help to those whom unjust enrichment turns away: *Schwark Estate v Cutting* (2008) 46 ETR (3d) 120 (Ont Sup Ct J) reversed in 2010 ONCA 61; *Brownlee*, *supra* note 35; *cf. Cowderoy*, *supra* note 9.
95. *No 151 Cathedral Ventures Ltd v Gartrell*, 2003 BCSC 1801; *Sherbeth*, *supra* note 53; *Stewart v Stewart*, 2014 BCSC 766; *cf. Sabey*, *supra* note 10 (disputing lower court's proprietary estoppel analysis and returning parties to trial level for consideration of restitutionary claim).
96. *Port Abino Association v Lee* 73 ACWS (3d) 44 (Ont Ct J (Gen Div)); *cf. Olchowy*, *supra* note 90. See also *Spicer v Middleton (Town)*, 2014 NSSC 66; *Pekurar v Hummingbird Farms Ltd*, [2015] OJ No 378 (Sup Ct J) (QL).

v Campsall.[97] While sharing possession of a parcel that belonged to her husband's parents, a woman affixed a mobile home to the land and made other improvements. When her marriage ended and she was removed from the property, she sued in unjust enrichment. Although the parents argued that they "just wanted the home — which they do not consider an improvement — off the land",[98] they rented out the unit, which was worth $34,000, for $600 per month. The court recognized an enrichment accordingly. *Conrad v Feldbar Construction Co Ltd*[99] came to a similar conclusion on the enrichment issue. The defendant owned an isolated property in an undeveloped area of Toronto. The plaintiff constructed an arterial roadway that serviced all of the properties in the area, including the defendant's. The defendant then sold his parcel for a price that was substantially inflated by reason of the improvement. He was held liable for those additional profits.

Far more remarkably, Canadian courts now frequently allow the first element of the action in unjust enrichment to be satisfied by proof that the plaintiff's services created a realizable financial gain by increasing the market value of the defendant's property.[100] In *Love v Schumacher Estate*[101] ("*Schumacher Estate*"), the defendant owned an unused cottage that he allowed the plaintiff and her daughters to occupy beginning in 1985. Over the next twenty-five years, the claimant spent approximately $100,000 on repairs and improvements, thereby raising the property's

97. 2000 BCSC 583.

98. *Ibid* at para 8.

99. (2004), 70 OR (3d) 298 (Ont Sup Ct J). The court's attempt to explain its decision in terms of free acceptance is fatally undermined by the fact that the defendant expressly informed the plaintiff, even before the work commenced, that he did not wish to contribute to the cost of the roadway. The defendant's enrichment must be explained instead by reference to the profit that he realized from the sale of the improved parcel.

100. *Idle-0, supra* note 30; *Clarke*, *supra* note 35; *Dutertre*, *supra* note 29; *Murphy*, *supra* note 29; *Simonin Estate v Simonin*, 2010 ONCA 900 [*Simonin Estate*]; *cf. Birch Paving & Excavating Co v Clark*, [2014] OJ No 1637 (Sup Ct J)(QL)(enrichment not proven because "there is no evidence supporting any increase in the value of the property" as a result of the plaintiff's services at para 64) [*Birch Paving*].

101. *Schumacher Estate*, *supra* note 35.

value from $35,000 to $174,000. She did so in part because the defendant promised, in 1993, that she would receive legal title on his death. In 2010, however, he executed a new will that gave his entire estate to his son. In the ensuing litigation, Justice Tausenfreund upheld claims in both proprietary estoppel and unjust enrichment. The issue of enrichment was resolved on the simple basis that the "value of the cottage property increased over the years based on the plaintiff's time, her labour, and her financial resources".[102]

Servello v Servello[103] ("*Servello*") involved a large immigrant family that successfully developed a business that operated out of a property that also contained their home. The youngest son, working alongside his father, substantially enlarged the onsite workshop, but subsequently became estranged from his family. In the litigation that followed, he sued for both proprietary estoppel and unjust enrichment. Despite ultimately rejecting both "equitable" claims because the son's behaviour during the squabble left him with "unclean hands", Justice Koke did agree that the parents had been enriched. Having valued the son's "contribution to the workshop … to be approximately $68,133.66", he observed that while "the overall value of the property" had not necessarily "increased by this much, it still represents an enrichment".[104]

MacLellan v Morash[105] ("*Morash*") similarly arose from a familial dispute. Having long allowed her seven children recreational use of an island that she owned, an elderly woman also permitted one son, named Ronald, to operate a lobster business from the property. He accordingly devoted more than $20,000 and 3500 man-hours to the construction

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102. *Ibid* at para 40.
103. *Servello*, *supra* note 35.
104. *Ibid* at para 105. See *Servello v Servello*, 2015 ONCA 434 at para 7, where, while affirming the decision below, the Ontario Court of Appeal said that there was "no evidence that the property increased in value as a result of the [son's contributions]". In fact, Koke J said that there was "no evidence … to indicate *how much* the value of the property has increased" in *Servello*, *supra* note 35 at 116 [emphasis added]. Despite the difference, both statements are consistent with the recognition of an enrichment on the basis of increased value.
105. *Morash, supra* note 93.

of a “fish shed”, as well as a causeway and a bridge that linked the island to the mainland. That connection both furthered his economic interests and made it much easier for family members to access the property. Against that backdrop, the mother’s decision to devise title to two other children understandably enraged Ronald, who tore down the bridge and blocked up the causeway with machinery. Even after that fit of pique, however, the remaining improvements enhanced the island’s value by some $300,000. Ronald consequently was entitled to relief. Although his claim for proprietary estoppel failed, because his acts were a product of his own initiative rather than any promise of title from his mother, his plea of unjust enrichment was successful. Justice MacLellan considered it “clear that the owner of the island” was enriched. Just as the “family started making considerably more use” of the island once the causeway was in place, the property became “much more valuable” once it could “be reached without using a boat”.[106]

Sherbeth v Sherbeth[107] (“*Sherbeth*”), the final case for consideration, provides the most robust illustration of the incontrovertible benefit doctrine. After the plaintiff announced his desire to start a construction business, his father offered the use of a section of land for that purpose. The plaintiff then spent almost $100,000 building business premises. The situation predictably turned ugly when the father transferred title to the plaintiff’s brother. And when the brother demanded vacant possession, the plaintiff countered with a claim in unjust enrichment. Against that restitutionary claim, the brother explained that he had no use for the improvements, which he intended to remove. Justice Menzies was prepared to accept that seemingly irrational threat, “not because there is no value in the building and yard site but rather because [the brother] would wish to remove any reminder of [the plaintiff]”.[108] He nevertheless found that the plaintiff’s services “represent an incontrovertible benefit to the [d]efendants even if they do not wish to take advantage of it”.[109] It might be different, he said, if the claimant left “behind some type of

106. *Ibid* at para 74.
107. *Sherbeth*, *supra* note 53.
108. *Ibid* at para 24.
109. *Ibid.*

structure that could serve no useful purpose to the [d]efendants on their farming operation".[110] On the facts, however, the plaintiff constructed "a yardsite which could be productively used in a farming operation or at very least could be sold or rented to realize on its value, whether the [d]efendants elect to take advantage of it or not".[111] In the absence of any juristic reason, that enrichment entitled the plaintiff to recover the value of the improvement.

1. A Step Too Far?

On reading the preceding cases, those who champion the cause of unjust enrichment are apt to echo Lord Mansfield's admonition: "I am a great friend to the [restitutionary] action ... and therefore I am not for stretching, lest I should endanger it".[112] The crucial question, it will be recalled, is whether the plaintiff can overcome the right of subjective devaluation by demonstrating that liability is consistent with the defendant's freedom of choice.[113] The mere receipt of an objective benefit must not be enough. To hold otherwise is to potentially impose an intolerable burden upon an innocent party. Irreplaceable property, having been improved without request or acquiescence, may have to be sacrificed for the purpose of satisfying judgment. That is why scholarly opinion, even at its broadest, formulates the relevant branch of incontrovertible benefit in terms of *readily realizable* financial gains. The restitutionary interest is reconcilable with the landowner's autonomy only to the extent that the claimant's contribution can be treated *as if* it consisted of a transfer of money.

At a glance, however, it is clear that Canadian courts have gone somewhat further. Granted, *Schumacher Estate* arguably fell within the spirit of the doctrine.[114] The plaintiff had greatly improved the property while enjoying exclusive possession for a quarter century; the defendant had no connection to the cottage before inheriting it from his father at the end of that period. In the circumstances, the court's decision to allow

110. *Ibid* at para 27.

111. *Ibid.*

112. *Weston v Downes* (1778), 1 Doug KB 23 (Eng) at 24.

113. Discussed above at Part III.B.

114. *Schumacher Estate*, *supra* note 35.

the claimant to remain in possession for another fifteen years does not seem an intolerable infringement of the titleholder's rights. *Servello* was more problematic. Restitution would have created genuine hardship.[115] Given the degree of acrimony within the family, as well as the defendant's residence on the property, shared use was not feasible; given the value of the improvements, *in personam* relief would have constituted a substantial debt. As a result, the court, presumably, was much relieved to be able to (speciously)[116] invoke the clean hands doctrine and make the case go away. That option was not available in *Morash*, which similarly involved an ugly family dispute.[117] Since the squabbling siblings "simply [could not] live together as joint owners", restitution took the form of a personal judgment for $65,000.[118] While the titleholders' financial status was not reported, most people do not have that kind of money close at hand and it is easy to imagine that the defendants were compelled to sell or mortgage the affected property in order to satisfy the judgment. The island, which several generations of the family had enjoyed for decades, undoubtedly held much more than monetary value. Is the law of unjust enrichment ever justified in effectively requiring innocent parties to sacrifice prized possessions?

Even those who agree with the decision in *Morash*[119] may question *Sherbeth*.[120] Acting entirely for his own benefit, the plaintiff dug down to bedrock, laid foundations, and built his business premises on an otherwise undeveloped piece of land. His father, who owned the parcel at the outset, permitted that work to be done, but had no use for the improvements. More dramatically, his brother, as successor in title, intended to exercise his right of exclusive occupation in order to remove the structures and allow nature to resume its course. The court nevertheless recognized an enrichment and imposed liability on the ground that — regardless of what a landowner wishes to do, or is likely to do, or can afford to do

115. *Servello*, *supra* note 35.
116. Discussed in Part VI, below.
117. *Morash*, *supra* note 93 at para 87.
118. *Ibid* at para 87.
119. *Morash*, *supra* note 93.
120. *Sherbeth*, *supra* note 53.

— the ability to realize a financial gain constitutes an incontrovertible benefit.[121]

The branch of incontrovertible benefit governing the realization of financial gains is inherently controversial. There is no singularly correct way to formulate the doctrine and, until the Supreme Court of Canada settles the issue, opinions will vary as widely as individual judicial philosophies. *Sherbeth* falls well to one side of that continuum. Without any discussion of the debate, Justice Menzies overwhelmingly privileged the plaintiff's restitution interest above the defendant's autonomy interest. Unless he had a substantial sum of money that he was willing to allocate to the judgment, the titleholder was at serious risk of losing control over his own property. And, while Canadian law may eventually regard such risks as an acceptable cost of reversing unjust enrichments, it is worth observing that *Sherbeth* raises precisely those concerns that traditionally inhibited courts from entertaining such claims.

B. The Decline of Special Relationships

While Canadian courts continue to struggle with incontrovertible benefits, they largely have overcome the troublesome doctrine of "special

121. Several aspects of the decision may appear to hedge that proposition. First, the defendants surprisingly "admit[ted] liability … but dispute[d] the Plaintiff's entitlement to any relief", *ibid* at para 1. The existence of an enrichment, however, was not treated as a foregone conclusion. Justice Menzies proceeded as though the elements of the action in unjust enrichment were contested. Second, the father initially had given the plaintiff some assurance that he eventually would receive title if he developed the land. Nevertheless, while that fact undoubtedly coloured the judge's perception of the dispute, it was logically irrelevant to the recognition of a realizable financial gain. Interestingly, notwithstanding the father's "promise", the plaintiff did not sue for proprietary estoppel. He relied exclusively on unjust enrichment. Third, the court referred to the defendants' "wrongful actions" and said that the "object of unjust enrichment is to compensate the Plaintiff for the losses he has suffered", *ibid* at para 52. Of course, if the facts did truly call for the reparation of wrongful losses, then any comments regarding restitutionary benefits would be *dicta*. Notwithstanding occasional terminological errors, however, the court properly focused on the issue of unjust enrichment.

relationship" that needlessly restricted the scope of restitutionary relief for a quarter century. Granted, old habits occasionally die hard. The purported rule of "bilaterality"[122] — a misinterpretation of *Nicholson*[123] — continues to be expressed from time to time.[124] Beginning in the late 1990s, however, judges increasingly employed a model of unjust enrichment that is capable of imposing liability for unsolicited services between strangers.[125] In *Wacky's Carpet & Floor Centre v Joseph,*[126] for instance, Justice Edwards revisited *Nicholson*'s *dicta* and correctly observed that while the concept of "special relationship" is a "thread that runs through the jurisprudence", it is not "an additional burden that must be met by a claimant".[127] "The absence of a special relationship", he explained, "will not necessarily defeat a claim".[128] Likewise, in *Bond Development Corp v Esquimalt (Township)*,[129] Justice Huddart focused on the actual message of *Nicholson* before stressing that, given the evolution of the action in unjust enrichment, it is no longer appropriate to determine rights of recovery on the basis of some vague principle of "special relationship".[130]

Huddart J undoubtedly was right in regarding the decline of "special relationships" as a mark of maturity. When MacKinnon J first formulated that doctrine in *Nicholson*, the Canadian law of unjust enrichment was under-developed and poorly understood.[131] There was no Canadian text on point and the three-part cause of action had yet to be authoritatively

122. *Campbell v Campbell* (1999), 173 DLR (4th) 270 (Ont CA) at paras 32-34 [*Campbell*].
123. *Nicholson*, *supra* note 81.
124. *J Lepera Contracting Inc v Royal Timbers Inc*, 2012 ONSC 271 at para 83; *Skibinski v Community Living British Columbia*, 2010 BCSC 1500 at para 192; *Murphy*, *supra* note 29 at para 86; *cf. Birch Paving*, *supra* note 100.
125. *Clearwater Well Drilling Ltd v Wile* (1996), 148 NSR (2d) 306 (SC) (restitution "may be granted in an exceptional case where no special relationship exists between the parties" at 309); *Gidney*, *supra* note 43.
126. 2006 NSSC 353.
127. *Ibid* at para 12.
128. *Ibid* at para 15.
129. 2006 BCCA 248.
130. *Ibid* at at para 47.
131. *Nicholson*, *supra* note 81.

articulated. Mistakes were inevitable and, given the traditional fear that restitution may threaten individual autonomy, courts understandably erred on the side of caution. However, by the turn of the twenty-first century, the situation had changed dramatically. Courts at the highest level routinely resolved restitutionary disputes, a substantial body of literature served the subject, and the profession had grown comfortable with the governing principles. As unjust enrichment evolved and expanded to its natural dimensions, it no longer had any need for "special relationships". Relief rightly became available between strangers.

That development gained additional impetus in 2004, when the test of restitutionary injustice was fundamentally reformulated. *Garland v Consumers' Gas Co*[132] ("*Garland*") provided an opportunity to resolve a long-standing debate regarding the precise basis upon which transfers are reversed.[133] Within common law systems, the reason for restitution consists of an *unjust factor* that positively justifies recovery (*e.g.* mistake, compulsion). Civilian systems, in contrast, generally award restitution in the *absence of any juristic reason* for a transfer (*e.g.* contract, donative intent). Though they usually come to similar conclusions, those two tests proceed in opposite directions. Whereas the former looks at the plaintiff and says, "[n]o restitution unless … ", the latter looks at the defendant and says, "[r]estitution unless … ". For complicated reasons that lie beyond this paper,[134] the Supreme Court of Canada decided to embrace the juristic reason approach.[135] Anomalously within the common law world, the Canadian action in unjust enrichment now operates on a civilian model.

Though the concept could be accommodated within either approach, a "special relationship" provides a positive reason for the claimant's

132. *Garland*, *supra* note 37.

133. *Ibid.*

134. McInnes, *supra* note 17 at ch 4 II-III.

135. The language, though not substance, of juristic reasons was introduced in *Rathwell v Rathwell*, [1978] 2 SCR 436 at 455, and adopted in *Pettkus*, *supra* note 14 at 848. See also *Lauréat Giguère Inc v Cie Immobilière Viger Ltée*, [1977] 2 SCR 67 at 77 which addressed, on appeal from Quebec, the civilian action *de in rem verso*. See now art 1493 CCQ.

recovery and therefore fits more naturally within a test of unjust factors.[136] In contrast, a "special relationship" has no real role to play within a test of juristic reasons. If the parties shared a "special relationship" insofar as the impugned transfer was undertaken pursuant to, say, a contractual obligation, then there will be a legal explanation for the defendant's enrichment and restitution will be denied. And if the parties shared a "special relationship" that fell outside the categories of juristic reason, then it is irrelevant.

1. Claims Between Strangers

By its very nature, the decline of "special relationships" is difficult to prove positively. A few judges have expressly disavowed the purported rule, but recent decisions dealing with unsolicited improvements to land are notable for what they do *not* say. While the late twentieth century cases were dominated by talk of "special relationships", Canadian courts now routinely proceed simply by reference to the three-part cause of action.

That development can be illustrated by re-visiting *Campbell v Campbell*[137] ("*Campbell*"), the decision that provided the most thorough attempt to justify the supposed need for "special relationships". Gordon Campbell operated a dairy farm for many years. Shortly before his death in 1977, he transferred his milk quota, which was essential to

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136. The point is complicated by the fact that *Garland* did not adopt a classic civilian test of juristic reasons. The Supreme Court of Canada instead formulated a two-stage analysis. The first stage requires the plaintiff to disprove the "established categories" of juristic reason — *i.e.* contract, donative intent, disposition of law, and "other valid common law, equitable or statutory obligations". Satisfaction of that burden raises a *prima facie* right to restitution, but the defendant is entitled to rebut that presumption by proving the existence of a "residual" juristic reason. That second stage of inquiry is guided by "all of the circumstances of the transaction", but focuses on "two factors: the reasonable expectations of the parties, and public policy considerations". See *Garland*, *supra* note 37 at para 44. Rules regarding "special relationships" could be accommodated within either of those factors.

137. *Campbell, supra* note 122.

the business, to his sons, John and Robert. His land and equipment, in contrast, passed to his widow, Laura, under his will. The survivors continued the business. The two sons assumed responsibility for day-to-day operations while the widow permitted use of her property and contributed her bookkeeping and household services. By 1988, the farm required modernization in order to remain economically viable. John and Robert accordingly replaced several pieces of equipment, renovated an existing barn, and constructed a new barn. The farm functioned in its improved state for three more years until Robert's death in 1991. At that point, John sold the milk quota to a third party and informed his mother that she no longer would be able to sell milk to the marketing board. Shortly thereafter, he and Robert's executor sued Laura for the restitutionary value of the improvements.[138] Having accepted an expert opinion that the farm's value continued to be enhanced as a result of the brothers' contributions, Justice Kent imposed liability for $151,200.

That decision was overturned by the Ontario Court of Appeal. Justice Borins stressed that "the absence of Laura's consent to the … improvements to the farm — indeed, the absence of any evidence that she expressly requested her sons to undertake this work — is the essential reason why the … claim … should fail".[139] Rephrasing his reasons as a general proposition, he baldly stated that "the law of unjust enrichment

138. The plaintiffs also sought, in the alternative, a declaration that the farm assets were partnership property held equally between themselves and the widow. That claim was dismissed at trial and not pursued on appeal.

139. *Campbell, supra* note 122 at para 26.

refuses recovery for unrequested benefits".[140] Of course, that simply is not true. The absence of a "bilateral" relationship, marked by the recipient's request or free acceptance, merely means that the plaintiff must show that the benefit, by its very nature, is incontrovertible and consequently consistent with the defendant's autonomy. On the facts of

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140. *Ibid* at para 34. Though typically traced to *Nicholson*, *supra* note 81 and presented in terms of "special relationships", Justice Borins JA drew his demand for "bilaterality" from an academic source: Abraham Drassinower, "Unrequested Benefits in the Law of Restitution" (1998) 48:4 University of Toronto Law Journal 459 at 460. See *ibid* at para 36. Regardless of the details, however, the purported requirement was irreconcilable with the rules of restitutionary liability as a matter of policy, principle, and historical precedent. The court similarly was led astray on another fundamental point, *Campbell, supra* note 122 at para 26. Borins JA stated the issue of juristic reasons should be treated as a "narrow question of fairness as between the parties. Courts should consider whether, having regard to the particular circumstances giving rise to an enrichment and to subsequent events, it is fair for the defendant to retain the benefit", quoting MM Litman, "The Emergence of Unjust Enrichment as a Cause of Action and the Remedy of Constructive Trust" (1988) 26:3 Alberta Law Review 407 at 451. That conception of injustice invites precisely the sort of "palm tree justice" that nearly proved fatal to unjust enrichment during the early part of the twentieth century. See *Holt v Markham*, [1923] 1 KB 505 (Eng) at 513 (rejecting "well-meaning sloppiness of thought" as a basis of liability); See *Beblow*, *supra* note 50 (Of course, the restitutionary action is not actually "a device for doing whatever may seem fair between the parties" at 987).

Campbell, liability might have been refused on other grounds,[141] but the improvements undertaken by the defendant's sons increased the value of her farm and provided her with a realizable financial gain.[142] And once an enrichment and a corresponding deprivation have been established, a transfer is reversible as long as it occurred without juristic reason.

Significantly, all of that would hold true even if the parties did not share a pre-existing relationship. Cases of that sort understandably are rare. It is easy enough to imagine a person acquiring possession

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141. *Campbell, supra* note 122 at para 11. When the issue first arose, Laura was "[n]ot agreeable" with her sons' plans to upgrade the farm. Because they "just ignored her and went ahead", their ensuing claim might have been barred on the grounds of *officiousness*. The law of unjust enrichment does not protect those who knowingly foist themselves on others. The plaintiffs resisted that conclusion by arguing that Laura's objections were a function of the fact that "her mind was so screwy". And indeed, given "her impaired state of mind", the court was "doubtful" that she was able "to properly acquiesce in what was taking place"; see *Campbell, supra* note 122 at para 38. Even if that was true, however, relief might have been refused on the basis that the defendant had received an *incidental benefit* from the claimants' self-interested acts. As Borins JA interpreted the situation, the brothers undertook the improvements because dairy production was their business. While their mother had stopped drawing an income several years earlier, their livelihood depended upon the efficient operation of the farm. They knowingly had acted without any expectation of compensation other than the profits generated by the business. See also *Simonin Estate*, *supra* note 100; *cf. Morash*, *supra* note 93 (relief available if plaintiff motivated only partially by self-interest). The concepts of officiousness and incidental benefit may be incorporated within *Garland*'s test of juristic reasons, but they are better addressed at a fourth stage of analysis, dealing with bars and defences: Mcinnes, *supra* note 17 at chs 41-42.
142. *Campbell, supra* note 122. So too, by replacing old equipment and building a new barn, the claimants arguably discharged a factually necessary expense. Without those improvements, the family business was not viable.

of a chattel and improving it without any knowledge of the owner.[143] Because it stays in one place, land does not readily lend itself to similar treatment. Restitutionary claims nevertheless may arise, outside of "special relationships", if, for instance, the plaintiff improved a parcel under a mistake of title.[144] Fortunately, the Canadian principle of unjust enrichment is now sufficiently mature to resolve such claims without the need for extraneous requirements.

VI. Conclusion

This paper is misleading in one respect. Its title suggests that improvements to land are remedied primarily, if not exclusively, in equity. As explained in the introduction, that largely was true in the past. Leaving aside the law's ability to reduce a landowner's right to *mesne* profits by the value of improvements provided by a *bona fide* trespasser, the only hope for relief was found in equity's passive right of set-off or its doctrine of proprietary estoppel. Since the turn of the century, however, the situation has changed dramatically. The criteria for proprietary estoppel have been relaxed, but much more importantly, the action in unjust enrichment has been allowed to operate according to its own logic. The concept of "special relationships", initially adopted in a misguided attempt to protect the autonomy of innocent recipients, increasingly has been abandoned. Canadian courts have recognized that, regardless of any request or acquiescence, beneficial services may incontrovertibly enrich the defendant, and, in the absence of any juristic reason, trigger a restitutionary obligation. The principle of unjust enrichment sufficiently

143. *Gidney*, *supra* note 43; *Mayne v Kidd*, [1951] 2 DLR 652 (Sask CA); *Ings v Industrial Acceptance Corp Ltd*, [1962] OR 454 (CA); *Greenwood*, *supra* note 44; *Robinson*, *supra* note 43; *cf. Webb*, *supra* note 44; *Munro v Willmott*, [1949] 1 KB 295 (Eng); *Mutungih v Bokun* (2006), 40 CCLT (3d) 313 (Ont Sup Ct J).

144. Even when the parties are aware of each other, they are not joined by a "special relationship" or "bilaterality" unless the defendant requests or receives beneficial services with knowledge that the plaintiff expects something in return. As a result, the parties effectively are strangers if, for instance, a purchaser makes improvements after taking early occupation under a contract that is later struck down: see *Nicholson*, *supra* note 81.

protects freedom of choice and the addition of extraneous requirements like "bilaterality" merely serves to defeat legitimate claims.

All of that would seem to reinforce the title of this paper: improvements to land are remedied in equity through the action in unjust enrichment. In truth, however, there is nothing inherently equitable about restitutionary relief. Indeed, the vast bulk of the subject now known as "unjust enrichment" derives from the ancient courts of law, rather than chancery.[145] Canadian judges come close to recognizing that fact when they address improvements to land in terms of *quantum meruit*, which, as one of the common counts under the writ of *indebitatus assumpsit*, operated in the courts of law.[146] Nevertheless, although the same error seldom is seen in other common law jurisdictions,[147] most Canadian lawyers believe that the whole of unjust enrichment is equitable in origin and nature.[148] The explanation for that belief is unclear, but there is simply no debate on the central point.[149] As with tort and contract, unjust enrichment is an essentially legal concept. Equity typically enters into the picture, as needed, at the margins. For instance, just as a tortious nuisance may attract injunctive relief and a contract to sell land may trigger specific performance, an unjust enrichment may be remedied by

145. McInnes, *supra* note 17 at 31-54.
146. *Idle-0, supra* note 30 at para 79; *McLeod*, *supra* note 53.
147. *Sinclair v Brougham*, [1914] AC 398 (HL)("the notion that [the restitutionary action] was an equitable action" has been "exploded" — it "was not devised by the Court of Chancery, nor was it applied there either in form or in substance" at 454-456); *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001), 208 CLR 516 (HCA)("a perfectly legal action" at 562); American Law Institute, *Restatement of the Law Third: Restitution and Unjust Enrichment* (St. Paul: American Law Institute, 2011), *Comment A* (warning against "the common misperception that liabilities or remedies described in terms of 'unjust enrichment' are necessarily equitable in origin" at § 4).
148. *Cf. Communities Economic Development Fund v Canadian Pickles Corp*, [1991] 3 SCR 388 (the restitutionary action "does not lie in equity" at 415); *Federated Co-Operatives Ltd v Canada*, 2001 FCA 23 at para 5; *Michelin Tires (Canada) Ltd v Canada*, 2001 FCA 145.
149. Mitchell McInnes, "The Equitable Action in Unjust Enrichment" (2007) 45:2 Canadian Business Law Journal 253.

a proprietary form of restitution (*e.g.* a trust or a lien) if a simple money judgment would be inadequate. While the response may be equitable, the underlying cause of action generally operates in law.[150]

Nearly 150 years after the *Judicature Act*s fused the administration of law and equity, pedigree should be largely irrelevant.[151] Within the context of this paper, however, it bears mention for one reason. Canadian lawyers tend to believe that unjust enrichment is "equitable" in two respects. Having attributed the cause of action to the courts of chancery, they further insist that the availability of restitution "necessarily" turns, to an unusual degree, on "discretion and questions of fairness".[152] That would suggest that one who improves another's land must both satisfy the three-part cause of action and bring the episode within the judge's concept of "good conscience". In *Servello*, for instance, the improver's claim was dismissed because he had not come to court with "clean hands".[153] In truth, that additional requirement is both unprecedented and unprincipled. As Lord Goff once explained, "restitution is not … a matter of discretion … A claim to recover money at common law is made as a matter of right; and even though the underlying principle of recovery is the principle of unjust enrichment, nevertheless, where recovery is

150. Exceptions do exist. That is true of the action for knowing receipt, which provides restitution if a stranger obtains property that beneficially belongs to the plaintiff under a trust. See *e.g. Citadel General Assurance Co v Lloyds Bank Canada*, [1997] 3 SCR 805. Because the misdirection of trust assets cannot be remedied by law, the Chancellor developed a species of the claim in unjust enrichment.

151. Andrew Burrows, "We Do This at Common Law But That in Equity" (2002) 22:1 Oxford Journal of Legal Studies 1.

152. *Garland*, *supra* note 37 at para 44.

153. *Servello, supra* note 35.

denied, it is denied on the basis of legal principle".[154] Just as it has no need for a "special relationship" doctrine, so too, the modern Canadian principle of unjust enrichment can consistently resolve restitutionary claims without recourse to ill-defined notions of "equitable" fairness.

154. *Lipkin Gorman v Karpnale Ltd*, [1991] 2 AC 548 at 578 (HL). See also *Beblow*, *supra* note 50 (cautioning against the "tendency … to view the action for unjust enrichment as a device for doing whatever may seem fair between the parties" at 987); *Peel*, *supra* note 50 (rejecting the suggestion that "recovery can be awarded on the basis of justice or fairness alone" at 767); *Pavey & Matthews Pty Ltd v Paul* (1987), 162 CLR 221 (HCA) (denying that unjust enrichment entails a "judicial discretion to do whatever idiosyncratic notions of what is fair and just might dictate" at 256).

"The execution of a trust shall be under the control of the court": A Maxim in Modern Times

Richard C Nolan*

This article examines the ancient, well attested, but largely unexamined, inherent jurisdiction of the court to supervise, and if necessary administer and execute, any trust. It considers the modern and inventive use of this jurisdiction, and its vital role in the juridification of innovative trust practice. The final section of the article draws out the significant theoretical implications of the court's inherent jurisdiction and sets out an agenda for further research.

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I. Introduction
II. An Outline of the Jurisdiction and its Practical Utility
III. The Jurisdiction in Recent Cases: Meeting New Needs
IV. Theory
V. Conclusion: A Research Agenda

I. Introduction

The inherent jurisdiction of the court in relation to trusts is ancient and well attested. The quotation in the title is taken from *Morice v Bishop of Durham*,[1] decided in 1805:

> As it is a maxim, that the execution of a trust shall be under the controul [*sic*] of the court, it must be of such a nature, that it can be under that control; so that the administration of it can be reviewed by the court; or, if the trustee dies, the court itself can execute the trust: a trust therefore, which, in case of maladministration could be reformed; and a due administration directed; and then, unless the subject and the objects can be ascertained, upon principles, familiar in other cases, it must be decided, that the court can neither reform maladministration, nor direct a due administration.[2]

Notwithstanding its antiquity, the court's inherent jurisdiction has attracted little academic attention.[3] However, it is of great importance to the administration of trusts and to the law of trusts generally. This article seeks to demonstrate the practical and theoretical significance of the court's inherent jurisdiction using recent examples to show that the jurisdiction is very much alive and well and that an important research agenda flows from a proper awareness of the court's inherent jurisdiction.

The first part of the article is a brief outline of the court's inherent jurisdiction in relation to trusts, something that should be common knowledge to all those concerned with the law of trusts. The second part of

1. (1805) 32 ER 947 (Ch) [*Morice*].
2. *Ibid* at 954, per Eldon LC.
3. Practitioners' works cover the technical aspects of the subject: see David Hayton, Paul Matthews & Charles Mitchell, *Underhill & Hayton's The Law of Trusts and Trustees*, 18d (London: LexisNexis, 2010) [Hayton]; and Lynton Tucker, Nicholas le Poidevin QC & James Brightwell, *Lewin on Trusts*, 19d (London: Sweet & Maxwell, 2014) [Lewin].

the article uses recent cases from England and some "offshore" jurisdictions to establish the continuing vitality and importance of the court's inherent jurisdiction. Next, the practical importance of the inherent jurisdiction of the court is examined, particularly its importance in the context of novel developments in the law of trusts and its consequent great utility in the juridification of trust practice. The final part draws out the theoretical implications of the inherent jurisdiction and considers possibilities for further research. These theoretical implications touch on central areas of the law of trusts — theories of contractarianism, asset partitioning and competing perspectives on trusts — the structural importance of the performance interest in the law of trusts and the nature of a trust beneficiary's rights. The research agenda focuses on the vital position of discretion in the law of trusts and what that means for future research and analysis.

II. An Outline of the Jurisdiction and its Practical Utility

The inherent jurisdiction of the Court of Chancery, and all its successor courts in common law jurisdictions across the world, to supervise and if necessary intervene in the administration of trusts is an ancient and well-established jurisdiction of such courts. It is a jurisdiction that marks a radical distinction between the law of trusts and the wider law of obligations.

While there is no comprehensive judicial statement of the court's inherent jurisdiction in relation to trusts, it may be useful to begin with a well-known statement of part of the jurisdiction given in *Public Trustee v Cooper*[4] by Justice Hart, who was in turn quoting part of an unreported judgment of Justice Robert Walker (later Lord Walker) from 1995:

> At the risk of covering a lot of familiar ground and stating the obvious, it seems to me that, when the court has to adjudicate on a course of action proposed or actually taken by trustees, there are at least four distinct situations (and there are no doubt numerous variations of those as well).
>
> (1) The first category is where the issue is whether some proposed action is within the trustees' powers. That is ultimately a question of construction of the

4. [2001] WTLR 901 (Ch (Eng)).

> trust instrument or a statute or both. The practice of the Chancery Division is that a question of that sort must be decided in open court and only after hearing argument from both sides. It is not always easy to distinguish that situation from the second situation that I am coming to … [He then gave an example].
>
> (2) The second category is where the issue is whether the proposed course of action is a proper exercise of the trustees' powers where there is no real doubt as to the nature of the trustees' powers and the trustees have decided how they want to exercise them but, because the decision is particularly momentous, the trustees wish to obtain the blessing of the court for the action on which they have resolved and which is within their powers. Obvious examples of that, which are very familiar in the Chancery Division, are a decision by trustees to sell a family estate or to sell a controlling holding in a family company. In such circumstances there is no doubt at all as to the extent of the trustees' powers nor is there any doubt as to what the trustees want to do but they think it prudent, and the court will give them their costs of doing so, to obtain the court's blessing on a momentous decision. In a case like that, there is no question of surrender of discretion and indeed it is most unlikely that the court will be persuaded in the absence of special circumstances to accept the surrender of discretion on a question of that sort, where the trustees are prima facie in a much better position than the court to know what is in the best interests of the beneficiaries.
>
> (3) The third category is that of surrender of discretion properly so called. There the court will only accept a surrender of discretion for a good reason, the most obvious good reasons being either that the trustees are deadlocked (but honestly deadlocked, so that the question cannot be resolved by removing one trustee rather than another) or because the trustees are disabled as a result of a conflict of interest. Cases within categories (2) and (3) are similar in that they are both domestic proceedings traditionally heard in Chambers in which adversarial argument is not essential though it sometimes occurs. It may be that ultimately all will agree on some particular course of action or, at any rate, will not violently oppose some particular course of action. The difference between category (2) and category (3) is simply as to whether the court is (under category (2)) approving the exercise of discretion by trustees or (under category (3)) exercising its own discretion.
>
> (4) The fourth category is where trustees have actually taken action, and that action is attacked as being either outside their powers or an improper exercise of their powers. Cases of that sort are hostile litigation to be heard and decided in open court. I mention that fourth category, obvious though it is, for a reason which will appear in a moment.[5]

This is certainly not the whole of the court's inherent jurisdiction.

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5. *Ibid* at 922-24.

One quite common aspect of the court's inherent jurisdiction — not mentioned above — is the court's inherent power to remove and appoint trustees, even contrary to the wishes of the trustees and the terms of the trust (if any) governing the succession of trustees.[6] The court also has power, in an emergency, to: authorise acts of administration of the trust that are not otherwise authorised;[7] authorise the trustees to take court proceedings paid out of trust funds;[8] authorise as a matter of salvage, the expenditure of capital in keeping up the trust property, for instance by raising money on mortgage and spending it on repairs of the property to save it from ruin which would otherwise ensue;[9] sanction a transaction which would otherwise constitute a breach of the trustee's fiduciary duty;[10] authorise a trustee to charge remuneration where none is provided by the terms of the trust or to charge remuneration in excess of that provided pursuant to the trust;[11] authorise the maintenance of minor beneficiaries out of income directed to be accumulated, and even out of capital in some circumstances, where this course is contrary to the strict terms of the trust instrument and the statutory power of maintenance in section 31 of the *Trustee Act 1925* is excluded or is otherwise not

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6. See *e.g. Re Chetwynd's Settlement*, [1902] 1 Ch 692 (Eng); *Re Harrison's Settlement Trusts*, [1965] 3 All ER 795 (Ch); and more generally Hayton, *supra* note 3 at 70.15-70.16, 71.32-71.57.
7. See *e.g. Re New*, [1901] 2 Ch 534 (CA (Eng)); *Re Tollemache*, [1903] 1 Ch 955 (CA (Eng)); *Chapman v Chapman*, [1954] 1 All ER 798 (HL) [*Chapman*]; and more generally Hayton, *supra* note 3 at 43.20-43.25; and Lewin, *supra* note 3 at 45-50.
8. *Re Beddoe*, [1893] 1 Ch 547 (CA (Eng)); *Evans v Evans*, [1986] 3 All ER 289; and *Alsop Wilkinson v Neary*, [1995] 1 All ER 431 (Ch).
9. *Re Jackson*, (1882) 21 Ch D 786 (Eng).
10. See *e.g. Campbell v Walker* (1800), 31 ER 801 (Ch); *Farmer v Dean* (1863), 55 ER 128 (Ch); *Holder v Holder*, [1968] 1 Ch 353 (Eng); and more generally John McGhee et al, *Snell's Equity* 33d (London, Sweet & Maxwell, 2015) [Snell's] at 17. See also Matthew Conaglen, "The Extent of Fiduciary Accounting and the Importance of Authorisation Mechanisms" (2011) 73:3 Cambridge Law Journal 548 at 564-73.
11. *Re Duke of Norfolk's Settlement* , [1982] Ch 61 (Eng).

applicable;[12] and approve on behalf of minor, unborn and unascertained persons compromises of genuine disputes over the destination of trust property.[13] There is, however, no general power to alter the terms of a trust because the court thinks it beneficial to do so.[14]

This summary of the court's inherent jurisdiction does not purport to be exhaustive. It would take a full paper in itself to exhaustively describe the jurisdiction. But it is immediately apparent from this summary that the inherent jurisdiction of the court, though far from limitless, is still a wide and important jurisdiction. Recent cases show how flexible and useful this jurisdiction remains.

III. The Jurisdiction in Recent Cases: Meeting New Needs

The first such case to consider is *Schmidt v Rosewood Trust Ltd*[15] ("*Schmidt*"). The question at issue in this case was quite simple. Mr. Schmidt's late father had established two discretionary settlements in the Isle of Man. Mr. Schmidt, the appellant in the present proceedings, sought to obtain trust accounts and other information from the trustees of the two settlements. The sole trustee of each settlement was Rosewood Trust Ltd, the respondent in the appeal, and an Isle of Man company whose business was to provide corporate and trustee services. Mr. Schmidt brought his claim for disclosure of the trust accounts and other information in two capacities: first, as a personal beneficiary and second, as the administrator of his father's estate which claimed an interest under the trusts. The claim was made in the Isle of Man and the final appeal

12. See *e.g. Re De Teissier's Settled Estates*, [1893] 1 Ch 153 (Eng); and more generally Snell's, *supra* note 10 at 28-53.
13. *Re Lord Hylton's Settlement*, [1954] 1 WLR 1055 (CA (Eng)); *Chapman*, *supra* note 7.
14. *Chapman*, *supra* note 7. In response to the *Chapman* case, statutory jurisdiction to approve alterations of beneficial interests on behalf of certain categories of people was conferred on the court by the *Variation of Trusts Act*, 1958 (UK) 6 and 7 Eliz 2, c 53; and see Hayton, *supra* note 3 at 43.25.
15. [2003] UKPC 26 (Isle of Man)[*Schmidt*].

of the Manx proceedings was therefore heard in the Privy Council in London. The Privy Council did not resolve the issues, but rather gave a ruling as to the correct law that the courts in the Isle of Man should apply to determine those issues. The importance of the court's inherent jurisdiction in that ruling is apparent from the following concluding summary from Lord Walker's advice:

> Their Lordships have already indicated their view that a beneficiary's right to seek disclosure of trust documents, although sometimes not inappropriately described as a proprietary right, is best approached as one aspect of the court's inherent jurisdiction to supervise (and where appropriate intervene in) the administration of trusts. There is therefore in their Lordships' view no reason to draw any bright dividing-line either between transmissible and non-transmissible (that is, discretionary) interests, or between the rights of an object of a discretionary trust and those of the object of a mere power (of a fiduciary character).[16]

The key point for present purposes is not who was entitled to access trust documents. Rather, it is that the foundation of any such rights is the inherent jurisdiction of the court to determine, and if necessary compel, the due administration of a trust.

While *Schmidt* concerned trusts operating in their traditional context of providing for the management and distribution of family wealth over generations, the next case illustrates the vital contemporary importance of the court's inherent jurisdiction in a commercial context. *Re Lehman Brothers International (Europe)*[17] ("*Lehman*") was one of the many cases which arose out of the collapse of Lehman Brothers International (Europe) ("LBIE") in the financial crisis of 2008. LBIE held a large amount of property on trust for thousands of clients. However, its record-keeping left a very great deal to be desired. When LBIE went into administration, it proved impossible for the administrators to work out which assets were held for which client. In order to resolve these problems, the administrators of LBIE applied to the High Court in London to establish whether a scheme of arrangement under Part 26 of the *Companies Act 2006*,[18] which the administrators wished to promote

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16. *Ibid* at para 66.
17. [2009] EWHC 2141 (Ch (Comp)) [*Lehman*].
18. (UK), c 46 [*Companies Act*].

between the company and certain "scheme creditors", was one which the court has jurisdiction to sanction under the *Companies Act*. (A scheme of arrangement, if approved by the requisite majorities provided by the *Companies Act* and sanctioned by the court, binds all scheme creditors, irrespective of any particular scheme creditor's consent.) The present scheme was designed to compromise and eliminate all the clients' existing rights against LBIE in respect of the assets and instead give the clients the right to seek payment out of a fund constituted by all the assets held by LBIE for all the clients. Both the High Court, and subsequently the Court of Appeal, held that the *Companies Act* could not be used to give effect to the scheme because the *Companies Act* provided for schemes of arrangement which compromised only personal rights and any security for such rights; it could not be used to give effect to a scheme which sought to alter equitable beneficial interests in assets.

This left the administrators of LBIE in a very difficult position, and one to which the court was very sympathetic, even though it could not give effect to the administrators' original proposal. The court did not want to leave the administrators with no way forward other than an inordinately expensive, and probably ultimately futile, forensic exercise of trying to identify precisely which assets were held for which client. Therefore, what the High Court and the Court of Appeal both did was to suggest that the administrators, acting on behalf of LBIE in its capacity as a trustee of client funds, should use and take advantage of the court's inherent jurisdiction in relation to trusts:

> Establishing what client assets of any given client LBIE holds or controls, what competing claims there may be to those assets by other clients or by LBIE (or others) and how LBIE and the administrators are to discharge their duties in respect of those assets with a view to their due distribution to those entitled to them are all matters where the court has, in the exercise of its trust jurisdiction, well-developed processes to assist the accountable trustee or other fiduciary. For example, the court is well used to authorising a trustee to make distribution of a fund where there can be no certainty that all of the claimants to it have been identified and the trustee desires the protection of a court order in the event that a further claimant should subsequently appear or matters subsequently come to light which question the basis on which the distribution is made. In one sense, dealing with the matter by recourse to the court's assistance in this way can be simpler (and less costly) than the often complex processes involved

> in the promotion of a scheme under Part 26. …[19]
>
> Like Patten LJ and Blackburne J, I have some sympathy with the administrators' desire to have a scheme under section 895 (of the 2006 Act) which extends to trust property, in the light of the difficulties which would otherwise almost certainly arise in connection with seeking to satisfy the rights of beneficiaries in relation to trust property held in the name of LBIE. However, as Blackburne J held, the fact that such a Scheme might well represent a reasonable proposal in this case is plainly not enough to bring it within the ambit of section 895, and, as is evidenced by the opposition to the proposed Scheme mounted by the London Investment Banking Association, it may, viewed in the wider perspective, be positively undesirable that such a Scheme could be approved under section 895. I hope, indeed I would expect, that, if the administrators decide to make an application under the Trustee Acts or pursuant to the court's inherent equitable jurisdiction, in relation to dealing with beneficiaries' rights, the court will provide effective assistance, by arriving at a practical and fair outcome, while ensuring that delay and cost are kept to a minimum.[20]

In this case, the administration of assets worth many millions of pounds by those responsible for resolving important aspects of one of the biggest corporate collapses in history was consigned to the inherent jurisdiction of the court in respect of trusts. By any standard, this was a significant invocation of that jurisdiction.

More recently still, the jurisdiction has been similarly deployed to deal with the distribution of client monies held by an investment bank in special administration in the case of *Re Worldspreads Limited*.[21] The company, a regulated bank, had provided an online trading platform for spread betting and trading in contracts for differences. The company became insolvent and was put into "special administration", a specialised form of insolvency proceeding for an insolvent investment bank.[22] There was a large deficiency in its client account. Monies in the client account were held on statutory trusts.[23] To cut a long story short, the statutory

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19. *Lehman*, *supra* note 17 at para 77, per Blackburne J.
20. [2009] EWCA Civ 1161, per Longmore LJ.
21. [2015] EWHC 1719 (Ch).
22. See the *Banking Act 2009* (UK), c 1; and the *Investment Bank Special Administration Regulations 2011* (UK), SI 2011/245.
23. See UK Financial Conduct Authority, *Client Assets Rules*, made in exercise of its powers under the *Financial Services and Markets Act 2000* (UK), c 8, ss 137(a), 137(b).

powers enabling an administrator to distribute the client monies in those circumstances proved inadequate. On application to the court, the court made an order exercising its inherent jurisdiction in relation to trusts and gave directions to the administrators (who controlled the company, which was trustee of the monies), authorising them to distribute the trust property on a particular basis, as the court was satisfied that it was just and expedient to make such an order in the circumstances of the insolvency.

Another commercial context in which the court's inherent jurisdiction over trusts has proven very useful and able to react to modern developments in finance is its use by the trustees of note issues. Notes are often issued pursuant to the terms of a trust deed. In such a case, the issuer (borrower/debtor) owes sums of money (interest, and ultimately capital) to one or more noteholders. The issuer also promises to pay equivalent sums of money to, or to the order of, a trustee. The trustee holds the benefit of that obligation on trust for the noteholders. In normal (solvent) circumstances, payment to the underlying investors will discharge the issuer's obligations both to the noteholder(s) and to the trustee, because the trustee (and, if necessary, the noteholder) will have directed payment to the investors until default. On default, the terms of the notes will prohibit separate actions by a noteholder. Instead, the trustee will enforce the debt owed to it for the benefit of the noteholders and thus the underlying investors. In effect, there will be collective realisation by the trustee, for the benefit of the noteholders, of the sums outstanding from the issuer. The trustee in these cases is usually little more than a cipher in economic terms.[24] The trustee will very likely have some minor administrative discretions, but on most questions of substance, such as whether to waive a material breach of covenant, whether to declare an event of default, and whether to enforce the debt, the trustee deed will direct the trustee to act on the directions of the noteholders (that is, the beneficiaries of the trust), usually acting by some specified majority. It is not unusual for the trustee to be caught in between competing groups of noteholders (beneficiaries).

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24. Consider *Concord Trust v Law Debenture Trust Corporation,* [2004] EWCA Civ 1001 at para 38; and *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL*, [2011] EWCA Civ 227 at paras 102-105.

In those circumstances, the trustee has the great help of the administrative jurisdiction of the court. The trustee can apply to court for directions on the appropriate course of action (or the range of possibilities from which it may lawfully choose) and is totally protected from all liability if it acts in accordance with the court's order.[25] Most of these applications take place on short notice, often in chambers. They leave no record easily accessible. Various practitioners in this field in both the City of London and in Hong Kong have, in conversations with the author, attested to the importance and usefulness of the court's inherent administrative jurisdiction in these circumstances. One reported example of this process is *Citibank NA v MBIA Assurance SA*.[26]

This case concerned one of several restructurings of debt issued by Eurotunnel, the builder and operator of the fixed train link between England and France under the English Channel. Citibank ("Citi") applied for directions from the court in Citi's capacity as trustee of a trust constituted by a trust deed dated 20 February 2001. This trust deed was itself the result of an earlier restructuring in which a company called FLF acquired a large tranche of Eurotunnel subordinated debt and paid for it by issuing seven ranked tranches of notes subject to the terms of the trust. The trust deed contained a covenant from FLF to pay the notes when due, which would then be financed out of the returns from the Eurotunnel debt it owned. The trust deed also provided for other covenants (including a covenant to pay equivalent sums to the trustee, or to the trustee's order) to be held on trust for the noteholders. Futher, the deed provided for MBIA Assurance SA ("MBIA") to be able to give directions and exercise a lot of control over what would otherwise be Citi's duties and discretions as a trustee, so long as MBIA remained the

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25. See *Civil Procedure Rules* (UK), r 64 and its accompanying Practice Direction; and see generally Hayton, *supra* note 3. In Australia, see also *Re Mirvac Ltd*, [1999] NSWSC 457 (Austl) at paras 40-41, a case in which Austin J considered this jurisdiction and a parallel jurisdiction under a New South Wales statute.
26. [2006] EWHC 3215 (Ch). A very recent example of an alternative means of proceeding, namely an application for a declaration rather than directions, is: *BNY Mellon Corporate Trustee Services Ltd v LBG Capital No 1*, [2015] EWHC 1560 (Ch).

"Note Controlling Party", that is, while MBIA remained liable under a guarantee it had given of some of the notes. When the underlying Eurotunnel debt was again restructured, MBIA exercised some of its powers under the terms of the trust to its own advantage so that it would be paid certain cash sums. This was challenged by other noteholders (that is, other beneficiaries of the trust), *inter alia* on the grounds that the trustee, if it acted in accordance with MBIA's directions, would breach its duties to look after the interests of all beneficiaries. Citi, as trustee, applied for directions. The court held it lawful for the trustee to act in accordance with MBIA's directions. If the express terms of the trust make a beneficiary's rights subject to the effect of such a direction, those express terms cannot be overridden or altered by some alleged "duty of fairness" to those beneficiaries.

What is important for present purposes is the availability of the court's inherent jurisdiction to give directions and thereby resolve the trustee's concerns. The court laid to rest a major financial question affecting notes worth in aggregate some £432,050,000 plus €745,000,000 and did so in a very short time. The originating process seeking the directions was issued on 20 November 2006. The Chancery Division of the High Court in London gave judgment on 13 December 2006; and on 22 January 2007 the Court of Appeal dismissed an appeal against the High Court's judgment. The whole process, from start to finish, took just nine weeks, including the Christmas and New Year vacation periods.

Cases from recent years in another area of law, this time in the traditional context of family wealth management, also illustrate the flexibility of the court's inherent jurisdiction and its enduring vitality. The cases in question concern protectors and they show the continuing ability of the inherent jurisdiction to cope with novel situations.

In English law, the term "protector" is not a term of art, though it is sometimes used as a defined term in the trust legislation of some (often offshore) jurisdictions.[27] All it means, essentially, is a person who is not acting as a trustee but who nevertheless has certain powers in relation to the administration and/or distribution of a trust fund and

27. See *e.g. Trustee Act 1998* (Bahamas), c 176, ss 3, 81.

may or may not be acting as a fiduciary in relation to those powers.[28] Other words are sometimes used to describe the person in this situation, such as "supervisor" or "special appointor", but nothing turns on the nomenclature for present purposes. What is significant is the court's use and development of its inherent jurisdiction over trusts to supervise and control protectors, and, when necessary, to intervene in the administration of the trust where its provisions for protectors have for some reason failed to work as anticipated.

In *Steele v Paz Ltd*,[29] a Manx appellate court had to consider a trust where the protector's consent was required for payments of income and capital and for the exercise by the trustees of a number of administrative powers. The protector also had power to appoint new or additional trustees. Unfortunately no protector was appointed when the trust was created and an issue arose as to whether the trust was therefore invalid. The court held that the position of protector in that trust was fiduciary and that the court could accordingly appoint a protector with fiduciary powers in the same way that it could appoint a trustee in order to prevent a trust from failing for want of a trustee.

In *Re Freiburg Trust*[30] ("*Freiburg*"), the Jersey Royal Court held that the protector of the trust, whose consent was required for the exercise by the trustees of a number of their powers, including payments of income or capital, was in the position of a fiduciary. The court, accordingly, could remove him pursuant to its inherent jurisdiction, and did so, because he had been convicted of offences of fraud in Belgium (including misappropriation of monies from the Freiburg Trust itself), had been sentenced in his absence to a term of imprisonment and had disappeared.

A final, more recent example is the Jersey case of *In the Matter of the A and B Trusts*.[31] Much of the factual background of the case was not

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28. See *e.g. Kan Lai Kwan v Poon Lok To Otto,* [2014] HKCFA 65 at para 67, per Gummow NPJ, citing with approval Matthew Conaglen & Elizabeth Weaver, "Protectors as Fiduciaries: Theory and Practice" (2012) 18:1 Trusts & Trustees 17.
29. [1995] Manx LR 426 (Isle of Man) [*Steel*].
30. [2004] JRC 056.
31. [2012] JRC 169A.

reported publicly for reasons of confidentiality. The court only authorised the publication of an extract from its judgment. In short, the applicants, who were the overwhelming majority of the adult beneficiaries of two Jersey discretionary trusts had lost confidence in the protector of the two trusts. Relationships between the parties had completely broken down, principally because the protector conceived of his role as ensuring that the wishes of the settlors were carried out, rather than upholding the interests of the beneficiaries at all times. The court ordered removal of the protector, exercising its inherent jurisdiction, because the protector had fundamentally misconceived his role. Though the protector's motivation for the way he exercised his role was *bona fide*, his role, ascertained from the terms of settlement, was to protect the beneficiaries' interests, not those of the settlors. It was also open to the settlors to specify a different role for the protector. It was common ground between the parties that the court had an inherent jurisdiction to remove a protector from office, akin to its power to remove a trustee from office,[32] and that the jurisdiction was an aspect of the court's inherent jurisdiction over the administration of trusts. The new development in the case is that the court made it clear that the jurisdiction could be exercised well beyond the extreme circumstances of cases such as *Freiburg*; the protector's mistaken view of his role, the breakdown in relations with so many beneficiaries, and the prejudice that caused to the administration of the trust, warranted his removal from office.

However, the inherent jurisdiction of the court has not been seen as entirely helpful. It has been seen by some as standing in the way of provision in a trust deed for mandatory arbitration of trust disputes. The argument, though it is contested, is that the inherent jurisdiction of the court cannot be ousted, so any provision of the trust requiring mandatory arbitration to the exclusion of court proceedings would necessarily be an attempt to oust the jurisdiction of the court in a manner which is not permissible and therefore void. The consequence would be that primary legislation would be required to authorise the mandatory arbitration of trust disputes. Certainly, this appears to be the view of the well-respected

32. *Supra* note 6.

Trust Law Committee as expressed in the journal of the Society of Trust and Estates Practitioners.[33]

Whatever the precise strength of this argument, it undoubtedly has a chilling effect on the adoption of arbitration for disputes arising under a trust deed. Yet for the reasons seen above, those who might seek to oust the inherent jurisdiction of the court should be careful what they wish for. The inherent jurisdiction is extremely flexible and useful, and ousting it could well result in a disadvantage to trustees and beneficiaries. For that reason alone, it seems preferable to provide for the arbitration of trust disputes, if desired, by carefully drafted legislation that preserves the advantages of access to court for guidance, directions and assistance, even if it invests the resolution of disputes in an arbitral tribunal. For present purposes, it is only fair to note that some practitioners indeed see some downside in the existence and availability of the inherent jurisdiction of the court, because of the doubt that jurisdiction casts on the effectiveness of arbitration clauses in trusts.

IV. Theory

It is surprising, given the ubiquity and importance of the inherent jurisdiction of the court over the administration and execution of trusts, that this jurisdiction has not attracted more academic attention. In England, this may be the consequence of so much academic attention being focused on implied trusts and their place in the taxonomy of the law, rather than on the express trust as a voluntary, substantive and functionally important legal institution used in a whole range of circumstances, many of them far removed from the origins of the trust in the intergenerational management of primarily land-based family wealth. In North America there has been, in recent years, renewed interest in

33. Trust Law Committee, "Arbitration of Trust Disputes" (2012) 18:4 Trusts and Trustees 296. For a thorough review of the law, see Matthew Conaglen, "The Enforceability of Arbitration Clauses in Trusts" (2015) 74:3 Cambridge Law Journal 450.

the trust as an organisational form and in legal theorising of this form.[34] But still, the existence and impact of the inherent jurisdiction has not featured much in these debates.

In fact, the existence of the inherent jurisdiction has significant theoretical ramifications in the law of trusts. At the risk of oversimplification, trust law has been seen as primarily about asset partitioning (essentially a matter of property law),[35] or contractarian freedom of management and disposition of trust assets (essentially a matter of the law of voluntary obligations — contract law in the economic, rather than the strictly legal sense),[36] or else, most persuasively, as a matter of organisational law.[37] The existence of the inherent jurisdiction challenges these simplicities. The inherent jurisdiction is a matter of positive law, not replicable by contract, and yet it is not concerned with asset partitioning, the traditionally conceived function of mandatory (property) rules in the law of trusts.

For example, it would be impossible by private bargain to provide for authoritative guidance and directions the effect of which, if followed, would be to insulate the trustee from all potential liability. At present, positive law in England would most likely forbid this as an impermissible ouster of the jurisdiction of the court.[38] But even if that were changed

34. See *e.g.* John H Langbein, "The Contractarian Basis of the Law of Trusts" (1995) 105:3 Yale Law Journal 625 [Langbein, "The Contractarian Basis"]; Henry B Hansmann & Ugo Mattei, "The Functions of Trust Law: A Comparative Legal and Economic Analysis" (1998) 73:2 New York University Law Review 434 [Hansmann & Mattei, "Functions of Trust Law"]; Henry B Hansmann & Reinier Kraakman, "The Essential Role of Organizational Law" (2000) 110:3 Yale Law Journal 387 [Hansmann & Kraakman, "The Essential Role"]; Henry B Hansmann, Reinier Kraakman & Richard Squire, "Law and the Rise of the Firm" (2006) 119:5 Harvard Law Review 1333 [Hansmann et al, "Rise of the Firm"]; and Robert Sitkoff, "An Agency Costs Theory of Trust Law" (2004) 89:3 Cornell Law Review 621.

35. Hansmann & Mattei, "Functions of Trust Law", *supra* note 34 at 454-59, 479.

36. Langbein, "The Contractarian Basis", *supra* note 34 at 650.

37. Hansmann & Kraakman, "The Essential Role", *supra* note 34 at 393-95; and Hansmann et al, "Rise of the Firm", *supra* note 34 at 1337-56.

38. *Steel*, *supra* note 29.

by statute, which is possible,[39] no tribunal can make itself immune from review by the courts. So the finality of any ruling by such a tribunal binding under the (now permitted) terms of a trust would always be subject to review. Only the state, through positive law, can provide complete finality, which trustees enjoy when acting in accordance with the directions of the court. It would be similarly impossible to provide for a body that will provide long stop enforcement of a trust, come what may. And private parties, by bargain, could not replicate the powers of the court to intervene in the administration of the trust, for example by removing trustees and appointing new ones, or by authorising deviations from the terms of the trust. Again, while in theory such powers could be conferred by the terms of a trust on a tribunal, the actions of such a tribunal would be open to review, and it would require the assistance of the state's (most likely the court's) coercive powers in order to secure compliance with its orders should they not be given effect willingly. In short, these forms of assistance offered by the court cannot be fully replicated by private bargain.

In theory, the role of the court in the *Lehman* litigation might just have been replicated by contract. But in practical terms, there was no such chance of a purely contractual solution, which was the very reason why the administrators had proposed a scheme of arrangement. There were so many people who were creditors or beneficiaries or both of the relevant LBIE entity that there was no practical possibility whatsoever of them all agreeing to a particular proposal for administering the funds held for their benefit. Indeed, even the administrators' proposal for a scheme of arrangement, which essentially saw the rights of LBIE's customers as *in personam* obligations (whether strictly contractual or not) nevertheless required the assistance of statute law and the intervention of the courts, through which the majority could be made to bind all the customers, if it were to be remotely feasible. In that event, the inherent jurisdiction of the court was used to achieve what in practical terms could not be achieved by private bargain alone.

The court's inherent jurisdiction is also important at the structural

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39. See *e.g. Trusts Law 2007* (Guernsey), c 2, s 63.

level of the law of trusts. Rules such as the requirements of "certainty of subject matter"[40] and "certainty of objects"[41] find their origin and justification in the court's inherent jurisdiction. These rules show distinct structural differences from their analogues in the law of contract and those differences are a consequence of the court's inherent jurisdiction.

The law of trusts, like the law of contract, requires certainty of intention. This is no more than a way of saying, in doctrinal terms, that there needs to be a sufficient and objective manifestation that the parties wish to create a particular form of legal relationship to which the organs of state, principally the courts, will then respond.

But the law of trusts is much more rigorous than the law of contract in its requirements that the subject matter of the trust be accurately identified or identifiable and that the beneficiaries of the trust likewise be clearly identified or identifiable. Contracts to deal with assets do not necessarily require that the assets be immediately identified or identifiable on formation of the contract; it is generally sufficient that the assets be identified on performance of the contract.[42]

In theoretical terms, it is the remedial structure of the law of contract which admits the more liberal rules on certainty. The courts do not need to know so much about what assets are in question if all they are required to do is award damages if assets of a particular description are not ultimately delivered as agreed. Correspondingly, the courts need to

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40. See *e.g. Sprange v Barnard* (1789), 2 Bro CC 585 (Ch (Eng)); *Knight v Knight* (1840), 3 Beav 148 (Ch (Eng)); *Boyce v Boyce* (1849), 16 Sim 476 (Ch (Eng)); *Palmer v Simmonds* (1854), 2 WR 313 (Ch (Eng)); *Mussoorie Bank Ltd v Raynor* (1882), 7 App Cas 321 (Ch (Eng)); *Re Kayford Ltd*, [1975] 1 All ER 604 (Ch); *Re London Wine Co (Shippers) Ltd*, [1986] PCC 121 (HC (Eng)); *Hunter v Moss*, [1994] 1 WLR 452 (CA (Civ) (Eng)); *Re Harvard Securities Ltd* (1997), 2 BCLC 369 (Ch (Eng)); and *White v Shortall*, [2006] NSWSC 1379 (Austl), aff'd [2007] NSWCA 372 (Austl) [*Shortall*] (approved by the Court of Appeal in *Lehman, supra* note 17). See generally Hayton, *supra* note 3 at 8.11-8.33.
41. See *e.g. Re Gulbenkian's Settlement Trusts*, [1970] AC 508 (HL) [*Gulbenkian's*]; and *McPhail v Doulton*, [1971] AC 424 (HL) [*McPhail*]. See generally Hayton, *supra* note 3 at 8.34-8.70.
42. See generally Gareth Jones & William Goodhart, *Specific Performance* (London: Butterworths, 1996) at 9-11.

know more if they are to be able and willing to order parties to deal with particular assets and subject them to penalties, including contempt of court, should they not do so.

The law of trusts therefore requires that trustees should know *ab initio* what the assets to be held on trust are, or to be able to ascertain that immediately,[43] again because of the (different) remedial structure of the law of trusts. Axiomatically, the law of trusts requires trustees to execute the trust, rather than merely pay compensation in respect of their failure to execute the trust. Ultimately, and equally axiomatically, the court will execute the trust if the current trustees fail to do so, whether acting itself or through the appointment of new trustees.[44] These axiomatic propositions require much more information to be available if they are to be realised. In other words, axiomatic doctrines which form part of the court's inherent jurisdiction are responsible for the tighter certainty requirements of the law of trusts as opposed to the law of contract.

Similar points can be made in connection with the rules on certainty of objects. The rules are not just about ascertainment of those who have *locus standi* to enforce the trust. If they were, then it would be very difficult to argue with the proposition that identification of a single such beneficiary would be sufficient to validate the trust, a proposition that was rejected decades ago in *Re Gulbenkian's Settlement Trusts*.[45] While the rules are designed to make sure that the trustees can execute the trust rather than pay compensation in respect of a failure to execute it, they are also designed to enable the court to execute the trust, or bring about

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43. Langbein, "The Contractarian Basis", *supra* note 34 at 650. The statement in the text is consistent with the interpretation given to *Hunter v Moss*, [1994] 1 WLR 452 (CA (Civ)(Eng)), and in the Australian case of *Shortall*, *supra* note 40, which in turn was itself approved in England by the Court of Appeal in *Lehman*, *supra* note 17.

44. *Morice*, *supra* note 1. Note also *Re Astor's Settlement Trusts*, [1952] Ch 534 (Eng) at 549; *McPhail*, *supra* note 41 at 439-40; *McLean v Burns Philp Trustee Co Pty Ltd* (1985), 2 NSWLR 623 (SC (Austl)) at 633, 637; *Re Rabaiotti 1989 Settlement* [2000], WTLR 953 (Royal Court (Jersey)) at 970; *Schmidt*, *supra* note 15 at paras 36, 51, 66; and *Crociani v Crociani*, [2014] UKPC 40 (Jersey) at para 36 [*Crociani*].

45. *Gulbenkian's*, *supra* note 41.

its execution, should the current trustees fail to do so.[46] The theoretical implications are the same as those flowing from the rules about certainty of subject matter. The axiomatic rule that a trust will, if necessary, be executed by the court or at its direction, generates the strict — or at the very least stricter — requirements in the law of trusts for information about the identity of beneficiaries.

The court's inherent jurisdiction also offers theoretical insights to counterbalance the undoubted insights of contractarianism.[47] Unlike contracts, trusts proceed from the axiom that the court will compel a trustee to perform his or her undertaking, regardless of any question of the adequacy of monetary compensation for non-performance, as was noted earlier. Trusts assume the "good person" theory of obligations (where the "good person" does faithfully as he or she is bound to in accordance with the terms or purposes of the trust), rather than a "bad person" theory (where he or she is allowed to breach his duties at the price of paying money). The relevance of this to remedies for breach of trust and their quantification has been explored elsewhere.[48] But the interest of trust law in performance has implications well beyond the law of remedies for breach of trust.

This interest in performance, if it is to be realised consistently in practice, necessitates some means of keeping the trust operating for its proper purposes in circumstances even where the beneficiaries are not all ascertained and *sui juris* — capable of reforming the administration of the trust themselves by consensual action. Even if the law allowed other mechanisms of enforcement, they too could break down. The court's inherent jurisdiction provides the necessary support that guarantees performance and execution of the trust. The court's inherent jurisdiction provides a kind of state-backed regulatory oversight of, and support for, the trust. As such, the court's inherent jurisdiction could not be replicated by private bargain. That fact provides a necessary corrective to an

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46. *Morice*, *supra* note 1.
47. See Langbein, "The Contractarian Basis", *supra* note 34 at 629.
48. See *e.g.* David Hayton, "The Development of Equity and the 'Good Person' Philosophy in Common Law Systems" (2012) 76 The Conveyancer and Property Lawyer 263.

excessively contractarian understanding of trusts. Trusts certainly exhibit similarities to contract — they respond to private bargaining and so are very flexible — but trusts are not contracts. Contractarianism provides one important perspective on trusts, but it is not the only perspective and must certainly not imply an identity between trusts and contracts. But equally, the court's inherent jurisdiction should remain deferential to the terms of the trust as established by the settlor; respect for voluntary undertakings should be maintained. The court's inherent jurisdiction can usefully aid the execution of voluntary undertakings and help them cope with unexpected events and maladministration; but, as hitherto, a court should not alter the terms of a trust simply because it thinks that it is beneficial to do so.[49]

A recent case from the Privy Council, *Crociani v Crociani*,[50] emphasises that the involvement of the court in the affairs of a trust is an important factor distinguishing trust from true contract. The Privy Council indicated that it would approach a jurisdiction clause in a trust differently from an equivalent clause in a contract, because of the court's concern for the beneficiaries' interests. In other words, beneficiaries are not treated just like a third-party beneficiary of a contract *stricto sensu*, or the assignee of the benefit of a contract. Clearly, execution of the undertaking as mandated by the settlor is key to the law of trusts. But the court's approach to interpretation, like the court's jurisdiction to aid and supplement the trustees' execution of the trust, is used to advance the beneficiaries' interests more firmly than those of a third party beneficiary of a contract or an assignee of the benefit of a contract. The *Crociani* case confirms from the perspective of interpretation what is also clear from the inherent jurisdiction: an unsophisticated equivalence between trust and contract is entirely inappropriate, even when considering the rights and duties of trustees and beneficiaries *inter se*, quite aside from any consideration of the proprietary aspects of a trust.

More fundamentally still, in theoretical terms, the very conceptualisation of an interest under a trust must accommodate and

49. *Supra* notes 13, 14.

50. *Crociani*, *supra* note 44.

reflect the implications of the court's inherent jurisdiction. An interest under a trust had its origins in the jurisdiction of the Chancellor, and later his court, and these origins are still visible. An interest under a trust, while it may be conceptualised as a single interest, is a complex of juridical components. The interest will involve proprietary aspects — the right to maintain and when necessary restore the integrity of the trust fund — as well as claims on the trustee by way of obligation.[51] But that interest also still crucially involves the holder's — the beneficiary's — right to invoke the inherent jurisdiction of the court. The non-proprietary aspects of the interest cannot simply be reduced to nothing more than a series of obligations owed to the holder of the interest. Of course, this is not to say that in a modern conceptualisation of a trust, such obligations do not exist, far from it. It is simply to emphasise that they are not the whole of the interest-holder's rights.

For example, the ability of the court to intervene in the administration of a trust when necessary to give guidance, to rule on the exercise of powers, to appoint new trustees and to permit departure from fiduciary and other rules, cannot all be conceptualised as obligations owed by the trustees. Nor are they in any sense rights of property. Nor could they be practically replicated by private bargain. And in some cases, such as the ability of the court to provide authoritative directions immunising the trustees from liability if they act within those directions, they could not be replicated by private bargain even in theory, because these rules depend on the state's unique ability to quieten disputes with finality and, when necessary, exercise coercive force to achieve such finality. A beneficiary's right to invoke the court's inherent jurisdiction is *sui generis*.

The court's inherent jurisdiction will inevitably involve an element of discretion. Discretion in the decisions of courts, particularly equitable discretion, has been roundly condemned by, amongst others, the late

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51. Richard Nolan, "Equitable Property" (2006) 122:2 Law Quarterly Review 232.

Professor Birks.[52] Yet the experience of social practice — the day to day activities of the courts — suggest that such discretion is not and need not be arbitrary and lacking in any predictability. Its existence is practically inevitable and, it seems, theoretically unavoidable.

Even a cursory survey of the court's inherent jurisdiction makes it very clear that the jurisdiction can be invoked in a large number of different circumstances and for a large number of different purposes. The court, in exercising its inherent jurisdiction, has to encompass a vast range of possibilities. The idea that enough fixed rules could be developed to deal with each one within that vast range to come before the court is self-evidently absurd. Any purported rule would soon become the subject of so many glosses, carve-outs and exceptions necessary to cope with changed circumstance that the process would amount in substance to the application of discretion but without the clarity of calling it such. In other words, discretion is practically inevitable as a component of the court's inherent jurisdiction.

Indeed, it is noticeable that the courts rely on equitable discretion when intervening in organisations to cope with the unexpected and the unanticipated and the breakdown of relationships even in other areas than the court's inherent jurisdiction over trusts. In these areas, the court's involvement in the organisation is rather less intense than its inherent jurisdiction over trusts: in these areas, the court sticks to resolving disputes, and, where necessary, arranging for the dissolution of the organisation, but does not offer the range of assistance, guidance and ultimately administration of the organisation that are part of the court's inherent jurisdiction over trusts.

A good example of the court's equitable discretion outside the law of trusts is the court's jurisdiction to wind up unincorporated

52. See *e.g.* the unrestrained criticism in Peter Birks, "Three Kinds of Objection to Discretionary Remedialism" (2000) 29:1 The University of Western Australia Law Review 1. Compare and contrast Paul Finn, "Equitable Doctrine and Discretion in Remedies", ch 17 in WR Cornish et al, eds, *Restitution Past, Present and Future: Essays in Honour of Gareth Jones* (Oxford: Hart, 1998) at 251.

associations and partnerships.[53] Where statute law has created new forms of organisations, such as the company limited by shares or by guarantee, statute, from very early on, had to provide discretion for the court to wind up such companies,[54] and later found it necessary to confer further discretion to allow the court to deal with disputes between members without necessarily winding up the company.[55] So even in statute law dealing with organisations, giving discretion to the courts was seen as necessary from the beginning, and the scope of that discretion only grew with time. Both practicality and history seem to suggest that such discretion is unavoidable and necessary when a court becomes involved in the administration of an organisation.

But this discretion certainly does not entail chaotic unpredictability in legal relations between the members of the organisation. Lawyers are perfectly capable of advising in such disputes, as patterns of circumstance, behaviour and judicial response allow the lawyers to predict and advise with a considerable degree of probability, if not complete certainty. Further, it should be remembered that purportedly fixed rules, which can nevertheless be manipulated and distinguished, are themselves far from entirely certain in their application. It is primitive and naive, indeed misleading, to set up a bipolar distinction between "rules" as certain and "discretion" as chaotic.

The same points can be made in theoretical terms. Given the multiplicity of parties and circumstances that may come before the court in its inherent jurisdiction over trusts, some of which are noted above, it

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53. The jurisdiction of the court in relation to partnerships originated in equity but was later codified in statute as section 35 of the *Partnership Act, 1890* (UK), c 53, 54 Vict, 39. See Roderick l'Anson Banks, *Lindley & Banks on Partnership* 19d (London: Sweet & Maxwell, 2013) at 1-01, 1-04-1-06, 1-13. The jurisdiction over unincorporated associations which are not partnerships remains a matter of the court's inherent equitable jurisdiction: *Re William Denby Sick and Benevolent Fund*, [1971] 1 WLR 973 (Ch (Eng)); and *Re GKN Bolts & Nuts Ltd (Automotive Division) Birmingham Works Sports and Social Club*, [1982] 1 WLR 774 (Ch (Eng)).
54. *Companies Act, 1862* (UK), c 39, s 79(5).
55. *Companies Act, 1948* (UK), c 38, s 210, and its much modified successors, culminating in the current *Companies Act*, *supra* note 18 at ss 944 *et seq.*

would be impossible for a court composed of human beings with limited information and bounded rationality to be capable of prospectively structuring rules to cope with every one of those parties and every one of those circumstances.

What this means is that any attempt to eliminate the element of the court's discretion from the law of trusts and the rights of beneficiaries is doomed to failure. Any such attempt would be doomed simply because of the court's involvement in the affairs of a complex organisation, as illustrated above. However the intensity of the court's inherent jurisdiction over trusts — that is, the much greater extent to which a court will positively become involved in the administration of a trust than the administration of any other organisation such as an unincorporated association, a partnership or a company — serves further to emphasise the inevitability of discretion in the administration of trusts and the corresponding inevitability of access to the court's discretion as an aspect of a beneficiary's rights.

V. Conclusion: A Research Agenda

A richer and more complete understanding of discretion is therefore a vital step in the study of the law of trusts. Discretion is not going to go away, notwithstanding a strong strain of academic distaste for discretion at least in England, particularly a distaste for equitable discretion.[56]

So what of future research? In 1956, while a visitor at Harvard Law School, the leading Oxford scholar of jurisprudence, Professor HLA Hart, considered the question of discretion in a presentation to the Harvard Law School Faculty. The text of that presentation was lost until very recently, but has now finally been published.[57] We need to

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56. Birks, *supra* note 52.

57. HLA Hart, "Discretion" (2013) 127:2 Harvard Law Review 652. Professor Hart's own text is accompanied by two fascinating essays about his once lost, now recovered, concern with discretion: Nicola Lacey, "The Path Not Taken: HLA Hart's Harvard Essay on Discretion" (2013) 127:2 Harvard Law Review 636; and Geoffrey C Shaw, "HLA Hart's Lost Essay: Discretion and the Legal Process School" (2013) 127:2 Harvard Law Review 666.

take forward its stalled agenda, and move beyond the unsophisticated excoriation of discretion.

One of the key aspects of Hart's consideration of discretion was his awareness of the widely varying circumstances in which discretion may be deployed. It is certainly not just a matter for a court. In the context of trust law, discretion is often vitally important in the decisions of trustees and others involved in the administration of trusts such as a protector. In all these contexts, we need a clear understanding of what distinguishes discretion both from rules and from arbitrary decisions. It is trite to say that trustees and protectors must not make arbitrary decisions,[58] but what precisely is "arbitrary" and to what extent does the nature of what is "arbitrary" vary, depending on the identity and duties of the decision-maker? And equally, we need to consider the limits of discretion and how it is to be controlled and reviewed without being abolished.

When the consideration of discretion focuses on the court, much broader questions emerge. The first, and so far unarticulated question, is the nature of the court's discretion in the context of the inherent jurisdiction: to what extent is it exercising administrative (or executive) discretion and to what extent is it exercising judicial discretion? In other words, to what extent is the court using its discretion to decide how a trust should be run, if necessary adjudicating between competing points of view as to what is appropriate or desirable, and to what extent is it adjudicating a disputed point of law, or claims to some entitlement pursuant to an obligation or a proprietary interest? The well known debate between Hart and Dworkin focused very much on the latter form of judicial discretion, that is, discretion in the interpretation, and possibly creation, of rules and discretion in the adjudication of claims to

58. See *e.g. Re Manisty's Settlement*, [1974] Ch 17 (Eng) at 26, per Templeman J.

some entitlement.[59]

To the extent that the discretion of the court's inherent jurisdiction is administrative in nature, it raises questions about the role of discretion in the very structure of the trust as a juridical institution and about the impact of that discretion on the nature of the rights and duties which arise under a trust, given that access to the discretionary remedies of the court is a fundamental aspect of a beneficiary's rights. Administrative discretion vested in a court also raises questions about the nature of courts and judging. To the extent that they exercise administrative discretion, courts and judges are not solely concerned with the resolution of disputes and the interpretation and application of rules. What does that imply for the idea of "access to justice": does the idea include access to such administrative functions of the courts?

To the extent that the discretion of the court's inherent jurisdiction is truly judicial — not merely the exercise of discretion by a judge, but the exercise of discretion in the interpretation of application of rules, or in the adjudication of claims to some entitlement — then that discretion does raise questions about the nature of judicial discretion, its legitimacy and its relation to the rule of law. These questions are the more familiar stuff of the debate between Hart and Dworkin. And though these questions arise principally in relation to judicial discretion, they do nevertheless still arise in connection with a court's administrative discretion, though perhaps not in such an acute form.

These broad questions may seem a long way removed from an area of doctrine that is often seen as dry and merits little academic attention, that is, the inherent jurisdiction of the court over the administration and execution of trusts. But they are the inevitable consequence of what is a

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59. See Ronald Dworkin, "Judicial Discretion" (1963) 60 Journal of Philosophy 624, which was published seven years after Hart had presented his work on discretion at Harvard, but long before the work's publication. Hart returned to the debate, particularly in the postscript to *The Concept of Law*, 2d (Oxford: Oxford University Press, 1997). Dworkin returned often to the debate in his later works. See generally Scott Shapiro, *The "Hart-Dworkin" Debate: A Short Guide for the Perplexed* (Ripstein, UK: Cambridge University Press, 2007) at 22-55.

vital and important jurisdiction.

The "Fusion" of Law and Equity?: A Canadian Perspective on the Substantive, Jurisdictional, or Non-Fusion of Legal and Equitable Matters

Leonard I Rotman*

Equity, in its broad understanding, has long been a fundamental part of law. Its history may be traced through principles illustrated in the Old Testament and, in various formulations, through Ancient Greek and Roman legal constructs, as well as in Natural Law and Canon Law. While the historic presence of equity within various systems of law is unquestioned, the jurisdiction of equity within contemporary legal systems has been a matter of significant debate and confusion. Facilitating a better understanding of the contemporary role of equity requires knowledge of its meaning and the implications of the historic merger of legal and equitable jurisdictions. This paper establishes a framework for appreciating the contemporary challenges faced by equity by examining the Supreme Court of Canada's analysis of the merger of legal and equitable jurisdictions in two major cases involving allegations of breaches of fiduciary duty: Canson Enterprises Ltd v Boughton & Co and Hodgkinson v Simms. The inconsistent application of equitable principles in these cases demonstrates the court's confusion over the effects of the historic merger of law and equity and offers a valuable perspective for the administration of justice in contemporary law.

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I. Introduction

Equity[1] has long been a part of law, complementing its strength and ameliorating its deficiencies. Over its history, equity developed a number of key principles that advanced the law. One of these is the trust, which is often described as equity's greatest invention.[2] Another

1. The use of the term "equity" herein refers to the larger philosophical jurisdiction under which various equitable jurisdictions and principles (such as the equitable, as opposed to legal, interest in land) exist. Where specific instances of equity are referred to in the text, they will be distinguished accordingly, such as by the use of the phrase "English Equity" to designate that specific jurisdiction and its principles.
2. See Frederick W Maitland, *Equity: A Course Of Lectures*, ed, by John Brunyate (Cambridge: Cambridge University Press, 1936)("[o]f all the exploits of Equity the largest and the most important is the invention and development of the Trust" at 23); see also Harold G Hanbury, "The Field of Modern Equity" (1929) 45:2 Law Quarterly Review 196 ("[t]he trust, as developed through the use, is the mainspring of equity" at 199); Roderick Pitt Meagher, William Montague Charles Gummow & John Robert Felix Lehane, *Equity: Doctrines and Remedies*, 3d (Sydney: Butterworths, 1992)("the recognition, protection and development of uses and trusts [is] equity's greatest contribution to the law ... " at 5).

is equity's single most representative creation, the fiduciary obligation.[3] Over hundreds of years, these and other developments helped to solidify equity's important place within the larger body of law it served to complement.[4]

Over time, the integration of equitable principles into the common law, including principles such as unconscionability and good faith in contract law and negligence in tort, has resulted in a narrowing of the historic gulf between law and equity. Adding this development to the merger of legal and equitable jurisdictions, or what has sometimes been described as the "fusion" of law and equity, has muddled the understanding of equity's traditional function as "the spiritual and reforming influence of the law".[5] This is a particular concern in Canada and the United States, where there is a lack of substantive discussion and explication of the purpose and function of equitable principles in mainstream jurisprudence and academic commentary.[6]

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3. Leonard I Rotman, *Fiduciary Law* (Toronto: Carswell, 2005) at 154 [Rotman, *Fiduciary Law*]; Gino Dal Pont & Don Chalmers, *Equity and Trusts in Australia and New Zealand*, 2d (Sydney: Law Book Co, 2000) (who describe the fiduciary concept as "arguably the premier equitable concept which illustrates equity's jurisdiction" at 71); John D McCamus, "The Evolving Role of Fiduciary Obligation" in *Meredith Lectures*, *The Continued Relevance of the Law of Obligations: Back to Basics* (Montreal: Les Editions Yvon Blais, 2000)("fiduciary obligation seems now to have assumed the traditional mantle and role of equity jurisprudence as a device for correcting defects in the common law" at 205).
4. As will be discussed further herein, equity was developed as a complementary jurisdiction to the common law that served to augment the latter and ameliorate its harshness and inflexibility.
5. William F Walsh, "Is Equity Decadent?" (1937) 22:4 Minnesota Law Review 479 ("[t]he latent power of equity [is] to shape and develop new law on a higher plane of reason and conscience, and with an increased effectiveness to meet human needs" at 494).
6. Certainly, substantive discussion of equity has been on the wane for much of the last century in North America, though some might argue that equity has faced significant challenges to its historic jurisdiction since the merging of legal and equitable jurisdictions in England through the *Judicature Act, 1873* (UK), 36 & 37 Vict, c 66; and *Judicature Act, 1875* (UK), 38 & 39 Vict, c 77.

Law's movement closer to equity in areas such as contract, tort, and unjust enrichment has combined with a greater emphasis towards achieving enhanced certainty in law to hasten equity's marginalization in contemporary jurisprudence.[7] These developments have had deleterious effects on the understanding of the substantive jurisdiction of law and equity. When this desire for certainty is combined with the decreased emphasis on substantive equity within Canadian and American law schools,[8] equitable doctrines such as fiduciary duty that emphasize abstract principles rather than more easily discernible and predictable rules have struggled to maintain their traditional roles.[9] What has generally been ignored in this restructuring of the legal landscape is that, despite its struggle towards achieving certainty, the law actually benefits

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7. Notwithstanding the general lack of knowledge of equity and equitable doctrine, the maxims of equity appear to retain a curious currency in contemporary jurisprudence: see *e.g.* Jeff Berryman, "Equity's Maxims as a Concept in Canadian Jurisprudence" (2012) 43:2 Ottawa Law Review 165.
8. While it is difficult to pinpoint precisely when the abandonment of equity as a substantive part of the law school curriculum occurred, it would seem to have occurred within the last half century; see Louise Weinberg, "The New Meaning of Equity" (1977) 28:4 Journal of Legal Education 532 at 536 (the author indicates that while in 1949, eight of 108 law schools responding to a survey answered that they had eliminated separate courses in equity, in a 1967 survey of all 115 law schools then-accredited by the Association of American Law Schools ("AALS"), equity, in some form, was a required first-year course in only 11 schools, a required upper-year course in a further 19 schools, and available as an elective in only 32 schools); see also Louis F Del Duca, "Comment, Continuing Evaluation of Law School Curricula: An Initial Survey" (1968) 20:3 Journal of Legal Education 309; Lester B Orfield, "The Place of Equity in the Law School Curriculum" (1949) 2:1 Journal of Legal Education 26.
9. For greater discussion, see Leonard I Rotman, "Fiduciary Law's 'Holy Grail': Reconciling Theory and Practice in Fiduciary Jurisprudence" (2011) 91:3 Boston University Law Review 921.

from a certain amount of fogginess.[10]

This paper emphasizes that equity ought to be understood to have a continuing and substantive role in contemporary law and legal education. Equity is not only a method by which the rigours of the common law are tempered and its gaps filled, nor is it merely a competing system to the positive law. Rather, equity is more appropriately understood as a process by which positive law is brought closer to the human condition.[11] It is a way of elevating the law and facilitating the achievement of justice in the

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10. This is becoming increasingly recognized in contemporary legal literature. See *e.g.* Seana Valentine Shiffrin, "Inducing Moral Deliberation: On the Occasional Virtues of Fog" (2010) 123:5 Harvard Law Review 1214 (where the author disputes the conventional wisdom that celebrating the clarity and certainty of legal *rules* must necessarily correspond to devaluing the flexibility and adaptability of legal *standards*. Instead, she argues that "[b]y framing the prima facie unclarity and uncertainty of legal standards as a defect, the traditional picture ignores the salutary impact that superficial opacity may have on citizens' moral deliberation and on robust democratic engagement with law" at 1214); note also Yuval Feldman & Shahar Lifshitz, "Behind the Veil of Legal Uncertainty" (2011) 74:2 Law and Contemporary Problems 133 (which "challenges the conventional view [that uncertainty in law is bad] and proclaims the advantages of legal uncertainty" at 134; and "properly used, uncertainty can dramatically enhance efficiency and fairness" at 174).
11. Gary Watt, *Equity Stirring: The Story of Justice Beyond Law* (Oxford: Hart Publishing, 2009)("[e]quity is not Utopian, it simply reaches beyond the routines of law towards the particularities of the human condition" at 243); see also Philip A Ryan, "Equity: System or Process?" (1956) 45:2 Georgetown Law Journal 213 ("[e]quity is a process, but it is a process of a far broader and more important kind than procedure, even when this is taken in its widest possible sense. Equity viewed as a process accomplished the conversion of morality into law; procedure is merely the means of recognizing the conversion in a particular case ... " at 222).

broadest sense of the term[12] while providing sound parameters for the exercise of judicial discretion. However, this historic role is threatened by misunderstandings of the implications of merging legal and equitable jurisdictions that remain in the present day.

In the process of establishing a conceptual framework for understanding the merger of law and equity, this paper looks initially to equity's historical and conceptual origins. Next, it examines the effect of the merging of legal and equitable jurisdictions, historically and by way of two contemporaneous cases decided by the Supreme Court of Canada: *Canson Enterprises Ltd v Boughton & Co*[13] ("*Canson*") and *Hodgkinson v Simms*[14] ("*Hodgkinson*"). The paper then illustrates, by way of these cases, how similar fact patterns sharing a common feature[15] may be resolved differently, depending on whether one views equity as being "fused" with

12. See Howard L Oleck, "Historical Nature of Equity Jurisprudence" (1951) 20:1 Fordham Law Review 23 ("[e]quity, certainly in its historical moral sense, and hopefully in its administrative sense, is the principal technique thus far developed to make certain that law always will be readily adaptable for, and directed toward, the achievement of justice" at 44); Watt, *ibid* ("[w]ithout equity, the law's story becomes all rules and no justice" at 45; and "[e]quity does not set out to produce an ideally righteous system … but it sets out to make the system of regular law more just" at 102-103); see also Ryan, *ibid* ("[w]hat is necessary is to have some adequate grasp of Equity as a built-in dynamism necessary for progress in any system which purports to administer justice" at 217); Robert H Rogers, "A Lesson in Equity" (1915) 49:4 American Law Review 510 ("[l]egal justice is the law's attempt at approximate justice from the standpoint of social expediency … But the justice of equity, as originally intended and administered, was man's best attempt to arrive at real justice regardless of law or rule" at 535).
13. (1991), 85 DLR (4th) 129 (SCC) [*Canson*].
14. (1994), 117 DLR (4th) 161 (SCC) [*Hodgkinson*].
15. In both of these cases, the damages claimed were not entirely related to the direct actions of the alleged wrongdoers, but were dependent upon the effects of secondary forces that were said to have flowed directly from the wrongdoers' breach of duty. In both cases, the Supreme Court of Canada was also confronted with, *inter alia*, the application of common law *versus* equitable causation and the relevance of the principles of foreseeability, remoteness, and intervening act.

the common law (and thereby having its principles being fully integrated with or subsumed under the common law) or simply merged with it (whereby equitable principles retain their theoretical and substantive distinctiveness from those of the common law).

II. The Historical and Conceptual Origins of Equity

Despite equity's historic role in developing greater justice for law, its continuation as the conscience of law has been potentially jeopardized by its uncertain application in contemporary jurisprudence.[16] Early in the history of various legal systems, it was recognized that for law to be just, it had to balance broadly-worded and rigidly applied positive laws of general application with more case-specific and flexible legal applications that could respond to new and unique circumstances. The challenge of appealing to the general and the specific, being rigid, yet flexible, and simultaneously precise and open-ended meant that complementary systems were required to bring together these antagonistic goals.

The idea of complementary legal jurisdictions helps to explain the historical purpose and function of equity. Equity works alongside the law, supporting it where it is deficient and enabling the law to adequately respond to the individual requirements of particular circumstances. It occupies a supplementary jurisdiction to the common law that props

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16. From a very early stage, conscience became one of the guiding principles of equity jurisdiction: see Carleton Kemp Allen, *Law in the Making*, 7d (Oxford: Clarendon Press, 1964)("[i]f we look for one general principle which more than any other influenced equity as it was developed by the Chancery, we find it in a philosophical and theological conception of *conscience*" at 406); see also George Spence, *The Equitable Jurisdiction of the Court of Chancery*, vol 1 (Philadelphia: Lea and Blanchard, 1846)("... if any distinction was originally recognized as to the respective import of the terms Equity and Conscience, they soon became confounded, and a very considerable latitude was admitted in the application of the terms Equity and Conscience" at 412-413); Donovan WM Waters, "The Reception of Equity in the Supreme Court of Canada (1875-2000)" (2001) 80:1 Canadian Bar Review 620 ("[e]quity is 'conscience' – this is its whole *raison d'etre*, doctrinal in character though it be ... " at 630, and "[e]quity was and is the voice of conscience" at 625).

up and improves the latter without being inferior to it or lesser in importance.[17] The development and situation-specific application of equitable principles humanized and contextualized the law's otherwise antiseptic nature, which made the law more just.[18] In accomplishing these diverse tasks, equity did not replace the common law, but maintained a conceptual separation from it, all the while harmonizing law with the needs and requirements of evolving social structures and relationships.

As a supplemental jurisdiction to the common law, equity could not function independently of the former; as Maitland famously said, equity, without the common law, would have been "a castle in the air".[19] It is equally important, however, to understand that the common law, without equity, would have been "barbarous, unjust [and] absurd".[20] Today, equity is clearly "part of the warp and woof of our substantive law",[21] but the precise role it plays in contemporary law is often unclear.

Despite the symbiotic relationship between law and equity, common law practitioners were concerned about the competition that equity

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17. Acknowledging the supplementary jurisdiction of equity does not, however, entail, that equity is either inferior to or lesser in importance than the common law. Rather, equity is not needed where the law is suitable or sufficient to address the issue in question, but augments it or replaces it where it is silent or deficient; see the discussion of this issue below; see *Re Vandervell's Trusts (No 2)*(1974), 1 Ch 269 (Eng) at 322; Sidney E Smith, "The Stage of Equity" (1933) 11:5 Canadian Bar Review 308 ("[e]quitable rights were not to supplant common law rights, and, in most cases, equitable rights were predicated upon the very existence of common law rights" at 312, and "[e]quity, as understood in English law, was not a self-sufficient system; at every point, it presupposed the existence of the common law" at 313).
18. See the references, *supra* note 12.
19. Maitland, *supra* note 2 at 19.
20. See also Watt, *supra* note 11 ("[t]he law provides just one among many stories of justice. If the law story is to convince us, it must include the character of equity. Without equity, the law's story becomes all rules and no justice" at 45); see also John Gardner, "The Virtue of Justice and the Character of Law" (2000) 53:1 Current Legal Problems 1 at 18.
21. Douglas Laycock, "The Triumph of Equity" (1993) 56:3 Law and Contemporary Problems 53 at 71.

posed for the common law prior to the merging of legal and equitable jurisdictions. This provided them with incentive to denigrate equitable principles or to critique equity practice.[22] Part of the historic discontent with equity also arose from ideological conflicts and procedural issues that created a legacy of stalled jurisprudence in the Court of Chancery.[23]

During the time the common law and equity were administered in separate courts, with separate rules and bases of relief pertaining to each, there was little or no reciprocity between them. This created a situation whereby plaintiffs had to choose which forum to air their disputes.[24] This was not always a straightforward matter about what jurisdiction was appropriate for their claims. Indeed, even lawyers had a difficult time discerning the appropriate forum to entertain claims. Judges were not always helpful either; their desire to solidify claims to jurisdiction

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22. Frederick Pollock, "The Transformation of Equity" in Paul Vinogradoff, ed, *Essays in Legal History* (London: Oxford University Press, 1913)("[c] omplaints ... were for the most part, if not altogether, made or instigated by practitioners of the common law who were aggrieved by the growing competition of the Chancery" at 293).
23. Walter Ashburner, *Principles of Equity* (London: Butterworth & Co, 1902) at 14-17 (Ashburner speaks of continual skirmishes between the jurisdictions during the reign of Elizabeth I. Attempts to introduce equitable concepts into common law – and thereby undermine the jurisdiction of English Equity); see also Spence, *supra* note 16 at 576; in a more contemporary American setting, see Lyman Johnson, "Delaware's Non-Waivable Duties" (2011) 91:2 Boston University Law Review 701 ("[e]quity in the Western legal tradition has always coexisted somewhat uneasily with law, threatening as it does to 'subvert' and destabilize legal principles" at 709, citing Margaret Halliwell, *Equity and Good Conscience in a Contemporary Context* (London: Old Bailey Press, 1997), who states that "[f]undamental misconceptions of equity abound … because of a persistent refusal to acknowledge that equity is, by its very nature, subversive of the law" at 6).
24. Laycock, *supra* note 21 ("[b]efore the merger, the choice between equity and law entailed an all-or-nothing choice between all the characteristics of each system: discretion or formalism, specific or substitutionary remedies, personal decrees or impersonal judgments, enforcement by the contempt power or by execution and garnishment, bench trial or jury trial, and the availability or unavailability of preliminary relief" at 78).

over a matter sometimes led to expansive interpretations that were not always consistent or logical. Inefficiency and delay often ensued, but these troubles were dispensed with by the merging, or fusion, of legal and equitable jurisdictions.[25]

III. Equity and "Fusion"

Many of the difficulties posed by the separate existence of courts of law and equity were ultimately removed by the administrative merging of those jurisdictions. At that point, the separate jurisdiction of equity was abolished and every judge of the new, combined court of law and equity was bound to recognize and give effect to all legal and equitable rights, obligations, and defences. While the remnants of Chancery practice, along with the various abuses said to have occurred within its walls, were

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25. *Ibid* ("[t]he merger of law and equity ought to mean that the choice between law and equity is no longer all-or-nothing" at 78); while the United Kingdom abolished the separate jurisdictions of law and equity through the *Judicature Acts* of 1873 and 1875, *supra* note 6, other countries maintained separations between the common law and equity for various lengths of time. In Canada, most provinces did not have separate jurisdictions for law and equity because the majority of them were formed after the UK *Judicature Acts* were promulgated. Quebec was an exception to this situation because of its use of civil law. The few provinces that did have separate jurisdictions for law and equity – Ontario, New Brunswick, Nova Scotia, and Prince Edward Island – adopted the idea of concurrent jurisdictions over time: New Brunswick in 1854, Nova Scotia in 1856, Prince Edward Island in 1873, and Ontario in 1881: see Waters, *supra* note 16 at 623. Ontario only had a Court of Chancery from 1837; however, as seen in Smith, *supra* note 17 even though "... [t]here was no Chancery Court there during that period ... there is no reason to believe that any great confusion resulted. What we do find, however, is that the judges of the common law Courts made a conscious effort to ameliorate the rigours of the common law and to do equity" at 313; in the United States, the procedural separation of law and equity was abolished under most state rules of civil procedure at various stages and, federally, through the Federal Rules of Civil Procedure of 1938: see Ralph A Newman, *Equity and Law: A Comparative Study* (New York: Oceana Publications, 1961) at 50-51. An obvious exception to this is the state of Delaware, which maintains a Court of Chancery to the present day.

abandoned, the doctrines of equity that were formulated and refined in Chancery did not lose their validity with the shuttering of that court. Watt expressly recognizes this important distinction:

> [w]e do not mourn the passing of the old Court of Chancery with all the evils it perpetuated … but we should not make the mistake of sealing its treasure in the tomb. The treasure of chancery is a living language; a vital repository of checks and balances that maintain the law's just operation in the zone between too much rigour and too much flexibility … [A] legal language of equity is a thriving legacy of the Court of Chancery. Chancery language still has the capacity to inform the art of bending rules without breaking them and the capacity to reform the law without deforming it.[26]

Despite the merging of law and equity, the continuing role of equity post-merger remained contentious. Lionel Smith has described the distinction in views over the merger of law and equity as "equity pragmatism" and "equity purism".[27] In his view, the equity pragmatist "sees the legacy of equity as an historical fact that merely complicates the correct understanding of the modern law".[28] To the equity pragmatist, the common law and equity are not watertight compartments, but part of the "tapestry of law" and can be drawn upon freely or even in combination. The equity purist, on the other hand, "believes in the continuing distinctness of equitable reasoning, equitable doctrines, equitable traditions".[29] To the equity purist, equity should never be infused with common law notions.[30] The fact of the jurisdictional merger of law and equity did not change the various reasons for creating equity in the first place nor make its doctrines and remedies

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26. Watt, *supra* note 11 at 131.
27. Lionel Smith, "Unravelling Proprietary Restitution" (2004) 40:3 Canadian Business Law Journal 317 [L Smith, "Unravelling"]; see also Lionel Smith, Book Reviews of *Equitable Damages* by Peter M McDermott; *Equity: Issues and Trends* by Malcom Cope, ed; *Commercial Equity: Fiduciary Relationships* by John Glover, (1996) 75:2 Canadian Bar Review 388.
28. L Smith, "Unravelling", *supra* note 27 at 317.
29. *Ibid.*
30. See also Laycock, *supra* note 21 (in a similar vein, Laycock speaks about a "segregationist spirit" in his paper, in which equity is to be preserved as a separate and distinct body from the common law, with the preservation of the former's own, separate traditions from those of law at 54).

any more broadly available than previously. It did, however, eliminate the uncertainty over which court to file a claim in and ended the wrongful duplication of claims in both courts.

Laycock is one prominent scholar who has argued in favour of the full and total integration of law and equity in a manner consistent with Smith's "equity pragmatist":

> these debates are no longer about law and equity; they are simply debates about our law. We should not view every incremental expansion of a feature once associated with common law or equity as an incremental victory for common law or equity. The one thing we may be sure of is that the legal or equitable origin of the feature does not motivate the decision. Equity is fully accepted; legal and equitable features compete on a level playing field, largely commingled and sometimes indistinguishable. The argument about law and equity is over; now we just argue what the rules ought to be on grounds that are substantive, political, or jurisprudential, but not on the grounds of the subordinate status of equity.[31]

To Laycock, other than where references to equity have been codified, "law-equity arguments are always and exclusively a misleading distraction".[32] This sentiment may also be observed in Justice Stevenson's judgment in *Canson*, where he warned that "talk of fusing law and equity, only results in confusing and confounding the law".[33]

Although this process of simplifying the law is a positive move, it does not require, nor should it require, the abandoning of principle. The fashioning of doctrine — and the corresponding rights and remedies flowing from it — is based in principle and should only be departed from on an equally principled basis rather than being rooted in mere practicality. Remedies are properly fashioned in relation to something; they ought not be developed for mere convenience or other equally inappropriate reasons. Remedies ought to always follow the law and be appropriate to the harm caused or loss suffered.

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31. *Ibid* at 81.
32. *Ibid* at 82.
33. *Canson*, *supra* note 13 at 165. See also Laycock, *supra* note 21 ("[t]o the extent that debate persists over discretion or other failures associated with equity, it is a general debate about the best way to run a legal system. The debate is not about the boundary between law and equity, and it distorts analysis to continue thinking in terms of law and equity" at 54).

In contrast to the equity pragmatist, who tends to focus only on outcomes, the equity purist focuses on doctrine and the applicability or appropriateness of any change or modification of principles or tenets of equity to assess changes to the application of equitable principles. These purists have stressed that the merging of legal and equitable jurisdictions is simply administrative and procedural in effect, bringing together historic law and equity jurisdictions in the same court, but maintaining the ideological distinctions between them. For example, Roscoe Pound has maintained that:

> [a]lthough in all but five of our jurisdictions law and equity are administered by the same court, and often by the same judge, and in a majority of our jurisdictions they may be and are administered in the same proceeding, we still think and teach, and courts still judge, as if they were distinct jurisdictions.[34]

Similarly, as Master of the Rolls Sir George Jessel famously said in *Salt v Cooper*:

> [i]t is stated very plainly that the main object of the [Judicature] Act was to assimilate the transaction of equity business and Common Law business by different Courts of Judicature. It has been sometimes inaccurately called "the fusion of Law and Equity"; but it was not any fusion, or anything of the kind; it was the vesting in one tribunal the administration of Law and Equity in every cause, action, or dispute which should come before that tribunal. That was the meaning of the Act.[35]

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34. Roscoe Pound, "Taught Law" (1912) 3:4 American Law School Review 164 at 168; see also Meagher, Gummow & Lehane, *supra* note 2 ("[t]here was nothing in the *Judicature Act* which attempted to codify law and equity as one subject matter or which severed the roots of the conceptual distinctions between law and equity. The term 'fusion' used frequently in discussion at that time referred to the establishment of the new court with, by virtue of s 26, the jurisdiction of the old courts … It did not describe some new body of law which was neither law nor equity, and it was not susceptible of a construction that in any given case the new court had jurisdiction to produce a result which could never have been reached in any one or more of the old courts" at 45).
35. (1880), 16 Ch D 544 (Eng) at 549; see also *Di Guilo v Boland* (1958), 13 DLR (2d) 510 (Ont CA)(where Justice Morden states that "[t]he *Judicature Act* did not merge law and equity, but only the Courts of law and equity. A litigant cannot succeed in a purely common law claim relying upon equitable grounds" at 514).

There is no reason why the historical and necessary tenets of equity ought to have been altered or abandoned because of an administrative or procedural change or without significant and substantive reasons for doing so. Streamlining procedure or consolidating courts does not provide adequate reason or explanation for such a departure from long-standing practices. Although discussion about the fusion of law and equity has generated heated debate, to ignore that debate (as Laycock and Stevenson J suggest, above) because of, *inter alia*: (i) the commingling of legal and equitable principles, as, for example, with the doctrine of unconscionability in contract law;[36] (ii) the sense that equity "won" the battle, so there is no need to revisit it[37] or; (iii) that there is the potential to cause confusion by raising such arguments, ignores fundamental implications about the merging of the two jurisdictions.

While avoiding law-equity jurisdictional debates because of their potential to cause confusion may well be expeditious, such avoidance trades off a necessary element of judicial inquiry in order to simplify the process of arriving at a final determination of the matter in issue. In doing so, it also potentially ignores fundamental implications about the merging of the two jurisdictions in order to expedite a resolution that may well bring into question the authority and legitimacy of that resolution.

IV. "Fusion" and the Supreme Court of Canada

The Supreme Court of Canada has weighed in on the debate over "equity and fusion" in two significant cases: *Canson*[38] and *Hodgkinson*.[39] While these cases do not paint a wholly uniform picture of the Supreme Court's position on the fusion debate, they indicate that court's recognition of equitable doctrines as a significant, if not always consistently understood,

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36. As stated by Laycock, *supra* note 21 at 81.
37. *Ibid* ("[t]he distinctive traditions of equity now pervade the legal system. The war between law and equity is over. Equity won … We should invoke equity just as we invoke law, without explanation or apology and without a preliminary showing that this is a case for equity" at 53-54).
38. *Canson*, *supra* note 13.
39. *Hodgkinson*, *supra* note 14.

component of Canadian law.

A. *Canson Enterprises Ltd v Boughton & Co*

In *Canson*, the appellants Canson Enterprises Ltd ("Canson") and Fealty Enterprises Ltd ("Fealty") and the respondent Peregrine Ventures Inc ("Peregrine") concluded an agreement to purchase and develop a property as a joint venture on the recommendation of the respondent, Treit. However, Treit had surreptitiously arranged a flip of the property in question, resulting in the developers paying $115,000 more for the property than necessary. Treit then split that "secret profit" with a third party. Peregrine knew about the flip, but did not disclose its existence to Canson and Fealty. The same lawyer, Wollen, acted as solicitor on all these transactions, including the final purchase by Canson, Fealty, and Peregrine. To further conceal the flip and secret profit from Canson and Fealty, the transaction in question was documented as a transfer from the original vendor directly to the purchasers.

Following the conclusion of the sale of the land, the appellants proceeded with their development, but the warehouse they built sank as a result of negligence by the soil engineers they had hired to analyze the property. The appellants initiated proceedings and subsequently won judgments against the soil engineers and pile-driving company for the damage caused to the warehouse. However, neither the soil engineers nor the pile-driving company had sufficient assets to satisfy the full amount owed. Ultimately, the mortgage company that had financed the sale and development of the property foreclosed, resulting in a shortfall of more than $1 million to the appellants.

The appellants subsequently commenced an action against Peregrine, Wollen, and his law firm Boughton & Co. The agreed-upon statement of facts indicated that "but for" the respondents' failure to disclose the land flip and the secret profit it generated, the appellants would not have purchased the property and, therefore, would not have been in a position to suffer the losses from its development caused by the negligence of the soil engineers and pile-driving company. The claim thus attempted to foist ultimate liability upon the respondents for initiating the chain of events that caused the warehouse to sink, notwithstanding that they

neither hired nor had authority over the soil engineers and pile-driving company. The claim's attempt to circumvent principles of, *inter alia*, causation, remoteness, and foreseeability required that it be founded in an equitable cause of action rather than on a common law basis. This choice of law issue became a particular focus upon the case's appeal to the Supreme Court of Canada.

In his majority judgment in *Canson*, Justice La Forest appropriately describes the appellants' claim as one which would have resulted in no recovery had it been founded in a common law cause of action:

> [i]f the action was one founded on breach of contract, it would be necessary to consider whether the damages suffered were within the reasonable contemplation of the parties. If the action was founded in negligence, it would be proper to apply principles of remoteness, foreseeability and intervening cause. And if the action was one for deceit or fraud, not only foreseeable but unforeseeable damages flowing from the deceit would be awarded, stopping, however, where the chain of causation was broken ... If the action were brought on any of these bases, then, the appellants could not recover for the very substantial damages that arose from the actions of the engineering firm and the pile-driving company.[40]

Despite the existence of precedent holding that these considerations did not apply to claims of breach of fiduciary duty,[41] the ability to circumvent these matters did not sit well with La Forest J. As he states, "barring different policy considerations underlying one action or the other, I see no reason why the same basic claim, whether framed in terms of a common law action or an equitable remedy, should give rise to different levels of redress".[42]

While La Forest J accepts that the appellants were entitled to

40. *Canson*, *supra* note 13 at 137.

41. *Guerin v The Queen* (1984), 13 DLR (4th) 321 (SCC).

42. *Canson*, *supra* note 13 at 148; see also Michael Tilbury, "Fallacy or Furphy?: Fusion in a Judicature World" (2003) 26:2 University of New South Wales Law Journal 357 at 370 (where he states that those who favour the substantive fusion of common law and equity or who believe that the *Judicature Acts* already created such an effect – whom he describes as "fusionists" – believe that a strong argument in favour of substantive fusion exists precisely so that like cases will be treated alike).

"choose the remedy most advantageous to them"[43] and that the respondents breached fiduciary duties owed to the appellants, his judgment indicates that he remains unconvinced that sufficiently different policy considerations existed to warrant granting equitable relief without accounting for foreseeability, intervening act, or remoteness. Consequently, his judgment limits the appellants' claim to losses directly attributable to Wollen's failure to disclose the property flip and not from the sunken warehouse development. The latter, he insists, were too far removed from the breach of fiduciary duty resulting from Wollen's failure to disclose the property flip and thus not appropriately attributable to the respondents.

In her minority judgment in *Canson*, Justice McLachlin, as she then was, correctly recognizes that different policy considerations apply to equitable compensation versus common law damages. Although she finds, in accordance with *Caffrey v Darby*[44], that a fiduciary in breach of duty may be liable for the actions of third parties that are linked to the breach, she determines that the appellants' loss was not the result of Wollen's breach of duty, but of decisions made by the appellants and the individuals they hired. As she explains, "[i]t is fairer that losses arising from construction on the property after the purchase be borne by those who assume responsibility for the construction rather than by the solicitor who acted in the purchase transaction".[45]

Stevenson J's judgment substantially agrees with La Forest J's reasoning in *Canson*, but differs on the issues of equitable compensation and the "fusion" of law and equity. Regarding the former, Stevenson J states that:

> ... a court of equity, applying principles of fairness, would and should draw the line at calling upon the fiduciary to compensate for losses arising as a result of the unanticipated neglect of the engineers and pile-driving contractor. The fiduciary had nothing to do with their selection, their control, their contractual or bonding obligations. ... [T]hese losses are too remote, not in the sense of failing the "but for" test, but in being so unrelated and independent that they

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43. *Canson*, *supra* note 13 at 140.
44. (1801), 31 ER 1159 (Ch) [*Caffrey*].
45. *Canson*, *supra* note 13 at 164.

> should not, in fairness, be attributed to the defendant’s breach of duty.[46]

Stevenson J also concludes that the merger of law and equity has nothing to do with the determination of liability in *Canson*.[47]

La Forest J’s assertion that a common law or equitable claim ought to give rise to the same level of redress “barring different policy considerations underlying one action or the other” fails to recognize, as McLachlin J does in her judgment, that there *are* different policy considerations underlying equitable actions like breach of fiduciary duty than those corresponding to common law claims. While “but for”, “cause-in-fact”, or “*sine qua non*” causation generally satisfies the requirements of equity, the common law requires a finding of materiality or substantial cause to link the impugned activity with the harm to the plaintiff.[48] To conflate the various requirements existing in common law and equity or to equate equitable compensation and common law damages ignores those jurisdictions’[49] separate and distinct historical and doctrinal development. Like La Forest J, McLachlin J does not hold the respondents liable for the full amount of the loss suffered; her conclusion, like his, stems from an unwillingness to find that Wollen’s liability would have extended to the appellants’ development of the property if rooted in fiduciary duty, but not if it was rooted in contract or tort. However, in arriving at the same conclusion, she remains faithful to the historic and doctrinal distinctions of the common law and equity.

The distinctions in common law and equitable approaches to causation that proved to be so prominent in the result in *Canson*, as well as in distinguishing the judgments of La Forest and McLachlin JJ, are never reconciled in that case. Interestingly, they arise again in the

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46. *Ibid* at 165.
47. *Ibid* (“[a] court of equity might not find some losses to be caused by a plaintiff rather than a defendant, and to be too remote in that sense, but it would not do so because of the fusion of law and equity” at 166).
48. See *e.g.* Andrew Tipping, “Causation at Law and in Equity: Do We Have Fusion?” (2000) 7:3 Canterbury Law Review 443 at 445.
49. For greater clarity, the use of the word “jurisdiction” here is not intended to indicate anything other than the separate conceptual and doctrinal bases of the common law and equity.

Supreme Court of Canada's subsequent judgment in *Hodgkinson*. In *Hodgkinson*, however, the implications of those distinctions are not seen to be problematic as they were held to be in *Canson*. Additionally, they are less clearly visible in the judgments in that latter case, notwithstanding that they figure equally prominently in the disposition in *Hodgkinson*.

B. *Hodgkinson v Simms*

In the *Hodgkinson* case, Hodgkinson, a stockbroker seeking advice on tax sheltering, hired Simms, an accountant who specialized in providing such advice. Hodgkinson advised Simms that he wanted to defer tax through the acquisition of stable, long-term investments. Simms suggested investing in multi-unit residential buildings ("MURBs"), which were conservative real estate investments according to conventional wisdom at the time. Hodgkinson then purchased four MURBs recommended by Simms. However, when the real estate market later experienced a sharp decline, Hodgkinson lost virtually all of his investments in the MURBs. Hodgkinson subsequently discovered that Simms and his firm had received fees and payments regarding three of the MURB developments he had invested in. At no time had Simms disclosed these payments or that he had provided advice to the MURB developers to make their projects more desirable tax sheltering investments.[50] Hodgkinson then commenced legal action against Simms for negligence and breach of fiduciary duty. As a stockbroker who was wary of the high risk world of promoters, Hodgkinson trusted Simms' advice and stressed in his pleadings that had he known of Simms' relationship with the MURB developer, he would never have invested in the MURBs in question.[51]

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50. During the time period in question, Simms billed the developers an amount representing one-sixth of his firm's total billable hours.
51. For the purposes of the *Hodgkinson* judgment and fiduciary law generally, whether or not Hodgkinson would have invested in some other MURBs and still lost his money as a result of the decline in the real estate market is an irrelevant consideration based on the principle espoused in *Brickenden v London Loan & Savings Co* (1934), 3 DLR 465 (SCC) [*Brickenden*]; see the discussion of *Brickenden*'s implications in Rotman, *Fiduciary Law*, *supra* note 3 at 659-70.

La Forest J's majority judgment in *Hodgkinson* places significant emphasis upon the integrity of the relationship in *Hodgkinson*, not simply upon Hodgkinson's personal vulnerability created by his individual interaction with Simms. La Forest J's judgment focuses more upon the broader purpose of protecting important social and economic relations of dependency and vulnerability than in addressing the particular circumstances that existed between Hodgkinson and Simms. It is in the context of the former that La Forest J speaks of the "social importance of the fiduciary principle"[52] and emphasizes that "the law has recognized the importance of instilling in our social institutions and enterprises some recognition that not all relationships are characterized by a dynamic of mutual autonomy, and that the marketplace cannot always set the rules".[53]

La Forest J also pays particular attention to the policy considerations that inform fiduciary law. This is indicated by his statement that "[t]he desire to protect and reinforce the integrity of social institutions and enterprises is prevalent throughout fiduciary law".[54] La Forest J emphasizes that "[b]y enforcing a duty of honesty and good faith, the courts are able to regulate an activity that is of great value to commerce and society generally".[55] This broader focus, which is characteristic of equity, is conspicuously absent in *Canson*.[56] However, La Forest J's judgment in *Hodgkinson* maintains the position he put forward in *Canson* that a plaintiff ought not be entitled to greater relief by choosing an equitable as opposed to common law cause of action.

52. *Hodgkinson*, *supra* note 14 at 185.
53. *Ibid* at 186.
54. *Ibid*.
55. *Ibid* at 184.
56. While some might argue that it is the result of the commercial interaction in *Canson* as opposed to the advisory relationship in *Hodgkinson*, recall that the key issue in *Canson* is the duty owed by the solicitor, Wollen, to the appellants as a result of his failure to act in their best interests as their fiduciary by not disclosing the existence of the real estate flip. Thus *Canson*, like *Hodgkinson*, also involves the duties owed by professionals to their clients, so there is, in fact, no such distinction in the nature of the duties contemplated in both cases.

Justices Sopinka and McLachlin J's dissenting judgment in *Hodgkinson* disagrees with La Forest J's finding that a fiduciary relationship existed between Hodgkinson and Simms. They also state that literal "but for" causation had been rejected in British, Canadian, and United States case law for both common law and equitable claims;[57] more specifically, they rely on the fact that the *Canson* judgment had found that "the results of supervening events beyond the control of the defendant are not justly visited upon him/her in assessing damages, even in the context of the breach of an equitable duty".[58] For this reason, they disagree with the result found by La Forest J, concluding instead that Simms ought not be held liable for Hodgkinson's losses.

C. Analysis

In *Canson*, both the majority and minority judgments insist that the respondents' breach of duty — failing to disclose the property flip — is insufficiently material and too remote from the damages emanating from the sunken warehouse development — which was directly caused by the negligence of the soil engineers and pile-driving company — to result in the respondents' liability for the latter. Curiously, no similar causal problem was found to exist in the majority judgment in *Hodgkinson*, where Simms' failure to disclose his conflict of interest in the MURBs he recommended to Hodgkinson founded his liability for the loss in value of the MURBs directly caused by the real estate market downturn.

Despite emphasizing the importance of the distinction between *Canson* and *Hodgkinson*, La Forest J does not truly explain why a distinction exists between the two similar situations arising in those cases. In both cases, a failure to disclose a conflict of interest results in a finding of breach of fiduciary duty. Equally, in both cases a conflict of interest established the scenario for a second, causally unrelated, event that resulted in greater losses suffered than those emanating from the conflicts of interest. Where the distinction between the judgments in the two cases lies is in how far liability for a breach of fiduciary duty extends

57. *Hodgkinson*, *supra* note 14 at 223.

58. *Ibid* at 224.

vis-à-vis the totality of losses suffered. In *Canson*, liability does not extend beyond the breach itself, which limits it to the increase in the purchase price of the property emanating from the flip and excludes losses from the warehouse development. Yet, in *Hodgkinson*, liability extends to the loss in value of the MURBs stemming from the market downturn, notwithstanding the lack of direct correlation between Simms' breach of duty and the market collapse.

La Forest J fails to indicate why the actions of the soil engineers and pile-driving company in *Canson* constitute an intervening act sufficient to break the chain of causation initiated by Wollen's lack of disclosure, whereas the results of the downturn in the real estate market, which was equally beyond Simms' control in *Hodgkinson*, remained causally tied to Simms' conflict of interest notwithstanding that that conflict neither caused nor otherwise influenced the real estate market crash. La Forest J insists in *Hodgkinson* that "[f]rom a policy perspective it is simply unjust to place the risk of market fluctuations on a plaintiff who would not have entered into a given transaction but for the defendant's wrongful conduct".[59] Regarded in isolation, that conclusion may be deemed plausible, if not valid. What goes unexplained is why it is not equally unjust to place the risk of market fluctuations on Simms, since he had no greater control over the effects of the market than Hodgkinson did? La Forest J does not address this point.

Meanwhile, in *Canson*, both La Forest and McLachlin JJ deem it improper to hold the respondents liable for damages caused by the negligence of the soil engineers and pile-driving company when they neither hired those companies nor had any connection to or authority over them. However, La Forest J does not indicate why, in *Canson*, it is not unjust to place the risk of unforeseen subsequent events tied to the development of the property on Canson and Fealty when they testified that they would not have closed the purchase of the property — and thus would not have been in a position to have pursued the warehouse development and suffered the losses associated with that situation — had the increased purchase price caused by the real estate flip been disclosed.

59. *Ibid* at 207.

Indeed, if one attempts to be consistent in the disposition of the *Canson* and *Hodgkinson* cases, then either of two scenarios ought to have occurred. To be consistent with the determination in *Canson* and the limitation of liability for breach of fiduciary duty, the result in *Hodgkinson* ought not have held Simms responsible for the decreased value of the MURBs, insofar as the fall in the real estate market was not causally linked to Simms failure to disclose his conflict of interest. In that situation, Hodgkinson's recovery should have been limited to the amount of the commissions paid to Simms from his purchase of the MURBs in question. If, however, the appropriate determination was that from the majority's judgment in *Hodgkinson*, then the result in *Canson* ought to have entitled Canson and Fealty to recover the entirety of their losses suffered from the warehouse development, insofar as they would not have suffered those losses had Wollen either: (a) not breached his fiduciary duty, or; (b) disclosed the existence of his breach. Just as the majority found in *Hodgkinson* that Mr. Hodgkinson would not have purchased the MURBs and thus suffered the losses emanating from the downturn in the real estate market had he known of Simms' dishonesty, Canson and Fealty claimed they would not have purchased the land in question — and resultantly not be: (i) in a position to develop the land; (ii) hire the negligent soil engineers and pile-driving company, and; (iii) have the warehouse sink, resulting in loss — had they known of the real estate flip.

La Forest J correctly asserts that Simms' breach of duty in *Hodgkinson* "goes to the heart of the duty of loyalty that lies at the core of the fiduciary principle".[60] Yet, could the same not be said of the breach of duty by the solicitor, Wollen, to his clients, the purchasers/developers in *Canson*? The distinction is made more curious by the fact that Simms' problematic action was his failure to disclose his conflict of interest, not that he failed to adequately perform his professional advisory function, whereas in *Canson*, Wollen neither adequately discharged his professional duties nor disclosed his conflict of interest in concealing the flip and pocketing fees from the appellants from transactions that were actually detrimental to

60. *Ibid* at 208.

their interests.

Holding Simms responsible for the market's effects on the MURBs appears to be based on equity's jurisdiction over conscience. If this is so, one may legitimately ask why the same rationale does not also justify placing the risk of misfortune resulting from the warehouse development in *Canson* on the respondents, who also acted against conscience by orchestrating and failing to disclose the real estate flip? By acting in breach of duty, the respondents in *Canson*, like Simms in *Hodgkinson*, ought to incur liability on the basis of the precedent in *Caffrey v Darby*, which McLachlin J relies upon in her judgment in *Canson*. There the court states:

> ... if they have been already guilty of negligence, they must be responsible for any loss in any way to that property: for whatever may be the immediate cause, the property would not have been in a situation to sustain that loss, if it had not been for their negligence. If they had taken possession of the property, it would not have been in his possession. If the loss had happened by fire, lightning, or any other accident, that would not be an excuse for them, if guilty of [the] previous negligence. That was their fault.[61]

This principle in *Caffrey v Darby* explains Simms' liability for Hodgkinson's losses, notwithstanding that the direct cause of the loss was the bottom falling out of the real estate market rather than from any direct result of action taken by Simms. A wrong-acting fiduciary takes the world as he or she finds it.[62] Thus, the fiduciary in breach of duty becomes liable for all tangibly related occurrences arising subsequent to the wrongful action, including the actions of third parties or the effects of catastrophic events

61. *Caffrey*, *supra* note 44 at 1162.

62. See Joshua Getzler, "Equitable Compensation and the Regulation of Fiduciary Relationship" in Peter Birks & Francis Rose, eds, *Restitution and Equity, Volume 1: Resulting Trusts and Equitable Compensation* (London: Mansfield Press, 2000)("[t]he negligent trustee must take the world as he finds it, such that unforeseeable real-world events in the chain of causation initiated by the breach cannot establish remoteness as a defence" at 240). While Getzler questions the need for such a strict standard in contemporary jurisprudence, his statement that "[t]he severe test is instituted primarily to put maximum pressure on trustees to uphold their trust, and is not really an attempt to fix causation rules precisely" indicates a valid reason, and continued need, for its existence at 240).

that are linked to the breach.[63] Simms caused Hodgkinson to purchase MURBs in which the former had a conflict of interest. In doing so, Simms set a scenario into motion that left Hodgkinson susceptible to the ebbs and flows of the real estate market. From that point, he became responsible for whatever transpired; the implication of *Caffrey v Darby* is clear.

Playing out that same principle from *Caffrey v Darby* in the *Canson* case, then, ought to have held the respondents liable for the full amount of the losses suffered by Canson and Fealty, including the losses from the botched warehouse development. The explanation for such a result, as drawn from the precedent in *Caffrey v Darby*, is that Wollen would be assumed to undertake financial responsibility for any losses reasonably, logically, or sequentially tied to events set into motion by his breach of duty. That would include anything tied to the development of the land, including the ill-fated warehouse project, because Wollen's breach was an intimate, albeit secret, part of the transaction by which Canson and Fealty acquired the land upon which they constructed the warehouse. Without that transaction, they would not have been in a position to develop the warehouse or to suffer the losses from that development,

63. Note McLachlin J's (as she then was) reliance on *Canson*, *supra* note 13, in *Doyle v Olby (Ironmongers) Ltd* (1969), 2 QB 158 (CA (Eng)) (in *Doyle*, Lord Denning MR states "[t]he defendant is bound to make reparation for all the actual damages directly flowing from the fraudulent inducement. The person who has been defrauded is entitled to say; 'I would not have entered into this bargain at all but for your representation. Owing to your fraud, I have not only lost all the money I paid you, but, what is more, I have been put to a large amount of extra expense as well and suffered this or that extra damages'" at 167. McLachlin J added in *Canson*, *supra* note 13 (that "it does not lie in the mouth of a fiduciary who has assumed the special responsibility of trust to say the loss could not reasonably have been foreseen" at 161).

notwithstanding that the losses were directly caused by third parties.[64]

When viewed this way, the situation in *Hodgkinson* is, effectively, no different than that in *Canson*, save for the fact that the direct responsibility for the loss to the appellants in the latter was not an intangible phenomenon like the market, but, rather, the actions of people.[65] While La Forest J correctly states that "[i]n *Canson* the defendant solicitor did not advise on, choose, or exercise any control over the plaintiff's decision to invest in the impugned real estate",[66] the solicitor facilitated a scenario in which losses occurred that would not have transpired but for his actions.[67] Consequently, his actions ought to be seen as being as directly related to the loss in *Canson* as Simms' failure to disclose his conflict of interest is to the loss in *Hodgkinson*.

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64. While it is plausible to suggest that, had the events subsequent to the real estate transaction occurred at a different time, an alternate soil engineer and pile-driving company may have been hired by Canson and Fealty who would not have been negligent and the warehouse would have been constructed without sinking or causing loss, such speculation is wholly irrelevant. Using the same logic, it could equally be said that had the situation in *Hodgkinson* arisen at a different time, there may not have been a real estate market downturn subsequent to Hodgkinson's purchase of the MURBs, with the result that he would not have lost the value of his MURBs, or perhaps may not have lost as much as he did.
65. See *Hodgkinson*, *supra* note 14 (where Sopinka, McLachlin and Major JJ determined that "[t]he loss in value was caused by an economic downturn which did not reflect any inadequacy in the advice provided by the respondent. We would reject application of the 'but for' approach to causation in circumstances where the loss resulted from forces beyond the control of the respondent who, the trial judge determined, had provided otherwise sound investment advice" at 226).
66. *Hodgkinson*, *supra* note 14 at 203.
67. Assuming, of course, that we believe Canson and Fealty were telling the truth when they stated they would not have closed the purchase of the land in question had they known of the flip and increase in purchase price, which would then have precluded them from taking any actions to develop the land in question because it would not have been theirs.

D. Summary

In light of the disparate judgments in *Canson* and *Hodgkinson*, how may one summarize the present position of the Supreme Court of Canada on the merger of law and equity? *Canson* clearly endorses their substantive fusion, as indicated most readily in La Forest J's judgment:

> [i]n time the common law outstripped equity and the remedy of compensation became [somewhat] atrophied. Under these circumstances, why should it not borrow from the experience of the common law? Whether the courts refine the equitable tools such as the remedy of compensation, or follow the common law on its own terms, seems not particularly important where the same policy objective is sought.[68]

However, La Forest J's majority judgment in the *Hodgkinson* case, while not directly addressing the issue of fusion, is wholly inconsistent with the conclusion that legal and equitable jurisdictions in Canada have been substantively merged.

Canson's endorsement of fusion eliminates the potential benefits associated with choosing an equitable versus common law cause of action. This determination is certainly at odds with the principle established in *Nocton v Lord Ashburton*,[69] the case which famously resurrected equitable compensation. In that case, Lord Chancellor Viscount Haldane states that a court of equity will not refuse jurisdiction to hear a matter simply because the plaintiff may have available remedies at common law:

> [i]t did not matter that the client would have had a remedy in damages for breach of contract. Courts of Equity had jurisdiction to direct accounts to be

68. *Canson*, *supra* note 13 at 153. Curiously, this statement appears to contradict La Forest J's earlier statement in *LAC Minerals Ltd v International Corona Resources Ltd* [1989] 2 SCR 574 [*Lac Minerals*] (where La Forest J stated that "I do not countenance the view that a proprietary remedy can be imposed whenever it is 'just' to do so, unless further guidance can be given as to what those situations may be. To allow such a result would be to leave the determination of proprietary rights to 'some mix of judicial discretion' ... subjective views about which party 'ought to win' ... and 'the formless void of individual moral opinion' per Deane J in *Muschinski v. Dodds* (1985), 160 C.L.R. 583, at p.616" at para 196).
69. (1914), AC 932 (HL).

> taken, and in proper cases to order the solicitor to replace property improperly acquired from the client, or to make compensation if he had lost it by acting in breach of a duty which arose out of his confidential relationship to the man who had trusted him.[70]

Curiously, La Forest J acknowledges this same principle in *M(K) v M(H)*,[71] where he expressly indicates that "a breach of fiduciary duty cannot be automatically overlooked in favour of concurrent common law claims".[72]

Even in *Hodgkinson*, La Forest J recognizes that "the existence of a contract does not necessarily preclude the existence of fiduciary obligations between the parties ... ".[73] Yet, La Forest J also refers positively to his finding of the substantive fusion of law and equity in *Canson* in his judgment in *Hodgkinson*.[74] This internal inconsistency plagues his judgment in *Hodgkinson*, where his recognition of the purpose of

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70. *Ibid* at 956-57; see also *Roe, McNeill & Co v McNeill* (1998), 45 BCLR (3d) 35 (CA)("[i]t would be anomalous indeed that the parties should have stipulated in the contract for one to owe a duty of good faith to the other, and for him to have been found in breach of that contractual duty, but that the law would deprive the other of a remedy for breach of fiduciary duty because he already had a remedy in contract" at para 38).
71. (1992), 96 DLR (4th) 289 (SCC).
72. *Ibid* at 323; refer also back to La Forest J's statement in *LAC Minerals*, *supra* note 68.
73. *Hodgkinson*, *supra* note 14 at 174.
74. *Ibid* ("[a]s I noted in *Canson*, at pp. 152-3, this approach is in accordance with the fusion of law and equity that occurred near the turn of the century under the auspices of the old Judicature Acts … Thus, properly understood *Canson* stands for the proposition that courts should strive to treat similar wrongs similarly, regardless of the particular cause or causes of action that may have been pleaded" at 202).

fiduciary relief belies his endorsement of fusion in *Canson*.[75] It also creates difficulty for those seeking a clear vision of the Supreme Court of Canada's perspective on fusion. The result is a rather muddled Canadian jurisprudence on the matter of fusion that lacks consistency and guidance for future applications.[76]

In characterizing the fusion of law and equity as including substantive matters, important distinctions between legal and equitable concepts and remedies have been inappropriately blurred. These distinctions are both historical and substantive; further, their implications reflect the separate historical rationale for and genesis behind the development of English

75. It is implicit in La Forest J's judgment in *Hodgkinson* that there are no comparable policy considerations at common law that would supersede the use of fiduciary principles. Thus, the policy underlying the fiduciary concept which La Forest J expressly recognizes in *Hodgkinson* provides an unequivocal example of the "different policy considerations" that he suggests in *Canson* "should give rise to different levels of redress" for claims of breach of fiduciary duty versus breach of common law obligations: *Canson*, *supra* note 13 at 148.
76. It should be recognized, though, that *Canson* is not the only contemporary judgment in the common law world that has characterized the fusion of law and equity as including substantive matters; see *e.g.United Scientific Holdings Ltd v Burnley Council* (1978), AC 904 (HL)(where it was stated that "[m]y Lords ... this metaphor has in my view become both mischievous and deceptive. The innate conservatism of English lawyers may have made them slow to recognise that by the Supreme Court of Judicature Act 1873 the two systems of substantive and adjectival law formerly administered by courts of law and Courts of Chancery ... were fused. … If Professor Ashburner's fluvial metaphor is to be retained at all, the waters of the confluent streams of law and equity have surely mingled now" at 924-25); see also *LeMesurier v Andrus* (1986), 54 OR (2d) 1 (CA)(where the Ontario Court of Appeal states that "[w]hatever the original intention of the Legislature, the fusion of law and equity is now real and total" at 9); whereas, in *Aquaculture Corp v New Zealand Green Mussel Co Ltd* (1990), 3 NZLR 299 (CA) it is said that "[f]or all purposes now material, equity and common law are mingled or merged. The practicality of the matter is that ... a full range of remedies should be available as appropriate, no matter whether they originated in common law, equity or statute" at 301.

Equity. As Justice of Appeal Keane explains:

> [t]he ethical values of individual restraint, mutuality and social responsibility at play within the framework bequeathed by Chancery differ from the individualism and the universalism of the common law. To regard equitable doctrines as modular, so that they may be mixed and matched with common law rules so as to expand the scope of the judicial branch of government’s regulation of self-interested action is to fail to appreciate these differences.[77]

Notably, most judgments supporting the substantive fusion of law and equity are rather far removed from the time when those jurisdictions were merged. Further, they ignore significant and straightforward commentary by judges and noted scholars that were contemporaneous with or much closer in time to that occurrence and which find only an

77. Patrick Keane, “The 2009 WA Lee Lecture in Equity: The Conscience of Equity” 10:1 Queensland University of Technology and Law Justice Journal 106 at 131.

administrative merging to have occurred rather than a substantive one.[78] Perhaps most tellingly, they rarely provide substantive commentary or

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78. *Hansard*, 3d Series, vol 214 (see in particular statements made by Lord Selborne, LC, who introduced the legislation merging common law and equity in Britain (the *Judicature Acts*), and Attorney-General Sir John Coleridge, who promoted it. Lord Selborne said "[i]t may be asked ... why not abolish at once all distinction between law and equity? I can best answer that by asking another question – Do you wish to abolish trusts? If trusts are to continue, there must be a distinction between what we call a legal [estate] and an equitable estate ... The distinction, within certain limits, between law and equity, is real and natural, and it would be a mistake to suppose that what is real and natural ought to be disregarded" at 339); see also *Hansard*, 3d Series, vol 216 (where Coleridge expressed essentially similar sentiments: "[t]o talk of the fusion of Law and Equity was to talk ignorantly. Law and Equity were two things inherently distinct ... All they could do was to secure that the suitor who went to one Court for his remedy should not be sent about his business without the relief [which] he could have got in another Court" at 1601); see further *Hansard*, 3d Series, vol 216 (where Coleridge makes the purpose of the legislation unequivocal: "[t]he defect of our legal system was, not that Law and Equity existed, but that if a man went for relief to a Court of Law, and an equitable claim or an equitable defence arose, he must go to some other Court and begin afresh. Law and Equity, therefore, would remain if the Bill passed, but they would be administered concurrently, and no one would be sent to get in one Court the relief which another Court had refused to give ... It was more philosophical to admit the innate distinction between Law and Equity, which you could not get rid of by Act of Parliament, and to say, *not that the distinction should not exist, but that the Courts should administer relief according to legal principles when these applied, or else according to equitable principles. That was what the Bill proposed*, with the addition that, whenever the principles of Law and Equity conflicted, equitable principles should prevail" at 644-45 [emphasis added]); see also *Ind Coope & Co v Emerson* (1887), 12 App Cas 300 at 308 (HL) and the discussion in Rotman, *Fiduciary Law*, *supra* note 3 ch 4.

rationales to support their contentions.[79]

While the boundary between the common law and equity is becoming increasingly blurred, it is important to recall, as Keeton explains, that "the distinction between common law and equity is not only one of history, but also one of attitude".[80] To substantively "fuse" legal and equitable jurisdictions would have required something more explicit than what may be seen in the legislation blending those jurisdictions in the various countries where such action was taken. What may be taken from this finding is to further affirm that the administrative fusion of common law and equitable jurisdictions altered procedure, but did not affect the distinct nature of legal and equitable doctrines.[81] In explaining the distinctiveness of legal and equitable principles, Loughlan states:

> [s]ince equitable principles such as those applicable to fiduciaries fulfil a different social purpose from the law of contract and of tort, imposing, as they do, a strong duty to act only in the interests of the other, it is by no means clear that principles developed in respect to common law obligations should be utilised in the equitable jurisdiction.[82]

The important distinction that remained after the merger of law and

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79. Meagher, Gummow, & Lehane, *supra* note 2 ("[t]hose who assert that law and equity are fused rarely (if ever) explain what they mean, how it happened and what follows from it" at 66); see also the essentially similar comments in JRF Lehane, Book Review of *Specific Performance* by Gareth Jones & William Goodhart, (1987) 46:1 Cambridge Law Journal 163 ("[t]hose who assert that law and equity are fused should explain what they mean, how it happened and what follows from it" at 165).
80. George W Keeton, *An Introduction to Equity*, 6d (London: Pitman, 1956) at 43-44; see also Allen, *supra* note 16 ("[t]here is still a frontier between the Common Law and the Chancery. The training is different, the habit of thought is different, the subjects of jurisdiction are different" at 413).
81. See Edmund HT Snell, *The Principles of Equity*, 11d by Archibald Brown (London: Stevens & Haynes, 1894)("[t]he distinction between Law and Equity ... will be found to be a distinction not so much of substance as of form, a distinction not of principle but of history ... and yet the distinction ... has not, as we shall presently see, been materially affected even by the recent so-called fusion of Law and Equity" at 2).
82. Patricia Loughlan, "The Historical Role of the Equitable Jurisdiction" in Patrick A Parkinson, ed, *The Principles of Equity* (Sydney: Law Book Co of Australasia, 1996) at 23-24.

equity is, indeed, one of history and attitude, but also one of profoundly distinct ideas and approaches to law, leading to different results. Thus, "the measure of relief under the common law and Equity ought not be similar where the nature of common law and equitable duties — and their underlying policy rationales — are dissimilar".[83]

V. The Status of the "Fusion" Argument in Canada Today

In the Supreme Court of Canada's landmark judgment in *Pettkus v Becker*,[84] which entrenched the remedial constructive trust in Canadian jurisprudence, Justice Dickson, as he then was, explained that "[t]he great advantage of ancient principles of equity is their flexibility: the judiciary is thus able to shape these malleable principles so as to accommodate the changing needs and mores of society, in order to achieve justice".[85] Although equity emphasizes the spirit and intent of law over more formal compliance with established rules or procedures and equitable principles may be shaped to fit the changing needs and mores of society, there are limits to their application. Equitable principles are not appropriately used in any situation in which there may be a need or desire for a novel application of law. Rather, they are properly limited by the parameters established via the maxims and principles of equity.

Maintaining a jurisprudential system that appropriately balances the certainty of law with the malleability of equity requires a delicate equilibrium that neither tilts too far toward taxonomy or arbitrariness.

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83. Rotman, *Fiduciary Law*, *supra* note 3 at 703; see also Justice of Appeal Heydon's judgment in *Harris v Digital Pulse Pty Ltd* (2003), 56 NSWLR 298 (CA (Austl))("[i]t is not irrational to maintain the existence of different remedies for different causes of action having different threshold requirements and different purposes. The resulting differences are not necessarily 'anomalous'" at 404).
84. (1980), 117 DLR (3d) 257 (SCC).
85. *Ibid* at 273; see also La Forest J in *Canson*, *supra* note 13 (where La Forest J emphasizes that "the maxims of equity can be flexibly adapted to serve the ends of justice as perceived in our days. They are not rules that must be rigorously applied but malleable principles intended to serve the ends of fairness and justice" at 151).

Part of the challenge of such a system is to stay true to the historical and doctrinal roots of common law and equitable doctrines, notwithstanding the administrative merging of law and equity and the resultant blurring of lines between legal and equitable doctrines over time. This challenge exists not only in Canadian law, but in every jurisdiction where the creation of some form of equity designed to ameliorate the rigour of the common law has played an important role in the shaping of modern legal discourse.

Writing in the early stages of the 20th century, American legal scholar Roscoe Pound postulated that traditional equity had been transformed over time into a decadent system of rules that destroyed its existence as a process of facilitating justice premised upon the measured use of judicial discretion.[86] Pound referenced a number of judgments that he believed reinforced his conclusion. What he failed to consider, however, was that the cases he referenced did not signify the decadence of equity, but instead were, as Walsh appropriately characterizes them, "illustrations of mistaken law applied by courts in apparent ignorance of the law involved, in no way indicating any decadence of equity".[87] More specifically, those cases evidence the courts' misunderstanding of the merger of legal and equitable jurisdictions much like the Supreme Court of Canada incorrectly characterizes the fusion of law and equity in the *Canson* case.[88]

In the aftermath of *Hodgkinson*, one may see how the Supreme Court of Canada's problematic holding in *Canson* could have been resolved differently had the court properly understood the implications of the merging of legal and equitable jurisdictions. Dean Pound did not have that same benefit. What Pound saw as the "decadence of equity" was, instead, multiple occasions of courts making mistakes based upon their common misunderstanding of what merging law and equity meant for the practice of law. Had those courts possessed a sounder appreciation of this merger, Pound would then likely have been extolling the virtues of the

86. Roscoe Pound, "The Decadence of Equity" (1905) 5:1 Columbia Law Review 20 [Pound, "Decadence"].
87. Walsh, *supra* note 5 at 480.
88. *Canson*, *supra* note 13.

continuation of equitable principles without the chaos and inefficiency caused by maintaining separate jurisdictions for law and equity rather than bemoaning the decadence of equity and the crystallization of its principles into a rigid system of rules and precedent.

Better education about the implications of the statutorily mandated merger of law and equity would not only have prevented the types of erroneous judgments cited by Pound, but also those in *Canson*. Such a development would have also assisted in fulfilling Dean Pound's recommendation to be vigilant and fight for the survival of a strong and principled equity — an understanding of equity that facilitated justice by tempering law, where appropriate, with more benevolent and situationally-apposite equitable principles.[89] However, it would also have been a complete reversal of the trend that witnessed law schools in Canada and the United States move away from the teaching of substantive equity more than two generations ago.[90]

To the contemporary law student, "equity" is far more likely to be associated with a form of investment in corporate finance courses, a form of interest in land, or principles of fairness in administrative, constitutional, or employment law than as a complementary system to the common law. However, the traditional understanding of equity as complementing the common law still plays an important role in contemporary jurisprudence and needs to be appropriately recognized for its vital function. The function of equity is not fully comprehended when it is regarded solely as a method by which the rigours of the common law are tempered and its gaps filled, nor when it is seen as a competing, though complementary, system to the positive law. Equity is more appropriately and accurately understood when it is recognized as a

89. Pound, "Decadence", *supra* note 86 ("[w]e must be vigilant ... we must fight for our law. No less must we fight for equity. Law must be tempered with equity, even as justice with mercy. And if, as some assert, mercy is part of justice, we may say equally that equity is part of law, in the sense that it is necessary to the working of any legal system" at 35).

90. Refer back to the discussion, *supra* note 8.

process by which positive law is brought closer to the human condition.[91] Equity is a way of facilitating justice in the broadest sense of the term[92] while providing sound parameters for the exercise of judicial discretion.

Equity works alongside law, supporting the latter where it is deficient and enabling it to better respond to the individual requirements of particular circumstances that the operation of its taxonomic tendencies hold in check. It occupies a complementary jurisdiction to law that supports and enhances it without being either inferior to the law or lesser in importance.[93] The development and situation-specific application of equitable principles provides law with a sense of humanity and context, which makes law more just.[94] In accomplishing these diverse tasks, equity does not replace law, but maintains a conceptual separation from it, all

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91. Watt, *supra* note 11 ("[e]quity is not Utopian, it simply reaches beyond the routines of law towards the particularities of the human condition" at 243); see also Ryan, *supra* note 11 ("[e]quity is a process, but it is a process of a far broader and more important kind than procedure, even when this is taken in its widest possible sense. Equity viewed as a process accomplished the conversion of morality into law; procedure is merely the means of recognizing the conversion in a particular case ... " at 222).
92. *Burke v Lfot Pty Ltd* (2002), 209 CLR 282 (HCA)(Kirby J states that the "business" of equity is "the attainment of justice" at 324); see also Oleck, *supra* note 12 ("[e]quity, certainly in its historical moral sense, and hopefully in its administrative sense, is the principal technique thus far developed to make certain that law always will be readily adaptable for, and directed toward, the achievement of justice" at 44); Watt, *supra* note 11 ("[w]ithout equity, the law's story becomes all rules and no justice" at 45; and "[e]quity does not set out to produce an ideally righteous system … but it sets out to make the system of regular law more just" at 102-103); see also Ryan, *supra* note 11 ("[w]hat is necessary is to have some adequate grasp of Equity as a built-in dynamism necessary for progress in any system which purports to administer justice" at 217); Robert H Rogers, "A Lesson in Equity" (1915) 49:4 American Law Review 510 ("[l]egal justice is the law's attempt at approximate justice from the standpoint of social expediency … But the justice of equity, as originally intended and administered, was man's best attempt to arrive at real justice regardless of law or rule" at 535).
93. See *supra* note 17.
94. See the references, *supra* note 12.

the while harmonizing law with the needs and requirements of evolving social structures and relationships.

These effects did not disappear, nor were they meant to disappear, with the merger of legal and equitable jurisdictions. Rather, quite the opposite intent was facilitated. Once equitable principles were operational within common law courts, the inevitable bleeding of equity into the common law occurred[95] and, with it, the facilitation of more situationally-specific and appropriate methods of resolving conflict. New causes of action like unconscionability and breach of confidence were created specifically as a result of the jurisdictional merger of legal and equitable jurisdictions that allowed for their development. Meanwhile, the Supreme Court of Canada's recent judgment in *Bhasin v Hrynew*[96] and its articulation of a general, good faith standard in contract law indicates the continuation and expansion of this practice.

In *Bhasin*, the Supreme Court holds that the principle of good faith is a fundamental element of contract law. The court clearly and unequivocally articulates that "good faith contractual performance is a general organizing principle of the common law of contract".[97] Although the court recognizes that "Anglo-Canadian common law has resisted acknowledging any generalized and independent doctrine of good faith performance of contracts",[98] it nonetheless holds that the concept of good faith "underpins and informs the various rules in which the common law, in various situations and types of relationships, recognizes obligations of good faith contractual performance".[99] The court further recognizes that one "manifestation of this organizing principle of good faith, [is] that there is a common law duty which applies to all contracts to act honestly in the performance of contractual obligations".[100] Consequently, it would

95. See Zechariah Chafee Jr, "Does Equity Follow the Law of Torts?" (1926) 75:1 University of Pennsylvania Law Review and American Law Register 1 at 5, 20.
96. 2014 SCC 71 at para 33 [*Bhasin*].
97. *Ibid.*
98. *Ibid* at para 32.
99. *Ibid* at para 33.
100. *Ibid.*

appear that, in the aftermath of *Bhasin*, parties to contractual dealings are implicitly understood to have duties of good faith towards each other in the execution of their contractual obligations. This development is an example of what can be described as "equitable bleed" — where concepts of equity are allowed to bleed into the common law and themselves become a part of the latter.

In determining that good faith ought to be recognized as foundational to Canadian contract law, the Supreme Court in *Bhasin* sought to "develop the common law to keep in step with the 'dynamic and evolving fabric of our society'".[101] This is precisely the function that equity plays in keeping the common law current, relevant, and situationally-appropriate. Part of ensuring the Canadian law of contracts remains consistent with the evolving fabric of Canadian society is to ensure that contract law reflects not only the reasonable expectations of the parties, but also the moral underpinnings of dealings between individuals in a manner consistent with the expectations and mores of Canadian society as a whole. Expressly incorporating good faith into all contractual dealings entails the Supreme Court's recognition that contemporary Canadian society is disinclined to accept sharp dealing or attempts to evade responsibility as acceptable in contractual relationships. Parties are expected to live up to the obligations they expressly agreed to when they sign contracts.

Post-*Bhasin*, then, the principled foundation of Canadian contract law more closely resembles the law applicable to unjust enrichment or even breaches of fiduciary duty than it did previously. This is not to say that contract law is now to be understood as either giving rise to remedial constructive trusts, seen as analogous to fiduciary law, or indicating the substantive fusion of historic legal and equitable jurisdictions. Rather, it signifies that Canadian tolerance for breaching contracts has lessened. With this reduction in tolerance comes the recognition that it is appropriate for law to enlarge the range of relief to remedy breaches of contract in a manner akin to what was historically done in equity so long as doing so does not result in doctrinal impropriety or an improper blurring of the conceptual distinctions between historic legal and

101. *Bhasin*, *supra* note 96 at para 40.

equitable jurisdictions.

Following the administration fusion of legal and equitable jurisdictions, the concepts of equity continued to complement and supplement the law just as they had when the common law and equity maintained their historically separate existence, but also to inform and modify the law where necessary while retaining their important conceptual separation from law. When both common law and equitable causes of action become available within a court with jurisdiction over both, procedural dilemmas and difficulties subsided, confusion abated, and the requirements of justice were better served.

Today, with the concurrent administration of the common law and equity in a unified court, the contemporary judge has a wider range of tools available to mete out situationally and doctrinally appropriate justice. This is to be celebrated, not sabotaged, even unintentionally, by the subordination of equitable doctrines to those of the common law as under a substantive merging of legal and equitable jurisdictions. As Chafee wrote almost 100 years ago:

> [o]ur single court of law and equity is like a workman with numerous tools lying before him. For some tasks he may want to use either the hard blows of the action for damages or the flexible injunction, according to circumstances. For other jobs, like the suppression of battery, the injunction is [wholly unjustified, and] only damages [or prosecution will serve]. There remains, however, delicate work where damages are of no use and bound to do harm, and yet an injunction would produce admirable results. Under such circumstances, no sound argument exists for a refusal to employ the appropriate tool, merely because he can not use another tool which does not meet the need at all. So long as judges are not expressly prohibited from using such a legitimate remedy as the injunction for a purpose which it will effectually obtain, the non-existence of an action for damages should be immaterial. As it is the function of a factory to produce goods, so it is the function of courts to produce justice, and they should feel free to use for that object all or any of the means which long custom and legislation have placed at their disposal.[102]

VI. Conclusion

Although the *Bhasin* judgment appears to provide a clear indication of the continued presence and prominence of equitable principles in

102. Chafee, *supra* note 95 at 35.

Canadian law, the inconsistency between the *Canson* and *Hodgkinson* decisions has not been revisited and thereby remains an impediment to characterizing the current understanding and application of fusion in Canadian law. While *Canson* seems to evidence the Supreme Court of Canada’s acceptance of the substantive merging of legal and equitable jurisdictions, the majority judgment in *Hodgkinson* retreats from *Canson*’s subordination of equitable constructs to their common law counterparts. Instead, it founds liability in a manner that is consistent with equity’s emphasis on conscience and adopts equity’s interpretation of causation by abandoning reliance on considerations such as foreseeability, remoteness, and intervening act that played a significant role in *Canson*. This unaddressed inconsistency between these important judgments is a troubling source of confusion and uncertainty for the contemporary understanding of fusion in Canadian law. However, in light of what the Supreme Court has subsequently articulated in *Bhasin*, it would appear that the Supreme Court has gravitated away from the idea of substantive fusion that it articulated in *Canson*. That would be a significant advance for the evolving law in Canada.

While it appears that Canada continues to embrace the foundational principles of equity in its jurisprudence, there remain some nagging considerations revolving around the treatment of causation and the ability of litigants to select equitable versus common law causes of action without interference from the courts. One wonders whether the Canadian experience is a bellwether for other jurisdictions. Whether it is or is not, it nonetheless offers an important perspective on the merging of law and equity that is relevant to the administration of justice in contemporary law.

Equity as a Vehicle for Law Reform: The Case of Unilateral Mistake

Irit Samet*

In this paper I ask whether English Law should permit rescission for unilateral mistakes in the formation of contract, in circumstances where the defendant (D) knew or should have known about the claimant's (C) mistake, and if so, should Equity be (re)employed to deploy the remedy. The paper introduces the Caveat Emptor Common Law rule on this issue, which rules out rescission, and the various considerations that count in its favour. I argue that neither considerations from efficiency, nor those based in ethics can justify the current rule, and that new, flexible and morally-sensitive resolution is called for. If we examine the way in which Equity intervenes to reform areas of law where the Common Law fails to provide a satisfactory solution to legal disputes, we will see that the Caveat Emptor rule displays exactly the kind of defects that Equity does a very good job at remedying. The law on the duty to disclose information at the pre-contractual stage emerges as an excellent example for Equity's great potential as a vehicle for improving the law in a measured, nuanced and imaginative way.

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I. Introduction

"This by nature is equitable, that no one be made richer by another's loss".[1]

The situation is painfully familiar: a party to contractual negotiations has information which is highly relevant for the subject matter of the purported deal. Keeping it to himself would improve his stakes, but the other party would be labouring under a mistake so that her share of the pie would be lower than if she were fully informed. The question whether the state would come to her assistance once the contract is signed and she becomes conscious of the information is part of the law on "contractual mistake"; this, it is widely agreed, is a "confusing and problematic area [of law] in England and in many of the common law countries which adopted the English doctrine".[2] In this paper, I discuss a very specific

1. Dig 12.6.14 (Pomponius Sabinus 21), cited in John P Dawson, *Unjust Enrichment: A Comparative Analysis* (Boston: Little, Brown and Company, 1951) at 3.
2. Catharine MacMillan, *Mistakes in Contract Law* (Portland: Hart Publishing, 2010) at 1.

aspect of the law on contractual mistake, and ask whether it should be reformed, and by what means: should we permit rescission for unilateral mistakes in the formation of contract, in circumstances where the defendant knew or should have known about the claimant's mistake?[3] And if so, should equity be (re)employed to deploy the remedy? To answer these questions, I will first introduce the Common Law rule on this issue and the various considerations that count in its favour. I then ask in which cases, and in what way, equity intervenes to reform areas of law where the common law fails to provide a satisfactory solution. The next section argues that many of the justifications offered for the Common law rule on unilateral mistake fail, and that as a result the rule displays the kind of difficulties that equity is designed to address. The law on the duty to disclose information at the pre-contractual stage emerges as an excellent example for the great potential of equity to improve the law in a measured, nuanced and imaginative way.

The basic rule of English contract law which applies to situations of un-induced unilateral mistake, of which the other party knew, says that the

> claimant has no basis for avoiding the contract. Even if the defendant knows that the claimant would never have entered the contract or anything like it had he known the truth, the defendant is fully entitled to take advantage of the mistake.[4]

In spite of some well-known exceptions found in common law and regulation (mainly in special contexts like insurance, family, financial

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3. There are many adjacent issues which I will not discuss here, like the timing of the relief, the quality of the remedy or the position of third parties. Unilateral mistakes can also occur when a party wrongly believes that the written contract reflects the terms agreed upon by the parties. The law here is very clear: if the other party knows about (or suspects) a mistake he needs to shout (*Commission for the New Towns v Cooper (Great Britain) Ltd*, [1995] Ch 259 (CA (Eng))). This is a case of equitable estoppel and is thus a branch of a different equitable doctrine. See Terence Etherton, "Contract Formation and the Fog of Rectification" (2015) 68:1 Current Legal Problems 367at 17-18.
4. Hugh Beale, *Mistake and Non-disclosure of Facts: Models for English Contract Law*, (Oxford: Oxford University Press, 2012) at 18.

markets, etc.), the residual rule is clear cut: "*caveat emptor*" or, "[i]f you don't know, ask. If you didn't ask, don't complain".[5] The *Caveat Emptor* rule is a concrete expression of the belief that in a perfectly competitive market, aggregate utility is maximized when every person rationally pursues her own ends. Misrepresentation, undue influence and unconscionable behaviour interfere with the ideal market conditions and English law is more than happy to allow rescission when such reprehensible practices are proved;[6] failure to look after your own interests is a different story. A peculiar gap thus emerges between the overall thrust of English contract law towards rules which promote fairness and social market, and the residual law that applies to un-induced unilateral mistakes which remains staunchly individualistic.[7]

Until the 19th century and the administrative fusion between common law and equity courts the common law courts did not attribute any importance to mistake in the formation of contract.[8] One important reason for the neglect was that chancery procedures (cumbersome as they were) were much better suited to ascertaining mistakes. As a result, suits that involved mistake were channelled by the barristers to the Court of Chancery, so that the common law had no opportunity to develop a

5. Beale, *supra* note 4 at 106. A detailed list of the traditional exceptions can be found in SM Waddams, "Precontractual Duties of Disclosure" in Peter Cane & Jane Stapleton, eds, *Essays for Patrick Atiyah* (Oxford: Clarendon Press, 1991) at 237.
6. The discussion here excludes contracts that are afflicted with undue influence or unconscionable bargain which raise a different set of questions, and the remedy for which is usually considered to be based on unjust enrichment principles. For a discussion of restitution in these cases as based on unconscionability, see Prince Saprai, "Unconscionable Enrichment?" in Robert Chambers, Charles Mitchell & JE Penner, eds, *Philosophical Foundations of the Law of Unjust Enrichment* (Oxford: Oxford University Press, 2009) at 417.
7. On the transformation of English contract law to a social-market embracing law see Hugh Collins, *The Law of Contract*, 4d (London: Cambridge University Press, 2008) ch 2.
8. MacMillan, *supra* note 2 at 38.

doctrine concerning the effect of mistake on contractual obligations.[9] Parties who laboured under a mistake and sought to rescind (or rectify) the resulted contract could find sympathy with the courts of equity who would intervene for victims of both *suggestio falsi* and *suppressio veri*. The latter was of course the greater innovation, as it went far beyond the doctrine of fraud — the closest counterpart which would be familiar to the common law jurists. But the equitable doctrine of unilateral mistake, like most of equity's jurisdiction, was never systematised to the level of its common law contemporaries. Only some general principles can be extracted from the (not too many) cases, while the treatises of the 19th century provide contradictory accounts, which too often do not follow the case law.[10] If a party seeks to enforce a contract in spite of the occurrence of mistake, one author tells us, he "must necessarily make that court [of common law] an instrument of injustice; … courts of equity have interposed, be restraining the party whose conscience is thus bound from using the advantage he has improperly gained".[11] When equity intervened it did so in the more flexible and particularistic manner that typifies it.[12] It offered restitution (a remedy which was conceived by its 19th century resuscitators as equitable in nature) to claimants who proved their mistake, and the unconscionability of

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9. *Ibid* at 39-44. A parallel line of cases in which remedy was offered to the mistaken party developed in Scotland, but today it is "considered controversial, and at most a narrow exception to the rule that an uninduced unilateral error is not sufficient to annul a contract": see Reid & MacQueen, *supra* note 4 at 355-56.
10. As shown in MacMillan, *supra* note 2; see also Reid & MacQueen, *supra* note 4 (a parallel line of cases in which remedy was offered to the mistaken party developed in Scotland, but today it is "considered controversial, and at most a narrow exception to the rule that an un-induced unilateral error is not sufficient to annul a contract" at 355-58).
11. John Mitford, *A Treatise on the Pleadings in Suits in the Court of Chancery* (London: W Owen, 1787) as in MacMillan, *supra* note 2 at 45.
12. On the flexible nature of the equitable doctrines and how this is essential to their function see Henry Smith, *An Economic Analysis Of Law Versus Equity* (2010) [unpublished, archived at Harvard Law School, Harvard University] (in the context of property law).

the other party who was silent.[13] But this equitable jurisdiction to assist parties who suffered harm as a result of un-induced unilateral mistake withered away as fusion kicked in, and claims concerning mistake were heard by a unified High Court. And so, the question of this paper can be posed as: should equity reclaim its pre-fusion power and intervene in the parties' common law rights where the defendant knew or should have known about the claimant's substantive mistake?

II. Justifying the Common Law Rule

Before we can judge whether equity should reclaim its authority to assist a party who worked under a mistake known to the other party (but not induced by him), we need to assess the merits of the law as it stands now. Under the current *Caveat Emptor* rule, parties to a contract are not under a duty to disclose information concerning the subject matter of the contract. People are expected to make all relevant investigations before committing to a contract, and have only themselves to blame if they fail to do so. As the courts of common law readily admit, the rule would strike the person on the street as unethical: "a man of tender conscience or high honour would be unwilling to take advantage of the ignorance of the other party"; it is a piece of law that clearly departs from our moral principles: "whatever may be the case in a court of morals, there is no legal obligation on the vendor to inform the purchaser that he is under a mistake, not induced by the act of the vendor".[14] In what follows I will present, briefly, some arguments to the effect that the inconsistency between the court of law and "the courts of morals" can be justified by second-order considerations of morality and public welfare. If valid, they show that the "tender conscience or high honour" which rejects the

13. Even where *restitutio ad integrum* was impossible see *Alati v Kruger* (1955) 94 CLR 216 (HCA) at 224 (when the parties were not in a position to give back exactly what each received under the contract). Also see more examples of equity's flexibility in this matter in Jamie Glister & James Lee, *Hanbury & Martin Modern Equity,* 19d (London: Sweet & Maxwell, 2012) at 29-001.

14. *Smith v Hughes* (1871), LR 6 QB 597 (Eng) at 604, per Chief Justice Cockburn, and at 607, per Justice Blackburn.

Caveat Emptor rule merely reflects moral intuitions that cannot survive a more reflective survey of the full range of considerations which apply to the legal treatment of un-induced mistakes.

In his book on restitution, Hanoch Dagan offers a powerful argument for the position that the law on restitution should be read as an expression of our commitment to the values of autonomy and utility, as well as to the value of community welfare.[15] This is not the place to assess the merits of his argument, but in what follows I discuss considerations in favour of the *Caveat Emptor* rule that concern both the parties to the dispute and the wider community. If, like Ernest Weinrib, you believe that only consideration of corrective justice (*i.e.* strictly between the parties to the dispute) should be taken into account when deciding disputes about the right to restitution (and in private law in general), you will discard reasons B-E below as irrelevant.[16] But if, like Dagan, you believe that a solution to these issues should be offered from a wide perspective which includes the effect of the decision on society as whole, you will (hopefully) find all the arguments (and counter arguments) in Part IV interesting and relevant. One more methodological note about mixing arguments from morality and efficiency: when thinking about rules of contract law, we need not worry too much about efficiency-oriented considerations crowding out concerns of morality. For in this area of the law, they actually tend to work in tandem, and lead in the same direction. As Charles Fried explains, the "convergence of [law-and-economics and normative analyses] is particularly salient [in] the design of institutions that facilitate the coordination, through agreements, of the energies of

15. Hanoch Dagan, *The Law and Ethics of Restitution* (London: Cambridge University Press, 2004) ch 2.

16. For example, see Ernest Weinrib, "Restoring Restitution" (2005) 91:3 Virginia Law Review 861.

otherwise independent persons".[17] Contradictory results may, of course, be found, but in our case these often incommensurable values converge quite nicely, and I will therefore leave this thorny issue for another time.

A. Moral Value 1: No Legal Duty to Prevent Harm

One argument against imposing a duty of disclosure on parties to contractual negotiations links it to the law's general reluctance to impose positive duties to assist other people in need. English law does not normally order us to save other people, even from severe harm, unless we actively contributed to its occurrence. This, it is widely agreed, is a good policy. The regulation of society ought to be achieved by means of prohibiting harmful acts, rather than by obliging citizens to engage in harm-preventing activities.[18] Two compelling thoughts are mentioned in support of this "no action no liability" principle. First, "a legal system that proscribed non-doing alongside doing would be profoundly intrusive … present individuals with fewer opportunities to avoid liability … (and is) likely to impinge to a greater extent upon one's interests".[19] Obligations to act limit the liberty of citizens to a greater degree than prohibitions since forbidding us from doing still leaves us with the freedom to engage in endless other non-doing actions. But when we are ordered to do X, in contrast, this is likely to tie us up for the duration, as we can hardly

17. Charles Fried, "The Ambitions of Contract as Promise" in Gregory Klass, George Letsas & Prince Saprai, eds, *Philosophical Foundations of Contract Law* (Oxford: Oxford University Press, 2014) at 23; see also Avery Katz, "Economic Foundations of Contract Law" in Klass, at 175; Eyal Zamir & Barak Medina, *Law, Economics, and Morality* (New York: Oxford University Press, 2010)(who say with regards to the parties' duties in the pre-contractual stage that "incorporating deontological constraints with economic analysis of contract law may be fruitful" at 350).

18. On the viability of the "act requirement" as a descriptive, as well as evaluative claim, see Douglas Husak, "Does Criminal Liability Require an Act?" in Douglas Husak, *The Philosophy of Criminal Law: Selected Essays* (New York: Oxford University Press, 2010) at 287-393.

19. AP Simester, "Why Omissions are Special" (1995) 1:3 Legal Theory 311 at 325; and Tony Honoré, *Responsibility and Fault* (Portland: Hart Publishing, 1999) at 54.

engage (attentively) in more than two activities at a time.[20] A good legal system, one that is concerned to protect the liberty of the citizens, would therefore operate by way of banning harm-causing activities, and introduce only a few positive prescriptions to top up these prohibitions, where this is necessary.

The other reason for the law's reluctance to order us to prevent harm is rooted in a widely held view about moral responsibility. By focusing on the people whose actions brought about a certain harm, and largely ignoring those who failed to help the victim to escape it, the law mirrors an essential difference in the degree of their respective responsibility for that harm. The standard example contrasts the man who did not help a drowning child, with the man who pushed her into the deep waters. While the behaviour of the person who noticed the unfortunate event but went on reading his paper on the beach is morally reprehensible (or monstrous), his blameworthiness is markedly different from that of the person who drove her over the cliff. Wrapping them together in one blanket of moral and legal responsibility would dilute the sense of personal responsibility, as perpetrators and bystanders will come to share a vague impersonal group responsibility. The norms of a legal system, which aims to gain the moral approval of the citizenry, must reflect this deep-seated moral intuition about the strong link between accountability and agency by sharply differentiating people who bring about harm from people who fail to prevent it. Together, these arguments present a powerful case against imposing legal responsibility for failing to help other people when their problem was not of your doing. The common law goes as far as declining to mandate actions to save other people's lives,

20. Michael S Moore, *Placing Blame: A Theory of the Criminal Law* (New York: Oxford University Press, 2010) at 241; Jonathan Bennett, "Morality and Consequences" (The Tanner Lectures on Human Values delivered at Bransenose College, Oxford University, 6, 19, 23 May 1980) at 66 [unpublished]. This is not necessarily the case in respect of every prohibition and obligation to act, as demonstrated by Patricia Smith, "Omission and Responsibility in Legal Theory" (2003) 9:3 Legal Theory 221 at 232-33; Victor Tadros, *Criminal Responsibility* (Oxford: Oxford University Press, 2007) ch 7.3.1, and others. But as a general observation about the operation of the law in democratic societies it is good enough.

even when the effort required is minimal.[21] The thought is that the huge gap that is thereby created between what we owe each other in morality and in law can be understood in light of the setback to freedom which legal positive duties inevitably lead to. And if a duty to save lives cannot overcome this mighty barrier, a duty to save people from self-induced mistakes stands no chance. The *Caveat Emptor* rule is thus understood as an expression of fundamental principles which concern the relationship between law, liberty and moral responsibility.

B. Moral Value 2: Self-Reliance

"I can buy my neighbour's land for a song, although I know and he doesn't that it is oil-bearing. That isn't dishonest, it is 'smart business' and the just reward for my superior individualism".[22] In this and other similar quotes from around the common law world, the *Caveat Emptor* rule is perceived as sending a message to patrons of the law that unless their agency (in the philosophical sense) is defective, or they are in some serious way dependent on the other party, they are expected to look after their own affairs. This expectation is a mark of respect for people's autonomy, and of their ability (and right) to decide how to allocate their resources — in this case, whether, and how much, to invest in finding out what is (for them) the true value of a certain contract. Moreover, industrious women and men that look after their business, rather than look to others to get them out of the mud should be rewarded, as such diligence is the basis for economic prosperity. The *Caveat Emptor* rule is thus an expression of dearly held values of autonomy and self-reliance.

C. Social Benefit 1: Certainty

The next argument in favour of the *Caveat Emptor* rule highlights the way in which it exemplifies a cluster of legal virtues that are often grouped together under the heading "rule of law". The rule of law is an exemplary

21. Civil law systems take a different stance, see Martin Vranken, "Duty to Rescue in Civil Law and Common Law: Les Extrêmes se Touchent?" (1998) 47:4 International and Comparative Law Quarterly 934.
22. *Blair v National Security Insurance Co*, 126 F (2d) 955 (3rd Cir 1942 (US)) at 958, per Chief Justice Clark.

state of affairs wherein

> legal norms fixed and announced beforehand – norms which make it possible to foresee with fair government in all its actions is bound by certainty how the authority will use its coercive power, and to plan one's individual affairs on the basis of this knowledge.[23]

The rule of law is designed to protect human dignity from the arbitrary power of the state by limiting the extent to which its agents can meddle with people's long term planning.[24] If I cannot know with reasonable clarity what the law is going to be like in the long term (because it changes constantly, or is retroactive), or if I cannot know what it demands of me (because it is unclear or unpublicized), or if it is impossible to predict how it will apply to my circumstances (because it is *ad hoc* or not enforced by the judiciary), then I cannot design my projects in a way that stirs clear of the law. As a result, my investment in meaningful long-term projects can be frustrated by the state at any moment. Such appalling state of affairs is not only an affront to the citizens' sense of dignity, but it will also decrease the overall efficiency of transactions, the planning of which requires information about the relevant law.[25]

Lon Fuller's famous list of rule of law *desiderata* is designed to replace the arbitrary reign of humans who are given excessive discretion (be they judges or government officials) with rule of rules that set in a clear way what would be the legal ramifications of your actions. A good law, he says, "is the enterprise of subjecting human conduct to the governance of rules";[26] or, in the words of Justice Scalia: "A government of laws means a government of rules".[27] These observations are thought to be true for any

23. This is an adaptation of Hayek's definition (adopted by Raz), with "legal norms" replacing his "rules" see Joseph Raz, *The Authority of Law: Essays on Law and Morality* (New York: Oxford University Press, 1979) at 210.
24. *Ibid* at 220.
25. Louis Kaplow, "General Characteristics of Rules" in Gerrit de Geest & Francesco Parisi, eds, *Production of Legal Rules* (Northampton: Edward Elgar, 2011) at 502; and review of the literature in Barbara Luppi & Francesco Parisi, "Rules versus Standards" in Geest, *ibid*.
26. Lon L Fuller, *The Morality of Law* (New Haven and London: Yale University Press, 1964) at 106.
27. *Morrison v Olson*, 487 US 654 (1988).

area of law. But when it comes to what Lord Mansfield called "mercantile transactions", the legal virtue of certainty is of such importance, that he thought that "it is of more consequence that a rule be certain, than whether the rule is established one way or the other".[28] This may be a little extreme, but the message is clear: in the context of legal norms that effect commercial relationships, adherence to the rule of law ideal is of a particular value, as the ability to calculate one's risk is a crucial factor in determining the worthiness of a transaction. Respect for autonomy (in choosing what transactions to engage in) and concern for efficiency both push hard for a commercial law that comprises of clear, general and predictable rules. From this point of view, the *Caveat Emptor* rule is an exemplary norm; it makes it crystal clear what is required around the negotiation table and what is not, and cuts the costs of litigations, as there is minimum space for court discretion as to its application. Sticking to the rule, even when the defendant turns out to be a selfish opportunist, may seem offensive at first sight, but sticking to the rule is the only way to secure the benefits promised by the rule of law. Under the surface, the *caveat emptor* law is a boon to the citizens' autonomy, well-being and material welfare.

D. Social Benefit 2: Law for Export

The benefits of a system of legal rules that abides by the requirements of the rule of law *desiderata* accrue to any legal system that adopts this model. But in England, zealous devotion to the virtues of clarity and predictability generates an extra social good: it supports a lucrative line of export, namely, commercial litigation. As Hugh Beale explains,

> [o]ur courts handle many cases that have no real connection with England save that the parties have chosen that the contract should be governed by English law. This is often coupled with a choice of England and Wales as the jurisdiction. This 'law for export' has deliberately been kept even closer to the classical model than the law for domestic consumption.[29]

The English strict position on rescission for unilateral mistakes is a primary example of such adherence to rule-based law in which the need

28. *Vallejo v Wheeler* (1774), 1 Cowp 143 (KB (Eng)) at 153.
29. Beale, *supra* note 4 at 116.

for discretionary *ex-post* judicial decision-making is, to a great extent, eliminated. This approach is indeed very different from the position of other European systems, which may explain why drafters of many business to business ("B2B") contracts indeed choose England as their jurisdiction. The relevant section of the *Principles of European Contract Law* captures the spirit of the typical European law on this crucial issue: Article 4:103 (Fundamental Mistake as to Facts or Law) establishes that a party who has entered a contract under a mistake of fact may avoid it provided that:

> a) the other party knew or ought to have known of the mistake, and it was contrary to good faith and fair dealing to leave the mistaken party in error; and
>
> b) the other party knew or ought to have known that the mistaken party, had it known the truth, would not have entered the contract or would have done so only on fundamentally different terms.[30]

The flexibility and discretion which are embedded in norms of this kind make the European law less clear and predictable than its English counterpart. And as predictability carries with it a parcel of benefits that are of utmost importance in the commercial world, the *Caveat Emptor* rule may well be making a direct contribution to a thriving export sector.[31]

E. Social Benefit 3: Generating Socially-Beneficial Information

In what has by now become a classic in legal economics, this argument demonstrates how a rule that allows a negotiating party to keep valuable information to himself incentivises entrepreneurial folks to unearth the true value of a piece of property which a placid owner may miss

30. Ole Lando & Hugh Beale, eds, *Principles of European Contract Law* (Netherlands: Kluwer Law International, 2000) at 191.
31. More on English law as an export sector can be found at: http://www.theguardian.com/law/2013/feb/07/uk-law-booming-export-crime and https://www.justice.gov.uk/downloads/publications/corporate-reports/MoJ/legal-services-action-plan-0313.pdf.

altogether.[32] A standard example is the owner of land who uses it for agricultural purposes without ever bothering to find out whether it holds riches like minerals or natural gas; another is the owner of an art collection who neglects to investigate the pedigree of the works on her walls, and thus deprives the world of a long-lost masterpiece. Those who are willing to take the initiative and invest in finding out the true value of a piece of property they do not own, will only do so if they can somehow benefit from it.[33] And so, by allowing parties to keep to themselves information about the subject matter of the contract, the law dangles the chance of fat profit in front of their eyes and encourages them to make the necessary investment. If information which affects the price need not be shared with lacklustre owners, the go-getters will presumably keep trying to uncover the real potential of what's around them. And so, again, we need to lift our eyes from the predicament of the owner who finds out that her ignorance led her to enter a loss-making deal; if instead, we focus on the interests of society at large, the Caveat Emptor rule, which at first looked morally bankrupt, will appear in a wholly different light. In a state of scarce resource, we should strive to end underuse of property which is the result of sheer passivity. The Caveat Emptor rule is promoting a state of affairs in which property ends up in the hand of those who realise its full potential. And this is the most efficient manner of allocating our limited resources.

III. When and Why Equity Intervenes in the Parties' Common Law Rights

In the rest of this paper I will argue that while the concerns raised by the above arguments are genuine and must be taken on board when thinking about the law's response to situations of unilateral mistake, they

32. Jack Hirshleifer, "The Private and Social Value of Information and the Reward to Inventive Activity" (1971) 61 The American Economic Review 561.

33. Anthony T Kronman, "Mistake, Disclosure, Information, and the Law of Contracts" (1978) 7:1 Journal of Legal Studies 1 ("[a] rule permitting non-disclosure is the only effective way of providing an incentive to invest in the production of such knowledge" at 9).

cannot support the current *Caveat Emptor* rule. We should, instead, reclaim the equitable authority to rescind the contract where the claimant can prove that the defendant knew, or should have known, that she is unaware of a critical piece of information, and nevertheless went ahead with the contract without alerting her to the mistake. The *Caveat Emptor* rule should become a well-defined exception to a rule that mandates disclosure of important details to the other party.

If equity were to intervene so as to disallow the informed party to insist on enforcing his contractual rights (to performance or compensation in its lieu), it would not do so on the basis of defective consent on the part of the ignorant party. Rather, equity would step in because the *conscience* of the defendant is affected by the way he sticks to his common law rights. Unconscionability, as Catharine MacMillan shows, has always been the historical basis of intervention in cases of un-induced unilateral mistake. "The principle is that it is against conscience for a man to take advantage of the plain mistake of another, or, at least, that a court of equity will not assist him in so doing".[34] Equity, in other words, works in a very specific way, by introducing a new factor to the equation: the defendant's conscience. It is therefore one thing to say that the rules on pre-contractual disclosure ought to change, and quite another to argue that a good way to do so is by means of equitable jurisdiction. And so, in this section, I look briefly at the very particular way in which equity acts to correct defects in common law rules. When we then move to examine why and where the *Caveat Emptor* rule fails, it will become clear that the unique way in which equity steps in to undo the damage of failing common law rules is particularly suitable for this situation; or, so I hope.

For many critics, even if the current law on unilateral mistake requires reform, equity would be the wrong means of bringing it about. Equity's distinctive *modus operandi*, they claim, disqualifies it from adjudicating commercial law disputes, or, indeed, from deciding the majority of cases in private law. This is because equity grants excessive discretion to judges,

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34. *Manser v Back* (1848), 6 HARE 443 (Ch (Eng)) at 448; MacMillan, *supra* note 2 at 45.

gives them a *de facto* licence to decide cases according to their private beliefs and encourages them to bend the common law rules when these do not reflect the current moral sensitivities of the society (or class) in which the court is embedded. In that way, it introduces into private law a highly unwelcome dimension of subjectivity and uncertainty and shows disrespect for the democratic processes of law making. Famous proponents of equity, like Justice Benjamin Cardozo from US Supreme Court, readily admit that equity's way of doing things has an adverse effect on the generality and certainty of the law: "[t]he plastic remedies of the chancery are moulded to the needs of justice"; one of equity's central characteristic, he maintained, is its ability to answer "the call of the occasion".[35] And thus, whereas Cardozo J celebrates the way in which equity empowers the judge to deviate from steadfast rules, wave aside the need for precedential stability and focus on a just solution to the case at hand, the critics believe that this behaviour disqualifies it from adjudicating disputes in private law.

All the features of equity which are of concern to this critique of equity as a mode of decision making in law are encapsulated in the concept of "unconscionability", which "was and remains the fulcrum upon which entitlement to equitable relief turns".[36] Equity, right from its birth, embarked on a quest after legal results that please the conscience.[37] And even as legal historians debate the question of what this reference to "conscience" meant for the very first courts of equity, there is no doubt that since the celebrated case of the *Earl of Oxford's Case,*[38] chancery

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35. *Foreman v Foreman*, 167 NE 428 at 429 (Cali App Ct 1929 (US)); Judge Cardozo in *Adams v Champion*, 294 US 231 (1935) at 237.
36. *Lift Capital Partners Pty Ltd v Merrill Lynch International*, [2009] NSWSC 7 (Austl) at para 126, per Justice Barrett.
37. Helmut Coing, "English Equity and the Denunciatio Evangelica of the Canon Law" (1955) 71:2 Law Quarterly Review 223 at 224 (in that, it was different from civilian systems which never pursued this course even when they implemented parallel mechanisms of *naturalis aequitas* borrowed from Roman law); and Timothy S Haskett, "The Medieval English Court of Chancery" (1996) 14:2 Law and History Review 245 at 267.
38. (1615) Rep Ch 1 (Eng).

judges who talked about conscience referred to the inner compass which tells us right from wrong: "The Office of the Chancellor says Lord Ellesmere 'Chancellor is to correct Men's consciences for Frauds, Breach of Trusts, Wrongs … "[39] and therefore "[w]hen a Judgment is obtained by Oppression, Wrong and a hard Conscience, the Chancellor will frustrate and set it aside, not for any error or Defect in the Judgment, but for the hard Conscience of the Party".[40]

The idea that legal relationships can be assessed by the court according to their fit with conscience was never to everyone's liking. As early as 1526 we can find Thomas Audley grumbling about "a law called 'conscience', which is always uncertain, and depends on the greater part on the 'arbytrement' of the judge; by reason thereof no man is certain of knowing his title to any land".[41] And ever since then judging in accordance with the standard of conscionability has been described, by proponents and opponents alike, as tending "not so much to the formation of fixed and immutable rules, [but] rather to a determination of the conscionability or justice of the behaviour of the parties according to recognised moral principles";[42] and equity's grand aims and critical principles were understood as determining its adaptable and flexible nature. As soon as equity in England emerged in the 1980s from a long period of hibernation and took the decisive step of "mov[ing] out of the

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39. *Ibid* at 7.
40. *Ibid* at 11. See also AJ Duggan, "Is Equity Efficient?" (1997) 113:4 Law Quarterly Review 601 at 617, 619. For the view that the term "conscience" in medieval times signified a different (more flexible) evidence gathering procedures, see MR Macnair, "Equity and Conscience" (2007) 27:4 Oxford Journal of Legal Studies 659.
41. Cited by Margaret McGlynn, *The Royal Prerogative and the Learning of the Inns of Court* (Cambridge: Cambridge University Press, 2004) at 188; and John Selden's quip from a hundred and fifty years later as in John Selden, Richard Milward & Edward Arber, *Table-talk* (London: A Murray & Son, 1689)("[f]or Law we have a measure … [but equity judges want to] make the standard for the measure, we call a foot, a Chancellor's Foot" at 46 solidified into an idiom that haunts equity to this day).
42. ICF Spry, *The Principles of Equitable Remedies: Specific Performance, Injunctions, Rectification and Equitable Damages,* 7d (Sydney: Lawbook Co, 2007) at 6.

family home and … into the market place”,[43] the old concerns about its subjectivity resurfaced with vengence. The target was, again, equity’s resort to categories of conscience: “unconscionability” declared one fierce opponent of equity’s renewed force, “[is] as vague and unstable a concept as could well be found”.[44] The heaviest fire is directed against the suggestion that unconscionability can be used as a general liability head, over and above what we find in individual doctrines which contain an unconscionability element, like breach of trust or proprietary estoppel.[45]

But unconscionability can take a less adventurous form as an integral part of well-defined doctrines so that its meaning is developed in tandem with other parts of the doctrine as the courts go about deciding cases that fall under its heading. When applied in that way, the conscionability standard is considered by many to be a most useful tool for achieving the goals set by the doctrine of which it is a part. Thus, in the recent case of *Cavendish Square Holding BV v Talal El Makdessi*[46] (“*Cavendish*”) the UK Supreme Court decided that the question whether a contractual obligation amounts to a “fine” — and would hence be struck down — is to be determined by an unconscionability test.[47] Looking back at the historical roots of the doctrine, the court observes that whereas the Common Law rule on when a clause would be considered an unenforceable fine was “mechanical in effect and involve[d] no exercise

43. Lord Justice Millett, “Equity – The Road Ahead” (1995–96) 6 King’s College Law Journal 1 at 4.
44. Peter Birks, “Meagher, Gummow and Lehane’s Equity Doctrines and Remedies” (2004) 120:2 Law Quarterly Review 344 at 345; on the 30 years stagnation of equity in English law until the 80s see PJ Millett, “Equity’s Place in the Law of Commerce” (1998) 114:2 Law Quarterly Review 214.
45. In England, see *Hussey v Palmer*, [1972] EWCA Civ 1 (Lord Denning’s (in)famous “constructive trust of a new model”) that has been described in *Carly v Farrelly*, [1975] 1 NZLR 356 (SC) by Justice Mohan (“justice [being] consigned to the formless void of individual moral opinion” at 367).
46. *Cavendish Square Holding BV v Talal El Makdessi*, [2015] UKSC 67 [*Cavendish*].
47. *Ibid* at para 213.

of discretion at all", in the "equitable jurisdiction … the classification of terms for the purpose of the penalty rule depends on the substance of the term and not on its form or on the label which the parties have chosen to attach to it".[48] This latter approach was endorsed by the post *Judicature Acts* High Court. In *Cavendish*, the Supreme Court set out to dispel some misguiding frills that had been added to the test over the years, and firmly established that "[t]he question whether [the clause is] enforceable should depend on whether the means by which the contracting party's conduct is to be influenced are 'unconscionable'".[49] Indeed, as the Court immediately admits, it can be argued that the old-new rule "undermines the certainty which parties are entitled to expect of the law".[50] However, the Court's discretion in this context is well-defined and confined to examination of the remedies for breach, rather than a "jurisdiction to review the content of the substantive obligations which the parties have agreed [on]".[51] As such the conscionability test preserves the right balance between the need for a flexible substance-based mode of decision-making, and the values of predictability and stability, so crucial to contract law.[52] An equitable duty not to withhold critical information in the pre-contractual stage would similarly employ the unconscionability standard in a regimented form.

Yet, embeddedness in the doctrine is unlikely to appease all the critics. For the conscionability element, even in its tamed version, still expresses equity's willingness to employ flexible, morally-sensitive principles, and a mode of legal reasoning that is *ex-post* and discretionary in nature. Equity, to put it this way, undercuts the rule of law in that it replaces certain, predictable and general rules with investigations into something as tentative as the defendant's conscience. I have argued elsewhere that the view of conscience as an idiosyncratic inner voice — a "set of deep-seated but idiosyncratic convictions" — is what gives rise to many of

48. *Else (1982) Ltd v Parkland Holdings Ltd*, [1994] 1 BCLC 130 (CA (Civ) (Eng)) at 144, per Justice Hoffmann; *Cavendish*, *supra* note 46 at para 15.
49. *Ibid* at para 31.
50. *Ibid* at para 33.
51. *Ibid* at para 42.
52. *Ibid*.

the worries lest legal categories of conscionability will lead to over-subjective results.[53] Equity, however, is employing a completely different model of conscience. The equitable standard of conscionability is built on an objectivist model which takes seriously both the phenomenon of conscience as a deep personal conviction and the objectivity of the moral principles it invokes.[54] The "voice of conscience" is an expression of a powerful inclination to abide by what we perceive as a universal moral duty, even in the face of adverse consequences to our interests.[55] The conscionability standard thus invites the court to delve into a pool of shared morality, *viz*, the collection of norms that are accepted by conscientious people, and scoop out the answer to the question "what was the moral duty of the defendant in the circumstances"?[56]

The appeal to shared morality assumes that the answers to many of the moral dilemmas faced by defendants are out there, and that a sincere

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53. As the subjective interpretation of the term would suggest, see Irit Samet, "What Conscience Can Do for Equity" (2012) 3:1 Jurisprudence 13. Some like Peter Birks, profess moral relativism that undermines any claim by the conscience to offer a path for moral truth (Peter Birks, "Annual Miegunyah Lecture: Equity, Conscience, and Unjust Enrichment" (1999) 23:1 Melbourne University Law Review 1). See David Enoch, "Disagreement", *Taking Morality Seriously* (Oxford: Oxford University Press, 2011) at 159 (for one of many powerful attacks on moral relativism of this kind).
54. Or so I have argued: see Samet, *supra* note 53.
55. Immanuel Kant, *Critique of Practical Reason* (Cambridge: Cambridge University Press, 1997) at 5.
56. Such appeal to common morality is not at all unique to equity. Tort law and property law make extensive use of shared understanding of the normative basis of legal rights and duties, both in order to confer legitimacy on the legal result and in order to use the moral "know how" to reduce the information costs of abiding by the law. See *e.g.* John CP Goldberg & Benjamin C Zipursky, "The Moral of MacPherson" (1998) 146:6 University of Pennsylvania Law Review 1733 at sec III; Andrew S Gold & Henry E Smith, "How Private Law is Simply Moral" online: <lawf.biu.ac.il/library/mb/9GoldSmith.pdf>; Jeremy Waldron, "Inhuman and Degrading Treatment: The Words Themselves" (2010) 23:2 Canadian Journal of Law & Jurisprudence 269 at 284. In the context of property law see Smith, *supra* note 12.

quest and attention to one's inner moral compass makes them readily available. The concern lest equity gives the judge a *carte blanche* to impose on the parties his or her own idiosyncratic values, with all the damage that such licence would cause to the rule of law, is therefore unwarranted.

Once we have cleared the suspicions that equity is a "sort of moral U.S. fifth cavalry riding to the rescue every time a claimant is left worse off than he anticipated as a result of the defendant behaving badly"[57] we can look for the working principle on the basis of which equity departs from the common law. Equity, I wish to argue, has a specialised role to play in our system, a role that is closely associated with the conscionability standard and its appeal to moral norms. Unfortunately, I do not have enough space here to expand on the argument or demonstrate how it works across a wide range of equitable doctrines.[58] Below is a brief summary of a theory about the way in which equity works to amend defects in the common law. My hope is that even in this nascent form, it will help us understand why resorting to equity would be a good way of reforming the law on un-induced unilateral mistake.

Equity has a clear vocation, and a distinct way of fulfilling it: it operates on the side of the common law to promote a legal virtue which I call the "[a]ccountability [c]orrespondence": when legal rules impose liability it should ideally correspond to the pattern of moral duty in the circumstances to which the rules apply. Barring unusual cases, the best way in which law can serve morality is by complying with the accountability correspondence requirement, namely, by ensuring that where legal liability is attached to an action it closely follows the matrix

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57. David Neuberger, "The Stuffing of Minerva's Owl? Taxonomy and Taxidermy in Equity" (2009) 68 Canadian Journal of Linguistics 537 at 540; see also Ben McFarlane, *The Law of Proprietary Estoppel* (Oxford: Oxford University Press, 2014) ch 5 for a careful and comprehensive review of the meaning of unconscionability in estoppel cases law.

58. As I attempt to do in my forthcoming book Irit Samet, *Equity Goes to Market* (Oxford: Oxford University Press, 2017).

of moral accountability for this action.[59] Major reforms which were designed to introduce greater convergence between legal liability and our perception of moral accountability have been introduced in many areas of law.[60] This is because a law in which the legal result is out of kilter with our deep convictions about moral accountability is not only dubious from the perspective of justice, it is also bound to alienate its addressees — the judiciary as well as the citizens.

The law, like any social institution, requires legitimacy if it is to develop and operate effectively.[61] And citizens are much more likely to become self-regulatory, that is, adopt a proactive approach for law abidance (rather than merely respond to external incentives) where the

59. The principle of accountability correspondence does not take a stance in the question which actions should have legal liability attached to them. It only says that once we decide that agents of action X should bear legal consequences, legal liability and moral responsibility for this action should be aligned.
60. Prominent examples would be the struggle to lessen the effects of "legal luck" on criminal responsibility, and the move from the traditional view that company directors' duty is to maximise of shareholders' profits, to the idea that they need to advance the "company's success" which is measured also by reference to "the firm's impact on the community and the environment" and its "reputation for high standards of business conduct" (see Yoram Shachar, "Wresting Control from Luck: The Secular Case for Aborted Attempts" (2008) 9:1 Theoretical Inquiries in Law 139; *Companies Act 2006* (UK), c 46, s 172; Florian Wettstein, "The Duty to Protect: Corporate Complicity, Political Responsibility, and Human Rights Advocacy" (2010) 96 Journal of Business Ethics 33; Michael Blowfield & Alan Murray, *Corporate Responsibility* (Oxford: Oxford University Press, 2011)).
61. Numerous legal policies seem to be premised on the thought that compliance is secured by the presence of sanctions for wrongdoers, but recent studies suggest that deterrence, although it sometimes significantly influences law-related behaviour, will, at other times, have no such effect (see Daniel Kahan, "The Secret Ambition of Deterrence" (1999) 113:2 Harvard Law Review 413); see also Daniel Nagin, "Criminal Deterrence at the Onset of the 21st Century" (1998) 23 Crime and Justice: A Review of Research 1 (much of the discussion was focused, naturally, on criminal policies).

government and its institutions — like the police and the courts — are perceived as legitimate.[62] In the context of legal systems, legitimacy would mean "the belief that the law and agents of the law are rightful holders of authority; that they have the right to dictate appropriate behaviour and are entitled to be obeyed".[63] Such sense of legitimacy can be rooted in different aspects of the authority's actions and decisions.[64] For our purposes, it is important to note that legitimacy perceptions, and the respect (or disrespect) for the law that follows, are strongly influenced by people's evaluation of legal results as just (or unjust). The connection between perceived legitimacy and the citizen's tendency to identify with the law and follow it willingly is so strong, that at the end of their classic study of the correlation between community views and criminal codes, Paul Robinson and John Darley state that "the moral credibility of the criminal code is its single most important asset".[65] The

62. Tom R Tyler, *Why People Obey the Law* (Princeton, New Jersey: Princeton University Press, 2006) ch 5.

63. Jonathan Jackson et al, "Why Do People Comply with The Law? Legitimacy and the Influence of Legal Institutions" (2012) 52:6 British Journal of Criminology 1053.

64. For example see Tyler, *supra* note 62, ch 9-11; Stephen Schulhofer, Tom Tyler & Aziz Huq, "American Policing at a Crossroads: Unsustainable Policies and the Procedural Justice Alternative" (2011) 101:2 Journal of Criminal Law and Criminology 305 (it has been shown that when legal enforcement institutions, like the police, follow principles of procedural fairness (understood mainly as allowing defendants a fair opportunity to state their case), it will significantly reduce the cost and alienation that are associated with policies which rely on threats to secure obedience); see also Jackson, *supra* note 63 (for similar results in the UK).

65. Paul H Robinson & John M Darley, *Justice, Liability, and Blame: Community Views and the Criminal Law* (Boulder: Westview Press, 1995) at 202. On the strong effect of result-based evaluation of the law on obedience, see also June L Tapp & Felice J Levine, "Persuasion to Virtue: A Preliminary Statement" (1970) 4:4 Law & Society Review 565; June L Tapp & Lawrence Kohlberg, "Developing Senses of Law and Legal Justice" (1971) 27:2 Journal of Social Issues 65; Kevin Carlsmith, John Darley & Paul Robinson, "Why Do We Punish? Deterrence and Just Deserts as Motives for Punishment" (2001) 83 Journal of Personality and Social Psychology 284.

"community views" about how a certain set of circumstances should be resolved is thus "an essential consideration that ought to be influential factor in the policy-making and code drafting process, [because] [t]he compliance power of criminal law is directly proportional to its moral credibility".[66]

This conclusion can be carried over to other areas of the law. Thus, rules of private law, company law, administrative law, etc., which divert from the community's strong moral intuitions should have a parallel adverse effect on the citizens' attitude to the law. Note that the damage to the sense of respect for the law is not limited to the specific area of law in which the perceived injustice is to be found. Research shows that in the face of a perceived injustice of a legal rule or result (in various areas from duties of landlord and tenants to civil forfeiture) people tend to flout the law *as a whole* in many subtle, lower level and harder-to-detect ways such as littering, tax avoidance and services theft.[67]

These findings have deep ramifications for areas in which the common law is so keen on realising the rule of law ideals of predictability, clarity and generality that it is willing to severely compromise the moral merits of the legal result. Think of the numerous situations in which the common law would enforce bright-line rules of property and contract law and refuse to make exceptions for circumstances where an opportunistic party used these rules to relinquish her moral responsibility for the defendant in a way that strongly offends the public's sense of

66. Robinson & Darley, *supra* note 65 at 6.

67. As argued by many and demonstrated in empirical research by Janice Nadler, "Flouting the Law" (2005) 83:5 Texas Law Review 1399 at 1401.

justice and fairness.[68] The strict *Caveat Emptor* rule is an excellent example of this willingness on the part of the common law to sacrifice the moral credibility of the legal result at the altar of the rule of law *desiderata* of certainty, predictability and generality. As we saw, even its proponents admit that the results of the *Caveat Emptor* rule stand in stark contradiction to people's moral intuitions. Moreover, as will become clear in the next section, a deeper scrutiny reveals that the moral standing of the *Caveat Emptor* rule is much more dubious than its proponents claim, and the gut feeling that it departs from basic moral norms is correct. At the same time, the rule allows shrewd actors to take unconscionable advantage of its clear-cut edges, *i.e.* they would be able to enjoy the clarity of its application, and obtain an advantage that

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68. Examples abound: in the context of negotiation to transfer rights in land, the common law would allow A to evade responsibility for B's detrimental reliance on A's words as long as they were not put down in writing; C can insist on enforcing a contract with D, regardless of the fact that it is clear that the document fails to accurately record the agreement of the parties as intended; E would be allowed to keep property which he inherited in a will, even where he orally promised the deceased to hand it over to someone else (as such gifts did not abide by the writing formalities of the *Wills Act*). In these and many other cases, the claimants could prove the morally relevant facts of their case: the pledge, the reliance, the frustrated expectation, the promise to a dying friend. But the crystal clear rules which regulate the transfer of property rights, bequests of property upon death and the interpretation of contracts trample the moral obligation under foot. The courts of equity, in contrast, paid close attention to the particularity of the situation, and employed open-ended conscience-based principles that enabled them to trace the pattern of moral responsibility in each case. Accordingly, in the above situations, writing formalities were waived so that the defendants were made to account for a setback in the claimant's life which they encouraged him to take risks (in "proprietary estoppel" (*e.g.* in *Crabb v Arun District Council*, [1975] EWCA Civ 7 a gap between the wording of the contract and parties' intention could give rise to a right to rescind *e.g. Mackenzie v Coulson* (1869), LR 8 Eq 368 (Ch (Eng)); and promisors were made to fulfil their promises to the dead man, even where testamentary rules were not complied with (via the equitable doctrine of secret trusts *e.g. McCormick v Grogan* (1869), LR 4 HL 82.

offends our shared conscience.

The common law's treatment of un-induced unilateral mistake is therefore afflicted with a dangerous fissure between the defendant's (lack of) *legal* liability and his *moral* duties towards the claimant. The *Caveat Emptor* rule is not the only context in which the courts are ready to bite the bullet and concede a deep inconsistency between legal and moral duty in relation to the defendant's actions. Their attitude to such unfortunate conflicts can be one of complacency:

> the application of... [legal] propositions may produce a result which appears unfair. So be it…I am convinced that in determining rights, particularly property rights, the only justice that can be attained by mortals… [is] justice which flows from the application of sure and settled principles.[69]

Equity adopted a very different approach. The courts of equity were willing to change the legal result and compromise the clarity, generality and predictability of the common law rules in order to avoid a dangerous fissure between the pattern of moral responsibility and that of legal liability for the same set of facts. In order to align moral and legal responsibility, the courts of equity would pay close attention to the particularity of the situation, and employ open-ended conscience-based principles that enable them to track the pattern of moral responsibility in each case. In that way, they stave off the serious danger created by the common law tendency to lose sight of the importance of maintaining equilibrium between intuitive perception of the morally right result and abstract considerations of common good (in the form of unity and reliability of the legal rules). Instead of sticking blindly to formalistic rule of law requirements, equity listens to the warning of Justice Marshall of the US Supreme Court: "however admirable its resolute adherence to the law as it was, a decision contrary to the public sense of justice [would] … diminish respect for the courts and for law itself".[70]

This, I believe, is the essence of the conscionability standard: it

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69. *Cowcher v Cowcher*, [1972] 1 All ER 943 (Fam) at 948, per Justice Bagnall.
70. *Flood v Kuhn*, 407 US 258 (1972)(Justice Marshall, dissenting, quoting from Peter L Szanton, "*Stare Decisis*: A Dissenting View" (1959) 10:4 Hastings Law Journal 394 at 397).

directs the court to find out whether assisting the defendant to enforce his common law right would tip the balance between the need to preserve the rule of law virtues of the norm and the need to ensure accountability correspondence. If it so does, then equity will prevent the defendant from standing on his rights so as to restore the correlation between the legal consequences of the defendant's actions and the pattern of moral rights and duties that it gives rise to. The law would thus be made to support the inter-personal morality of the parties, and as a result, strengthen the legitimacy of the system in the eyes of the community.

But the conscionability standard is not only for the courts. It can, thanks to its strong connotation, be used by the citizens to guide their behaviour.[71] By using a term like "conscience" that is universally associated with morally-oriented deliberation as a foundation for legal liability, equity sends a strong message to the citizens that the law expects them to rise above considerations of self-interest even when they deal with other market participants. It tells them that the call of conscience should be heeded not only when dealing with family and friends, but also when doing business with strangers. Their conscience (if they keep it in good working condition) will tell them how to plan their actions so that they end up on the right side of the law. The call of conscience should be used by the law's addressees as an additional source of information, which they must consult (on top of legal instruments and balance sheets) when deciding whether, and how, to use their legal rights. Once this message is internalised, people will work hard to nurture and protect this inner compass from conscience-muting

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71. For a presentation of the expressivist theory of law see Elizabeth S Anderson & Richard H Pildes, "Expressive Theories of Law: A General Restatement" (2000) 148:5 University of Pennsylvania Law Review 1503. On the potential of the expressive character of law to lift the moral standards of its addressees see sources in Kenworthey Bilz & Janice Nadler, "Law, Psychology, and Morality" in Brian H Ross, ed, *Psychology of Learning and Motivation*, vol 50 (New York: Academic Press, 2009) at 102.

mechanisms of rationalisation and self-deception;[72] for otherwise they may lose a valuable guide to the do and don'ts of behaviour in market. They will understand, in other words, that feelings of guilt and shame are warning signs not only of moral culpability, but also of potential trouble with the law, which may cost them dear.

If my account of the reference to conscience is viable, the court of equity sees itself as appealing to the defendant's ability to decipher the moral intricacies of her situation, arrive at correct appreciation of her moral duty and act on it. Once she does not so act, because she chose to ignore the call of her conscience, or to give in to conscience silencing psychological mechanisms, she will not be allowed to take shelter behind a formal ideal of the rule of law and the values of certainty, clarity and generality it enshrines. In the next section, I move to inspect more closely the claims in favour of the *Caveat Emptor* rule. We will see that in fact, our instinctive response to the *Caveat Emptor* rule, which was dismissed in *Smith v Hughes*[73] as the sensibility of a "tender conscience", closely traces the result of a deeper analysis of the values the rule instantiates and the social benefits it may generate. Equity, I will claim, should therefore step (back) in, and change the *Caveat Emptor* rule so as to realign the moral responsibility with the legal liability of a person who let the other party sign a contract in the knowledge that she misses a critical piece of information about the deal.

72. On our strong tendency to succumb to self-deception and rationalisation about the moral standing of our actions see for example Alfred R Mele, *Self-Deception Unmasked, Princeton Monographs in Philosophy* (New York: Princeton University Press, 2003); Michael K Green, "Kant and Moral Self-Deception" (1992) 83 Kant-Studien 149 at 164; and Daniel Goleman, *Vital Lies, Simple Truths*: *The Psychology Of Self-Deception* (New York: Simon & Schuster, 1996) part II at 55-91.

73. *Supra* note 14.

IV. The Moral Demerits of the *Caveat Emptor* Rule, and Why Equity is the Right Way to Correct Them

In this section, I want to show that the justifications provided for the *Caveat Emptor* rule are either defective on their own terms, wrongly presented as ideology free, or too slight to justify the stark departure from moral standards which it embodies. As the discussion unfolds it will become clear why a norm based on a conscionability standard is highly suitable to fix the deep problems of the current bright line rule. We will see that, indeed, efficiency considerations which ought to inform a good solution to the disclosure conundrum can many times be addressed by a set of fine-tuned well defined rules. But a truly successful ordering of disclosure duties in the pre-contractual stage would require an open-ended standard which combines clear guidelines with room for discretion in applying moral criteria.

Melvin Eisenberg summarises the view of many when he writes that "social morality indicates that if one actor knows a material fact that is relevant to the transaction, and knows that the other actor does not know the fact, non-disclosure is sharp dealing, or a kind of moral fraud".[74] In Part II above, I tried to show that the *Caveat Emptor* rule is not merely a reflection of a different attitude to the ethical standards in business (or the lack thereof); it is not just that "conduct which on the continent is regarded as fraud is regarded in England as good business".[75] The claim was that an array of arguments show that, on deeper inspection, the *Caveat Emptor* rule serves the common good on more than one level, and that therefore its unpalatable surface belies its real moral merit. In what follows, I address these arguments and argue that, in most cases, the *Caveat Emptor* rule does not serve the common good, but rather the interests of a small section of the public. To make the law on un-induced unilateral mistakes do justice in the wide range of cases to which it applies, the *Caveat Emptor* rule should become a carefully curved exception to

74. Melvin Eisenberg, "Disclosure in Contract Law" (2003) 91:6 California Law Review 1645 at 1653-65.

75. Beale, *supra* note 4 at 73.

a general rule that would require disclosure of critical information in the pre-contractual stage.[76]

A. Legal Duty to Prevent Harm

The *Caveat Emptor* rule, we saw, can be read as motivated by the belief that legal duties "to do X", and in particular to save strangers from predicaments you did not cause, unduly infringes on personal freedom. However, the reasons behind the "no duty to save" policy are not incontestable, and their applicability to the case of unilateral mistake is particularly dubious. First, the idea that moral responsibility changes in such a dramatic way between actions and omissions is far from consensual. For some serious thinkers, our tendency to feel less guilty for failing to help, than for inflicting harm, is nothing but a rationalisation that enables us to keep to our comfortable lives.[77] Moreover, it is widely agreed that special relationships, like friendship, mentorship or parenthood, break down the distinction (as much as there is one) between responsibility for damaging action, and responsibility for omitting to help. Teachers, for example, are not only under a moral obligation not to molest their pupils, but they are also obligated to act when they suspect that a pupil

76. See also Eisenberg, *supra* note 74 ("The law should require disclosure of material facts except in those classes of cases in which a requirement of disclosure would entail significant efficiency costs" at 1655); Zamir & Medina, *supra* note 17 who say that the set of rules on pre-contractual deception, which is informed by considerations of morality, as well as of efficiency, "should prohibit all forms of deception, including false assertions, half-truths, and silence" at 278; and Nicholas J Mcbride "Rescission of Settlement for Mistake and Non-disclosure" (1999) 58:3 Cambridge Law Journal 461, n 46.

77. As helping those in need is so much more demanding than merely avoiding causing unnecessary pain. See for instance Jonathan Glover, *Causing Death and Saving Lives* (London: Penguin Group, 1977) ch 7; Jonathan Bennett, "Whatever the Consequences" (1966) 26 Analysis 83.

is being abused by others.[78] Association can differentiate the person in need of help from the nameless mass of strangers so that a duty to go out of your way to help (and not merely refrain from harming) arises.

The situation of parties to contractual negotiation arguably gives rise to a proximity that can beget a positive duty to correct other people's mistakes. The strong policy consideration against enacting positive legal duties can be suspended in that case because the number of strangers whom you are requested to assist is well defined and limited. Indeed, if the defendant is a business owner who engages in contractual negotiations much of the day, the number of strangers whose mistake it would be his responsibility to correct would be high. But even then, he will only need to correct those mistakes of which he knows, or should have known. In such cases, a flexible unconscionability standard would become handy: an equitable standard will allow the court to look closely at the particular case and mark out those errors that, given the volume of the defendant's business and the interaction he in fact had with the complainant, she could not expect him to correct. This is likely to change from one case to another, but the conscionability standard should give enough guidance to parties as to when they are expected to save a person, with whom they are negotiating, from acting under a mistake. In this way, a cleverly deployed equitable rule can point out those cases where a duty to assist another person in trouble would be too onerous to be imposed by the law (even if in morality one may be obliged to do so).

B. Who's Self-Reliance?

A major building block in the justification of the *Caveat Emptor* rule is a value laden distinction between a proactive party who makes all the

78. See Irit Samet, "Proprietary Estoppel and Responsibility for Omissions" (2015) 78:1 Modern Law Review 85. A similar change in responsibility levels happens with people who hold special positions such as community leaders. In equity, land owners are expected to correct strangers' mistakes about their proprietary rights, or otherwise, forever hold their piece, as the doctrine of proprietary estoppel will force them to accept the situation assumed by the stranger's action.

necessary inquiries and a lacklustre one who waits for others to supply her with the material she needs in order to make an informed choice about the contract. Whether you put it in terms of the state's role in fostering the virtue of self-reliance, or of the law's aim to promote efficiency (here, by incentivising entrepreneurial spirit), the message is similar: the law will not assist those who cannot be bothered to take care of their own business. But such presentation of the way in which the *Caveat Emptor* rule operates is misleading. In its current universal application, what it does many times is simply allow the strong to prevail over the weak. As Hugh Beale observed:

> the *caveat emptor* approach depends on the buyer being sophisticated enough to ask the right questions—or to take advice. And the latter is not just a question of sophistication; it is also one of the cost of taking legal advice.[79]

The idea that the *Caveat Emptor* rule rewards the entrepreneurial is built on an assumption that the parties are equal in their ability to assemble all the information they require, and that whether they in fact did so is down to their approach, *i.e.* a "go-getter" or a "sitting on the fence" type. But since the rule covers the whole spectrum of potential parties to contracts, from big business to small and medium ones, as well as private people, its operation often merely reflects the power relations between the parties, not their virtues or vices.

And just as the *Caveat Emptor* rule does not necessarily recompense the industrious, disclosure duties do not, usually, reward laziness. Treatise writers in the nineteenth century were already careful to note that in proscribing non-disclosure, equity took care not to protect the negligent. There was "no case in which the Court of Equity had been successfully asked to interpose in favour of a man who wilfully was ignorant of that

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79. Beale, *supra* note 4 at 28. Later, at 30 he maintains that the presence of "a blanket rule of non-disclosure … [expresses] a very strong ideological message about self-reliance, or [shows that] that we are unable to devise a workable rule to deal with the problem".

which he ought to have known".[80] The standard of conscionability is flexible enough to allow the court to factor in the expectation that people do what they can to look after their affairs to the best of their ability. The particularistic nature of the equitable inquiry allows the judge to ask to what extent the specific claimant is responsible for her ignorance with regards to a crucial matter that concerns her position. From the point of view of a party who considers whether to spend the time and resources on finding the information she needs — and it may take a lot of time and money to find out what exactly one should ask once we venture beyond the standard set of questions — it would be very unwise to sit back and rely on the disclosure requirement. For "there is no certainty that the existence of your mistake will become known to the other party and so trigger the duty to point it out".[81] It is even less certain that the other party would be deemed as someone who "should have known" about your mistake *and* as unconscionable in failing to correct it. A disclosure duty would not incentivise a "sit around" attitude to information gathering. It is the party who is unconscious even of the *possibility* of making further inquiries who is most likely to fall back on the disclosure duty of the other side.

C. Certainty and Other Legal Virtues

From the point of view of the rule of law ideal, we saw, the *Caveat Emptor* rule is an exemplary legal norm. It has a minimal penumbra of uncertainty, its operation is hence easy to predict, and it applies across a wide range of cases so that a nuanced understanding of the phenomenon is not necessary in order to assess its effect on one's actions. However, this fit with the rule of law virtues of certainty, predictability and generality comes at a high price. The gap that the *Caveat Emptor* rule opens between the pattern of legal liability and that of moral duty is deep and, for reasons

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80. *Duke of Beaufort v Joseph Neeld*, [1845] 8 ER 1399 (HL) as in MacMillan, *supra* note 2 at 50 (and more cases cited there). Similar limitation can be found in the French law and the principles of European contract law, see Beale *supra* note 4. See also Eisenberg, *supra* note 74 at 1684-85.

81. Beale, *supra* note 4 at 82.

I reviewed in Part III, dangerous.[82] If equity (re)assumes its authority to intervene in order to close (or, at least, narrow) this gap, will the result be fatal to the certainty of the law on un-induced unilateral mistake? Not necessarily. The first thing to note is that mistakes about a critical aspect of the contract are only likely to occur in out-of-the-ordinary contracts, or with regards to odd pieces of information. This is because run of the mill situations will very often be covered by standard practices of investigations and off-the-shelf questionnaires.[83] Moreover, especially when it comes to sellers, a disclosure duty should not introduce a big transformation in the current practice. Ample research in economics shows that sellers will frequently share information with the other party even if they have no legal obligation to do so, as the advantage gained by non-disclosure will often unravel under competition.[84] In addition, numerous statutes and regulations require disclosure by sellers.[85] This means that only in a limited number of cases would the equitable norm operate to undo a deal to which one party only entered because she was unaware of a critical piece of information known to the other party.

Moreover, one of the biggest benefits of a clear certain rule, namely, that people can calculate its effects on their action and plan accordingly (by purchasing insurance, etc.) does not pertain to the typical case of a unilateral mistake. Unilateral mistakes often come as a nasty surprise, not as a realisation of risk whose chances of occurring one could have

82. As celebrated novels like Michael Frayn's *Headlong* testify, the existence of the "no need to disclose" rule is known to the wide public (New York: Faber & Faber, 1999). The book describes the disastrous results of an attempt to take advantage of the rule in the context of art dealings, and was shortlisted for the Man Booker Prize.

83. Many such forms can be found on the internet; for the sale of land see for instance <http://www.houseweb.co.uk/house/sell/hips/PIQ.pdf>; for sale of business see <http://www.certifiedacquisitions.com/uploads/Seller_Questionnaire.pdf>.

84. Eisenberg, *supra* note 74 at 1678 (and sources cited there).

85. *E.g. The Consumer Protection from Unfair Trading Regulations 2008* (UK), SI 2008/1277 s 6; *The Provision of Services Regulations 2009* (UK), SI 2009/2999 s 8; consultation on *The Occupational and Personal Pension Schemes (Disclosure of Information)(Amendment) Regulations 2015* (UK), SI 2015/482.

calculated in advance. A description of the *Caveat Emptor* rule in terms of certainty would not cut much ice with the surprised party, especially if she is a non-specialist and therefore expects the law to mirror the widely shared moral intuition that the other party should have alerted her that she labours under an error. Another point to note is that the effect of uncertainty on third parties would be dramatically reduced due to the way in which equity protects *bona fides* purchasers.[86] The worry lest third parties will have to bear the risk of relying on a contract that is in fact voidable strongly militates against releasing the mistaken party from the contract. Equity, with its built-in mechanism of sheltering innocent outsiders from such risks is thus well suited for the task of reforming the *Caveat Emptor* rule.

Furthermore, as I explained in Part III, the standard of conscionability can be used by the law's addressees as a useful guide, even if it cannot achieve the level of certainty secured by fixed *ex-ante* rules. In the context of un-induced unilateral mistakes, a norm that instructs you to reveal critical information, if you suspect that the other party is unaware of it, is pretty clear and certain.[87] True, as we will see below, a successful disclosure duty would include some exceptions whose application requires court discretion. In the large majority of cases, however, a duty to alert the other party to a mistake that is known to you may be burdensome, but is in no way unclear. Certainty is therefore mainly jeopardised by the availability of a remedy where one party should have known about the other party's mistake. The extent to which a conscionable person ought to infer that the other party is ignorant and take steps to ascertain it may, indeed, be less than clear-cut. Nevertheless, the reference to conscience — a concept whose moralistic connotations are obvious to everyone — directs the law's addressees towards an ethical approach to the issue of ignorance in pre-contractual negotiation. A conscience in a good working condition,

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86. That was already the case when equity granted rescission for unilateral mistakes in the 18th and 19th century: see MacMillan, *supra* note 2.

87. See Beale, *supra* note 4 at 119-22. For another way of reducing the effect of uncertainty is to allow opt out in business to business ("B2B") contracts.

i.e. an alert sensitive inner compass, would tell its owner that the less than favourable conditions which the other party agrees to may be a result of some ignorance on his part (rather than, say, generosity, lack of experience or absentmindedness). Conscience would drive the party in the know to ask "by the way, did you know that X?" even when that may rob him of an advantage, and the conscionability standard would make it clear that, to stir clear of the law, one should follow this advice. This is not the certainty of a fixed *ex-ante* general rule, but it is a legal principle that definitely offers the parties to contractual negotiations a useful guide on how to conduct themselves so as to avoid interference by the state. A conscionability-based duty of disclosure will therefore strike a better balance between the value of certainty and the ideal of accountability coherence, *i.e.* a state of affairs in which the law follows the pattern of moral responsibility in the circumstances.[88]

D. Generating (very little) Socially-Beneficial Information

One of the most compelling arguments in favour of the *Caveat Emptor* rule is the way in which it incentivises the entrepreneurial to obtain useful information about other people's property. While the lacklustre owner fails to fully realise the potential of the resource over which she was given control, the eager beaver probes the quality of her property, tempted by the chance of making a nice turnover if he manages to buy it from her for what *she* thinks it is worth. This is all very nice, but in fact the *Caveat Emptor* rule can potentially encourage socially valuable investigations in a very limited number of factual scenarios, while its application is general and far-reaching. If we look at the problem of un-induced unilateral mistake from a perspective of economic efficiency, our point of departure should be that mistakes always increase the resources which must be devoted to the process of allocating goods to

88. See Beale, *ibid* (who says about his suggestion for disclosure duty: "I think that this proposal, though less certain than the current law, would nonetheless be workable. Rules that are a great deal less certain are used in countries whose economies seem as successful as our own" at 99).

their highest-valuing users.[89] And so, a rule that allows the enforcement of contracts which are based on an error must be justified by showing that the benefits it entails exceed the costs inherent to mistakes. A closer look at the *Caveat Emptor* rule reveals that it incentivises valuable investigations only in very specific cases, with the result that the current wholesale right to withhold information is inefficient.

Since Kronman's 1978 ground-breaking paper on the efficiency of disclosure duties, it has been the consensus that, broadly speaking, we should distinguish between information that was acquired by a party in a "casual" manner and information which she deliberately obtained, as only the latter ought to be protected by a right not to disclose.[90] Why, from efficiency point of view, should we oblige the party who casually came by a relevant piece of information to reveal it to the other party? Mistakes, like accidents, are costly, and in principle should be avoided "since the actual occurrence of the mistake, always (potentially) increases the resources which must be devoted to the process of allocating goods to their highest valuing users".[91] Only if non-disclosure generates a substantial social benefit should the informed party be allowed to keep it to herself. Casually getting hold of information which is relevant to other people's property does not generate sufficient social benefit to justify the cost of allowing a mistake to determine the course of a contract.[92] But neither is it the case that all *deliberate* acquisitions of information are beneficial to such a degree that encouraging them warrants a right to keep it to yourself; it all depends on the kind of information thus attained. For instance, in contrast with the famous US Supreme Court decision

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89. Kronman, *supra* note 33; see also Zamir & Medina, *supra* note 17 (who conclude: "Ordinarily, the cost of transferring the correct information to the uninformed party is small and its benefit clear. Accordingly, prohibitions against deceit and pre-contractual disclosure duties are prima facie efficient" at 269).
90. Kronman, *supra* note 33 at 13.
91. *Ibid* at 2-3.
92. Stumbling on information by chance is indifferent to incentives to act one way or another. See more detailed argument in Eisenberg, *supra* note 74 at 1656-61.

in *Laidlaw v Organ*,[93] the deliberate obtainment of mere foreknowledge (*i.e.* information that will, in due time, be evident to all) is not worthy of encouragement as it does not increase the pie, only the share of the person who happened to have the information.[94]

Another substantial limitation on the ability of the *Caveat Emptor* rule to incentivise the search for socially beneficial information relates to the position of sellers. As Melvin Eisenberg shows,[95] the distinguishing characteristics of sellers make it the case that they should *always* be required to disclose material facts concerning their property. Sellers typically have asymmetric access to adventitiously acquired information about the property they are selling, while they are sufficiently incentivised to look for other information about a property they own; they do not need the extra incentive in the form of a right to withhold information about the subject matter of the contract.[96] From the perspective of clarity and predictability it would have been good if the disclosure duty could swiftly apply to all sellers. But justice and efficiency dictate some fine-tuned exceptions. Thus, when a universally known practice in a specific market (*e.g.* commercial real estate) is one of "each party to herself", expectation that information would be disclosed cannot be justified. Similarly, if a party was ignorant about a material fact in circumstances where a diligent buyer would have been put on notice, or because she failed to conduct a reasonable research, the law should not absolve her

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93. 15 US (2 Wheat) 178 (1817) [*Laidlaw*].

94. Hirshleifer, *supra* note 32 at 562; *Laidlaw*, *supra* note 93; Robert Cooter & Thomas Ulen, *Law and Economics*, 3d (New York: Addison-Wesley, 2000) at 273-74. Many cases of foreknowledge would fall under what Cooter and Ulen called "redistributive information", *i.e.* such that only "creates a bargaining advantage that can be used to redistribute wealth in favor of the informed party". Working to obtain this kind of knowledge is socially wasteful and should be discouraged by imposing disclosure duties. Only with regards to information that "can be used to produce more wealth", we can show that "[e]fficiency demands giving people strong incentives to [produce it] …" by exempting them from the duty to disclose it at 273-74.

95. *Supra* note 74.

96. *Ibid* (see detailed discussion at 1674-77); Zamir & Medina, *supra* note 17 at 272.

of her contractual obligations.[97] The disclosure duty of sellers should therefore be drafted as a standard which, while it establishes a pretty general duty of disclosure for sellers, does allow the court to peg the sellers' duty of disclosure to the level of their moral responsibility for *this particular* erroneous buyer.

In contrast with the above rule that mandates a disclosure duty on sellers which can be, all and all, reasonably clear on the edges, a just and efficient regulation of *buyers*' disclosure duties will have to take the form of a flexible open-ended standard that accommodates the more prevalent exceptions to the duty to alert the seller to her mistake. Apart from the above case of the studious buyer who worked hard to reveal hidden qualities of a piece of property, in some social context the pre-contractual interaction is best understood as a game in which buyers troll for mistakes by sellers. Used book trades and art auctions are the most obvious examples of such social games — where sellers cannot legitimately expect buyers to reveal their assessment that the item they wish to buy is actually worth much more than the owner's asking price.[98] Other, less obvious, situations may fall into this category, and a space should be left for the court to exercise discretion as to whether this is the case. Another set of circumstances where a buyer should be allowed to keep critical information to himself is where

> a certain [building] project requires assembling a considerable number of parcels. Revealing the entrepreneur's plan to prospective sellers would result in … a 'holdout' [*i.e.* some agents may exploit the need for their consent to extract a portion of the producer surplus in excess of their opportunity costs].[99]

A duty to disclose information in this case would thus open the door not only to inefficiency but to opportunism and an unfair distribution of the

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97. See examples in Eisenberg, *supra* note 74 at 1683-85.
98. *Ibid* at 1686; see also Peter Walker, "Multimillion-dollar Photo of Billy the Kid Playing Croquet was $2 Junk Shop Find", *The Guardian* (13 October 2015), online: <www.theguardian.com/us-news/2015/oct/13/billy-the-kid-croquet-junk-shop-two-dollars> (example of a photo bought for $2 in a junk shop and sold for $2.3 million can be found in this article).
99. Zamir & Medina, *supra* note 17 at 273.

pie.[100]

The bottom line of all these complex considerations is that the *Caveat Emptor* rule increases the efficient use of property only in a narrow range of cases which involve resourceful buyers. And even in these cases, the claim that the only (or by far the best) way to incentivise socially valuable explorations of other people's property is to allow the entrepreneurial buyer to keep critical information to himself has not gone unchallenged.[101] Anyway, as Eisenberg clearly shows, the chances that in our times one will be able to find out valuable information about another's property (such as the existence of minerals or natural gas) are slim, while exploration companies that engage in the business do not exploit the right to withhold information in their negotiations with owners.[102] In most cases of industrious parties who worked hard to discover hidden qualities of property they do not own, the claim that one has a right not to share his findings with the owner will not be raised. In some other situations, court discretion would be necessary in order to avoid holdouts and for adjusting liability to responsibility in special

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100. It is worthwhile mentioning that up until now courts in the US have failed to tailor their decisions in contract disputes in accordance with legal economics finding about the utility of each course of action: see Kimberly D Krawiec & Kathryn Zeiler, "Common-Law Disclosure Duties and the Sin of Omission: Testing the Meta-Theories" (2005) 91:8 Virginia Law Review 1795 at 1818-21 who argue, on the basis of a large scale statistical survey of American cases, that courts are not more likely to require disclosure when the information is casually acquired as opposed to deliberately acquired; see also Eric A Posner, "Economic Analysis of Contract Law After Three Decades: Success of Failure?" (2003) 112:3 Yale Law Journal 829 (the answer is "failure", at least when it comes to influence on actual courts' decisions).
101. Other mechanisms to profit from the obtainment of such information are at hand. For example, where inheritance goes to next of kin, no matter how remote, you find people who specialise in tracing such remote relatives of lone deceased. They then approach the potential heir with the promise to reveal the identity of the long lost relative in return for a hefty percentage of the inheritance. A similar approach can be taken with respect to unknown qualities of one's property.
102. Eisenberg, *supra* note 74 at 1687-91.

market conditions. The bottom line is that the secrecy allowed by *Caveat Emptor* rule ought to become an exception to a general standard which obligates disclosure in the pre-contractual stage as required by justice and efficiency. Again, a conscionability based standard which allows the court to exclude such scenarios from a general disclosure duty would work very well.

V. Conclusion

The law on un-induced unilateral mistakes probably comes into effect only in a rather small number of contract cases. Economic reality and practices which developed over the years often lead both sellers and buyers to be frank about their assessment of the subject matter of the contract. Nevertheless, the decision taken by each legal system as to the duty of people who negotiate a contract to save the other party from making a costly error says a lot about its most fundamental values. The message that it sends to the parties about the ethical level they should aspire to attain ripples well beyond the specific issue of disclosure. In the case of the English *Caveat Emptor* rule, the common law professes a set of individualistic values, or tolerance of sheer selfishness, that do not reflect the moral convictions of the wider community. Arguments to show that the *Caveat Emptor* rule actually embodies a commitment to a lofty rule of law ideal and promotes economic utility fail to show that the alternative (*viz* a fairly wide duty of disclosure that follows ethical standards) will seriously undermine the law's aspiration to legality, or efficiency. On the contrary, the disutility of mistakes and erosion of the legal system's legitimacy — both clear risks of the *Caveat Emptor* rule — strongly militate against adhering to the current law. A change is needed; but by what means?

English law, I have argued, has a ready-made device for introducing the necessary reform: the nineteenth century equitable jurisdiction to rescind a contract where insisting on its performance (or expectation damages) would be unconscionable since the defendant knew, or should have known, that the claimant only entered the deal because she was ignorant of a crucial fact. An *ex-post* flexible standard of that kind will allow the court to take into account subtle differences between

cases which may change the moral standing of the defendant and/or the benefit to society from forcing a disclosure duty in a particular case.

Moving from the bright-line *Caveat Emptor* rule to a conscionability-based standard would indeed detract from the certainty of the law in that area. But equity does not simply neglect the rule of law value; it is bent on reintroducing a *balance* between the demands of clarity, generality and predictability, and the ideal of coherence between law and moral principles. We saw how the invocation of conscience provides a pretty good guide on how the law would apply in different situations — a guide that relies on our inbuilt ability to recognise, and be motivated by, our moral duty. Coupled with the demand that the mistake is substantial and an in-built protection for innocent third parties, an equitable conscionability-based disclosure duty will lend relatively few surprises on people who know the law and think about it seriously. The unfortunate situation of un-induced unilateral mistake is thus an excellent example of the prowess of equity: through its carefully-developed mechanisms it is able to realign legal liability and moral responsibility in a way which is respectful of the rule of law ideal and sensitive to the shared values of the community.

The Genetically Modified Constructive Trust

Graham Virgo*

In England the constructive trust is characterised as institutional, arising by operation of law at the time of a recognised triggering event. In Canada and Australia the remedial constructive trust is recognised through the exercise of judicial discretion to secure equity and justice. In fact, the categories of constructive trust are not as distinct as orthodoxy dictates. Motivated by the aim of seeking harmonisation where possible, this paper proposes a new model of constructive trust, the modified constructive trust, which embodies the institutional core but modified by reference to recognised principles.

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I. Introduction

This article is ultimately about legal cultures, particularly in Australia, Canada and England. Justice Finn[1] has said, specifically of the legal culture in England and Australia (but Canada could be included as well), that there are "differing casts of mind, distinctive methodologies and markedly different contexts". To some extent he is right. Certainly, since Australia and Canada abolished appeals to the Privy Council, the Australian and Canadian legal systems have inevitably become distinct from English law. There has, however, been an important recent riposte to Finn J's analysis of legal culture, as delivered by Lord Neuberger in the UK Supreme Court concerning the nature of the constructive trust, where he said:

> [a]s overseas countries secede from the jurisdiction of the Privy Council, it is inevitable that inconsistencies in the common law will develop between different jurisdictions. However, it seems to us highly desirable for all those jurisdictions to learn from each other, and at least to lean in favour of harmonising the development of the common law round the world.[2]

It is in that spirit of seeking to learn from each other, and even seeking some degree of harmonisation, that this paper will examine

1. Honourable Paul Finn, "Common Law Divergences" (2013) 37:2 Melbourne University Law Review 509 at 511.

2. *FHR European Ventures LLP v Cedar Capital Partners LLC*, [2014] UKSC 45 at para 45 [*FHR*].

the constructive trust, a trust that is prevalent in all three jurisdictions, which share a common legal tradition, common doctrines and common terminology, especially in that body of law known as equity. What we can learn from each other as regards the operation of the constructive trust will depend on the legal and judicial culture of each jurisdiction, particularly as to whether the dominant view is that the recognition of the trust should be rule-based, discretionary or something in between.

II. The Nature and Function of the Constructive Trust

It is important at the outset to identify the nature and function of the constructive trust. In all three jurisdictions it is a genuine trust, the creation of which does not depend on the intention of the parties. Property is held on trust by the constructive trustee for the beneficiaries, each of whom will have an equitable proprietary interest in the trust property. The creation of this equitable proprietary interest has three significant advantages for the beneficiary. First, if the constructive trustee becomes insolvent, the beneficiary will gain priority over the trustee's creditors as regards claims to the trust property. Secondly, if the value of any asset which is held on constructive trust has increased, the beneficiary will gain the benefit of that increase. Thirdly, the beneficiary of the trust can assert his or her equitable proprietary rights against innocent third parties who have received and retained the asset or its traceable substitute, as well as recipients who received but have not retained the asset or its traceable substitute, but who knew or should have known that the property had been held on trust.[3]

Whilst there is a broad consensus about the function of the constructive trust, the three jurisdictions have very different understandings of its nature. In England the constructive trust is, generally, analysed as an institution, such that it arises by operation of law on the occurrence of a

3. By means of a claim for knowing receipt. See *Bank of Credit and Commerce International (Overseas) Ltd v Akindele*, [2001] Ch 437 (CA (Civ)(Eng)); *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*, [2007] HCA 22; *Citadel General Assurance Co v Lloyds Bank Canada*, [1997] 3 SCR 805.

certain event where a constructive trust has previously been recognized.[4] In Australia[5] and Canada[6], however, it is the remedial constructive trust which is recognised. The essential difference between the institutional and remedial constructive trust was identified by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington LBC* ("*Westdeutsche*"):

> [u]nder 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.[7]

In other words, whereas an institutional constructive trust arises by operation of law from the date of the event which gives rise to it, the remedial constructive trust arises through the exercise of the judge's discretion, whenever it is considered to be just to recognise that the claimant has an equitable proprietary interest in property received by the defendant.[8] As a consequence, the court could require the transfer to the claimant of an asset, which otherwise belongs to the defendant and in which the claimant did not have a pre-existing legal or equitable right. The purpose of the remedial constructive trust is to enable the judge to create an equitable proprietary right which did not exist before the

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4. See *e.g. Halifax Building Society v Thomas*, [1996] Ch 217 (CA (Civ) (Eng)) at 229, per Gibson LJ.
5. *Muschinski v Dodds* (1985), 160 CLR 583 (HCA) [*Muschinski*]; *Grimaldi v Chameleon Mining NL (No 2)*(2012), 200 FCR 296 (FCA (Austl)) at para 569, per Finn J [*Grimaldi*]. Also in New Zealand: *Powell v Thompson*, [1991] 1 NZLR 597 (HC).
6. *Pettkus v Becker* [1980] 2 SCR 834 [*Becker*]; *Soulos v Korkontzilas* [1997] 2 SCR 217 at para 34, per McLachlin J [*Soulos*]; *Kerr v Baranow*, 2011 SCC 10 at para 50, per Cromwell J [*Kerr*].
7. [1996] AC 669 (HL) at 714 [*Westdeutsche*].
8. *Ibid,* per Lord Browne-Wilkinson; *Soulos*, *supra* note 6 at para 34, per McLachlin J.

exercise of the judge's discretion.[9]

In *FHR European Ventures LLP v Cedar Capital Partners LLC*[10] ("*FHR*") the Supreme Court rejected the remedial constructive trust in English law. In *FHR*, the claimants had purchased the share capital of a company which owned the lease of the Monte Carlo Grand Hotel. Cedar Capital Partners LLC acted as the claimants' agent in negotiating the purchase of the shares and, as an agent, owed fiduciary duties to the claimants. The defendant had earlier entered into an agreement with the vendor of the hotel by virtue of which the vendor would pay it €10 million following the successful sale of the shares, but the defendant failed to disclose this payment to the claimants in breach of fiduciary duty. It was held that the agent held the secret commission on constructive trust for the claimants, and this trust arose automatically because the payment had been received by the defendant in breach of fiduciary duty, and not through the exercise of judicial discretion.[11]

Although the Supreme Court cited the judgment of Lord Browne-Wilkinson in *Westdeutsche*[12] in support of its decision to reject the remedial constructive trust in England, and it is certainly true that he did not formally recognise the remedial constructive trust in English law, he was not adverse to the recognition of such a trust and considered that there may be circumstances where it might be beneficial to recognise it, because it would enable proprietary relief to be tailored to the particular circumstances of the case, but he did not consider that it was appropriate to recognise it at that point in time. Despite that, the remedial constructive trust appears to be extinct in England.

III. Institutional Versus Remedial Constructive Trust

The rejection of the remedial constructive trust in England, and its acceptance in Australia and Canada, may well reflect different legal cultures as to the function of the law and the role of the judge, particularly

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9. *Polly Peck International v The Marangos Hotel Company Ltd*, [1998] 3 All ER 812 (CA (Civ)) at 830, per Nourse LJ [*Polly Peck*].
10. *FHR*, *supra* note 2 at para 47, per Lord Neuberger.
11. See further Part III.B.3, below.
12. *Westdeutsche*, *supra* note 7 at 716.

the legitimacy of judicial discretion. The English appear to be suspicious of the judge being given the opportunity to exercise their discretion: judges are not to be trusted. So, for example, Lord Camden in *Doe v Kersey* said:

> [t]he discretion of a judge is the law of tyrants; it is always unknown; it is different in different men; it is casual, and depends upon constitution, temper, and passion. In the best it is oftentimes caprice; in the worst it is every vice, folly, and passion, to which human nature is liable.[13]

This has not always been the consistent view, however, particularly in equity. For example, 500 years ago Sir Thomas More in *Utopia* wrote:

> [t]he law and Judges should avoid arcane interpretations and debates about law but should instead judge the overall equity or justice of a situation and decide accordingly.[14]

This was equated with the exercise of the judge's conscience, which was considered to be fundamental to the equitable jurisdiction. But it is the approach of Lord Camden which appears to underpin the rejection of the remedial constructive trust in England. Lord Neuberger, who delivered the single judgment in *FHR* which rejected the remedial constructive trust, subsequently expressed his concerns about its recognition extra-judicially,[15] and sought to provide detailed justification for its rejection, which was lacking in his judgment in *FHR*. He considered that "the notion of a remedial constructive trust displays equity at its flexible flabby worst". He considered it to be "unprincipled, incoherent and impractical". He was opposed to its recognition in England for the following reasons:

i. it would render the law unpredictable;
ii. it would be an affront to the common law view of property rights and interests;
iii. it would involve the courts usurping the role of the legislature: the creation

13. Lord Camden, cited in Edward Wynne, *Eunomus, or, Dialogues Concerning the Law and Constitution of England: with an Essay on Dialogue*, 5d, (London: S Sweet and R Millikin, 1822) at 91.
14. Sir Thomas More, *Utopia Book 1* (Leuven: More, 1516) at 45.
15. David Neuberger, "The Remedial Constructive Trust: Fact or Fiction" (delivered at the Banking Services and Finance Law Association Conference New Zealand, 10 August 2014) [unpublished] at para 6.

> of new property rights being something which should be left to Parliament.[16] This reflects a particular concern about the use of the remedial constructive trust to undermine priorities on insolvency as identified by statute.[17]

The Court of Appeal in *Re Polly Peck International (No 2)*[18] *("Polly Peck")* had explicitly refused to recognise the remedial constructive trust for this reason. It was considered that the variation of property rights should be a matter for Parliament rather than for the discretion of the judiciary, especially where the creation of an equitable proprietary right by a judge would exclude assets from distribution to the unsecured creditors of the defendant.[19] In *Polly Peck*, the claimant had sought to recover money from an insolvent company and argued that it was held on a remedial constructive trust to enable the claimant to gain priority over the defendant's other creditors. The Court of Appeal refused to recognise such a trust, especially because the distribution of assets on insolvency was governed by the *Insolvency Act 1986*[20] and it was not for the courts to interfere with this statutory regime. As Lord Justice Mummery recognised: "[t]he insolvency road is blocked off to remedial constructive trusts, at least when judge-driven in a vehicle of discretion".[21] Lord Justice Nourse went further and said that, even had the defendant been solvent, he would not have recognised a remedial constructive trust because proprietary rights should be varied only by statute.[22]

But the real concern about the recognition of the remedial constructive trust is fundamentally that the law needs clear and predictable rules as to whether or not equitable proprietary rights have

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16. But the Supreme Court in *FHR*, *supra* note 2, did create a new property right in the secret commission in circumstances where that right had not existed previously. See further Part III.B.3, below.
17. Neuberger, *supra* note 15 at para 6.
18. *Polly Peck*, *supra* note 9.
19. See also, *Cobbold v Bakewell Management Ltd*, [2003] EWHC 2289 (Ch) at para 17, per Rimer J; *Re Farepak Food and Gifts Ltd*, [2006] EWHC 3272 (Ch) at para 38, per Mann J; *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*, [2011] EWCA Civ 347 at para 37, per Lord Neuberger MR.
20. (UK), c 45.
21. *Polly Peck*, *supra* note 9 at 827.
22. *Polly Peck*, *supra* note 9 at 830.

been created, and the remedial constructive trust is antithetical to such clarity and predictability,[23] being perceived to involve unrestrained judicial discretion. Professor Peter Birks was especially strongly opposed to its recognition for that reason. He said:

> [t]he law of remedies is not exempt from the demands of certainty and predictability: nor is the law as a whole intellectually respectable if, even at the level of remedies, it takes refuge in an inscrutable case to case empiricism. Practising lawyers need to be able to advise their clients as to the likely results of litigation. The judges on whom these results depend need the insulation from personal criticism which only objectively ascertainable rules and principles can provide.[24]

He also described the remedial constructive trust as a remedy that is "ugly, repugnant alike to legal certainty, the sanctity of property and the rule of law".[25] Despite this, there have still been calls for the recognition of the remedial constructive trust in England. In *London Allied Holdings Ltd v Lee*,[26] Justice Etherton suggested that *Polly Peck* was concerned only with the recognition of the remedial constructive trust where the defendant was insolvent, and Lord Justice Mummery and Lord Justice Potter in *Polly Peck* did indeed focus on that particular context. Justice Etherton considered that the way was therefore clear for the recognition of such a trust where the defendant was solvent and suggested that the judiciary should have a discretion to fashion such a remedy, by analogy with the discretion to fashion the remedy in respect of proprietary estoppel. He concluded that:

> … there still seems scope for real debate about a model more suited to English jurisprudence, borrowing from proprietary estoppel: namely, a constructive trust by way of discretionary restitutionary relief, the right to which is a mere equity prior to judgment, but which will have priority over the intervening

23. Peter Millett, "Equity: The Road Ahead" (1995) 9:2 Trust Law International 35 at 42.
24. Peter Birks, "The Remedies for Abuse of Confidential Information" (1990) 4 Lloyd's Maritime and Commercial Law Quarterly 460 at 465.
25. Peter Birks, "Property and Unjust Enrichment: Categorical Truths" (1997) 1997:5 New Zealand Law Review 623 at 641. See also, Peter Millett, "Equity's Place in the Law of Commerce" (1990) 114:2 Law Quarterly Review 214.
26. [2007] EWHC 2061 (Ch).

> rights of third parties on established principles … [27]

This reflects the remedial constructive trust as it operates in Canada. But such a debate appears now to be terminated in England by the apparently clear decision of the Supreme Court in *FHR*.

But, if the real concern about the recognition of the remedial constructive trust is that it would undermine the certainty of the law by introducing unacceptable judicial discretion, it is necessary to be much more precise in our analysis of what discretion means for these purposes and what the real concern is. In an important and helpful analysis, HLA Hart[28] argued that discretion is fundamentally different from arbitrary choice: discretion by its nature is guided by rational principles, so that a decision which is not susceptible to principled justification is not an exercise of discretion at all but simply an arbitrary choice. Consequently, if the remedial constructive trust is to be defended, the determination of whether the trust should be recognised and how it should operate must be determined with reference to recognised principles, for otherwise the judicial decision will not involve the exercise of discretion, but will simply depend on the whim of the judge; it is such an arbitrary choice which should be considered to be contrary to the rule of law. If principles can be identified for the exercise of the judge's decision, that decision can be defended as involving the legitimate exercise of judicial discretion. The key question will then be what principles, or reasons of

27. *Ibid* at para 274. See also, *Thorner v Major,* [2009] UKHL 18 at para 20 (in which Lord Scott indicated that the remedial constructive trust should be used where the defendant has represented that the claimant would receive property in the future, for example in the defendant's will, in reliance on which the claimant acted to his or her detriment. This is presently dealt with through the doctrine of proprietary estoppel) [*Thorner*].
28. HLA Hart, "Discretion" (Essay delivered at the Legal Philosophy Discussion Group at Harvard Law School, 19 November 1956)(2013) 127 Harvard Law Review 652 at 665.

general application,[29] might be identified to determine when a remedial constructive trust should be recognised. If it is not possible to do so, the remedial constructive trust project is doomed to failure.

There is a further difficulty with the recognition of the remedial constructive trust in England, which is that the award of such a remedy must be triggered by a cause of action. What would that cause of action be? It could be equitable wrongdoing, such as breach of trust or breach of fiduciary duty, but, following the decision in *FHR*, the constructive trust that is recognised where there is a breach of fiduciary duty is institutional in form, so there is no scope for the remedial constructive trust to operate. Similarly, where the defendant has obtained an asset from the claimant in circumstances where the defendant knows or suspects that the claimant's intention to transfer the asset has been vitiated or is absent, the defendant's unconscionable retention of that asset will trigger an institutional, rather than a remedial, constructive trust.[30] The remedial constructive trust might be considered to be an appropriate response to the defendant's unjust enrichment, and this has been recognised as the relevant cause of action in Canada.[31] But, at least in England, the fact that the defendant has been unjustly enriched at the claimant's expense is not a sufficient reason to recognise an equitable proprietary interest; the claimant should instead be confined to a personal remedy against the defendant. Something more is needed to justify the creation of an equitable proprietary interest.[32] A remedy without a cause of action is meaningless and, if such a cause of action cannot be identified, the remedial constructive trust cannot be recognised either.

So, if the remedial constructive trust is ever to be recognised in England, and if the Australian and Canadian adoption of the remedial

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29. John Gardner, "Ashworth on Principles" in Julian Roberts and Lucia Zedner (eds), *Principles and Values in Criminal Law and Criminal Justice: Essays in Honour of Andrew Ashworth* (Oxford: Oxford University Press, 2012) 3 at 8.
30. *Westdeutsche*, *supra* note 7.
31. See *Becker*, *supra* note 6; *Soulos*, *supra* note 6; and *Kerr*, *supra* note 6.
32. See Graham Virgo, *The Principles of the Law of Restitution*, 3d (Oxford: Oxford University Press, 2015) at 559-67.

constructive trust is to be justified, it will be necessary both to identify an underlying cause of action and clear principles which enable the judge to exercise a legitimate discretion rather than make an arbitrary choice. Both objectives can in fact be achieved by adopting a different model which involves the recognition of a hybrid, or modified, constructive trust.

IV. The Modified Constructive Trust

In England, Australia and Canada we have got caught up in a sterile debate about the constructive trust where there are two camps, institutional versus remedial. It is now time to ditch the intemperate language and the lazy characterisation and acknowledge that there is just one constructive trust, which should preferably be treated as a response to unconscionability.[33] Indeed, as Justice Deane said in *Muschinski v Dodds* "for the student of equity, there can be no true dichotomy between the two notions".[34]

Now there are certainly examples in Australia[35] and Canada[36] of judges interpreting the constructive trust in a purely remedial sense and without reference to any obvious principles. There certainly appears to be a greater willingness amongst the Australian and Canadian judiciary to embrace creative judicial decision-making with reference to the justice of the case, whereas the English judge is generally more likely to emphasise the need for certainty. This might in part be due to different commercial cultures in the different jurisdictions. The English court, especially the Commercial and also the Chancery courts, are centres for dispute resolution of international significance. Commercial players are perhaps

33. Which might even be considered to underpin the Canadian construction of unjust enrichment.

34. *Muschinski*, *supra* note 5 at para 7, per Deane J.

35. See especially Finn J in *Grimaldi*, *supra* note 5 at para 569.

36. In *Becker*, *supra* note 6 (where Laskin J described the remedial constructive trust as " … a broad and flexible equitable tool" used "… to determine beneficial entitlement [to property]" at 843-44). See also *Soulos*, *supra* note 6 (where McLachlin J, as she then was, emphasised that the equitable remedy was flexible and turned on "what is just in all the circumstances of the case" at para 34).

more likely to select the English jurisdiction and choose English law because of a desire for predictability and certainty. The Australian and Canadian courts and judges might be less concerned about the need to attract business to their courts.

But even so, when the Australian and Canadian cases are examined there are plenty of examples of principled reasoning. For example, Justice McMillan recognised that "[u]nstructured judicial discretion … has no place in the law of constructive trusts in Australia".[37] In Canada the remedial constructive trust has explicitly restitutionary principles to guide the exercise of judicial discretion. And Deane J in *Muschinski v Dodds* emphasised that:

> [t]he fact that the constructive trust remains predominantly remedial does not, however, mean that it represents a medium for the indulgence of idiosyncratic notions of fairness and justice. As an equitable remedy, it is available only when warranted by established equitable principles or by the legitimate processes of legal reasoning, by analogy, induction and deduction, from the starting point of a proper understanding of the conceptual foundation of such principles … proprietary rights fall to be governed by principles of law and not by some mix of judicial discretion, subjective views about which party "ought to win" … and "the formless void of individual moral opinion" …[38]

In fact, *Muschinski v Dodds* might be considered to be one of the worst examples in Australian jurisprudence of remedial discretion. The case concerned a cohabiting couple who held the home they had purchased and developed as tenants in common in proportion to their contribution to it by means of a constructive trust, but this trust was only imposed at the time when the reasons of the court were published. Justice Finn has described this as an "astounding proposition".[39] In some other Australian cases the remedial nature of the constructive trust has been expressed with reference to the importance of only recognising the trust if there are no other appropriate remedies available.[40] This itself is concerning, even though it purports to be principled, because it appears that there is no

37. *State Trustees Ltd v Edwards*, [2014] VSC 392 (Austl) at para 143.
38. *Muschinski*, *supra* note 5 at paras 8-9, per Deane J.
39. *Grimaldi*, *supra* note 5 at para 569.
40. *Bathurst City Council v PWC Properties Pty Ltd* (1998), 195 CLR 566 (HCA) at 585; *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd*, [2010] HCA 19 at paras 37, 128.

proprietary interest until the court creates one at the time of trial having considered what other remedies might be appropriate. It would be more apposite to acknowledge that the constructive trust exists automatically at the time of the relevant triggering event, but the claimant might not be allowed to vindicate his or her equitable right because an alternative remedy would be more appropriate. Consequently, the constructive trust which already exists could be modified if other judicial orders are capable of doing full justice.

Even in England, where the constructive trust is characterised as absolutely institutional with no apparent role for the exercise of judicial discretion to modify its operation, such characterisation does not reflect the actual operation of the constructive trust. There are many significant examples of cases where the recognition or the operation of the constructive trust depends on the exercise of judicial discretion. First, where the elements of proprietary estoppel are satisfied, the claimant's rights might be vindicated by recognising that the defendant holds property on a constructive trust.[41] Secondly, in *Boardman v Phipps*,[42] fiduciaries who profited from breaching their fiduciary duty were found to hold their profit on constructive trust for the principal. But this trust was modified in respect of one of them, who was awarded an equitable allowance to reflect the value of his work in making the profit. Thirdly, if a situation arose where a fiduciary had made a profit in breach of fiduciary duty and that profit would continue to accrue over a period of time as the result of the fiduciary's continued work, surely the court would modify the constructive trust in some way, such as to limit it to the profits obtained over a restricted period of time.[43]

Finally, in England the problem of identifying beneficial interests in a house occupied by a cohabiting couple as the family home has

41. *Thorner*, *supra* note 27.
42. [1967] 2 AC 46 (HL).
43. As in the Australian case of *Warman International Ltd v Dwyer*, (1995) 182 CLR 544 (HCA).

been dealt with through the common intention constructive trust.[44] This is an apparently institutional trust which does not respond to unconscionability, but instead is triggered by reference to the express, implied, or imputed intention of the parties as to whether they have a beneficial interest in the property and, if so, what the extent of that interest might be. As the jurisprudence relating to the common intention constructive trust has developed,[45] a structured approach has been adopted involving presumptions which are rebuttable by reference to the parties' common intention. So, where the property is registered in the name of one party, it will be presumed that the other does not have a beneficial interest in it. This can be rebutted by the other party showing that there was a common intention that he or she would have a beneficial interest in the property and, having done so, what proportion of the beneficial interest is appropriate.[46] In *Jones v Kernott*[47] the majority accepted that imputation of common intent was appropriate where it was clear that the parties intended to share the beneficial interest but it was not possible to determine any agreement as to the proportions in which the interest was to be shared.[48] This does not involve proving an actual intent shared by the parties, but involves the attribution of an intention that they might not have shared, but which the court considers they would have agreed had they thought about the allocation of the beneficial interest. Where imputation of an intention is required, the court must consider what is "fair having regard to the whole course of dealing" in respect of the property, with reference to the claimant's financial and non-financial contribution to the property.[49] It is at this point that the proof of a common intention could disintegrate into a

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44. This has replaced the resulting trust as the means of dealing with the proprietary consequences of a relationship breakdown where the couple is unmarried.
45. Notably through the decision of the House of Lords in *Stack v Dowden*, [2007] UKHL 17 and *Jones v Kernott*, [2011] UKSC 53 [*Jones*].
46. *Ibid*.
47. *Jones*, *supra* note 45.
48. *Ibid*, at para 31, per Lady Hale and Lord Walker.
49. *Ibid*, at para 51 (see number (4)), per Lady Hale and Lord Walker, and at para 64, per Lord Collins.

determination of an allocation of the beneficial interest that the court considers to be fair. Indeed, Etherton J has said that "there is now a hair's breadth between the [common intention constructive trust] … and a remedial constructive trust".[50] The nature of the common intention constructive trust is controversial, but, whilst in form it appears to be institutional, in reality there is scope for modification of it with reference to what the court considers to be the just result.

It follows that, even in England, the institutional constructive trust is not as rigid as it is often perceived to be. This should give the English court confidence to develop a new model of constructive trust which is principled but also flexible, without recourse to arbitrary choice. This model builds on the orthodox institutional constructive trust, but this trust should, however, be capable of modification in the exercise of judicial discretion, but itself in a principled and not an arbitrary way. The legitimacy of this model of trust depends on the identification of appropriate principles both as regards the identification of when the constructive trust should be recognised and when it should be modified.

A. Recognition of the Institutional Constructive Trust

The most important principle underpinning the constructive trust, at least in England and Australia, is that of unconscionability,[51] which appears to require consideration of the defendant's conduct and so is fault-based. Fault in equity is typically determined objectively, albeit assessed with reference to the defendant's knowledge or suspicion about the relevant facts.[52] That standard is appropriate to justify the imposition of personal liability, such as where the defendant is liable for receipt of property transferred in breach of trust or dishonestly assisting a breach of trust or breach of fiduciary duty. But something more should be needed for the recognition of proprietary rights in equity, which is why

50. Sir Terence Etherton, "Constructive Trusts and Proprietary Estoppel: The Search for Clarity and Principle" (2009) 2 The Conveyancer and Property Lawyer 104 at 125.

51. *De Bruyne v De Bruyne*, [2010] EWCA Civ 519 at para 49, per Patten LJ.

52. This is sometimes described as "dishonesty". See *Williams v Central Bank of Nigeria*, [2014] UKSC 10 at para 64, per Lord Neuberger.

subjective unconscionability should be the standard for the recognition of the constructive trust. This should not be the absolute standard, however, since there will be circumstances where an objective test of unconscionability can be justified, especially where a fiduciary is liable for breach of duty, because of the high standard of conduct expected of fiduciaries. That would be consistent with what Hayton has called the "good person" philosophy, namely that fiduciaries are expected to act as good people for the benefit of their principals.[53] For that reason we can justifiably deem a fiduciary to have acted unconscionably where he or she acted in breach of fiduciary duty, which would be sufficient to recognise a constructive trust.[54]

Why should the defendant's fault be relevant to create a proprietary interest? This can be justified because a defendant who can be considered to have acted unconscionably should be deprived of all benefits arising from their unconscionable conduct; the claimant's claim to the assets is stronger than that of the defendant; the defendant should have his or her conscience purged by disgorging all benefits obtained from the unconscionable conduct; and all those claiming through the defendant should likewise have their conscience purged from all possible unconscionability. Of course, these justifications become progressively more absurd and unconvincing, but that is why the constructive trust should not be absolute but should be capable of modification, with the type and extent of unconscionability of the defendant or a third party being a key factor to be taken into account.

B. Modification of the Constructive Trust

Once it is accepted that the constructive trust which has arisen by operation of law by virtue of the defendant's unconscionable conduct might be modified, it is important to consider when such modification might be justified. In assessing this, the three key implications of recognising proprietary interests in equity need to be borne in mind, namely: (i)

53. David Hayton, "The Development of Equity and the 'Good Person' Philosophy in Common Law Systems" (2012) 4 The Conveyancer and Property Lawyer 263 at 272.

54. See further Part III.B.3, below.

priority over unsecured creditors when the defendant is insolvent; (ii) obtaining the benefit of increase in the value of the property held on constructive trust; and (iii) recovery of the property, or its identifiable substitute, from a third party, even if he or she was unaware of the circumstances which triggered the constructive trust in the first place. It is important to consider whether each of these proprietary advantages is justifiable in each case.

Determining when and how the institutional constructive trust might be modified can be assessed by reference to three of the very difficult cases for the contemporary constructive trust. In each case it will be necessary to consider how the institutional constructive trust arises and whether the three advantages of having an equitable proprietary interest can be justified in the light of the state of the defendant's conscience or the conscience of a third party recipient.

1. Theft

It is recognised in both Australia[55] and in England[56] that a thief holds stolen assets on a constructive trust for the victim. This can be justified on the ground that, although the victim will typically have retained legal title to the stolen asset, the thief's conduct in committing theft constitutes unconscionable conduct and this is sufficient justification for the thief to hold possessory title on constructive trust for the victim.[57] Equity sees the fault and, from a desire to purge the defendant's conscience, will deprive the defendant of all benefits. But should this constructive trust ever be modified?

First, if the thief has become insolvent, should his or her creditors be able to assert a claim against the stolen assets in priority to the claim of

55. *Black v S Freedman and Co* (1910), 12 CLR 105 (HCA).

56. *Westdeutsche*, *supra* note 7.

57. *Armstrong DLW GMBH v Winnington Networks Ltd*, [2012] EWHC 10 (Ch) at paras 277-78 [*Winnington Networks*], per Stephen Morris QC. See John Tarrant, "Property Rights to Stolen Money" (2005) 32:2 University of Western Australia Law Review 234 at 245; John Tarrant, "Thieves as Trustees: in Defence of the Theft Principle" (2009) 3 Journal of Equity 170 at 172.

the victim? Since the stolen property never legitimately formed part of the thief's pool of assets, there is no reason why the creditors of the thief should gain priority over the victim, so the constructive trust should not be modified for this reason.

Secondly, if the stolen asset has increased in value there is no reason why the victim of the theft should be deprived of the benefit of this increase either, since the thief should not profit from his or her crime in any way. Consequently, the constructive trust should not be modified to enable the thief to keep the benefits of the increase in value. Even if, for example, money has been invested or used to buy a national lottery ticket which has won a jackpot, all these profits, whether obtained directly or indirectly, should be considered to be the proceeds of the crime and should be held on the constructive trust, such is the extent of the defendant's unconscionable conduct in stealing in the first place.

Finally, should innocent third parties who subsequently obtained possession of the stolen asset or its identifiable substitute be allowed to keep the asset, or must they give it up to the victim of the theft? It appears to be a vital consequence of the stolen asset being held on constructive trust that, if the asset is received and retained by a third party, it continues to be held on constructive trust for the victim of the theft, regardless of the fact that the third party was unaware of the circumstances of the theft so that their conscience cannot be considered to have been tainted in any way. This position is, however, qualified in two situations. First, if the third party recipient of the stolen property or its traceable substitute had provided value and acted in good faith, the victim's equitable proprietary claim will be defeated. Secondly, if the third party received but did not retain the stolen asset, he or she will be personally liable for the value of the asset but only if he or she should have been aware that it had been held on constructive trust, in the light of the facts known or suspected by the defendant. It follows that, where the third party did not provide value for what had been received and has retained the stolen asset or its traceable substitute, that asset will still be held on constructive trust so that the victim's equitable proprietary right will defeat the third party's possessory right. But, whilst this appears to be a fundamental principle of equitable proprietary rights, is it defensible? Where the third party

recipient of the stolen asset is unaware of its provenance, such that the third party's conscience is not tainted in any way by the theft, why should the victim's equitable proprietary right prevail? Would it not be preferable to conclude that, as between the two innocent parties, their claim should be at least as good, and possibly the third party's claim even better than that of the victim of the theft? There was even an indication in a recent decision of the English Court of Appeal which is consistent with such an approach. In *Relfo Ltd v Varsani*[58] Arden LJ stated that money or its substitute could be recovered from a third party where the money was stolen by the fiduciary, if the money or its substitute was *knowingly* received by the third party. Whilst she did not elaborate on the significance of knowledge, and she might have been meaning to refer to a personal claim for knowing receipt, her dictum might be considered to reflect the fact that, absent knowledge, the recipient's conscience would not have been affected such that the constructive trust should be treated as terminated, with the victim of the theft confined to a personal claim against the thief.

It follows that the constructive trust of stolen property should not be modified to benefit creditors of the thief or the thief him or herself, but there might be a case to treat the constructive trust as revoked once the asset has been received by an innocent third party, albeit that he or she had not provided value for the receipt.

2. Mistaken Payment

Where the claimant has paid money to the defendant as a result of a mistaken belief that the claimant was liable to pay the money, the defendant will be personally liable to the claimant to restore the amount of money paid by virtue of a claim in unjust enrichment. Legal title in the money will typically pass, so that it belongs to the defendant. Some cases in Australia,[59] Singapore[60] and in England[61] recognise that, if the

58. [2014] EWCA Civ 360 at para 1.
59. *Wambo Coal Co Pty Ltd v Ariff*, [2007] NSWSC 589 (Austl).
60. *Wee Chiaw Sek Anna v Ng Li*, [2013] SGCA 36 at paras 169-84.
61. *Westdeutsche*, *supra* note 7 at 709, per Lord Browne-Wilkinson and *Winnington Networks*, *supra* note 57.

defendant knew of the mistake and failed to repay, the property will be held on constructive trust. The failure of the defendant to repay the money when he or she knew of the mistake constitutes unconscionable conduct which triggers the institutional constructive trust by operation of law. Crucially, at least in Australia and England, this trust is not triggered by the defendant's unjust enrichment. In England, establishing the elements of the unjust enrichment claim will simply enable the mistaken payer to bring a personal claim against the recipient, this being a strict liability claim which can be established even if the defendant was unaware that the money had been paid by mistake. To establish an equitable proprietary claim to the money paid by mistake, fault needs to be proved by showing that the defendant knew that the money had been paid by mistake, for then the defendant's conscience will have been tainted. But will there ever be any circumstances where the proprietary implications of this constructive trust should be modified?

First, if the defendant has become insolvent, there is no reason why the defendant's creditors should have a better claim to the money held on trust than the claimant. Since the money has been received from the claimant it should be restored to the claimant. If the defendant's receipt is unconscionable an equitable proprietary interest should be recognised. By virtue of the analogy with theft, there is no reason why the creditors of the defendant should obtain any advantage over the claimant.

Secondly, the defendant should not be allowed to benefit from any gain arising from retention of the money paid by mistake, save where that gain cannot be causatively linked to the receipt. So, if the asset is invested and increases in value, the defendant should hold that increase on constructive trust. But, if the defendant used the money paid by mistake to buy a lottery ticket which wins the jackpot, to determine whether that jackpot is held on constructive trust should depend on whether it can be shown that, but for the receipt of the money paid by mistake, the defendant would not have bought the ticket. If the defendant would have bought the ticket anyway, and used the mistaken payment by chance, this would be an appropriate reason to modify the constructive trust so that the jackpot is not held on trust. If the defendant did not rely on the receipt to buy the ticket, there is no reason why the claimant should have

a proprietary claim to the jackpot.

Finally, should the equitable proprietary right of the claimant be defeated by the innocent receipt of a third party who has not provided value for the property? Whilst the law assumes that the claimant should have a proprietary claim against such a third party recipient,[62] this is difficult to defend. The claimant should be confined to a personal claim in unjust enrichment against the direct recipient of the mistaken payment, who has not retained that payment or its traceable substitute, and not have a proprietary claim against an innocent third party recipient, at least where the only reason why the equitable proprietary right was created was because of the defendant's unconscionable retention. If the third party's receipt cannot similarly be characterised as unconscionable, there is no reason why the claimant should have a proprietary claim against that recipient.

3. Gains obtained in breach of fiduciary duty

Where a fiduciary has profited from breach of his or her fiduciary duty it has been a matter of some controversy as to when these profits should be held on constructive trust for the principal.

Where the fiduciary has misappropriated an asset from the principal, it has long been recognised that the asset will be held on constructive trust for the principal.[63] This includes where the fiduciary has obtained a bribe or a secret commission and it can be shown that this was derived from money which was paid by the principal to the fiduciary.[64] The recognition of a constructive trust in such circumstances is defensible because the profits made by the defendant can be considered to represent the fruits of the claimant's property. Consequently, it is entirely appropriate that the claimant should have an equitable proprietary interest in those profits. In addition, it is justifiable that the fiduciary should hold property on constructive trust where the consequence of the breach of duty is that

62. *Re Diplock's Estate*, [1948] Ch 465 (CA (Eng)) at 539.

63. See *Primlake Ltd v Matthews Associates*, [2006] EWHC 1227 (Ch) at para 334, per Collins J.

64. *Daraydan Holdings Ltd v Solland International Ltd*, [2004] EWHC 622 (Ch) at paras 60, 87-88 [*Daraydan Holdings*].

the fiduciary obtains property which the principal would have obtained had the defendant not breached his or her duty. Goode has described the property which the defendant obtains in such circumstances as a "deemed agency gain",[65] which should be held on constructive trust for the principal simply because the demands of the fiduciary relationship are such that it should be assumed that the defendant obtained the property for his or her principal rather than for him or herself. This is illustrated by *Cook v Deeks*,[66] where the directors of the claimant company were negotiating a contract with a third party on behalf of the company. Rather than signing the contract on behalf of the company some of the directors signed it on behalf of themselves. It was held that the directors were liable for a breach of fiduciary duty and held the profits they had made on constructive trust for the company. This can be justified because, had the defendants not breached their duty, the company would have obtained the contract, so the defendants' gain could be presumed to have been made on behalf of the company.

The most controversial issue arises where the fiduciary has obtained a benefit from a third party rather than misappropriating the principal's property or depriving the principal of the opportunity to make a profit. This has proved to be particularly controversial where the fiduciary has received a bribe or a secret commission from a third party. In such circumstances the profit cannot be considered to have derived from the principal. Consequently, the orthodox view has been that only the personal remedy of an account of profits was available, and not a proprietary constructive trust. The leading English case was *Lister & Co v Stubbs*[67] in which the defendant was employed by the claimant company to purchase supplies for the claimant firm. He bought goods from another company, having received secret commissions of over £5,000 to induce him to place

65. Roy Goode, "Property and Unjust Enrichment" in Andrew Burrows, ed, *Essays on the Law of Restitution* (Oxford: Clarendon Press, 1991) 215 at 230.

66. [1916] 1 AC 554 (PC (Canada)); see also, *Keech v Sandford* (1726), Sel Cas Ch 61 (Eng).

67. (1890) 45 Ch D 1 (CA (Eng)). See also, *Metropolitan Bank v Heiron* (1880), 5 Ex D 319 (CA (Eng)).

orders with that company. The defendant invested this money in land. It was held that the bribes did not belong to the claimant, for otherwise the claimant would have priority over the defendant's unsecured creditors if the defendant were to become insolvent, and, if the bribes were invested in property that increased in value, the claimant would get the benefit of that increase in value. Neither of these conclusions was considered to be appropriate. The relationship between the parties was consequently not one of trustee and beneficiary, but was simply one of debtor and creditor

This was, however, rejected by the Supreme Court in *FHR*.[68] It was held that, wherever a fiduciary is liable to account for profits made as a result of a breach of fiduciary duty, they will be held on constructive trust for the principal, even though they did not derive from interference with the principal's property or from the exploitation of an opportunity which should have been exploited for the principal. Consequently, wherever a fiduciary receives a bribe or secret commission in breach of fiduciary duty, the money will be held on constructive trust. The decision in *Lister & Co v Stubbs* was also overruled. The constructive trust recognised by the Supreme Court is an institutional constructive trust and is justified because the fiduciary is treated as though he or she had acquired the bribe or secret commission on behalf of the principal,[69] who therefore has an equitable proprietary interest in it. This involves the creation of equitable rights in property which did not exist before.

The decision of the Supreme Court in *FHR* does at least resolve a long-standing controversy as to the role of the constructive trust where the fiduciary has profited from breach of his or her fiduciary duty. The real difficulty with *FHR* relates to the Supreme Court's emphasis that the constructive trust was institutional, arising by operation of law, rather than remedial. But might there be circumstances where the proprietary consequences of this constructive trust could be modified?

First, if the defendant fiduciary has become insolvent, should the principal have priority over the defendant's unsecured creditors? This can be easily justified where the fiduciary has misappropriated the principal's

68. *FHR*, *supra* note 2.

69. *Ibid* at para 7, per Lord Neuberger.

property, since it is not appropriate for the principal's existing proprietary rights to be subject to the claims of the defendant's creditors. In such circumstances the restoration of the principal's property effects corrective justice. It would also be appropriate to reach such a conclusion where the profit would have been made by the principal had the defendant not breached his or her fiduciary duty. This too can be considered to correct an injustice, by restoring to the principal what he or she had lost as a result of the breach of fiduciary duty. But, should the principal be accorded such priority where the profit was obtained from a third party and would not have been obtained by the principal had the defendant not breached his or her fiduciary duty, such as where the defendant has obtained a bribe or a secret commission from a third party? Lord Millett[70] has argued that the principal should gain priority in such circumstances, because the fiduciary's creditors claim through the fiduciary and should have no better claim to property to which they are not entitled. In *Grimaldi v Chameleon Mining NL (No 2)*,[71] however, Finn J said that the bribe should be held on constructive trust but, if the fiduciary was bankrupt, he considered that a lien would be sufficient to ensure practical justice. This was obiter and is, frankly, an odd distinction to draw. Even if a lien was awarded, the principal would still have priority over the fiduciary's creditors by virtue of the security interest, but would not obtain the fruits of the bribe, and it is difficult to see why the fact of the fiduciary's insolvency should prevent the principal from claiming all the fiduciary's profits. It is true that this would mean that those profits would be available to the fiduciary's creditors, but this would be a blunt instrument for effecting such a result. The judgment of Finn J does, however, indicate a willingness to modify the constructive trust where the fiduciary was insolvent.

The possibility of such modification was even canvased in *FHR*.[72] In a very significant dictum the Supreme Court recognised that concern about the position of unsecured creditors of the defendant fiduciary will

70. Peter Millett, "Bribes and Secret Commissions Again" (2012) 71:3 Cambridge Law Journal 583.
71. *Grimaldi*, *supra* note 5 at para 583.
72. *FHR*, *supra* note 2 at para 43.

have considerable force in some contexts, although it was considered only to have limited force in the context of bribes and secret commissions. The Court did not elaborate beyond this and it is unclear why the position of unsecured creditors might matter more in some contexts, such as where the fiduciary's profit took the form of bribes or secret commissions. But, acknowledging that the position of the unsecured creditors of the fiduciary might need to be considered in some cases is very important. It suggests a willingness of the English court to recognise the existence of an institutional constructive trust, but to modify its effects to ensure that the relative positions of the principal and unsecured creditors are treated equally.

Such modification of the constructive trust is especially appropriate where the fiduciary's profit was obtained from a third party in the form of a bribe or secret commission. This is because the rationale behind imposing liability on the defendant fiduciary in such circumstances is different from other situations where a profit is made. Where the fiduciary has profited by appropriating property from the principal, the fiduciary is liable to make restitution of that property or its value to the principal; this is justified as effecting corrective justice. Where, however, the defendant fiduciary's profit derived from a third party, requiring the defendant to disgorge that profit to the principal is not justified by correcting injustice through restoring to the principal what he or she has lost, since the principal has not lost anything. Rather, the imposition of liability on the fiduciary effects distributive justice, by ensuring that the fiduciary is deprived of the gain.[73] Since the focus of equity's response is on the defendant's gain rather than reversing loss, there is no reason why the principal's proprietary claim should rank above the claims of the defendant's unsecured creditors. The principal should simply be regarded as any other unsecured creditor, whose claim should rank equally with those of all the defendant's creditors. It follows that the advantage of the constructive trust of obtaining priority over other creditors should be

73. Katy Barnett, "Distributive Justice and Proprietary Remedies Over Bribes" (2015) 35:2 Legal Studies 302. See also, Matthew Harding, "Constructive Trusts and Distributive Justice" in Elise Brant and Michael Bryan, eds, *Principles of Proprietary Remedies* (Sydney: Lawbook Co, 2013) 211.

modified where the fiduciary's profits derive from a third party. Indeed, rather than being a scenario where, as the Supreme Court suggested, modifying the constructive trust is less defensible, this is a situation where modification of the proprietary consequences of the constructive trust is much easier to justify. This focus on the distinction between effecting corrective and distributive justice must, however, be treated with some caution where the relevant profit obtained in breach of fiduciary duty is a bribe or secret commission. This is because there will be circumstances where the bribe or secret commission does reflect a loss suffered by the principal, such as where the fiduciary has induced the principal to enter into a transaction where the price paid by the principal was inflated to reflect the amount of the bribe or the secret commission received by the defendant.[74] But, where the principal has not suffered loss, there is much greater scope for modifying priority as between the principal and creditors of the fiduciary.

Secondly, where the defendant has profited from the investment of the profit made in breach of fiduciary duty, he or she should not benefit from this indirect profit, so the institutional constructive trust should not be modified to exclude such profits because of the strict nature of fiduciary duties. So, for example, in *Attorney-General for Hong Kong v Reid*[75] ("*Reid*") the defendant fiduciary held a number of public offices in Hong Kong, including that of acting Director of Public Prosecutions. He had accepted bribes to induce him to obstruct the prosecution of some criminals. He purchased land in New Zealand with this money and the claimant claimed that it had an equitable proprietary interest in this land. The Privy Council agreed and ordered that the land was held by the defendant on constructive trust for the claimant. This must be right. Fiduciary duties are strictly interpreted and enforced to ensure that the fiduciary complies with the strictest standards of loyalty and is not tempted to act against the principal's interests.

Finally, should the equitable proprietary rights of the principal be defeated if the profit which is held on constructive trust has been

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74. *Daraydan Holdings*, *supra* note 64.
75. [1994] 1 AC 324 (PC (NZ)) [*Reid*].

transferred to an innocent third party who had not provided value for its receipt? Again, where the asset which is held on constructive trust has been appropriated from the principal, or would have been obtained by the principal had the fiduciary not intervened, the proprietary claim of the principal should prevail against all recipients. But this is much more difficult to justify where the profits derived from a third party rather than the principal. In such circumstances it would be appropriate to modify the institutional constructive trust so that the principal and third party volunteer share the property equally. Indeed, in *FHR*[76] Lord Neuberger indicated that bribe money held on constructive trust by a fiduciary could be claimed from a *knowing* recipient, suggesting that an innocent recipient might not be liable to disgorge it to the principal. Where, however, the third party's receipt and retention[77] can be considered to be unconscionable, because they knew or suspected that the fiduciary had obtained the profit in breach of fiduciary duty, it is appropriate to enable the principal to assert his or her equitable proprietary rights against the third party, whose conscience has been tainted. So, for example, in *Reid*[78] assets were transferred to the fiduciary's wife and his solicitor who appear to have been aware that they had been purchased with bribe money. In such circumstances it is appropriate that the proprietary claim of the principal should prevail over such recipients whose consciences have been tainted by their knowledge of the breach of duty. But, as English law stands, the principal has a proprietary claim against the third party recipient who has received and retained the property or its substitute which was held on constructive trust, regardless of the recipient's ignorance of the breach of fiduciary duty. This is an unfortunate consequence of the recognition of the institutional constructive trust, which could be avoided if there

76. *FHR*, *supra* note 2 at para 44.

77. Where the third party has received but not retained the property in which the principal has an equitable proprietary interest, the third party will only be personally liable to the principal for the value of the property received if he or she should have realised that the property had been transferred in breach of fiduciary duty, in the light of the facts known by the third party.

78. *Reid*, *supra* note 75.

was greater willingness to modify the proprietary impact of such a trust.

V. Conclusions

The appropriate model of the constructive trust in England, but, it is submitted, in Canada and Australia as well, is one where the trust arises by operation of law, and preferably where the defendant's receipt or retention of property is characterised as unconscionable, whether actual or deemed. This trust can be modified with reference to recognised principles, such that the proprietary nature of the trust might sometimes be defeasible, especially where innocent third parties have received the property which has been held on trust.

Whilst this modified constructive trust model has not yet been recognised in English law, its recognition is not necessarily inconsistent with authority, including the decision of the Supreme Court in *FHR* itself. Crucially, the recognition of a modified constructive trust would assuage some of Lord Neuberger's judicial and extra-judicial concerns. This model of the constructive trust is not remedial in the sense that the judge creates equitable proprietary rights through the exercise of his or her discretion. Consequently, it should not be considered to subvert the statutory insolvency regime, for, what equity has created, equity can take away, as long as this is done on a principled basis. Indeed, the very creation of equitable proprietary rights by operation of judge-made law might be regarded as upsetting the statutory insolvency regime, but there are numerous examples of equity doing that. Modification of the institutional constructive trust is much less controversial than, for example, the *Quistclose* trust,[79] which clearly has the potential to subvert the statutory insolvency regime.

A key benefit of recognising the modified constructive trust is that it is possible to move on from the old debate about whether the institutional or the remedial constructive trust should be recognised. The modified constructive trust should be classified as institutional in origin but with scope for the judge to modify it on a principled basis.

79. *Barclays Bank Ltd v Quistclose Investments Ltd*, [1970] AC 567 (HL); *Twinsectra Ltd v Yardley*, [2002] UKHL 12.

This model of the constructive trust balances the need for certainty and predictability in the law, with the ability to achieve an equitable outcome on the facts of the case, something which the pure interpretation of the remedial constructive trust in Canada and Australia fails to do. The need for legal cultures to respect certainty and predictability was expressed powerfully by Llewellyn:

> unless the appellate courts consciously awaken to what their duty is in this regard ... they are threatened with loss of their own souls, and we are threatened with loss of the greatest asset of the common law. Every opinion must be directed forward, it must make sense and give guidance for tomorrow for the type of situation in hand. Only in the light of that are the equities and decencies of the particular case to be attended to, for in the working out of that forward-looking guidance two things occur: first, the authoritative material at hand to work with exercises its due restraint … and that gives a court firmness of heart and rock-solidity of work; second, no pressure of the particular case can readily mislead into sentimentality when all is judged against right guidance through the type of situation for the future … [80]

Ultimately the true role of the constructive trust in contemporary equity reflects a battle about the very nature of private law. There is a spectrum of approach. At one end is the pure logic of the law, founded on reason and principle and predictability; at the other, reflected in the approach of many judges, is the desire to reach the just result on the facts. The preferable approach falls somewhere between the two extremes. Discretionary justice is principled. In the same way as scientists having mapped the genome, which enables them to understand the nature of DNA, such that genetic modification becomes possible in a principled way, so too lawyers need to map the nature of the institutional constructive trust and, only having done so, start to engage with modification of that trust, but always with reference to clear and accepted principles.

80. Karl Llewellyn, *The Bramble Bush* (New York: Oxford University Press, 2008) at 15.

Modelling Subrogation as an "Equitable Remedy"

Stephen Watterson*

Following the landmark decision of the House of Lords in Banque Financière de la Cité v Parc (Battersea) Ltd, *the English courts have come to say that subrogation to extinguished rights is an "equitable remedy" designed to reverse "unjust enrichment". This creative re-rationalisation requires a fresh look at the nature and operation of this phenomenon, and in particular, at the key components of the "new" orthodoxy — that such subrogation is a "remedy", which is "equitable" in origin, and is "restitutionary" in aim and effect. A clear understanding of these components is not of merely academic interest. It is vital for a proper understanding of the nature and timing of the entitlements that are afforded to subrogation claimants, and of a court's role in their recognition and effectuation. On closer examination, the cases reveal an unacknowledged and unresolved tension between two different conceptions of the remedy's operation: (i) a "strong institutional model"; and (ii) a weaker institutional model, which is labelled the "liability model". Adopting either model, subrogation is not a drastically "remedial" phenomenon which yields entitlements for claimants only by virtue of some judicial order. Subrogation-justifying facts will immediately trigger some form of entitlement for a subrogation claimant, which arises prior to, and independently of, any subsequent court order. Nevertheless, the nature and quality of this pre-court entitlement, and the court's role in its recognition and effectuation, will differ depending on the model preferred. On balance, the liability model is the more defensible in principle. It should ultimately prevail.*

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I. Introduction

There is a substantial body of English authorities, encountered in various contexts, which exhibit the following general pattern: (i) C claimant has been responsible for discharging a liability owed by D debtor to X creditor; and (ii) subject to further conditions, C is said to be subrogated to X's rights against D, including any security that X held for D's debt. Often, C is a disappointed lender, who loaned money to finance a property purchase or to re-finance existing liabilities, and did not obtain the security for its advance that it bargained for. Alternatively, C is an unwitting victim of a misappropriation of funds, which are used without his authority to discharge another's liabilities. In yet other cases, C is a surety, or someone equivalently placed, who has paid the guaranteed debt and thereby discharged liabilities of the principal debtor and co-sureties.

At first sight, references to subrogation in this context can look puzzling. The most familiar species of subrogation, as encountered in the field of indemnity insurance, undoubtedly works differently: an

indemnity insurer, having indemnified its insured, is ordinarily entitled to bring proceedings, in the insured's name, to enforce the insured's *subsisting* rights against third parties. In the different cases that are presently in view, how can C be subrogated to the rights of X, the paid-off creditor, when, *ex hypothesi*, X's rights were *extinguished*? In English law, the modern answer to this puzzle has involved recognising that in this context, the language of subrogation is a "metaphor" rather than a "literal truth".[1] Although past cases sometimes spoke of X's rights being "kept alive" in equity for C's benefit,[2] C does not actually acquire X's rights, or the benefit of X's rights, by transfer or otherwise. X's rights are extinguished, and C acquires rights only to the extent that that has occurred.[3] In truth, what appears to be happening in these cases is that equity is affording new rights to C, which prima facie replicate X's extinguished rights.[4] Why? Since the House of Lords' landmark decision in *Banque Financière de la Cité v Parc (Battersea) Ltd*[5] ("*Banque Financière*"), the answer which the English courts have given is that equity affords such rights to C where that is appropriate to reverse the unjust enrichment that would otherwise accrue from the discharge of X's rights, to D and others, at C's expense. In short, this form of subrogation is said to be an "equitable remedy" directed at a very specific goal: it is a "restitutionary remedy" for "unjust

1. See especially *Banque Financière de la Cité v Parc (Battersea) Ltd*, [1999] 1 AC 221 (HL) at 236-37, per Lord Hoffmann [*Banque Financière*].
2. See *e.g. Chetwynd v Allen*, [1899] 1 Ch 353 (Eng) at 357 [*Chetwynd*]; *Butler v Rice*, [1910] 2 Ch 277 (Eng) at 282 [*Butler*]; *Ghana Commercial Bank v Chandiram*, [1960] AC 732 (PC (Ghana)) at 745 [*Chandiram*]; *Western Trust & Savings Ltd v Rock*, [1993] NPC 89 (CA (Civ)(Eng)) [*Western Trust*].
3. See especially *Boscawen v Bajwa*, [1996] 1 WLR 328 (CA (Civ)(Eng)) at 340, per Millett LJ [*Boscawen*]; *Banque Financière*, *supra* note 1 at 236.
4. See especially Charles Mitchell & Stephen Watterson, *Subrogation: Law and Practice* (Oxford: Oxford University Press, 2007) ch 8 [Mitchell & Watterson, *Subrogation*]; for explicit recent acceptance, see *Day v Tiuta International Ltd*, [2014] EWCA Civ 1246 at para 43 [*Tiuta*].
5. *Banque Financière*, *supra* note 1.

enrichment".[6]

The creative re-rationalisation of past decisions has not received unanimous approval. In particular, whilst several other common law jurisdictions appear receptive to the *Banque Financière* approach, Australian courts have rejected it.[7] There is no need to enter into that controversy. This article's ambition is different: to undertake a deeper, conceptual inquiry into the nature and operation of the subrogation remedy, as presently conceived by the English courts. This involves unpacking three key components of the post-*Banque Financière* orthodoxy: i.e. that subrogation is a "remedy", which is "equitable" in origin, and is "restitutionary" in aim and effect.

A clear understanding of these components is not of merely academic interest. It is essential for a proper understanding of the nature and timing of the entitlements afforded to subrogation claimants, and of the court's role in their recognition and effectuation. To anticipate this article's major conclusions, it will be argued that the cases that concern the restitutionary remedy of "subrogation to extinguished rights"[8] — hereafter, "*Banque Financière* subrogation" — exhibit an unacknowledged and unresolved tension between two different conceptions of the remedy's operation: (i) a "strong institutional model"; and (ii) a weaker institutional model, which will be labelled the "liability model". Adopting either model, subrogation is not a drastically "remedial" phenomenon that yields entitlements for a claimant only by virtue of some judicial order. Subrogation-justifying

6. See especially, *ibid*, at 231-32, 234-37, per Lord Hoffman. For very recent affirmation of this understanding, see the decision of the Supreme Court in *Menelaou v Bank of Cyprus UK Ltd,* [2015] UKSC 66 [*Menelaou* SC] (where only Lord Carnwath expressed scepticism).
7. See the High Court of Australia's vehement rejection of the English approach, *obiter*, in *Bofinger v Kingsway Group Ltd*, [2009] HCA 44 [*Bofinger*], echoing scepticism previously expressed in, *inter alia*, *Highland v Exception Holdings Pty Ltd (in liq)*, [2006] NSWCA 318 (Austl) and *Challenger Managed Investments Ltd v Direct Money Corp*, [2003] NSWSC 1072 (Austl) [*Challenger*].
8. For the distinction between subrogation to "subsisting" rights and subrogation to "extinguished" rights, see Mitchell & Watterson, *Subrogation*, *supra* note 4, ch 1.

facts do immediately trigger some form of entitlement for a subrogation claimant, which arises prior to, and independently of, any subsequent court order. Nevertheless, the nature and quality of this pre-court entitlement, and the court's role in its recognition and effectuation, will differ, depending on the model preferred. On balance, the liability model is the more defensible in principle. It should ultimately prevail.

II. A "Restitutionary" Remedy

In what sense is subrogation a "restitutionary" remedy? On some visions of the law of unjust enrichment, it looks like a rather unusual response. The standard restitutionary remedy, where a cause of action in unjust enrichment is established, is an award of monetary restitution: the law imposes a personal liability on D, measured by the value in money of the unjust enrichment that D received at C's expense.[9] The *Banque Financière* subrogation remedy, afforded where C discharges liabilities that D owes to X, is not of this nature. C will certainly seek this remedy in order ultimately to procure some monetary recovery, directly from D or indirectly by recourse to D's assets. Nevertheless, C's claim to relief by way of subrogation is not immediately a claim to an award of monetary restitution.[10] C will be asserting that he should be afforded rights equivalent to those previously enjoyed by X. That ordinarily means a security interest, which replicates X's, and secures the amount of the debt, owed by D to X, which C was responsible for discharging.

9. See *e.g.* Charles Mitchell, Paul Mitchell & Stephen Watterson, eds, *Goff & Jones: The Law of Unjust Enrichment*, 8d (London: Sweet & Maxwell, 2011) ch 36 [Mitchell, Mitchell & Watterson, *Goff & Jones*].

10. This has led some to suggest that subrogation cannot be a response to unjust enrichment, on the basis that a cause of action in unjust enrichment can *only* trigger an award of monetary restitution against the discharged debtor, and cannot account for the acquisition of a security interest by subrogation: see especially the doubts expressed about the *Banque Financière* unjust enrichment rationalisation in *Challenger, supra* note 7 at para 97.

A. "Factual Enrichment" and "Legal Enrichment"

In identifying subrogation's role as a restitutionary remedy, one might usefully begin with a distinction recently highlighted by Andrew Lodder,[11] between two different kinds of enrichment: "factual" and "legal".[12] What Lodder labels "factual" enrichment consists of the receipt of *value* by a defendant — in the form of money, or some non-money benefit, such as services, susceptible to valuation in money. "Factual" enrichments are the familiar subject-matter of awards of monetary restitution.[13] By contrast, a "legal" enrichment consists of either the acquisition of rights or the release of duties/liabilities.[14] These might also be treated as "factual" enrichments, and reversed via an award of monetary restitution. However, on Lodder's account, viewing them as legal enrichments, the law may respond differently: reversing the enrichment "in law" via a *specific* restitutionary mechanism. For example, following Lodder's account, one can contemplate the law achieving specific restitution, where D is enriched by the acquisition of rights, via C's entitlement to rescind a defective transfer, or the imposition of a trust in C's favour.[15]

B. The Role for the Subrogation "Remedy"

It remains hotly contested within English law whether, and on what basis, the courts might award something other than the "standard" remedy of monetary restitution in circumstances of unjust enrichment.

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11. Andrew Lodder, *Enrichment in the Law of Unjust Enrichment and Restitution* (Oxford: Hart Publishing, 2012).
12. *Ibid* ch 3. *Cf.* the distinction previously drawn by Robert Chambers, on which Lodder builds, between enrichment by the receipt of "value" and enrichment by the receipt of "rights": see Robert Chambers, "Two Kinds of Enrichment" in Robert Chambers, Charles Mitchell & James Penner, eds, *Philosophical Foundations of the Law of Unjust Enrichment* (Oxford: Oxford University Press, 2009) ch 9.
13. See Lodder, *supra* note 11 ("[w]henever the claimant seeks restitution of a factual enrichment, the response is always the same: a right to be paid the value of the enrichment received at the claimant's expense" at 64).
14. *Ibid* at 55-67 and ch 5.
15. *Cf. ibid* at 64-66.

Nevertheless, in light of recent scholarship, it looks plausible to suggest that *Banque Financière* subrogation — the remedy of subrogation to another's *extinguished* rights — is a restitutionary remedy, addressed to a very particular sub-set of legal enrichments, which reverses such legal enrichments by a very particular form of specific restitutionary response.[16] Three key points need brief elaboration.

1. Enrichment via the release of rights, at a third party's expense

First, properly understood, *Banque Financière* subrogation is contextually confined to circumstances that involve an enrichment in the form of a *release of another's rights*, achieved at a *third party's* expense. What ordinarily triggers subrogation is the discharge of a liability which D owed X, by a payment for which C, a third party, is relevantly responsible. This last feature is crucial. It is C's status as a third party to the original creditor-debtor relation between X and D that makes it possible to talk of C acquiring equivalents of X's extinguished rights by a process of "subrogation". A similar enrichment could arise in a bipartite setting — *e.g.* where labouring under a mistake, C, a creditor, releases his security for D's liabilities.[17] In such circumstances, the law might also afford C a form of specific relief, which restores his released rights.[18] However, this would not be subrogation: C would not step into *another's* shoes, actually or metaphorically. He would reacquire his own previously-released rights.

16. *Cf. ibid* ch 5. There are difficulties with Lodder's brief account of how subrogation works; however, the core of his analysis, that subrogation offers a form of *specific* restitution, addressed to the release of a duty/liability, is plausible.

17. *Cf. NRAM v Evans,* [2015] EWHC 1543 (Ch); *Garwood v Bank of Scotland*, [2013] EWHC 415 (Ch); *Fender v National Westminster Bank,* [2008] EWHC 2242 (Ch); *Dixon v Barton*, [2011] NSWSC 1525 (Austl).

18. *Ibid.* This is the effect of the relief ultimately afforded, in different ways, in the cases listed.

2. A form of specific restitutionary mechanism, involving newly-created rights that replicate the old

Secondly, *Banque Financière* subrogation can be regarded as a form of *specific* restitutionary mechanism. When C brings about the release of D's liabilities to X, in circumstances involving unjust enrichment, the law can obviously afford C a monetary remedy, measured by the value of the discharged liabilities: the value in money of the unjust enrichment that accrues to D, at C's expense, from their release. That would be an award of monetary restitution, addressed to D's "factual" enrichment. However, in the same circumstances, equity can also afford C a different remedy, in the form of a *Banque Financière* subrogation. This would be a specific restitutionary mechanism, addressed to the release of D's liabilities, conceived as a "legal" enrichment. On this analysis, equity achieves the in specie reversal of the unjust enrichment that would otherwise accrue from the release, to D and others, by effectively recreating the released liabilities in favour of C, a new party: C is afforded new rights, against D and others, which *prima facie* replicate those previously enjoyed by X.[19]

This explanation seems the most faithful to what the recent cases say about the basis of the remedy and its nature. Nevertheless, it is important to acknowledge that it depends on some contestable assumptions about the nature of "restitutionary" remedies afforded within the law of unjust enrichment.[20] In a bipartite setting,[21] if the law was to restore C's previously-released rights against D, it would be effecting "specific restitution" in the strongest/fullest sense: the law would restore *to* C rights that *he* formerly held against D. In contrast, the subrogation cases necessitate the adoption of a broader, and in one sense weaker/diluted vision of what would be involved in specific restitution, according to

19. *Cf.* Lord Carnwath's sceptical statements in *Menelaou* SC, *supra* note 6 at para 117 (which seems to overlook this explanation).

20. *Cf.* an alternative, "reductionist" model of subrogation's role as a "restitutionary remedy" which is developed and critically examined in Stephen Watterson, "Subrogation", in Graham Virgo and Sarah Worthington, eds, *Commercial Remedies: Resolving Controversies* (Cambridge: Cambridge University Press, forthcoming 2016).

21. See the text, *supra* notes 17-18.

which the primary remedial objective would be the *in specie* reversal of D's unjust enrichment. *Ex hypothesi*, the subrogation "remedy" involves the creation of equivalents of D's released liabilities to X in favour of a new party, C. This reverses D's enrichment *in specie*, but only via a "restitutionary" mechanism that affords C rights of a nature that he did not previously have.[22]

3. In particularised circumstances of unjust enrichment

Thirdly, when the House of Lords held in *Banque Financière* that subrogation was a remedy for *unjust enrichment,* they did not mean that unjust enrichment merely provided a meta-principle that loosely connected the subrogation cases, at a high level, to the wider body of authorities conventionally gathered in treatises on the law of restitution/ unjust enrichment. Subrogation was a remedy *for* unjust enrichment in the fullest sense: in the future, the remedy's availability was to be tested by reference to the components of the unjust enrichment framework that has been used to analyse and determine the availability of a cause of action in unjust enrichment sufficient to support standard awards of monetary

22. This is an available understanding of "specific restitution", which may require a corresponding commitment to a particular position in a more general controversy within the law of unjust enrichment concerning the essential character of "restitutionary remedies". In broad terms, the debate concerns whether the law's focus is (i) on the reversal of D's unjust enrichment; or is (ii) a more two-sided process, where the existence and extent of any restitutionary remedy is limited by reference to C's equivalent/corresponding "loss". Unjust enrichment scholars divide. Lodder explicitly assumes the former, broader conception of "restitution": see Lodder, *supra* note 11 at 7-8. *Cf.* the discussion in Peter Birks, *Unjust Enrichment,* 2d (Oxford: Oxford University Press, 2005) at 78-86 [Birks, *Unjust Enrichment*]; Andrew Burrows, *The Law of Restitution*, 3d (Oxford: Oxford University Press, 2011) at 64-69; Graham Virgo, *The Principles of the Law of Restitution*, 3d (Oxford: Oxford University Press, 2015) at 116-18; Mitchell, Mitchell & Watterson, *Goff & Jones, supra* note 9 at 6.63-6.74; Michael Rush, *The Defence of Passing On* (Oxford: Hart Publishing, 2006) Part II.

restitution.[23] Accordingly, to establish his subrogation entitlement, C would need to identify some legally recognised ground for restitution (*e.g.* a restitution-grounding mistake or failure of basis);[24] and he might find his claim defeated/diminished by any defence/bar that could be raised to any unjust enrichment claim (*e.g.* illegality/public policy, change of position, bona fide purchase, contractual exclusion/limitation, expiry of a limitation period).[25] Some early post-*Banque Financière* cases showed unease about the implications of this new approach.[26] Nevertheless, a gathering tide of English cases has followed their Lordships' lead, and explicitly justified the availability of the subrogation remedy, on particular facts, using the unjust enrichment framework.[27]

C. Outstanding Questions

Even if it is accepted that *Banque Financière* subrogation functions as a restitutionary remedy as just outlined, important questions remain unanswered regarding its operation and effects. In particular, what is the court's role in these cases? Does the availability of the subrogation remedy depend upon a court order, which a judge might grant or refuse as appropriate? Or does a subrogation claimant have some form of pre-court entitlement, generated as the facts happen? If the latter, what exactly is the nature of this entitlement? And if its existence does not strictly depend upon a judicial order, what exactly is the court's role, when subsequently asked to determine the parties' legal positions? It is to these questions that our attention must now turn.

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23. See especially *Banque Financière*, *supra* note 1, per Lord Hoffmann and Lord Steyn; and see now *Menelaou* SC, *supra* note 6. *Cf.* the very different vision of the law in Australia presented in *Bofinger*, *supra* note 7.
24. See Mitchell & Watterson, *Subrogation*, *supra* note 4 ch 6 (the ground identified there as "ignorance" is now better labelled as "lack of consent" or "want of authority": Mitchell, Mitchell & Watterson, *Goff & Jones*, *supra* note 9 ch 8).
25. See Mitchell & Watterson, *Subrogation*, *supra* note 4 ch 7.
26. See *e.g. Halifax v Omar*, [2002] EWCA Civ 121 [*Omar*].
27. See most recently, *Menelaou* SC, *supra* note 6; and see further the cases cited *infra* notes 113 and 143.

III. An Entitlement Arising Out of Court

On examination, there is overwhelming evidence that *Banque Financière* subrogation yields some form of entitlement for C, the subrogation claimant, as the legally significant facts occur, and independently of any court order. To that extent, *Banque Financière* subrogation represents an "institutional" response, which affects the parties' legal positions "on the ground", "as the facts happen". It is not a radically "remedial" response, which brings legal consequences only from the time of any subsequent court order. This is evident from the cases in at least the following eight ways.

A. Party Pleadings, Judicial Reasoning, and Court Orders

First, the language of parties' pleadings, judicial reasoning, and court orders points strongly to C having some form of pre-court entitlement. Claimants in their pleadings and arguments, and judges when addressing them, have often spoken of the claimant "being" subrogated, or having "become entitled" to be subrogated from some material date in the past; or more often in older cases, of the former creditor's rights "being kept alive" or "having been kept alive" for the claimant's benefit. Consistently with this, when claimants ask a court to adjudicate as to their subrogation rights, the primary remedy sought is a *declaration* that they are or have become entitled to a security interest by subrogation[28] — terms suggestive of a confirmatory, rather than purely constitutive, order. The courts routinely oblige, granting declarations which have often declared,

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28. See *e.g. Butler*, *supra* note 2 at 278; *Congresbury Motors Ltd v Anglo-Belge Finance Co Ltd*, [1971] Ch 81 (CA (Civ)(Eng)) at 83 [*Congresbury* CA]; *Coptic Ltd v Bailey*, [1972] Ch 446 (Eng) at 448; *Burston Finance Ltd v Speirway Ltd*, [1974] 1 WLR 1648 (Ch (Eng)) at 1650 [*Burston Finance*]; *Boodle Hatfield & Co v British Films Ltd*, (1986) 2 BCC 99221 (Ch (Eng)) [*Boodle Hatfield*]; *Castle Phillips Finance Co Ltd v Piddington*, (1995) 70 P&CR 592 (CA (Civ)(Eng)) at 598 [*Piddington*]; *Boscawen*, *supra* note 3 at 329-30; *Primlake Ltd v Matthews Associates*, [2009] EWHC 2774 (Ch) at para 17 [*Primlake*]; *Lehman Commercial Mortgage Conduit Ltd v Gatedale Ltd*, [2012] EWHC 848 (Ch) at para 2 [*Lehman*].

in explicit terms, that C's rights exist *as at a particular, material date in the past*.[29]

Although the courts have rarely analysed the nature of C's position before he comes before them, the few dicta that do also point strongly to some form of pre-court entitlement. In particular, in the influential pre-*Banque Financière* decision in *Boscawen v Bajwa*[30] ("*Boscawen*"), Lord Justice Millett spoke of a pre-existing subrogation "right" or "equity", which the court's order would "satisfy" — apparently meaning by this to deny that C's subrogation entitlement *depends* on any judicial order, or indeed on any election by C, and to affirm that C's subrogation "right" or "equity" was an entitlement that came into being, out of court, *as the triggering facts occurred*.[31] Reinforcing this, Millett LJ drew an explicit analogy with constructive trusts, which in English law at least are regarded as "institutional" responses, which arise as the legally significant facts occur.[32] The same vision is endorsed in subsequent Court of Appeal decisions: *Halifax v Omar*[33] ("*Omar*"), *Eagle Star Insurance Co Ltd v Karasiewicz*[34] ("*Karasiewicz*"), and *Day v Tiuta International Ltd*[35] ("*Tiuta*").

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29. See *e.g. Chetwynd*, *supra* note 2 at 358-59; *Thurstan v Nottingham Permanent Benefit Building Society*, [1902] 1 Ch 1 (CA (Eng)) at 14 (affirmed [1903] AC 6 (HL)(explicit dating back) [*Thurstan*]; *Butler*, *supra* note 2 at 283-84; *Chandiram*, *supra* note 2 at 747 (explicit dating back); *Congresbury Motors Ltd v Anglo-Belge Finance Co Ltd*, [1970] Ch 294 (Eng) at 321 (affirmed *Congresbury* CA, *supra* note 28 (explicit dating back)); *Coptic Ltd v Bailey*, [1972] Ch 446 (Eng) [*Bailey*]; *Banque Financière*, *supra* note 1 at 237 (explicit dating back); *UCB Group Ltd v Hedworth (No 2)*, [2003] EWCA Civ 1717 at para 150 [*Hedworth*].
30. *Boscawen*, *supra* note 3.
31. *Ibid* at 335, 342.
32. *Ibid* at 335.
33. *Omar*, *supra* note 26 at paras 79-84.
34. [2002] EWCA Civ 940 at para 19 [*Karasiewicz*].
35. *Tiuta*, *supra* note 4 at para 42.

B. Priority Disputes

Secondly, when C claims that he is subrogated to another's security interest, questions may arise as to the effect of subsequent transactions, under which third parties acquire interests in the same asset, by transfer or grant from D, the discharged debtor. Imagine that C discharged X's security interest over D's property, in circumstances that justified C's being subrogated to X's rights, and that D subsequently sold, leased or charged his property to a third party, Y. Is this third party, Y, affected by C's subrogation "remedy"? Recent cases indicate that Y may be affected, apparently on the assumption that C acquired an entitlement *in rem* as the legally significant facts occurred, which can prevail against subsequently-interested parties, like Y, in accordance with the rules that generally govern the priority of competing interests of the relevant quality affecting the same subject-matter.[36] Within English law's system of registered land titles, this includes, *inter alia*, the possibility of preserving the priority of C's entitlement *vis-à-vis* later transactions by entering a notice against the affected register of title.[37]

C. The Validity of Supervening Enforcement Action

Thirdly, in *Tiuta*,[38] the Court of Appeal appeared to assume that a court might determine the legal effect of supervening conduct of C, which occurred before he brought proceedings asserting a subrogation entitlement, and even in ignorance that he had any subrogation entitlement, on the basis that, *at the time C acted, C was entitled to exercise*

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36. *Cf.* especially *Chandiram*, *supra* note 2; *Boscawen*, *supra* note 3; *Omar*, *supra* note 26; *Cheltenham & Gloucester v Appleyard,* [2004] EWCA Civ 291 at para 44 [*Appleyard*]; *Bank of Scotland v Joseph*, [2014] EWCA Civ 28 [*Joseph*]. *Cf. Anfield (UK) Ltd v Bank of Scotland*, [2010] EWHC 2374 (Ch) [*Anfield*], criticised in Mitchell, Mitchell & Watterson, *Goff & Jones*, *supra* note 9 at 39.68-39.76.

37. *Joseph*, *supra* note 36 (a notice entered against a registered title in respect of the claimant's invalid charge was held to be effective to protect the priority of the subrogation entitlement that arose due to the charge's invalidity).

38. *Tiuta*, *supra* note 4.

rights that replicated the rights of the paid-off creditor.

Tiuta International Ltd ("TIL") had loaned money to Day, secured by a charge over Day's property, which was used to pay off an existing charge held by Standard Chartered ("SC"). Day failed to repay TIL's loan when it became due for repayment, and TIL appointed receivers under its charge, with a view to having the property sold and recovering its debt. Day opposed this enforcement action arguing, *inter alia*, that he could avoid TIL's charge *ab initio* for fraudulent misrepresentation, and that this would necessarily render the receivers' appointment invalid. This was not, however, quite the end of the matter. The Court of Appeal held that even if TIL's charge was voidable *ab initio*, TIL would f*rom that time* have been entitled to be subrogated to the SC charge, which also conferred powers to appoint receivers.[39] Day answered that this should make no difference: the receivers were appointed under powers in TIL's invalid charge, and not under the subrogation-based charge; as such, it was necessary to appoint the receivers again, expressly relying on powers conferred by the subrogation based charge:

> a party purporting to exercise subrogated rights had to do so pursuant to the powers contained in the subrogated security; therefore it was not sufficient for TIL to have appointed the [r]eceivers by reference to the TIL Charge and then have sought to justify such appointment by reference to the SC Charge, or by reference to any new equitable charge created by reference to the equitable doctrine of subrogation; TIL needed to appoint the [r]eceivers again, but this time in express reliance on the SC Charge.[40]

The Court of Appeal disagreed: the receivers *could* be deemed to have been properly appointed. Lady Justice Gloster stated that it was "immaterial" that TIL "did not purport to rely on the SC Charge when appointing the [r]eceivers", and that unaware of the potential defect, TIL had "purported to rely only on the TIL Charge to make the appointment".[41] Subrogation, "in conferring a new equitable proprietary right on TIL" that "replicates the [paid-off] creditor's old interest", "operated to entitle TIL to the notional benefit of the SC Charge for the purposes of securing repayment of the TIL Loan made under the terms of the

39. *Ibid* at paras 37-40.
40. *Ibid* at para 41.
41. *Ibid* at para 44.

TIL Loan Facility".[42] The SC charge had included an express right to appoint receivers at any time after the lender had demanded any of the secured liabilities, or breach by the chargor of the charge provisions, or an event of default. Some event of this nature had certainly occurred in relation to the TIL loan. And according to Gloster LJ, the equitable doctrine of subrogation was "clearly flexible enough", where the secured creditor is not aware that there is any challenge to his security, "*to deem an appointment purportedly pursuant to a voidable security as one having been made pursuant to subrogation rights*".[43] This decision presents some difficulties, but it undoubtedly provides further support for the existence of some pre-court entitlement.

D. Assignability

Fourthly, it has been assumed that a subrogation claimant may have a pre-existing entitlement that is transmissible by assignment;[44] and cases can be found where a party has brought proceedings in the capacity of assignee without any exception being taken.[45]

E. Sub-Subrogation

Fifthly, there are cases involving so-called "*sub*-subrogation", where C is held to be entitled to be subrogated to an *intermediate* creditor's entitlement to be subrogated to an *earlier* creditor's rights.[46] This needs more explanation.

One of the most common contextual applications of *Banque Financière* subrogation involves defective financing/re-financing transactions. Typically, C advances money to D, in order to discharge D's existing secured liabilities to X, on the basis that C will be granted some new

42. *Ibid* at paras 43-44.
43. *Ibid* at para 47 [emphasis added].
44. *Omar*, *supra* note 26 at para 61 (counsel's concession).
45. *Lehman*, *supra* note 28 (a lender and the loan's subsequent assignee brought proceedings claiming *inter alia* that, if the original charge was void, they were entitled to be subrogated to two earlier charges which were discharged using the monies advanced by the original lender).
46. See Mitchell & Watterson, *Subrogation*, *supra* note 4 at 9.16-9.37.

effective security for its loan over D's assets. If C's expectation of security is not realised, C is commonly subrogated to X's security interest, which its advance discharged. However, what if, exceptionally, X's security interest *also* turns out to have been defective? Any entitlement to be subrogated to that security will be of limited value: any subrogation-based security, mirroring X's security, will suffer from the same frailty. Nevertheless, in such circumstances, it is conceivable that X, who previously advanced money to fund a property purchase by D, or to refinance D's existing liabilities, would have been entitled to be subrogated to the valid security held by an *earlier* creditor, who was paid off via X's loan. Where that is so, the courts have been willing to say that C may be "(*sub*)-subrogated" to X's subrogation entitlement: *i.e.* C is subrogated to the subrogation entitlement that X held, which was discharged when D's outstanding liabilities to X were cleared via C's payment.[47]

Consider *UCB Group Ltd v Hedworth (No 2)*.[48] Barclays Bank loaned monies to fund the joint purchase of a farm by Mr. and Mrs. Hedworth, expecting a valid first legal charge over the property as security for its advance. Subsequently, UCB lent monies which were used to discharge the Barclays charge, also expecting a valid first legal charge as security. On the assumption that each of the legal charges executed by Mr. and Mrs. Hedworth could be avoided by Mrs. Hedworth, because her consent was obtained by misrepresentations or undue influence of her husband, of which the lenders had notice, the Court of Appeal held (i) that Barclays had been entitled to be subrogated to the unpaid vendor's lien, which its advance had discharged; and (ii) that when UCB's advance was later used to repay Barclays' advance, UCB in turn became entitled to be "sub-subrogated" to the unpaid vendor's lien.

Such "sub-subrogation" is difficult to explain unless one assumes that X had a *pre-existing* subrogation entitlement, which could have been discharged by C's payment, so as to generate new rights for C, mirroring X's extinguished rights, by a process of sub-subrogation (or, in the

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47. See especially *Piddington*, *supra* note 28 at 600-601; *Hedworth*, *supra* note 29 at paras 134-48. See also *Kingsway Finance Ltd v Wang Qingyi*, [2013] HKCFI 1178 at paras 26-31; affirmed [2014] HKCA 578 at paras 35-37.

48. *Hedworth*, *supra* note 29.

problematic language of pre-*Banque Financière* cases, which could have been "kept alive" for C's benefit, when C paid X).

F. Loss of Existing Rights by Waiver, Abandonment or Merger

Sixthly, pre-*Banque Financière* cases commonly adopted a generous presumption that where C loaned money to discharge another's secured liabilities, he must have intended to "keep alive" the earlier creditor's security for his own benefit — a presumption that apparently yielded an immediate subrogation entitlement. Adopting this starting-point, the courts might then ask whether C had *lost* the subrogation entitlement that he had acquired in this way, by virtue of his having been *granted* some form of security by the borrower.[49] Typically, the courts might inquire whether C had "waived" or "abandoned" his subrogation-based security, as a result of that transaction, or whether his subrogation-based security was "lost" by "merger" into some "higher-ranking" security that C had been granted. These cases would certainly be reasoned differently today, post-*Banque Financière*, in which the House of Lords explicitly preferred a restitutionary explanation for subrogation, to the earlier over-reliance on fictitious presumptions of party intentions. Nevertheless, these decisions are interesting as further evidence of an assumption that there is nothing contrary to principle in C acquiring some form of immediate entitlement, as the relevant facts occur.

G. Interest Entitlements

Seventhly, the courts' approach to interest awards in subrogation cases also evidences a pre-existing entitlement. Ordinarily, D's debt to X, which C discharged, will have carried a contractual right to interest for X. Modern English cases consistently assume that where C is subrogated to X's rights as secured creditor, C is *prima facie* subrogated to X's security interest, and with it, both the principal debt discharged, and X's previous

49. See *e.g. Chandiram*, *supra* note 2 at 745; *Congresbury* CA, *supra* note 28 at 94; *Bailey*, *supra* note 29 at 454; *Burston Finance*, *supra* note 28 at 1652-58; *Orakpo v Manson Investments Ltd*, [1978] AC 95 (HL) [*Orakpo*]. *Cf.* also post-*Banque Financière*: *Appleyard*, *supra* note 36.

contractual right to interest. On that assumption, the "subrogation debt" which C can recover via its subrogation rights typically encompasses the amount of the debt that C was immediately responsible for discharging, plus interest on that sum, at X's contractual rate, *running from the time of discharge of X's debt*.[50]

H. Compatibility with the Juristic Basis of *Banque Financière* Subrogation

Finally, *Banque Financière*'s new rationalisation for subrogation — as a "restitutionary remedy" afforded to reverse "unjust enrichment" — can also justify C's being afforded an immediate, pre-court entitlement. This is important. Earlier cases were not reasoned using the principles of the modern law of unjust enrichment, and the explanations explicitly adopted — which might rationalise subrogation as a contractually-derived entitlement,[51] or as afforded by the law to effectuate actual/attributed party intentions[52] — might have different logical implications from the *Banque Financière* rationalisation. Nevertheless, an unjust enrichment framework is equally capable of justifying a pre-court entitlement.

First, it is orthodox that as soon as the components of a cause of action in unjust enrichment are present (*e.g.* from the moment D receives a mistaken payment from C, in the absence of any justifying ground), C has a cause of action against D which, if proceedings are brought, ordinarily results in an award of monetary restitution: *i.e.* a court order requiring D to pay C the money value of the enrichment he has received. It is currently controversial whether D comes under an immediate *duty* to make restitution to C, who acquires an immediate, correlative claim-*right* to restitution; or alternatively, whether D merely becomes *liable* to

50. See *e.g. Piddington, supra* note 28 at 602; *Filby v Mortgage Express (No 2) Ltd,* [2004] EWCA Civ 759 at paras 63-67 [*Filby*]; *Kali Ltd v Chawla*, [2007] EWHC 2357 (Ch) at para 31 [*Kali*] and following. See further *infra* at note 159 below.

51. *Cf.*, *e.g.* the contractual flavour of the reasoning in *Orakpo*, *supra* note 49, per Lord Diplock.

52. *Cf.*, *e.g.* the reasoning in the influential decision of *Chandiram*, *supra* note 2, per Lord Jenkins.

be ordered by a court to make restitution to C.[53] Either way, D's duty or liability arises out of court, "as the facts happen".

Secondly, the *Banque Financière* subrogation remedy's function seems to require C's subrogation entitlement to be dated from the time when D's liabilities were unjustly released at C's expense. If the remedy is a specific restitutionary mechanism, which reverses *in specie* the unjust enrichment that would otherwise flow from the release of D's liabilities, then dating C's subrogation entitlement *from the time of the unjust release* looks natural: it is the most closely-tailored way of achieving that specific reversal.

Thirdly, recent descriptions of subrogation as a restitutionary "remedy"[54] do not necessarily contradict the idea that subrogation claimants have some pre-court entitlement. "Remedy" is a notoriously unstable term.[55] It is certainly common in legal discourse to use "remedy" to denote orders that a *court* might make; and on that assumption, the courts, when labelling subrogation a "restitutionary remedy", *might* be describing relief *dependent on court intervention*. Nevertheless, that cannot be decisive. A court, when granting the relevant subrogation "remedy", could be effectuating a pre-existing entitlement held by C, the subrogation claimant. In any case, there is a broader sense of "remedy" — a cure for an ill, or a legal response to a legally recognised mischief (*e.g.* a wrong or an unjust enrichment) — which is apt to describe legal institutions like English law's "institutional" constructive trust, which operate by affording substantive rights to a claimant, independently of any court order, as the legally significant facts occur. This broader usage can easily accommodate descriptions of subrogation as a "restitutionary remedy", even if it works in the most strongly "institutional" way — via

53. The leading proponent of the "liability" view is Stephen A Smith; a key recent contribution is Stephen A Smith, "A Duty to Make Restitution" (2013) 26:1 Canadian Journal of Law and Jurisprudence 157.

54. See *e.g. Filby*, *supra* note 50 at paras 1, 52, 55, 60, 62; *Appleyard*, *supra* note 36 at para 32; *Banque Financière*, *supra* note 1 at 228, 231-32, 236-37; *Boscawen*, *supra* note 3 at 335.

55. On the meaning(s) of the term "remedy", see in particular, Rafal Zakrzewski, *Remedies Reclassified* (Oxford: Oxford University Press, 2005) chs 2-4.

equity affording a subrogation claimant immediate rights, independently of any court order, that are equitable replicas of the paid-off creditor's extinguished rights.

Finally, a pre-court entitlement is supportable *even* if the "liability" model of the law of unjust enrichment is preferred — that is, even if D, against whom a cause of action in unjust enrichment has arisen, merely incurs a "*liability*" to be ordered by a court to make restitution, in proceedings brought by C.[56] Translated to subrogation cases, an equivalent analysis would be that subrogation-justifying facts do not result in C immediately acquiring rights that are equitable replicas of the paid-off creditor's extinguished rights. Instead, subrogation-triggering facts would immediately yield only a liability on D and relevant others to be subjected, via court order, to legal relations mirroring those that were extinguished (and a concomitant entitlement in C to bring proceedings to obtain such relief). This important possibility is examined further in Part IV, below.

IV. The Nature of Any Pre-Court Entitlement

If C has some form of pre-court entitlement in a subrogation case, two key questions remain to be answered: (i) what is the nature of this entitlement?; and (ii) what is the court's role in effectuating it? Although interconnected, these questions will be tackled separately, in turn, in the following two Parts. On closer examination, some features of C's pre-court entitlement seem undisputed, whilst others are more open to doubt. It will be argued that the uncertainty reflects an as-yet-unrecognised and unresolved tension in the authorities between two different conceptions of the operation of the *Banque Financière* subrogation "remedy" — a "strong institutional model" and a weaker institutional model, which can be termed the "liability model".

56. Smith, *supra* note 53.

A. The Essential Characteristics of the Pre-Court Entitlement

1. An equitable entitlement?

In its earliest manifestations, *Banque Financière* subrogation was the product of intervention by courts of equity. This heritage remains evident in the modern law. Leading modern cases expressly classify this species of subrogation as an "equitable remedy",[57] and it is common to find it referred to as the "remedy", "doctrine" or "principle" of "*equitable* subrogation".[58] Consistently with this jurisdictional basis, there is a consensus that the pre-court entitlement is some species of *equitable* entitlement. In older cases, this might be conveyed by statements that the security interest of X, the paid-off creditor, was "*kept alive*" "*in equity*" for C's benefit,[59] or that C was in the position of, or equivalent to, an "*equitable assignee*" of X's security interest.[60] Post-*Banque Financière*, we know that such statements are metaphors, rather than literal truths. X's rights are not actually "kept alive", and C does not actually acquire X's rights, or the benefit of X's rights, by transfer or otherwise. In Lord Hoffmann's words:

> the phrase 'keeping the charge alive' needs to be handled with some care. It is not a literal truth but rather a metaphor or analogy: see Birks, *An Introduction to the Law of Restitution*, pp 93-97. In a case in which the whole of the secured

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57. See *e.g. Menelaou* SC, *supra* note 6 at para 49; *Filby*, *supra* note 50 at paras 1, 52, 55, 60; *Appleyard*, *supra* note 36 at para 32; *Banque Financière*, *supra* note 1 at 228, 231-32, 236-37; *Boscawen*, *supra* note 3 at 335.

58. See *e.g. Swynson Ltd v Lowick Rose LLP,* [2015] EWCA Civ 629 at para 47; *Tiuta*, *supra* note 4 at paras 14, 23, 27, 50, 52, 81; *Pickenham Romford Ltd v Deville,* [2013] EWHC 2330 (Ch) at para 54 and following; *Filby*, *supra* note 50 at paras 19, 31, 44, 51-52, 55, 57, 62; *Cressman v Coys of Kensington (Sales) Ltd*, [2004] EWCA Civ 47 at para 44; *Appleyard*, *supra* note 36 at para 30.

59. See *e.g. Chetwynd*, *supra* note 2 at 357; *Butler*, *supra* note 2 at 282; *Chandiram*, *supra* note 2 at 745; *Western Trust*, *supra* note 2.

60. See *e.g. Burston Finance*, *supra* note 28 at 1652; *Western Trust*, *supra* note 2. In cases involving subrogation to an *unsecured* debt, the courts have also sometimes described the personal claim arising via subrogation as an "*equitable* liability": *e.g. Baroness Wenlock v The River Dee Company*, (1887) 19 QBD 155 (CA (Eng)) at 166.

> debt is repaid, the charge is not kept alive at all. It is discharged and ceases to exist. … It is important to remember that … subrogation is not a right or a cause of action, but an equitable remedy against a party who would otherwise be unjustly enriched. It is a means by which the court regulates the legal relationships between a plaintiff and a defendant or defendants in order to prevent unjust enrichment. When judges say that the charge is "kept alive" for the benefit of the plaintiff, what they mean is that his legal relations with a defendant who would otherwise be unjustly enriched are regulated *as if* the benefit of the charge had been assigned to him. It does not by any means follow that the plaintiff must for all purposes be treated as an actual assignee of the benefit of the charge and, in particular, that he would be so treated in relation to someone who would not be unjustly enriched.[61]

It has been suggested that the older cases, on which Lord Hoffmann based this analysis, proceeded via a "legal fiction": equity regulated the parties' relations "as though the [paid-off] creditor's rights were not extinguished by the payment, [and] were transferred to the claimant so that he could enforce them for his own benefit".[62] However, in truth, this elaborate fiction is unnecessary. One can say simply that where this form of subrogation operates, equity operates on the facts to afford C *new* equitable rights, *which prima facie replicate the rights that X previously held, and C extinguished*.[63] The English cases now tell us that this is a "restitutionary" mechanism, to reverse the unjust enrichment that would

61. *Banque Financière*, *supra* note 1 at 236.
62. See Mitchell & Watterson, *Subrogation*, *supra* note 4 at 1.05, and see further ch 3.
63. See further *ibid* ch 8; and now *Tiuta*, *supra* note 4 at para 43, adopting passages from this text with approval.

otherwise arise from their release.[64]

2. Potentially *in rem*?

Where C has discharged another's *unsecured* debt, C obviously cannot acquire more than an *in personam* entitlement by subrogation.[65] However, where C has discharged another's security interest, and there is no objection in principle to C acquiring the special advantages of a security interest by subrogation, the English courts have afforded C's pre-court entitlement an *in rem* status — reflecting his entitlement to be treated, in equity, as if he had the paid-off creditor's security.

This looked in doubt immediately following *Banque Financière*.[66] Both the decision, and Lord Hoffmann's reasoning, hinted that subrogation was an unnervingly flexible remedy in two connected senses: (i) even where a security interest was discharged, subrogation did not yield rights *in rem* — instead, the court operated *in personam*, regulating C's relations with one or more other parties *as if* C had taken an assignment of the paid-off creditor's rights; (ii) as a corollary, if a court had to decide whether a third party, who had subsequently acquired an interest in the relevant subject-matter, was subject to C's subrogation claim, the answer was to be found by asking *directly* whether (if he were not so subject) the

64. As Australian authorities seem to confirm, it is unnecessary to subscribe to the unjust enrichment theory to accept that "equitable subrogation" operates like this: *e.g. Re Dalma No 1 Pty Ltd,* [2013] NSWSC 1335 (Austl) at paras 20-21 ("legal fiction" of revival); *Saraceni v Mentha (No 2)*, [2012] WASC (Austl) 336 at para 238 ("legal fiction" of revival) (quoting Mitchell & Watterson, *Subrogation*, *supra* note 4); *Taleb v NAB Ltd*, [2011] NSWSC 1562 (Austl)("keeping a previous security alive is a figure of speech" at para 69); *Saraceni v Mentha*, [2011] WASC 94 (Austl) at paras 39-40 (quoting Mitchell & Watterson, *Subrogation*, *supra* note 4); *Cook v Italiano Family Fruit Co Pty Ltd*, [2010] FCA 1355 (Austl) at para 106 ("legal fiction" of revival)(quoting Mitchell & Watterson, *Subrogation*, *supra* note 4).

65. For recent illustrations of subrogation to unsecured debts, see *e.g. Filby*, *supra* note 50 (unsecured HSBC joint loan account debt); and *Niru Battery Manufacturing Co v Milestone Trading (No 2)*, [2004] EWCA Civ 487 (unsecured judgment debt).

66. See Mitchell & Watterson, *Subrogation*, *supra* note 4 at 8.48-8.60.

third party would be unjustly enriched at C's expense.

After early equivocation,[67] the consensus today is that *Banque Financière* has not radically destabilised past cases. Thus: (i) where a security interest is discharged, *Banque Financière* subrogation does typically generate an entitlement *in rem*, as the facts happen, as a mechanism for reversing *in specie* the unjust release of an earlier security interest; and (ii) C's ability to assert this entitlement *vis-à-vis* a later party is determined by reference to its quality as such — *i.e.* on the assumption that C has some form of pre-existing and potentially competing equitable entitlement *in rem*.

3. The nature of the equitable entitlement *in rem*

We come, finally, to the most difficult question: what exactly is the nature of C's equitable entitlement *in rem*? The puzzle can be illustrated by reference to the "ordinary and typical"[68] subrogation case, which arises from a defective lending transaction. If C lender is entitled to be subrogated to the security held by X, which was extinguished via C's advance, what does C acquire, as the facts happen? Is C immediately afforded rights, before any court order, which are equitable replicas of X creditor's extinguished rights, or does that put C's position too strongly? If it is too strong, what exactly does C obtain as the facts happen? No sustained attention has yet been given to these questions, despite their theoretical and practical importance. The major contention of this article is that it will be hard to achieve satisfactory answers unless one recognises that there is a hitherto unrecognised and unresolved tension in the authorities between two different conceptions of the operation of the *Banque Financière* subrogation "remedy".

B. Two Different Models of the Pre-Court Entitlement

English law is frequently said to adopt an "institutional" form of constructive trust, implying that such trusts are generated by operation

67. See especially *Omar*, *supra* note 26, discussed further, *below*, Part IV.C.2.
68. The terminology used by Walton J in the much-cited decision in *Burston Finance*, *supra* note 28.

of law, in accordance with legal rules, as the trust-justifying facts occur.[69] They do not arise only by virtue of any later court order. *A fortiori*, English law has not yet adopted any strong form of "remedial constructive trust", which might allow courts, exercising a broad remedial discretion in proceedings before them, to impose a trust or lien over a defendant's assets, retrospectively or prospectively from the date of the court's order, as they think appropriate.[70]

It would be surprising if English law tolerated a dramatically different vision of the equitable entitlements generated in subrogation cases. The analysis in Part III confirms, beyond reasonable doubt, that it does not. The evidence overwhelmingly suggests that the *Banque Financière* subrogation remedy involves a species of pre-court entitlement, generated as the legally significant facts occur, independently of any court order. To that extent, where C is entitled to be subrogated to X's extinguished security interest, the subrogation remedy, like English law's constructive trust, appears to involve an "institutional" form of proprietary response.

Caution is nevertheless needed. "Institutional" responses are not necessarily homogeneous. And on examination, two different "institutional" models may be discernable in the subrogation cases.

1. An orthodox vision: the "strong institutional model"

The orthodox conception of subrogation seems to be a "*strong*" institutional conception: it assumes that C immediately acquires rights, independently of any court order, as the subrogation-justifying facts occur, *which are an immediate equitable replica of the extinguished rights of X, the paid-off creditor*. In effect, C is immediately placed in a position akin to an equitable assignee, albeit by operation of law, rather than by any voluntary disposition of X, the former right-holder.

69. For this distinction, see *Westdeutsche Landesbank Girozentrale v Islington LBC*, [1996] AC 669 (HL) at 714-16, per Lord Browne-Wilkinson [*Westdeutsche*].

70. See *e.g. Westdeutsche*, *ibid*; *Polly Peck International (No 5)*, [1998] 3 All ER 812 (CA (Civ)); *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*, [2011] EWCA Civ 347 at para 37; *FHR European Ventures LLP v Mankarious*, [2013] EWCA Civ 17 at para 76.

If accepted, this model is likely to have important implications for the resolution of priority disputes where C is subrogated to a security interest: it assumes that C has an immediate equitable security interest, rather than a mere equity. However, it may also bring implications for the court's role in subrogation cases.[71] Arguably, there is no *legal* necessity for C to obtain any court order at all. C is obviously well-advised, to avoid subsequent challenge, to obtain a declaration *confirming* that the relevant rights have arisen; and C could certainly seek consequential orders, as necessary, with a view to *enforcing* the rights so declared — *e.g.* orders for possession or for the appointment of a receiver. Nevertheless, adopting this strong institutional model, any court order would have no role in creating or constituting the entitlements that C acquires "by subrogation". They have already been delivered fully-fledged and fully-formed, out of court, as the subrogation-justifying facts occurred.

2. An alternative vision: the "liability model"

On closer examination, there are reasons of both authority and principle to question the veracity of this "orthodox" vision of subrogation, and to prefer a "weaker" institutional model. Adopting this alternative model, C does not immediately acquire rights which are equitable replicas of X creditor's extinguished rights, as subrogation-justifying facts occur. Instead, those legally significant facts merely trigger a *liability* on D and relevant others to be subjected by subsequent court order to legal relations equivalent to those which previously existed, if this is needed to reverse their unjust enrichment (and a concomitant entitlement in C to bring proceedings to obtain such relief). It is aptly labelled the "liability model".

The distinction between this liability model and the strong institutional model is not merely semantic. Important practical implications may follow. For example, adopting the liability model, where C is subrogated to X's extinguished security interest, priority disputes should not be resolved on the simple premise that C has an immediate, vested equitable security interest *ab initio*. C has the benefit

71. See for further exploration, Part V, below, "The Role of the Court".

of a *liability* to have a court subject D and relevant others to legal relations equivalent to those which previously existed. The law faces a genuine choice whether — for priority purposes — this "liability *in rem*" (and C's concomitant entitlement) should rank as a full equitable interest, or have the lesser status of a "mere equity", which is more vulnerable in priority disputes. Equally importantly, a court asked to adjudicate a subrogation case will have a real, non-trivial role, in effectuating C's subrogation entitlement. At the very least, a court order will be a *necessary* step, in conclusively crystallising C's pre-existing entitlement. However, one can also contemplate the court having *some* latitude, to deny/shape the remedy, on a principled basis.[72]

C. Choosing Between the Models: the Position as a Matter of Authority

Which model is the more "correct"? Looking to authority alone, the messages seem mixed. Much material from the subrogation cases is inconclusive. One Court of Appeal decision, *Omar*,[73] seems to point decisively towards the strong institutional model, and thus requires extended discussion. However, on closer inspection, the case turns out to be an unsafe foundation from which to derive any general theory about the nature and operation of the *Banque Financière* "remedy".

1. The largely inconclusive state of the authorities

On a cursory examination, the support for the strong institutional model might seem uncontestable. Certainly, in key pre-*Banque Financière* cases, the parties and the courts commonly spoke in terms which implied that, within the traditional categories of subrogation, C *would be regarded from the outset as equivalently placed to an equitable assignee of another's security*, and by extension, would immediately have a vested equitable security interest, effective *in rem*. Nevertheless, the best test of the veracity of such language is whether the legal characteristics which the courts have afforded to C's entitlement *in practice* are only consistent with the strong

72. *Ibid.*

73. *Omar*, *supra* note 26.

institutional model. On closer examination, it seems that they are not. With little straining, the liability model can also accommodate the evidence, reviewed in Part III, that C has some pre-court entitlement. In particular:

- Common linguistic usage, which describes C as being "entitled to" be subrogated or "having become entitled to be" subrogated, or as having a "right to be subrogated", is compatible with a vision of the law that involves C immediately acquiring the benefit of a *liability* of D and relevant others, to have a court subject them to legal relations equivalent to those that previously existed.
- A court's "declaration" that C is entitled to security by subrogation at some earlier point in time[74] can be interpreted as effectuating a pre-existing *liability*, dating from that time, to have the court recognise/impose legal relations equivalent to those that previously existed.
- The liability model can support the courts' approach to priority disputes, which assumes that a subrogation claimant, who is entitled to be subrogated to a security interest, has a species of equitable entitlement, of a proprietary quality, which exists independently of any court order.[75] One can conceive of subrogation-justifying facts triggering what amounts to a "liability *in rem*", which has the quality of a proprietary entitlement — a liability to have a court recognise/impose legal relations in relation to an asset, equivalent to those that previously existed, which has the potential to affect third parties who later acquire competing claims to the same subject matter.
- The benefit of an uncrystallised "liability" of this sort might be assignable, just as one might assign an unliquidated claim in unjust enrichment, or an unliquidated liability to pay

74. See on court declarations, Part III.A, above.
75. See on priority disputes, Part III.B, above.

damages for a wrong, within the limits that public policy allows.[76]

- A liability model can accommodate the phenomenon of sub-subrogation, merely by adjusting one's understanding of what is released/extinguished, when C pays X. It is not a pre-existing, fully-fledged security interest held by X, which replicates an earlier creditor's security that X previously discharged. Instead, it is the benefit of an uncrystallised *liability* to have the court recognise/impose legal relations of that sort.[77]
- A court might decide to treat the parties' legal positions, *before* proceedings are brought, *as regulated in material respects as if C had the relevant rights from the time that the relevant liability accrued*.[78]
- With little modification, cases exploring the possibility of waiver, abandonment, or merger of C's subrogation-based charge are susceptible to a reading that what is "waived" or "abandoned" or lost by "merger" is the benefit of an uncrystallised *liability* to have the court recognise/impose legal relations equivalent to those that previously existed.[79]

In fact, the case for the liability model can be put more positively. In *Banque Financière* and ensuing cases, the availability of subrogation has sometimes been described in subtly different terms that, if anything, seem more consistent with the liability model. Three points require particular mention.

First, the courts commonly refer to this species of subrogation as a

76. See on assignment, Part III.D, above.
77. See on sub-subrogation, Part III.E, above.
78. See on the validity of supervening enforcement action, Part III.C, above.
79. See on loss by waiver, abandonment or merger, Part III.F, above.

"remedy".[80] This is potentially significant. In legal discourse, the term "remedy" often refers to orders that *courts* make in proceedings before them. Indeed, consistently with this, in some influential recent cases, judges have explicitly referred to subrogation as a "remedy" which is "granted" by the court.[81] Such language points strongly towards the liability model, which assumes that the court has a *necessary* role, in crystallising subrogation entitlements by the orders that it makes. Rather more straining is needed to explain this language consistently with the premises of the strong institutional model. One would have to imagine that the term "remedy" is being used more broadly[82] to describe a legal response to some legally recognised mischief, according to which *the law* alters the parties' legal positions, out of court, where this is required by the principles of the law of unjust enrichment.

Secondly, even more tellingly, in some of the same decisions, judges have drawn an explicit distinction between (i) the pre-existing entitlement that C has acquired independently of any court decision; and (ii) the "remedy" or "order" for subrogation that a court might later make. Again, whilst not completely unequivocal, this distinction is more suggestive of the liability model, according to which a court's order has a *necessary* role in crystallising C's pre-existing subrogation entitlement. Particularly important in this respect are Millett LJ's words in the key pre-*Banque Financière* case of *Boscawen*.[83] His Lordship seemed to draw a clear distinction between the pre-existing "equity" of subrogation and

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80. See *e.g. Filby*, *supra* note 50 at paras 1, 52, 55, 60; *Appleyard*, *supra* note 36 at para 32; *Banque Financière*, *supra* note 1 at 228, 230, 231-32, 234, 236-37; *Boscawen*, *supra* note 3 at 335.

81. See *e.g. Boscawen*, *supra* note 3 at 335, 342; *Omar*, *supra* note 26 at 81; *Karasiewicz*, *supra* note 34 at para 19; *Tiuta*, *supra* note 4 at para 42. *Cf.* Lord Hoffmann, in *Banque Financière*, *supra* note 1 ("subrogation is not a right or a cause of action but an equitable remedy against a party who would otherwise be unjustly enriched. It is a means by which *the court* regulates the legal relationships between a plaintiff and a defendant or defendants in order to prevent unjust enrichment" at 236 [emphasis added]).

82. *Cf.* Zakrzewski, *supra* note 55 ch 2.

83. *Boscawen*, *supra* note 3.

any subsequent court order for subrogation. To quote his words:

> [s]ubrogation … is a remedy, not a cause of action … It is available in a wide variety of different factual situations in which it is required in order to reverse the defendant's unjust enrichment. Equity lawyers speak of a right of subrogation, or of an equity of subrogation, *but this merely reflects the fact that it is not a remedy which the court has a general discretion to impose whenever it thinks it just to do so*. The equity arises from the conduct of the parties on well-settled principles and in defined circumstances which make it unconscionable for the defendant to deny the proprietary interest claimed by the plaintiff. A constructive trust arises in the same way. *Once the equity is established the court satisfies it by declaring that the property in question is subject to a charge by way of subrogation* in the one case or a constructive trust in the other.[84]

And later:

> [t]here is no justification for the proposition that [the claimant's] right to be subrogated to the Halifax's charge did not arise until [the claimant] elected to seek that remedy. *Nor … is there any justification for the proposition that [the claimant's] right to be subrogated … did not arise until the court made the necessary order …* It arose at the very moment that the Halifax's charge was discharged, in whole or in part, with [the claimant's] money. It arose because, having regard to the circumstances in which the Halifax's charge was discharged, it would have been unconscionable for [the debtor, Mr. Bajwa] to assert that it had been discharged for his benefit. At law, Mr. Bajwa became the owner of an unencumbered freehold interest in the property; but he never did, even for an instant, in equity.[85]

Drawing on Millett LJ's words, in *Omar*,[86] Lord Justice Jonathan Parker said that in the "ordinary and typical" case, where a claimant seeks to be "subrogated to security rights", "the remedy of subrogation gives effect to a property right which already exists in equity, *i.e.* the right to be regarded as chargee of the property in question".[87] Likewise, in *Karasiewicz*,[88] building on Jonathan Parker LJ's analysis, Lady Justice Arden said that the "effect of the … decision [in *Omar*] is that … the creditor who seeks to be subrogated is given the remedy by way of satisfaction of a pre-existing equitable proprietary right which is vindicated by the order

84. *Ibid* at 335 [emphasis added].
85. *Ibid* at 342 [emphasis added].
86. *Omar*, *supra* note 26.
87. *Ibid* at para 81.
88. *Karasiewicz*, *supra* note 34.

for subrogation".[89] And most recently, in *Tiuta*, Gloster LJ again cited Jonathan Parker LJ's analysis for the proposition that "the remedy of subrogation afforded by the court gives effect to a pre-existing equitable proprietary right (*i.e.* the right to be regarded as the chargee of the question)".[90]

Thirdly, unlike the strong institutional model, the liability model does not assume that C immediately acquires a fully-formed, fully-fledged bundle of rights that represent an equitable replica of the paid-off creditor's discharged rights. As such, the liability model seems consistent with the juristic basis of this form of subrogation,[91] and with the indications that the courts sometimes give, that the subrogation "remedy" has a degree of flexibility, and is susceptible to a degree of principled court shaping.[92] The exact nature of this flexibility is examined in Part V, "The Role of the Court".[93] On any view, C's entitlement is not dramatically inchoate, to the same extent as an entitlement grounded in proprietary estoppel is sometimes — and perhaps wrongly — assumed to be. Nevertheless, its existence and extent may be in some respects uncertain, and therefore properly dependent on a necessary stage of court crystallisation — as the liability model assumes. This uncertainty is increased by the fact that later events can vitally affect the continued existence, extent and enforceability of any rights that C might appear to acquire via subrogation.[94]

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89. *Ibid* at para 19. She went on to acknowledge, in the same paragraph, that there may be "factors which would lead the court to the conclusion that subrogation was not the appropriate relief".
90. *Tiuta*, *supra* note 4 at para 42.
91. See further, Part V.B, below.
92. *Cf. Chetwynd*, *supra* note 2; *Boodle Hatfield*, *supra* note 28; *Western Trust*, *supra* note 2; *Halifax Mortgage Services Ltd v Muirhead*, (1998) 76 P&CR 418 (CA (Civ)(Eng)) [*Muirhead*]; *Mortgage Corporation v Shaire*, [2001] Ch 743 (Eng) at 756; *Karasiewicz*, *supra* note 34; *Appleyard*, *supra* note 36; *Filby*, *supra* note 50; *Kali*, *supra* note 50; *Anfield*, *supra* note 36; *Menelaou v Bank of Cyprus*, [2013] EWCA Civ 1960 [*Menelaou* CA], and on further appeal *Menelaou* SC, *supra* note 6; *Sandher v Pearson*, [2013] EWCA Civ 1822 [*Sandher*].
93. See further, Part V.B.3, below.
94. For a clear demonstration of this, see *Muirhead*, *supra* note 92.

2. A leading authority for the strong institutional model — *Halifax v Omar*

Pausing here, the liability model might appear to be a viable interpretation of the authorities on *Banque Financière* subrogation. There is, however, one key post-*Banque Financière* decision that seems to stand as clear authority for the opposing, strong institutional model: the Court of Appeal's decision in *Omar*.[95] *Omar* is the only modern English authority to have directly considered the quality and status of a subrogation claimant's pre-existing entitlement, and it reaches some emphatic conclusions. In short: (i) where C is entitled to be subrogated to a security interest, C has a fully-fledged equitable (security) interest, and not any lesser form of "mere equity"; (ii) the priority of C's entitlement vis-à-vis later transferees/incumbrancers falls to be determined on that assumption; (iii) this is because "[C] who is subrogated to a security right is treated in equity as if it had that security",[96] by which the Court of Appeal appears to have meant "treated from the outset as if". This important decision warrants extended analysis.

i. The decision in *Halifax v Omar*

The proceedings in *Omar* arose out of frauds practiced on Halifax by a "Mr. Khan", with the assistance of a corrupt solicitor. Mr. Khan had obtained a £147,000 loan from Halifax, ostensibly to buy the registered long-leasehold of a flat for £210,000 from its proprietor, Ms. Garcia. The loan was to be secured by a first legal charge over Mr. Khan's newly-acquired registered title. In truth, the price paid to Ms. Garcia, via the loan monies, was only £132,000, and the transaction never proceeded as Halifax was led to expect. Two transfers of the leasehold title were apparently executed by Ms. Garcia — one in favour of Unitbase, a company controlled by Mr. Khan, and a second in favour of Mr. Khan, expressed to be at Unitbase's direction. However, neither leasehold transfer was ever completed by registration, and no legal charge was ever executed in favour of Halifax to secure its advance. When it subsequently

95. *Omar*, *supra* note 26.

96. *Ibid* at para 84.

discovered the frauds, Halifax attempted to rescue itself by claiming that it was subrogated to the unpaid vendor's lien, previously held by Ms. Garcia, which had been discharged via its £132,000 advance. Unfortunately, an obstacle emerged in the shape of Mr. Omar, then in possession of the flat, who claimed to have acquired a superior equitable interest in the property some months later, by virtue of (i) a contract to purchase the leasehold from Unitbase; or (ii) a 20-year equitable lease from Unitbase. As argued, the case presented itself as a priority dispute between Halifax's entitlement to be subrogated to Ms. Garcia's unpaid vendor's lien, and Mr. Omar's later, competing equitable interest, acquired via the transaction(s) with Unitbase.[97]

The first instance judge found in favour of Halifax. Apparently on the assumption that Halifax had acquired an *equitable* interest, by subrogation, as the relevant facts occurred, the case was treated as a familiar priority dispute between *competing equitable interests*, which fell to be resolved in accordance with the familiar equitable principle that where the equities are equal, the first in time prevails. As Halifax's interest pre-dated Mr. Omar's, and there was no gross negligence or inequitable conduct to deprive Halifax of the priority that it would otherwise enjoy, Halifax prevailed.[98]

Mr. Omar appealed. His counsel's arguments, insofar as they appear from Jonathan Parker LJ's discussion, were ambitious. The starting assumption was clear: following *Banque Financière*, Halifax's entitlement to be subrogated to Ms. Garcia's unpaid vendor's lien was a restitutionary remedy, awarded by the law of unjust enrichment. Less clear is what counsel sought to derive from this. On close inspection, Mr. Omar's counsel seems to have presented three distinct lines of argument on his behalf. They can be restated as follows:[99]

97. Unitbase's entitlement to the leasehold, of which Mr. Omar's must have been derivative, was not closely analysed in the Court of Appeal's reported decision; the argument probably proceeded on the assumption that Unitbase had acquired an equitable title to Ms. Garcia's registered leasehold, by virtue of the unregistered transfer in its favour.

98. *Omar*, *supra* note 26 at para 25.

99. The arguments are extracted/re-constructed from *ibid* at paras 61-63, 84.

- *Argument 1*: Halifax acquired an immediate equitable entitlement, in the nature of an entitlement *in rem*, which was nevertheless a lesser form of entitlement — a "mere equity". Applying conventional priority principles, this left Halifax vulnerable: a bona fide purchaser of a competing legal *or equitable* interest (which is what Mr. Omar claimed to be), would not be subject to an earlier "mere equity".
- *Argument 2*: Halifax acquired an immediate entitlement, in the nature of an entitlement *in rem*. It was an equitable interest, but having been generated by the law of *unjust enrichment*, it was more fragile. The developing law of unjust enrichment embodied a defence of "*bona fide* purchase", and there was no reason why this developing defence should track historic technical distinctions adopted within property law. *Any* innocent purchaser, whether of a legal interest, or of an equitable interest (as Mr. Omar claimed to be), should take free of this form of entitlement.
- *Argument 3*: Halifax did not have an entitlement *in rem*. As suggested by a literal reading of Lord Hoffmann's reasoning in *Banque Financière*, the question whether a later party would be bound to respect Halifax's claim was not determined on the basis that Halifax had an immediate *in rem* entitlement, whose priority and enforceability should be determined by applying property law's conventional priority rules. Instead, it was answered by directly inquiring whether, unless bound by Halifax's claim, that later party would be unjustly enriched at Halifax's expense. That would not be so, if the later party was an innocent purchaser of a competing interest in the same property.

These contentions raise obvious difficulties. *Argument 3* depends upon a radical reading of *Banque Financière*,[100] which sees the remedy operating

100. See Part IV.A.2, above.

in a dramatically *in personam* fashion, inconsistently with widespread assumptions that subrogation can yield a real, fully-fledged security interest. *Argument 2* meanwhile requires the unorthodox assumption that Halifax immediately acquired an equitable interest, which had a lesser *in rem* quality than a conventional equitable interest — and was the practical equivalent of a "mere equity" for priority purposes — *merely because it was generated by the law of unjust enrichment*. *Argument 1* offers a more orthodox route to the same conclusion. *If* Halifax's subrogation entitlement was a "mere equity", then on conventional property law principles, it would attract priority rules that rendered it more fragile in the face of later competing interests.

The Court of Appeal did not hesitate in dismissing Mr. Omar's claims. Unpacked, there were four essential steps in Jonathan Parker LJ's reasoning.

- *Step 1*: Wary of the unsettling implications of the *Banque Financière* decision, Jonathan Parker LJ attempted to confine it within a narrow sphere. In his view, the unjust enrichment theory had no role in "ordinary" cases, where a claimant claimed to be entitled to a security interest by subrogation. Such cases should be resolved via well-established principles, and not by reference to any novel unjust enrichment analysis. As such, the origin of Halifax's entitlement, and its persistence vis-à-vis a third party like Mr. Omar, did not fall to be shaped by references to the law of unjust enrichment at all.[101]

To quote Jonathan Parker LJ:

> [t]he key to the decision in the instant case lies in the distinction, emphasised by Lord Hoffmann in the *BFC* Case … between on the one hand subrogation to a security … and on the other hand subrogation merely to the indebtedness itself … The former category includes rights *in rem*; the latter is limited to rights *in personam*. The instant case falls within the former category; the *BFC* Case falls within the latter. … In the *BFC* Case, the House of Lords fashioned the restitutionary remedy of subrogation to meet a situation in which … property rights were not in issue. It did so by the application of the wider doctrine of

101. *Omar*, *supra* note 26 at paras 70-83.

> unjust enrichment, so as to confer personal rights (as opposed to property rights) on a claimant who had been unjustly deprived as against a defendant who had been unjustly enriched. The instant case, on the other hand, does not require the remedy of subrogation to be fashioned in that special way. […] *[It is] a straightforward case involving property rights, calling into play well-settled principles.*[102]

Jonathan Parker LJ went on to cite a handful of earlier authorities, including Justice Walton's classic encapsulation of the "ordinary and typical example" of subrogation in *Burston Finance Ltd v Speirway Ltd*,[103] whereby A, having paid off secured debts owed to B, was "entitled to be regarded in equity as having had an assignment to him of B's rights as a secured creditor". He then continued:

> [t]he correctness of that statement of the law by Walton J is not in any way affected by the reasoning or the decision of the House of Lords in the *BFC* Case. As Walton J makes clear, he is addressing the "ordinary and typical" case where the claimant seeks to be subrogated to security rights … *In such a case, the remedy of subrogation gives effect to a property right which already exists in equity, i.e. the right to be regarded as chargee of the property in question.*[104]

Adopting these premises, *Arguments 2* and *3* necessarily failed at the first hurdle. Each depended on the unjust enrichment theory, which *ex hypothesi*, was not in play.

- *Step 2*: A long line of authorities indicated that in "ordinary" cases, where a claimant claimed to be entitled to a security interest by subrogation, the claimant acquired an immediate equitable proprietary entitlement, independently of any court order, as the triggering-facts occurred.[105]
- *Step 3*: The priority of this equitable proprietary entitlement should be resolved in accordance with the principles that ordinarily govern the priority of competing interests of the relevant quality, in the relevant subject-matter.

Stopping here, *Argument 1* might still seem viable. A court might conclude, adopting a conventional property law perspective, that the

102. *Ibid* at paras 70-71 [emphasis added].
103. *Burston Finance*, *supra* note 28 at 1652.
104. *Omar*, *supra* note 26 at paras 80-81 [emphasis added].
105. *Ibid* at paras 71, 80-81.

pre-court entitlement of a subrogation claimant like Halifax was a "mere equity". However, this point was apparently only weakly pressed by counsel,[106] and it was dismissed very perfunctorily at the end of Jonathan Parker LJ's judgment:

- *Step 4*: For priority purposes, the subrogation claimant's equitable proprietary entitlement was a fully-fledged equitable interest, and not a "mere equity". Any argument to the contrary was "bad". The authorities cited made it "clear [that] a claimant who is subrogated to a security right is *treated in equity as if it had that security*".[107]

This last step was crucial. Jonathan Parker LJ's explicit premise was that the entitlement that Halifax acquired from the time of the subrogation-justifying facts was a full equitable interest, *because it was an (equitable) replica of the paid-off creditor's security*. Halifax was "*treated in equity as if it had that security*". In *Omar*, the paid-off creditor's security was Ms. Garcia's unpaid vendor's lien. To the extent that Halifax's money was used to pay the purchase price for the property, Halifax was therefore "an equitable chargee".[108] It further followed that Halifax had priority:

i. Halifax had an equitable interest which pre-dated Mr. Omar's competing equitable interest;
ii. applying conventional priority principles, Halifax's interest had prima facie priority, as the first equitable interest in time; and
iii. Halifax was not guilty of any "inequitable conduct" or "gross negligence" that could justify the postponement of its interest to the interest subsequently acquired by Mr. Omar.

Presented in this way, the decision in *Omar* looks like clear authority for the strong institutional model of subrogation. A subrogation claimant like Halifax was assumed to acquire an *immediate* equitable entitlement *in rem*, amounting to an equitable replica of the paid-off creditor's security interest, from the time of the subrogation-justifying facts.

106. *Ibid* at para 84 (observing that the argument, made in written skeletons, was "rightly" not developed in oral argument).
107. *Ibid* [emphasis added].
108. *Ibid*.

ii. Doubts about the status of *Halifax v Omar*

It is certainly *possible* to read early cases as Jonathan Parker LJ did.[109] Nevertheless, we should not leap too quickly to the conclusion that the strong institutional model has prevailed. There are several reasons, cumulatively weighty, for doubting the authoritative status of the *Omar* decision on this point.

First, the cases on which Jonathan Parker LJ relied pre-date the authoritative re-rationalisation of "equitable subrogation" in *Banque Financière*, as a restitutionary remedy to reverse unjust enrichment. The language of those earlier cases certainly pointed to a strongly "institutional" response, insofar as C was described as, or as equivalently placed to, an equitable "assignee", or X's rights were said to be "kept alive" for C's benefit. However, this is a vision which cannot be sustained, without qualification, post-*Banque Financière*.

Secondly, Jonathan Parker LJ's conception of subrogation partly depended on the assumption that the *Banque Financière* rationalisation can be marginalised, and has no role in explaining subrogation to a security interest. However, the *Banque Financière* rationalisation cannot be dismissed so easily: their Lordships' analysis does not bear the narrow reading that Jonathan Parker LJ proposed. Although the facts of *Banque Financière* were unusual, and the subrogation entitlement recognised by the House of Lords took an unusual, *in personam* form, the unjust enrichment framework was *not* thought to operate only in such unusual cases. It was being offered as a general rationalisation for the remedy afforded even in "ordinary and typical cases", where the claimant had discharged another's security interest, and was claiming to be entitled to

109. See also later cases, which seem to accept the same understanding, *obiter*, without close scrutiny: *Tiuta*, *supra* note 4 (where the *Omar* case is relied on); *Trustees Executors Ltd v Steve G Ltd,* [2013] NZHC 16 (where *Boscawen* is cited as authority that an equitable charge arises "on the discharge of the secured creditor's debt, independently of any court order" at paras 114-115).

a security interest by subrogation.[110]

On close examination, the line that Jonathan Parker LJ drew between "subrogation to a security interest" (in relation to which he thought unjust enrichment had no role) and "subrogation to a mere debt" (which he thought was governed by the *Banque Financière* rationalisation) does not withstand examination, either conceptually or as an accurate reading of *Banque Financière*. It confuses the subject-matter of the subrogation claim with the nature of the rights generated by subrogation.

In *Banque Financière*, BFC had advanced money for the purpose of paying off an earlier first charge held by RTB over Parc's land, in the belief that it had effective security in the form of a postponement agreement with Parc's group creditors, including OOL, a second charge-holder. In fact, the postponement agreement was not effective, and BFC sought to rescue itself, by alleging that it was entitled, by subrogation, to be placed in the same position as RTB — the first chargee — had previously occupied. To that extent, *Banque Financière* did involve subrogation "to a security interest", and it seems that the court might have been justified in finding that BFC had an equitable entitlement *in rem*, mirroring the nature and priority of RTB's security interest, but for one crucial circumstance. This was that to afford such an entitlement to BFC — as BFC originally claimed — would have left BFC unjustifiably better off than it had expected. It did not bargain for proprietary security over Parc's land: it loaned money in the mistaken belief that it had an effective postponement agreement with BFC's group creditors. That is why the House of Lords chose, exceptionally, to recognise BFC's subrogation entitlement in an attenuated *in personam* form: *i.e.* BFC was treated as if it were an assignee of RTB's first charge, but *only vis-à-vis* OOL, the second charge-holder, over whom BFC had expected priority by virtue of

110. For recent acceptance of this at Supreme Court level, see *Menelaou* SC, *supra* note 6 (and in particular Lord Clarke, giving one of two majority opinions: "I would accept … that the analyses in *Banque Financière* have rationalised the older cases through the prism of unjust enrichment" at para 50). *Cf.* the lone sceptical voice of Lord Carnwath, in the same case, at para 108.

the postponement agreement.[111]

Immediately post-*Omar*, some judges appeared tempted to accept Jonathan Parker LJ's awkward distinction.[112] However, this view has not persisted. In numerous subsequent cases, the courts have directly invoked the *Banque Financière* unjust enrichment framework to justify the availability of subrogation even in what Jonathan Parker LJ described as the "ordinary and typical" case: *i.e.* where a claimant claims to be entitled to a security interest by subrogation.[113]

Thirdly, contrary to Jonathan Parker LJ's assumptions, pre-*Banque Financière* cases may not have authoritatively determined the exact nature of the subrogation claimant's pre-court entitlement. They certainly indicated that it ordinarily had some form of *in rem* status. However, it is hard to find a pre-*Banque Financière* case in which a court had to decide the exact quality of C's pre-court entitlement, in a competition with a third party who later acquired rights in relation to the same subject-matter. Either the issue did not arise, or the result would not have been different, according to whether the interest was an "equitable interest" or a "mere equity".[114] If that is correct, then the proper characterisation of C's pre-court entitlement was arguably a matter of first impression.

Fourthly, past cases, so far as they bear on this priority issue, are slightly more equivocal than Jonathan Parker LJ indicates. In particular, *Boscawen*,[115] a case on which he placed much reliance, does not necessarily

111. A reading of *Banque Financière*, *supra* note 1, recently expressly accepted by Lord Clarke in *Menelaou* SC, *supra* note 6 at para 50.

112. See, in particular, *Karasiewicz*, *supra* note 34.

113. See *e.g.* *Menelaou* SC, *supra* note 6; *Tiuta*, *supra* note 4; *Menelaou* CA, *supra* note 93; *Sandher*, *supra* note 93; *Lehman*, *supra* note 28; *Anfield*, *supra* note 36; *Primlake*, *supra* note 28; *Kali*, *supra* note 50. And see *Appleyard*, *supra* note 36 at para 31 (where Neuberger LJ specifically dismisses as incorrect the assumption in the *Omar* and *Karasiewicz* cases that *Banque Financière* introduced any radical new principles into the law of subrogation). And see too *Boscawen*, *supra* note 3 (on which Jonathan Parker LJ placed heavy reliance, where Millett LJ expressly describes subrogation as a "remedy" for "unjust enrichment").

114. *Cf. Boscawen*, *supra* note 3 (where a priority issue did not arise, for reasons given by Millett LJ at 331); see also *Chandiram*, *supra* note 2.

115. *Boscawen*, *supra* note 3.

support the line he took. There are interesting passages of Millett LJ's discussion where he considers *Re Diplock*,[116] and the difficulties which the Court of Appeal had found in recognising that the next of kin might be subrogated to charges which the charities had paid off using monies improperly distributed by the deceased's personal representatives. Lord Justice Millett noted the Court of Appeal's evident concerns about the impact of such subrogation rights on third parties. Responding to the view that "insoluble problems" might arise in a case where in the meanwhile fresh charges had been created on the property", Millett LJ said:

> [it is not] clear to me why insoluble problems would arise in a case where there had been fresh charges created on the property in the meantime. The next of kin would obtain a charge by subrogation with the same priority as the charge which had been redeemed except that it would not enjoy the paramountacy of the legal estate. A subsequent incumbrancer who obtained a legal estate for value without notice of the interest of the next of kin would take free from it. *It is not necessary to decide whether a subsequent incumbrancer who took an equitable charge only would take free from the interest of the next of kin; the question has not yet arisen for decision, but it is not insoluble.*[117]

Lord Justice Millett's equivocation in the last sentence concerning the resolution of a competition between any pre-existing subrogation entitlement and a later equitable charge is interesting. It is open to two interpretations. On one view, Millett LJ was recognising that in a competition between two equitable interests, the priority position is more complicated to state, because the "first in time" starting-point is qualified by exceptions that may favour the later interest. However, on another view, Millett LJ might have been registering uncertainty about the proper characterisation of the status of a claimant's pre-court entitlement — more particularly, its classification as an "equitable interest", or as a "mere equity". The latter status would, of course, render it more fragile in a competition with later interests, legal or equitable.[118] Although also inconclusive, the terms in which Millett LJ described the "remedy" of subrogation seem consistent with that analysis. On several occasions, he

116. [1948] Ch 465 (CA (Eng)) at 549-50.

117. *Boscawen*, *supra* note 3 at 341 [emphasis added].

118. But *cf.* now the position under the *Land Registration Act 2002* (UK), c 9 ss 28-30, 116 [*Land Registration Act 2002* (UK)]: see *infra* note 120.

spoke of a "pre-existing *equity*" of subrogation, which arose independently of any court order, as the relevant facts occurred, and which a court order would subsequently "satisfy".[119]

Fifthly, as previously noted, in *Boscawen*, Millett LJ appeared to draw a distinction between (i) the pre-existing entitlement which the subrogation claimant acquired as the facts happen; and (ii) any order that a court would later make, to "satisfy" the "equity". This seems important. The strong institutional model, which Jonathan Parker LJ appears to endorse, suggests that a court has no *necessary* role in the process of crystallising a claimant's subrogation entitlement. The entitlement has already come into being, fully-formed and fully-fledged, just like the entitlement of an assignee pursuant to a voluntary assignment. However, Millett LJ's analysis is susceptible to a different interpretation, more consistent with the liability model. Adopting this approach, the "pre-existing equity" to which Millett LJ referred is C's entitlement to bring proceedings to enforce the "liability", of D and relevant others, to have the court recognise/impose legal relations equivalent to those that previously existed. In these later proceedings, the court has a real, non-trivial role in crystallising the claimant's subrogation entitlement, by its "order" for subrogation. Furthermore, adopting this approach, it does not follow that because a court will declare that C occupies the position of the paid-off creditor, this necessarily means that, for the purposes of determining the priority of C's entitlement *vis-à-vis* parties who had acquired competing interests through intermediate transactions, C's position is to be determined on the assumption that C, at that earlier point in time, had a fully-fledged, fully-crystallised equitable entitlement mirroring the paid-off creditor's previous entitlement. There is a choice for the law to make, regarding the proper status of the *in rem* entitlement constituted by the "liability *in rem*". It could be afforded the quality of a full equitable interest, or just a mere equity, depending upon how robustly the courts wish to protect

119. *Boscawen*, *supra* note 3 at 335 and 342.

later parties from undiscovered burdens.[120]

Finally, although Jonathan Parker LJ resisted this rationalisation, once subrogation cases are viewed within the context of the wider law of unjust enrichment, as *Banque Financière* and later authorities require, then the case for the liability model looks more compelling. In contrast, the strong institutional model, if adopted, risks some unfortunate inconsistencies with the wider law. These points are explained in the following sections.

D. Choosing Between the Models: the Position in Principle

It seems to follow that the English courts are at a crossroads when it comes to understanding the nature of C's pre-court entitlement in cases involving *Banque Financière* subrogation. This question cannot be conclusively answered as a matter of authority. There is therefore a choice for future courts, when it comes to determining how, in principle, the *Banque Financière* subrogation remedy truly works.

This is not, of course, an easy question. Indeed, on deeper inquiry, another wrinkle threatens to complicate the picture. So far, the discussion has presented a binary choice between two models: the strong institutional model and the liability model. However, recent unjust enrichment scholarship raises a question whether this is a flawed vision, in ignoring a third, and on some accounts more satisfactory, analytical

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120. In fact, in relation to rights affecting *registered* titles to *land*, the *Land Registration Act 2002* (UK), *supra* note 118, which came into force after *Omar*, *supra* note 26 was decided, now seems to render the distinction between full equitable interest and mere equity irrelevant for priority purposes. Thus, s 116 declares for the avoidance of doubt that "in relation to registered land", a "mere equity" "has effect from the time the equity arises as an interest capable of binding successors in title"; whilst ss 28-30 lay down the basic priority principles which would now apply, without distinction, to determine a priority dispute between a prior full equitable interest/mere equity and a later interest.

possibility: what tends to be called the "power model".[121] Happily, on closer consideration, this turns out to be a red herring. The power model is ultimately a version of the strong institutional model, and suffers from the same pitfalls. The liability model should be preferred to both.

1. A possible third way: the "power model"?

The availability and nature of proprietary restitutionary responses is undoubtedly one of the most contested and difficult areas of the English law of unjust enrichment.[122] On any view, the authorities have not developed in a coherent, systematic fashion. Opinions sharply divide about the best interpretation of the existing materials, and the best direction for the law's future development. One aspect of this debate concerns the precise mechanism by which the law achieves proprietary/specific restitution.

Recent academic accounts have come to distinguish two key

121. A potential source of confusion needs to be anticipated at the outset. Under the "liability model", a subrogation claimant, C, *might* be said to hold a "power", in so far as C can, by bringing successful proceedings against D, precipitate a court order that crystallises his subrogation entitlement and affects an alteration in the parties' legal positions. It might then appear that the "liability model" is merely a "power model", viewed from the opposite side. However, within this article's area of concern, this is an unhelpful and misleading equation. The "power" assumed by the "power model" involves something narrower: *i.e.* a power held by C to bring about a change in the legal relations of C and D *by virtue of his own act of will*, and without the necessity for any court order. In short, whereas the "liability model" assumes that a court order is necessary for the crystallisation of C's subrogation entitlement, the "power model" assumes that *C* can crystallise his subrogation entitlement, by the exercise of a power vested in him. Alternative terminology, which might more directly capture the essential distinction, would be "court-crystallised"/"claimant-crystallised".

122. For a survey of some key controversies, see Mitchell, Mitchell & Watterson, *Goff & Jones*, *supra* note 9 ch 37.

conceptual possibilities.[123] One approach assumes that the law immediately generates fully-fledged proprietary rights in favour of C: the "immediate rights" analysis. A second assumes that C does not initially acquire such rights, but instead has merely a *power* to bring those rights into being, on his validly exercising the power: the "power (*in rem*)" analysis. Imagine, for example, that D receives an asset from C as a result of some restitution-justifying mistake, and that the law is willing to reverse this defective transaction *in specie*. Might the law achieve this by immediately rendering D a trustee for C, or alternatively, by affording C a power, which brings about that consequence — crystallising D's status as trustee for C, and C's status as trust beneficiary — only contingently, upon the power's exercise?

If the availability of the *Banque Financière* subrogation remedy falls to be justified by reference to the principles of the law of unjust enrichment, then there will certainly be cases where the remedy's availability must at least sometimes, and to some extent, be "power-contingent". That is, there will be cases where its availability will assume the exercise of a "power" by C: *e.g.* the rescission by C of a transaction, induced by D's fraudulent misrepresentation, under which C paid the money that was used to discharge X creditor's security for D's debts.[124] However, some recent scholarship is bolder than this. Prominent accounts have suggested that for reasons of principle and policy, the law's proprietary restitutionary responses should more generally operate via a "power model" (what Birke Häcker thus calls a "generalised power model"), rather than by an "immediate rights" approach.[125] Translated to the subrogation cases, this

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123. See *e.g.* Birks, *Unjust Enrichment*, *supra* note 22 at 182 and following; Mitchell, Mitchell & Watterson, *Goff & Jones*, *supra* note 9 at 37.25-37.28; Birke Häcker, *Consequences of Impaired Consent Transfers: A Structural Comparison of English and German Law* (Oxford: Hart Publishing, 2013) at 125 and following [Häcker, *Consequences*]; Birke Häcker, "Proprietary Restitution After Impaired Consent Transfers: A Generalised Power Model" (2009) 68:2 Cambridge Law Journal 324 [Häcker, "Proprietary Restitution"].

124. See Part IV.D.2, below.

125. See generally Häcker, "Proprietary Restitution", *supra* note 123; see also Häcker, *Consequences*, *supra* note 123, at 125 and following.

vision of the law might suggest that the *Banque Financière* subrogation remedy should generally operate via a similar "power model". Accordingly, unlike the model so far presented as the strong institutional model, C would not automatically acquire a fully-formed, vested equitable replica of X paid-off creditor's security as the subrogation-justifying facts occur. Instead, the crystallisation of those rights in favour of C would depend on C validly exercising a "power", which he held *ab initio*, to *bring those rights into being.*

This "power model" merits close consideration. However, ultimately, for reasons developed in the following sections, it does not call into the question the conclusions reached here that the liability model remains the better vision for the *Banque Financière* subrogation remedy.

2. The multiple sources of "power-contingency"

When it comes to evaluating the plausibility of the "power model", it is vital to recognise that the legal materials are, in important respects, "noisy". There are several reasons why C's ability to claim a restitutionary remedy for unjust enrichment might be contingent on C's exercising some form of *de jure* power, to alter his legal relations with D and/or others. Consider the following situation:

- *Example*. C is induced by D's fraudulent misrepresentation to sell an asset to D. Thereafter, and before C becomes aware of the fraud, D sells the asset, and then uses the money proceeds to discharge a legal charge over his property held by X.

There are at least three reasons why C's ability to seek a remedy on these facts, founded on the law of unjust enrichment, might be "power-contingent".

- *Power-contingency 1*. C's ability to seek *any* restitutionary remedy against D might be found to depend upon C choosing to rescind the sale transaction. D's fraudulent misrepresentation is likely to render the sale voidable *ab initio*, at C's election; however, until avoidance, the transaction is legally valid. On that assumption, it might

seem that, for the time being, the contract provides a basis/ground that justifies D's receipt and retention of the benefits obtained under it. Unless the contract can be and is avoided, through C's election to rescind, no unjust enrichment claim can be brought to recover for any benefit accruing to D, by a money claim or otherwise, inconsistently with the contract. Following this argument through, if C's ability to require D to make restitution in respect of the asset immediately received under the fraud-induced transaction is dependent upon C rescinding the transaction with D, then so *a fortiori*, is any entitlement that C might have to be subrogated to X's charge, based on D's subsequent application of what was received from C under that transaction.

- *Power-contingency 2*. A second and distinct form of power-contingency may arise if C wishes to obtain a proprietary remedy against D, and D no longer retains the asset originally received. In such a case, C will probably find it necessary to rely on the law's tracing rules for the purpose of establishing a claim to some different asset in D's hands. In our example, if D had identifiably retained the proceeds of sale, then C might seek to trace from his original asset, into those proceeds, for the purposes of making some form of proprietary claim to the identifiable money fund. On the more complex facts of the example, C might wish to trace the proceeds of sale further into the hands of X, the paid-off creditor, for the purpose of justifying C's claim to be subrogated to X's extinguished security interest.

English law is undoubtedly generous in affording rights to unauthorised substitutes in circumstances such as these. However, there is an unresolved controversy as to whether this occurs by the law affording a person in C's position immediately vested rights to the unauthorised substitutes,

or only a more fragile "power *in rem*" to acquire such rights.[126] In the example, C's ability to bring *any* claim should depend on his decision to "rescind" the transaction with D. There should be no question of his acquiring any vested rights at least prior to that occurring. However, even assuming that such a decision is effectively made by C, adopting the "power" model of rights to unauthorised substitutes, C should not acquire any vested rights to the money proceeds prior to his exercising the assumed "power" to acquire them. The same analysis would seem to dictate that C should acquire no vested security interest by subrogation *at least* prior to his exercising his assumed power to obtain rights in respect of the substitute for those money proceeds: *i.e.* prior to his validly electing to claim a security interest by subrogation, based on the use of that money to pay off D's debts to X. On that assumption, our ability to conceive of C being entitled to a security interest by subrogation in the example might appear at least doubly power-contingent.

- *Power-contingency 3*. A third possible form of power-contingency is that highlighted by the recent literature, already noted, which argues that proprietary/specific restitutionary responses should more generally work via a "power" model.[127] According to this vision, the law does not/should not generally reverse unjust enrichments *in specie* by means of immediately vested rights; it only does so/should only do so contingently on the exercise by C, the unjust enrichment claimant, of a "power" to acquire such rights. Insofar as the *Banque Financière* subrogation remedy is a proprietary/specific restitutionary mechanism, this vision would suggest that, even without any other reason

126. *Cf.*, *e.g.* the competing visions offered by Lionel Smith, *The Law of Tracing* (Oxford: Oxford University Press, 1997) at 356-61; see also, *e.g.* Peter Birks, "Overview: Tracing, Claiming and Defences", in Peter Birks, ed, *Laundering and Tracing* (Oxford, Oxford University Press, 1995) at 307-11; and more recently in Birks, *Unjust Enrichment*, *supra* note 22 at 198-99.

127. See, in particular, Birke Häcker's illuminating contributions: Häcker, "Proprietary Restitution", *supra* note 123.

for power-contingency, C's acquisition of a "vested" security interest by subrogation should similarly be contingent on C's exercising a "power" to acquire such an interest.

3. Implications of power-contingency for the operation of the subrogation remedy

It is impossible within the confines of this article to explore the validity of the foregoing assumptions; however, neither is it necessary to. Even if it is accepted that the availability of an unjust enrichment claim, and therefore the *Banque Financière* subrogation remedy, is at least sometimes contingent on the exercise of a "power" by C, this insight does not compel us to adopt any particular model of the *Banque Financière* subrogation remedy, and certainly not what has been identified so far as the "power model". Four points require particular emphasis.

First, whether, when, and why the exercise of a "power" by C may be a necessary preliminary to the availability/enforceability of an unjust enrichment claim are much bigger questions for the wider law of unjust enrichment.[128] In principle, whatever answers are given to those questions within that wider body of law should apply to the *Banque Financière* subrogation remedy in the absence of very good reasons to the contrary; legal consistency/coherence requires this. It follows that if future courts are to afford the remedy in a manner that is faithful to its modern juristic basis — *in the law of unjust enrichment* — they must pay very close attention to what that body of law has to say regarding whether C's entitlement is, in any sense, power-contingent. This will be increasingly important if the boundaries of the subrogation remedy are enlarged beyond their historic contextual applications, under the banner of the *Banque Financière* "generalisation".

128. *E.g.* does C's claim in a particular case require his avoidance of a valid transaction? Does the remedy which C seeks depend on his asserting rights consequent on a successful tracing exercise, and if so, do such rights depend for their crystallisation on the exercise of a "power" by C? Even more dramatically, do proprietary restitutionary mechanisms generally operate via a "power", with C's rights not crystallising at least until the power's "exercise"?

Secondly, the fact that C's subrogation entitlement exhibits some degree of power-contingency does not *compel* the adoption of a distinct power model. On inquiry, two major questions of principle arise for resolution:

i. Can C, a subrogation claimant, acquire a fully-formed, vested equitable replica of X's rights out of court (*Model 1* (= the strong institutional model)), or does he only ever acquire the benefit of a *liability*, of D and relevant others, to have the court impose/recognise legal relations mirroring those that previously existed? (*Model 2* (= the liability model))?
ii. In what circumstances, if any, does the existence/enforceability of those vested rights (Model 1) or of that liability (Model 2) depend on the exercise of some form of power by C?

To put the same point a different way, there is no logical contradiction between either of the two models presented earlier and some degree of power-contingency. C's subrogation entitlement might depend, in at least some cases, and to some extent, on the exercise of a power. Nonetheless, that does not determine, as a matter of irrefutable logic, *the nature of the entitlement that crystallises upon the exercise of the relevant power*. In a subrogation case, exercise of the power might bring about the immediate crystallisation, out of court, of fully-formed, vested equitable replicas of X's rights. Alternatively, it might merely trigger a liability to have a court impose/recognise such relations. In other words, there is no obstacle to the liability model operating, if necessary, in a manner that is conditioned on the exercise of one or more powers by C. Thus, for example, in our earlier example, it might at least depend on C's having elected to rescind the fraud-induced transaction, under which the asset being indirectly traced into the eventual discharge of X's security, was transferred to D.

Thirdly, when evaluating the merits of the power model, it is essential to understand its relationship to the other models. As so far described, the strong institutional model embodies an "*immediate* rights" analysis, rather than a "*power*" analysis. Even so, it would be wrong to view the power model as a truly distinct model, which stands diametrically opposed to the strong institutional model. On the contrary, the power model is really a *version* of the strong institutional model. *Ex hypothesi*, C is assumed to acquire fully-formed, vested rights independently of any court order — the hallmark of the strong institutional model. The only material difference lies in whether these rights arise automatically, as the

relevant facts occur (= the "immediate rights" version) or whether their crystallisation is made to depend on C exercising a "power" to bring them into being (= the "power-based" version). The liability model, by contrast, operates in a fundamentally different way. As the subrogation-justifying facts occur, C merely acquires the benefit of a liability to have a court order recognise/impose legal relations equivalent to those that previously existed. C's rights do not arise automatically, but neither do they arise by virtue of C's act of will alone: they only finally crystallise *by virtue of the court order*. C can of course *precipitate* their final crystallisation, by bringing a successful claim for a judicial order. However, that is quite different from the *de jure* power that is assumed by the "power model" whereby C can, by his unilateral act of will alone, bring the relevant rights into being.

Fourthly, it seems to follow that debates about the relative merits of immediate rights and power-based approaches to proprietary/specific restitution are, in an important respect, a beguiling distraction. There is a more immediately important question of principle when it comes to understanding the subrogation remedy. Simply put: should C ever acquire fully-formed, vested equitable replicas of the paid-off creditor's rights without any court order, or should the final crystallisation of C's rights *depend upon a court determination*?

4. The desirability of/necessity for court-dependent crystallisation

Although the point is not easy, the better answer, in light of the function of *Banque Financière* subrogation as an unjust enrichment remedy, is that court crystallisation should be required. The corollary is that the remedy can only operate via the liability model. Wherever subrogation-justifying facts exist, they should only trigger a "liability" to have a court impose/recognise legal relations equivalent to those that previously existed. Those legal relations only finally crystallise upon, and by virtue of, the court's order; they do not crystallise automatically, or merely by virtue of the exercise of a "power" by C to bring them into being. There are three key points that need to be appreciated, to understand that conclusion.

First, whilst proponents of a "generalised power model" of proprietary/

specific restitution offer several reasons for thinking that the power analysis is superior to the immediate rights analysis,[129] these arguments are not obviously directed to explaining why C's rights should crystallise out of court. They seem to proceed on the unexamined assumption that that *can* occur; the focus of attention is on challenging the assumption that C, the unjust enrichment claimant, should acquire vested rights automatically, rather than upon C exercising a "power" to acquire them. In other words, the debate is substantially cast as a narrow debate *about which version of the strong institutional model is correct.*

Secondly, on deeper analysis, some of the strongest arguments that have been offered *against* the immediate rights analysis, and in favour of the power analysis, can be accommodated within a liability model. To give one of the more important illustrations, the power analysis has been supported on the basis that it better reconciles the interests of C, the unjust enrichment claimant, and innocent third parties who assert competing claims to the same subject-matter. The "power *in rem*" that C initially acquires is assumed to have a lesser *in rem* status, prior to its exercise, insofar as it is susceptible to being defeated by/postponed to later bona fide purchasers of any form of competing interest. However, the liability model is equally capable of achieving a similar reconciliation, if desired. As explained earlier, the priority treatment of the liability model is not preordained: there is a choice for the law/the courts to make, regarding whether C's claim to relief/the corresponding "liability *in rem*" should have the status, for priority purposes, of a full equitable interest or the lesser status of a mere equity.

Thirdly, all of this elaborate discussion is, in any case, a distraction. There are good positive arguments for thinking that *whenever* a subrogation claim arises, all that C should be considered to acquire is the benefit of a "liability". What is more, these arguments stand opposed to any version of a strong institutional model. They supply reasons for thinking that court crystallisation should be a necessary precondition for C's rights, which cannot be overcome by making the vesting of C's rights

129. See, in particular, the arguments offered by Häcker, "Proprietary Restitution", *supra* note 123. *Cf.* also the supportive noises of Mitchell, Mitchell & Watterson, *Goff & Jones*, *supra* note 9 at 37.25-27.28.

depend on C exercising a "power" to acquire them (as the power model suggests). If they stand up, the liability model must be preferred. There are two key arguments:

iii. Above all, whilst the subrogation remedy is not in any real sense a discretionary remedy, significant judicial judgement may well be required, in order to determine its ultimate shape and implications. The liability model seems to offer the most realistic depiction of the court's role in this respect, but it is also the model that is most respectful of the need of all sides for authoritative resolution of their legal entitlements liabilities. Full substantiation of this first argument is deferred to the last Part of this article.

iv. Reinforcing this point, the liability model may also be the more coherent, when situated within the wider law of unjust enrichment. It has recently been argued that personal claims in unjust enrichment operate through what amounts to a form of liability model.[130] The premise is that where the facts establishing a cause of action in unjust enrichment are made out, D does not come under an immediate duty to make restitution to C, who acquires an immediate, correlative claim-right to restitution. Rather, D merely becomes liable to be ordered by a court to make restitution to C. Some key arguments for this vision can also apply to explain why it would be wrong to imagine C acquiring fully-crystallised rights in a subrogation case, without court order.[131] Indeed, it would seem incoherent if personal claims in unjust enrichment operated via a liability model, whereas subrogation did not.

To illustrate this last point, imagine a simple case in which C discharges an unsecured debt owed by D debtor to X creditor, in circumstances where the release of this debt amounts to an unjust enrichment accruing to D, at C's expense. The liability model of personal claims in unjust enrichment holds that D does not immediately owe a *duty* to make restitution in money of the enrichment that he received: *i.e.* of the monetary value of the discharged liability. He is merely "liable" to be subjected to such a duty, by court order. On the same facts, C might in theory put his claim a different way, arguing that he should be subrogated

130. See especially Smith, *supra* note 53 and its accompanying text.

131. Some of Smith's arguments will be controversial. Nevertheless, he does appear to be on firm ground in highlighting the difficulties for D and C in an unjust enrichment case, of understanding whether and to what extent D might owe any duty to make restitution to C: see *ibid* at 173-76. The apparent focus of his concern is the "standard" remedy of monetary restitution. However, there is, if anything, even greater potential uncertainty in subrogation cases in relation to the availability, nature and extent of the "remedy", as explained in Part V, below.

to the unsecured debt which X owed to C.[132] In light of the common foundation of this alternative claim in the law of unjust enrichment, it would seem anomalous if it yielded a structurally different response — *i.e.* if D came under an immediate, fully-crystallised duty to pay C, which replicated the duty previously owed by D to X, rather than merely incurring a *liability* to be subjected to such a duty by a later court order. What is true of the simple but unusual case of subrogation to unsecured personal rights must also be true of the complex but common case of subrogation to another's security interest. It would be similarly anomalous if the subrogation "remedy" saw C acquire an immediate, fully-crystallised equitable replica of X's more complex bundle of rights and powers.[133]

V. The Role of the Court

It is implicit in Part IV's analysis that the correct model of the *Banque Financière* subrogation remedy does not just affect the nature and quality of any pre-court entitlement which is held by C, a subrogation claimant; it also has a crucial bearing on the court's role in the process of effectuating C's claim. The strong institutional model sees courts in an essentially *confirmatory or affirmatory* role: confirming that the facts justify the conclusion that C already holds rights that replicate the paid-off creditor's, automatically or by virtue of his having validly exercised a "power" to crystallise them. In contrast, the liability model assumes that the court's decision and resulting orders have a necessary *crystallising* function. The relevant facts trigger a *liability* to a court order, which is enforceable in proceedings brought by C. However, pending such court

132. See *e.g.* in *Filby*, *supra* note 50 (unsecured overdraft debt). This is ordinarily a redundant argument, insofar as it gives C no advantages over a direct personal claim in unjust enrichment; but that is not always so. See further Mitchell & Watterson, *Subrogation*, *supra* note 4 at 8.32-8.38.

133. Although it is difficult to identify unequivocal explicit recognition of the point in the authorities, the nature of the subrogation remedy, understood as suggested in Part II, above, appears to be that C acquires *prima facie* equivalents of (i) the discharged personal rights to payment that X previously held against D; and (ii) the security interest that X held as security for the satisfaction of those discharged liabilities of D.

order, C's subrogation rights do not have a present and immediately enforceable existence.

The task for this last Part is to substantiate the argument that the liability model offers the best interpretation of the court's involvement. To anticipate the conclusions that follow, two key considerations strongly favour that vision. First, the liability model seems to offer the best reconciliation of: (i) the universal instinct that C acquires some form of "entitlement" to the subrogation remedy as the relevant justifying facts occur; and (ii) the undeniable fact that, whilst subrogation is not a "discretionary" remedy, outside of the simplest cases, it may not possible, without court determination, conclusively to determine whether and on what assumptions subrogation is permissible, the form and extent of the entitlement, and/or its wider implications. Second, reflecting this, the liability model also offers the more realistic account of the parties' positions in the period before any court order is made. Unlike the strong institutional model, the liability model does not require any counter-intuitive assumption that, even before any court's determination, C's rights already had a present, fully-formed existence. It allows instead for the more realistic, transparent recognition that the legal relations that are "crystallised" by the court's order can be dated back to the circumstances that justify their recognition, with binding effect at least on those who are bound by the "liability" to the remedy. However, it also means that this legal consequence is not a matter of irrefutable logic. It remains a matter for principled judicial determination, as it should be, how far, and for what purposes, any backdating assumptions should be allowed to run.

A. Forms of Court Order in Subrogation Cases

An obvious place to begin any inquiry into a court's involvement in subrogation cases might seem to be with the orders that courts typically make, in cases involving *Banque Financière* subrogation. Generally speaking, these take two key forms. Unfortunately, on closer inquiry, these orders are inconclusive: they are compatible with either vision of the subrogation remedy. Surer guidance must be found elsewhere.

1. Declaratory orders

In practice, claimants invariably seek a "declaration" as to their subrogation entitlements. These declaratory orders[134] are susceptible to more than one interpretation.

Adopting a purely "confirmatory" (or "purely declaratory") analysis, these declarations are not technically constitutive of C's subrogation rights. Indeed, they are technically unnecessary. *Ex hypothesi*, C already has the rights thus declared, and can in theory take steps lawfully to enforce them without any declaration being made. The role of a declaratory order in this sense is to confirm, in a form that does not admit of later dispute, that C *has the relevant rights.* However, strictly speaking, the rights declared pre-date and exist independently of the court's order. They do not derive from the court's order, any more than they would in a case where a court was asked to — and did — pronounce upon the legal effect of an assignment.

This confirmatory interpretation is substantially the analysis required by the strong institutional model. In contrast, the liability model requires a different interpretation, which sees the court's declaration as at least partly "constitutive" of C's subrogation entitlement. There is a sense in which it is partly confirmatory: it is awarded on the basis that the facts have generated a liability on D and relevant others, to a court order being made in proceedings brought by C. However, the court's order is also unavoidably constitutive. The court's determination, given legal expression via the declaration, is necessary to finally crystallise, in favour of C, rights against D and relevant others that replicate the rights that X previously held.

Viewed in isolation, these declaratory orders seem equivocal. Nonetheless, the language of some prominent recent decisions, which talk in terms of a court "remedy of" or "order" for subrogation, which "satisfies" or "vindicates" or "enforces" a pre-existing equity, might be thought to imply that these orders are viewed as "constitutive" of C's rights — *i.e.* as right-crystallising.[135] Reference can also be made to Lord

134. See the cases cited, *supra* note 29.

135. See the cases cited, *supra* notes 83-90.

Justice May's words in *Filby v Mortgage Express (No 2) Ltd*: "[t]he essence of the remedy is that the court declares the claimant to have a right having characteristics and content identical to that enjoyed [by the paid-off creditor]".[136] Such modes of expression seem far less apt to describe a court order which is merely affirming.

2. Consequential enforcement orders

Alongside declaratory orders, the courts also commonly make what might be called "enforcement orders". These are the entirely conventional orders that can be sought from a court by holders of conventional security interests, depending upon the bundle of rights/powers conferred by an interest of that nature and the ordinary mode(s) of their enforcement — *e.g.* orders for possession, for the appointment of a receiver, or for sale. Where such orders are sought by subrogation claimants, the range of potential orders should, in principle, mirror those available in respect of the security interest to which C is subrogated; *e.g.* if C is found to be subrogated to an unpaid vendor's lien, then the range of orders that a court may make are the more limited orders ordinarily available to a lien-holder.[137] Nothing more needs to be said about these orders. They are inconclusive as between the two models of the *Banque Financière* subrogation remedy, and relatedly, the two models of declaratory order. They can be conceived of as enforcing the rights that are confirmed (on one model) or constituted or crystallised (on the other model) by the court's declaration.

B. Determining the Existence and Extent of Any Subrogation Entitlement

Rather surer pointers to the "correct" role of the courts in subrogation cases can be found in two different forms. One, considered in the following section, concerns how the courts determine the *implications* of

136. *Filby*, *supra* note 50 at para 63.

137. As indicated by *Thurstan*, *supra* note 29 ("[t]he defendant society, having only an equitable charge, was not entitled to take possession of the mortgaged property. The proper remedy of the society was to obtain a receiver" at 13, per Romer LJ).

C's subrogation entitlement, particularly for events occurring before the court's order is given. The other, examined here, concerns the basis on which the courts determine the existence and extent of C's subrogation rights, which are then declared and enforced. This is a complex issue, on which many chapters could be written,[138] but there are nevertheless several key points that can usefully be extracted. What they boil down to is that it may not be possible, without a court's order, to determine conclusively whether and on what assumptions subrogation is permissible, and the nature and extent of a claimant's entitlement — except in the most simple cases. The sheer number of issues on which a court decision may be required presents a real challenge for a strong institutional model. It points firmly, if not conclusively, towards the liability vision — with its vision of nascent entitlements finally crystallised only by a court order.

1. The court's general approach to the remedy

An important preliminary point is that, whilst *Banque Financière* subrogation is commonly described as an "equitable remedy", a court, when asked to determine C's subrogation entitlement, is not exercising a strongly discretionary jurisdiction. The courts do not claim any broad or unbounded discretion to grant or deny C the "remedy", or even to shape it, as the justice of the case requires.[139] The *Banque Financière*

138. See *e.g.* Mitchell & Watterson, *Subrogation*, *supra* note 4 chs 3-9.

139. See, most emphatically, *Filby*, *supra* note 50 ("[w]ithin [the unjust enrichment framework] the remedy is discretionary in the sense that at each stage it is a matter of judgment whether on the facts the necessary elements are fulfilled"; however, "[i]f … they are fulfilled, there is no residual general discretion to withhold the remedy nor to modify it simply to avoid harsh reality"; the flexibility "[does] not extend, and should not extend, to an unrestrained palm tree discretion" at paras 62, 67, per May LJ); see also, *e.g.* *Appleyard*, *supra* note 36 (a "flexible remedy, which nonetheless must be applied in a principled fashion" at para 34, per Neuberger LJ); *Boscawen*, *supra* note 3 ("it is not a remedy which the court has a general discretion to impose whenever it thinks it just to do so. The equity arises from the conduct of the parties on well settled principles and in defined circumstances […]" at 335, per Millett LJ); and *Banque Financière*, *supra* note 1 at 237, per Lord Clyde.

subrogation remedy, where recognised, follows from the reasoned application of established principles to the case at hand. It would also be wrong to read too much into broad suggestions sometimes encountered that subrogation is a "flexible" or "adaptable" remedy,[140] which the court can "fashion".[141] On examination, the flexibility which is referred to is simply a reflection of the diverse contexts in which the remedy might be sought and the many factual nuances of individual cases, which mean that the application of those established principles will not necessarily yield a single, uniform outcome.

2. Identifying subrogation-justifying facts

Secondly, the *Banque Financière* decision has brought a step-change in the English courts' approach to the identification of subrogation-justifying facts. Pre-*Banque Financière*, the cases, so far as susceptible to any rational explanation, typically proceeded in a categories-focused manner, on the basis of principles narrowly formulated by reference to those categories, and subject to analogical extension.[142] Post-*Banque Financière*, the picture looks rather different. In principle, a court, in rationalising subrogation, is engaged in an exercise of explaining, using the principles supplied by the wider law of unjust enrichment, why the discharge of X creditor's rights would *prima facie* constitute an "unjust enrichment" of D and others, at C's expense, so as potentially to require reversal via the subrogation "remedy". Consistently with this, in *Banque Financière*, the House of Lords made explicit use of the familiar analytical framework of the law of unjust enrichment, with its core inquiries into whether the defendant was relevantly "enriched" "at the claimant's expense", whether there were circumstances rendering this an "unjust"

140. See *e.g. Filby*, *supra* note 50 ("[t]he remedy is flexible and adaptable to produce a just result" at para 62); see also *Appleyard*, *supra* note 36 at para 34.

141. *Cf. Sandher*, *supra* note 92 at para 15.

142. See *e.g.* the former principle, authoritatively represented by the decision in *Chandiram*, *supra* note 2 ("where a third party pays off a mortgage, he is presumed, unless the contrary appears, to intend that the mortgage shall be kept alive for his own benefit" at 745).

enrichment, and whether there was any applicable defence/bar. Later cases have increasingly followed this lead.[143] One necessary caveat is that this framework merely represents an abstract, organising framework, and not a set of concrete principles susceptible to immediate, direct application to the case at hand. Each component of the inquiry brings into play a substantial volume of detailed common law doctrine, which remains, in key respects, subject to ongoing judicial development and significant interpretative controversies.[144]

3. Identifying the nature and extent of C's subrogation entitlement

Thirdly, whilst it would be wrong to regard the nature and extent of C's subrogation entitlement, where *prima facie* justified, as radically inchoate or undetermined, it would also be wrong to assume the reverse: *i.e.* to assume that C simply occupies the position of, or at least equivalent to, an equitable assignee of the paid-off creditor's security, in all circumstances and in every respect. The modern "remedy" operates by generating *new* equitable rights in favour of C, which *prima facie* replicate the characteristics and content of the former creditor's rights.[145] However, that is merely the *prima facie* position, justifiable only to the extent that this is an appropriate mode for reversing the "unjust release" of the legal relations that previously existed.

It is inherent in that underlying remedial objective that C cannot

143. See most recently *Menelaou* SC, *supra* note 6. See previously *Menelaou* CA, *supra* note 92; *Sandher*, *supra* note 92; *Lehman*, *supra* note 28; *Anfield*, *supra* note 36; *Primlake*, *supra* note 28.

144. See most recently *Menelaou* SC, *supra* note 6, which primarily raised a question as to what must be shown to establish that another's debt was discharged "at the claimant's expense", in a sense sufficient to justify the subrogation remedy.

145. See *e.g.* the very clear statements to this effect in *Filby*, *supra* note 50 ("[t]he essence of the remedy is that the court declares the claimant to have a right having characteristics and content identical to that enjoyed [by the paid-off creditor]" at para 63, per May LJ); and more recently, *Tiuta*, *supra* note 4 at para 43, per Gloster LJ. See also *Muirhead*, *supra* note 92 at 426-28, per Evans LJ.

obtain *greater* rights by this mechanism than those previously held by X, the paid-off creditor. However, by the same token, the principles that support the remedy's availability may well also dictate that C should be afforded different — *i.e. lesser* — rights, in one or more respects, than X previously held; and sometimes, that he should have no rights by subrogation at all.[146] This may be the result of the application of *inter alia*: (i) familiar "equitable" defences and bars;[147] (ii) defences, bars and other limiting principles that are characteristically available to defeat or limit any cause of action in unjust enrichment;[148] and (iii) additional considerations that reflect the peculiar *proprietary* nature of relief ordinarily sought, when C claims to be subrogated to an extinguished security interest.

To give some obvious examples, even when C was responsible for discharging X's security interest, the cases show that there may be valid reasons why: (i) it would be inappropriate to afford C the advantages

146. As recognised by Lord Hoffmann in *Banque Financière*, *supra* note 1 at 236. See for a full account, Mitchell & Watterson, *Subrogation*, *supra* note 4 ch 8, recently adopted with approval in *Tiuta*, *supra* note 4 at para 43, per Gloster LJ; see also Mitchell, Mitchell & Watterson, *Goff & Jones*, *supra* note 9 at 39.29-39.40.

147. As assumed in *Appleyard*, *supra* note 36 at para 44. These include: laches/ acquiescence (discussed in *Appleyard*); and "he who seeks equity must do equity" and "must come with clean hands" (recently examined in *Tiuta*, *supra* note 4).

148. These include: (i) change of position (recognised/assumed in *Gertsch v Atsas,* [1999] NSWSC 898 (Austl) [*Gertsch*]; and contemplated in *e.g. Anfield*, *supra* note 36 at para 31, and *Boscawen*, *supra* note 3 at 341); (ii) *bona fide* purchase (implicit in *e.g. London Allied Holdings Ltd v Lee* [2007] EWHC 2061); (iii) "receipt for good consideration" (allowed in *e.g. National Australia Bank Ltd v Rusu,* [2001] NSWSC 32 (Austl), at paras 44-45, 51); (iv) the objection that the rights being claimed would be inconsistent with a valid contract to which C is a party with X, D or some other; (v) illegality/public policy (as argued for in *e.g. Lehman*, *supra* note 28; *Anfield*, *supra* note 36); (vi) limitation/lapse of time. See generally, Mitchell & Watterson, *Subrogation*, *supra* note 4 ch 7.

of *any* form of security interest, by subrogation;[149] or (ii) it would be inappropriate to recognise in favour of C a security interest which has exactly the same priority status as X's interest, *inter alia*, (a) because this would be unjustifiably inconsistent with the basis on which C has validly transacted with D, X or relevant others;[150] (b) because a third party, who was subject to X's interest, can establish a defence that counters any claim by C to equivalent priority for his security interest;[151] (c) because this might unjustifiably prejudice the ability of X, the paid-off creditor, to obtain satisfaction for any outstanding liabilities of D;[152] or (iii) where the *enforceability* of any subrogation-based rights needs to be postponed, in light of the basis on which C transacted with D, X or relevant others.[153]

Whatever the nature of C's subrogation entitlement, there is also — inevitably — an important *quantification* exercise that must be

149. See *e.g.* cases where it would be inconsistent with the basis on which C validly contracted with D, and/or with some other party, to obtain a security interest by subrogation, as in *Paul v Speirway Ltd*, [1976] Ch 220 (Eng); *Banque Financière*, *supra* note 1; *Re Rusjon Ltd*, [2007] EWHC 2943 (Ch).

150. *Cf.*, *e.g. Investors Group Trust Co Ltd v Crispino,* [2006] 147 ACWS (3d) 1069 (Ont Sup Ct).

151. See *e.g.* where C has made a binding priority agreement with another creditor, over whom he might otherwise have priority via subrogation to X's security, postponing his claims to those of that other creditor; or where a junior creditor might establish that he changed his position as a result of the discharge of X's security, by lending further money or by failing to take enforcement action to realise his security (*cf. Anfield*, *supra* note 36 at para 31; and *Armatage Motors Ltd v Royal Trust Corp of Canada* (1997), 34 OR (3d) 599 (CA)).

152. *Cf.* the variety of solutions offered by the courts to this problem: (i) denying C subrogation rights until X is fully paid; (ii) denying C immediately enforceable rights until X is fully paid; (iii) accepting that C might have an immediate subrogation entitlement, but that it ranks immediately after X's subsisting security. For comprehensive discussion, see Mitchell & Watterson, *Subrogation*, *supra* note 4 at 9.50-9.101.

153. See *e.g.* common cases where a surety agrees with a creditor not to assert subrogation rights *vis-à-vis* the principal debtor until the creditor's claims have been fully paid.

undertaken.[154] Thus, in a routine case, where C paid off X's security interest, and is found to be entitled to an equivalent security interest by subrogation, this security interest will secure a monetary liability now owed to C by D. This liability — the "subrogation debt" — must be ascertained and quantified, as a necessary precursor to any enforcement action being taken by C, relying on his subrogation rights. This quantification exercise may not be straightforward, even in what might appear to be "simple" cases.

The presumptive "principal" amount of the subrogation debt will certainly be the monetary liability that C discharged; however, there are a number of reasons why it may be less than this, in light of immediate or subsequent events.[155] To give just two examples, where C's subrogation claim relies on monies advanced by way of a loan to D, it is very likely to be necessary for C to give appropriate credit for any repayments of that loan received from D;[156] and the proper measure of D's liability may sometimes be appropriately reduced or extinguished to reflect some qualifying supervening change of position.

Adding yet another layer of complexity, the measure of the "subrogation debt" will also be fundamentally affected by the basis on which the courts determine any liability of D to pay interest. This remains a contested issue.[157] Recent English cases have tended to proceed on the under-examined assumption that the rationale of the subrogation remedy dictates that interest should be calculated and awarded on a "parasitic" basis — *i.e.* C can claim interest at the rate that would otherwise have been chargeable by X, the paid-off creditor, on the debt

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154. For fuller discussion, see Mitchell & Watterson, *Subrogation*, *supra* note 4 at 8.145-8.156.
155. *Ibid.*
156. *Cf.*, *e.g. Rogers v Resi-Statewide Ltd,* (1991) 105 ALR 145 (FCA); *Muirhead*, *supra* note 92; *Filby*, *supra* note 50 at para 65.
157. See especially Mitchell & Watterson, *Subrogation*, *supra* note 4 at 9.102-9.121, which pre-dates *Sempra Metals Ltd v IRC*, [2007] UKHL 34 (a landmark decision on the availability of compound interest).

that C paid off.[158] However, even this apparently simple starting-point presents complexities. To give some obvious illustrations: (i) as lending rates rarely remain static, it may be necessary to make some (increasingly unrealistic/hypothetical) assumptions about how the paid-off creditor's applicable interest rate would have changed; (ii) to ascertain the sum on which interest is chargeable from time to time, it may be necessary to give appropriate credit for any relevant payments that C may have received from D (as is likely where C provided the relevant monies as a loan to D); and (iii) the courts have some latitude to find that a lower rate is appropriate, *e.g.* where C provided the relevant monies as a lender, at a lower rate. A very different approach to the interest issue, evident in other authorities, is even more indeterminate. This "independent" approach denies the inevitability of "parasitic" interest awards, and assumes instead that interest can be awarded to subrogation claimants on an appropriate compensatory/restitutionary basis, *selected by the court*.[159]

4. Implications

It should be evident from what has just been said that the identification of C's subrogation entitlement is very far from straightforward. On any analysis, it is certainly not a straightforward question of C obtaining equivalents of X's rights, as a matter of course, and in all respects. Once this is realised, the liability model emerges as the more obviously appropriate representation of the court's role in effectuating subrogation rights. It is simply implausible to assume, as the strong institutional model requires, that C held the relevant rights, fully-formed and susceptible to immediate enforcement from the time of the subrogation-justifying facts, and that in any later proceedings, the court is just involved in a (technically

158. See *e.g. Western Trust*, *supra* note 2; *Piddington*, *supra* note 28 at 602; *Muirhead*, *supra* note 92; *Filby*, *supra* note 50 at paras 63-67; *Kali*, *supra* note 50 at para 31 and following, 42; *Primlake*, *supra* note 28 at para 62.

159. For a recent case, where the choice of approaches was squarely confronted for the first time, see *Titles Strata Management Pty Ltd v Nirta* [2015] VSC 187 (Austl). For earlier decisions taking an "independent" approach without discussion, see Mitchell, Mitchell & Watterson, *Goff & Jones*, *supra* note 9 at 39.85.

unnecessary) exercise of confirming/affirming their existence. So much potentially stands to be clarified, and turn on a court's judgement/decision, that it seems more realistic to imagine that the court is engaged in a *necessary* exercise of "crystallising" C's nascent entitlement — *i.e.* transforming, *by its order*, the "liability" to the remedy, into an enforceable set of rights. This also seems to be the more appropriate analysis from the point of view of ensuring legal certainty for all sides. The potential indeterminacy of the subrogation "remedy" brings an important degree of uncertainty for those affected by it; furthermore, in routine cases, the affected parties are not merely C and D, the discharged debtor. On appropriate facts, they will also include: X, the paid-off creditor, who might retain outstanding claims against D; pre-existing incumbrancers, who hold superior/subordinate interests in the same property which may be adversely affected by C's claim; and other third parties who have subsequently acquired competing interests in the same subject matter. Due regard for their interests, including their need for clarity about the existence and extent of C's entitlements, further reinforces the case for a necessary stage of court "crystallization".[160]

C. Determining the Wider Implications of Any Subrogation Entitlement

There is one final point that must be made. Even once the existence and extent of C's subrogation entitlement is ascertained, there is a further potential source of difficulty: *i.e.* working out the wider ramifications of C's entitlement. This has many possible dimensions, which cannot exhaustively be surveyed here. A few examples must suffice.

In many subrogation cases, C will bring proceedings with a view to taking some form of enforcement action, relying on whatever are found to be his subrogation-based rights. A question then arises whether, in

160. *Cf.*, *e.g.* recently *Kali*, *supra* note 50: the primary driver for extended discussion of what sums could be charged under the claimant's subrogation-based security interest, as interest and costs, was the concerns of an existing junior secured creditor, whose subordinate security interest would be more or less deficient depending on the exact sum secured by the claimant's superior subrogation-based charge.

light of the nature of those rights, the action is justified. That can raise some difficult questions of interpretation and attribution for a court for the purpose of determining (i) the basis on which enforcement action might be taken, pursuant to C's subrogation rights; and (ii) whether an occasion for such action can be "deemed" to have accrued. This is amply illustrated by *Halifax Mortgage Services Ltd v Muirhead*[161] ("*Muirhead*"), where the Court of Appeal held that the judge had prematurely made an order for possession in favour of the claimant lender, based on its being subrogated to an earlier charge. No such order should have been made, without first ascertaining what sums, if any, could be deemed to be due under the subrogation-based charge, and potentially in default. This required, *inter alia*, a court determination to ascertain how far sums received by the claimant lender, in repayment of its loan, should be taken to reduce the subrogation debt. The answer, on inquiry, might be that there was no outstanding debt, with the result that any enforcement action, based on that charge, must fail.

The *Muirhead* case illustrates how important a court's determination may be to the practical enforcement of C's rights, even in what may be perfectly routine cases. Even more challenging questions may sometimes arise as to the significance of C's subrogation entitlement for events that occurred *before any court's determination*, and potentially at a time when the parties were unaware of any potential subrogation claim. It seems very likely that these will be susceptible to more appropriate, transparent resolution if the premises of the liability model are accepted. Consider two simple hypotheticals:

i. C lender takes enforcement action, out of court, by taking possession of D's property, pursuant to what it believes is a valid legal charge.[162] There is in fact no such charge, with the result that C's conduct is *prima facie* unlawful. However, at the time C lender took possession, and unknown to all sides, C was potentially entitled to be subrogated to an earlier legal charge, held by X, which the monies loaned by C had paid off, under which X lender would have had the right to possession. In light of C's potential subrogation entitlement, has C acted wrongfully, in taking possession?
ii. C lender takes enforcement action, out of court, by appointing a

161. *Muirhead*, *supra* note 92.

162. *Cf.* the facts of *Thurstan*, *supra* note 29.

> receiver, who takes possession of D's property, pursuant to what C believes is a valid charge.[163] There is in fact no such charge, with the result that the receiver's appointment is obviously challengeable. However, at the time C lender appointed the receiver, C was potentially entitled to be subrogated to an earlier charge, held by X, which C had paid off, under which X lender would have had the right, on certain conditions, to appoint a receiver. In light of C's subrogation entitlement, should the receiver be deemed to have been invalidly appointed?

On what basis should these sorts of question be resolved? The strong institutional model suggests a bold answer: *i.e.* C acquired fully-formed, immediately enforceable replicas of the paid-off creditor's rights as the subrogation-justifying acts occurred; and the legal implications of earlier events should be straightforwardly determined on that basis. However, on closer examination, that is unlikely to be a satisfactory way forward: it seems dangerously conclusive of rather difficult issues. The truer picture — that pending court clarification, the existence, nature and extent of C's subrogation entitlement may well be indeterminate in important respects — suggests that the liability model promises a more appropriate, nuanced solution. Adopting that model: (i) the court's order is a necessary stage in the crystallisation of C's rights; (ii) as a consequence, those rights do not have a present, and immediately enforceable existence, in the period before the court order; (iii) the legal relations that are confirmed and crystallised by the court's order might of course be dated *back* to the circumstances that justified their recognition, with binding effect at least for those who are "liable" to the remedy; (iv) nevertheless, the liability model allows us to see that this legal consequence does not follow as a matter of irrefutable logic; it remains a matter for principled judicial determination how far, and for what purposes, any backdating assumptions should be allowed to run.

VI. Conclusion

Banque Financière's "new" rationalisation of subrogation to "extinguished rights", as an "equitable remedy" designed to reverse "unjust enrichment",[164] forces us to take a fresh look at the nature and operation of this long-standing equitable phenomenon. On closer inquiry, several

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163. *Cf.* the facts of *Tiuta*, *supra* note 4.

164. See Part II, above.

models compete for recognition, but one must ultimately prevail: the weaker institutional conception embodied in the liability model. This model respects the consistent assumption[165] that a subrogation claimant, C, acquires some form of entitlement as *the subrogation-justifying facts happen*. At the same time, it rejects the dangerously bold premise of any stronger institutional conception, that C acquires fully-formed, enforceable equitable replicas of the paid-off creditor's rights, prior to any court order being made. The better, alternative view[166] is that as the facts happen, D (the discharged debtor) and relevant others (*e.g.* junior secured creditors) merely come under a *liability* to be subjected by subsequent court order to legal relations, equivalent to those that previously existed, if this is necessary to reverse the unjust enrichment that resulted from their release; whilst C acquires a concomitant entitlement to bring legal proceedings to obtain such relief. In a typical case where C is entitled to obtain a security interest by this process of subrogation, this equitable liability/C's concomitant equitable entitlement certainly has an effect "*in rem*". Nevertheless, the final crystallisation of that nascent entitlement into an enforceable, vested equitable replica of the paid-off creditor's security interest, properly depends upon a court's determination and order.

165. See Part III, above.
166. See Parts IV and V, above.

Joint Bank Account Trusts and the Protection of Older Adults from Financial Abuse: Exploring Equity's Preference for Beneficiary-Direction Over Beneficiary-Protection

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The equitable doctrine of resulting trusts plays a significant role in defining and allocating the rights and responsibilities of adult children and older adult parents who are co-holders of joint bank accounts. Where equity deems the adult child to be a resulting trustee for their parent, it also imposes a rule that the adult child must follow the directions of the older adult, that is, a beneficiary-direction rule. This rule suffices to hold to account a financially abusive adult child co-holder, but it appears to preclude a beneficiary-protection power, that is, a power of an honest adult child co-holder to take protective action, against the wishes of the older adult, to safeguard the parent from financial abuse by others. This article explores, from a Canadian perspective, but with comparative aspects, the preference of equity for a beneficiary-direction rule over a beneficiary-protection power in the context of joint bank account resulting trusts. While it is contended that it is possible for equity to recognize a beneficiary-protection power, by analogizing such resulting trusts to express trusts, it is ultimately concluded that the preference for the beneficiary-direction rule is reasonable. That conclusion is reached on the basis of considerations of precedent and policy that give rise to a number of interconnected barriers to this analogy. However, since it can be anticipated that a need for protective action might arise, it is argued that equity should respect an express grant of protective power. This, in turn, has implications for lawyers and other advisors on financial affairs and related legal matters.

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I. Introduction

In Canada, as in the comparable common law jurisdictions of England and Wales, and Australia, it is increasingly being recognized that older adults are vulnerable to financial abuse by people with whom they are closely involved in their day-to-day lives, including their adult children.[1] One means of financial abuse can occur when an older adult is influenced by an adult child to draw on her savings for expenses that are partially or entirely to the benefit of the adult child, rather than the older adult. Just such a situation was at issue in the relatively recent Canadian case of *Bakken Estate v Bakken*.[2] A dispute arose between an adult son, who was suspected of selfishly influencing his elderly mother, and his adult

1. See *e.g.* Senate of Canada, Special Senate Committee on Aging, *Canada's Aging Population: Seizing the Opportunity* (April 2009) at 24-26 (Chair: Sharon Carstairs); UK, House of Commons, Health Committee, *Elder Abuse: Second Report of Session 2003-04*, vol 1 (March 2004) at 23-25 (Chair: David Hinchliffe); Government of South Australia, Department for Health and Ageing, *Strategy to Safeguard the Rights of Older South Australians 2014-2021*, (May 2014) at 15.
2. 2014 BCSC 1540 [*Bakken Estate*].

sister who, as co-holder of the joint bank account from which money was being withdrawn by her mother, made a preventative withdrawal of the funds remaining in the account. The daughter's motive was to protect her mother's assets. So motivated, the daughter's action may appear, at least at first blush, to be a morally understandable and appropriate exercise of her capacity to protect her mother's interests. Indeed, it might even be thought that the daughter was not merely morally entitled, but morally obliged, to act. However, on the present state of the law, which in this area is heavily dependent on equity, a strong argument could be made that the daughter acted wrongfully, would be required to immediately reverse the withdrawal and would be liable for any damage or loss associated with her wrong. Although ultimately resolved in favour of the daughter on other grounds, the *Bakken Estate* case illustrates a difficult issue that can arise for adult children who are co-holders of joint bank accounts with their older adult parents — namely, whether the adult child is entitled to act protectively against the immediate wishes of the older adult. The objective of this article is to explore and assess the legal framework applicable to this issue, with a focus on the role played by the rules and principles of equity.

Equitable rules and principles, particularly in the area of resulting trusts, are intimately involved in the definition and allocation of rights and responsibilities between joint bank account holders, at least where one of the co-holders is the source of all of the original funds in the account. Typically, if the older adult intended that the funds would only be used for her benefit during her life, then the funds will be subject to a resulting trust in favour of the older adult and the co-holding adult child will only be permitted to deal with the funds for the older adult's benefit. This general arrangement of rights and responsibilities is adequate to address another means of financial abuse of older adults, namely, when the co-holding adult child independently and without permission expends money from the joint account for her own benefit. Selfish expenditure of this kind is a clear violation of the responsibilities of a resulting trustee. The numerous cases and decisions attesting to that violation rest on the basic rule that resulting trustees may only act with the knowledge and consent, or direction, of the older adult beneficiary

— what will herein be called the "beneficiary-direction" rule. In contrast, there appears to be no Canadian or comparative cases or decisions on the issue of whether and to what extent the rules and principles relating to resulting trusts might allow or, even, require a resulting trustee to proactively protect the older adult from the selfish influence of others — what will herein be called a "beneficiary-protection" power (which, if not merely allowed but required, would be a duty). At the same time though, the doctrine articulated on the basis of the beneficiary-direction rule in the cases dealing with selfish resulting trustees appears to leave no room for protective action. Moreover, where relevant equitable rules and principles have been applied in similar contexts, such as ostensibly protective action by adult children holding powers of attorney, those children have been held to have acted wrongfully.

This article considers the apparent preference of equity for a beneficiary-direction rule over a beneficiary-protection power in the context of adult children who are co-holders of joint bank accounts with their older adult parents. Ultimately, it is argued that this preference is reasonable in the sense that there are good reasons of precedent and policy for equity not to automatically or presumptively provide resulting trustees with discretion to act protectively. At the same time though, since it can be anticipated that a need for protective action might arise, and that a power to act protectively might be useful, the door should remain open to the possibility that equity would respect an express grant of protective power. The article proceeds in three parts. In Part II, it provides an overview of the approach of equity, via the doctrine of resulting trusts, to the situation where older adults enter joint bank account relationships with an adult child, including how the doctrine of resulting trusts identifies and allocates any beneficial interest. Part III then situates the doctrine of resulting trusts in relation to other relevant areas of equitable doctrine, especially on trustee and fiduciary obligations, and contextualizes the issue of the rights and responsibilities of resulting trustees. This includes an explanation of the beneficiary-direction rule and of the possibility of recognizing a beneficiary-protection power via an analogizing of the position of a resulting trustee to that of an express trustee. Part IV then identifies and assesses four barriers to that analogy,

namely: (i) the paramountcy of the resulting trust approach and the beneficiary-direction rule in cases addressing joint bank accounts; (ii) the mixed treatment of, and concerns raised over, claims to a beneficiary-protection power in non-trust fiduciary contexts; (iii) the consistency between the judicial preference for the beneficiary-direction rule and the balancing of the interests of older adults in related statutory regimes and law reform initiatives; and, finally, (iv) the likelihood that older adults may somewhat consciously prefer to avoid an express trust approach to joint bank accounts. Since the consideration of these barriers leads to a finding that the preference for a beneficiary-direction rule is reasonable, Part V provides a brief discussion of the possibility of leaving the door open to equitable recognition for express grants of protective power, including mention of the implications for lawyers and others providing advice to older adults on their financial affairs. As it proceeds, the analysis conducted in this article offers a modest comparative dimension in that it gives some attention to case law and other relevant material from England and Wales, and Australia.

II. Older Adult Joint Bank Accounts and Resulting Trusts

Canadian and comparative case law provide numerous illustrations of older adults creating joint bank accounts with one or more of their adult children.[3] Often this occurs in the context of the older adult considering issues of capacity or convenience in managing her financial affairs as she ages, as well as issues of estate planning. In a typical scenario, an

3. From Canada, see *e.g. Ast v Mikolas*, 2010 BCSC 127; *Miller v Miller*, 2011 ONSC 7239 [*Miller*]; *Coulston v Dixon*, 2014 ONSC 6134; *Gollan v Burnett*, 2014 BCSC 2424; *Sawdon Estate v Sawdon*, 2014 ONCA 101 [*Sawdon*]; *Mroz v Mroz*, 2015 ONCA 171. From the UK, see *e.g. Aroso v Coutts & Co*, [2001] EWHC 443 (Comm); *Re Northall (Deceased)*, [2010] EWHC 1448 (Ch) [*Northall*]; *Drakeford v Cotton*, [2012] EWHC 1414 (Ch) [*Drakeford*]; *Mathews v Revenue and Customs Commissioners*, [2012] UKUT 658 (TCC). From Australia (and New Zealand), see *e.g. Russell v Scott* (1936), 55 CLR 440 (HCA); *Oliver v Davison* (24 August 1983), NSW BC8311926 (SC)(QL) [*Oliver*]; *Re Brownlee*, [1990] 3 NZLR 243 (HC); *Logan v Gardiner*, [2006] NSWSC 1069 [*Logan*].

older adult creates a new joint bank account with an adult child and is the sole contributor of funds to the account. The older adult intends to retain control over the funds for the remainder of her life, but also wants an adult child to have the power to assist with financial transactions, as needed. In terms of empowering the assistance of the adult child, creation of a joint bank account makes this possible because, at common law, a joint bank account is a recognized form of joint tenancy, with each co-holder entitled to an undivided share of the funds in the account and associated individual and independent rights of deposit and withdrawal. However, at common law, there is no recognition of the primacy of the older adult's interests; it is equity that provides that recognition, through the doctrine of resulting trusts.

The equitable doctrine of resulting trusts is multi-faceted and applies to a variety of situations that can be quite different but, to over-simplify, have in common a voluntary transfer of property that is not intended to benefit the recipient.[4] The general operation of the doctrine of resulting trusts can be illustrated in the context of the creation of a joint bank account co-held by an older adult and an adult child. Where, as is typical,

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4. This is an over-simplification in two senses. First, there is a lively jurisprudential debate about whether the basis of resulting trusts is intention or restitution. For a comprehensive overview of the law of resulting trusts, which argues for a restitution-based approach, see Robert Chambers, *Resulting Trusts* (Oxford: Oxford University Press, 1997) [Chambers, *Resulting Trusts*]. For an encapsulation and view of the debate over the appropriate approach, see John Mee, "Presumed Resulting Trusts, Intention, and Declaration" (2014) 73:1 Cambridge Law Journal 86. Second, resulting trusts can arise in circumstances of error (for example, unintended shortcomings in the establishment of an express trust) or mistake (for example, a misplaced deposit into the wrong bank account), where the question of intention is more complicated or, perhaps, less fruitfully explored. Often, circumstances of error and mistake, among others, are said to give rise to "automatic resulting trusts", whereas circumstances such as those currently under discussion in relation to joint bank accounts are said to give rise to "presumed intention resulting trusts". For an overview of resulting trusts that is structured around this nomenclature, see Dennis Pavlich, *Trusts in Common-Law Canada* (Markham: LexisNexis, 2014).

the older adult contributes all of the funds to the joint account, equity presumes that the older adult did not intend to transfer the beneficial proprietary interest (or, in other words, the equitable interest) in the funds to the adult child.[5] Or, to put it the other way around, equity presumes that the older adult intended to retain the benefit of the funds. The effect of the presumption of a resulting trust is two-fold. First, when the presumption arises, equity presumptively binds the legal rights obtained by the adult child upon the creation of the joint account with a trust relationship that distinguishes the beneficial or equitable interest in the funds and allocates that interest to (or, in historical language, "results" that interest back to) the older adult. Second, having imposed this presumptive allocation, equity then places the onus of proof on any party who may oppose that allocation, whether it is the co-holding adult child or a third party, to show that there was an intention to transfer the beneficial interest. Where such an intention is demonstrated, the presumption of resulting trust is rebutted and the recipient will usually be regarded as having received an immediate gift of the funds. The courts have identified a variety of factors that can be considered in attempting to prove the intention of the older adult, but before discussing those it is necessary to recognize two possibilities that may affect the resulting trust analysis. First, there is the possibility of the older adult establishing the joint account in circumstances that give rise to a contrary equitable presumption, namely, the presumption of advancement. Second, there is the possibility of the older adult having distinct intentions as to the benefit of the funds in the account during the older adult's life and the benefit of the funds remaining in the account upon the older adult's death.

5. Technically speaking, the proprietary rights exist not in any money itself, but in the chose in action that arises through the creation of a bank account and that defines the rights and obligations of the bank and the account holders in relation to each other.

In terms of the contrary equitable presumption of advancement, historically, it applied where the voluntary transferor, or donor, was the husband or father of the donee. In situations of that type, the donor was presumed to be intending to make an "advance" of anticipated future entitlements of a wife or child. In other words, equity presumed that a gift was intended. In the context of a joint bank account, this would mean that if the older adult created co-holding rights in his wife or his child, then the wife or child would be presumed to have received an immediate (*i.e. inter vivos*) gift of the beneficial interest in the funds. Consequently, in equity, any party seeking to contest that presumptive allocation of the beneficial interest would have the onus of proving that there was no intention to give or, in other words, that there was an intention to retain the beneficial interest. The current status of the presumption of advancement differs among common law jurisdictions. In Canada, since the decision in *Pecore v Pecore*,[6] the presumption has been extended to apply equally to both husbands/fathers and wives/mothers, but, with respect to parent-to-child voluntary transfers, has been restricted to minor children. On the other hand, in some Canadian provinces, statutory intervention in relation to spousal division of property on breakdown of family relationship requires that the presumption of resulting trust be applied — and therefore that the presumption of advancement not apply — to all voluntary transfers of property between the spouses.[7] However, some of these statutes also provide that, where spouses are co-holders of joint bank accounts, they will be presumed to be jointly entitled, subject to demonstration of a contrary intention.[8] For England and Wales, the historical common law

6. 2007 SCC 17 [*Pecore* SCC].

7. *Family Law Act*, RSO 1990, c F.3, s 14 [*Family Law Act Ontario*]; *The Family Property Act*, SS 1997, c F-6.3, s 50(1) [*Family Property Act Saskatchewan*]; *Matrimonial Property Act*, RSNS 1989, c 275, s 21(1) [*Matrimonial Property Act Nova Scotia*].

8. *Family Law Act Ontario*, *ibid*, ss 14(a), 14(b); *Family Property Act Saskatchewan*, *supra* note 7, s 50(2)(a); *Matrimonial Property Act Nova Scotia*, *supra* note 7, s 21(1)(a); *The Family Property Act*, CCSM c F25, s 35(4); *Matrimonial Property Act*, RSA 2000, c M-8, s 36(2)(a).

position has remained unchanged,[9] but the presumption of advancement has been statutorily abolished.[10] In Australia, there has been no statutory intervention and no evolution in the common law position.[11] At any rate, in the illustrative joint bank account situation providing the present (and Canadian) context, the presumption of advancement would not apply because the co-holding child is an adult. Therefore, the presumption of resulting trust would apply.

Moving then to the second possibility, in any assessment of the older adult donor's intention in terms of giving or retaining a beneficial interest in the joint bank account funds, it is necessary to recognize the possibility of her having distinct intentions as to the benefit of the funds in the account during her life and to the benefit of the funds remaining in the account upon her death. Doctrinally, this possibility has been managed by allowing the older adult to have a distinct intention for the transfer of the right to survivorship that is an inherent element of a joint tenancy. By virtue of the right of survivorship, when either of the two co-holders of the joint account dies, the survivor is automatically vested with the sole interest in the remaining funds. Equitable doctrine has accepted that an

9. The approach taken in *Pecore* SCC, *supra* note 6, does not appear to have been expressly rejected in any cases from England and Wales, but Glister has suggested that the traditional conception of the presumption of advancement is treated as so well entrenched in both England and Australia that it would be highly unlikely that any court in those jurisdictions would adopt the Canadian approach: see Jamie Glister, "Is There a Presumption of Advancement?" (2011) 33:1 Sydney Law Review 39 at 49 [Glister, "Presumption of Advancement"].

10. *Equality Act 2010* (UK), c 15, s 199; for a critical appraisal of this intervention, see Jamie Glister, "Section 199 of the Equality Act 2010: How Not to Abolish the Presumption of Advancement" (2010) 73:5 Modern Law Review 807.

11. For an overview of the status of the presumption of advancement in Australia and other Commonwealth jurisdictions, see Glister, "Presumption of Advancement", *supra* note 9 at 49. For discussion of the need to consider statutory intervention in Australia, in the context of voluntary transfers relating to land, see Susan Barkehall-Thomas, "Parent to Child Transfers: Gift or Resulting Trust?" (2010) 18:1 Australia Property Law Journal 75.

older adult may intend both to retain the benefit of funds in a joint bank account during her life and to have the right of survivorship operate, in favour of the co-holding adult child, on any funds remaining in the account upon her death. One reason for this dual-intention can be that the older adult wishes to avoid having the remaining funds transfer as part of her estate under her will. Depending upon the circumstances, it can be either more convenient (*e.g.* the rights of the surviving co-holder are already recognized by the financial institution) or less costly (*e.g.* lower probate fees) for property to transfer upon death by virtue of the right to survivorship, rather than via a testamentary disposition (*i.e.* her will). Although the doctrinal approach of allowing a distinct gift of an equitable interest in the right of survivorship is vulnerable to criticism as inconsistent with some of the basic rules and principles of property law in common law systems,[12] it is now well entrenched.[13] The recognition of the possibility of distinct intentions for the beneficial interest in the jointly-held funds during life and after death must therefore be considered in any analysis of whether a presumption of resulting trust has been rebutted.

Having acknowledged the relevance of the possibilities of the presumption of advancement and of distinct intentions, I now return to the work of the courts in identifying a variety of factors that may be taken into account in discerning the intention of the older adult creating a joint bank account. Obviously enough, the primary factor is any verbal or documented expression of intention by the older adult at the time of establishing the joint account. In addition, and as held in *Pecore*, a variety of other factors are also eligible for consideration, specifically: acts and declarations subsequent to the creation of the account that indicate the intention at the time of establishing the account; contents of bank documents relating to the account; control and use of the account during the lifetime of the older adult; any grants of power of attorney; and, the tax treatment of the funds in the account. In examining evidence relating

12. See, *e.g.* Michael J Welters & Emma A McArthur, “Pecore’s Troubles” (2010) 29:2 Estates, Trusts & Pensions Journal 139 at 149-60.

13. *Pecore* SCC, *supra* note 6 at para 50; *Drakeford*, *supra* note 3 at para 73; *Oliver*, *supra* note 3.

to any of these factors, the question is always what the intention of the older adult was at the time of the creation of the joint account. In joint bank account situations where the presumption of resulting trust is not rebutted, the beneficial interest in the legal proprietary rights that the co-holding adult child enjoys with respect to the account will remain with the older adult. In other words, the legal proprietary rights of the adult child will be bound by a resulting trust in favour of the older adult. To illustrate the application of the doctrine of resulting trusts in the context of joint bank accounts, as well as how consideration of the various factors can lead to different conclusions on the older adult's intentions, I will briefly review *Pecore* and *Bakken Estate*.

In *Pecore*, an older adult father created joint bank accounts with his adult daughter. Following the death of the father, a dispute arose between the daughter and her ex-spouse as to the balance of funds remaining in the joint bank accounts. Both the daughter and her ex-spouse were beneficiaries under the father's will, but the ex-spouse stood to gain if the balance in the accounts did not vest solely in the daughter, via the right of survivorship, but, rather, became part of the residue of the father's estate. The trial judge decided that the presumption of advancement applied and that, considering a number of the relevant factors, it had not been rebutted.[14] The trial judge did not clearly distinguish beneficial entitlement to the funds in the accounts during the father's lifetime from the beneficial right to survivorship but, since the father was deceased, the decision that the daughter had been given the rights of survivorship was sufficient. On appeal, the trial judge's decision was upheld, although the appeal court took the approach that since the father's intention to make a gift of the rights of survivorship was sufficiently clear, there was no need to invoke the presumption of advancement.[15] On further appeal to the Supreme Court,[16] Justice Rothstein, on behalf of the majority, held that neither of the lower courts had taken the correct approach but that, in the end, they had reached the correct result. As a consequence of

14. *Pecore v Pecore* [2004] OTC 188 (Ont Ct J) at paras 28, 44.
15. *Pecore v Pecore* [2005] 202 OAC 169 (Ont CA) at para 46.
16. *Pecore* SCC, *supra* note 6 at para 75, Abella J dissenting in part (on the revision of the presumption of advancement).

reworking the Canadian approach to the presumption of advancement, as mentioned above, Rothstein J held that it was instead the presumption of resulting trust that applied. Moving to a consideration of intention, the following evidence pointed in favour of an intention of the father not to retain an interest in the rights of survivorship: the father and daughter had a close relationship; the daughter relied upon the father for financial assistance; the father was concerned to provide for his daughter after his death; and, in his dealings with his lawyer in relation to his will, the father had treated ownership of the joint accounts as not passing via his estate. Evidence that the father alone had controlled and used the funds in the account during his life and had paid all relevant taxes was treated as indicating that the father intended to retain his beneficial interest in the funds in the accounts during his life, but also as not inconsistent with an intention to give the rights to survivorship. More potentially contra-indicating was evidence that the father had written letters to financial institutions declaring that the joint accounts were not a gift to his daughter, but these were ultimately dismissed from relevance on the basis that they merely evinced an intention to avoid triggering an immediate liability to capital gains tax (which, again, was not inconsistent with intending to give the rights of survivorship). Ultimately then, Rothstein J found that there was ample justification for the trial judge's finding that the father had intended to make a gift of the rights of survivorship and so, even though the analysis needed to be framed in terms of the presumption of resulting trust, rather than the presumption of advancement, the result would be the same and so the appeal could be dismissed.

As such, *Pecore* established the currently prevailing Canadian approach to application of the doctrine of resulting trusts to the situation where an older adult enters a joint bank account relationship with an adult child. This approach was followed in *Bakken Estate*, but led to a different outcome.[17] In *Bakken Estate*, the British Columbia Supreme Court decided that the presumption of resulting trust that arose upon the creation of the joint account between the older adult mother and her adult daughter was rebutted both with respect to the beneficial interest

17. *Bakken Estate*, *supra* note 2.

in the funds during the mother's life and with respect to the balance remaining upon the mother's death. As mentioned earlier, the need to decide upon the allocation of proprietary rights in this case arose in the context of a dispute between the co-holding adult daughter and an adult male sibling. The adult brother was living with the mother, and helping her to manage the family business, when suspicions arose that he was improperly influencing his mother to make withdrawals from the joint account for his own benefit. In response, the co-holding daughter made a preventative withdrawal of the remaining funds in the account. Her brother, on the mother's behalf, sought legal advice on the possibility of contesting his sister's right to make such a withdrawal and the action was commenced a few months later. Less than two months after the commencement of the litigation, a medical assessment concluded that the mother lacked the mental competence to capably manage her own financial affairs and this led to the Office of the Public Guardian and Trustee ("PGT") becoming involved to act as Committee for the mother. Before or despite the PGT assuming this role, and less than two weeks after she was assessed as incapable, the mother purported to transfer her most significant real property interest — the land upon which she lived and operated the family business — into a joint tenancy with her son. As the litigation process was unfolding, the PGT investigated the management of the mother's financial affairs and informed the lawyer for the son and mother that it would not commence its own proceedings relating to the withdrawal from the joint bank account but, rather, was contemplating doing so in relation to the transfer of the real property interest. That is to say, the PGT was more concerned about the actions of the son than of his sister. The mother died nine months after the litigation was commenced. The son, who was the executor of her estate and a co-beneficiary with all of his siblings, continued the litigation on behalf of the estate. At this point the dispute had developed a similar complexion to the dispute in *Pecore* in that the determination of the issue of whether a resulting trust existed in relation to the joint bank account would determine whether the co-holding daughter, or the estate, was the rightful owner of the withdrawn amount and the balance in the account.

In finding that the presumption of resulting trust had been rebutted,

the trial judge in *Bakken Estate* noted evidence that all of the adult children, except the impugned brother, agreed that the purpose of the creation of the joint account was to give the co-holding daughter a gift of an inheritance of $100,000 that the mother had recently received from her deceased sister. This was justified on the basis that, over the years, the mother had given substantially less financial assistance to that daughter than to her other children. The judge found that the terms on which the bank account was established were effective to grant full and equal rights to the joint holders. There was incomplete evidence on the use of the funds in the joint account, as only two uses were mentioned but they do not account for the full amount of the funds. First, soon after opening the account, the mother unilaterally transferred the full $100,000 into a separate investment holding, seemingly in her name only. The capital initially grew but, when it then declined to approximately $90,000, the co-holding daughter assisted the mother in terminating the investment and re-depositing that amount into the joint account. The second use of the account mentioned in evidence was the daughter's preventative withdrawal of $69,970, which was the balance in the joint account at that time. There was no evidence to account for the approximately $20,000 difference, although it would seem that this money may have been that which was expended by the mother under her son's influence. Despite this lack of evidential clarity, the trial judge found that the co-holding daughter had not otherwise drawn on the joint account. Although this finding, combined with the mother's earlier unilateral withdrawal, potentially indicated that neither regarded the co-holding daughter as the beneficial owner of the funds, the judge held that these facts were not conclusive and nor was either fact necessarily inconsistent with an intention to make an immediate gift of the originally deposited funds. On the other hand, the judge noted that the daughter had declared the interest earned on the invested funds, which was consistent with a gift. On the basis of this accumulation of circumstances, the trial judge in *Bakken Estate* held that the presumption of resulting trust had been rebutted both with respect to the funds in the joint account during the mother's life and with respect to the balance of funds upon her death. Consequently, as the sole beneficial owner of the funds, the co-holding daughter was entitled

to make the withdrawal, regardless of her preventative intentions. Since she had been given the funds in the joint account when it was created, she was entitled to deal with the funds as she saw fit. In the context of the case, and especially with regards to the undue influence apparently being wielded by the son over his mother, the finding that the funds had been given to the daughter upon creation of the joint account seems morally appropriate because it effectively denied the son a share of the funds and relieved the daughter of any liability to her mother's estate. The legal appropriateness of the decision is perhaps more questionable though, because the facts seem to point as much, if not more, in the direction of both the mother and the daughter intending that the mother retain the benefit of the funds during her life, rather than in the direction of the mother immediately relinquishing that benefit to her daughter. But if the court had held that the presumption of resulting trust had not been rebutted in relation to the funds during the mother's life, then it would have had to grapple with the apparent preference of equitable doctrine for a beneficiary-direction rule over a beneficiary-protection power. Consideration of that preference raises the more general issue — that did not fall to be addressed in either *Pecore* or *Bakken Estate* — of the rights and responsibilities of a resulting trustee. This article now moves to that territory, which requires a consideration of the broader context of relevant equitable doctrines and statutory regimes.

III. Equitable Doctrine on the Rights and Responsibilities of Trustees and Fiduciaries: The Possibility of a Beneficiary-Protection Power

In order to identify and explain the rights and responsibilities of resulting trustees it is necessary to situate resulting trust doctrine with respect to other areas of equitable doctrine applicable to trustees and fiduciaries more generally. This part thus begins with an overview of equitable doctrine on trustee and fiduciary obligations and then proceeds to explain the extent to which different types of trustees are subject to a beneficiary-direction rule or, instead, enjoy a zone of autonomy from the wishes of their beneficiaries. This leads to an introduction of the possibility of recognizing a beneficiary-protection power via an analogizing of the

position of a resulting trustee to that of an express trustee who enjoys some autonomy.

The legal roles of trustees and fiduciaries are creatures of equity. These roles, and the rights and responsibilities that go along with them, are both distinct and inter-connected. At the outset of providing an overview of the relevant components of equitable doctrine applicable to trustees and fiduciaries though, and especially in the context of a consideration of resulting trustees, it is important to bear in mind the following conclusion reached by Chambers in the course of what remains one of the few academic inquiries into the role of the resulting trustee:

> [j]ust as there is no uniform set of obligations applicable to all fiduciaries, there is no one set for all trustees or even all resulting trustees. The principle of resulting trust applies in such a wide variety of situations that it is impossible to deduce, solely from the classification of resulting trust, that any particular set of fiduciary obligations applies.[18]

According to Chambers then, not only are the rights and responsibilities of resulting trustees variable and context-dependent, but also, this reflects the fact that, within the general doctrinal frameworks that structure the roles of trustees and fiduciaries, there is significant potential for variability at the more specific level of particular trustees and fiduciaries.

Despite the significance of Chambers' conclusion, which will be brought back into play later in this section, the main elements of the general doctrinal frameworks applicable to trustees and fiduciaries can be outlined. To begin with, all trustees are fiduciaries, but trustees are not the only type of fiduciaries. What typically distinguishes trustees from other types of fiduciaries — such as lawyers, real estate agents, holders of powers of attorney and doctors — is that they hold property and manage it in the interests of their beneficiaries.[19] At a general level, the fundamental responsibility of a fiduciary is the duty of loyalty, which entails acting selflessly, without conflict of interest and only in the best interests of

18. Chambers, *Resulting Trusts*, *supra* note 4 at 200.

19. It should be acknowledged that other types of fiduciaries can have trustee responsibilities if the need to hold or manage property arises. For instance, when lawyers need to handle money or other assets for their clients, they are required to use trust accounts.

the beneficiary. Moreover, breaches of this fundamental responsibility are subject to strict liability in the sense that, for instance, where a fiduciary acts in circumstances of conflict of interest, he or she will have committed a wrong even if the action was taken honestly, in good faith and with reasonable care. As fiduciaries, all types of trustees are similarly bound. As such, trustees are an example of the so-called *per se* or category-based types of fiduciaries. People who occupy certain categories of roles, such as trustees or guardians or agents, are automatically deemed by equity to be acting in a fiduciary capacity and so are subject to fiduciary obligations. The unifying characteristic of these roles is an express or implied undertaking or understanding that the person occupying the role has the capacity to unilaterally affect substantial interests of the other person and must only act in that other person's best interest. This type of fiduciary can be contrasted with *ad hoc* or fact-based types of fiduciaries whose classification as fiduciaries arises from application of general principles to the particular circumstances that existed at the time the person took on the role in question. To simplify, the general principles require an inquiry into the existence of circumstances reflecting the unifying characteristic of categorical fiduciaries.[20]

For their part, the primary responsibility of trustees is to properly administer and dispose of trust property. The scope and nature of this responsibility will vary according to whether the situation involves an express trust, a resulting trust, or a constructive trust. In terms of express trusts, that is, those trusts that are intentionally created, there are three dimensions to the primary responsibility of express trustees. First, express trustees are bound by the terms of their trust, as specified by the creator of the trust. The terms of express trusts can vary widely and impose more or less constraint on the ways in which the trust property must be administered and disposed of. A key issue is the amount of discretion allowed to the trustee in making decisions about administration and

20. This summary reflects the approach of the Supreme Court of Canada as relatively recently stated in *Galambos v Perez*, 2009 SCC 48. See also *Alberta v Elder Advocates of Alberta Society*, 2011 SCC 24.

disposal.[21] A second dimension of the primary responsibility of express trustees is that, to the extent they have any discretion, they must exercise it honestly, in good faith and in accordance with the requisite standard of care. Importantly though, to the extent that an express trustee is directed by the terms of the trust to act in certain ways, without an allowance for discretion, a showing of honesty, good faith and reasonable care will generally be no defense.[22] In other words, express trustees are strictly liable for breaches of non-discretionary trust duties. The third dimension to the primary responsibility of express trustees is that they must fulfill it in accordance with the dictates of the fundamental fiduciary duty of loyalty.

One consequence of the primacy of the terms of the express trust is that, generally speaking, express trustees are meant to act independently of the beneficiaries in the sense that they are not generally regarded as under the control of their beneficiaries. Express trustees are accountable to their beneficiaries, but not subject to direction by those beneficiaries. In turn, where the terms of an express trust diverge from the wishes of beneficiaries, tensions can arise between trustees and their beneficiaries. Likewise, to the extent that an express trustee may be granted discretion, tension can arise where the express trustee and a beneficiary diverge in their opinion of what is in the best interests of a beneficiary in relation to exercise of the discretion. For that matter, a similar tension can arise for any other fiduciary.

It is at this point though that the more specific rights and responsibilities of different types of trustees need to be attuned to the

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21. Trust law draws a fundamental distinction between fixed and discretionary trusts. In a fixed trust, the trustee has no discretion as to identifying the beneficiaries of the trust or as to identifying the amounts or shares of trust property that each shall receive. A discretionary trust arises where discretion of either type is allowed to the trustee. See *e.g.* Albert H Oosterhoff et al, *Oosterhoff on Trusts: Text, Commentary and Materials*, 7d (Toronto: Carswell, 2009) at 20.

22. It should be noted that there is a limited statutory right to be excused of liability for actions by trustees that, although technically breaches of the terms of the trust, are taken honestly, in good faith and with reasonable care: *Trustee Act*, RSO 1990, c T.23, s 35.

nature and circumstances of their trusts. The principle of the primacy of the terms of the trust is most applicable in the context of express trusts, where the terms are deliberately and explicitly articulated. By extension, trustees of express trusts are also understood to enjoy a meaningful degree of autonomy in relation to the wishes of the beneficiaries of express trusts, at least to the extent that the terms of the trust do not provide to the contrary. In other words, unless arising expressly or by necessary implication from the terms of an express trust, an express trustee is not subject to a "beneficiary-direction rule". In contrast, and at the other end of the spectrum, trustees in constructive trust situations, which generally arise through wrongful conduct, rather than deliberate creation, typically have no right to act independently and are essentially awaiting directions from the victim of their wrongful conduct, who will be the beneficial owner, as to when and to whom to transfer the property. In the middle of this spectrum are trustees of resulting trusts, which, as discussed in Part II, arise from a combination of intention and circumstances that, in theory, are distinguishable from those giving rise to express trusts. The degree of autonomy available to a resulting trustee will vary in accordance with variation in the intention and circumstances from which the resulting trust arises.[23] For his part, Chambers analyzes a number of factors potentially relevant to defining the obligations of resulting trustees and argues for adherence to the following general markers.[24] To begin with, he argues that where a resulting trust arises from circumstances associated with the failure of an express trust, the resulting trustee should be subject to the same duties as would have applied to the express trustee, had the express trust not failed. Consequently, whether the resulting trustee in this situation was subject to the beneficiary-direction rule would depend

23. It should be noted that, in Penner's view, all resulting trustees (in presumed intention situations) should be treated as bare trustees but with the proviso that as soon as any intention beyond allocation of beneficial ownership is alleged or identified, the situation should be approached as one of informal express trust, rather than resulting trust: see Jamie E Penner, *The Law Of Trusts*, 6d (Oxford: Oxford University Press, 2008) at 106.

24. Chambers, *Resulting Trusts*, *supra* note 4 at 219.

upon the intended terms of the failed express trust. Next, but at the other end of the spectrum, where a resulting trust arises in circumstances where the resulting trustee is an innocent recipient of the property bound by the trust, the only duty of the resulting trustee ought to be to convey the property at the beneficiary's request. In other words, the beneficiary-direction rule should apply. Finally, and more generally, Chambers argues that although knowledge of the circumstances giving rise to a resulting trust should not be a prerequisite to the recognition of the existence of the resulting trust, liability for breach of fiduciary obligations associated with the resulting trust should not arise until the resulting trustee has such knowledge. Putting all of this together, and bearing in mind the context of the present discussion of older adult joint bank accounts, it would appear possible to contend that where a resulting trustee has assumed that role voluntarily, and with knowledge of the circumstances giving rise to the resulting trust, including an appreciation of the intention behind those circumstances, then the nature and content of her rights and responsibilities ought to be understood more in accordance with the approach taken to those of an express trustee than to those of a constructive trustee or an innocent or unknowing resulting trustee. For present purposes, the key distinction between the two ends of this spectrum is the extent to which the resulting trustee should be subject to the beneficiary-direction rule. Constructive trustees and innocent or unknowing resulting trustees are essentially required to act as directed by the beneficiary. In other words, the fundamental obligation to act in the best interests of the beneficiary collapses into an obligation to act according to the wishes of the beneficiary. In contrast, express trustees are primarily required to act as directed by the terms of the trust and not generally meant to act at the direction of the beneficiaries, except as required by those terms. Further, to the extent that the terms of an express trust allow an express trustee to exercise discretion, he or she is legally understood as enjoying what might be called a "zone of autonomy" in relation to the wishes of the beneficiary, albeit a zone that is always to be navigated only in accordance with an assessment of the best interests of the beneficiary (and with honesty, good faith and reasonable care). Most significantly for present purposes, this legal understanding enables

an express trustee, in determining how to exercise his or her discretion, to independently consider whether the wishes of the beneficiaries align with their best interests and to act against those wishes where the trustee deems it appropriate to do so.

In the context of the present inquiry, this legal understanding that an express trustee may refuse to follow the wishes of the beneficiaries in order to protect the best interests of those beneficiaries amounts to a legal recognition that the express trustee has a beneficiary-protection power. Confirmation of the legal recognition of this power can be found in, for instance, the longstanding precedent in *Tempest v Lord Camoys*[25] (*"Tempest"*), where the English Court of Appeal strongly affirmed the zone of autonomy for express trustees in the context of a dispute over a decision that can be regarded as protectively-motivated. In *Tempest*, the two express trustees had to make a decision about what land to purchase with certain trust funds. While the terms of the trust required that the funds be used for a land purchase, the trustees had to exercise their discretion as to what land to purchase. The adult beneficiaries of the trust requested that the trustees use the funds to purchase a property that had historic significance for the Tempest family. To do so, the trust would have had to take out a mortgage on the property to complete the purchase, but the power to mortgage was a power enjoyed by the trustees. In assessing, as they were duty-bound to do, whether the purchase would

25. (1882), 21 Ch D 571 (CA (Eng)); another foundational case on the zone of autonomy enjoyed by express trustees in discretionary matters is *Gisborne v Gisborne* (1877), 2 App Cas 300 (HL); for what remains an insightful analysis of the trajectory of judicial decision-making since those cases, see Maurice Cullity, "Judicial Control of Trustees' Discretion" (1975) 25:2 University of Toronto Law Journal 99. Cullity's analysis convincingly argues that courts have subsequently established that their power to intervene on grounds of *mala fides* in the exercise of discretion extends far beyond instances of fraud and now includes, for example, instances of consideration being given to irrelevant or extraneous factors — but that expansion does not contradict the legitimacy of trustees' consideration of protective action. Cullity's analysis has more recently been judicially approved in *Fox v Fox Estate* (1996), 28 OR (3d) 496 (CA), per Galligan J.

be in the best interests of the beneficiaries, one trustee was of the view that the purchase and mortgage was appropriate, while the other was not — seemingly due to a concern that it would be imprudent for the trust to burden its property with a mortgage. When the beneficiaries sought an order from a court to compel the transaction, both the trial and appeal courts refused the order. For its part, the Court of Appeal firmly stated the legal position that, where trustees have discretion, and properly exercise it, the courts should not intervene. As such, the decision in *Tempest* confirmed that trustees exercising discretionary powers enjoy a zone of autonomy from the wishes of their beneficiaries and are, in a nutshell, entitled to protect the beneficiaries from themselves.[26]

By analogy, it might be contended, a voluntary and knowing resulting trustee should also be regarded as enjoying a similarly structured zone of autonomy in relation to the wishes of the beneficiary of the resulting trust, subject to evidence of a contrary intention — that is, an intention for beneficiary-direction — existing when the circumstances of the resulting trust arose. By extension, to the extent that protective action might be justifiable by reference to the best interests of the beneficiary, it might then be argued that such a resulting trustee ought to be regarded as holding a beneficiary-protection power or, even, duty.

There are, however, four main barriers to this analogizing of the position of the voluntary and knowing resulting trustee of an older adult joint bank account to the position of an express trustee. In the following part of this article, I will first identify these barriers and then discuss each in turn.

26. Another example of the legal legitimacy of express trustees acting protectively is the validation available to a trustee who seeks the assistance of a court to vary the terms of a trust in order to further the best interest of the beneficiaries by, for instance, postponing a disposition of property to a beneficiary to a time when the beneficiary ought to be adequately equipped to manage the property appropriately: see *NS (Re)*, 2007 NSSC 288.

IV. Barriers to a Beneficiary-Protection Power

The contention that, in relation to a potential power of beneficiary-protection, the position of the voluntary and knowing resulting trustee of an older adult joint bank account can be analogized to the position of an express trustee faces the following four barriers. First, to the extent that existing case law from Canada, as well as England and Wales, and Australia, addresses the situation of voluntary and knowing resulting trustees of joint bank accounts, it all suggests that the beneficiary-direction rule is paramount. Although this case law has only considered situations of allegations of selfish, rather than protective, conduct by the resulting trustees, it would seem to be strongly implied that there is no scope for recognition of a beneficiary-protection power. A second barrier, which reinforces the first, are concerns raised in Canadian precedents dealing with instances of beneficiary-protection action taken by non-trustee fiduciaries with responsibilities for older adults, specifically, adult children with powers of attorney. To some extent, those concerns have revolved around issues of conflict of interest that would be applicable to the situation of joint bank account resulting trusts. In addition though, the concerns have been informed by judicial perceptions of the underlying interests at stake for older adults, and how they should be balanced, in part as reflected in statutory regimes applicable to assistive and substitute decision-making. Those interests, and the fact they are defined, prioritized and balanced in ways that can be regarded as running counter to a beneficiary-protection power, then represent a third barrier to analogizing the position of voluntary and knowing resulting trustees to that of express trustees. The fourth barrier to the analogy is that in the resulting trust situation, the relevant beneficiary is also and always the same person whose actions and intention drove the creation of the resulting trust. This can be contrasted with express trust situations, where the creator of the trust, if a beneficiary at all, will often be but one of numerous beneficiaries. Generally speaking, it might be argued, the creator of an express trust, even if he or she will also be a beneficiary, is likely to be more aware of the significance of his or her actions, in terms of giving over control to the trustee, than would the creator of a resulting trust. Indeed, that awareness may explain why an older adult

would create a joint bank account instead of creating an express trust. In turn, the potential for that awareness may need to inform the approach equity takes to the rights and responsibilities of resulting trustees. I will now discuss each of these barriers in more depth.

A. Barrier #1: The Paramountcy of the Beneficiary-Direction Rule

This section provides a review of two relevant and representative lines of reasoning emanating from cases in Canada, England and Wales, and Australia dealing with rights and responsibilities of resulting trustees in the context of older adult joint bank accounts.

One line of reasoning addresses situations where adult child co-holders of joint bank accounts are accused of financially abusing the older adult by using the funds for their own benefit. Claims against these adult children are usually based on breach of trust and breach of fiduciary obligations. Generally speaking, where wrongful conduct is found, the wrong is said to consist in a departure from the rule that resulting trustees of joint bank accounts can only act as directed by the older adult — that is, a violation of the beneficiary-direction rule. Where an adult child resulting trustee acts so as to benefit him or herself, either without direction from the older adult or contrary to directions, then both a breach of trust and a breach of fiduciary duty has occurred.

An example of the application of the beneficiary-direction rule in England and Wales is provided by *Re Northall (Deceased)*,[27] where an aging mother deposited the proceeds of a sale of her home into a joint bank account created with one of her adult sons. The son made a number of withdrawals from the account during the lifetime of his mother and withdrew the balance for his own benefit following her death. A dispute arose over whether the balance in the account ought to have formed part of the mother's estate and this led to questions being raised about the propriety of the other withdrawals made during the mother's life that did not appear to be for the mother's benefit. Applying the presumption of resulting trust, the court held that it had not been rebutted, either

27. *Northall*, *supra* note 3.

with respect to the beneficial interest in the funds during the mother's lifetime, nor with respect to the right to survivorship. Then applying the beneficiary-direction rule, and finding that the mother had not requested or consented to the co-holding son's withdrawals, the court ordered him to account for those withdrawals and the balance.

To similar effect is the Canadian decision in *Miller v Miller*,[28] where a recently separated older woman deposited the proceeds of a significant disbursement from a trust in her favour into a joint bank account she created with one of her adult daughters. The daughter made numerous large withdrawals from the joint account for her own benefit. Although the daughter even went so far as to have her mother removed from the daughter's home, where she was then living, to a psychiatric ward, the mother eventually received assistance from her estranged husband and brought an action to recover her funds. Applying the presumption of resulting trust, the court held that it had not been rebutted in relation to the beneficial interest in the funds in the joint account during the mother's lifetime (but did not need to address the beneficial interest in the right to survivorship). The court then ordered the daughter to account for the withdrawn funds on two bases that were regarded as distinct. One basis was conversion, which was founded on breach of the beneficiary-direction rule. As reasoned by the court, when a resulting trustee in the position of the daughter makes withdrawals without the knowledge or permission of the older adult beneficiary then she has converted the funds to her own use. The alternative basis was breach of fiduciary duty. The relevance of fiduciary obligations was not based on the daughter's status as a resulting trustee but, rather, was built on reasoning that applied the principles for determining whether an *ad hoc* or fact-based fiduciary relationship had been brought into existence. Finding that the daughter had knowingly undertaken a fiduciary position with respect to her mother, the court had no trouble finding that her self-interested withdrawals violated her fiduciary obligation to act only in the best interests of her beneficiary.

As illustrated by both *Re Northall* and *Miller*, the beneficiary-direction rule is entirely adequate for bringing to account a resulting trustee who

28. *Miller*, *supra* note 3.

acts in a self-interested way. But the beneficiary-direction rule would also preclude a resulting trustee from acting in a protective manner against the wishes or without the knowledge of the beneficiary. In other words, the beneficiary-direction rule appears to eliminate any zone of autonomy for a resulting trustee to assess and safeguard the best interests of the beneficiary. In that sense then, this line of reasoning erects a first barrier to analogizing a resulting trustee to an express trustee in relation to a zone of autonomy and a beneficiary-protection power. However, I have noted the fiduciary basis of liability in *Miller* because it may open an alternative pathway to a protective responsibility. Similarly, and perhaps more feasibly than the *Miller* alternative, there is another line of reasoning emanating from other cases dealing with older adult joint bank accounts that raises the possibility of regarding the circumstances as ultimately giving rise to an express trust, rather than a resulting trust. I will now discuss illustrative examples of this line of reasoning.

The reasoning in these other cases essentially proceeds on the basis that presumptions of either resulting trust or advancement can be rebutted by an intention to create an express trust, although that result has so far only been reached in relation to the right to survivorship in joint bank accounts. An example of this is provided by the Australian case of *Logan v Gardiner*[29] ("*Logan*"), in which an older adult mother was the sole depositor to a joint account opened with her adult daughter. At the same time, the mother attached a note to her will that provided instructions on the distribution of the funds in the joint account. Following the mother's death, the co-holding daughter, who was also administrator of her estate, set about distributing the funds in accordance with the instructions, although only with respect to herself and her immediate family. While acknowledging the entitlements of other family members, the daughter assumed for herself a degree of discretion in distributions to them that was held to be inconsistent with the terms of the mother's note. In the course of litigation brought by those other family members for misadministration of the estate, the court found that the mother had intended to create a secret trust over the right to survivorship relating to

29. *Logan*, *supra* note 3.

the joint account. Although the reasoning is not entirely straightforward, it appears that this intention was treated as rebutting the presumption of advancement (it was the presumption of advancement that applied, rather than the presumption of resulting trust, because, as discussed earlier, in Australia, the presumption of advancement continues to operate in favour of adult children as well as minor children). All parties appeared to accept that there was no intention on the part of the mother to give up control or use of the funds during her lifetime. Having found that a secret trust had been created, the court faulted the co-holding daughter for assuming too great a discretion to herself as the trustee, in contradiction of the terms of the secret trust. She was thus ordered to distribute the funds in accordance with the mother's intentions.

To similar effect is the appeal decision in the Canadian case of *Sawdon Estate v Sawdon*,[30] in which a father converted a number of bank accounts into joint accounts with two of his sons. Following the death of the father, a dispute arose over whether the balances of the various accounts ought to form part of the residue of his estate, which residue had been left to a religious organization. The trial court found that the co-holding sons had been instructed by their father that the balances in the various accounts were to be distributed equally among his five children, including themselves. According to the trial court, in agreeing to this arrangement, the two co-holding sons became either express trustees of the right to survivorship or recipients of a conditional gift of the right to survivorship. At the same time though, the trial court found that the presumption of resulting trust had been rebutted in relation to the money in the various accounts during the father's lifetime. In the words of the trial court, this meant that the father had made immediate *inter vivos* gifts of the funds (a result that was akin to the decision reached in *Bakken Estate*). On appeal, the somewhat contradictory nature of these holdings was corrected. Partially overruling the trial court, the appeal court held that the presumption of resulting trust had not been rebutted in relation to the control and use of the beneficial interest in the funds during the lifetime of the father. As for the arrangement with respect to

30. *Sawdon*, *supra* note 3.

the right of survivorship, the appeal court held that it was best understood as creating an express trust, with the two co-holdings sons as trustees and all of the children as beneficiaries. In other words, the intention to create an express trust displaced the presumption of resulting trust in relation to the right of survivorship.

The significance of the line of reasoning in cases such as *Logan* and *Sawdon* lies in the position that a presumption of resulting trust, or of advancement, can be rebutted, or displaced, by an intention to create an express trust. This is significant because it raises the possibility of finding that an express trust was created not only in relation to a right of survivorship in an older adult joint bank account, as in those two cases, but also in relation to the funds in the account during the older adult's lifetime. After all, the intention of the older adult plays no less pivotal a role in the resulting trust analysis of the allocation of either type of beneficial interest. If it were possible to regard the adult child as (or, at least, as analogous to) an express trustee of the funds then, in turn, it could be argued that the adult child, as an express trustee, enjoys a presumptive zone of autonomy that includes a beneficiary-protection power. In this way, the barrier posed by the application of the beneficiary-direction rule to resulting trustees could be sidestepped. And yet the possibility that an adult child might be regarded as (or analogous to) an express trustee of the funds in an older adult joint bank account during the older adult's lifetime does not appear to have been raised in any cases — although, as noted above, it was suggested in *Miller* that the adult child might somehow be regarded as a stand-alone fiduciary.

Why might courts or counsel be overlooking or avoiding this express trust possibility? One reason might be that the framework of resulting trusts, and more particularly the constraints of the beneficiary-direction rule that it imposes, are perceived as more appropriate to the situation, for the very reason that they preclude the zone of autonomy that might be presumptively enjoyed by an express trustee or *ad hoc* fiduciary. A source of reinforcement for any such perception, and the second barrier to be addressed, is the concerns raised in Canadian cases dealing with adult child holders of powers of attorney who purport to act to protect the interest of their older adult beneficiaries but without the parents'

knowledge or consent.

B. Barrier #2: The Mixed Treatment of, and Concerns Raised About, Beneficiary-Protection Powers

Precedent is scarce on the issue of the validity of a beneficiary-protection power for non-trustee fiduciaries. The little that exists is mixed on the issue and raises some potentially significant concerns that would require attention if resulting trustees were analogized to express trustees.[31] Two Canadian cases that represent the mixed treatment and also illustrate relevant concerns will be discussed in this section. The first case, *Banton v Banton,*[32] is receptive to a beneficiary-protection power where a beneficiary lacks competence to manage their own property, but raises concerns about conflict of interest. The second, *McMullen v Webber*[33] ("*McMullen*"), is negative and raises concerns about properly respecting the autonomy of older adults.

Banton involved an elderly and twice-widowed father who was

31. A search of case law databases covering Canada, England and Wales, and Australia identified only two Canadian cases discussed in this section as addressing what could be regarded claims to a beneficiary-protection power by non-trustee fiduciaries. A further Canadian case is *Fareed v Wood*, [2005] OTC 526 (Ont Ct J)(in which a lawyer was held to have violated his fiduciary duties as both solicitor to, and holder of power of attorney for, an older adult when he accepted responsibility for managing some of her financial affairs but then failed to properly account for or explain a depletion of her assets) [*Fareed*]. Although it was the older adult herself who had transferred away her assets, the lawyer was present at meetings between the older adult and the person to whom she made the transfers but when, following her death, he was asked by beneficiaries under her will to account for the assets, he refused to provide an explanation. While *Fareed* would therefore appear to be imposing a beneficiary-protection duty on a non-trustee fiduciary, this seems to have been based upon a judicial approach that treated the lawyer, in the circumstances (which also included indications that the older adult had lost capacity to manage her property), as a *de facto* express trustee and essentially faulted him for failing to adequately account for a depletion of trust assets.
32. (1998), 164 DLR (4th) 176 (Ont Ct J (Gen Div)) [*Banton*].
33. 2006 BCSC 1656 [*McMullen*].

subjected to the undue influence of a much younger woman who was an employee in the nursing home where he resided. Under her influence, and as his mental capacity deteriorated, the father married the woman and altered his will and powers of attorney in her favour. The factual history was substantial and convoluted and by the time of the litigation gave rise to myriad complicated legal issues. This included a need to define and apply the different legal test for determining mental capacity to marry, testamentary capacity, capacity to manage property and capacity to grant powers of attorney for property and for personal care. For present purposes, the key event was the joint decision by the father's two sons, acting on the authority of the continuing power of attorney that they jointly held, to protectively transfer some of their father's assets into an irrevocable trust for his benefit during his lifetime, with remainder to be shared equally between themselves and their siblings. One of the grounds upon which the validity of this express trust was contested was that the assets that it protected had been improperly distributed to the father, by the sons, as trustees of an earlier express trust established by the father. Under that earlier express trust, the father and his then wife had a life interest, with remainder to be shared equally between the sons and their siblings. The trial judge, Justice Cullity (who is a recognized expert in the trusts field), held that the sons had improperly distributed the capital of that express trust to the father. Consequently, the sons had no power to establish a new trust, even though in similar terms, with what remained of that same capital. Nevertheless, Cullity J went on to consider the further and alternative allegation that the new trust was also an invalid exercise of the continuing power of attorney and this is the allegation that is of most immediate relevance.

In the course of considering this allegation, Cullity J discussed the nature of the rights and responsibilities of holders of a continuing power of attorney, as well as the legitimacy of protective action. Two key points emerge from the discussion. First, Cullity J took the position that a *general* power of attorney — that is, one that applies while the donor/beneficiary is mentally competent — essentially establishes an agency

relationship in which the beneficiary-direction rule is paramount.[34] In contrast, according to Cullity J, where there is a *continuing* power of attorney, and the beneficiary has thus been found to lack capacity to manage property, "[t]he status of such an attorney is much closer to that of a trustee than an agent of the donor".[35] In the eyes of the court, the significance of this shift lay in the extent and degree of the fiduciary duties owed to the donor: "[a]s an agent, such an attorney owes fiduciary duties to the donor but these are pale in comparison with those of an attorney holding a continuing power when the donor has lost capacity to manage property".[36] The second key point made by Cullity J was that the holder of a continuing power of attorney does have the power to establish an express trust on behalf of the donor and is not precluded from doing so for protective reasons. However, given the heightened fiduciary duties, akin to those of trustees, the court will closely scrutinize the attorney's actions and, in particular, will be concerned both with any appearance of conflict of interest or self-benefit and also with any measures that curtail the donor's rights to a greater extent than necessary. In the course of elaborating this point, Cullity J observed as follows:

> I do not share the view that there is an inviolable rule that it is improper for attorneys under a continuing power [of attorney] to take title to the donor's assets either by themselves or jointly with the donor. This must depend upon whether it is reasonable in the particular circumstances to do so to protect or advance the interests, or otherwise benefit, the donor. It is conceivable that circumstances in which this would be reasonable may arise, although I think the burden of demonstrating that this is so should be on the attorneys if the propriety or reasonableness of their conduct is challenged. The authorities that condemn such acts of attorneys where the donor has capacity to manage property are not in point.[37]

Ultimately, although Cullity J expressed the view that the sons had acted at all times in good faith, with selfless motivations, and with valid concerns, he held that the sons had gone too far in three respects: in creating remainder interests in themselves and their siblings; in the extent to which the establishment of the trust would nullify the legal capacities

34. *Banton*, *supra* note 32 at para 150.

35. *Ibid*.

36. *Ibid*.

37. *Ibid* at para 157.

that the father was still deemed mentally capable of exercising; and, in the potential detrimental impact on the statutory rights of the father's new spouse upon his death. A more reasonable approach, according to Cullity J, would have been to vest the remainder in the father's estate.

The decision in *Banton* therefore has mixed implications for the possibility of validating a beneficiary-protection power for resulting trustees by analogizing them to express trustees. On the one hand, *Banton* offers some legal legitimacy to the basic idea that a beneficiary-protection power can be integrated into the rights and responsibilities of those fiduciaries who are regarded as akin to express trustees. On the other hand though, in drawing a distinction between the rights and responsibilities attaching to holders of general and continuing powers of attorney, with the former being framed more as agents, *Banton* reinforces the idea that it is more appropriate for resulting trustees, whose beneficiaries are typically mentally competent, to be subject to a beneficiary-direction rule. In addition, in drawing attention to the issue of conflict of interest and self-benefit, the decision in *Banton* raises an issue that could be expected to often arise for adult child resulting trustees of joint bank accounts because it is they who will typically stand to ultimately benefit from a preservation of the joint bank account funds, either as beneficiaries of the right of survivorship or as heirs to the estate. To the extent that an appearance of a conflict of interest might be an inevitable aspect of the adult child resulting trustee's situation, a preference for the beneficiary-direction rule may be more appropriate.

Insofar as *Banton* associates holders of general powers of attorney with a beneficiary-direction rule, and by implication also associates resulting trustees with that rule, it is reinforced by the decision in the second illustrative case. The litigation in *McMullen* revolved around the actions of the two daughters who jointly held, with their brother, power of attorney in relation to their older adult father. The power of attorney, which enabled the attorneys to do on the father's behalf anything that he could lawfully do by an attorney, required that any two of the three co-holders could act together under it and was granted in accordance with

the *Power of Attorney Act*.[38] The father executed the power of attorney just a few months before the death of his wife, following which he relied upon his family for emotional support and financial advice. One of the daughters was particularly active in assisting her father with organizing his financial affairs and assessing his financial needs. Over the ensuing months the father's children became concerned that he was depressed, acting erratically and being financially exploited by a new romantic partner whom he had met on a vacation he took following his wife's death. Eventually, the daughters utilized the power of attorney to transfer 99% of the value of the father's last remaining significant asset — his condominium — to their spouses. This was despite the fact that, on two occasions during the period of rising concerns among his children, the father's mental capacity had been professionally assessed and found sufficient to continue managing his own financial affairs. The daughters' purported motivation was to protect the property for the longer-term benefit of the father, although they did not inform him of the transaction for fear of upsetting him. Nevertheless, when the father eventually discovered the transaction he immediately called for a reversal and began litigation to set it aside, arguing that the daughters had improperly exercised their powers of attorney.

The court accepted that the daughters were genuinely motivated by a concern for the best interests of their father and also accepted that there was evidence that the father's behavior had changed significantly. Indeed, the court also accepted that there was evidence that the father may have been a victim of financial exploitation. However, since there was no evidence that the father had become incapable of managing his financial affairs and, in fact, given that there was evidence to the opposite effect, it was held that the daughters had violated a duty to provide the father with an accounting of his finances, and had also violated a beneficiary-direction rule, both of which bound them as fiduciary obligations associated with their role as attorneys.

For present purposes, the failure to account need not be addressed. The more immediately relevant aspect of *McMullen* is the application

38. RSBC 1996, c 370.

of the beneficiary-direction rule in this non-trustee context. There is little reasoning in the case as to why the beneficiary-direction rule ought to apply. The decision quotes a Canadian lower court precedent which states that the holder of a power of attorney is a fiduciary and that, as such, the attorney has a duty to account, to exercise reasonable care and to "not act contrary to the interests of the donor".[39] That precedent would not appear to be decisive though, since acting protectively is not necessarily acting contrary to best interests. The decision goes on to advert to a common statutory rule that renders invalid any transfer by an attorney, to him or herself, of property belonging to the beneficiary, unless expressly authorized or ratified by the beneficiary. But that rule is also not decisive because the transaction at issue in *McMullen* was not quite of that type. The pivotal component of the reasoning thus becomes the judge's subsequent statement that "the fiduciary relationship created the duty to act only in accordance with the donor's intentions"[40] and that, regardless of the protective motivation, in acting without the father's knowledge or consent, this duty had been breached. In other words, the key argument is that acting in accordance with the donor-beneficiaries intent can only be achieved if acting with his knowledge and consent — which amounts to an application of the beneficiary-direction rule.

Despite the shortcomings in this chain of reasoning as to the applicability of the beneficiary-direction rule to holders of powers of attorney, it must be acknowledged that it is consistent with the legal position that is basically taken for granted in *Banton* (and, for that matter, in treatises on trusts law).[41] Rather than, as in *Banton*, analogizing the position of the joint-attorney daughters to the position of agents though, the judge in *McMullen* found reinforcement in the nature and limits of related statutory regimes and the ways in which those regimes express and balance relevant interests. This brings me to the third barrier standing in the way of recognition of a beneficiary-protection power for

39. *McMullen*, *supra* note 33 at para 52, quoting from *Andreasen v Daniels-Ferrie*, 2001 BCSC 1503 at para 27, per Quijano J.
40. *McMullen*, *supra* note 33 at para 57.
41. See discussion in Waters et al, *Waters' Law of Trusts in Canada,* 3d (Toronto: Thomson Carswell, 2005) at 53.

resulting trustees.

C. Barrier #3: The Interests of Older Adults and the Balances Struck in Statutory Regimes

The typical parameters of Canadian statutory regimes dealing with the related issues of assisted and substitute decision-making are illustrated in the statutory framework discussed by the judge in *McMullen*. The judge adverted to this framework in addressing the argument, made on behalf of the daughters, that since the daughters' spouses were holding their newly acquired interests in the father's condominium in trust for the father, they ought to be allowed to continue to do so unless and until the father could prove that he was competent to manage his financial affairs in his own best interests and, most importantly, free from manipulation and exploitation. On behalf of the father, it was countered that this was reversing the onus of proof in relation to capacity, contrary to the presumption of capability contained in the *Adult Guardianship Act*.[42] Moreover, accepting the daughters' argument would also improperly circumvent the provisions of the *Patients Property Act* that establishes the process for applications for substitute decision-making power on the basis of mental incapacity.[43] On these issues the court essentially sided with the father. In doing so, the court first invoked a basic legal principle that "[t]he law does not require individuals to make decisions in their own best interests".[44] In fact, the court noted, this guiding principle was reflected in one of the statutory principles formulated to guide administration and interpretation under the *Adult Guardianship Act*: "all adults are entitled to live in the manner they wish and to accept or refuse support, assistance or protection as long as they do not harm others and they are capable of making decisions about those matters".[45] Against the backdrop of this

42. RSBC 1996, c 6, s 3(1) [*Adult Guardianship Act*]. A similar presumption is found, for example, in section 2(1) of the *Substitute Decisions Act*, SO 1992, c 30 [*Substitute Decisions Act*].
43. RSBC 1996, c 34,. ss. 2-3. A similar process is prescribed, for example, in the *Substitute Decisions Act*, *supra* note 42, ss 16(1), 16(2).
44. *McMullen*, *supra* note 33 at para 67.
45. *Adult Guardianship Act*, *supra* note 42, s 2(a).

statutory framework, the judge refused to take up the invitation, from the daughters' counsel, to "fill the gap" into which the circumstances of the case purportedly fell. That gap was the lack of legal power to take protective action in relation to a person, such as the father, who had not crossed a legal threshold of incapacity to manage his own affairs but who appeared to be emotionally and psychologically vulnerable to exploitation and to acting uncharacteristically and unwisely. In refusing to fill this gap, the judge expressed "considerable empathy" for the father's family and acknowledged the dilemma that they faced, however, she stated:

> [t]he issues involved in filling the gap in the law are complex and controversial. Principles of personal autonomy conflict with principles of protection for vulnerable individuals. Legislation dealing with incompetent persons … provide blunt instruments to address problems of incapacity. There are few tools which address the issue of exploitation of vulnerable individuals … Given this complex arena, it is not for this Court to fill the legislative gap, particularly given the evidence in this case.[46]
>
> …
>
> Removing an individual's autonomy is extremely significant. Mr. McMullen is entitled to live his life as he wishes unless and until he is found to be incompetent to manage his own affairs.[47]

The interests identified by the judge in these passages, and the position taken on how to weigh and balance them, are broadly reflective of the current approaches taken by older adult advocacy organizations and authoritative law reform bodies.[48] For instance, in 2012 the Law Commission of Ontario ("LCO") concluded a multi-year study to formulate *A Framework for the Law as it Affects Older Adults* and that framework is built upon a recognition of the following fundamental principles for promoting substantive equality for older adults: respecting

46. *McMullen*, *supra* note 33 at para 72.
47. *Ibid* at para 76.
48. See *e.g.* UK, Law Commission, *Adult Social Care Report*, Law Com No 326 (London: The Stationary Office, 2011) at para 4.26; Ireland, The Law Reform Commission, *Consultation Paper on Law and the Elderly* (LRC CP 23)(Dublin: The Law Reform Commission, 2003) at 158-59; Australia, Cth, Seniors' Rights Victoria, *Submission to the Australian Law Reform Commission: Equality, Capacity and Disability in Commonwealth Law* by Lauren Adamson, Melanie Perkins & Faith Hawthorne (Melbourne: June 2014) at 3.

dignity and worth; fostering independence and autonomy; promoting participation and inclusion; recognizing the importance of security; responding to diversity and individuality; and, understanding membership in the broader community.[49] In elaborating upon these principles, the LCO noted not only that they are interdependent but also that there may be tensions between them. Although the report does not specifically address the issue of beneficiary-protection, in the course of discussing the principles, the LCO seems to favour an approach that reflects the position taken in *McMullen*. This is evident in the general endorsement given to a submission by the Advocacy Center for the Elderly, a longstanding and highly respected specialty legal clinic in Toronto, and the inclusion of the following quotation from them in the report:

> [the principle of security should address] possible vulnerabilities of older adults, whether short-term or long-term, without discounting the principles of dignity, independence and participation. The LCO is discouraged from recommending a framework based on the notion of vulnerability and a perception that older adults lack capacity and need protection.[50]

Ultimately then, when it comes to considering the interests of older adults that are at stake in assessing the merits of equitable recognition of a beneficiary-protection power, the position adopted by the judge in *McMullen* appears not only generally consistent with relevant statutory frameworks but also generally consistent with the approach preferred by a representative leading older adult advocacy organization and a recently concluded representative law reform initiative. That position involves a prioritizing of dignity, autonomy and independence over protection. A key reason for that prioritization is a deep-seated concern over the

49. Law Commission of Ontario, *A Framework for the Law as it Affects Older Adults: Advancing Substantive Equality for Older Persons through Law*, *Policy and Practice*, final report (Toronto: April 2012) at 86 [Law Commission of Ontario, *Advancing Substantive Equality*].

50. *Ibid* at 95, citing Advocacy Centre for the Elderly, *Submission to the Law Commission of Ontario Concerning the Law as it Affects Older Adults* (July 2008) at 5.

debilitating effects on older adults of paternalistic treatment.[51] Clearly enough, there is a very real danger that purportedly protective action may be motivated by or amount to paternalism and so it follows that there would be a general preference for a beneficiary-direction rule over a beneficiary-protection power. In turn, this approach would count against any move to analogize the position of a voluntary and knowing resulting trustee to the position of an express trustee. Similarly, it would also justify a refusal to explore the possibility of regarding an adult child co-holder of a joint bank account as an express trustee, rather than a resulting trustee, of the beneficial interest held by an older adult in the funds in the account during his or her lifetime. In each case, to the extent that a move towards an express trusteeship would potentially open the door to a beneficiary-protection power, a consideration of the underlying interests at stake for older adults, and in particular the risk of paternalism, would discourage that move.

This brings me to a discussion of a fourth and final barrier to analogizing the adult child resulting trustee to an express trustee, namely, the basic dis-analogy that might exist in the mind of the older adult. At the same time though, this discussion leads to an identification of what would appear to be the most appropriate means of managing the dilemma of beneficiary-protection.

D. Barrier #4: The Dis-Analogy of Resulting and Express Trusts

The key component of the dis-analogy between resulting and express trusts is the potential for an affirmative perception, in the mind of the older adult, that the arrangement of an express trust necessarily involves a degree of giving up of control over assets to the express trustee, whereas the arrangement from which the resulting trust arises does not. The existence of this affirmative perception may be attributable to the older adult's general or particular knowledge or experience, or to legal or other

51. The problem of paternalism is emphasized by the Law Commission of Ontario in its discussion of the key ways in which "ageism" can manifest: Law Commission of Ontario, *Advancing Substantive Equality*, *supra* note 49 at 77-78.

professional advice, or both. Regardless, even if it is unlikely that an older adult would be aware of the phenomenon of the resulting trust, and even if similarly unlikely to have ever considered whether he or she preferred a beneficiary-direction rule or a beneficiary-protection power, it may be quite likely that an older adult perceives an express trust as involving a potentially significant degree of empowerment and independence of a trustee that he or she wishes to avoid. Moreover, it may be quite likely that an older adult comprehends that to create a joint bank account, on the basis of an understanding that the funds in the account will only be used for the older adult's benefit during her lifetime, is not to create an express trust. To the extent that this is likely to be the state of an older adult's perception, or to the extent that it makes sense to presume that this is what the older adult perceives, there is a further reason to resist analogizing the position of the adult child resulting trustee to that of an express trustee.

Put another way, this argument could be that the intention that is being investigated in relation to the issue of whether the older adult intended to retain or give up a beneficial interest has a different specificity or robustness than the intention that needs to be demonstrated in relation to the issue of whether an express trust has been created. In keeping with this argument, the explanation for why intentions to create express trusts have only been found in relation to rights of survivorship in joint bank accounts may simply be that it has only been in relation to that aspect of the accounts that the relevant specificity or robustness of intention — what I will call a requisite difference of intentionality — has been found to exist.

Having arrived at the point where the explanation for the preference for the beneficiary-direction rule over a beneficiary-protection power might be reinforced by reference to a difference of intentionality, we also arrive at the point where the most appropriate means of managing the dilemma of beneficiary-protection might be appearing.

V. The Possibility of an Expressed Intention for Beneficiary-Protection Power

On the basis of the foregoing discussion it seems reasonable for equity to approach joint bank account resulting trustee situations by imposing a beneficiary-direction rule and refusing a beneficiary-protection power. At the same time though, and especially given the role of intention in the recognition of resulting trusts, those positions could be regarded as not precluding a recognition that an older adult and co-holding adult child could agree that a beneficiary-protection power will be granted. In other words, the door should be left open to equitable recognition for situations where an older adult expresses an intention that their co-holding adult child should hold a beneficiary-protection power. Arguably, this may involve a degree of intentionality that tips the situation from one of resulting trust to express trust but, since this tip would be based in an express intention, any such argument is really beside the point.

If equity were to take the approach of only recognizing a beneficiary-protection power on the basis of expressed intention, then there would still be a need to grapple with the task of establishing appropriate standards and tests for the valid exercise of such a power. This article does not seek to explore that territory, although attention can at least be drawn to the position expressed by Cullity J, as mentioned in the earlier discussion of *Banton*, that the onus for demonstrating the reasonableness of protective action might best be placed on the fiduciary — that is, in the context of joint bank account resulting trusts, the onus should be on the adult child resulting trustee.

One further point, in relation to implications for the professional responsibility of lawyers, should also be noted. To the extent that the door is still open to equity recognizing an expressed intention for a beneficiary-protection power, this may have significance for the lawyers and others who typically advise clients, either or both older adults and their adult children, on matters relating to joint bank accounts. Practically-speaking, the possibility that an older adult could expressly grant a beneficiary-protection power may be of more interest to their potential co-holding adult children. But since either party may have some interest in the possibility, and since it now seems entirely predictable that circumstances

may arise where there is perceived to be a need to act protectively towards the older adult, it could be argued that discussion of the possibility of expressly granting a beneficiary-protection power should be regarded as a new element of due diligence and, therefore, professional responsibility for lawyers (or other professionals or service providers) who find themselves in the position of advising either or both of the older adult and the adult child on the creation of a joint bank account.

VI. Conclusion

The rules and principles of equity play a significant role in defining and allocating the rights and responsibilities of adult children and older adult parents who are co-holders of joint bank accounts. In a typical situation, adult children are deemed by equity to be resulting trustees for their older adult parents in relation to the funds in the joint bank account, at least during the older adult's lifetime. A particular concern in these contexts is financial abuse of older adults. In situations where the adult child resulting trustee is financially abusing the older adult, without her knowledge or consent, equity applies a rule of beneficiary-direction to resulting trustees. The beneficiary-direction rule is adequate to hold an abusing resulting trustee to account, but in doing so it appears to rule out recognition of a resulting trustee having a beneficiary-protection power, — that is, a power to act against the wishes of the older adult in order to protect her from financial abuse by others. In contrast, equitable rules relating to express trusts can be understood to preserve a zone of autonomy for discretionary responsibilities of express trustees and, in turn, this zone enables a beneficiary-protection power, subject always to the terms of the trust and an assessment of the best interests of the beneficiary. Given that the definition and allocation of the rights and responsibilities of resulting trustees needs to take account of the context within which the resulting trust arises, it might be argued that a voluntary and knowing resulting trustee of a joint bank account could be analogized to an express trustee, at least in terms of enabling a beneficiary-protection power. However, considerations of both precedent and policy give rise to a number of interconnected barriers to this analogy, specifically: (i) the paramountcy of the resulting trust approach and the beneficiary-direction rule in cases

addressing joint bank accounts; (ii) the mixed treatment of claims to a beneficiary-protection power in non-trust fiduciary contexts, including concerns raised over both conflict of interest and appropriate respect for the autonomy of older adults; (iii) the consistency between the judicial preference for the beneficiary-direction rule and the way in which related statutory regimes and law reform initiatives balance the interests of older adults, especially the importance of avoiding paternalism; and, finally, (iv) the likelihood that older adults may somewhat consciously prefer to avoid an express trust approach to joint bank accounts. In assessing these barriers, the analysis conducted in this article draws the conclusion that they are based on a solid and coherent foundation of equitable rules and principles and policy considerations. Ultimately, these barriers construct a strong argument that resulting trustees should not be analogized to express trustees in the sense that equity should continue to prefer a beneficiary-direction rule over a beneficiary-protection power in relation to resulting trustees. At the same time though, since it can be anticipated that a need for protective action might arise, and that a power to act protectively might be useful, the door should remain open to the possibility that equity would respect an express grant of protective power.

This endorsement of equity's apparent preference for a beneficiary-direction rule over a beneficiary-protection power creates a difficult situation for adult children who are resulting trustees of joint bank accounts co-held with their older adult parents when they suspect that their parents are being financially manipulated and exploited. So long as the older adult parent retains mental capacity to manage her financial affairs, and so long as she expresses wishes to use the joint account in specified ways, the adult child who suspects that those wishes are symptoms of financial abuse is legally prohibited from taking preventative protective action by shifting the funds in the joint account out of the reach of the older adult. It can be anticipated that some adult children who face this difficult situation will nevertheless choose to take protective action because, practically-speaking, doing so may be effective in preventing the abuse and, in turn, the adult child may be willing to run the risk of negative legal consequences for such wrongful conduct. While it may be understandable that an adult child would opt for this risky route out of

the difficult situation, and while courts may be tempted to allow him or her to escape liability (after-all, "hard cases" are well-known to make "bad law"), it is important to realize that there are ways to avoid the difficult situation in the first place. One means of avoidance would be an express grant of a beneficiary-protection power to the resulting trustee. Another means would be to undertake the intentional creation of an express trust, rather than merely relying upon a presumed intention resulting trust. For either means to be available though, both the adult child and their older adult parent will need to be aware of the potential for a difficult situation to arise and the possibilities for managing or avoiding it. Ultimately, responsibility for establishing that awareness lies more in the realm of diligent legal/professional practice than equitable legal doctrine. The case law, such as *Bakken Estate*, provides numerous examples of legal and other professionals advising older adults about joint bank accounts in the context of broader discussions of capacity to manage financial affairs and estate planning. It would appear that the resulting trust approach to older adult joint bank accounts is often presented as an option of convenience. But with the problem of older adult financial abuse now clearly apparent, and with case law on the potential for a difficult situation to arise gradually accumulating, the best lesson for lawyers and other professionals to take from *Bakken Estate,* and other litigation of disputes over resulting trustees taking preventative protective action, may be the need to provide advice on the means for preventing resulting trustees from finding themselves in such difficult situations.

Four Questions on Fiduciaries

Sarah Worthington*

This article explores four pressing analytical challenges in fiduciary law. The problems are exposed by seeking answers to the pointed "who, what, and so what?" questions on fiduciaries. In short, "Who is a fiduciary?" and just how far does this protective jurisdiction stretch. Secondly, "What distinctive obligations rest on a fiduciary's shoulders?" — what is it that defines and sets apart the fiduciary regime, providing it with mechanisms which differ from the routine restrictions applying to anyone who acts for others? And, finally, "What particular and distinguishing consequences follow upon a breach of these special restrictions?" This last question breaks down into two familiar but seemingly intractable parts: when and how do profits need to be disgorged; and when and how do losses need to be compensated? The answers to these four questions have never proved easy, yet these are the questions we must answer. Here it is suggested that a tightly rationalised (and, as it turns out, rather narrow) answer to the first question leads inescapably to more readily defensible answers to the three questions which follow it.

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II. Who?: Who is a Fiduciary?
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A. What Profits Must be Disgorged?: Constructive Trusts and Personal Disgorgement of Profits
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I. Introduction

Some areas of equity seem to have presented practical and analytical challenges almost from their inception. Fiduciary law is just such an area. Given its importance in regulating commercial and domestic life, this is a problem. A more settled landscape might have been expected, especially after 50 years of sustained legal analysis by commentators[1] and longer still by judges. That makes its examination ideally suited to the broad but challenging theme of this special issue of the *Canadian Journal of Comparative and Contemporary Law*, with its focus on "Equity in the 21st Century: Problems and Perspectives".

In this article I examine the most pressing and persistent challenges in fiduciary law by exposing four questions which seem to have remained the most intractable throughout the development of this area. Instead of adopting the usual journalistic "who, what, when, where, why?" of fiduciaries, I have gone for the rather shorter "who, what, so what?"

1. Effectively beginning with Leonard Sedgwick Sealy, "Fiduciary Relationships" (1962) 20:1 Cambridge Law Journal 69 [Sealy, "Fiduciary Relationships"]; Leonard Sedgwick Sealy, "Some Principles of Fiduciary Obligation" (1963) 21:1 Cambridge Law Journal 119; and Leonard Sedgwick Sealy, "Director as Trustee" (1967) 25:1 Cambridge Law Journal 83. The earlier work by Austin Scott, by contrast, assumed the category and focused on the consequences: Austin W Scott, "The Fiduciary Principle" (1949) 37:4 California Law Review 539 [Scott, "The Fiduciary Principle"].

series of questions: who are we talking about? What activities are being scrutinised? And — so what? — meaning, so what consequences follow? "So what?" is undoubtedly the most important question for lawyers, and especially for common lawyers.[2] It is the question about remedies, and provides the final two of my four intractable questions on fiduciaries. We only really understand our rights and obligations, and by implication who should be the subject of them, if we understand the remedies. In short, "so what?" often tells us quite a lot about "what" and "who?"

For the most part I have tried to address these issues without delving into the detail of specific cases. But, perhaps predictably, two controversial cases on fiduciary remedies are in my sightlines, one on disgorgement, and one on equitable compensation. Both have emerged from the UK Supreme Court. They are selected because they illustrate especially clearly the issues being addressed in all common law jurisdictions, and provide telling vehicles for exposing the problems. The first is *FHR European Ventures LLP v Cedar Capital Partners LLC*[3] ("*FHR*"), on disgorgement of profits made by a disloyal fiduciary agent taking bribes (or secret commissions, an expression less suggestive of moral turpitude); the second is *AIB Group (UK) v Mark Redler & Co Solicitors*[4] ("*Redler*"), on equitable compensation for losses caused when solicitors made unauthorised payments out of their client account.

But the arguments which underpin this article extend well beyond fiduciary law; they embrace the equitable jurisdiction in its entirety. My larger agenda is that we should stop investing equity with mystique and mystery. Most equitable rules do not need a special language, or a special thought process, or a special philosophy, for their explanation or justification.[5] More than that, we should be able to explain all these

2. This is because common law rights are *defined* by the remedies the courts will award for their protection.
3. [2014] UKSC 45 [*FHR*].
4. [2014] UKSC 58 [*Redler*].
5. Contrast Peter Millett, "The Common Lawyer and the Equity Practitioner" (2015) 6 UK Supreme Court Yearbook 193 ("[e]quity is not a set of rules but a state of mind" at 193) [Millett, "The Common Lawyer"].

rules, and their context, and why they are appropriate, in legal language which makes plain the demarcation between situations where the general (typically common law) rule suffices, and those where some "special" (typically equitable) rule is warranted.[6] The rules may concern legal rights, or obligations, or remedies, or defences. It matters little. Sadly, given the historical baggage and the disinclination to cut free from it, this can probably only be done by the highest courts in each jurisdiction. Only these courts can now give the sort of explanation that cuts through established language and defines principle, doctrine and policy so as to settle, and settle properly, the law in these difficult areas. And by "settle properly" I mean provide judgments which command respect for the force of their reasoning, not merely the weight of their authority.

At least in my two cases on fiduciary remedies, the UK Supreme Court has set out well, exceptionally well in some respects, but (for different reasons in each case) has in the end avoided closing the loop on these difficult issues. I know in saying this I am conforming to academic caricature. During the hearing of *Redler*, Lord Neuberger apparently commented that one thing was certain: whatever the court decided, the decision would be criticised.[7] But I hope this commentary is also appropriately complimentary.

Putting the law on a secure footing is important. Until that is done, debates will persist. These debates create turbulence, destabilising judicial assertions of principle, policy, process, technique and language. They also provide impetus for counsel and courts to seek out exceptions and distinctions and qualifications which, with a more robust rule, perhaps

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6. This was the overarching message in Sarah Worthington, *Equity*, 2d (Oxford: Oxford University Press, 2006) [Worthington, *Equity*]. As I said in the Preface to the first edition, "[a] distinctive equity jurisdiction keeps its resolutions isolated, segregated in a box labelled 'solutions to hard cases'". No wonder equity earned a reputation as "hard law".

7. Simon Hale, "*AIB v Mark Redler*", Case Comment, online: The Professional Negligence Bar Association <http://pnba.co.uk/aib-group-uk-v-mark-redler-co-solicitors/> ("[l]eading Counsel for AIB, Nicholas Davidson QC, reports that Lord Neuberger wryly observed during argument that '*only one thing was certain. Whatever we decide, it will be criticised*'" in the final paragraph of the case note [emphasis in original]).

would not or should not have been sustainable. This is a process that does little for any national or international rule of law and the ambition to treat like cases alike.

In summary, the goal in this article is to expose something of what *does* make the fiduciary jurisdiction special, and what troubling questions most need to be answered if the jurisdiction is to serve the needs of the 21st century.

II. Who?: Who is a Fiduciary?

This question is not easy. It might seem otherwise, since it is impossible to obtain a law degree, or practise as a lawyer, without finding out something about these people called fiduciaries. We all know that certain individuals — typically catalogued as trustees, company directors, partners, agents, solicitors, and such like — are within the catchment.

Yet, despite the millions of words devoted to the issue,[8] it seems impossible to define a fiduciary in a way which *includes* all these well-recognised fiduciary types, yet excludes others in whom we might legitimately repose trust and confidence without attracting this added

8. The literature is vast. For a summary of the principal views advanced, see *e.g.* Ernest J Weinrib, "The Fiduciary Obligation" (1975) 25:1 University of Toronto Law Journal 1; JC Shepherd, "Towards a Unified Concept of Fiduciary Relationships" (1981) 97:1 Law Quarterly Review 51; D Gordon Smith, "The Critical Resource Theory of Fiduciary Duty" (2002) 55:5 Vanderbilt Law Review 1399; Lionel Smith, "The Motive, Not the Deed" in Joshua Getzler, ed, *Rationalizing Property, Equity and Trusts: Essays in Honour of Edward Burn* (London: LexisNexis, 2003) ch 4; and Paul B Miller, "The Fiduciary Relationship" in Andrew S Gold & Paul B Miller, eds, *Philosophical Foundations of Fiduciary Law* (Oxford: Oxford University Press, 2014) [Miller, "The Fiduciary Relationship"]. And contrast Finn's approach in his classic monograph, dealing with all the different types of "obligations" the courts have described as "fiduciary": Paul Desmond Finn, *Fiduciary Obligations* (Sydney: Law Book Co, 1977) [Finn, *Fiduciary Obligations*].

baggage.[9] My solicitor is a fiduciary,[10] but not my plumber, even though I may be equally at the mercy of both, invest both with discretions to exercise on my account, and be compelled to trust both with decisions which affect my welfare and my finances.[11] Similarly, my business partner is a fiduciary, but not the project manager on my building site; the director of my company is a fiduciary,[12] but not my co-shareholders or

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9. Peter Millett, "Equity's Place in the Law of Commerce" (1998) 114:2 Law Quarterly Review 214 [Millett, "Equity's Place in the Law of Commerce"] (noting that the task "continues without evident sign of success" at 219). Also see Robert P Austin, "Commerce and Equity: Fiduciary Duty and Constructive Trust" (1986) 6:3 Oxford Journal of Legal Studies 444 at 445; Dennis R Klinck, "The Rise of the 'Remedial' Fiduciary Relationship", Case Comment on *International Corona Resources Ltd v Lac Minerals Ltd*, (1988) 33:3 McGill Law Journal 600 at 603.
10. Although see the comments later.
11. Paul Desmond Finn, "Fiduciary Reflections" (2014) 88:2 Australian Law Journal 127 at 137 [Finn, "Fiduciary Reflections"]; also see Paul Desmond Finn, "The Fiduciary Principle" in Timothy G Youdan, ed, *Equity, Fiduciaries and Trusts* (Toronto: Carswell 1989), ch 1 at 46 [Finn, "The Fiduciary Principle"]; and Paul Desmond Finn, "Contract and the Fiduciary Principle" (1989) 12:1 University of New South Wales Law Journal 76. See too *Grimaldi v Chameleon Mining NL (No 2)*, [2012] FCAFC 6 (Austl) at para 177 [*Grimaldi*].
12. But even then, note that the duties are owed to the *company*, not to the company's shareholders, despite their vulnerability: *Percival v Wright*, [1902] 2 Ch 421 (Eng); *Peskin v Anderson*, [2001] 1 BCLC 372 (CA (Civ)(Eng)) at paras 29-30, per Mummery LJ; *Re Chez Nico (Restaurants) Ltd*, [1992] BCLC 192 (Ch (Eng)) at 208 obiter, per Nicolas Browne-Wilkinson VC; *Sharp v Blank*, [2015] EWHC 3220 (Ch) at paras 12-13, per Nugee J [*Sharp*]. Of course, a fiduciary relationship explicitly between director and shareholder could arise on the specific facts, if warranted: *Allen v Hyatt* (1914), 30 TLR 444 (PC (Judiical Committee)); *Coleman v Myers*, [1977] 2 NZLR 225 (CA).

co-bondholders.[13] This is despite the fact that all can profoundly affect my interests.[14]

This matters, because rather dramatic obligational and remedial advantages come with the fiduciary label. My solicitor is amenable to such claims; my plumber is not. The territory is fought over precisely because of the attractive idea that fiduciaries must conduct themselves "at a level higher than that trodden by the crowd",[15] and the remedies for breach are perceived to be better.

In England we have not troubled ourselves much by these boundaries. As Lord Millett put it, writing extra-judicially, "as usual, we [the English] have tried to muddle through without attempting a definition, believing that anyone can recognize a fiduciary when he sees one".[16]

But it is far from clear that we can. We understand the consequences clearly enough, but not when to expect them. Absent a fiduciary relationship, the basic premise of party dealings is assumed to be "buyer beware", with each party looking to its own interests.[17] Within a fiduciary relationship, however, the fiduciary is expected to be "on the other party's

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13. Although there will be constraints on the exercise of power by both. For shareholders, see *Allen v Gold Reefs of West Africa Ltd*, [1900] 1 Ch 656 (CA (Eng)) at 671, per Lord Lindley MR; *Peter's American Delicacy Co Ltd v Heath* (1939), 61 CLR 457 (HCA) at 504, per Dixon J. In the US the assertion is subject to special treatment of shareholders in closely held corporations in some states. For bondholders, see *Redwood Master Fund Ltd v TD Bank Europe Ltd*, [2002] EWHC 2703 (Ch) at paras 105-106, per Rimer J; *Azevedo v Imcopa Importação, Exportação E Indústria De Olèos Ltda*, [2013] EWCA Civ 364; *Assénagon Asset Management SA v Irish Bank Resolution Corp Ltd (formerly Anglo Irish Bank Corp Ltd)*, [2012] EWHC 2090 (Ch).

14. Indeed, the scale of the discretion or the likely harm is not determinative: both fiduciaries and non-fiduciaries cover a broad spectrum. On fiduciaries, see the classic statement in *Re Coomber*, [1911] 1 Ch 723 (CA (Eng)) at 728-29, per Fletcher Moulton LJ.

15. *Meinhard v Salmon*, 164 NE 545 at 546 (NY App Ct 1928).

16. Millett, "Equity's Place in the Law of Commerce", *supra* note 9 (adding that "[r]ecent experience shows this to be optimistic" at 218, n 11).

17. Although even that is modified by a good number of common law, equitable and statutory rules.

side" — loyalty is claimed. When is the line crossed?

The line is not crossed simply because we have handed over some part of our autonomy to another,[18] or (saying much the same thing) invested another with powers and discretions which must be exerted in the interests of the principal and not the fiduciary power-holder.[19] Of course, exactly this fiduciary limitation on power is true *if* the power-holder is a fiduciary. But not all power-holders are fiduciaries. And constraints on the exercise of power do not depend on fiduciary status; all power-holders are equally constrained.[20] What the fiduciary context adds, if it applies, is that the *purpose* of the exercise of the powers is unequivocally to advance the principal's interests, and any considerations which call into play the fiduciary's interests are either "irrelevant considerations" or reflect "improper purposes". The same easy assertion is not possible with other power-holders, such as shareholders, or bondholders, or ordinary contracting parties, even though these are all people to whom we might delegate powers or in whom we might vest part of our decision-making autonomy.

Just last year the UK Law Commission suggested that "[t]he key test [for a fiduciary] is whether there is a *legitimate expectation* that one

18. Lionel Smith, "Fiduciary Relationships: Ensuring the Loyal Exercise of Judgement on Behalf of Another" (2014) 130:4 Law Quarterly Review 608.
19. This is an increasingly common view, perhaps intuitively seeking out the circumstances when a fiduciary relationship might be needed. The clearest exponent of the "powers" view is Miller, "The Fiduciary Relationship", *supra* note 8; and Paul B Miller, "Justifying Fiduciary Duties" (2013) 58:4 McGill Law Journal 969.
20. *Vatcher v Paull*, [1915] AC 372 (HL) at 378, per Lord Parker; *Equitable Life Assurance Society v Hyman*, [2002] 1 AC 408 (HL) at 451-62. Also see the references at note 13, above.

party will act in another's interest".[21] But this repeats the question rather than delivering the answer: *when* is there a legitimate expectation that one party will act in another's interest? There are many instances where one party has an expectation, perhaps even a well-founded expectation, that the other will act in their interests.[22] But the real question is whether the law will *insist* that this expectation, and indeed perhaps even more than this expectation, is delivered. This is rarer than we might think. The hurdle might seem to be overcome by suggesting that the fiduciary rule applies only when there is an "undertaking" by one party to perform

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21. UK Law Commission, *Fiduciary Duties of Investment Intermediaries* (*Law Commission No 350*)(1 July 2014), online: UK Law Commission <http://lawcommission.justice.gov.uk/docs/lc350_fiduciary_duties.pdf>, discussing the definition of a fiduciary generally at 3.16-3.24, and finally settling on the cited definition at 3.24 [emphasis added], adding that discretion, power to act and vulnerability are all indicators of such an expectation. See the references cited there, especially *Arklow Investments Ltd v Maclean*, [2000] 1 WLR 594 (PC (NZ)) at 598; and James Edelman, "When Do Fiduciary Duties Arise?" (2010) 126:2 Law Quarterly Review 302 [Edelman, "When Do Fiduciary Duties Arise?"]. See also Finn, "Fiduciary Reflections", *supra* note 11.
22. See for example, *JP Morgan Chase Bank v Springwell Navigation Corporation*, [2008] EWHC 1186 (Comm)(Gloster J rejecting Springwell's contention that, although the relationship of investment advisor and client was not one of the categories of relationship where a fiduciary relationship would simply be presumed by the law, such a relationship arose on the facts. She observed: "[b]ut the mere fact that one party to a commercial relationship 'trusts' the other does not predicate a fiduciary relationship. The word 'trust', like the word 'advice' has a variety of meanings. … Springwell no doubt 'trusted' Chase to conduct itself in a commercially appropriate manner. But I do not consider that Springwell had any legitimate expectation that, in its commercial dealings with Springwell, Chase would subordinate its interests to those of Springwell" at para 574). See also *Barclays Bank v Svizera Holdings BV*, [2014] EWHC 1020 (Comm) at para 8; *Bailey v Barclays Bank*, [2014] EWHC 2882 (QB) at paras 89-90 (appeal outstanding).

in this way,[23] but in all the recognised fiduciary contexts we want the fiduciary requirement enforced regardless: we do not want trustees or company directors to be able to escape the fiduciary regime simply by denying an undertaking to comply with it.[24]

Despite all the effort, therefore, we still lack a compelling way of describing, never mind rationalizing, the imposition of fiduciary rules.[25] These rules impose heavy constraints on the fiduciary's personal autonomy, and should be imposed only when nothing else will do the

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23. For suggestions that an "undertaking" is important, see *Hospital Products Ltd v United States Surgical Corporation* (1984), 156 CLR 41 (HCA) at paras 96-97, per Mason J [*Hospital Products Ltd*]; *Bristol and West Building Society v Mothew*, [1998] Ch 1 (CA (Civ)(Eng)) [*Bristol*]; Scott, "The Fiduciary Principle", *supra* note 1; Sealy, "Fiduciary Relationships", *supra* note 1; Edelman, "When Do Fiduciary Duties Arise?", *supra* note 21 at 317-318.
24. Although contrast the findings in other circumstances: see *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Limited (ACN 113 114 832)(No. 4)*, [2007] FCA 963 (Austl) at paras 276-81, per Jacobson J (finding that an exclusion clause was effective (the clause providing that Citigroup was engaged "[a]s an independent contractor and not in any other capacity including as a fiduciary" at para 145). This conclusion was roundly criticised in Finn, "Fiduciary Reflections", *supra* note 11 at 140ff. Note that purported exclusion of the fiduciary duty entirely is quite different from the permissible express curtailment of its scope, see for example, *New Zealand Netherlands Society Oranje Inc v Kuys*, [1973] 2 All ER 1222 (PC (NZ)) [*Kuys*]; *Hospital Products Ltd, supra* note 23 at paras 97, 102; *Kelly v Cooper*, [1993] AC 205 (PC (Bermuda)) at 213-215, (or the whitewash provided by the fiduciary giving advance notice of, and obtaining the principal's agreement to, the pursuit of conflicting opportunities).
25. There is debate over whether these duties are "imposed" or "undertaken". While I agree a person will not be a fiduciary if ignorant of any circumstances which ought to affect her behaviour (as with ignorant recipients of trust property or of mistaken payments), I otherwise favour the view that these duties are imposed by the law in a limited range of circumstances. See *Westdeutsche Landesbank Girozentrale v Islington LBC*, [1996] AC 669 (HL); Finn, "The Fiduciary Principle", *supra* note 11.

job.[26] But when is that?

In seeking answers, I suggest that our language is impeding our analysis. In particular, the search for a category of *person* is doomed to failure. For good reason the law typically seeks to define categories of *obligations*, *duties* and *remedies*, not categories of people. It may look to relationships, but generally only to explain the context in which particular obligations and duties are owed. By contrast, the search for categories of people who will be obliged to "act in another's interest" makes us forget that there are very many categories of obligations which might deliver these ends. Even a short list would include: contractual regimes, tort rules, duties of confidence, duties to provide full information,[27] the undue influence and fair-dealing rules,[28] and duties controlling the exercise of powers. But the people who owe some — or even all — of these duties are not necessarily fiduciaries. Equally, even though people who *are* fiduciaries are likely to owe all these duties, it is not this which attracts the fiduciary

26. Worthington, *Equity*, *supra* note 6 at 127ff; and Sarah Worthington, "Fiduciaries: When is Self-Denial Obligatory?" (1999) 58:3 Cambridge Law Journal 500 [Worthington, "Fiduciaries: When is Self-Denial Obligatory?"]. Also see Millett, "Equity's Place in the Law of Commerce", *supra* note 9 at 217-218.
27. *Sharp*, *supra* note 12.
28. Despite some suggestions that the fair-dealing rule is merely an application of the fiduciary no-conflict rule: see *e.g. Re Thompson's Settlement*, [1986] Ch 99 (Eng) at 115, per Vinelott J; and Matthew Conaglen, "A Re-Appraisal of the Fiduciary Self-Dealing and Fair-Dealing Rules" (2006) 65:2 Cambridge Law Journal 366. For the argument that they are distinct, see *Tito v Waddell (No 2)*, [1977] Ch 106 (Eng) at 241, per Megarry VC; and Finn, *Fiduciary Obligations*, *supra* note 8 ch 20-21. Also see Sarah Worthington, "Fiduciaries: Following Finn" in Tim Bonyhady, ed, *Finn's Law: An Australian Justice* (Leichhardt, Austl: Federation Press, 2016)(forthcoming).

label. The fiduciary label (as we now understand it)[29] describes people who are expected "act in another's interest" in a very special way: these are people who are required to put the other's interests *ahead* of their own, and to the extent that they do not do this they will have to disgorge the benefits thereby obtained. This is quite unusual intervention.[30] This duty can be breached even when all the other duties are not.[31] When is this sort of intervention *necessary* if the arrangement between the parties is to be functional? In short, moving from the language of people-labelling to the language of obligation-labelling,[32] when are obligations of self-denial *needed*? When is it appropriate to prevent one party pursuing conflicting

29. Contrast the approach taken in Finn's classic work on fiduciaries, Finn, *Fiduciary Obligations*, *supra* note 8. There, *all* the equitable duties just listed were covered. This was done precisely because the courts had used the word "fiduciary" to describe the people subject to these rules. But Finn made the point that very different people were subject to each rule, and the consequences varied for each rule, and each therefore needed to be considered quite independently.
30. See Worthington, *Equity, supra* note 6 ch 5. See, for example, *Henderson v Merrett Syndicates Ltd,* [1995] 2 AC 145 (HL) at 206, per Lord Browne-Wilkinson. Note that there are some exceptions. *Attorney General v Blake*, [2000] UKHL 45 [*Blake*] is an exception in contract law, although it has not been widely adopted despite early fears; see Sarah Worthington & Roy Goode, "Commercial Law: Confining the Remedial Boundaries" in David Hayton, ed, *Law's Future(s): British Legal Developments in the 21st Century* (Oxford: Hart Publishing, 2000) at 281-312. See too the various interpretations of *Wrotham Park Estate Co Ltd v Parkside Homes Ltd*, [1974] 1 WLR 798 (Ch (Eng)), discussed in Andrew Burrows, "Are 'Damages on the Wrotham Park Basis' Compensatory, Restitutionary, or Neither?" in Djakhongir Saidov & Ralph Cunnington, eds, *Current Themes in the Law of Contract Damages* (Oxford: Hart Publishing, 2008) 165 at 165-85; and Sarah Worthington, "Reconsidering Disgorgement" (1999) 62:2 Modern Law Review 218.
31. *Boardman v Phipps,* [1967] 2 AC 46 (HL) is typically cited.
32. It turns out that this is crucial across the board, but especially so in considering remedies: see the discussion in Part IV below, and also *Bank of New Zealand v New Zealand Guardian Trust Co Ltd*, [1999] 1 NZLR 664 (CA) at 686, per Tipping J [*Bank of New Zealand*].

gains?[33]

This question clearly requires more work. A move on language is unlikely to be the only move needed in delivering a tighter analysis of "who is a fiduciary", but it has some ramifications which are immediately evident. The fiduciary no-conflicts rule is, at base, directed at ensuring that the fiduciary does not *compete*, *i.e.* does not pursue her own interests in arenas which lie within the scope of her fiduciary role, however wide or narrow that might be. It says nothing about carrying out the tasks which are assigned; nothing, for example, about making shrewd investments or distributing assets properly and wisely. Other rules are required to deliver those ends. So the question becomes, when is a "non-compete" rule *essential*, so much so that the law will impose it? It is perhaps easy to see why it is needed with company directors (especially since companies can act only through human agents, and, primarily, precisely the agents on whom the non-compete restriction is imposed);[34] similarly with trustees, and by extension with agents.[35] But it is far less clear that it is needed with solicitors (unless they too are also holding assets on trust), or Crown servants, even though these people are commonly included in lists of

33. And constraints should not be imposed unless they are essential, not merely pleasing extras: see generally, Sarah Worthington, "Common Law Values: The Role of Party Autonomy in Private Law" in Andrew Robertson & Michael Tilbury, eds, *The Common Law of Obligations: Divergence and Unity* (Oxford: Hart Publishing, 2016) ch 14. Also see Millett, "Equity's Place in the Law of Commerce", *supra* note 9 ("[i]t is of the first importance not to impose fiduciary obligations on parties to a purely commercial relationship who deal with each other at arms' length and can be expected to look after their own interests" at 117-118).
34. Noting that the fiduciary duty is owed to the company, not to the shareholders.
35. This is so even though in some cases the only thing these people have to do is comply with directions concerning the disposition of property. In these circumstances the non-compete rule is then limited to preventing the fiduciary from using the property to generate private gains: see *Foskett v McKeown*, [2001] 1 AC 102 (HL) [*Foskett*] (although the trustee in that case undoubtedly had broader duties).

status-based fiduciaries. This may be an historical hangover:[36] with these people, surely, all the duties mentioned earlier will cover the required territory, providing adequate and appropriate protection to the parties to the relationship.[37]

These are just the sorts of issues which must be addressed. What do we mean by the word "fiduciary", and who is caught within its web? The modern battleground for applying the fiduciary label is typically joint venturers and financial advisers. The problems are easily extended

36. See Finn, *Fiduciary Obligations*, *supra* note 8. Note *e.g.* the common use of expressions such as "relationships of trust and confidence" and "confidential relationships". These relationships are not necessarily "fiduciary", in the sense that the conflicts rule applies, although other equitable restrictions are apt. Employees provide an illustration. Older cases might have included employees in the list of status-based fiduciaries; see *e.g. Hospital Products Ltd*, *supra* note 23 at para 68. But the modern approach is quite different: see *Ranson v Customer Systems*, [2012] EWCA Civ 841; *Helmet Integrated Systems Ltd v Tunnard*, [2006] EWCA Civ 1735; *University of Nottingham v Fishel*, [2000] ICR 1462 (QB (Eng)) especially at 1491, per Elias J.

37. It is not to the point that fiduciary constraints would provide even better protection: they always would. With a few notable exceptions, the cases seem to support the non-fiduciary approach mooted here. "Fiduciary" cases concerning solicitors typically seek remedies for non-disclosure, fair-dealing, proper purposes, negligence, etc., *or* misuse of client trust funds. These are not remedies for "competition"/breach of the no-conflict rule (unless in making profits from the trust fund, which is caught by "trustee" fiduciary rules). So far as Crown or public servants are concerned, the general rule is that employees are not fiduciaries: see note 36. The well-known exceptional cases are *Attorney General v Goddard* (1929), 98 LJKB 743 (Eng); *Reading v Attorney General*, [1951] AC 507 (HL); and *Attorney General for Hong Kong v Reid*, [1994] 1 AC 324 (PC (NZ)) [*Reid*]. The former decisions have been criticised by many commentators: see *e,g.* Gareth Jones, "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968) 84:4 Law Quarterly Review 472; Finn, *Fiduciary Obligations*, *supra* note 8 at 215. And the last case, along with *Blake*, *supra* note 30, might be seen as a hard case making bad law, both cases being stymied by jurisdictional issues in pursuing what were seen a justified remedies (although, to be fair, there is no hint of this motivating the courts or affecting their deliberations).

to all commercial intermediaries. When Sir Anthony Mason described fiduciary law as "a concept in search of a principle" he made a troubling assessment of the territory under discussion and our inability to be certain about rights and duties and the reasons for imposing them.[38] This, then, is the first question which needs a compelling answer: who *is* a fiduciary? Or, as I would prefer to put it, who is subject to the no-conflicts/non-compete rule, and therefore to the unusual disgorgement liabilities which then follow?

III. What?: What do Fiduciaries Have to Do?

The question here is clear. Even if we cannot say precisely *who* is a fiduciary, can we at least say precisely *what* such a person, once identified, will have to do? Although I start with the now conventional divisions of the duties owed by fiduciaries, the point I want to make in this Part is more subtle: it is to highlight the modern risk of misjudging the *non-fiduciary* duties owed by fiduciaries.

The words of Lord Millett (Millett LJ as he was) are familiar:

> [t]he distinguishing obligation of a fiduciary is the obligation of loyalty … [This] core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict … [39]

Note that Lord Millett speaks of the distinguishing obligation, not the only obligation. This was a point made in the previous Part. It is now accepted modern orthodoxy that "[n]ot every breach of duty by a

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38. Anthony Mason, "Themes and Prospects" in Paul Desmond Finn, ed, *Essays in Equity* (Sydney: Law Book Co, 1985) 242 at 246.

39. *Bristol*, *supra* note 23 at 18.

fiduciary is a breach of fiduciary duty".[40] Note too that this distinguishing obligation — an obligation of loyalty — does not raise an expectation of benefits to be delivered. It requires only that the fiduciary counterparty will not exploit the relationship for personal gain, but will — and will be obliged to — put the principal's interests *ahead* of the fiduciary's. Only to the extent that she acts contrary to that will fiduciary law intervene.

In the language we are used to, fiduciary rules are proscriptive rules,

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40. Millett, "Equity's Place in the Law of Commerce", *supra* note 9 at 218. In *Bristol*, *supra* note 23 (Millett LJ rejected "unthinking resort to verbal formulae", insisting that the fiduciary label should be "confined to those duties which are peculiar to fiduciaries and the breach of which attracts legal consequences differing from those consequent upon the breach of other duties" at 16). Also see Finn, "The Fiduciary Principle", *supra* note 11 at 27-28. See too, *Chan v Zacharia* (1984), 154 CLR 178 (HCA) (Deane J put it this way: "… the one 'fundamental rule' embodies two themes. The first is that which appropriates for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest. The second is that which requires the fiduciary to account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it: the objective is to preclude the fiduciary from actually misusing his position for his personal advantage. Notwithstanding authoritative statements to the effect that the 'use of fiduciary position' doctrine is but an illustration or part of a wider 'conflict of interest and duty' doctrine [see *e.g. Kuys*, *supra* note 24] the two themes, while overlapping, are distinct. Neither theme fully comprehends the other and a formulation of the principle by reference to one only of them will be incomplete" at 198-99) [*Chan*]; and *Lac Minerals Ltd v International Corona Resources Ltd*, [1989] 2 SCR 574 per Sopinka J ("not all obligations existing between the parties to a well-recognized fiduciary relationship will be fiduciary in nature" at 597).

not prescriptive ones.[41] The fiduciary is not positively obliged to act in the interests of the principal, with damages awarded for failure to deliver some advantageous end-point.[42] This is important. What is special about the fiduciary role is something essentially negative:[43] fiduciary relationships demand self-denial, not due care and obedience to agreed terms.[44] As already noted, this rather dramatic constraint on party autonomy is rare in private law.

But notice too that the resulting interventions are rather narrow. Paul Finn stressed the consequences of this realignment from the older approach to fiduciaries to this new more restrictive approach, and the detail merits repeating:

> [l]oyalty is thus exacted, often in a draconian way. But … no more than loyalty is exacted. This warrants emphasis. It is not the case that the pure negligence of a lawyer, an agent's excess of authority, a partner's breach of the partnership contract or a trustee's improvident investment is, as such, a breach of fiduciary duty, no matter how harmful to the interests of the client, the principal, etc. If no issue of disloyalty is involved, such matters will be actionable through those primary bodies of law which constitute or govern the ordinary incidents of the

41. *P & V Industries Pty Ltd v Porto*, [2006] VSC 131 (Austl)("[t]his means that the no conflict and no profit rules encompass the whole content of fiduciary obligations and the duty of loyalty imposed on a fiduciary is promoted by prohibiting disloyalty rather than by prescribing some positive duty" at para 23). Similarly, see *Bristol*, *supra* note 23 at 18; *Breen v Williams* (1996), 186 CLR 74 (HCA) at 113 [*Breen*]; *Attorney-General v Blake*, [1998] Ch 439 (CA (Civ)(Eng)) at 455 (not affected by the appeal).
42. *Ibid* at 137-38; *Pilmer v Duke Group Ltd*, [2001] HCA 31 at para 74, but generally, see also paras 69-83. Also see Geraint Thomas, "The Duty of Trustees to Act in the 'Best Interests' of their Beneficiaries" (2008) 2:3 Journal of Equity 177.
43. See Millett, "Equity's Place in the Law of Commerce", *supra* note 9 ("[i]t is the principle that a man must not exploit the relationship for his own benefit. This is what distinguishes a fiduciary relationship from a commercial one" at 222), but generally, see also 219-21. Millett was clearly much influenced by Finn's work, citing it here with warm approval.
44. Although those duties, and others too, may well be owed by the fiduciary. See Worthington, "Fiduciaries: When Is Self-Denial Obligatory?", *supra* note 26.

relationship in question – negligence, breach of contract or breach of trust.[45]

That is worth reading twice. Modern fiduciary law — and the particular idea of "loyalty" it describes — may be comprehensively addressed by rather tightly defined proscriptive obligational rules relating exclusively to improper profits from misuse of position and the avoidance of conflicts of interest and duty.[46] But inevitably fiduciaries, as individuals, are subject to a great number of other legal rules, breach of which will also deliver useful remedies.

This means there are two different answers to the "What?" question. There is the narrow proscriptive conflicts/misuse of position rule which constrains fiduciary activity, and is accepted as defining the territory of the rules which are unique to fiduciaries. But there are also all the other obligations to which a fiduciary may be subject — typically to:[47] (i) comply with the terms of the engagement; (ii) in an appropriate manner; and — returning to fiduciary proscriptions — (iii) do so loyally.

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45. Finn, "The Fiduciary Principle", *supra* note 11 at 28.
46. Dividing these two limbs is common modern practice (see *e.g. Chan*, *supra* note 40 at 198-99, per Deane J) but in practice it is difficult to think of misuses of position which do not also involve conflicts of duty and interest: see the discussion in Sarah Worthington, "Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae" (2013) 72:3 Cambridge Law Journal 720 at 732-35 [Worthington, "Fiduciary Duties and Proprietary Remedies"] (suggesting that *Reid*, *supra* note 37, might provide a very rare illustration; it seems that all the other classic fiduciary cases can be classified, or re-classified, with relative ease as conflicts cases).
47. Typically we do not separate out clearly enough exactly what — from the various options on this list — the trustee has done which counts as a wrong and has caused the loss, etc. Often the identified categories are called different things by different judges and academics (see *Redler*, *supra* note 4 at paras 59-60; and *Bank of New Zealand, supra* note 32 at 687, per Tipping J). Often the context is identified rather than the particular duty in issue: *e.g.* custodial and management stewardship. This then leads to talk of substitutive and reparative compensation, falsifying and surcharging, accounting on the basis of wilful default, and restitutive and restitutionary damages, all aligned precisely with particular different contexts, but perhaps not precisely enough with particular different wrongs. Not much of this is then sufficiently useful or informative.

Another way of making the same point is to consider not the duties themselves, but the context of what can go wrong. Take the case of a trust, as it provides a simple illustration with several possibilities for mistakes to be made:

- *Wrongful paying out of assets*: this covers payments out contrary to terms (either payments for disallowed investments or to disallowed beneficiaries) *or* payments out based on a wrong decision-making process, etc. (*e.g.* in determining which investments/exchanges to pursue, or which beneficiaries should receive a share). Note that the former attracts strict liability; the latter requires proof of the abuse. And note too that the wrongful disposition may have been in return for something now in the trust fund (or now on-delivered to the beneficiary — as indeed in *Target Holdings Ltd v Redferns*[48] ("*Target Holdings*") and *Redler*[49]), or may have been paid to a beneficiary who is not entitled (as in *Re Diplock*[50]), or indeed may be a "hand in the till" breach by the trustee (as in *Foskett v McKeown*[51] — and note that here, but only here, there is disloyalty as well as breach of trust, and the disgorgement remedy is an alternative); or
- *Wrongful management of the assets*: this typically involves negligence of some form or other (*e.g.* in investment, custody, insurance, taking advice, etc.). Here there is an obvious overlap with the previous category: is a negligent investment decision the "wrongful paying out of assets?" But the former category does not cover the field: *e.g.* negligent custody leading to theft or damage of the Picasso painting is clearly in this category, but is not a "wrongful paying out".

48. *Target Holdings Ltd v Redferns*, [1996] AC 421 (HL) [*Target Holdings*]. See the discussion below in Part IV.B: What Losses Must be Compensated?

49. *Redler*, *supra* note 4. See the discussion below in Part IV.B: What Losses Must be Compensated?

50. *Ministry of Health v Simpson*, [1951] AC 251 (HL)(*sub nom Re Diplock*).

51. *Foskett*, *supra* note 35.

- *Disloyalty*: this involves the trustee acting disloyally in her own interests, for gain. Then the remedy is disgorgement of the disloyal gain: the focus is on fiduciary's enhanced position, not claimant's damaged one. The gain in question may have come directly from the trust fund (as when the trustee puts her hand in the till, or enters into a self-dealing sale or purchase transaction), or may be gained from an independent source, but one which must necessarily involve a conflict of duty and interest or a misuse of fiduciary position. Absent a breach of this "non-compete" rule, the fiduciary's gain is not disloyal and need not be disgorged.

This multiplicity of duties to which the typical fiduciary is subject creates a potential problem which is not often highlighted. In older cases, decided before much of the modern writing on fiduciaries emerged, judges typically identified *relationships* as fiduciary (or not), and with that label then felt able to fine tune every aspect of the relationship to ensure that moral ends were delivered, often with little explanation or justification. As Robert Austin put it:

> [i]f a relationship was fiduciary, that characteristic was taken to be at the heart of the entire relationship, identifying more than merely one or a few duties amongst many. … Generally, fiduciary terminology was applied, often loosely, to standards of good faith, disclosure standards, limits on the proper exercise of discretionary powers, and even 'fiduciary care'.[52]

More than that, the remedies — if I can pre-empt the next Part, but at this stage only for the purpose of illuminating the "What?" question

52. Robert P Austin, "Moulding the Content of Fiduciary Duties" in AJ Oakley, ed, *Trends in Contemporary Trust Law* (New York: Oxford University Press, 1996) 153 at 156-57. See too the earlier comments on solicitors and employees, *supra* notes 36 and 37.

— were typically discussed through the language of "account".[53] This language was routinely used to deal with *all* these duties, regardless of whether the duties were especially fiduciary, or even especially equitable. The modern debates over the nature of the fiduciary's duty of care are stark reminder of this sort of slippage, with only slow realisation that the duty of care owed by a fiduciary is of the same nature as the duty of care owed by other parties.[54] The risk is then very high that like cases will not be treated alike. The remedies for *fiduciary* negligence, for example, or *fiduciary* abuse of powers, or *fiduciary* failure to comply with the terms of the engagement, are at risk of being determined on a different basis from breaches of the same sorts of rules by non-fiduciary parties. This may be the right approach, but it needs more by way of justification than mere assertion that "[t]he fiduciary relationship is a creature of equity and the remedy for breach of a fiduciary's equitable obligations lies within equity's exclusive jurisdiction".[55] The key issue is the particular *obligation* in issue, not the particular *relationship.*

Moreover, the language of account brings added disadvantages. First, it is not illuminating. An assertion that

> [t]he primary remedy for breach of trust is not equitable compensation but account, and the orders which follow are not compensatory but restorative; the court enforces the trustee's duty to account for his stewardship of the trust

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53. This is certainly true for trustees, and generally true for agents and partners; it is not common with company directors. For a short description of account, see Peter Birks, "Equity in the Modern Law: An Exercise in Taxonomy" (1996) 26:1 University of Western Australia Law Review 1, especially at 45-48; and *Libertarian Investments Ltd v Hall* (2013), 16 HKCFAR 681 at paras 166-73, per Lord Millett NPJ [*Hall*].
54. Now see *Permanent Building Society v Wheeler* (1994), 11 WAR 187 (SC (Austl)) at 238, per Ipp J; *Bristol*, *supra* note 23 at 17; *Hall*, *ibid* at 77. Of course, the fiduciary context will influence what counts as a breach: contrast the duty of care in trust investment (see *Trustee Act 2000* (UK), c 29, s 1; and *Speight v Gaunt*, [1883] 9 App Cas 1 (HL) [*Speight*]) with that which might be owed in other contexts (including other fiduciary contexts).
55. Millett, "The Common Lawyer", *supra* note 5 at 194.

> fund and to make good any deficit which appears when the account is taken[56]

says little which helps in deciding the basis by which to measure the "deficit" which must be made good (or, in other contexts, the profits which must be disgorged).[57] Secondly, the language of account necessarily segregates fiduciary analysis from common law notions of compensating for loss (surely not too far removed from "making good a deficit"?). The inevitable consequence is that potentially relevant analogies are missed.

In considering the duties owed by fiduciaries, two ideas are important. First, that modern analysis recognises that fiduciaries typically owe their principals a good number of different duties. Many are of the same type as owed by non-fiduciaries in similar contexts. Only one — the proscriptive fiduciary duty of loyalty — is unique to fiduciaries. And secondly, going against this, historical fiduciary language was to the opposite effect: "fiduciary" described a relationship, embracing all the relationship duties, and "account" provided the vehicle for all the remedies. The tension in moving forward is obvious.

It follows that my second intractable question is this. Given the history of assessing all fiduciary remedies in a distinctive way — by account — and given that remedial consequences depend on the precise nature of the particular obligation breached or right infringed,[58] *is* there anything which renders all the various non-fiduciary duties somehow different when owed by a fiduciary from when they are not? I suggest there is not, or no more than merely reflects the different context. If this is true, then principle, policy, language and analysis must be appropriately and carefully attuned to reflect that truth.

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56. *Ibid*. Although contrast the assertion in *Hall*, *supra* note 53, per Lord Millett NPJ ("[i]t is often said that the primary remedy for breach of trust or fiduciary duty is an order for an account, but this is an abbreviated and potentially misleading statement of the true position. In the first place an account is not a remedy for wrong ... " at para 167).
57. See the section on account in Worthington, "Fiduciary Duties and Proprietary Remedies", *supra* note 46.
58. *Redler*, *supra* note 4 at para 76, per Lord Toulson.

IV. So What?: What Remedies Follow a Breach of Duty by Fiduciaries

The previous Parts provide an entrée to the core debates over remedies. This is always where the battles are hardest fought. A discussion of remedies is often assisted by examples, and, as indicated at the outset, I will use two cases by way of illustration: *FHR*[59] on the remedies for breach of the proscriptive fiduciary duty, and *Redler*[60] on the remedies for breach of the non-fiduciary duties owed by fiduciaries. Both are controversial; both were decided over a year ago, and neither seems to have settled the debates completely.

A. What Profits Must be Disgorged?: Constructive Trusts and Personal Disgorgement of Profits

Disloyal profiteering by fiduciaries comes in two basic guises. These reflect the two broad practical ways in which a fiduciary holding assets under management (whether on trust or not) can make an unauthorised personal profit. First, the fiduciary can deal disloyally with the assets themselves. She can do this simply by taking these assets without authority (a "hand in the till" type of breach); alternatively, she can engineer a transaction where she is on both sides of the deal, either buying from or selling to herself on behalf of her principal (a "self-dealing" transaction). In either case the dealing clearly involves a conflict between duty to the principal and personal self-interest. In these circumstances the disgorgement remedy is universally conceded to exist, and to be proprietary. If the trustee simply takes the asset from a trust fund, the asset will continue to be held on the original trusts, and its traceable proceeds will be held

59. *FHR*, *supra* note 3.

60. *Redler*, *supra* note 4.

on constructive trust.[61] Alternatively, if the transaction is a self-dealing transaction, then a different route leads to the same ultimate ends: the transaction is voidable at the election of the principal (subject to the usual constraints on rescission), thus compelling the fiduciary to return the original managed asset (or its value), but requiring the principal to return whatever was received in exchange.[62] Of course, the principal's remedy can only be proprietary if the assets which must be handed back to the principal are identifiable; even if they are not, the fiduciary will still be subject to a personal obligation to disgorge profits.[63] These outcomes are not in dispute and are not considered further.

Secondly, the fiduciary may make a disloyal profit without directly subtracting assets from the trust fund or fiduciary "pot". This is typically done by competing with the principal (or "the trust") for an opportunity or advantage which, if the fiduciary had acted loyally, might have been acquired for the principal.[64] This can include pursuing competing business opportunities, or taking a bribe or secret commission from the counterparty to a deal being done on behalf of the principal. This latter was the *FHR* context: that case involved a £10 million bribe, or a secret commission, taken by an agent who was negotiating the sale of a hotel complex. The principal sued the agent for disgorgement, successfully alleging the remedy was proprietary: *i.e.* the bribe was held

61. Many cases could be cited, but see *e.g. Docker v Soames* (1834), 39 ER 1095 (Ch); *Aberdeen Town Council v Aberdeen University* (1877), 2 App Cas 544 (HL); *Scott v Scott* (1963), 109 CLR 649 (HCA); *Paul A Davies (Aus) Pty Ltd v Davies (No2)*, [1983] 1 NSWLR 440 (CA (Austl)); and perhaps most famously *Foskett*, *supra* note 35. And in the corporate context, where there is no initial trust or title split, the misappropriated corporate funds will be held on constructive trust.

62. See *e.g. Erlanger v New Sombrero Phosphate Co* (1878), 3 App Cas 1218 (HL); *Re Cape Breton Co* (1885), 29 Ch D 795 (CA (Eng)); *P&O Steam Navigation Co v Johnson* (1938), 60 CLR 189 (HCA); *Maguire v Makaronis* (1997), 188 CLR 449 (HCA).

63. *McKenzie v McDonald*, [1927] VLR 134 (SC (Aust))(also noting compensation as a further alternative remedy if raised on the facts (as it was here)).

64. Classic modern descriptions would also add the possibility of disloyal gains made by "misuse of position", but see *supra* note 46.

by the fiduciary on constructive trust for the principal. Here the remedial analysis is more difficult.

Everyone concedes that the disloyal fiduciary cannot keep the gains: the fiduciary must "account" to the principal for them. What had been in dispute in England for 20 years or more was whether the disgorgement remedy was proprietary or personal. This is the debate which *FHR* settled: the remedy is proprietary. Settlement of the issue is certainly welcome, although we might now say that in England we know that the remedy *is* proprietary, because the Supreme Court has said so, but we still do not know quite *why* it is, or why it *should* be so. This question needs answering, or its ramifications will return to haunt us.

Almost twenty years before *FHR*,[65] the Privy Council in *AG for Hong Kong v Reid*[66] ("*Reid*") had suggested that, if the fiduciary had to account, it then followed from the very nature of things that such a remedy would be proprietary if the gain was identifiable, since "equity treats as done that which ought to be done".[67] This held sway as the dominant view for decades, both in England and in many Commonwealth jurisdictions. It was a view which had explicitly rejected an earlier Court of Appeal

65. This description of context is abbreviated from Worthington, "Fiduciary Duties and Proprietary Remedies", *supra* note 46 at 723-24.

66. *Reid*, *supra* note 37. A public prosecutor in Hong Kong took bribes to "lose" files, thus subverting prosecutions. The bribes were used to buy houses in New Zealand, held in the names of the fiduciary's wife and solicitor. The Privy Council held that the fiduciary (or his wife or solicitor) held the bribes or their proceeds on constructive trust for the Crown.

67. *Ibid* at 331. If it makes a difference, Lord Millett has added a further gloss to this, suggesting that the conclusion can be justified on the basis that the breach was not the fiduciary's receipt of the bribe, but the failure to hand it over: Peter Millett, "Restitution and Constructive Trusts" (1998) 114:3 Law Quarterly Review 399 at 407. Also see Peter Millett, "Proprietary Restitution" in Simone Degeling & James Edelman, eds, *Equity in Commercial Law* (Sydney: Lawbook Co, 2005) 309 at 324 [Millett, "Proprietary Restitution"].

decision in *Lister & Co v Stubbs*[68] ("*Lister*") which had held that proprietary remedies would lead to such unacceptable consequences for third parties that they could not possibly represent the law. In short, at least in relation to bribes, *Reid* took one firm view of what ought to be done, and *Lister* another. Commentators were divided.

The difference matters because all sides are agreed that *if* the principal's remedy is proprietary then it carries with it a number of significant advantages. Most obviously, it entitles the principal to insolvency protection as against the fiduciary's creditors; to trace into identifiable exchange products; and to follow the asset or its traceable proceeds into the hands of third parties who are not bona fide purchasers for value without notice of the principal's interest. All these proprietary consequences significantly privilege the principal, and all are contingent on the initial claim to the disloyal profits being proprietary.

In the face of this longstanding debate, the UK Supreme Court judgment was relatively brief: fifty-one paragraphs, none of them especially long. Lord Neuberger PSC delivered the judgment for the court, and made little of the fact that he was overruling his own sustained deliberations in *Sinclair v Versailles*,[69] an earlier case in the Court of Appeal, where — supported by precedent[70] — he had preferred the outcome in *Lister*. It does not omit much detail to summarise the Supreme Court judgment as follows: the choice between the two competing views (*i.e.* proprietary and non-proprietary disgorgement) must be based on "legal principle, decided cases, policy considerations, and practicalities";[71] neither decided cases nor the writings of academics suggest any plainly right or plainly wrong answer;[72] in these circumstances, and "in the absence of any other

68. (1890), LR 45 Ch D 1 (CA (Eng)). In *Lister & Co v Stubbs*, an agent took bribes from the vendor in return for contracts with his principal. The Court of Appeal held that the agent was personally liable to the principal for the value of the bribe only, and neither the bribe nor its successful investment proceeds were held on constructive trust for the principal.

69. [2011] EWCA Civ 347 [*Sinclair*].

70. Although he defended his conclusions on the basis of precedent, principle and policy.

71. *FHR*, *supra* note 3 at para 12.

72. *Ibid* at para 32.

good reason, it would seem right to opt for the simple [*i.e.* proprietary] answer";[73] that other common law countries do this;[74] that principle[75] and policy[76] (both rather scantily addressed) support this approach; and precedent[77] does not contradict it. Especially in the latter steps, there seems to be an implicit presumption that almost universally conceded *personal* obligations to disgorge are, and should be, the equivalent of proprietary remedies, at least when owed by fiduciaries.[78] This may well be right, but it is the question in issue, not its robust answer. And I say that as one who has argued that the remedy should indeed be proprietary in every case I can think of other than *Reid*.

This criticism is hardly fair, perhaps. Even the most committed adherents seem to have problems justifying the move from widely-accepted personal remedies for fiduciary disgorgement to the more contested remedies by way of a constructive trust. It was Lord Millett's article in the *Restitution Law Review*[79] which underpinned Lord Templeman's proprietary analysis in *Reid*, and Lord Millett has pursued this theme in the intervening 20 odd years, including commenting on *FHR* itself.[80]

Lord Millett's most recent elaboration of the outcome is that equity does not provide a proprietary remedy for breach of a personal obligation; it "provides a personal remedy which has proprietary consequences".[81] The footnoted explanation of this is that it "is in accordance with the

73. *Ibid* at para 35.
74. *Ibid* at para 45.
75. *Ibid* at paras 33, 36.
76. *Ibid* at paras 42-43.
77. *Ibid* at para 45.
78. *Ibid* at paras 33, 36, 42-44.
79. Peter Millett, "Bribes and Secret Commissions" (1993) 1 Restitution Law Review 7.
80. See *e.g.* Millett, "Proprietary Restitution", *supra* note 67; Peter Millett, "Bribes and Secret Commissions Again" (2012) 71:3 Cambridge Law Journal 583 [Millett, "Bribes and Secret Commissions Again"]; and Millett, "The Common Lawyer", *supra* note 5.
81. Millett, "The Common Lawyer", *supra* note 5 at 196.

obligational theory of the [express] trust" and with Maitland's ideas.[82] And so it is. But an obligation to hold assets on an express trust for certain beneficiaries is quite some distance from an obligation to disgorge disloyal gains to the principal. However, Lord Millett takes some time to explain why the outcome for express trusts is equally applicable in this disgorgement context. The core idea depends on accounting, and comes from an assertion that where equity enforces performance of a personal obligation in relation to specific property, it does so by ordering accounts to be taken as if the obligation had been performed when it should have been, and this, in modern terminology, constitutes a proprietary remedy.[83]

Accounting is surely a distraction: it does not indicate whether the remedy is personal or proprietary.[84] The accounting process can be adopted in compensation cases when the remedy can only be personal. And in earlier bribe cases the defaulting fiduciary's obligation to "account in equity"[85] was taken by some to indicate that the disgorgement obligation was personal only (*Lister*, *Sinclair*)[86] and by others to indicate precisely the opposite, that it was inherently proprietary (*Reid*).

Omitting the accounting distraction, it certainly seems true that specific enforcement of an obligation in relation to identified property has proprietary consequences. This explains express trusts and equitable security interests; it explains proprietary estoppel; it explains constructive and resulting trusts in all the cases other than fiduciary disgorgement. So why not in the fiduciary disgorgement cases too?

True, it *might* do that, but before we can say so it is important to

82. *Ibid* at 196, n 10.
83. *Ibid* at 196-98.
84. See Worthington, "Fiduciary Duties and Proprietary Remedies", *supra* note 46 at 736-38.
85. And indeed it is a moot point whether the language applies only to trustees or more widely to fiduciaries in general. It is commonly said that fiduciaries (using the expression generally) are obliged to "account in equity", but assertions that the principal can "falsify" or "surcharge" the accounts is typically confined to express trustees.
86. Also see William Swadling, "The Fiction of the Constructive Trust" (2011) 64:1 Current Legal Problems 399.

notice one very dramatic difference between the last example and all the others. Disloyal gains must be disgorged because the fiduciary *must not* have them, even though there is no inherent and often no particular reason why the principal *must* have them. This is why they are often described as windfalls to the principal. By contrast, in all the other examples above the core purpose of the obligation is to deliver a particular asset *to the claimant*, and, where a constructive trust is recognised, that is simply shorthand for the assertion that equity recognises that the claimant *must* have the asset in question, and can insist on having it not only as against the defendant but also as against any stranger to that relationship. This is what it means to have a proprietary interest in an asset. It follows that in the distinctive disgorgement cases there may be no reason to treat the principal as (already) owning the asset in equity. This may not be "what ought to be done"; it may not be the function of the disgorgement obligation.

Put another way, if the purpose or objective of the disgorgement remedy is specifically to take the *fiduciary* back to first base, and not specifically to situate the *principal* at a particular endpoint, then the desired protection can be secured without the need for proprietary attributes.[87] Of course, and by contrast, if the remedy *is* designed to give the principal what a proper performance of the fiduciary's obligations is designed to deliver, then the answer is different, and the remedy might legitimately be proprietary, provided the underlying relationship is seen

87. See the argument in Vanessa Finch & Sarah Worthington, "The Pari Passu Principle and Ranking Restitutionary Rights" in Francis Rose, ed, *Insolvency and Restitution* (London: Mansfield Press, 2000) ch 1.

as sufficiently valuable to warrant "over-protecting" it in this way.[88]

I attempted in my 2013 *Cambridge Law Journal* article to put forward just such an argument, and concluded that the disgorgement remedies could be justified as being proprietary on the basis that the principal did indeed have an entitlement to the disloyal gains in every case I could think of bar *Reid*.[89] In short, in all cases bar this one, there was not merely a reason to *remove* the disloyal gains from the fiduciary; there was also a reason to give them *to* the principal. But the Supreme Court in *FHR* did not adopt this analysis. And nor did it provide one of its own, or not one which provides a compelling analytical foundation.

The issue matters. The right analysis needs to settle conclusively and convincingly the competing arguments of principle and policy. Courts in other common law jurisdictions are clearly sufficiently alert to the competing policy arguments to have settled universally on the view that the constructive trust in these circumstances is "remedial".[90] This means that, just when proprietary consequences really matter, these courts have

88. This last qualification is necessary. We are used to constructive trusts where common law damages are inadequate: this explains the vendor/purchaser constructive trust (of land and Picasso paintings, etc., but not ordinary goods or shares), equitable security interests, etc. Here the law protects — "over-protects" — assets regarded as unusually special. But the protective title split in express trusts, and the proprietary remedies which follow mis-dealings in the trust assets, are not protecting "special" property. They might, however, be justified as "over-protecting" relationships regarded as especially deserving, being fiduciary relationships. This was the argument advanced in Worthington, *Equity*, *supra* note 6 ch 6. But even here the pre-requisite for this sort of protection ought to be that the asset in question is being held specifically for the principal, as indicated in the text above.

89. This was the distinction sought to be addressed in Worthington, "Fiduciary Duties and Proprietary Remedies", *supra* note 46 at 731-35. The conclusion reached was that *all* the cases on fiduciary breaches fell into the category meriting proprietary protection *other* than *Reid*, *supra* note 37, despite this being a case where it *was* awarded. See the similar argument, but focusing more on policy concerns, in Worthington, *Equity*, *supra* note 6 ch 5.

90. For the detail, see *Grimaldi*, *supra* note 11; and Millett, "Bribes and Secret Commissions Again", *supra* note 80.

the right to, and may well, decide that a proprietary remedy should be denied.[91] On insolvency, but also more generally, this discretionary approach to proprietary entitlements has little to recommend it.[92] But just as it seems inappropriate for judges to "play God" over a claimant's property rights — asserting that although there is an "entitlement" to a constructive trust or profits, this remedy might then be withheld if the circumstances are inappropriate — so too is it inappropriate in England to "play God" by insisting that the claimant does have a property right without properly justifying that superior level of protection. This is because granting the principal a proprietary right will inevitably have profound and generally detrimental effects on the rights of third parties not before the court. In this context the court cannot therefore simply take the simplest and most convenient approach to dealing with the two parties before the court.

This choice about where the benefits should lie is difficult because it is not a matter of doctrine; it is exclusively a matter of policy: what is the obligation in issue and what is its purpose? The appropriate remedy follows ineluctably from that. The essential choice is between seeing the fiduciary non-compete rule as so important to protecting the fiduciary relationship that, when the fiduciary does compete, the benefits of that competition should go *to* the principal, and do so in an "over-protective"

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91. See *Grimaldi*, *supra* note 11, per Finn J ("[t]o accept that money bribes can be captured by a constructive trust does not mean that they necessarily will be in all circumstances. As is well accepted, a constructive trust ought not to be imposed if there are other orders capable of doing full justice … Such could be the case, for example, where a bribed fiduciary, having profitably invested the bribe, is then bankrupted and, apart from the investment, is hopelessly insolvent. In such a case a lien on that property may well be sufficient to achieve 'practical justice' in the circumstances. This said, a constructive trust is likely to be awarded as of course where the bribe still exists in its original, or in a traceable, form, and no third party issue arises" at paras 582-83).

92. See the robust analysis in David Neuberger, "The Remedial Constructive Trust: Fact or Fiction" (speech delivered at the Banking Services and Finance Law Association Conference, New Zealand, 10 August 2014), online: The Supreme Court website <www.supremecourt.uk/docs/speech-140810.pdf>.

proprietary sense. (An allied conclusion might be that the fiduciary rule on disloyalty is comprehensively embraced by the non-compete rule, and that the misuse of position rule is merely a sub-category. I doubt anything would be lost by this move.) The alternative is that the fiduciary disloyalty rule *is* only proscriptive, not prescriptive, and its purpose is simply fiduciary profit-stripping, not delivery of any end-point for the principal, not even the one that the fiduciary has disloyally and competitively chosen for himself. The remedy would then be exclusively personal. This choice is not easy; there are good arguments both ways. But note that this choice concerns the non-*compete* rule, and could, if thought appropriate, be isolated from the remedies which follow misuse of any *assets* held in a fiduciary capacity.[93]

So my third question on fiduciaries is this: *what* makes the disgorgement remedy proprietary? This question is difficult precisely because the answer depends on policy: what *is* the purpose of the fiduciary non-compete rule? The arguments are finely balanced. In this sense, the UK Supreme Court's conclusion in *FHR* cannot be criticised — they plumped for a proprietary conclusion, as would I — but it would have been reassuring to have the problem and its resolution set out more robustly.

B. What Losses Must be Compensated?: Equitable Compensation and Accounting

The previous sub-Part dealt with the disgorgement remedy for breach of the non-compete/no conflicts fiduciary rule. This sub-Part deals with equitable compensation for losses caused by breach of the fiduciary's *non-fiduciary* duties. These include the fiduciary's custody and management duties in relation to assets held in a fiduciary capacity,[94] although

93. Although those remedies also need work, especially when the fiduciary makes a profit from use of the assets. See Sarah Worthington, "Justifying Claims to Secondary Profits" in EJH Schrage, ed, *Unjust Enrichment and the Law of Contract* (The Hague: Kluwer Law International, 2001) 451 at 451 and the references cited there.

94. *E.g.* held by the fiduciary on trust or held by the director-fiduciary's company.

fiduciaries without such responsibilities are also in the frame.[95] A simple illustration is provided by *Redler*,[96] where solicitors paid away client trust assets contrary to settled instructions. The breach was clear, but the remedy disputed.

Something should be said at the outset about language. Had the claim in *Redler* been simply that the solicitors had committed a breach of contract, or been negligent, there would have been no debate about quantum.[97] The dispute arose because the breaches also concerned fiduciaries dealing with trust assets. This meant that equitable obligations, equitable remedies (especially equitable compensation) and accounting all moved centre stage.

These equitable tags are not necessarily illuminating. "Equitable compensation" illustrates the problem: the term is used even when the breach is not of an equitable obligation[98] and the remedy is not compensating a loss.[99] Labels aside, however, the legal question is important. Does the remedy available against the defaulting solicitors in *Redler* depend on their fiduciary status or the fact that they were misapplying trust assets?[100] The question has been debated in England for over two decades, with two significant decisions defining the context: *Redler* in the Supreme Court in 2014 and *Target Holdings*[101] in the House of Lords in 1996.

Both *Redler* and *Target Holdings* involved claims by banks against

95. See *e.g. Nocton v Lord Ashburton*, [1914] AC 932 (HL); *Bristol*, *supra* note 23.
96. *Redler*, *supra* note 4.
97. *Ibid* at para 71 (in the end, the Supreme Court held that the quantum of the remedy was the same for all the common law and equitable breaches).
98. Being, alternatively, a breach by a fiduciary of non-fiduciary duties. See *supra* notes 52-58 and their associated texts.
99. It is, instead, merely describing the provision of a monetary remedy rather than a remedy *in specie*, but the money may be providing compensation for loss, disgorgement of profits, or restitution of an unjust enrichment.
100. Of course it would matter if the trust assets or their traceable proceeds remained in existence, but that was not the case here and can be ignored for present purposes.
101. *Target Holdings*, *supra* note 48.

solicitors. In both cases the banks had lent large sums to purchasers of property, requiring those loans to be secured against the purchase property. In both cases the solicitors paid out the funds before obtaining the necessary security. In *Target Holdings*, security was obtained a short time later, so one might think no real harm was done. In *Redler* the result was that a first mortgage which should have been cleared was not, and it ranked ahead of AIB's security to the extent of £300,000. In both cases, the purchasers defaulted on their repayments and the banks sought to enforce their security. And in both cases the property market had collapsed between the time of the initial loan and the time that enforcement was sought. As a result both banks faced large losses[102] and both sought to make their trustee solicitors liable.

The banks' arguments were simple. The loan funds had passed from the banks to their solicitors' client accounts. These funds were held on trust, subject to the clients' instructions: the funds should have been held until paid out as instructed. Instead, the funds were paid out contrary to instructions. The appropriate remedy in these circumstances, it was urged, was reinstatement of the trust fund wrongly paid away — *i.e.* replacement of the total loan funds, being £3.3 million for AIB and £1.5 million for Target — but with both banks being required to bring into account what they had actually recovered from the sale of the properties. In this way, both banks would obtain effective protection against *all* their losses on the deals, recovering roughly £2.4 million from the solicitors in *Redler*, and £1 million in *Target Holdings*.

The solicitors' counterarguments were equally simple. The solicitors pointed out that even if they had performed precisely according to their instructions, Target would have suffered exactly the same loss, that loss being caused entirely by the fall in the property market not by any failure to get in the security; and AIB would have suffered a loss of only £300k, being the sum paid in priority to Barclays as a result of a first mortgage which it otherwise would not have had.

In short, depending on which argument was accepted, Target would recover either £1 million or nothing, and AIB would recover either £2.4

102. £2.4 million for AIB and £1 million for Target Holdings.

million or £300,000. The argument was clearly worth pursuing. In both cases the solicitors won, with the Supreme Court in *Redler* accepting the core argument in *Target*.

The problem looks relatively simple, and common sense might suggest that a different answer from that given by the courts would have been bizarre.[103] But the Supreme Court did not simply rely on common sense. Their entire analysis was driven by one utterly compelling principle. This was that *any* analysis of remedial consequences must start with a precise understanding of the obligation which had been breached and the detailed performance requirements demanded by it.[104] Only this would reveal the position the claimant would have been in if the obligation had *not* been breached. Knowing that was crucial if the remedial goal was to make the claimant "whole", *i.e.* to give the claimant the money equivalent of what should have been given by proper performance.[105] This focus on the *particular* obligation in issue is perhaps the most important message in the entire judgment, and is at risk of being lost sight of precisely because it is so simple.

Following this approach, the court identified the relevant obligation as being to ensure that the trust fund was duly administered, and the remedy of equitable compensation as being designed to make good any loss suffered by reason of a failure to perform in that way.[106] Of course, that does not deal with the peculiarly "equitable" features noted earlier,

103. Although see the warning against the value of common sense in Leonard Hoffmann, "Common Sense and Causing Loss" (Lecture to the Chancery Bar Association, 15 June 1999), online: The Chancery Bar Association <www.chba.org.uk/for-members/library/annual-lectures/common-sense-and-causing-loss>.

104. See *e.g. Redler*, *supra* note 4 at paras 52, 59, 61, 64, 66, 70, 76, per Lord Toulson SCJ, and paras 92-93, 138, per Lord Reed SCJ. Also see *Bank of New Zealand*, *supra* note 32, per Tipping J — cited in *Redler* at para 59 — noting that the characterisation of the *obligation* in issue is what is crucial, not the characterisation of its historical source or of the entire relationship.

105. Of course there are other remedial goals, typically delivered by punitive, exemplary, restitutionary, disgorgement and reliance damages, but no one was suggesting that these were relevant on the facts here.

106. *Redler*, *supra* note 4, per Lord Toulson SCJ at paras 64, 66.

but, if this analysis is right, then there seems to be no good reason for treating the claim in equity any differently from a claim for damages for wrongdoing at common law. The duty is *precisely* the same whether defined in contract or in equity (if such is even possible). Even the critics agree with this.[107]

But this approach did not silence the critics. They suggest, variously, that the courts in *Redler* and *Target Holdings* had misunderstood the problem, or the solution, or both. One group of "dissentients" suggests that the flaw in both cases is a failure to appreciate the full range of different claims available against defaulting fiduciaries.[108] On their analysis, there is effectively one additional claim in equity where both breach and loss are irrelevant. This, they say, was inexplicably ignored by both the Supreme Court and the House of Lords. For this reason they may well regard the issue as still open in the UK.

By contrast, Lord Millett considers the Supreme Court to have delivered the right answer, but for the wrong reasons,[109] and indeed that it granted the wrong remedy.[110] He thinks the remedy should not

107. See note 108, below.
108. Most forcefully, see Charles Mitchell, "Causation, Remoteness, and Fiduciary Gains" (2006) 17:2 Kings College Law Journal 325; Charles Mitchell, "Stewardship of Property and Liability to Account" (2014) 78 Conveyancer 211; Charles Mitchell, "Equitable Compensation for Breach of Fiduciary Duty" (2013) 66:1 Current Legal Problems 307; S Elliott & James Edelman, "Target Holdings Considered in Australia" (2003) 119:4 Law Quarterly Review 545. Also see *Agricultural Land Management Ltd v Jackson (No 2)*, [2014] WASC 102, per Edelman J; and James Edelman, "An English Misturning with Equitable Compensation" (delivered at the UNSW Australia colloquium on equitable compensation and disgorgement of profit, Australia, 7-8 August 2015), online: Federal Court of Australia <www.fedcourt.gov.au/publications/judges-speeches/justice-edelman/edelman-j-201508>. These are the "dissentients" referred to in the discussion which follows. Taking a different but still critical line, see Millett, "Equity's Place in the Law of Commerce", *supra* note 9 (criticising *Target Holdings* as "disquieting", "disappointing" and "misleading" at 224).
109. Millett, "The Common Lawyer", *supra* note 5 at 199.
110. *Ibid* at 203.

have been "[equitable] compensation for loss but payment of the sum necessary to make good a deficit in the trust account. A common lawyer should recognise the distinction; it is the difference between debt and damages".[111] It could equally well be called "reconstituting the trust fund" or "redrawing the trust account".[112]

But "reconstituting the trust fund" or "redrawing the trust account" does not tell you what *ought* to be there, which can then be compared with what is *actually* there, so that the deficit can be made good. That is precisely the question the Supreme Court sought to answer, and the question which the dissentients think they got wrong. Lord Millett's debt analogy is one they use, and use to reach very different conclusions. How do they manage that?

These dissentients run their argument using either the old language of account or the modern language of compensation. In examining the trustee's duties, they divide them this way: there are primary duties (to perform the trust) and secondary duties (to compensate for losses from non-performance or faults in performance), and of course fiduciary duties requiring disgorgement of disloyal benefits which can be left to one side for present purposes.

They then describe the different claims which are available for breaches of these different duties. The language used is important, and not necessarily easy or intuitive. In summary, a claimant might seek to:

i. Enforce the primary duties: this is effectively the seeking of an order for specific performance of the trust obligations, or the money equivalent of specific performance. No breach is needed, so no issues of causation and remoteness arise. In accounting language, the beneficiary seeks to "*falsify* the account" — or seeks "*substitutive* compensation" — the objective is to "preserve the trust assets".

ii. Enforce the secondary duties: this is effectively the seeking of an order for repair of the damage caused to the trust fund by the breach (and is what the court did in *Target Holdings* and *Redler*). In accounting language, the beneficiary seeks to "*surcharge* the account" — or seeks

111. *Ibid.*

112. *Ibid.*

"*reparative* compensation" — the objective is to "manage the trust assets".

iii. Enforce fiduciary loyalty: this does what it says. In accounting language, the beneficiary seeks an "account of profits" — or seeks "restitutionary/restorative compensation" (*i.e.* disgorgement) — the objective is to ensure "loyalty".

A beneficiary can elect between the first two remedies, and can have the third too if it is not inconsistent.[113]

In *Target Holdings* and *Redler*, the proponents of this analysis note that the third option is not available, but suggest that the court focused on the second option and inexplicably ignored the first. According to the first option, they suggest, the trustee is obliged to *hold* the fund transferred on trust until it is paid out in an authorised way. This obligation to hold only comes to an end if the conditions for payment out are satisfied. The claim under the first option is a claim to enforce this duty of the trustee to hold the assets in this way, not a claim for compensation for breach. Under this head, the solicitors are obliged to restore the fund — *i.e.* pay into the trust fund £1.5 million in *Target Holdings* and £3.3 million in *Redler*.

They further suggest that if a common law analogue is thought helpful, the correct one is the action for the agreed sum (a debt, as Lord Millett put it), not a claim for damages. In this context, it is simply not to the point, they suggest, to insist that even if things had been done as they should have been, the funds would nevertheless have been lost. The clock is stopped before then, and there is no escape by arguing the counterfactual.

These arguments are invariably put very elegantly. And the analogy with contract is apt, certainly, but not a contract for an agreed sum, and not in a context where the clock can stop in this way. Two mistakes are being made here. First, the fiduciary's obligation (the fiduciary's primary duty) is not to pay an agreed sum, nor to hold a specific fund in a client account. The fiduciary's obligation is far more complex, involving a series of steps which must all be taken if due performance is to be delivered. In

113. *Tang Man Sit v Capacious Investments Ltd*, [1996] AC 514 (PC (HK)).

the *Redler* context, these steps were designed to deliver a particular agreed end result. Theoretically, if specific performance were ordered against a recalcitrant solicitor, the requirement would be to perform fully, to execute all the steps, not merely to complete one or two steps and then stop. This is the obligation in issue. It is not merely a custodial obligation (to hold an asset with due care, etc.); it is a more complex mix of custodial and management obligations. Many contracts are of this form; so too are many trusts. Rather fewer are of the form "simply hold, carefully", or "hold carefully and then hand over", although perhaps trusts of family castles and art collections illustrate this genre.

Secondly, the analogy with debt is typically used to demonstrate a common law disregard for the claimant's personal circumstances. When a claim is made in debt, proof of loss to the claimant is not part of the claim: it is irrelevant what the claimant intended to do with the money; it matters nought that she might either have invested it to great effect or simply given it away. The trust analogy, it is suggested, is that in cases such as *Redler* and *Target Holdings*, it matters not what would have happened after the restored funds were received; they must simply be restored. Performance is key, not loss.

But this reflects a second mistake. Performance of trustee obligations, or remedies for failure to perform, *never* look to the personal circumstances of the beneficiary or to making the beneficiary "whole".[114] The trustee's obligations relate exclusively to custody and management of the pot of trust assets, and both trustee performance and trustee remedies are directed solely to ensuring that the trust pot is kept in the state it ought to be in, or returned to that state if there has been any slippage. Unless the trust is terminated or the trustee dismissed, this duty persists. It follows that when the court assesses what ought to be in the trust pot, and makes that assessment at the date of judgment, it is *not* (despite its own assertions to contrary) making that assessment "with the benefit of hindsight". It is simply assessing what state the trust pot ought to be at that date *given the trustee's ongoing duties up to that date*. This does

114. Other than in the incidental manner which may be required in a discretionary trust in deciding which beneficiaries should receive benefits.

not always make valuation easy,[115] although typically there are fewer unknowns than with many complex contract and tort claims. And if the funds should have been dispersed to the beneficiary, an assessment is made of what ought to have been dispersed, at the appropriate date, from a trust pot which is presumed to have been in its required state, and *that* too then needs to be valued at the date of judgment and delivered to the beneficiary: that is what the beneficiary should have received.[116] Similarly, the rules of remoteness and foreseeability are not somehow uniquely inapplicable to the assessment of trust remedies. Given the focus on the identified pot of assets under the trustee's management, it would simply be impossible for loss to the pot from a breach of the trustee's duty to be either unforeseeable or too remote. Loss, and the kind of loss, is invariably foreseeable, even if its quantum is not. It is the particular trust context which denies these rules any relevance, not some peculiar equitable quirk. All this is a trap which both the House of Lords and the Supreme Court may equally have fallen into, given some of their general comments.

The issues can be seen more clearly if illustrated. Take a simple example: a trustee takes £1 million from the trust funds for his own use, and uses it non-traceably. Assume that what he should have done, according to the trust deed, was invest these particular funds in shares which would now be worth £½ million. On these facts, two claims are open to the beneficiary. The first is a profits disgorgement claim for £1 million: this is the gain the trustee made from appropriating the assets for himself, acting with a personal conflict, and the profits gained in this way must be disgorged; in assessing the gain, it is irrelevant what the trustee then does with the money.[117] Alternatively, but to less advantage,

115. See *e.g. Hall, supra* note 53; and even *Dawson (dec'd), Re* (1966), 2 NSWR 211 (SC (Aust)) [*Dawson*].

116. *Dawson ibid*; *Hall, Ibid*. The beneficiary will not be able to argue that she would have made profitable investments, etc., in the interim, unless regard for this is also a provable part of the trustee's (non-fiduciary) duties.

117. Unless of course the trustee uses the funds in a successful investment. Then the beneficiary might claim disgorgement of *that* benefit: *Foskett, supra* note 35.

the beneficiary could claim equitable compensation for breach of trust, requiring the trustee to restore the trust fund to the state it *would* have been in if proper performance had been delivered (or the state it would have been in had there been no breach; there is no difference between the two):[118] *i.e.* £½ million. Of course, the market could equally well have moved the other way, and the nominated shares might now be worth £5 million. This, then, would be the measure of compensation required. Note that on these facts the required calculation is easy. It is a little more difficult if the trustee were obliged to *manage* the fund in the best interests of the beneficiary; then some "guessed" but rational assessment of the likely proper state of the fund would have to be made.[119]

The cases routinely notice these two options — the disgorgement remedy and the compensation remedy — and notice too that the compensation remedy depends crucially on what *ought* to have been done with the fund. Merely insisting that a trustee must "account", or pay "compensation" labelled in a particular way (see above), does not answer the question about what ends the remedy should deliver and how this is quantified. As the Supreme Court in *Redler* so clearly identified, the key issue in this analysis is determining exactly what proper performance of the obligation should have delivered to the principal. The gap between factual delivery and what ought to have been delivered gives the measure of equitable compensation.

This exposes my fourth question on fiduciaries. It is whether, in a modern context, we have any further need for this historical and distinctive language of "equitable compensation" or the process of "accounting" (other than "giving an account", in the simple sense of requiring the fiduciary to provide information)? The focus should, it seems, be straightforwardly on the precise nature of the particular obligations in issue and their intended objectives. As it is, the language of equitable compensation and accounting lies like a cloak over so much

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118. Which makes the point that the remedies for breach of the trustee's primary and secondary obligations come to the same thing. This is the conclusion also reached in *Redler*, *supra* note 4.

119. See *Bartlett v Barclays Bank Trust Co Ltd (No 2)*, [1980] Ch 515 (Eng); *Speight*, *supra* note 54.

of fiduciary law. It does not illuminate, explain or justify what goes on under its cover.

V. Conclusion

And that is it. The "Who?", "What?" and "So what?" of fiduciary law, suggesting four questions which still bedevil this area: who is a fiduciary? What, if anything, does the fiduciary role add to the nature of the non-fiduciary obligations owed by fiduciaries? Why is the disgorgement remedy proprietary? And what, if anything, does it mean by way of distinctive remedy to say the fiduciary must "account" or deliver "*equitable* compensation"?

In all of this I am making a claim for more (or even more) rigorous analysis of the fiduciary terrain and careful exposure of its detail. This is far more effectively achieved if we untangle the precise obligations in issue and their particular objectives or goals, and, further, if we describe these findings in a simple, common, legal language. This will enable important comparisons to be made across the common law landscape, and ensure significant analogies are not missed. Lord Millett's assertion that "[e]quity is not a set of rules but a state of mind"[120] is a typically beguiling turn of phrase, but more progress will be made by following Lord Reed's claim that "[l]egal analysis is as important in equity as in the common law".[121]

120. Millett, "The Common Lawyer", *supra* note 5 at 193.

121. *Redler*, *supra* note 4 at para 95.

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