Questioning the Mistaken Payment Constructive Trust

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INTRODUCTION

[1] In *Wambo Coal v Ariff* (2007) 63 ACSR 429 (***Wambo Coal***) the Supreme Court of NSW recognised for the first time in Australia that a constructive trust arose over money paid by mistake at the time the recipient acquired knowledge of the mistaken payment (hereafter the ***Wambo* principle** or the ***Wambo* constructive trust**). This paper respectfully suggests that the *Wambo* constructive trust is a step in the law of constructive trusts which should not be followed.

[2] To make good that proposition it is necessary:

(a) **First**, to consider aspects of the law of constructive trusts generally, and the development of some categories of constructive trust in particular;

(b) **Second**, to set out some background to the law of restitution and the development of the *Wambo* principle as a proprietary remedy for a restitutionary claim for mistaken payments;

(c) **Third,** to articulate the reasons why it is submitted that the Wambo principle should not be followed; and

(d) **Finally,** to submit that the *Wambo* principle is not yet entrenched in Australian law.

THE CONSTRUCTIVE TRUST: GENERAL PRINCIPLES

Definition

[3] It has been said that it is almost impossible satisfactorily to define a constructive trust and this paper is not going to attempt to do the almost impossible.[1] However, a framework of analysis is necessary. A convenient starting point is Deane J's well know statement in *Muchinski v Dodds* (1984) 169 CLR 583 at 614, where his Honour observed[2]:

> Viewed in its modern context the constructive trust can properly be described as a remedial institution which equity imposes regardless of actual or presumed agreement or intention (and subsequently protects) to preclude the retention or assertion of beneficial ownership of property to the extent that such retention or assertion would be contrary to equitable principle.

[4] The leading texts also refer to statements by Professor Scott and Chief Justice Cardozo in similar terms[3]:

> It is impossible to satisfactorily define a "constructive trust". In *Muschinski v Dodds*, Deane J stated that a constructive trust may be imposed where an applicable equitable principle

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[1] P Young, C Croft, & M Smith, *On Equity* (Thomson Reuters (Professional)Australia Limited, 2009) at [6.640] ('*On Equity*')

[2] Referred to with approval in *Baumgatner v Baumgartner* (1987) 164 CLR 137 at 147-148.

[3] *On Equity* at [6.640]. and see J D Heydon, M J Leeming, *Jacobs' Law of Trusts in Australia* (Lexis Nexis Australia, 8th ed, 2016) at [13-01] ('*Jacobs'*) and H Ford et al, *Ford & Lee: The Law of Trusts* (Thomson Reuters (Professional) Australia Limited, 2020) at [22.020] ('*Ford & Lee*')

> requires that a person who owns property should hold it for the use of benefit of another. *Scott* concluded that a constructive trust is imposed where:
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> > the court finds from the circumstances that some of the consequences that would follow from the creation of an express trust should also follow.
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> Cardozo J, in *Beatty v Guggenheim Exploration Co*, described the constructive trust as "the formula through which the conscience of equity finds expression", and concluded that:
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> > [w]hen property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.
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> In *Giumelli v Giumeli*, the High Court approved a passage from *Scott on Trusts* pointing out that the adjective "constructive" derives from the verb "construe" and not the verb "construct", and that it was false to suggest that the court "constructs" a trust. Rather, the court "construes the circumstances in the sense that it explains or interprets them; it does not construct that".

[5] These statements beg the question of precisely what circumstances will give rise to a constructive trust, and in what form. Courts have rejected the proposition that a constructive trust is established by reference to idiosyncratic ideas of fairness. Rather, as a creation of equity, a constructive trust[4]:

> 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 such principles… The mere fact that it would be unjust or unfair in a situation of discord for the owner of a legal estate to assert his ownership against another provides, of itself, no mandate for a judicial declaration that the ownership in whole or in part lies, in equity, in that other. Such equitable relief by way of constructive trust will only properly be available if applicable principles of the law of equity require that the person in whom the ownership of property is vested should hold it to the use of for the benefit of another. That is not to say that general notions of fairness and justice have become irrelevant to the context and application of equity. They remain relevant to the traditional equitable notion of unconscionable conduct which persists as an operative component of some fundamental rules of principles of modern equity.

The constructive trust is a trust

Taxonomy

[6] Equity recognises three forms of trust: the express trust, the resulting trust and the constructive trust.[5] A constructive trust is nonetheless a trust and shares the institutional requirements of all trusts. It requires the certain identification of subject-matter, object, trustee and personal obligation. [6]

[7] The key point of distinction between the three classes of trust is the place of intention in the establishment of the personal obligation element. For an express trust, an intention to create trust obligations is a necessary element. In *Byrnes v Kendall* (2011) 243 CLR 253 at [276], the High Court held that intention in the express trust is to be understood intention imputed to the relevant party by what has been objectively manifested by the words used and acts of the relevant person or

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[4] *Muchinski v Dodds* at 616

[5] The writer recognises that this tripartite classification can itself be the subject of dispute, with the ambiguous concept of an implied trust sometimes being added as a further classification.

[6] Deane J in *Muschinski v Dodds* at 614

persons considered in their context. The search is for actual intention, albeit objectively identified.

[8] For resulting trusts, intention is presumed in contexts:

(a) Where a person pays for property which is vested in another or transfers property for no consideration to a person who does not have some claim on the generosity of the transferor (the presumed resulting trust); and

(b) Where a person transfers property intending to create an express trust and fails properly to do so either in whole or in part (the automatic resulting trust).

[9] By contrast, as Deane J observed, the constructive trust arises regardless of intention. It is also worth noting that the content of the personal obligation element differs in another important way as between express and resulting trusts on the one hand and constructive trusts on the other hand. For the express trust, the content of the obligation is determined directly or by implication from the circumstances of express creation of the trust, usually by trust deed. For the resulting trust, the content of the personal obligations is predictable and arises from the circumstances in which the resulting trust arises. For example, the holders of a joint bank account who are not in one of the advancement relationships are presumed to hold its balance on trust for the several contributions of the two account holders.[7]

[10] For a constructive trust, the Court does not have express or implied intention to guide the identification of the scope and content of the trust obligations. The Court must therefore construe from the circumstances not only that trust obligations arise but also the content of those obgliations. A good example of this process is *Baumgartner v Baumgartner* (1987) 164 CLR 137, where the majority observed (at 149-150):

> It therefore becomes necessary to determine the terms of that constructive trust. The facts that the Leumeah property was acquired and developed as a home for the parties and that, at least indirectly, it was largely financed out of money drawn from the pool of their earnings, this being one of the purposes which the pool was to serve, combine to support an equality of beneficial ownership at least as a starting point. Equity favours equality and, in circumstances where the parties have lived together for years and have pooled their resources and their efforts to create a joint home, there is much to be said for the view that they should share the beneficial ownership equally as tenants in common, subject to adjustment to avoid any injustice which would result if account were not taken of the disparity between the worth of their individual contributions either financially or in kind. The question which has caused us particular difficulty is whether any such adjustment is necessary in the circumstances of the present case to avoid any injustice which would otherwise result by reason of disparity between individual financial contributions. The conclusion to which we have come is that some such adjustment is necessary.

Regardless of intention

[11] As noted, the constructive trust arises "regardless of intention"[8] and arises because the circumstances are such as to cause the Court to construe trust obligations to arise in respect of certain property. This characterisation of the distinction

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[7] *Charles Marshall Pty Ltd v Grimsby* (1956) 95 CLR 353 and see *Ford & Lee* at [21.190]
[8] Deane J in *Muschinki v Dodds* at 613

between the constructive trust and the express or resulting trust is confirmed in *Baumgartner*.[9] In that case, the majority specifically disagreed with the characterisation of constructive trusts as giving effect to intentions of the parties articulated by Glass JA in *Allen v Snyder* [1977] 2 NSWLR 685 at 693 and 695.

[12] The classification of trusts by reference to the place of intention in their creation can be contested at the margins as can the question of how specific cases where identified intention is recognised as giving rise to a trust or trust obligations should be categorised.[10] That is not to say that intention is irrelevant in construing a constructive trust. Intention is a circumstance, which together with other circumstances, can give rise to a constructive trust. The position is explained in *Ford & Lee* as follows[11]:

> The second misunderstanding relates to the role of intention in the law of constructive trusts. The term "operation of law" does not mean that the parties' intentions or expectations are irrelevant to the imposition of a constructive trust. An intention to benefit the claimant will be critical to establishing the existence of some applications of the trust, such as a "common intention" constructive trust or in cases of proprietary estoppel where a promise or representation has been made relating to the acquisition of an interest which has relied upon to her detriment by the plaintiff, or where a constructive trust is imposed over property subject to a mutual wills arrangement. In other cases the constructive trust will be a component of a wider property transaction which parties entered into voluntarily, such as a specifically enforceable contract for the sale of land.
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> The difference between constructive trusts, on the one hand, and express trusts, on the other, does not depend on the irrelevance of intention to the finding of a constructive trust. The distinction rests, rather, on the source of authority for enforcing the trust. Constructive trusts derive their authority from the order of the court, or from the application of settled equitable principles to the facts of the case. In contrast, express trusts derive their authority from the objectively ascertained intention of a settlor. More compendiously, the role of intention in the law of express trusts is constitutive whereas its role in the law of constructive trusts is non-constitutive. Resulting trusts occupy the middle ground between express and constructive trusts: a resulting trust arises from the absence of intention on the part of a transferor of legal rights in property to confer a beneficial interest on the recipient of those rights.
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> [underlining added]

Proprietary and personal remedies

[13] At its most basic level, a constructive trust is operative in circumstances where equity requires a person to hold or account for property as if the person was an express trustee. This may occur in one of two ways:

(a) Where equity construes an obligation on a person to hold property as a trustee for another. That is, equity construes a proprietary interest in

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[9] *Baumgartner* at 149-150

[10] For example, as will be seen *Ford & Lee* at [21.250] to [21.310] categorise those cases where a trust arises over money paid by mistake as resulting not constructive trusts. The High Court could not agree in *Bahr v Nicolay (No.2)* (1988) 164 CLR 604 whether the trust arising from acknowledgement of by a subsequent registered proprietor of the earlier unregistered rights of the Bahr's gave rise to an express or constructive trust.

[11] *Ford & Lee* at [22.040]

property in the hands of a constructive trustee in favour of an identified beneficiary; and

(b) Where equity imposes a personal obligation to account on a person which is congruent with the obligation which a trustee of property would have had in respect of a breach of trust in respect of that property.

[14] This dichotomy was explained in *Giumelli v Giumelli* (1999) 196 CLR 101 at 112 as follows (citations omitted):

> The term "constructive trust" is used in various senses when identifying a remedy provided by a court of equity. The trust institution usually involves both the holding of property by the trustee and a personal liability to account in a suit for breach of trust for the discharge of the trustee's duties. However, some constructive trusts create or recognise no proprietary interest. Rather there is the imposition of a personal liability to account in the same manner as that of an express trustee. An example of a constructive trust in this sense is the imposition of personal liability upon a person "who dishonestly procures or assists in a breach of trust or fiduciary obligation" by a trustee or other fiduciary.

[15] It should also be borne in mind that if the Court construes a constructive trust on certain terms over property in the hands of a person constituted a trustee, all the remedies which flow from a proprietary interest over trust property will be available. For example, a beneficiary will be able to trace in equity with a view to asserting proprietary or personal claims against property other than the trust property or against persons other than the constructive trustee.

[16] English law adheres to the institutional constructive trust analysis in which such trusts arise by operation of law and are not imposed remedially or at the Court's discretion. Consequently, the second category referred to in paragraph [13] above has been characterised as not involving a constructive trust at all.[12] In *Dubai Aluminium Co Ltd v Salaam* [2003] 2 AC 366 at [142], Lord Millett said that for the second catetory of case "*we should not discard the words 'accountable as constructive trustee' in this context and substitute the words 'accountable in equity*."

Institutional and remedial constructive trusts

[17] Leading texts classify constructive trusts as institutional or remedial, though do not agree entirely on how different trusts should be categorised. Deane J grappled with this issue in *Muschinski v Dodds*. His Honour said, after noting the debate about the character of constructive trusts in the common law world (footnotes omitted)[13]:

> At times, disputing factions have tended to polarise the discussion by reference to compeing rallying points of "remedy" and "institution". The perceived dichotomy between those two catchwords has, however, largely been the consequence of lack of definition. In the broad sense, the constructive trust is both an institution and a remedy.
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> …
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> There is, however, a more limited sense in which there is some superficial plausibility in the notions of "institution" and "remedy" as characterisations of the constructive trust. If

[12] *Paragraph Finance plc v D B Thakerar & Co* [1999] 1 All ER 400 at 408-409.
[13] At 613-615

> "institution" is understood as connoting a relationship which arises and exists under the law independently of any order of a court and "remedy" is defined as referring to the actual establishment of a relationship by such and order, the catchwords of "institution" and "remedy" do serve the function of the highlighting a conceptual problem that persists about the true nature of a constructive trust. Even in this more limited sense, however, any perceived dichotomy between the two notions tends to prove ephemeral upon closer examination. Equity acts consistently and in accordance with principle. The old maxim that equity regards as done that which ought to be done is as applicable to enforce equitable obligations as it is to create them and, notwithstanding that the constructive trust is remedial in both origin and nature, there does not need to have been a curial declaration or order before equity will recognise the prior existence of a constructive trust: cf. Scott, *Law of Trusts* 3rd ed. (1967), vol. V, par. 462.4. Where an equity court would retrospectively impose a constructive trust by way of equitable remedy, its availability as such a remedy provides the basis for, and governs the content of, its existence inter partes independently of any formal order declaring or enforcing it. In this more limited sense, the constructive trust is also properly seen as both "remedy" and "institution". Indeed, for the student of equity, there can be no true dichotomy between the two notions.
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> The acknowledgement of the institutional character of the constructive trust does not involve a denial of its continued flexibility as a remedy: cf. *Wirth v. Wirth*. The institutional character of the trust has never completely obliterated its remedial origins even in the case of the more traditional forms of express and implied trust. This is a fortiori in the case of constructive trust where, as has been mentioned, the remedial character remains predominant in that the trust itself either represents, or reflects the availability of, equitable relief in the particular circumstances. Indeed, in this country at least, the constructive trust has not outgrown its formative stages as an equitable remedy and should still be seen as constituting an in personam remedy attaching to property which may be moulded and adjusted to give effect to the application and interplay of equitable principles in the circumstances of the particular case. In particular, where competing common law or equitable claims are or may be involved, a declaration of constructive trust by way of remedy can properly be so framed that the consequences of its imposition are operative only from the date of judgment or formal court order or from some other specified date.
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> [underlining added]

[18] His Honour's observations leave one to wonder why the discussion about institutional v remedial matters at all in Australian law. *A fortiori* when one considers that there seems to be little use of the institutional v remedial dichotomy in any subsequent High Court decision. Despite that, Courts and texts continue to make use of the language of institutional and remedial.[14] A comprehensive attempt to analyse the issue is that contained in *Ford & Lee*. There, the learned authors posit three ways in which the distinction between institutional and remedial constructive trusts can be explained and understood.[15] In the writer's respectful view, however, it is sufficient to refer to the second explanation in the current online edition (which was the only explanation referred to in earlier editions):

> **A distinction based on the availability of non-proprietary relief**
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> A constructive trust is institutional if the plaintiff will, almost automatically, be entitled to a beneficial interest in the trust property, or to the traceable proceeds of that property, once the equitable criteria for imposing the trust have been met. Conversely, a constructive trust is remedial if the award of a proprietary remedy is dependent on the exercise of judicial discretion.

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[14] G E Dal Pont, *Equity and Trusts in Australia* (Thomson Reuters (Professional) Australia Limited, 7th ed, 2019) at [38.10] to [38.15] ('*Dal Pont*'); *On Equity* at [6.690] and *Jacobs* at [13-10] to [13-11]. See also *Sze Tu v Lowe* (2014) NSWLR 317 at [141] to [162] where, despite referring to *Muschinki v Dodds*, the Court upheld the finding by the trial judge of an "institutional constructive trust".

[15] *Ford & Lee* at [22-120]

> Previous editions of *Ford and Lee* emphasised this distinction between institutional and remedial constructive trusts. The distinction has utility in that it draws attention to those applications of the constructive trust, as a proprietary remedy, which arise so routinely that a commercial transaction can reliably be undertaken on the assumption that a constructive trust will enable equitable title to pass. The imposition of constructive trusteeship over the subject matter of a specifically enforceable contract is a case in point, such as a contract for the sale of an interest in land. Another example, based on the same principle, is the trust arising by virtue of the doctrine of *Holroyd v Marshall* (1862) 10 HL Cas 191; 11 ER 999 where, under a contract for valuable consideration, future property is assigned, the trust attaching to the property as soon as it is received by the assignor as present property. These are examples of an institutional constructive trust, defined in terms of regularity of application. They can be contrasted with the constructive trust imposed over family property under the doctrine of *Baumgartner v Baumgartner* (1987) 164 CLR 137; 62 ALJR 29; 76 ALR 75; [1987] HCA 59 (see [22A.520] which are remedial because a plaintiff can never be certain that proof of the elements of the claim will result in the award of a beneficial interest in property.
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> This distinction, based on the predictability of the award of a proprietary remedy. understates the function of equitable discretion in the award of all constructive trusts. A claimant will never be automatically entitled to a beneficial interest in property under a constructive trust because of the possibility that relief may be barred on discretionary grounds, such as delay or because the claimant has not come to equity with clean hands. Moreover, constructive trust relief will often be conditioned on the imposition of terms or conditions so that the plaintiff will not be entitled to the benefit of the constructive trust without complying with the terms. See, for example, *Boardman v Phipps* [1967] 2 AC 46; [1966] 3 WLR 1009; [1966] 3 All ER 721, discussed at [22A.880].
> These exercises of discretion are common to all jurisdictions that recognise the concept of the constructive trust. But Australian law arguably goes further than English law in one respect. In *Bathurst City Council v PWC Properties Pty Ltd* (1988) 195 CLR 566; 72 ALJR 1470; 157 ALR 414; [1998] HCA 59, Gaudron, McHugh, Gummow, Hayne and Callinan JJ stated at [42]:
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> > In any event, before the court imposes a constructive trust as a remedy, it should first decide whether, having regard to the issues in the litigation, there are other means available to quell the controversy.
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> [underlining added]

[19] The institutional/remedial distinction seems more important in the UK than in Australia. In *Westdeutsche Landesbank Girozentrale v Islington Lond Borough Council* [1996] AC 669 at 714, Lord Browne-Wilkinson said that English law has "*for the most part only recognised an institutional constructive trust*" and that whether the remedial constructive trust should be adopted was a matter for the future. In that statement, his Lordship appears to have meant institutional constructive trusts to cover those that occur automatically at the moment of the wrong recognised as giving rise to such a trust, and that the discretionary imposition of such a trust at a different date by the Court is a remedial trust. The contrast with the statement in *Ford & Lee* is small but significant: the learned authors there refer to an institutional contstructive trust *almost* automatically arising.

[20] It appears to remain the case that English Courts do not admit of the existence of the "remedial" constructive trust, being a trust which *may* but not *must* arise on the establishing at trial of the factual preconditions of a constructive trust. That theme

is evident in the recent English cases on constructive trust remedies for bribes and secret commissions.[16]

[21] However, the plenary statements in the High Court emphasising the role of discretion in the imposition of a constructive trust appear to make the distinction between "institutional" and "remedial" one which has no practical content.[17] Certainly, based on the cases set out in the next section, it does not appear that any constructive trust automatically arises.

[22] The true position seems to be that in many circumstances recognised as giving rise to a constructive trust, it is uncommon for discretionary considerations to favour a lesser remedy such that the proprietary remedy (or a remedy based on recognition of trust obligations over certain trust property leading to an obligation to account or some other equitable remedy) is "almost automatically" granted. In others, where the prima facie circumstances are made out for equitable relief, the prospect of modification of the content or timing of equitable relief might be more likely.[18]

The place of discretion in constructive trusts in Australia

[23] As just explained, in Australia the constructive trust is discretionary even where the established criteria for its recognition arise. The impact of a constructive trust on the rights of third parties may justify the Court in modifying or entirely excluding recognition of the trust, despite the facts which ordinarily give rise to a constructive trust being established. This point has been made repeatedly by the High Court since *Muschinski v Dodds*. Indeed the outcome in *Muschinski* involved the exercise of discretion by the Court to cause the date from when the trust was recognised to be made later to avoid injustice to third parties. Justice Deane observed (at 623) that the constructive trust construed by the Court from the circumstances of that case should take effect only from the date when the Court's reasons for judgment where published "*lest the legitimate claims of third parties be adversely affected*".

[24] *Giumelli v Giumelli* (1999) 196 CLR 101 was also decided based on the place of discretion in recognition of a constructive trust. In that case parents and their sons were involved in an agricultural partnership over many years. As is often the way, promises were made by the parents relevantly, to one of the sons that he could have a parcel of land upon which he had built a house and planted an orchard. That parcel was part of a large parcel used in the partnership. The son claimed, credibly, that he relied on that promise to take various significant steps, not least building the relevant house. The parents resiled from that promise. The son succeeded in establishing that the circumstances gave rise to a proprietary estoppel in his favour. The Full Court of the Western Australia Supreme Court declared that the parents owned the large parcel on trust to convey the promised lesser parcel to the son and ordered such conveyance. The form of that relief was appealed. The majority

[16] See "Secret Profits and Bribes" below.
[17] The extensive analysis of the authorities in the area in *Jacobs* ends with the comment that the debate is beside the point. "*What matters is not what it is called, but what its substantive ingredients are*": see page 245.
[18] In the writer's view, the analysis by Professor Dal Pont supports this statement of the position: see *Dal Pont* at [38.10].

(Gleeson CJ, McHugh, Gummow and Callinan JJ, Kirby J concurring in separate reasons) held that the Full Court erred in granting that remedy. Their Honours relevantly observed by way of principle (footnotes omitted):

> [10] The present case fell within the category identified by the Privy Council in *Plimmer v Mayor, &c, of Wellington* where "the Court must look at the circumstances in each case to decide in what way the equity can be satisfied". Before a constructive trust is imposed, the court should first decide whether, having regard to the issues in the litigation, there is an appropriate equitable remedy which falls short of the imposition of a trust. At the heart of this appeal is the question whether the relief granted by the Full Court was appropriate and whether sufficient weight was given by the Full Court to the various factors to be taken into account, including the impact upon relevant third parties, in determining the nature and quantum of the equitable relief to be granted.

[25] In applying that principle, their Honours concluded:

> [49] However, the appellants correctly challenge the Full Court order on other grounds. Before making an order designed to bring about a conveyance of the Promised Lot to the respondent, the Full Court was obliged to consider all the circumstances of the case. These circumstances included the still pending partnership action, the improvements to the Promised Lot by family members other than Robert, both before and after his residency there, the breakdown in family relationships and the continued residence on the Promised Lot of Steven and his family. It will be recalled that Steven is a party to the partnership action but not to the present action.
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> [50] When these matters are taken into account, it is apparent that the order made by the Full Court reflected what in *Verwayen* was described as the prima facie entitlement of Robert. However, qualification was necessary both to avoid injustice to others, particularly Steven and his family, and to avoid relief which went beyond what was required for conscientious conduct by Mr and Mrs Giumelli. The result points inexorably to relief expressed not in terms of acquisition of title to land but in a money sum. This would reflect, with respect to the third promise, the approach taken by R D Nicholson J when giving relief in respect of the second promise.

[26] The mandatory language used at [49] is to be noted. As is the reference to the entitlement to a constructive trust being only prima facie entitlement, subject to qualification to avoid injustice to others.

[27] In *Bathurst City Council v PWC Properties Pty Limited* (1998) 195 CLR 566 at [42], the Court made the same point, this time (notably for this paper) by reference to the unjust effect of a constructive trust on unsecured creditors. There the Court held:

> In any event, before the court imposes a constructive trust as a remedy, it should first decide whether, having regard to the issues in the litigation, there are other means available to quell the controversy, An equitable remedy which falls short of the imposition of a trust may assist in avoiding a result whereby the plaintiff gains a beneficial proprietary interest which gives an unfair priority over other equally deserving creditors of the defendant. This appears to have been the cause of division between Gibbs CJ on the one hand and Mason J and Deane J on the other hand in *Muschinski v Dodds*. The Chief Justice saw as an adequate equitable remedy an entitlement of the appellant to a contribution from the respondent to the extent to which she had paid more than one-half of the purchase moneys, coupled with an equitable charge for that amount upon the half interest of the respondent in the land.

[28] Further, in *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1 at [128] to [129], the High Court concluded that the imposition of a constructive trust by the Court over land held by the defendant was wrongly imposed because of the impact of that order on an unregistered mortgagee of the land.[19] Notably for this paper, their Honours observed that the fact that remedies other than a constructive trust may lack practical utility for the plaintiff because of the impecuniosity of the defendant does not of itself justify imposition of a constructive trust where third party interests might be affected.

[29] It has been observed a constructive trust remedy may comprise a proprietary remedy over identified property (be it a trust or some lesser or different interest such as an equitable charge) or a personal remedy requiring a person to account as if they were a trustee or by way of equitable compensation, whether secured by a charge or lien or otherwise. It is difficult to set out definite rules for the kind of remedy which will be justified in a specific case, as the equity's remedial response must address the conduct in question in the circumstances in which it occurs.[20]

[30] It is recognised that the above High Court decisions do not specifically deal with all forms of constructive trust. One might wonder about the extent to which a constructive trust arising from mutual wills retains a discretionary aspect. However, the High Court has used plenary language in asserting the discretionary power of the Court to modify or refuse to recognise a constructive trust. There is no warrant for reading those comments down.

The categories of constructive trusts

[31] The reference to analogy, deduction and induction in paragraph [5] above directs attention to those categories of cases where Courts have already concluded that a constructive trust arises. No concerns about idiosyncratic notions of justice needs be harboured by a trial Judge in those categories of case. The learned authors of *Jacobs*[21] express the point:

> The difficulty is in isolating or defining those circumstances in which equity will treat it as unconscionable for a party to deny the trust. Up to a point, the difficulty is diminished by the existence of well-recognised categories of cases in which a constructive trust arises. These categories are not uniform in the sense that the incidents of the trusts involved vary; in one category the obligation is to account for a profit, in another to hand over specific assets, in another to effect restitution for a loss. The categories may all reflect equity's concern with fraud, but they have distinct characteristics.

[32] They go on to observe that the list is not closed, and nor could it be. Indeed, it is the recent addition to the list of a constructive trust for money paid by mistake which is the subject of this paper. It is helpful to later points made in this paper to

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[19] See also *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1 at [128] to [129] where the High Court concluded that the imposition of a constructive trust by the Court over land held by the defendant was wrongly imposed because of the impact of that order on the interests of the third parties.
[20] See the analysis by the Full Court of the Federal Court in *Grimaldi v Chameleon Mining NL (No. 2)* (2012) 200 FCR at [509] to [510].
[21] *Jacobs* at [13-02]

identify some of the main categories of cases recognised as giving rise to a constructive trust.

CATEGORIES OF CONSTRUCTIVE TRUST

Breach of trust and fiduciary duty

[33] The first and perhaps most frequently litigated category of cases is those involving constructive trusts arising out of breaches of trust by trustees or fiduciaries other than the special case of secret profits and bribes (dealt with next). The principles applicable to this category of case are well known and it is beyond the scope of this paper to detail those principles.

Secret profits and bribes

[34] The second category of cases comprises those cases where a fiduciary has obtained a bribe or secret profit. This category of case raises issues which are of central relevance to this paper.

[35] Prior to *Attorney-General (Hong Kong) v Reid* [1994] 1 AC 324, bribes stood outside the remedial regime for other breaches of fiduciary duty. The liability of a fiduciary for a bribe or secret profit was as debtor, not as constructive trustee. *Lister & Co Ltd v Stubbs* (1890) 45 Ch D 1 was the leading case. The principal reasons for adopting that position given in *Lister* were that[22]:

(a) Imposition of a constructive trust was not justified because the bribe or secret profit was never property which was or could have been property of the fiduciary or the result of misuse of an opportunity of the principal's;

(b) The imposition of a constructive trust unfairly disadvantaged unsecured creditors in an insolvency; and

(c) The policy against bribery could be vindicated by a personal remedy.

[36] *Reid*, a decision of the Privy Council on appeal from New Zealand, changed that position, at least for New Zealand. The Privy Council did not follow *Lister*, asserting that the principle in that case was inconsistent with the broad principle that a fiduciary must not be allowed to benefit from a breach of duty, *particularly* where that benefit is the result of a bribe or secret profit. The Privy Council held that the bribe is immediately held on constructive trust for the principal on its receipt and that the iniquitous fiduciary will be stripped of all traceable gains made with the bribe.

[37] The Privy Council gave short shrift to concerns about the position of the long suffering unsecured creditors in an insolvency: "*the unsecured creditors cannot be in a better position than their debtor*"[23], a comment which sounds, respectfully, more like the rules based certainty of the common law than the subtle concern for unconscionable conduct which is the concern of equity. Of course, in that case,

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[22] *Lister* at 15
[23] At 331

there was no insolvency, but the decision in *Reid* gave no consideration to the discretionary application of a proprietary remedy. This constructive trust was institutional in the sense used by Lord Browne-Wilkinson.

[38] *Reid* was applied (almost) in *Grimaldi v Chameleon Mining NL (No. 2)* (2012) FCR 296. While the Full Court of the Federal Court followed that decision in overruling the previous position in *Lister*, the Court did so with an eye to the "remedial" character of all constructive trusts in Australian law. With perhaps more sensitivity to the unsecured creditor, the Court held:

> [583] There are two additional comments we should make. First, to 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: see *John Alexander's Clubs* at [128] and the cases there footnoted. 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

[39] Interestingly, the principle in *Lister* persisted in English law, despite *Reid,* for some years. *Lister* was followed in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2012] Ch 453, where Lord Neuberger MR reasserted the correctness of *Lister*, not only because of the unfair potential impact on unsecured creditors but also by reasserting the point made at [35](a) above. Also interesting for this paper, is the identification in *Sinclair* that a proprietary claim would arise over a bribe or secret commission where it:

(a) Came from the principal's own property; or

(b) Was derived from some opportunity which was that of the principal.[24]

[40] These two categories might be thought to be unremarkable. They arguably arise from the underlying premise for excluding a proprietary remedy articulated in *Lister*: that the bribe could never have been property of the principal. The two categories identified in *Sinclair* involve bribes which were property or opportunities of the principal. In both cases, claims based on the general law in respect of breaches of fiduciary duty would arguably be available as an alternative basis to claim a proprietary remedy in any event.

[41] *Sinclair* was not an ordinary bribe/secret commission case, but rather arose out of a complex financial fraud engaged in by a Mr Cush. The funds claimed by a disappointed investor were the proceeds of sale of shares in another company which fell within neither of the categories identified. The appeal was dismissed.

[42] The point came up for consideration again just a few years later in the Supreme Court in *FHR European Ventures LLP v Cedar Captial Partner LLC* [2015] AC 250. Ironically, it was Lord Neuberger who gave the judgment of the Supreme Court which overruled *Lister* and *Sinclair* and adopted the approach in *Reid*,[25] and

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[24] *Sinclair* at 454

[25] *FHR European Ventures LLP v Cedar Captial Partner LLC* [2015] AC 250

largely for the reasons given in *Reid* (meaning no disrespect to the efficient but comprehensive judgment).

[43] On the fate of the long suffering unsecured creditors, the Supreme Court was concerned, but ultimately unmoved. It considered that the proceeds of the bribe should not have been in the agent's estate at all (though it conceded the same could be said for other assets if the insolvent had honoured his or her obligations) and that in many cases, the bribe will have come indirectly at the cost of the principal (as could be inferred in *FHR* itself where a secret commission was paid to agents of the purchaser of a hotel for arranging the purchase. The Court ruminated that the seller would likely have sold for the selling price less the commission if it had not also had to pay the commission, which was €10m on a sale of €211m).[26] It is inherent in the judgment that no discretion existed to make allowances for impacts on unsecured creditors, reflecting the institutional character of English constructive trusts.

Accessory liability claims

[44] The third category of cases is accessory liability claims. The cases of accessory liability are identified succinctly in *Jacobs* as follows[27] (footnotes omitted):

> **Five Categories of Accessory Liability**
>
> [13-35] At this point, after that introduction to three forms of accessorial liability, it is desirable to summarise the overall position for accessorial liability. At the present stage of development in Australia, accessorial liability for breach of fiduciary duty (including breach of trust) may be divided into at least the following categories:
>
> (a) The first limb of *Barnes v Addy* (1874) LR 9 Ch App 244: receipt of trust property with particular types of notice.
>
> (b) The second limb of *Barnes v Addy:* the second limb of *Barnes v Addy: assisting in* (that is, participating, without inducing or procuring) a dishonest and fraudulent design on the part of the fiduciary with particular types of notice.
>
> (c) Procuring or inducing a breach of fiduciary duty (whether that breach be a dishonest or fraudulent design or not) with a particular mental state. An example may be found in the liability of a solicitor who persuades a trustee to apply trust property in a way the trustee honestly believes is permissible but which the solicitor knows to be a breach of trust, a fact which the solicitor deliberately conceals from the trustee. This is the category with which the Privy Council was dealing in *Royal Brunei Airlines Sdn Bhd v Tan*. The High Court kept the rules of this category distinct from those applying to the second limb of *Barnes v Addy* in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*. English law, following the Privy Council decision in the *Royal Brunei Airlines* case, treats this category as a remodelling of the second: there is no need for a dishonest and fraudulent design, but the accessory must have behaved dishonestly.
>
> (d) A company which is the 'corporate creature, vehicle, or alter ego' of the fiduciary who uses it to secure the profits of, or to inflict the losses by, the fiduciary's breach of fiduciary duty is fully liable for the profits made from, and the losses inflicted by, the fiduciary's wrong.

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[26] See [37] and [43] to [44]
[27] At [13-35]

(e) A person who presumes to act as a trustee though not so appointed and then commits a breach of trust or makes a profit from the position may be liable as a trustee de son sort.

[45] It is beyond the scope of this paper fully to survey the principles applicable to accessory liability claims. However, the development of constructive trust remedies in restitution has turned in part on knowledge of the restitutionary unjust factor, particularly mistake. It is necessary to review those principles, familiar though they might be. The starting point remains the so-called *Baden* categories[28], where Peter Gibson identified five categories of knowledge of the breach of trust or fiduciary duty:

(a) Actual knowledge;

(b) Wilful shutting of the eyes to the obvious;

(c) Failing to make inquiries that an honest and reasonable person would make;

(d) Knowledge of circumstances which would indicate the facts to an honest and reasonable person; and

(e) Knowledge of circumstances which would put an honest and reasonable person on inquiry (characterised as constructive notice).

[46] The first two categories have been equated with actual knowledge: the first involves proof of actual knowledge and the second reflecting the circumstance where actual knowledge can be inferred. The third arguably falls into the same category, where a calculated decision not to inquire for fear of discovering the breach of duty is probably equivalent to actual knowledge. The remaining two categories are probably species of constructive notice.[29]

[47] Much of the legal debate in the area of knowledge for accessory liability relates to the second limb of *Barnes v Addy*, dealing with knowing assistance.[30] That does not loom large as an issue in this paper. For the first limb, which does, the following should be noted.

[48] A person who receives trust property knowing that its transfer is in breach of trust or breach of fiduciary duty will be made a constructive trustee of that property for the benefit of the principal. Knowledge of the breach is essential to liability because the person otherwise does not owe fiduciary duties to the principal. It follows that receipt of trust property without the requisite knowledge does not attract liability under the first limb of *Barnes v Addy*.

[49] That is not to say that liability cannot arise in that situation. Liability to account for trust property as constructive trustee can also arise where knowledge of the breach is acquired at some point after receipt. In that case, a constructive trust arises at the time at which that knowledge is acquired to the extent of the value of remaining

[28] Still useful in analysis of knowledge in Australia, though never actually adopted by the High Court.
[29] *Jacobs* at [13-36]
[30] See the extensive analysis in *Dal Pont* at [38.65] to [38.95]

trust property. This was characterised as a distinct basis for accessory liability by Lemming JA (with whom Bathurst CJ and Sackville AJA agreed) in *Fister v Riverwood Legion and Community Club Ltd*, (2016) 91 NSWLR 732 at [45]:

> The second way that liability under the first limb of Barnes v Addy is not the only way in which a reciepient of trust property may become bound in conscience to account for it. A peron who reseicves trust roperty, otherwise than as a bona fide purchase for value without notice, but innconently, and thereafter acquires notice of the trust and dealt with it in a manner inconsistent with the trust will be liable as a constructive trustee. Although this is similar to first limb *Barnes v Addy* liability, it is conceptually distinct, because it is the *subsequent* dealing, rather than the *receipt of property*, that founds liability.

[50] What kind of knowledge is required? Professor Dal Pont answers (footnotes and cross references omitted):

> *Requisite knowledge*
>
> **[38.105]** It seems established in Australian law that the knowledge required for recipient liability to accrue includes actual knowledge, wilful shutting of the eyes to the obvious, wilful and reckless failure to make inquiries that an honest and reasonable person would make, and knowledge of circumstances that would indicate the facts to an honest and reasonable person (the latter being "constructive knowledge"). In other words, it includes categories (1)-(4) in the *Baden* scale…It does not extend to category 5 in that scale – constructive notice – which includes notice of facts discoverable by inquiries that a reasonably prudent person would conduct as a matter of course, and goes no higher than mere negligence. Liability is premised on a recipient's knowledge, not on notice to her or him, although the line dividing constructive knowledge from constructive notice can, in practice, be fine. What the line between knowledge and notice does do, however, is distinguish the boundaries of a cause of action for recipient liability (which cannot extend to a defendant with mere constructive notice of the fiduciary breach) from the equitable doctrine of tracing trust property into the hands of another (pursuant to which an entitlement to trace ends once the property is in the hands of a bona fide purchaser for value without *notice* of the breach…).

[51] For a recent articulation of the difference see *Fister* at [40] to [46].

Other categories

[52] There are a number of other recognised circumstances which may give rise to a constructive trust. They include:

(a) A constructive trust necessary to give effect to an agreement to make and keep mutual wills;

(b) A constructive trust as a response to circumstances that give rise to proprietary estoppel;

(c) The constructive trust arising under executory contracts for the sale of land;

(d) The *Muschinski v Dodds* constructive trust to address the consequences of failed joint endeavours and the related common intention constructive trust;

(e) Constructive trusts arising over the legal title to a gift where the benefactor has taken all steps required by him or her to make the gift or transfer the property; and

(f) Constructive trust arising from a transfer of property or money which is voidable for undue influence, unconscionable conduct or fraud.

Theft, fraud and the constructive trust

[53] It has long been the case that a thief is a constructive trustee of property which is stolen. The starting point is *Black v S. Freedman & Co Ltd* (1910) 12 CLR 105. That case recognised for the first time in Australia that a trust arose over stolen property immediately on its theft by the thief. A summary of the case is as follows (footnotes omitted)[31]:

> Mr Black was employed as an accountant of Freedman & Co. Black stole at least £1,394 in cash from his employer. From the stolen money Black deposited £754 into his wife's bank account and used £250 to buy circular notes (an early form of traveller's cheque) in the name of Mrs Black. The £754 was deposited to Mrs Black's account between November 1909 and April 1910. The money remained in the account which had a balance of £759 at the time of the trial. The proceeds of Black's theft therefore existed in two forms: the money in Mrs Black's bank account and the circular notes. The plaintiff claimed a declaration that £754 of the money in Mrs Black's bank account was their property and that the £250 of circular notes were also their property. The framing of the claim by the plaintiffs in this way turned out to be critical. Instead of claiming a money remedy for conversion they sought a declaration that they had a continuing legal property right in the proceeds of the stolen money.
>
> In the High Court, Griffith CJ proceeded on the basis that the stolen money could be traced in equity as trust property. He made no attempt to explain why it was trust property other than to refer to property being disposed of by a person in a fiduciary position. Black was an employee and thus a fiduciary and therefore it may have been that Griffith CJ considered that the money was trust property because of this fiduciary relationship and not solely because of the theft. O'Connor J agreed with Griffith CJ but observed that where money is stolen it is trust money in the hands of the thief. The significance of O'Connor J's statement is that it suggests that a trust will arise from a theft even in the absence of a fiduciary relationship. He also held that, when given to a third party without consideration, "the money" retained its character as trust money. This would suggest that a trust arose at the moment of the theft. The conclusion of the High Court that a thief becomes a trustee of stolen money has been described as heretical. However, heretical or not, it is the position in Australia.
>
> [underlining added]

[54] The principle for which the case is widely known was not the subject of detailed consideration in the judgments, perhaps because the Court considered the answer obvious (Barton J, in agreeing with Griffith CJ, merely added "*I do not wish to waste words on this endeavour to retain the fruits of a crime*". O'Connor J's judgment referred to above was very brief).

[55] However, any ambiguity was dispelled in *Creak v James Moore & Sons Pty Ltd* (1912) 15 CLR 246. That case is less often cited, but it has particular relevance for this paper. There the High Court confirmed the principle articulated by O'Connor J in *Black*, in the context of the facts in that case. It is again helpfully summarised by Mr Tarrant as follows (footnotes omitted)[32]:

> …Watson, an employee of James Moore & Sons Pty Ltd, stole … galvanized iron from his employer. Quine, an accomplice of Watson's then sold the iron to Creak and deposited the proceeds in a bank account in the name of Watson. Watson was subsequently arrested by

[31] With thanks to Tarrant, *Theft Principal in Private Law* (2006) 80 ALJ 531 at 532–533
[32] Ibid at 534-535

> Detective Lonsdale who arranged for Watson to withdraw the funds from the bank account and Detective Lonsdale then delivered those funds to James Moore.
>
> Therefore, James Moore had received the proceeds of the sale of the stolen goods but continued to pursue a claim for conversion against Creak. James Moore justified this on the basis that Watson owed them other moneys and they applied the money received from Detective Lonsdale to that other debt on the basis that they had no knowledge that the money represented the traceable proceeds of the sale of the goods to Creak. Accordingly they continued to pursue an action in conversion against Creak.
>
> When the case came before the High Court, Griffiths CJ observed that the case raised the question as to whether James Moore were "entitled to recover the value of the goods and also to keep a sum of money which was in fact the actual proceeds of the goods when sold by the thief". He went on to observe that the issue was "free from direct authority, and must be determined by the application of general principles of law". In discussing James Moore's right to the proceeds Griffiths CJ referred to "their independent equitable title to it". As a result James Moore had continuing legal title to the stolen iron as well as equitable title to the proceeds received by the thief. This prima facie provided them with two remedies: damages for conversion and the ability to vindicate their right to the trust property. But Griffiths CJ held that James Moore could not obtain both remedies. He held that:
>
> > In my opinion the following proposition is good law: If a man, having received a sum of money which is identified as being in fact the proceeds of property of his that has been sold without his authority, afterwards becomes aware of the fact, he is prima facie bound to elect whether he will affirm or disaffirm the sale. That is to say, he cannot keep the money and recover the full value of the goods.
>
> Barton J agreed with Griffith CJ, observing that it would "be monstrous to hold that they are entitled to keep both the money and the goods".

[56] In both decisions, the source of the trust obligations is the theft of property from the plaintiff and the effect of *Creak* is that the source of that trust is the theft itself, not some pre-existing fiduciary relationship. The principle has been applied many times by intermediate Courts of Appeal, though the debate continues as to whether the trust which exists is a constructive trust or a resulting trust.[33] The writer prefers the analysis of the trust as a constructive trust. The use of the resulting trust analysis necessarily involves the deployment of the idea of presumed intention in a circumstance where intention is, definitionally, non-existent.

[57] Interestingly, in an example of extension of the constructive trust by analogy, the trust arising where theft has occurred has been extended to apply to some cases where property passes under a contract induced by fraud but where the contract has not been rescinded.

[58] The orthodox position for property passing under a contract induced by fraud is that the innocent party must rescind the contract before equitable title to property passing under the contract arises. The position is explained in a leading text as follows[34]:

> **Fraud**
>
> Disaffirming a voidable transaction confers an equitable interest in assets transferred if the transaction was procured by fraud. The key authorities are *Lonrho plc v Fayed (No 2)* and

[33] See *Fistar* at [39]

[34] D O'Sullivan, S Elliott & R Zakrzewski, *The Law of Rescission* (Oxford University Press, 2nd ed, 2014) at [16.23] to [16.25]

Shalson v Russo behind both of which is the Australian case of *Alati v Kruger*. In that case the High Court of Australia held as follows:

> Equity has always regarded as valid the disaffirmance of a contract induced by fraud even though precise *restitutio in integrum* is not possible, if …it can do what is practically just between the parties, and by so doing restore them substantially to the *status quo*…Rescission for misrepresentation is always the act of the party himself: *Reese River Silver Mining Co v Smith* (1869) LR 4 HL 64 at 73. The function of a court in which proceedings for rescission are taken is to adjudicate upon the validity of the purported disaffirmance as an act avoiding the transaction *ab initio*, and, if it is valid, to give effect to it and make appropriate consequential orders…Of course a rescission which the common law courts would not accept as valid cannot of its own force revest the legal title to property which had passed, but if a court of equity would treat it as effectual the equitable title to such property revests upon the rescission.

It seems from the context that the reference to equitable title revesting 'upon the rescission' refers to a rescission that follows an election to disaffirm, and that the High Court contemplated a rescinding party obtaining an equitable title to property transferred after he elected to rescind.

In *Lonrho pls v Fayed (No 2)* Millett J considered a submission that the vendor of shares could bring claims for breach of fiduciary duty against the buyer because the sale was voidable for fraud. In explaining why this submission was misconceived, Millett J said as follows:

> A contract obtained by fraudulent misrepresentation is voidable, not void, even in equity. The representee may elect to avoid it, but until he does so the representor is not a constructive trustee of the property transferred pursuant to the contract…: see *Daly v Sydney Stock Exchange Ltd* (1986) 160 CLR 371, 37-390, per Brennan J. It may well be that if the representee elects to avid the contract and set aside a transfer of property made pursuant to it the beneficial interest in the property will be treated as having remained vested in him throughout, at least to the extent necessary to support a tracing claim. But the representee's election cannot retrospectively subject the representor to fiduciary obligations of the kind alleged…

[59] The legal propositions in that passage are uncontentious. They seem to exclude the possibility that a constructive trust arises over property passing under a contract induced by fraud in the same way as it arises when property is stolen. A constructive trust could not arise, immediately legal title passes, because until the contract is rescinded, the fraudster holds the property absolutely. The contract stands like a wall between the innocent party and equitable title to the property which has passed under the contract.

[60] However, the constructive trust appears to have opened a breach in that wall. There are two lines of authority, travelling in the same direction but not so far overlapping, which have created an exception where a contract induced by fraud can be characterised as 'nothing but an instrument of the fraud'.

[61] The first line of authority has developed in the UK and is articulated in *Halley v Law Society* [2003] EWCA Civ 97. In that case the Court of Appeal had to consider whether the plaintiff had a beneficial interest in money held in a solicitor's bank account which was to comprise his share of a fee in relation to an investment made by a company in a high yield 'bank instrument' that had turned out to be worthless. The Law Society had intervened in the solicitor's practice and alleged that the transaction was a fraud. The victim of the fraud had not, however,

rescinded the transaction. Carnwath LJ (with whom the other members of the court agreed) held relevantly:[35]

> The submission, as I understand it, is that this is not simply a case of a valid contract being induced by fraud; but that the fraud so infected the whole transaction that it had no legal effect at all. The "contracts" were in reality no more than devices to extract money by fraud; in Mr Dutton's words
>
> > "The "agreements" were fictitious contracts. They were as the judge found merely part of an elaborate charade (or mechanism) by which the loser was persuaded to part with his money."
>
> The position, accordingly, is said to be "akin to theft". Where property is stolen, no beneficial interest passes to the thief. Mr Dutton submits that the same applies where money is extracted by fraud, otherwise than under a legally enforceable contract. He relies on *Westdeutsche Bank v. Islington LBC* [1996] AC 669 at 705C-D, 715H-716D (per Lord Browne-Wilkinson).
>
> > "I agree that the stolen moneys are traceable in equity. But the proprietary interest which equity is enforcing in such circumstances arises under a constructive, not a resulting, trust. Although it is difficult to find clear authority for the proposition, when property is obtained by fraud equity imposes a constructive trust on the fraudulent recipient: the property is recoverable and traceable in equity. Thus, an infant who has obtained property by fraud is bound in equity to restore it: *Stocks v. Wilson* [1913] 2 K.B. 235, 244; *R. Leslie Ltd. v. Sheill* [1914] 3 K.B. 607. Moneys stolen from a bank account can be traced in equity: *Bankers Trust Co. v. Shapira* [1980] 1 W.L.R. 1274, 1282C-E: see also *McCormick v. Grogan* (1869) L.R. 4 H.L. 82, 97."
>
> Mr Tager submits that so to hold would be contrary to the decision of this Court in *Twinsectra v. Yardley* [1999] LlLR 527 (paras 98-9), where his own submissions to like effect (as counsel for the claimant in that case) were rejected. Twinsectra lent money to a Mr Yardley, on the security of a solicitor's undertaking given by a Mr Sims, whom Twinsectra believed to be acting for him. Mr Yardley fraudulently failed to inform them that, by the time of the loan, he had withdrawn Mr Sims' instructions (para 64). It was held that this was sufficient to establish Twinsectra's claim in deceit, but not, in the absence of rescission, to given them a proprietary right over the money lent. Mr Tager, relying on the Westdeutsche case, had argued that the obtaining of money by false pretences should be regarded as "theft", and that accordingly it should be held that a constructive trust was imposed on the recipient at the moment of receipt (para 98). This argument was rejected. Potter LJ said (para 99):
>
> > "It seems to me that, whatever the legal distinctions between 'theft' and 'fraud' in other areas of the law, the distinction of importance here is that between non-consensual transfers and transfers pursuant to contracts which are voidable for misrepresentation. In the latter case, the transferor may elect whether to avoid or affirm the transaction and, until he elects to avoid it, there is no constructive (resulting) trust; in the former case the constructive trust arises from the moment of transfer. The result, so far as third parties are concerned, is that, before rescission, the owner has no proprietary interest in the original property; all he has is the 'mere equity' of his right to set aside the voidable contract…"
>
> Within the dichotomy which begins that passage, Mr Tager submits that the present case cannot be categorised as one of "non-consensual transfer". The transfers were made voluntarily by the applicants under what they at least believed to be valid contracts.
>
> In my view, however, there are important distinctions between that case and the present. In that case, there was a straightforward contract of loan, under which legal and beneficial interest in the money passed to Mr Yardley (subject only to a "purpose" trust, which does not

[35] At 537-538

> affect the present argument). The contract may have been induced by the fraud, but it was not itself the instrument of fraud. In this case, the contract has been held to be the instrument of fraud, and nothing else. The elaborate documentation was, in the words of the judge, "no more than a vehicle for obtaining money… by false pretences" (para 119). Furthermore, the legal interest in the money passed to the escrow agent, but the beneficial interest remained with Toro, unless and until it passed to Tidal under the contract. In my view, the court is entitled to disregard the apparent effect of that fraudulent contract, and hold that the beneficial interest remained throughout with Toro.
>
> In such a case, it is meaningless to impose a requirement for the fraudster to be notified of "rescission". From the fraudster's point of view there is nothing to rescind; for practical purposes, he has parted with nothing of value and incurred no obligations; the victim is left with some documents which, from the outset, were known and intended by the other party to be worthless. The "election" to which Potter LJ referred is not a real option. Although the case does not fit neatly into Potter LJ's binary classification, he was not dealing with these facts. Subject to any direct authority, I see no reason why it should not be regarded as a simple case of "property obtained by fraud", in Lord Browne Wilkinson's terms.
>
> [underlining added]

[62] In *Global Currency Exchange Network v Osage 1 Limited* [2019] EWHC 1375, Henshaw QC referred to *Halley* and identified that it had been suggested that the analysis should be treated with caution, but accepted he was bound by the decision.

[63] The writer did not locate any consideration or application of *Halley* in Australia, with the exception of a recent judgment of the writer's, discussed below.[36]

[64] However, a very similar principle has, separately, emerged in New South Wales. In *Orix Australia Corporation Ltd v Moody Kendall & Partners Pty Ltd* [2005] NSWSC 1209, Justice White reasoned to a similar conclusion as that reached in *Halley*. There, Orix (an equipment financier) acquired six cranes from a seller for hire to a hirer. The cranes did not exist, and the transaction was entirely fraudulent. Orix sought to recover from the defendant finance broker and the person (Mr Nelson) who stood behind the seller, inter alia, on a *Barnes v Addy* basis.

[65] In that context, Justice White observed:

> 154. Orix also claimed equitable compensation from Mr Nelson as an accessory who knowingly, or dishonestly, assisted in Nelson Equipment's breach of trust.
>
> 155. There was no fiduciary relationship between Nelson Equipment and Orix. I accept that Nelson Equipment held the purchase moneys paid to it by Orix on trust for Orix immediately it received the funds. It obtained the funds through fraud. Stolen property is trust money in the hands of the thief. (*Black v S Freedman & Co* (1910) 12 CLR 105 at 110). In *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 Lord Browne-Wilkinson said (at 716):
>
> > "*…when property is obtained by fraud equity imposes a constructive trust on the fraudulent recipient: the property is recoverable and traceable in equity.*"
>
> In *Robb Evans v European Bank Ltd* (2004) 61 NSWLR 75, moneys obtained by fraud were deposited by the fraudster into an account with a company called Benford Ltd which the fraudster controlled. Spigelman CJ, with whom Handley and Santow JJA agreed, held that Benford Ltd held the stolen funds as trustee for the defrauded credit card holders. (At 99, [111]). His Honour said that the trust was better described as a presumed or resulting trust, rather than as a constructive trust. However the trust is classified, it arises upon the receipt by

[36] *Wylie v Orchard (No. 2)* [2020] QDC 31

> Nelson Equipment of the moneys. (*Robb Evans v European Bank Ltd* at [113]-[115], 100; *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* at 714-715).
>
> 156. Moreover, the fraud went to the heart of the contract so that Nelson Equipment received the price from Orix, but gave nothing in return such that there was a total failure of consideration for the payment of the purchase price. It is not merely the fact that the purchase price was received by Nelson Equipment by a fraudulent representation that gives rise to the trust, but the fact that Nelson Equipment gave nothing of value in return. This was explained in a judgment of the Court of Appeal of Vanuatu, (noted in 79 ALJ 600), of *Barrett & Sinclair v McCormack* [1999] VUCA 11. The Court, after referring to *Neste Oy v Lloyds Bank plc* [1983] 2 Lloyd's Rep 658, *Re Goldcorp Exchange Ltd* [1995] 1 AC 74, *Westdeutsche Landesbank Girozentrale v Islington LBC*, *Cowern v Nield* [1912] 2 KB 419, *Stocks v Wilson* [1913] 2 KB 235, and *Bankers Trust Co v Shapira* [1980] 1 WLR 1274, said:
>
> > "The fraud here goes to the heart of the contract resulting in a total failure or absence of consideration. The appellants [scil vendor] in essence provided nothing in exchange for the respondent's money. The shares … were a scam. This amounted to theft, the taking of something for nothing in return. The taking of something without anything in return, not qualifying as a gift or some other lawful assignment, is the very basis for the imposition of constructive trusts in the above cases of Nest Oy, Cowern, Stocks and Bankers Trust. In Nest Oy, the payee received money when it knew it could not perform the contract. Likewise, the payee in Cowern provided the payer with nothing in return as the goods the payee supplied were worthless. Further, Cowern, like Stocks, are cases involving infants who could not at law contract for non-necessities. The promises of infants were not legally enforceable against them by the other party. Thus, these infants provided no consideration at the formation of executory contracts where consideration is the exchange of legally enforceable promises. There was an absence of consideration as the party contracting with the infant received nothing in exchange for its promise to provide and subsequent provision of property. The infants in Cowern and Stocks had fraudulently misrepresented their age. The fraud of the infants in Cowern and Stocks went to the heart of the contract as it concerned their ability to contract and provide consideration. In like fashion, though [the vendor] had fraudulently misrepresented the true value of the shares in an arms length vendor-purchaser transaction, their fraud went to the heart of the contract, resulting in the total failure or absence of consideration. [The vendor] was getting something for nothing. In Bankers Trust, the fraudulent parties had defrauded the bank with the use of forged cheques. Again, there was the taking of something without something in return. In every case, a proprietary remedy was appropriate."

[66] In the writer's respectful view, there is a coincidence in the underlying reasoning of *Halley* and *Orix*. Justice White's focus on the fact that Nelson gave nothing in return for the sale price (except a fraudulent promise) which attracted the principle in *Black* is apt to identify a contract which is nothing more than an instrument of fraud. His Honour's reference to giving nothing in return, and the cases referred to in the quotation adopted by his Honour, also seem to invoke the cause of action for restitution where there has been a total failure of consideration because a contract is void.[37] However, there is some difficulty with that analysis as an explanation for the outcome in *Orix* given that a contract induced by fraud is voidable not void.

[67] The same analysis recommended itself to Hodgson JA (with whom Ipp JA agreed) in *MBF Australia v Malouf* [2008] NSWCA 214. There the fraudster had fraudulently promised to use certain funds from the victim to acquire an insurance policy for a large business loan with no intention of doing so. In fact, the funds

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[37] See K Mason, J W Carter and G J Tolhurst, *Mason & Carter's Law of Restitution* (Lexis Nexis Australia 3rd ed, 2016) at [1015] ('*Mason & Carter*')

were obtained in a bank cheque made payable to the landlord of the fraudster's company and collected by the landlord.

[68] On the trust question, Hodgson JA observed:

> [30] The cheque was handed to Mr Hill either by Ms Waters or by Mr Malouf. If it was handed to Mr Hill by Ms Waters, she did so as Mr Malouf's agent. The result intended and achieved was that the cheque, previously owned by Mr Malouf, became the property of Mr Hill, subject to whatever contractual or equitable rights might have arisen from the transaction.
>
> [31] It is true that payment of the cheque to MBF was consistent with the intention of Mr Malouf and Mr Hill; and it is also true that Mr Malouf had not, prior to 6 December 2000 when the cheque was sent to MBF, terminated his contract with Isagila. However, this was a case not merely of a fraudulent misrepresentation inducing entry into a contract, but one where, on the evidence and findings of the primary judge, the whole transaction was a fraud perpetrated by Mr Hill. As found by the primary judge (Judgment [30]), Mr Hill never intended to carry out any part of the purported transaction: that is, he never intended to use overseas funds or acquire a Lloyds' policy, and he never intended to provide a loan to Mr Malouf.
>
> [underlining added]

[69] In my view, although *Halley* does not appear to have been directly applied, the principle it represents has already been recognised in the two authorities to which I have just referred, with the added clarity that the contract can be ignored where the fraudster provided nothing for the money other than the false promise.

[70] These cases provide authority for the principle that a fraudster receives property on constructive trust for the owner of the property pursuant to the terms of a contract induced by fraud where the contract can be characterised as *no more than* an instrument of the fraud.

[71] This is a modest expansion of the constructive trust by analogy into the area of property passing under contract affected by fraud which is arguably anomalous (compared to the existing law on rescission of fraudulently induced contracts) and uncertain (as to when a contract is an instrument of fraud). The writer initially thought to challenge the cases on that basis.

[72] However, it is hard to work up too much enthusiasm for the idea. The "victims" of this expansion of the constructive trust are primarily fraudsters who use contracts to perpetrate fraud (subject to the insolvency issue). It might be that it is the common law which needs to change to recognise an additional and more subtle form of ineffective contract beyond the current state of the authorities in which a contract is either a sham or valid. Note a sham requires both parties to not intend to create the contract, despite the outward appearance of a binding contract.[38]

[73] Further, although one might not be able comprehensively to define exactly when a contract is an instrument of fraud, you know it when you see it. Certainly, the writer had no difficulty applying these authorities to find that a contract which was not technically a sham was no more than an instrument of fraud in *Wylie v Orchard*

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[38] *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) 82 ALR 530 at 536; *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* (2004) 218 CLR 471 at [46]

(No. 2) [2020] QDC 31, given the clear fraud perpetrated by Mrs Orchard on the naïve Mrs Wylie. What the writer might have done if Mrs Orchard was insolvent and unsecured creidtors were at risk is another matter.

RESTITUTION AND THE CONSTRUCTIVE TRUST

Introduction to the law of restitution

[74] Resitutionary claims are a category of claims which have the following common features:

(a) Enrichment of the defendant at the expense of the plaintiff;

(b) Which enrichment occurs in circumstances which the law recognises as unjust (sometimes called the unjust factor).

[75] Despite this simple articulation, the High Court has rejected the concept that there is a single cause of action in unjust enrichment which arises where a defendant is enriched unjustly at the expense of the plaintiff. Rather, unjust enrichment is an organising concept which recognises common features of a series of causes of action.[39] The key distinguishing characteristic of those causes of action is the so-called unjust factor. The unjust factor can be described as the elements which give rise to a right to restitution. When determining whether a restitutionary remedy is available, the starting point is to determine whether the facts give rise to any recognised unjust factor.[40]

[76] There unjust factors form Chapter headings in the leading texts. For our purposes it is sufficient to identify the following:

(a) **First**, resitiution may be available where money or property passes under as a result of a material mistake of fact or mistake of law. This factor will be the focus of much of the attention in this case;

(b) **Second**, restitution may be available where money or property passes under an ineffective contract. This commonly arises where the consideration for a contract is invalid as consideration or because the contract itself is void, whether for illegality, or is against public policy; and

(c) **Third**, where goods or services have been provided at the request of the defendant, but the plaintiff does not have a contractual right for payment, the plaintiff may be entitled to reasonable price for the benefits conferrred. This cause of action is sometimes called a *quantum meruit* claim.

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[39] A recent explanation of the character of the concept of unjust enrichment in Australian law was given by Justice Julie Ward in a paper entitled *What's in a name? The taxonomical and conceptual divide between unjust enrichment and equity* delivered in the Banco Court of the Supreme Court of Queensland on 13 June 2019 as part of the 2019 Current Legal Issues seminars. Published in the *Queensland Legal Yearbook 2019* at 89 to 99

[40] *Muschinski* v *Dodds* at 617.6; *Farah* at [150] to [151]; The High Court fully restated its established position on this issue most recently in *Equuscorp Pty Ltd v Haxton* (2012) 246 CLR 498 at [26] to [30].

[77] There are many other causes of action arising out of other recognised situations where restitution is available. And, as might be expected, there is some contentions around the margins. Most famously, the New South Wales Court of Appeal sought to bite the proverbial bullet in their decision under appeal in the High Court in *Farah Constructions v Say-Dee Pty Ltd* (2007) 230 CLR 89 and create a new restitutionary cause of action. The unjust factor in that new cause of action was the recipient by a third party of property transferred in breach of trust (or of fiduciary duty). The High Court, speaking with one voice, comprehensively rejected that development and reasserted that the liability of recipients of trust property transferred in breach of trust arose under the first limb of *Barnes v Addy*.[41]

[78] Where one of the restitutionary causes of action are established, a plaintiff is entitledsubject to restitutionary defences, to a personal remedy in the amount of the enrichment of the defendant resulting from the events giving rise to the claim. The most common defences are change of position on the faith of the receipt and bona fide purchaser for value.

[79] Resitutionary claims are common law claims. There is no residual discretion about the form or content of the remedy once the cause of action is established.

Restitution and constructive trusts

[80] There is an immediate and obvious affinity between restitutionary causes of action and proprietary remedies. A restitutionary claim (nearly always[42]) involves identified money or property passing from one person (the de-riched) to another (the en-riched). This factual context lends itself to trust remedial responses because they ensure that the elements required for a constructive trust are nearly always present: there is a trustee (the enriched), a beneficiary (the de-riched) and,trust property which can be identified with certainty (the money or property passing). It might be argued that constructive trust responses to restitutionary causes of action was a development just waiting to happen.

[81] This factual affinity distinguishes restitutionary causes of action from other common law claims which do not provide the feature necessary for a trust response. Claims for damages for negligence, breach of contract, defamation, passing-off and similar do not usually involve property or money passing from the plaintiff to the defendant but rather harm being done to the plaintiff or the plaintiff's financial interests by conduct of the defendant.

[82] The affinity between restitutionary causes of action and trust remedies has manifested itself in the United States and Canada.[43] In the United States, the *Restatement of Restitution* (3rd Edn) provides:

> If a recipient is unjustly enriched by the acquisition of legal title to specifically identifiable property at the expense of the claimant or in violation of the claimant's rights, the recipient

[41] See [148] to [155] of the Court's reasons.
[42] The exception is resititution for wrongs. In that case, a plaintiff can waive a tort (and the resulting right to compensatory damages) and instead sue for a restitutionary measure calculated by reference to the gain to the tortfeasor from the tort: *Mason & Carter* at [1501]
[43] As to the similar position in Canada see *Pettekus v Becker* [1980] 2 SCR 834

> may be declared a constructive trustee, for the benefit of the claimant, of the property in question and its traceable product.

[83] There is a further source of what might be called natural affinity between the constructive trust and restitutionary common law claims: at the heart of all resitutuionary claims is the unjust, dare one say unconscientious, enrichment of one at the expense of another. The similarity in the concepts has not gone unremarked in the High Court. In *Equuscorp Pty Ltd v Haxton* (2012) 246 CLR 498, the majority (Fench CJ, Crennan and Kiefel JJ) said (footnotes omitted)[44]:

> [31] Failure of consideration is one of the factors that makes retention of a benefit prima facie unjust. It was recognised by Lord Mansfield (69) as a ground for a claim for money had and received. It was a criterion of recoverability which survived the rejection in the United Kingdom and Australia of the implied contract theory. This Court has, on more than one occasion, described failure of consideration in terms set out by the late Professor Birks (70):
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> > "Failure of the consideration for a payment … means that the state of affairs contemplated as the basis or reason for the payment has failed to materialise or, if it did exist, has failed to sustain itself."
>
> [32] As Gummow J pointed out *in Roxborough v Rothmans of Pall Mall Australia Ltd* (71), failure of consideration for the purpose of a claim for money had and received is not confined by contractual principles (72). In that case there had been no failure of performance by Rothmans of any promise it had made. There was no question of repudiation by it of its contractual obligations. The question was whether it was "unconscionable" for Rothmans as the recipient of payments to retain them in circumstances in which it was not specifically intended or especially provided that it should so enjoy them (73). The question of unconscionability, as his Honour explained, derived from the general equitable notions which found expression in the common law count for money had and received (74). This Court acknowledged in *Australia and New Zealand Banking Group Ltd v Westpac Banking Corporation* (75) that "contemporary legal principles of restitution or unjust enrichment can be equated with seminal equitable notions of good conscience" albeit the action itself is not for the enforcement of a trust. The reference to conscionability in this context, however, does not mean that whether enrichment is unjust is to be determined by reference to a subjective evaluation of what is fair or unconscionable. As the Court reiterated in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (76): "recovery rather depends on the existence of a qualifying or vitiating factor falling into some particular category." (Footnote omitted.)
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> [underlining added]

[84] Consistent with this passage, Australian law has not followed the USA and Canada in accepting that a constructive trust arises on the establishment of a restitutionary cause of action.[45]

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[44] The High Court also recognised the equitable concepts which underpinned and informed the scope of the defence of change of position in *Australian Financial Services and Leasing Pty Ltd v Hills Industries* (2014) 253 CLR 560 at [126].

[45] *Msuchinski v Dodds* at 617

The emergence of the Wambo constructive trust

Chase Manhattan

[85] The starting point for any analysis of constructive trust arising from mistaken payments is *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] 1 Ch 105.

[86] Chase Manhattan (**Chase**) transferred an amount due to Israel-British Bank (**IBB**). Unfortunately, it mistakenly did so twice, and the amount involved was US$2 million. The case is cited as authority for the proposition that a constructive trust arises over money passing by reason of a mistake of fact from the moment of the payment. It was heavily criticised for adopting that position.

[87] While Goulding J did state that proposition, however, there is quite a bit more to the story. The context in which the litigation was conducted is important. IBB had become insolvent within weeks of the mistaken payment. There remained funds in various accounts of that bank under the control of the liquidator. Chase wanted to trace its mistaken payment into one of those accounts. The real issue in the case was whether Chase could do so. There were complicating factors. First, the funds were held in an account in New York state. It was uncontroversial that the proper law for asserting rights over that account was New York law. Second, the real controversy was whether a right to trace could arise where a payment had not been made in breach of trust or fiduciary duty.

[88] Justice Golding has been hard done by by history. His Honour correctly determined both of the key issues:

(a) He determined that a fiduciary obligation was not an essential foundation for asserting a right to trace; and

(b) He determined that the law of New York recognised that a constructive trust arose on the payment of money under a mistake of fact.

[89] The latter conclusion is of course consistent with US law. His Honour went on, however, and observed, entirely in obiter, that the law of the UK was the same. This observation is what drew the criticism. For the purposes of tracing the emergence of a constructive trust response to payments made by mistake, it is important to note two matters:

(a) First, his Honour adopted the position, consistent with US authority, that the constructive trust arose by virtue of the mistake alone. No other factor needed to be shown; and

(b) Second, his Honour also found (in a prescient finding) that the key officers of IBB knew of the mistake before the company went into liquidation.

[90] The state of knowledge of the recipient of the payment is fundamental to the Wambo principle. However, the finding had nothing to do with the ultimate decision in *Chase Manhattan*. The constructive trust recognised by his Honour was not "fault based".

[91] Counsel for the liquidator submitted that the assets of IBB became subject to a statutory trust on the winding up order and therefore a trust could not be recognised over those assets by the Court. Justice Golding rejected this proposition by finding that the constructive trust arose immediately on the making of the mistaken payment, and accordingly it was always subject to a trust and never became part of the company's assets. This conclusion was consistent with the orthodox English position that the trust which arose was "institutional", in that there was no discretion about its existence, extent or timing. Take that, unsecured creditors.

Westdeutsche Landesbank Girozentrale

[92] Subsequently, Justice Golding's (obiter) decision that Chase was entitled under UK law to a constructive trust has received considerable support, but his reasoning has not. Most relevantly in the UK, it came under consideration in the House of Lords in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 699. That was not a constructive trust case. It arose out of the litigious festival which followed the determination that interest rate swap contracts entered into by English local authorities to manage exchange rate risk on public debt were *ultra vires* and the swap contracts were ineffective.

[93] The issue in the House of Lords was whether compound interest could be awarded on money paid under an ineffective contract (or on the failure of consideration ground as it is known). Islington Council had repaid the money due to Westdeutche by way of restitution for money paid under an ineffective contract. The Bank sought compound interest. Compound interest could only be awarded in equity, but the Bank did not argue that the money paid by the Bank under the void swap agreement was subject to a constructive trust because the local authority did not know of the ineffective nature of the swap agreement until the money paid by the Bank had become unidentifiable. Rather, the resulting trust was appealed too. That approach was rejected.

[94] However, Lord Browne-Wilkinson (with whom Lord Slynn agreed) considered *Chase Manhattan*. He disagreed with the reasoning (as distinct from the decision in *Chase Manhattan*) inter alia, because in the absence of knowledge of the mistake there was nothing which bound the conscience of IBB. However, he did suggest that the decision might have been correct for another reason. He observed (at 715):

> However, although I do not accept the reasoning of Goulding J., *Chase Manhattan* may well have been rightly decided. The defendant bank knows of the mistake made by the paying bank within two days of the receipt of the moneys. The judge treated this fact as irrelevant but in my judgement, it may well provide a proper foundation for the decision. Although the mere receipt of the moneys, in ignorance of the mistake, gives rise to no trust, the retention of the money after the recipient bank learned of the mistake may well have given rise to a constructive trust.

[95] He continued on the issue, explaining his reason for being tentative (at 716):

> Although the resulting trust is an unsuitable basis for developing proprietary restitutionary remedies, the remedial constructive trust, if introduced into English law, may provide a more satisfactory road forward. The court by way of remedy might impose a constructive trust on a defendant who knowingly retains property of which the plaintiff has been unjustly deprived. Since the remedy can be tailored to the circumstances of the particular case,

> innocent third parties would not be prejudiced and restitutionary defences, such as change of position, are capable of being given effect. However, whether English law should follow the United States and Canada by adopting the remedial constructive trust will have to be decided in some future case when the point in directly in issue.

[96] It is worth noting that although only two members of the House of Lords expressed this somewhat guarded view as to when a constructive trust arises, it is plain from the way that that counsel for the bank (who expressly disavowed any appeal to the constructive trust because of lack of knowledge of the ineffective contract by the Council at any relevant time) and the other Lords approached the matter that they did not consider *Chase* to be correct. It is also worth noting that Lord Browne-Wilkinson put the positive proposition favouring a constructive trust in a tentative manner.

Wambo Coal v Ariff

[97] There has been support for, and resistance to, the *Westdeutsche Landesbank Girozentrale* approach in key Australian texts. Perhaps not surprisingly, a leading restitution text supports it[46] and a leading equity text speaks against it.[47] However, the key judicial decision on the point is Justice Richard White's decision in *Wambo Coal Pty Ltd v Ariff* 63 ACSR 429.

[98] As always when the limits of proprietary remedies are in play, the case involved a liquidation. The facts are summarised by his Honour:

> [1] The first defendant, Mr Ariff, is the liquidator of the second defendant, Singleton Earthmoving Pty Ltd (in liquidation), (Singleton Earthmoving). He was appointed administrator of Singleton Earthmoving on 28 September 2004 and became liquidator on 17 December 2004.
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> [2] The plaintiff, Wambo Coal Pty Ltd (Wambo), seeks to recover from Mr Ariff and Singleton Earthmoving two payments totalling $46,130.15 which Wambo mistakenly made to Singleton Earthmoving on 10 September and 31 October 2005. Mr Ariff caused most of the moneys paid by Wambo to Singleton Earthmoving to be transferred to S Ariff Nominees Pty Ltd, a company which he controls, to reimburse it for disbursements it had paid, on his direction, in the liquidation of Singleton Earthmoving
>
> [3] There is no issue that the moneys were paid by Wambo under a mistake of fact and that Singleton Earthmoving is liable to repay the moneys. However, Singleton Earthmoving is insolvent. Its assets will not satisfy Mr Ariff's right to be indemnified against liabilities incurred by him in the liquidation, let alone satisfy creditors entitled to prove in its liquidation. Moreover, Wambo is not entitled to prove in the liquidation as its claim did not arise until after the day on which Singleton Earthmoving's winding-up is taken to have begun: s 553(1) of the Corporations Act 2001 (Cth). That is not to say Wambo cannot recover from Singleton Earthmoving any property still held by Singleton Earthmoving which is held on trust for it.

[99] Again, it is important to understand the precise issue which arose on the facts in that case. Wambo was entitled to a personal action against Singleton Earthmoving for money paid by mistake. However, that action was worthless because of the insolvency. Wambo therefore sought a proprietary remedy. None of the money

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[46] *Mason & Carter* at [454].

[47] J D Heydon, M J Leeming & P G Turner, *Meagher, Gummow & Lehane's Equity Doctrines & Remedies* (Lexis Nexis Butterworths, 5th ed, 2015) at [14-010] ('*Meagher, Gummow & Lehane's Equity Doctrines & Remedies*')

was still in Singleton's account. Both payments were transferred, soon after receipt by Singleton, to an account of Mr Ariff which was used to pay outgoings in the administration. Any recovery would therefore have to be against Mr Ariff. This necessarily required Wambo to establish a proprietary interest in the mistaken payments and, additionally, to fix Mr Ariff with liaibility to account in respect of that trust property. Wambo failed on the first payment of $27,000 but succeeded on the second payment of $18,000.

[100] The first question for the Court was whether Wambo had any proprietary interest in the mistaken payment in the hands of Singleton Earthmoving. Counsel for Wambo, not surprisingly, relied on *Chase Manhattan* to contend that a payment by mistake was held on trust for the payer from the moment of receipt. Justice White referred to *Westdeutsche* and rejected that argument, finding that the receipt of money by mistake of itself did not give rise to a constructive trust. However, his honour went on to adopt the formulation of when mistaken payments can give rise to a constructive trust tentatively suggested in *Westdeutsche*. In doing so he relied on the following considerations.

[101] **First**, he considered that the concern about introducing a remedial constructive trust expressed by Lord Browne-Wilkinson was not a barrier to the constructive trust based on knowledge of the mistake because of the recognition in Australia of the remedial aspect to constructive trusts. He referred to *Muschinski v Dodds*

[102] **Second**, he considered that the trust would in any event be "institutional". He stated that the constructive trust over stolen property was institutional in the sense that it applied from the moment of theft because the thief's conscience was immediately bound. He drew an analogy between theft and property obtained by fraud which also immediately bound the property in hands of the fraudster. He referred to *Orix* and the cases referred to in *Orix* (all English cases). He also characterised property obtained by fraud as an example of failure of consideration, another recognised unjust factor. Again, he considered, these cases show property being held subject to a constructive trust as soon as the conscience was bound.

[103] His Honour then concluded:

> [42] I do not see why, in principle, a constructive trust arising from the retention of moneys known to have been paid by mistake, and for which there was no consideration, would not arise from the time the payee acquired such knowledge, if the moneys paid could still be identified at the time such knowledge was acquired. Such a trust is as much an institutional trust as a trust imposed on property in the hands of the thief

[104] His Honour then developed the reasons for concluding a constructive trust arose:

> [43] The payments made by Wambo to Singleton Earthmoving were not only made by mistake. They were also made for no consideration. It would be against conscience for Singleton Earthmoving to use the moneys as its own once it knew of Wambo's mistake. Notwithstanding the criticism of this passage from the speech of Lord Browne-Wilkinson in Meagher, Gummow and Lehane's *Equity: Doctrine & Remedies* at [14–010], in my view, his Lordship's admittedly obiter statement is consistent with principle. It is consistent with those cases in which a constructive trust is declared over property obtained by fraud where no consideration was provided for the payment: *Bankers Trust Co v Shapira* [1980] 1 WLR 1274 at 1282; *Stocks v Wilson* [1913] 2 KB 235 at 245 and 247; *Neste Oy v Lloyds Bank Plc*

> at 665–6; *Westdeutsche* at 716*; Barrett & Sinclair v McCormack* [1999] VUCA 11 in the passage cited in *Orix Australia Corporation Ltd v Moody Kiddell & Partners Pty Ltd* at [158]. The recipient's conscience is bound only upon being aware of the mistake. But once the recipient is aware that, by a mistake, he has got something for nothing, a proprietary remedy is appropriate. The fact that the company is insolvent does not affect this conclusion. It would be an unwarranted windfall for the company's creditors to share in the payment: compare *Re Polly Peck International plc (in administration) (No 2)* [1998] 3 All ER 812 at 825–7. There is no question in this case of interfering with the statutory scheme for the order of priority of debts recoverable from the company.

[105] His Honour then dealt with the kind of knowledge required to give rise to a constructive trust. The specific articulation of the knowledge required was that for the second limb of *Barnes v Addy* stated in *Farah* as follows:

> For the purposes of the second limb of *Barnes v Addy*, a defendant will be treated as having knowledge of a dishonest and fraudulent design on the part of the trustee or fiduciary if the defendant has: (a) actual knowledge, or (b); wilfully shuts his or her eyes to the obvious, or (c); wilfully and recklessly fails to make such inquiries as an honest and reasonable person would make, or (d); has knowledge of circumstances which would indicate the facts to an honest and reasonable person.

[106] His Honour then analysed the evidence and concluded that Mr Ariff (as the guiding mind of Singleton) knew of the mistake only after disbursement of the first payment from the account of Singleton with the consequence that no constructive trust ever arose over that first payment. However, his Honour found that Singelton, by Mr Ariff, knew (in the relevant sense) that the second payment was mistaken and accordingly a constructive trust arose over that payment.

[107] It will be recalled that both payments had been used to pay disbursements incurred in the administration. There was no suggestion that these disbursements were not properly incurred. However, his Honour found that Mr Ariff was liable under the first limb of *Barnes v Addy* for knowing receipt of the trust property comprised in the second payment. There was no difficulty tracing the funds from Singleton to him.[48]

The *Wambo* constructive trust

[108] *Wambo Coal* broke new ground in the law of constructive trusts. For the first time in Australian law, a constructive trust was recognised as arising from a common law restitutionary claim (outside the area of restitution for theft, which has unique characteristics).

[109] In summary, his Honour relied on the following matters as justifying the recognition of the Wambo constructive trust:

(a) It arises where the recipient of the payment got something for nothing;

(b) It is unconscionable for the recipient to keep something you received for nothing once her or she knows that they got it for nothing;

[48] An argument was made that the money was not paid to Mr Ariff but rather to a service company. His Honour found however that the payments were received by Mr Ariff because the payment met liabilities of Mr Ariff as liquidator and were made to a service company related to Mr Ariff's practice: see [57] to [60]

(c) The situation is analogous to an established category of constructive trusts arising where property is obtained by theft and fraud; and

(d) Insolvency does not stand in the way of the trust arising because the payment is an unwarranted windfall to creditors.

Subsquent consideration

[110] *Wambo Coal* is frequently cited at trial level in supreme and intermediate trial Courts. However, many of those cases refer to other parts of his Honour's decision, particularly his summary of the law on constructive trust responses to fraud and the discussion of *Barnes v Addy*.

[111] The writer's research disclosed three intermediate appeal decisions which refer to *Wambo Coal* but only one specifically considers the principle under consideration here,[49] *AE Brighton Holdings Pty Ltd v UDP Holdings Pty Ltd* [2020] VSCA 235.

[112] *AE Brighton* involved an application for leave to appeal from an interlocutory decision. It arose out of a share sale agreement between a company controlled by a Mr Esposito as seller and UDP Holdings as buyer (in respect of a milk and dairy products business). A dispute arose about misrepresentations and entitlements to recover payments made under the share sale agreement. The dispute went to arbitration. The arbitrator found in favour of UDP and found that a significant part of the purchase price was paid under a mistake of fact by UDP. The arbitrator also declared that those payments were the subject of a constructive trust, presumably relying on the analysis in *Wambo Coal*. An appeal against that decision failed.

[113] UDP then publicly examined Mr Esposito and established during his evidence that some of the millions paid by mistake had been used by Mr Esposito to buy valuable properties through AE Brighton. UDP lodged caveats over the properties, alleging they were held by AE Brighton on constructive trust.

[114] AE Brighton applied to have the caveats removed and failed before the trial Judge. AE Brighton sought leave to appeal that refusal. That is the matter which was before the Victorian Court of Appeal.

[115] Nonetheless, in stating the principles applicable to resolution of the appeal, the Court adopted *Wambo Coal* as correct as follows:

> 30. A constructive trust of the type upon which UDP relied in the present case is an institutional trust which arises from the retention of funds known to have been paid by mistake. Such a trust will arise at the point in time when the person who received the funds acquired knowledge of the mistake. The recipient's conscience is bound at that time and it would be against conscience for the recipient to use the funds as his or her own. In *Wambo Coal Pty Ltd v Ariff*, White J stated:
>
> > I do not see why, in principle, a constructive trust arising from the retention of moneys known to have been paid by mistake, and for which there was no consideration, would not arise from the time the payee acquired such knowledge, if the moneys paid could still

[49] *AE Brighton Holdings Pty Ltd v UDP Holdings Pty Ltd* [2020] VSCA 235; *Argyle Building Services Pty Ltd v Mark Franek* [2020] VSCA 196 and *Sze Tu v Lowe* 89 NSWLR 317

> be identified at the time such knowledge was acquired. Such a trust is as much an institutional trust as a trust imposed on property in the hands of [a] thief.
>
> 31. The payee in the above circumstances will be treated as having the requisite level of knowledge as to the mistake if he or she: has actual knowledge; wilfully shuts his or her eyes to the obvious; wilfully and recklessly fails to make such inquiries as an honest and reasonable person would make; or has knowledge of circumstances which would indicate the facts to an honest or reasonable person.

[116] Their Honours also used the language of institutional constructive trusts. They seemed to do so to answer the principal argument on appeal, which was the the interest which arose in the land at the time the properties were acquired was a mere equity rather than an equitable interest.

ARGUMENTS AGAINST THE *WAMBO* CONSTRUCTIVE TRUST

The common law provides

[117] Trying to create a taxonomy of cases where constructive trusts arise is fraught with difficulty. The leading texts and cases go about the matter in different ways and this paper does not seek to assert a new and impregnable taxonomy.[50] However, for the purposes of the argument, it is submitted that one way that constructive trusts can broadly be categorised is this:

(a) Those cases which are concerned with policing trust and fiduciary relationships; and

(b) Those which are concerned with circumstances arising outside the scope of equitable relationships and equitable causes of action. In broad terms, the constructive trust arises in equity's auxiliary jurisdiction.

[118] The first category includes breach of trust and breach of fiduciary duty claims, secret commission and bribe claims, accessory liability claims, claims arising from contracts and transfers of property defeasible in equity for influence.

[119] The second category includes failed joint endeavour claims, secret trusts and mutual wills, the co-called common intention constructive trusts, transfers affected by unconscionable conduct and proprietary estoppel cases. It also includes the theft and fraud cases as explained above.

[120] For categories of cases in that second field, a common feature is that the common law generally provides no remedy for the conduct of the subject of the claim. The *only* remedial response to the unconscientious conduct in question is the constructive trust. In *Muschinski v Dodds*, without the constructive trust, Mr Dodds could simply ignore Ms Muschinsiki's claim and rely on his title to the improved property. The surviving spouse in a mutual wills case can rely on his or her general law right to testamentary freedom to ignore the mutual will agreement. The parent promising a proprietary interest to the son and daughter in law working on the farm could simply take the benefit of their work and ignore their promise.

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[50] Cf *Jacbos* at [13.02], *Ford & Lee* at [22A.020] and *Dal Pont* at [38.10] to [38.15].

[121] That is not the position in respect of payments made by mistake. There is a common law cause of action which allows recovery of the payment. Not only does it provide a remedy, but it provides a remedy which arises regardless of the defendant's state of mind. The recipient of a mistaken payment is strictly liable to repay, subject to defences.

[122] The *Wambo* constructive trust is in fact a narrower and more difficult claim to establish. It requires the additional element of knowledge of the mistake, which brings the complexity of demonstrating the necessary state of mind to attract the remedy.

[123] So why should a narrower cause of action requiring proof of fault be created by equity, when a broader, strict liability cause of action is already provided by the common law? These considerations suggest equity should stay out of it.

[124] One answer to this argument might be to say that equity intervenes in other situations where there is a common law remedy, most noticeably in cases of theft and fraud. This analogy was specifically relied upon in his Honour's reasoning to sustain the constructive trust. However, it is submitted that the analogy is not strong.

[125] **First**, in respect of theft, the recognition of equitable title at the moment of theft mirrors the common law position that legal title does not pass. That is not the case where a payment is made which is intended by the payer to pass title, albeit by mistake as to the law or a material fact. The analogy breaks down on this point alone. That is certainly the view expressed in the current edition of a leading equity text.[51]

[126] **Second**, in respect of fraud, the constructive trust only arises where there is, as a matter of substance, no 'true' contract. This concept is criticised in paragraphs [70] to [73] above, but accepting that the principle arises, it is really a very similar case to a theft case. The "contract as an instrument of fraud" cases are really cases of out and out theft by trickery.

[127] **Third**, there is a strong distinction between the case where a person directly obtains another's property by theft or fraud and where the other person is the author of their own divestment by their mistake.

[128] The realpolitik of the situation is that even the blackest of black letter common lawyer would shed few tears for the rogue. Further, stripping a rogue of gains flowing from use of stolen property is an understandable policy objective for the law.

Risk of inconsistent liability

[129] The Wambo constructive trust arises where there is a payment by mistake and the recipient acquires knowledge of the mistake. It is unclear from the articulation of the *Wambo* principle, however, how it is to account for different common law and equitable defences. At common law, it is a defence to a restitutionary claim for

[51] *Gummow & Lehane's Equity Doctrines and Remedies* at [14-010]

money paid under a mistake that the recipient has changed position on the faith of the receipt.[52] However, it remains unclear how that defence relates to the Wambo constructive trust. Does the trust arise on proof of the mistaken payment? Or does it only arise if there is a mistaken payment and the receipient is unable to establish a defence to the restitutionary claim? If the latter, then the cause of action for the establishment of the constructive trust will only arise if the common law claim is made out and no defences are established.

[130] If on the other hand, the *Wambo* constructive trust arises regardless of whether there are restitutionary defences made out prior to acquisition of the relevant knowledge, then it is possible to be not liable to the common law remedy but liable on the *Wambo* constructive trust.

[131] It might be argued that the same facts which would give rise to the Wambo trust will also give rise to discretionary considerations which would lead a Court to refusing to recognise the constructive trust and/or granting a lesser or perhaps no remedy at all. There are two points to make about that proposition.

[132] **First**, it would not necessarily be the case that the scope of the change of position defence and the response of the Court to discretionary considerations would be the same, though it is accepted they would overlap. The potential for inconsistency arises because the premise of the common law defence is that there is no basis for restitution for the mistake. The premise of the constructive trust is that the recipient has engaged in unconscientious conduct. They are quite different starting points and different end points can not be excluded.

[133] **Second**, if indeed the common law defences and equitable discretion would produce the same result, it is an additional reason to wonder whether the constructive trust is justified at all.

[134] Lord Browne-Wilkinson was cautious about a constructive trust like the Wambo constructive trust because of his concerns about how the points raised in this section would be dealt with. It is unclear how they would or should be dealt with.

The solvent defendant

[135] The elephant in the room in this area is the impact of the constructive trust where the defendant is insolvent. *Wambo Coal*, of course, involved that situation. However, it is convenient first to consider the case where the reciepient is solvent. As already noted, where the recipient is solvent, the payer will have a remedy to recover the payment. What good reason exists for equity to intervene in that circumstance?

[136] It might be argued that even if the payer has a good remedy for the amount of the mistaken payment at law, the constructive trust is justified because it permits the payer to trace their money in equity into other assets acquired by the receipient with their funds. This allows the payer to recover not only their payment but also

[52] *ANZ v Westpac* (1988) 164 CLR 662

any gain to the recipient. It might be argued that this is a good reason for equity to intervene.

[137] However, why should the recipient be stripped of any gains made using the traceable proceeds of the mistaken payment?

No equitable duty to protect

[138] That result cannot be justified by the same policy which underpins the constructive trust for breach of fiduciary duty. The policy which underpins the constructive trust in that circumstance is to protect the integrity of relationships of trust and confidence. The stripping of any gain, even gain which could not have been made by the principal or beneficiary, serves to ensure single minded commitment to the interest of the principal.

[139] The primacy of this policy is most starkly evident in the eventual recognition of the construction trust as a response to payments which comprise bribes or secret profits. It will be recalled that one of the principal arguments which carried the day in *Reid*, and was adopted in *Grimaldi* and ultimately in the UK Supreme Court in *FHR* to support the determination that a bribe or secret profit should be immediately subject to a constructive trust was the concern of the Courts for that policy: see [34] to [42] above. The Courts adopted that position regardless of whether or not the bribe came at the expense of the principal and regardless of whether the principal could ever have obtained the benefit of the bribe if the agent had acted honestly.

[140] To ensure strictly fidelity of fiduciaries, the Courts consider they must be stripped of any gain they made from a bribe or secret profit. It is hard to cavil with the proposition that imposition of a constructive trust powerfully supports that key policy objective of the law of fiducaries.

[141] But is does not apply to the recipient of a mistaken payment. In that case the recipient of the payment, whether they know of the mistake or not, did not come by the windfall of the mistaken payment by reason of any breach of fiduciary duty or indeed any other legal duty owed to the payer.

[142] It will be recalled that Justice Deane required a constructive trust to be justified by equitable principles. The principle of protecting the integrity of relationships of trust and confidence does not arise here.

No opportunity of the payer lost

[143] The secret profit cases provide another useful perspective on this situation. It will be recalled in those cases, the Courts grappled with the idea that a constructive trust should not be imposed because the gains made by the recipient were never going to be available to the principal. As we have seen, in *Sinclair Investments*, the Court of Appeal confirmed that where the bribe did not arise from the principal's property or opportunity, the constructive trust was not justified: see [39] above.

[144] The fate of that proposition in *FHR* is instructive. In altering his view on the question of constructive trusts for bribes, not only did Lord Neuberger accept the

primacy of the policy of fiduciary fidelity, he also found that on the facts in that case, it appeared likely that the secret profit of the selling agent indirectly reduced the purchase price: see [43] above.

[145] However, it is extraordinarily unlikely that the gains made by a receipient of a mistaken payment from use or investment of that money will be in any way related to the affairs of the payer such that there is any conceivable link between the gains on the payment and the affairs of the payer. The parties are, by definition, thrown together randomly because of the payer's mistake. It was recognised in *Grimaldi* (at [510]) and *Johns Alexander's Clubs* (at [129]) that a consideration which tells against recognising a constructive trust if doing so would be disproportionate to the defendant's wrongdoing or the extent to which the benefit derived was attributable to the wrong doing.

[146] Further, as will be seen, the authorities seek to justify the consequence for unsecured creditors of imposition of a constructive trust by asserting that the gain of a mistaken payment is a windfall gain. This will be challenged below. But the idea of windfall gain can certainly be turned against the constructive trust as well.

[147] If the recipient of the payment, even with knowledge of the mistake, uses the money to successfully speculate in land, and the payer claims the whole of the gain from that speculation, then it is the payer who gets the windfall. Adding to the injustice of the constructive trust outcome, if the speculation fails, the payer is not at risk because the payer retains his or her common law money claim.

[148] Reward without risk is not a proper basis for equity's intervention.

Resitution for loss of use of money?

[149] It might be argued that imposing a constructive trust over a mistaken payment which has the potential to capture gains from use of the money can be justified on a subtractive enrichment basis as a rough and ready way of providing for restitution of the enrichment of the defendant arising from transfer from the plaintiff to the defendant of the benefit of holding the capital sum. That is not a persuasive argument.

(a) **First**, there is no reason to think that there will be any correlation between gains by the recipient and the benefit which the payer would have derived from the capital.

(b) **Second**, restitutionary measures of loss are not compensatory, they are concerned with reversing enrichment. The payer must prove not only a gain but also that that gain was at the expense of the payer. The best way to measure this is by interest being recovered. There is an argument that the law should recognise interest as part of the measure of enrichment in the manner in which has been recognised as available as damages under *Hungerfords v Walker* (1989) 171 CLR 125, which would permit compound interest to be awarded.

[150] There are real conceptual difficulties with interest as a stand alone restitutionary claim. However, the recovery of statutory interest provides some restitution of the benefit of use of money.

Conclusion on the solvent defendant

[151] It is submitted that, for the above reasons alone, equity should not recognise a constructive trust over money paid by mistake. There is no need for the constructive trust remedy to supplement the common law remedy and no justification for equitable intervention which arises from equitable principles. Quite the opposite in fact.

The insolvent defendant

Key elements of insolvent administration

[152] The following comments apply to corporate insolvency, but they apply equally to personal insolvency.[53]

[153] Liquidation up is a process whereby the assets of a company are collected and realised by the liquidator, the resulting proceeds are applied in discharging all its debts and liabilities, and any balance which remains is distributed among the members.

[154] Liquidation is, like bankruptcy, a procedure of an inherently collective nature, in that each creditor forfeits the individual right to take action to enforce the debt owed and must depend on the result of the collective proceedings. That is, the primary beneficiary of the proceedings is the general group of unsecured creditors. Winding up should not be seen as a means of enforcing a judgment, and courts will not permit a creditor to obtain a collateral personal advantage. The procedure is compulsory, in order to ensure that there is an orderly, cooperative system. The result is that any attempt by a creditor to undermine the collective nature of liquidation is outlawed.

[155] The liquidator is responsible for dealing with the liabilities of the company. This is done by inviting proofs of debt from persons claiming to be creditors, which, after scrutiny, are either admitted or rejected, and, if admitted, are then discharged by payment out of the proceeds of realisation of the assets. Where the company is insolvent, the general creditors (such as ordinary unsecured creditors) share rateably in the assets, each receiving a proportion of the sum due to her or him, which necessarily varies according to the extent to which the company is capable of meeting its commitments.

[156] This concept of rateable distribution of available assets is called *pari passu* distribution and lies at the heart of insolvency administration.

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[53] Paragraphs [153] to [155] are adopted from M Gronow & S Maiden, *McPherson's Law of Company Liquidation* (Thomson Reuters (Professional) Australia Limitied) at [1-10], [1-20] and [1.140] ('*McPherson's Law of Company Liquidation*')

[157] The assets of the company available for realisation to pay creditors admitted to proof in the administration comprises all the real and personal property of the company. However, that does not include property subject to a trust[54] or subject to legal or equitable security interests.[55]

[158] The holy grail for a creditor in an insolvency therefore is to establish a proprietary interest in identified assets of the company so as to avoid the effect of *pari passu* distribution.

Insolvency and the constructive trust

[159] The resort to the constructive trust for mistaken payments arises most commonly where the recipient of the payment is insolvent. It is obvious why. A constructive trust confers a proprietary interest in identified property of the company which insulates the mistaken payer from the fate of the unsecured creditor. In the absence of the constructive trust, the payer would be left to share *pari passu* with other unsecured creditors. The effect of constructive trusts on unsecured creditors is frequently advanced as a reason why those trusts should not be recognised.

[160] The argument frequently advanced by those opposing the recognition of novel constructive trusts is that to do so is unjust to the body of unsecured creditors. Another version of that argument is that a constructive trust, arising at the time of the making of a payment (or receipt of a benefit) confers an unfair advantage on the claimant over creditors with floating charge securities.

[161] Those arguments ultimately failed during the litigation over constructive trusts over bribes and secret commissions in the UK. As is more fully explained in paragraphs above, *Lister* adopted the view that unfairness to secured creditors was a reason to refuse to recognise the trust over a bribe. However, the Privy Council in *Reid* gave the creditors short shift because the creditor must take their debtor as they find him. The *Sinclair* decision maintained concern for the effect of a trust on unsecured creditors. Lord Neuberger MR held (citations omitted):

> Sixthly, it seems to me that Lord Templeman may have given insufficient weight to the potentially unfair consequences to the interests of other creditors if his conclusion was right. His dismissal of their concerns on the basis that they should be in no better position than the defaulting fiduciary stands in rather stark contrast with what was said in the *Lister* case, and in *Archers Case*, as well as more recently in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*. In that case Lord Browne-Wilkinson disapproved extending the reach of resulting trust as it could produce most unjust results, namely conferring on the plaintiff a right to recover property from, or at the expense of [for example] the lender whose debt is secured by a foating charge and all other parties who have purchased an equitable interest only.

[162] Lord Neuberger's comments in that case usefully restate Lord Browne-Wilkinson's concerns for secured creditors holding floating charges or holding equitable security interests later in time.

[163] But the Supreme Court in *FHR* ultimately was not persuaded that effects on unsecured creditors justified refusing to recognise a constructive trust in the context

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[54] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 268 CLR 524
[55] See generally *McPherson's Law of Company Liquidation* at [13.110]

of bribes and secret profits. That decision was influenced by the finding that the bribe was indirectly at the expense of the principal, but the Court also accepted the so-called windfall argument: i.e that the bribe should not have been in the insolvent company's assets at all.[56]

[164] That line of authorities reflects two of the principal arguments to answer the unjustness of recognising a constructive trust in the insolvency context: the unsecured creditors must take the debtor as they find them and the windfall argument.

[165] As noted in the paragraph above, the matter was considered in the bribes context in *Grimaldi* where their Honours recognised that the impact on insolvency might lead to a lesser remedy being awarded, but did not consider that option in any detail.

[166] Before turning to address those arguments, one observation. Much of the discussion in constructive trust cases focuses on insolvency consequences as a reason why not to recognise a constructive trust in particular cases where some unconscionability by a defendant is identified. The method of reasoning might be characterised, albeit implicitly, as placing an onus on a defendant to identify reasons why a constructive trust should not be recognised, once some unconscionability has been identified. Alternatively, it might be seen as reasoning backwards from consequences. However, this is not a proper method of judicial reasoning and has tended in the writer's view to conceal a full consideration of whether a constructive trust should be recognised at all. In that regard, reference is made to the points already made.[57]

Defects in the windfall gain argument

[167] The windfall gain argument was expressly adopted in *Wambo Coal*. It is respectfully submitted that there are persuasive counter arguments.

[168] The premise of the windfall argument is rarely expressly articulated. It seems to be that the unsecured creditors get a windfall benefit from a payment made by mistake because the payer did not intend to, and never did, take the chance on the solvency of the recipient. The payment was randomly made by a mistake. So, there is no injustice from removing the payment from the assets of the insolvent. It never should have been there. If this is the premise of the argument, it is submitted that it has difficulties.

[169] **First**, not every case of mistake involves a random payment mistakenly made to an unknown third party. The restitution of payments made by mistake arises in many more circumstances, many of which involve payments deliberately made to the recipient, thereby undertaking the risk of insolvency of the payee.

[170] That will nearly always be the case for mistakes of law. For many years, the common law resisted giving restitution for mistakes of law but the so-called

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[56] At [42]

[57] Similar points are made by William Swadling in "Policy Arguments for Proprietary Restitution" published in S Degeling and J Edelman (eds), *Unjust Enrichment in Commercial Law* (Thomson Reuters (Professional) Australia Limited, 2008) at 372-373(*'Swadling')*

mistake of law bar has been swept away. When a payment is made by mistake of law, it is frequently because of a mistake as to the legal obligation to make a payment deliberately made. This is demonstrated clearly by the decision which swept away the mistake of law bar in Australia, *David Securities v Commonwealth Bank of Australia* (1992) 175 CLR 353. That case is explained *Mason & Carter* as follows (footnotes omitted):

> [414] In *David Securities v Commonwealth Bank of Australia* a customer paid its mortgagee bank money in addition to interest, pursuant to a covenant in a mortgage. The covenant was designed to 'gross up' the amount of withholding tax that the Australian customer deducted from interest payable to its overseas lender. Unbeknown to the customer, s 261 of the *Income Tax Assessment Act* 1936 (Cth) avoided the covenant. The customer's claim to set off the additional amounts paid under the covenant was rejected by the Full Federal Court, in accordance with the traditional rule denying recovery of money paid under a mistake of law or mixed mistake of law and fact. On appeal, the High Court declared that the rule precluding recovery of money paid under a mistake of law should be held not to form part of the law in Australia. The injustice of the enrichment of the recipient of a mistaken payment no longer depends on the nature of the mistake that caused the payment to be made. The case was remitted for further hearing (subject to reopening), to determine whether the customer has paid because of its mistaken belief that the contractual arrangements with the bank required the payments, or whether the payment was 'voluntary' and irrecoverable. The case was also remitted to allow to be litigated the change of position defence which the High Court recognised for the first time.
>
> The majority justices in *David Securities* suggested that a working definition of moneys paid under mistake of law might be money paid to a recipient who is not legally entitled to receive them. This will doubtless cover situations where recovery would have been denied until the recent abolition of the fact/law distinction in this context.
>
> Thus, a person who pays money due to a mistaken construction of a statute or contract, or mistaken belief as to its validity, or a misinterpretation of a common law rule, or through ignorance of a statute or principle which would make the payment unnecessary or prohibited, will have prima facie right of recovery, at least where the payer assumed the application of the statute or rule, or the enforceability of the contract pursuant to which the payment was made. Likewise, a person who pays pursuant to an obligation in an agreement, believed at the time to be valid, but later held to be ultra vires and void. Similarly, a person who misconstrues a contract or deed and thereby pays money that is not in truth due may recover. Mistake may include sheer ignorance of a statute or legal principle absolving the payer from any obligation, so long as the payer assumes that some legal obligation exists.

[171] Similarly, the mistake of fact made by a payer does not always involve a mistake as to the identity of the recipient of the payment. It can relate to the amount, or the due date for payment, or as to the existence of the obligation believed to be owed to the payer.[58]

[172] Where a payer has intentionally paid a sum to the receipient but is mistaken as to liability to the receipient (as opposed to the identity of the recipient), it could be argued that the payer is in no materially different position to an unsecured creditor who advances credit on a mistaken but reasonable belief that the debtor is financially secure. Creditors of Lehman Brothers, for example, could have been forgiven for making such a mistake. Are those payments windfall gains?

[173] **Second**, if the key consideration is unintentionally paying money to the recipient and thereby unintentionally becoming a creditor of the insolvent, there are other

[58] See examples in *Mason & Carter* at [411] to [412]

circumstances in which a person unintentionally becomes a creditor of an insolvent debtor. For example, persons who have claims against an insolvent defendant for negligence unintentionally become creditors of an insolvent. Is it a windfall *loss* to unsecured creditors that those liabilities are part of the liabilities of the insolvent? Perhaps those creditors should be excluded from proving to avoid that windfall loss.

[174] This argument can be taken further. The failure to repay money paid under a mistake represents a failure to perform an obligation imposed by law on the debtor to a creditor. Looked at in that way, every unpaid creditor could make the same claim. This point was relied upon by the New Zealand Court of Appeal to reject the proposition, established at trial, that a constructive trust arose over employee contributions which were intended for investment in a pension fund. Professor Swaddling helpfully sumarises the gravamen of the trial and appeal judgment: [59]

> The windfall argument was rightly rejected in the New Zealand case of *Fortex Group Ltd v MacIntosh*. An insolvent company, Fortex, had failed to pay over the contributions it collected from its employees' claim for a constructive trust succeeded before Gallen J on the ground that:
>
> > 'neither secured nor unsecured creditors could have complained if Fortex ha made payments which it was required and obliged to make and which it could have made … during most if not all of the period in respect of which that plaintiff's claims arise. Had it done so, then there would have been that much less available for distribution.
>
> The argument was dismissed by the Court of Appeal. Tipping J said that, taken to its logical conclusion, 'ordinary trade creditors and others with unsecured debts would, by means of a … constructive trust, be able to obtain priority over those with secured debts on the basis that the secured creditors could not have complained if those others had been paid int h ordinary course, as they should have been.

[175] **Third**, it is difficult to see why the windfall gain argument makes sense in the context of the *Wambo* principle where the constructive trust only arises when the recipient knows of the mistake. If the payment by mistake is a windfall gain, it is a windfall gains regardless of whether the recipient knows of the mistake or not. The windfall gain argument is only logically compelling if the constructive trust arises immediately on payment, as an automatic proprietry response to a mistaken payment. That is the *Chase Manhattan*/US position, which has been consistently rejected in Australia and the UK.

[176] **Fourth**, the imposition of a constructive trust at the time the recipient comes to know of the mistake might, in some circumstances, wreak unjust havoc on unsecured creditors to the unfair advantage of the mistaken payer. Take this scenario: the debtor in a parlous financial state receives a mistaken payment which he or she reasonably believes is due. The payment is not due because of a mistake by the payer as to legal liability, or amount or some other error. The unstable debtor thereby concludes his or her financial position is better than it is. They proceed to incur further debts in circumstances where, absent the payment, they would not have. The unstable debtor and the mistaken payee discover the mistake later, while the mistaken payment can still be traced into the debtor's account. The

[59] *Swadling* at 380 to 381

mistaken payer at that point secures proprietary remedy over the balance in the bank account, while unsecured creditors who became such because of conduct by the debtor on the faith of the payment are left to prove.

[177] It is accepted that those facts might give rise to a change of position defence, though it would be a complicated one. And further, it might be impracticable for a subsequent liquidator to be able to establish the defence, bearing in mind that the liquidtor does not know what occurred in the company's affairs except through its records and the support of the directors and officers. Sometimes the records are terrible and the directors and officers unhelpful.

Taking your debtor as you find them

[178] This basis for disregard of the effect of a constructive trust on unsecured creditors is unhelpful for analysing whether the Court should recognise a novel constructive trust. It reflects the consequence of the Court's decision, not a reason for that decision.

Conclusion on insolvency

[179] No unsecured creditor ever voluntarily chooses to advance credit, knowing or suspecting that the receipient of the credit will become insolvent. Unsecured creditors end up in their unfortunate position in different ways. Insolvent administrations are often complicated and carried out on limited information. There will often be windfalls and losses in that process. It is respectfully suggested that it cannot be said as a general rule that mistaken payments are an unjust "windfall" to unsecured creditors in insovlencies, nor that as a matter of basic policy, even if they are windfalls, that sanitises the harm done to unsecured creditors by the imposition of a constructive trust on the *Wambo* principle.

The answer does not lie in discretion

[180] It is implicit in the High Court cases that all constructive trusts, at least in theory, are discretionary and might be refused in favour of a lesser or different equitable remedy (or perhaps no remedy at all) depending on the circumstances. However, it is submitted that the *Wambo* principle should not be preserved by relying on discretionary considerations to avoid injustice.

[181] The points made against the *Wambo* principle above go to whether the foundation for recognition of a constructive trust can be sustained at all. Further, those considerations also support the conclusion that the complexity and cost which is likely to arise from introducing a discretionary proprietary remedy, particularly in an insolvency, is not justified.

[182] Further, as already explained, many of the considerations which would inform the discretion which arises in respect of a constructive trust also inform common law defences to restitutionary claims. The risk of inconsistent liability is real and highly undesirable.

[183] Finally, in the context of an insolvency, for the reasons already given, it is submitted that the *Wambo* constructive trust would seldom be able to be defended on discretionary grounds. There is at least some suggestion that the High Court might support that view: see the passage in *Bathurst City Council v PWC Properties Pty Limited* at [27] above.

Avoiding limitation periods[60]

[184] An important consequence of the recognition of a constructive trust over money paid by mistake might in some cases be that a limitation period applying to the money claim can be avoided. This is true of course for any trust claim which corresponds with a common law claim. The most obvious example is the constructive trust arising over property paid by reason of a fraud. For both restitutionary money claims and fraud, the limitation period is 6 years from the date that the cause of action accures. In each case that will be when the money is paid or property is transferred.[61]

[185] Where a constructive trust is recognised over property, however, those limitation periods do not apply. While breach of trust claims and claims to recover trust property from persons other than a trustee are subject to a six year limitation period in Queensland, that period does not apply to fraudulent breaches of trust or claims to trust property in the hands of the trustee.[62] The former is apt to apply to constructive trusts arising from theft or fraud (of the kind described in this paper) and latter is apt to apply to claims to recover property or traceable proceeds in the hands of a recipient of a mistaken payment. Recognition of a constructive trust can thereby appear to avoid the injustice which can arise in deserving cases which otherwise are statute barred. That can even avail a plaintiff where the postponement of the extension of the limitation period for conealed fraud or mistake until discovery of the fraud or mistake is insufficient to bring the claim within time.[63]

[186] It can be tempting to recognise a constructive trust to facilitate a good, but otherwise statute barred, claim. However, this cannot provide any justification of itself for doing so. Statute bars frequently appear to work injustice in individual cases. However, they serve the broad public policy purpose of ensuring certainty and finality in legal exposure and of seeking to ensure a fair trial is possible of claims in the face of the passage of time. These broad policy considerations should be respected.

Inconsistency with unilateral mistake in contract?

[187] Finally, it is arguable that the approach in *Wambo* is inconsistent with the approach of equity in the closely analogous situation where a contract is entered into by a

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[60] The following analysis is conducted by reference to the Queensland limitation statute, though analogous provisions exist in other states.
[61] Section 10(1)(a) *Limitiation of Actions Act 1974* (Qld) (**LAA**)
[62] Section 27 LAA
[63] Section 38 LAA. This occurred in *Wylie v Orchard (No 2)* [2020] QDC 315, where the writer followed decisions which sustained the "instrument of fraud" constructive trust line of authority: see [306] to [323]

party operating under a unilateral mistake. The position in that regard differs from the approach in the *Wambo* constructive trust because in the unilateral mistake context, seems (based on High Court authority) that it is not sufficient to attract equitable relief that the other contracting party knew of the mistake. In addition, that other party must also take advantage in some way of the mistake by some positive step. The law is stated by the High Court in the majority judgment in *Taylor v Johnson* (1983) 151 CLR 422 at 432-433:

> The particular proposition of law which we see as appropriate and adequate for disposing of the present appeal may be narrowly stated. It is that a party who has entered into a written contract under a serious mistake about its contents in relation to a fundamental term will be entitled in equity to an order rescinding the contract if the other party is aware that circumstances exist which indicate that the first party is entering the contract under some serious mistake or misapprehension about either the content or subject matter of that term and deliberately sets out to ensure that the first party does not become aware of the existence of his mistake or apprehension. What we have said is sufficient to demonstrate the broad basis of support which the authorities provide for that proposition. Moreover, and perhaps more importantly, it is a principle which is best calculated to do justice between the parties to a contract in the situation which it contemplates. In such a situation It is unfair that the mistaken party should be held to the written contract by the other party whose lack of precise knowledge of the first party's actual mistake proceeds from wilful ignorance because, knowing or having reason to know that there is some mistake or misapprehension, he engages deliberately in the course of conduct which is designed to inhibit discovery of it.

[188] So, the *Wambo* principle appears inconsistent with the approach in *Taylor v Johnson* because it recognises the constructive trust as arising when knowledge of the mistake is acquired. It does not require some other step or act which involves concealing the mistake or doing some other act which amounts to take unconscientous advantage of the mistake.

[189] The position is not as clear as that in practice, however. While some authorities[64] maintain the approach in *Taylor v Johnson*, other have found that merely knowing of the mistake and keeping quiet about it is sufficient to attract the equity such that the mistaken party may rescind.[65] The analogy cannot be pushed too far in any event because, of course, in mistake in contract the parties are necessarily in a commercial negotiation leading up to the contract. However, on current High Court authority, *Wambo* has equity intervening for mistaken payments in a circumstance which it would not for unilateral mistake in equity.

Conclusion

[190] As we have seen, at a high level of generality, the constructive trust is concerned with preventing the unconscientious assertion of legal title outside the area where the conscience of the legal title holder is bound by express intention or presumed intention of the settlor or transferor of title. This is reflected in Justice Deane's broad statement of principle in *Muschinki v Dodds*, echoed in other cases and the leading texts, and cited in [5] above. However:

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[64] *Blackley Investments Pty Ltd v Burnie CC (No. 2)* [2011] TASFC 6

[65] *DCT v Chamberlain* (1990) 26 FCR 221; *Thermoplastic Foam Industries Pty Ltd v Imthouse Pty Ltd* (1990) 5 BPR at 11,181

> The mere fact that it would be unjust or unfair in a situation of discord for the owner of a legal estate his ownership against another provides, of itself, no mandate for a judicial declaration that the ownership in whole or in part lies, in equity, in that other…[66]

[191] The reasoning behind the *Wambo* constructive trust relies on analogy with theft and fraud cases, where the recipient has received something for nothing. The writer has already identified the arguably inapt nature of the analogy with theft and fraud cases in paragraphs [124] to [127] above.

[192] Beyond that, the foundation of the reasoning is that a constructive trust should arise because the recipient has got something by mistake and knows it. For the reasons already given, looked at from the perspective of the issues raised in this paper, that consideration is insufficient to raise the circumstances beyond the level of being (arguably) merely unjust or unfair. The mistaken payment, whether known of or not, does not engage any equitable principle which justifies a proprietary remedy. And to the extent it is unjust or unfair, the common law provides an efficacious remedy.

THE *WAMBO* PRINCIPLE REMAINS AN OPEN QUESTION

The High Court

[193] So far as the writer can determine, the *Wambo* principle has never been approved or considered in the High Court. However, *Mason & Carter* contends[67] that *Chase Manhattan* has been cited with approval by three High Court justices, and one judge who would later be a High Court justice. They rely on three cases: *Daly v The Sydney Stock Exchange* (1985) 160 CLR 371 per Brennan J, *Ilich v R* (1986) CLR 110 per Wilson and Dawson JJ and *Re Hartogen Energy Ltd (In Liq)* (1992) 36 FCR 557 per Gummow J. It is respectfully submitted that none of those references rise above the passing comment level. None involve any analysis of the issues which *Chase Manhattan* raises, nor of the specific Wambo constructive trust:

(a) In *Daly*, Brennan J referred *Chase Manhattan* to emphasise a quite different point his Honour was making about the law of recission;

(b) *Ilich v R* was, as its title suggests, a criminal appeal. The case concerned whether a trial judge's summing up of the law to the jury was so seriously defective that the conviction cannot be allowed to stand. Wilson and Dawson JJ observed at [26]:

> However where property passes with possession, as with currency, no such conclusion is possible in relation to an amount overpaid. There is, we should add, a civil action to recover money paid under a mistake of fact and equitable rights may arise. See *Chase Manhattan v. Israel-British* (1981) Ch 105.
>
> [underlining added]

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[66] *Muschinski v Dodds* at p. 616
[67] *Mason & Carter*at [454]

(c) Equitable rights may arise carries with it the implied suggestion, "or they may not".

(d) *Re Hartogen Energy Ltd (In Liq)* (1992) 36 FCR 557 concerned a claim for privilege advanced by a liquidator over documents of a company in liquidation. During argument, the principle in *Ex Parte James* arose which in broad terms, prevents liquidators from doing anything which would be regarded as dishonourable or unconscionable for an ordinary person to do. The specific issue was the application of that principle in a manner which could require the liquidator to repay money paid under a mistake of law, despite such payments not being recoverable at that time because of the mistake of law bar. It was in that context that Gummow J referred to *Chase Manhattan* at [59]:

> Two years later the same judge said, in *Rogers v Ingham* (1876) 3 Ch D 351 at 355:
>
> > "I have no doubt that there are some cases which have been relied on, in which this Court has not adhered strictly to the rule that a mistake of law is not always incapable of being remedied in this Court; but relief has never been given in the case of a simple money demand by one person against another, there being as between those two persons no fiduciary relation whatever, and no equity to supervene by reason of the conduct of either of the parties."
>
> The passage which I have set out from *Ex parte James* has to be read with this in mind. The passage is concerned with explaining what in the circumstances of that case led the Court to find that there was an equity in the party claiming repayment. Further, the proposition that the money in equity belonged to the claimant for repayment is consistent with modern authority, exemplified by *Chase Manhattan Bank v Israel-British Bank* (1981) Ch 105.

[194] This is the closest to actual endorsement of *Chase Manahattan*, though again there is no analysis of the case and the context of the decision is not concerned with constructive trusts. It is also not an endorsement of the *Wambo* principle as such but rather the much broader, and rejected, trust recognised as arising on making of a mistaken payment.

[195] Also relied upon in *Mason & Carter* is the decision of the High Court in Australia and *New Zealand Banking Group Ltd v Westpac Banking Corporation* (1988) 164 CLR 662. That case concerned the circumstances in which a commercial bank could defend a claim for a mistaken payment made to customer and received by the bank on the customer's behalf. In that context, the High Court made the following general statement of principle (at 673):

> The basis of the common law action of money had and received for recovery of an amount paid under fundamental mistake of fact should now be recognized as lying not in implied contract but in restitution or unjust... In other words, receipt of a payment which has been made under a fundamental mistake is one of the categories of case in which the facts give rise to a prima facie obligation to make restitution, in the sense of compensation for the benefit of unjust enrichment, to the person who has sustained the countervailing detriment (cf. *Pavey & Matthews Pty. Ltd. v. Paul* [1987] HCA 5; (1987) 162 CLR 221, at pp 227, 254-257, 267). The common law right of action may arise in circumstances which also give rise to a resulting trust of specific property or funds or which would lead a modern court to grant relief by way of constructive trust. However, notwithstanding that the grounds of the action for recovery are framed in the traditional words of trust or use and that contemporary legal principles of restitution or unjust enrichment can be equated with seminal equitable

> notions of good conscience, the action itself is not for the enforcement of a trust or for tracing or the recovery of specific money or property. It is a common law action for recovery of the value of the unjust enrichment and the fact that specific money or property received can no longer be identified in the hands of the recipient or traced into other specific property which he holds does not of itself constitute an answer in a category of case in which the law imposes a prima facie liability to make restitution.
>
> [underlining added]

[196] This passage does not provide any direct support for the *Wambo* principle in the writer's view. While the first underlined passage seems to assist, it is stated in the most general of terms and does not purport to identify the circumstances contemplated. Further, the second underlined passage might be thought to be cause of caution in assuming a trust remedy arises in restitutionary claims generally. The passage from *Equuscorp* set out at [83] above also appears inconsistent with trust remedies as a response to restitutionary causes of action.

[197] In the writer's view, there is no support to be found in High Court authority for the *Wambo* constructive trust.

Intermediate Courts of Appeal

[198] Reference is made to the discussion of intermediate Court of Appeal decisions in paragraphs [110] to [116] above. As noted there, only *AE Brighton Holdings Pty Ltd v UDP Holdings Pty Ltd* [2020] VSCA 235 dealt with the *Wambo* principle. However, as explained there, that was an appeal of an interlocutory judgment in which all that was required was for the respondent to establish an arguable case in favour of the interest asserted in the caveat. Strictly speaking, the decision of the Court establishes no more than that, as the Court expressly recognised.[68] In the writer's respectful view, it remains open to an intermediate Court of Appeal in Australia to make up its own mind on the *Wambo* constructive trust, free of any constraints arising from any extant intermediate appeal decision.[69]

CONCLUSION

[199] It is respectfully submitted that it is open to an Australian Court at trial level (at least outside NSW) and at appeal level not to follow *Wambo* coal and that for the reasons given in this paper, it should not be followed.

Judge Bernard Porter QC

11 March 2022

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[68] See [55] of the joint reasons.

[69] See *Farah Constructions v Say-Dee* at [135], where the High Court held that trial judges and intermediate appellate courts in Australia should not depart from the decisions in intermediate appellate courts in another jurisdiction unless convinced that that decision is plainly wrong.