Proprietary Remedies and Commercial Contexts: The North America Experience of Considering the Interests of Third Parties

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Introduction

Proprietary remedies[1] are rare. There is great familiarity with the main legal remedies, such as damages, injunctions, specific performance and so on. But one concern with the Australian legal system is uncertainty over how to apply proprietary remedies in a commercial context. There exists two ways to go about examining this concern. One possible way to examine this concern is to pose two questions. The first question, concerning whether property can ever be utilised as a remedy, would appear to have been answered extremely cautiously in England and Australia in the affirmative.[2] This is despite strong, but ultimately futile, resistance by Professors Birks and Goode.[3] The second question, which is how to correctly

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1 The word 'remedy' is problematic. In 'Rights, Wrongs and Remedies' (2000) 20 *Oxford Journal of Legal Studies* 1 and 'Three Kinds of Objections to Discretionary Remedialism' (2000) 29 *University of Western Australia Law Review* 1, Birks has proposed five meanings of the word. There has been an intense debate on this issue under the heading of 'discretionary remedialism'. In an important article in this debate, 'Defending Discretionary Remedialism' (2001) 23 *Sydney Law Review* 463, Evans has indicated that Birks' five definitions fail to include equitable remedies, which is extremely important to this article, as proprietary remedies are equitable remedies.

2 Although this is accurate, England adopts a more conservative approach to the issue than Australia. For this reason, England can still produce decisions like *Foskett v McKeown* [2001] 1 AC 102, where Lord Browne-Wilkinson held that 'It is a fundamental error to think that because certain proprietary rights are equitable rather than legal, such rights are in some way discretionary' (at 105). These statements produced the observation from S Waddams, *Dimensions of Private Law* (2003) 189 that 'These comments assume a strict unchanging and unchangeable dichotomy between property and obligation that has not been characteristic of Anglo-American law'.

3 However, Birks and Goode may take some comfort in the cautious approach that the courts have adopted with the use of proprietary remedies. The cases which have indicated that England cautiously accepts proprietary remedies include *Lord Napier and Ettrick v Hunter* [1993] AC 713, where the House of Lords adopted some

apply proprietary remedies in a commercial context, is therefore of great importance. Rather than these individual questions, perhaps of greater importance is to discover a common approach. The second possible way to examine this concern is to look for this common approach. This may turn out to be a more productive avenue, and, in turn, it may well provide information relevant to the two questions that have been posed.

Property is an extremely useful concept, but is largely an intellectually neglected one. It plays an important role in criminal law, constitutional law and taxation law, to name but a few legal areas. Nonetheless, the law of property is a construct. The consequence of this is that property, although at its core relatively stable, is, at its margins, an unstable concept.[4] This is particularly accurate with regard to equity and property. Equity creates interests that are similar to common law property but are not identical. Intellectual difficulties are encountered when ideas of common law property are transferred to equitable property.[5] The unstable nature of property makes it difficult to deal with proprietary remedies that are frequently equitable in nature.[6]

discretion regarding the proprietary remedy to be applied. Interested readers should also examine the recent and important book by C Rotherham, *Proprietary Remedies in Context* (2002) for further English decisions supporting property as a remedy. In Australia, in both *Bathurst City Council v PWC Properties* (1998) 195 CLR 566 and *Giumelli v Giumelli* (1999) 196 CLR 101, the High Court accepted a limited version of property as a remedy. Also, Goode may provide a point of commonality with Canadian and United States material. This is mentioned at the end of this article.

4 The problems of the unstable nature of property are well recognised. The circularity involved with property and remedies was clearly identified by Windeyer J in *Colbeam Palmer Ltd v Stock Affiliates Pty Ltd* (1968) 122 CLR 25, 34. Sometimes property is thought of as inherently separate from obligations. This explains Birks and Goode's stout defence of *Lister v Stubbs* (1890) 45 ChD 1. Relevant to this article, two Canadian academics have adopted this line. It is extremely important to note that both Smith and Chambers are Birks' former D Phil students. Further, *Lister* has not been rejected by the Privy Council in *AG (HK) v Reid* [1994] 1 AC 324. For a full discussion of the debate from a Canadian view, see the chapter entitled 'Property and Obligation' in Waddams, *Dimensions of Private Law*, above n 2. For a further discussion of the unstable nature of property, see also K Gray, 'Property in Thin Air' (1991) 50 *Cambridge Law Journal* 252, as well as K Gray and S Gray, 'The Idea of Property in Land' in S Bright and J Dewar (eds), *Land Law: Themes and Perspectives* (1998). Both of these pieces were cited by the High Court in *Yanner v Eaton* (1999) 201 CLR 351. But as R Meagher, D Heydon and M Leeming, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, 2002) 126 pointed out after discussing the earlier article by Gray, 'the hard fact is that a large part of equitable doctrine operates by reference to a system of interests, some of which are "proprietary" in character whilst others are not'. Therefore, it is appropriate to discuss proprietary remedies, but the unstable nature of property must never be over-emphasised.

5 These difficulties can be minimised by the process that Waddams has adopted in *Dimensions of Private Law*, above n 2, 189.

6 Perhaps the difficulty encountered by the unstable nature of property is at its most critical when insolvency law is also involved.

Although proprietary remedies are rare, the correct application of them is important for the proper functioning of the litigation system. There are numerous academic theories concerning whether property should be utilised as a remedy, particularly in a commercial setting.[7] The High Court has recently been examining the issue of the use of proprietary remedies in cases such as *Bathurst City Council v PWC Properties*[8] and *Giumelli v Giumelli*.[9] While these cases make it clear that proprietary remedies do exist, they cast little illumination on the correct approach to the use of proprietary remedies in Australia, in commercial contexts where the interests of third parties are involved. The correct approach still has not been 'discovered' in Australia.[10]

7 The legal literature on proprietary remedies is extensive. However, there is a limited number of particularly relevant pieces. For example, P Birks, 'Proprietary Rights as Remedies' in P Birks (ed), *The Frontiers of Liability* (1994) vol 2; R Goode, 'Proprietary Restitutionary Claims' in W Cornish et al (eds), *Restitution: Past, Present and Future* (1998) 63; M Cope, *Constructive Trusts* (1992); D Wright, *The Remedial Constructive Trust* (1998) and *Proprietary Claims and Remedies* (1997); A Oakley, *Constructive Trusts* (3rd ed, 1997); A Oakley, 'Proprietary Claims and their Priority in Insolvency' (1995) 54 *Cambridge Law Journal* 377; and most recently, Rotherham, above n 3. Birks has been a mini publishing industry himself on this issue. In addition to the work cited above, interested readers are referred to: *An Introduction to the Law of Restitution* (1989); 'Book Review' (1999) 21 *Adelaide Law Review* 151; *The Classification of Obligations* (1997); 'The End of the Remedial Constructive Trust' (1998) 12 *Trust Law International* 202; 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 *University of Western Australia Law Review* 1; 'Establishing a Proprietary Base' [1995] *Restitution Law Review* 83; 'Inconsistency Between Compensation and Restitution' (1996) 112 *Law Quarterly Review* 375; 'The Law of Restitution at the End of an Epoch' (1999) 28 *University of Western Australia Law Review* 13; 'The Law of Unjust Enrichment: A Millennial Resolution' [1999] *Singapore Journal of Legal Studies* 318; 'Misnomer' in W Cornish et al (eds), *Restitution: Past, Present and Future* (1998); 'Property and Unjust Enrichment: Categorical Truths' [1997] *New Zealand Law Review* 623; 'Property in the Profits of Wrongdoing' (1994) 24 *University of Western Australia Law Review* 8; 'Review and Notices' (1999) 115 *Law Quarterly Review* 681; 'Rights, Wrongs, and Remedies', above n 1; 'Three Kinds of Objections to Discretionary Remedialism', above n 1; and 'Trusts Raised to Reverse Unjust Enrichment: The *Westdeutsche* Case' (1996) 4 *Restitution Law Review* 3. As if the situation was not confused sufficiently by the number of conflicting theories, the issue of proprietary remedies has now been caught up with the argument over discretionary remedialism: see, for example, Birks, 'Rights, Wrongs and Remedies', above n 1; Birks, 'Three Kinds of Objections to Discretionary Remedialism', above n 1; Evans, 'Defending Discretionary Remedialism', above n 1; and Jensen, 'The Rights and Wrongs of Discretionary Remedialism' [2003] *Singapore Journal of Legal Studies* 178.

8 (1998) 195 CLR 566.

9 (1999) 196 CLR 101.

10 See D Wright, 'Proprietary Remedies and the Role of Insolvency' (2000) 23 *University of New South Wales Law Journal* 143.

This article hopes to make a contribution to this 'discovery' by examining the contribution of two important jurisdictions to this issue. It is possible to discern that more robust approaches have been developed in both the United States and Canada. However, these approaches are extremely contentious and slightly different from each other. The decision to focus upon the two countries making up North America has been made for three reasons. The first reason is that the United States and Canada have extremely similar approaches to the use of proprietary remedies. The second reason for investigating these two jurisdictions is that we share a legal history with these countries. The final reason for this modification is that both jurisdictions are important to Australia, both economically and culturally.

This article will focus primarily on the most contentious proprietary remedy, the constructive trust. There are three varieties of trusts: express; resulting; and constructive. The express trust is based upon actual intention. The resulting trust is based upon presumed intention.[11] The constructive trust disregards intention. This article will also largely focus upon the most contentious of all commercial contexts, bankruptcy/ insolvency. The constructive trust is a highly powerful tool in this area as it can greatly reduce the size of the bankrupt's estate by reducing the amount of money that the unsecured (or general) creditors receive.

Proprietary Remedies in Canada: The Commercial Setting

Canada's use of proprietary remedies in the commercial setting reveals a judiciary that is receptive to the employment of proprietary remedies.[12] Equitable remedies are having important consequences in the commercial world, and, in particular, in the bankruptcy setting. While the remedial constructive trust is the main protagonist in this arena, other doctrines, such as equitable subordination, are developing a vital role.

The Canadian Supreme Court decision of *Peter v Beblow*[13] articulates that the basic principles governing the award of a constructive trust are the same whether the context is family or commercial. The comment by

[11] This begs the question of presumed intention for what? The debate in England is whether it is presumed intention to retain a beneficial interest, or presumed *lack* of intention to pass property; it is certainly *not* presumed intention to create a trust (for this would be an express trust). The dominant view seems to be that what is presumed is, in fact, *lack* of intention to pass property. See R Chambers, *Resulting Trusts* (1997) and Lord Millett's views in *Twinsectra v Yardley* [2002] 2 AC 164.

[12] Although there has been an academic backlash against the Canadian courts: see Chambers, above n 11 and L D Smith, *The Law of Tracing* (1997).

[13] (1993) 101 DLR (4th) 621.

McLachlin J in *Peter v Beblow* that she 'doubt[ed] the wisdom of dividing unjust enrichment cases into two categories – commercial and family – for the purpose of determining whether a constructive trust lies',[14] is important to remember when considering the most recent Supreme Court of Canada decision involving the constructive trust. *Korkontzilas v Soulos*[15] is vitally significant in understanding the jurisprudence of the Supreme Court regarding the basis of the constructive trust. *Korkontzilas* overturned the Canadian doctrinal orthodoxy of the constructive trust being solely based upon unjust enrichment. The decision will require a rewriting of many trusts books that have placed Canada together with the United States when discussing the operation of the constructive trust.[16] This divergence is the starting point of difference between these two jurisdictions.

In *Korkontzilas*, the respondent made an offer to purchase certain property and the appellant real estate agent undertook to deliver it to the vendor. The appellant was also the agent of the vendor. The appellant did not do this, but purchased the property himself. When the respondent discovered what had occurred, he brought proceedings claiming, inter alia, a constructive trust. In this case there had been no unjust enrichment, but he claimed that the property had special significance to him. The question before the Supreme Court was whether the respondent was entitled to a constructive trust in the absence of unjust enrichment. The majority of the Court held that the respondent was entitled to such relief.

McLachlin J gave the judgment for the majority.[17] Her Ladyship perceived the appeal in extremely stark terms. McLachlin J held:

> The appeal thus presents two different views of the function and ambit of the constructive trust. One view sees the constructive trust exclusively as a remedy for clearly established loss. On this view, a constructive trust can arise only where there has been enrichment of the defendant and corresponding deprivation of the plaintiff. The other view, while not denying that the constructive trust may appropriately apply to prevent unjust enrichment, does not confine it to that role. On this view, the constructive trust may apply absent an established loss to condemn a wrongful act and maintain the integrity of the relationships of trust which underlie many of our industries and institutions.[18]

14 Ibid 649.

15 (1997) 146 DLR (4th) 214 ('*Korkontzilas*').

16 Oakley, *Constructive Trusts*, above n 7, 19-21.

17 La Forest, Gonthier, Cory and Major JJ concurred with her Ladyship.

18 (1997) 146 DLR (4th) 214, 220-1.

It is my view that the second, broader approach to constructive trusts should prevail.[19]

Her Ladyship rejected the proposition that the decision in *Pettkus v Becker*[20] meant that all constructive trusts were based upon unjust enrichment.[21] Later, McLachlin J stated that:

> [t]his court's assertion that the remedial constructive trust lies to prevent unjust enrichment in cases such as *Pettkus v Becker* should not be taken as expunging from Canadian law the constructive trust in other circumstances where its availability has long been recognized ... I conclude that the law of constructive trust in the common law provinces of Canada embraces the situations in which English courts of equity traditionally found a constructive trust as well as the situations of unjust enrichment recognized in recent Canadian jurisprudence.[22]

Her Ladyship found that the unifying general concept of both varieties of the constructive trust is 'good conscience', which is the same concept that, amongst others, Lord Denning and Cardozo J employed. McLachlin J held that:

> [g]ood conscience addresses not only fairness between the parties before the court, but the larger public concern of the courts to maintain the integrity of institutions like fiduciary relationships which the courts of equity supervised ... The constructive trust imposed for breach of fiduciary relationship thus serves not only to do the justice between the parties that good conscience requires, but to hold fiduciaries and people in positions of trust to the high standards of trust and probity that commercial and other social institutions require if they are to function effectively.[23]

To defeat the obvious claim of 'good conscience' being too general to be of any use,[24] her Ladyship stated that:

> [a] judge faced with a claim for a constructive trust will have regard not merely to what might seem fair in a general sense, but to other situations

19 Although it should be noted that this division can be attacked. If there are only two types of constructive trust – based on wrongful conduct and unjust enrichment – then where does a purchase money constructive trust (on sale of land) fit in? Arguably, a better view is that a constructive trust can arise as a result of wrongs, unjust enrichment, or in other ways.

20 (1980) 117 DLR (3d) 257.

21 Sopinka and Iacobucci JJ, in dissent, accepted this proposition. This constitutes a primary difference between the majority and minority.

22 (1997) 146 DLR (4th) 214, 222-3, 224.

23 Ibid 226-7.

24 Lord Denning was, and is, constantly attacked for his subjective 'constructive trust of a new model'.

> where courts have found a constructive trust. The goal is but a reasoned, incremental development of the law on a case-by-case basis.[25]

This comment, advocating an evolutionary approach, must be seen as a reply to those who criticise the Court for being too discretionary in applying the constructive trust.[26] McLachlin J then divided the constructive trust into two varieties:

> The situations, which the judge may consider in deciding whether good conscience requires imposition of a constructive trust, may be seen as falling into two general categories. The first category concerns property obtained by a wrongful act of the defendant, notably breach of fiduciary obligation or breach of duty of loyalty. The traditional English institutional trusts largely fall under but do not exhaust (at least in Canada) this category. The second category concerns situations where the defendant has not acted wrongfully in obtaining the property, but where he would be unjustly enriched to the plaintiff's detriment by being permitted to keep the property for himself.[27]

Therefore, according to the majority of the Supreme Court of Canada, the constructive trust is based on either wrongful acquisition of property[28] or unjust enrichment. This case involved a claim for a constructive trust based upon wrongful conduct. McLachlin J identified four prerequisites for the imposition of a constructive trust based upon wrongful conduct.[29] These are:

1. The defendant must have been under an equitable obligation in relation to the activities giving rise to the assets in his hand;
2. The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;
3. The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties; and

25 (1997) 146 DLR (4th) 214, 227.

26 Possibly the strongest critic of this discretion is Birks. See, for example, Birks, 'Proprietary Rights as Remedies', above n 7. With regard to discretion, see S Waddams, 'Judicial Discretion' (2001) 1 *Oxford University Commonwealth Law Journal* 59.

27 (1997) 146 DLR (4th) 214, 227.

28 Or wrongful conduct.

29 These four prerequisites coincide with the four given by R M Goode in 'Property and Unjust Enrichment' in A S Burrows (ed), *Essays on the Law of Restitution* (1991) for the generation of the remedial constructive trust.

4. There must be no factors that would render imposition of a constructive trust unjust in all circumstances of the case.[30]

McLachlin J found that these prerequisites were satisfied and that the respondent was entitled to a constructive trust.

There are several important developments that this case points towards. These include what will, and will not, constitute a legitimate reason for seeking a proprietary remedy. For example, will the desire to gain a priority in insolvency be considered a legitimate reason? In addition, it is fascinating to note that the approach of Goode relating to a bifurcated approach to the constructive trust has been adopted,[31] as have his prerequisites. Nowhere in her judgment did McLachlin J explicitly state into what category a case such as *LAC Minerals Ltd v International Corona Resources Ltd*[32] would be placed. These categories are extremely important, particularly the category not based upon unjust enrichment. Goode's division into the constructive trust founded either on a proprietary base or as a remedy for a wrong stemming from deemed agency gains is not consistent with this Canadian division. Goode's approach *in name* has been adopted, but not his analysis. At best, it is simply misleading to apply some of Goode's analysis, while ignoring other parts of it without explicitly stating so. Further, this case begs the question of what will the courts do to his idea of 'deemed agency'? It is this concept that has most scope for widespread development. In addition, the first prerequisite, which involves an equitable obligation, places stress upon the finding of a fiduciary obligation. In Canada, there has been a trend to a rapid expansion of the fiduciary relationship. This trend has not been obvious elsewhere in the Commonwealth.[33] Finally, the difference that Goode suggests between his two forms of constructive trust does not seem to have been adopted by the Supreme Court. *Rawluk v Rawluk*[34] appeared to be a constructive trust based upon unjust enrichment, but its commencement date is the date of the unjust enrichment and not, as Goode would suggest, the date of the court order.

It would be fascinating if, after so many years, Canadian and English jurisprudence on the constructive trust came together. *Korkontzilas* holds out this possibility with its decision that the constructive trust has two

30 It is with step 4 that the interests of third parties, such as creditors, are considered.

31 Although it is important to note that his categories of the constructive trust based either on a proprietary base or deemed agency gains have not been adopted.

32 (1989) 61 DLR (4th) 14.

33 See, for example, *Breen v Williams* (1996) 186 CLR 71 and *Bristol and West Building Society v Mothew* [1996] 4 All ER 698, 710.

34 (1990) 65 DLR (4th) 161.

bases, unjust enrichment and traditional grounds for the award of a constructive trust. In England there have been indications of some merging between the two jurisdictions' jurisprudence on constructive trusts. Lord Browne-Wilkinson indicated this in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*[35] by holding that:

> 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 is directly in issue.[36]

Arguably *Korkontzilas* makes this possibility more of a reality.

Although not a remedy itself,[37] the doctrine of equitable subordination has been of assistance to some claimants in insolvency matters. This doctrine has recently been introduced into Canada from its native United States. The doctrine operates to allow a court to alter the statutory distribution scheme by moving a creditor down the priority chain.[38] While the doctrine also exists in the United States, Canada is moving beyond the confines of American jurisprudence. It still remains undecided to what extent equitable subordination applies in Canada.[39] There is no express provision in the *Companies Creditor's Arrangement Act*, RS 1985, c C-36 or the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 for the doctrine of equitable subordination.[40] There has been mixed reception in case law for the doctrine. However, the decisions of *Global Equity Corp v Nexus Ventures Ltd*[41] and *Blue Range Resource Corp*[42] support the use of the doctrine and its capability of being asserted in pleadings.[43] Similar ar-

35 [1996] 2 All ER 961.

36 Ibid 999. It is unfortunate that 'Counsel for the bank specifically disavowed any claim based on a constructive trust' and the court did not have to discuss this issue in detail: ibid 990.

37 Perhaps this repeats the debate concerning whether tracing is a remedy or a process.

38 T Telfer, 'Transplanting Equitable Subordination: The New Free-Wheeling Equitable Discretion in Canadian Insolvency Law?' (2001) 36 *Canadian Business Law Journal* 36, 36.

39 Ibid 53.

40 Ibid 54.

41 [2000] BCJ No 430 (QL) (BCSC); [2000] BCJ No 1036 (QL) (BCCA).

42 [2000] 4 WWR 738.

43 Telfer, above n 38, 70.

guments arise in the use of equitable subordination as with other proprietary remedies in the commercial setting. The need for certainty is held against the need for flexibility and preventing wrongdoing in this context. Whilst there is much debate about the need for equitable principles in commercial law, it appears that Canadian courts are welcoming the flexibility of equitable proprietary remedies. This is most evident in the use of the remedial constructive trust.

An article by Paciocco[44] has created much discussion amongst commentators and the judiciary in Canada.[45] Paciocco acknowledges that the meaning, principles and terms of the remedial constructive trust are not clear, and that the constructive trustee is not a trustee in the ordinary sense, and not even always a fiduciary.[46] The remedial constructive trust in the commercial setting (particularly in bankruptcy) is a powerful tool in that:

> If successful, the relief that the plaintiff obtains is proprietary in the sense that it gives the successful plaintiff rights in the specific property which are good, not only against the defendant but also against most others, including and most especially, the general creditors of the defendant.[47]

Priority over creditors is the most concerning aspect of the use of the constructive trust in the bankruptcy setting. While bona fide purchasers for value without notice and secured creditors are given priority over the constructive trust beneficiary, the priority of unsecured creditors is at stake.[48] Paciocco argues that acceptance of risk is a key factor in the award of a constructive trust in the commercial setting, and that it should be acknowledged that not all general creditors take on risk, for example, tortious and small trade creditors.[49] The difference between general creditors and constructive trust beneficiaries is that the former 'have dealt with the defendant while accepting the risk of his insolvency'.[50] Therefore, where the potential constructive trust beneficiary has also accepted the risk, the constructive trust should not be awarded. He suggests that caution should be taken in awarding a constructive trust in the commercial setting, and

44 D M Paciocco, 'The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors' (1989) 68 *Canadian Bar Review* 315.

45 For example, this article was cited by the Supreme Court in *Korkontzilas v Soulos* (1997) 146 DLR (4th) 214.

46 Further on this point, see *Giumelli v Giumelli* (1999) 196 CLR 101, [4].

47 Paciocco, above n 44, 315.

48 Ibid 321.

49 Ibid 325.

50 Ibid 341.

that principles applied in the family context should not necessarily be used in the commercial setting.[51]

For the remedial constructive trust, Paciocco suggests that the close scrutiny of the causal connection requirement in the commercial setting should involve a factual tracing process at least as pure as that imposed for the remedy of equitable tracing.[52] He also suggests that competing equities should be important, and in some cases of unjust enrichment, where there are creditors that will be affected, a remedial constructive trust should not be awarded.[53] Paciocco suggests that contracts that are void or voidable may contemplate the enrichment of the defendant. Where the defect in the contract does not vitiate voluntariness, 'a plaintiff who contemplated assuming the role of a general creditor should be denied constructive trust relief'.[54] Paciocco argues that the wrongdoing of the defendant is irrelevant in awarding a constructive trust in a bankruptcy setting. For an award of a constructive trust in the commercial setting, Paciocco suggests that there must be: (a) a causal connection between the claimant's loss and the defendant's gain; (b) absence of 'acceptance of risk'; and (c) recognition that the deprivation of the plaintiff is in issue, not the enrichment of the defendant.[55]

Rotman agrees with many of Paciocco's statements, but not with his view on the enrichment of the defendant.[56] Rotman argues that the defendant does benefit where the excess of profits over deprivation goes to their creditors. In this situation, 'the fiduciary's indebtedness to the creditors is reduced, thus conferring a real and tangible benefit to the fiduciary'.[57] Rotman articulates the difficult policy issues involved as a result of the constructive trust being awarded long after a declaration of bankruptcy, and the hardship faced by creditors in properly protecting their interest against the potential constructive trust beneficiary. For this reason, a constructive trust claimant should only be given priority where there is a 'legitimate reason for subordinating creditor's rights to those of the plaintiff'.[58] Rotman argues that the plaintiff's claim must be demonstrably superior to those of other creditors, and that monetary damages must be

51 Ibid 329.

52 Ibid 335.

53 Ibid 340.

54 Ibid 344.

55 Ibid 351.

56 L I Rotman, 'Deconstructing the Constructive Trust' (1999) 37 *Alberta Law Review* 133.

57 Ibid 169.

58 Ibid 168.

inadequate. The leading cases on the remedial constructive trust in Canada have taken some of these issues and left others.

An important Canadian decision on the use of proprietary remedies is *Cadbury Schweppes Inc v FBI Foods Ltd*,[59] where the Canadian Supreme Court considered an action for breach of confidence over FBI's use of information regarding the ingredients of Clamato juice, a juice composed of clams and tomato juice.

Duffy Mott had disclosed the confidential information to Caesar Canning Ltd, who was originally licensed to manufacture and market the drink in Canada. Caesar Canning Ltd sub-contracted the manufacture of the drink to a third party, FBI Ltd, and disclosed the confidential information to it. Binnie J, delivering the unanimous judgment of the Supreme Court,[60] held that FBI, as a third party to the confidant, was still liable. He held that as FBI knew it was in receipt of confidential information, it too was liable for breach of this confidence. Cadbury Schweppes purchased the licensor's (Duffy Mott) rights to Clamato and gave notice that they would terminate the licence with Caesar Canning Ltd in 12 months. While the licence agreement left FBI free to compete with Cadbury Schweppes after termination, it was prohibited from manufacturing a product containing clam and tomato juice for five years. FBI then used confidential information to develop and market a similar, but clamless, product. Hence, while not in breach of the licence agreement, it had clearly misused the confidential information relating to Clamato juice.

The plaintiff commenced an action claiming compensatory damages and an injunction to prevent FBI from producing their product. The trial judge refused an injunction but awarded 'head start damages'. The rationale was that the breach of confidence had provided FBI with a springboard. FBI appealed to the Supreme Court. At the Supreme Court level, liability for breach of confidence was no longer challenged. The appeal focused on the 'appropriate remedies for breach of confidence in a commercial context',[61] and, particularly, on what principles financial compensation was to be calculated, and whether a permanent injunction is an appropriate remedy.

The Supreme Court allowed the appeal and dismissed the cross appeal. In discussing the appropriate remedy, Binnie J, delivering the unanimous judgment of the Court, rejected a rigid approach to determining remedies

59 (1999) 167 DLR (4th) 577.

60 Delivered by Binnie J, on behalf of L'Hereux-Dube, Gonthier, McLachlin, Iacobucci, Major and Bastarache JJ.

61 (1999) 167 DLR (4th) 577, [2].

in breach of confidence cases purely according to strict doctrinal considerations. He quoted Davies with approval, saying that *International Corona Resources Ltd v LAC Minerals Ltd*[62] stands for the fact that 'if a ground of liability is established, then the remedy that follows should be the one that is most appropriate on the facts of the case rather than the one derived from history or over-categorization'.[63]

Binnie J stated that it is important to keep in mind that the objective in a breach of confidence case is to put the confider in as good a position as it would have been in but for the breach, and to 'that end, the court has ample jurisdiction to fashion appropriate relief out of the available remedies including appropriate financial compensation.'[64] He asserted that the 'sui generis' characterisation for breach of confidence action recognises the flexibility that is available in finding a remedy.

Binnie J highlighted, however, that in fashioning the appropriate remedy in a breach of confidence case, the character of the interest protected is of great importance.[65] The reason for this is the very basis of breach of confidence. He cited with approval Sopinka J's statement in *International Corona Resources Ltd v LAC Minerals Ltd*[66] that the 'multi-faceted basis' for a breach of confidence action 'provides the court with considerable flexibility in fashioning a remedy'.[67] It is 'multi-faceted' in the sense that the jurisdictional basis for a breach of confidence action is not settled, and in different situations is derived from principles of contract, tort, equity and property.[68] He suggests it is therefore necessary to ascertain the true character of the interest being protected in order to decide whether an appropriate remedy should be fashioned according to the principles of contract, tort, property or equity. He asserts that the court has jurisdiction to fashion a remedy according to the policy objectives underlying the particular action as reflected by the nature of the interest being protected.[69]

However, while he emphasised that the contractual, tortious, proprietary or trust character of the breach of confidence will influence the appropriateness of the remedy, it is not conclusive in itself. The 'doctrinal flavour' of the breach of confidence is influential, but does not restrict the court to

62 (1989) 61 DLR (4th) 14.
63 (1999) 167 DLR (4th) 577, [24].
64 Ibid [61].
65 Ibid [5].
66 (1989) 61 DLR (4th) 14.
67 (1999) 167 DLR (4th) 577, [22].
68 Ibid [20].
69 Ibid [26].

using a remedy traditionally tied to that particular doctrine.[70] He suggests the court should grant a remedy that is most appropriate to the facts of the case, rather than the doctrinal basis of the action.[71] *Cadbury Schweppes Inc v FBI Foods Ltd* therefore stands as 'authority for the cross-fertilization of remedies across doctrinal boundaries'.[72]

Binnie J denied a proprietary remedy in this case for several reasons. Firstly, Binnie J refused to accept Cadbury Schweppes's argument and recognise confidential information as a species of property. He identifies its basis as being more the 'violation of confidence' than a proprietary right. Hence, he concluded, a proprietary remedy does not automatically follow from a breach of confidence.[73] According to Freedman, had he accepted their argument, a proprietary remedy would be available 'as of right'.[74] However, Binnie J, while not dismissing the availability of a proprietary remedy outright, argued that the remedy for breach of confidence should be decided on a case-by-case basis by balancing all the competing equities.[75] In discussing whether a proprietary remedy was an appropriate remedy in this case, Binnie J concluded that the 'nothing special' nature of the confidential information in this case militated against a proprietary remedy being appropriate.[76] While a proprietary remedy is available, the 'quality' of the information and thus the character of the breach of confidence means that it is inappropriate in the circumstances.

The reasoning and principles coming out of all of these cases forms the basis of the much discussed decision of *Ellingsen v Hallmark Ford Sales Ltd*.[77] In *Ellingsen v Hallmark*, Hallmark Ford Sales Ltd agreed to sell a truck to Ellingsen and let him take the truck to his logging operations without paying. Hallmark transferred ownership of the truck to Ellingsen on the expectation that the deal would be financed by the bank, with the balance covered by a trade-in. At all times it was clear that the transaction was subject to obtaining finance. There were delays in the financing arrangements and Ellingsen made an assignment in bankruptcy. The trustee had possession of the truck (or the proceeds of sale) and claimed that it

70 Ibid.

71 Ibid [24].

72 A Abdullah and T T Hang, 'Making the Remedy Fit the Wrong' (1999) 115 *Law Quarterly Review* 376, 377.

73 (1999) 167 DLR (4th) 577, [48].

74 D Freedman, 'The Great Canadian Juice War' (1999) *Cambridge Law Journal* 288, 289.

75 (1999) 167 DLR (4th) 577, [48].

76 Ibid [86].

77 (2000) 190 DLR (4th) 47 (*'Ellingsen v Hallmark'*).

was an asset forming part of the bankruptcy estate. Following the assignment in bankruptcy, a representative of the trustee advised Hallmark that they had no claim on the truck as a Financing Statement under the *Personal Property Security Act*, RSBC 1996, c 359 ('PPSA') had not been filed. Without legal advice, Hallmark urgently lodged a statement in the Personal Property Registry. At first instance, the chambers judge decided that the transaction was a sale, rather than the creation of a trust, with the unpaid sales price giving rise to a security interest which could, and should, have been registered. Had it been registered, it would have protected Hallmark from the bankruptcy.[78] This was overturned by the Court of Appeal.

Donald JA (Lambert JA concurring) decided that the evidence did not reasonably support a finding that the transaction was a sale and the proposition that Hallmark retained a security interest after it released the truck. Because of the condition precedent (ie the financing), there was no enforceable contract on which Hallmark could sue Ellingsen for the purchase price.[79] The transfer of ownership registration to Ellingsen did not complete any transaction because the condition precedent had not been fulfilled. The transfer allowed the transaction to move along, but did not complete it.[80] His Honour focused on the fact that Ellingsen had a truck that he had no right to keep, and this may be an underlying factor in the decision.

Donald JA articulated three conditions that must be satisfied before a constructive trust may be awarded: (1) no transaction vesting property rights has taken place; (2) the property must be able to be traced; and (3) against the actual possessor of the property it must be unjust that the claimant not take it:

> Hallmark meets all three conditions: the contract was ineffective because no financing was arranged; the truck was still in Ellingsen's possession at the time of bankruptcy; and Hallmark did not extend credit to Ellingsen. Not having extended credit, Hallmark occupies a different position from that of the general creditors of the bankrupt estate who did extend credit. The creditors would unfairly enjoy a windfall if the truck formed part of the assets available to them.[81]

The difficulty in this analysis for Donald JA is the relationship between the PPSA and the remedial constructive trust. For Hallmark to succeed, it

78 Ibid [17].

79 Ibid [18].

80 Ibid [19].

81 Ibid [22].

needed to find an exclusion from the PPSA, because if its interest was a 'security interest' unless registered, it would not be effective against a trustee in bankruptcy by virtue of s 20(b)(i). His Honour stated that the proprietary interest in the truck was not a security interest, and that 'Hallmark's remedy lies outside the document and is found in the power of the court to provide a restitutionary remedy'.[82] In his Honour's opinion, Hallmark had nothing to register. The purpose of the constructive trust is not to secure a payment or the performance of an obligation, but to prevent an unjust outcome.[83] Lambert JA argues that the integrity of the PPSA is maintained by the award of a constructive trust because:

> First, that the acts of the parties and not the failure to register created the right to restitution and the unjust enrichment, both of which came into being entirely independently of the Act, and both of which came into being through a failure of a contract to arise at all and not from non-performance of a contract or from a breach of contract, and, second, that no-one has been shown to have been prejudiced by an absence of registration, neither a secured creditor, nor a general creditor, nor a third party, all of whom must have taken their credit risks without any assumption that the second truck was unencumbered.[84]

Donald JA followed the test formulated by McLachlin J in *Peter v Beblow*[85] and re-emphasised in *Korkontzilas v Soulos*[86] that an action for unjust enrichment requires: (1) enrichment; (2) corresponding deprivation; and (3) the absence of a juristic reason for the enrichment.[87] Because Hallmark had no instrument to register under the PPSA, there was no juristic reason for the enrichment. Donald JA acknowledges Paciocco's article and adheres to some of his ideas. However, following McLachlin J in *Peter v Beblow,* his Honour departs from Paciocco by stating that there is no distinction between family and commercial settings when it comes to constructive trusts. Donald JA does, however, articulate the need to look to the impact on third parties, but moves on to state:

> In weighing the equities other creditors may have to be considered. In my judgment, for the reasons I have given, Hallmark does not stand on the same footing as the general creditors and as a result I do not think the remedy I would impose unfairly deprives other creditors of an asset to which they have any reasonable entitlement.[88]

82 Ibid [26].
83 Ibid [28].
84 Ibid [80].
85 (1993) 101 DLR (4th) 621.
86 (1997) 146 DLR (4th) 214.
87 (2000) 190 DLR (4th) 47, [29].
88 Ibid [37].

As Hallmark never intended to grant credit, there is no justification for placing Hallmark in a class with all other creditors. Lambert JA also places great importance on looking to other competing equities and measuring the injustices of enrichment by 'good commercial conscience'.[89] The remedial constructive trust will not be imposed where an alternative remedy is available, or without taking into consideration the interests of those affected by the granting of the remedy.[90]

The timing of the constructive trust is a much-debated topic. For the remedy to have any practical effect, Donald JA argues that it must be deemed to operate before bankruptcy, otherwise s 67(1)(a) of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 cannot be invoked to exclude the trust property from the bankruptcy estate. Donald JA uses the case of *Rawluk v Rawluk*[91] to assert that the constructive trust arises when the unjust enrichment first occurred.[92] Hallmark was therefore entitled when it first became certain that the condition precedent could not be fulfilled.

McEachern CJBC delivered a dissenting judgment concerned with the certainty that the complex arena of commercial law needs. His Honour viewed Hallmark as the unpaid vendor of the truck and decided that, at common law, Hallmark was entitled to be paid or have the truck returned. Hallmark waived the subject to finance clause by transferring title to Ellingsen, and Ellingsen waived the clause when he kept the truck when he knew financing could not be delivered.[93] McEachern CJBC reveals concern with maintaining the certainty that the PPSA aims to ensure in the commercial context. The lack of registration under the PPSA provided a good juristic reason for the enrichment. His Honour described the situation as one where Hallmark took a chance that a bank would pay the purchase price on behalf of Ellingsen, and neglected to perfect its security interest by filing an appropriate statement before Ellingsen's bankruptcy.[94] Even if a constructive trust could have been awarded, McEachern CJBC seems to suggest that the remedy has no place in the commercial setting:

> Turning to s 4 [PPSA], the *Act* does not apply to interests 'given by a rule of law' which could include a constructive trust, although I have serious reser-

89 Ibid [65].

90 Ibid [71].

91 [1990] 1 SCR 70.

92 (2000) 190 DLR (4^{th}) 47, [38].

93 Ibid [45].

94 Ibid [51].

> vations about the introduction of such concepts into consumer transactions.[95]

McEachern CJBC seems hesitant to introduce equity into the commercial setting. His concern with the need for certainty echoes much of the criticism of the majority decision. On the other side, the majority judgment and the Supreme Court recognise the need for flexibility, and that where an unjust enrichment occurs or a defendant commits a wrongful act, legality and certainty should not protect the undeserving defendant.

Ellingsen v Hallmark has received some negative comment. However, the decision follows closely the precedent set by the Supreme Court in *Peter v Beblow* and *Korkontzilas v Soulos*. Thus, such criticism may be aimed not at the logic in the decision, but at the role of equity in commercial law. Ziegel launches a critical commentary on the case.[96] He sees the decision as a troubling threat to commercial law. Ziegel's main criticism is with the lack of exploration of common law answers to the problem. He argues that Donald JA should have engaged in a comparison of the legal remedies with the remedies for unjust enrichment available to Hallmark on the facts.[97] Donald JA dismisses the legal remedies available by deciding that the contract was not a registerable instrument, and that the PPSA did not deal with the separation of ownership. His Honour then moves on to discuss equitable remedies and unjust enrichment. Perhaps Ziegel simply does not agree with the common law conclusion at which Donald JA arrives.

Ziegel suggests that Lambert JA misconstrued the PPSA:

> It is now thoroughly well established under all the provincial *PPSA*s that an unperfected security interest is subordinated to the claim of a trustee in bankruptcy regardless of whether the trustee or any creditor represented by the trustee has been actually prejudiced by the absence of a proper financing statement.[98]

What Ziegel must have overlooked is that Lambert JA states that the transaction entered into by Hallmark was not a security interest. He explicitly states that the constructive trust is excluded by s 4 of the Act.[99] Therefore the transaction is not as Ziegel describes it (an unperfected security interest) but an interest to which the Act does not apply. Ziegel also

95 Ibid [56].

96 J S Ziegel, 'The Unwelcome Intrusion of the Remedial Constructive Trust in Personal Property Security Law: *Ellingsen (Trustee of) v Hallmark Ford Sales Ltd*' (2001) 34 *Canadian Business Law Journal* 460.

97 Ibid 463.

98 Ibid 464.

99 (2000) 190 DLR (4th) 47, [79].

criticises the decision of McEachern CJBC, stating that the divorce of ownership and possession is outside the operation of the Act and therefore it could not apply. This somewhat contradicts his earlier argument.[100] Ziegel's argument is premised by his belief that unjust enrichment remedies have no role to play in the commercial setting. He suggests that common law and statutory remedies should have been first addressed, such as s 81 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3:

> Subsection (1) provides that where a person claims any property or interest in property in the possession of a bankrupt he must file a proof of claim with the trustee. The trustee is then required, under subsection (2), within 15 days of the filing of the claim or within 15 days after the first meeting of creditors, whichever is later, either to admit the claim and deliver possession of the property to the claimant or to notify the claimant that the claim is disputed. Subsection (5) stipulates that the procedure laid down in s 81 is to be the only mechanism for bringing property claims against the estate.[101]

Ziegel argues that there was no suggestion that the trustee would not have complied with an order that Hallmark was entitled to the return of the truck. With respect, this is a very simplistic way of looking at the situation. The complexity of the situation involves the relationship between the PPSA and the separation of ownership from possession and legal title. A simple order not dealing with these issues is both illogical and unrealistic. For Ziegel's hypothesis to work, Hallmark would have to file a proof of claim with the trustee. Without a registerable instrument, or a certificate of registration of ownership, what recourse would Hallmark have under this method? Ziegel agrees that the PPSA did not cover this situation. He agrees that Hallmark should have had recourse to the truck. What he does not agree with is that an equitable remedy was utilised in the commercial setting.

The need for equitable proprietary remedies in the commercial setting is a much-debated topic. Despite its criticism, it would appear that the Supreme Court of Canada in *Peter v Beblow* and *Korkontzilas v Soulos* are determined to allow equitable proprietary remedies to be imposed where there is unjust enrichment on the part of a defendant, or where a defendant has committed a wrongful act. *Ellingsen v Hallmark* merely follows the ground prepared by these two earlier cases. The position held by the minority in *Ellingsen v Hallmark* is that shared by commentators who feel that certainty in the commercial setting is somehow threatened with the intervention of equity. It should be concluded that Canadian jurisprudence leans slightly away from this view.

[100] Ziegel, above n 96, 467.

[101] Ibid 469.

Proprietary Remedies in the United States[102]

The role of equitable remedies in the commercial setting is a much-debated topic in America. The most controversial remedy is the constructive trust and how it operates in the bankruptcy setting. Many commentaries suggest that the constructive trust has no role in bankruptcy, and is in fact inimical to the principles of the *Federal Bankruptcy Code* 11 USC.[103] However, the American courts of appeal have left the door open to the award of a constructive trust in bankruptcy where the circumstances warrant a proprietary remedy. Section 541(d) of the *Bankruptcy Code* excludes property held on trust from the bankrupt's estate, and therefore gives the constructive trust claimant priority over an ordinary creditor. The remedy is a powerful tool in the bankruptcy setting and its impact is dangerous for creditors. These are some of the reasons the remedy is debated so widely. Sherwin's article, 'Constructive Trusts in Bankruptcy',[104] is the starting point for exploring the use of the constructive trust in bankruptcy in America. Sherwin describes the constructive trust as a remedy developed in equity to give relief against unjust enrichment.[105] Sherwin argues that limits should be placed on the constructive trust in bankruptcy to address the underlying question of unjust enrichment in a contest between the constructive trust claimant and other creditors.[106] She articulates the importance of the remedy in many areas of equity, and the difficulties associated with using the remedy in bankruptcy in the placing of one claimant ahead of other creditors in relation to the property in issue.

In America, although the *Bankruptcy Code* operates at the federal level, the existence of a constructive trust is determined according to State law. Tracing and priority are two elements central to the constructive trust. The tracing element acts as a deterrent, because if the defendant exchanges the property for something more valuable, the plaintiff receives a windfall.[107] The right to specific restitution of a constructive trust remedy

[102] Although not American, reference should be made to the work by Rotherham, above n 3, to understand the history in the United States of the use of property as a remedy in the light of the American legal realist movement.

[103] 'Bankruptcy Code'.

[104] E Sherwin, 'Constructive Trusts in Bankruptcy' [1989] *University of Illinois Law Review* 297.

[105] Although it should be noted that A Kull in 'Restitution in Bankruptcy: Reclamation and Constructive Trust' (1998) 72 *American Bankruptcy Law Journal* 265, 288-9 attacks this idea of the constructive trust simply being a remedy.

[106] Sherwin, above n 104, 298. It should be noted that she does not at all suggest that constructive trusts should not be utilised in bankruptcy.

[107] Ibid 304.

gives the claimant priority over the defendant's unsecured creditors. Sherwin's article rejects this position:

> Instead, the priority of a restitution claimant in bankruptcy (or a similar collective creditor proceeding) should be based on the strength of her claim in relation to the claims of competing parties who will bear the burden of the remedy. Put another way, the right to a constructive trust in bankruptcy should depend on whether sharing in the property the plaintiff claims would unjustly enrich creditors.[108]

The first requirement for the award of a constructive trust is that the plaintiff show that the defendant was unjustly enriched by the acquisition or retention of certain property.[109] The tracing requirement then demands that the plaintiff must identify the specific assets that represent the claim at the time of trial. If the specific property is no longer present, the plaintiff must trace the property through specific transactions leading from the original to the present form. Where funds are commingled, the plaintiff can only recover from the commingled fund the lowest balance of the fund between the time the defendant deposited money subject to the constructive trust into the fund and the time of the trial.[110]

Sherwin agrees that the constructive trust should be determined according to State law. However, she argues that the priority of a constructive trust claimant misunderstands the remedial nature of constructive trusts. Sherwin suggests that a constructive trust is not a right of ownership, but rather an equitable remedy against unjust enrichment between the claimant and other creditors.[111] Court imposed limitations on constructive trusts are twofold. Firstly, stricter tracing rules apply, preventing the claimant from tracing into commingled funds.[112] The claimant must identify specific assets or their proceeds. Secondly, trustee strong arm powers prevent the constructive trust claimant from taking priority over a trustee under 11 USC s 544. This section elevates the trustee to the position of a bona fide purchaser who has priority over the constructive trustee. Sherwin argues that courts need a new approach and must understand and apply constructive trusts as remedies against unjust enrichment. The important question for Sherwin is whether 'creditors will be unjustly enriched at the claimant's expense if allowed to share in the property she claims'.[113]

[108] Ibid 306.
[109] Ibid 307.
[110] Ibid 310.
[111] Ibid 317.
[112] Ibid 318.
[113] Ibid 327-8.

Three elements are required for an award of constructive trust in bankruptcy. Firstly, the defendant must have gained what the plaintiff has lost.[114] Secondly, property, or visibly traceable products of the property, must represent the unjust enrichment. Thirdly, the claimant must be an involuntary creditor. The constructive trust claimant had no opportunity to demand compensation for the risk of insolvency (ie interest or collateral).[115] Sherwin argues that caution is needed in the award of constructive trusts in bankruptcy. In a claimant's dispute with other creditors, 'the combination of a loss to the plaintiff and a corresponding gain to the estate is essential to her case for priority'.[116] In commingled funds, Sherwin suggests that the bankruptcy court should not presume the debtor spent her own money first, 'or allow the full amount of her claim on the balance of a commingled fund'. The best solution is proportional division.[117] Sherwin proposes to abolish constructive trusts in bankruptcy, rather than to continue with the current position of a constructive trust equalling equitable ownership.

In *Re Omegas Group*,[118] many of Sherwin's concerns were judicially articulated by the 6th Circuit when Batchelder J in the Court of Appeals reversed the decision of the bankruptcy court to award a constructive trust. The creditor (Datacomp) claimed that the debtor (Omegas) defrauded it and that money paid to the debtor in the course of business was held in constructive trust, since the debtor knew that the bankruptcy was imminent, but assured the creditor otherwise. On the other hand, Omegas argued that Datacomp was no different to any other creditor. Batchelder J held that the *Bankruptcy Code* does not say that property held by the debtor subject to a constructive trust is excluded from the debtor's estate. His Honour stated that the constructive trust is not really a trust. He quotes Sherwin's position. He states 'a claim filed in a bankruptcy court asserting rights to certain assets held in constructive trust for the claimant is nothing more than that: a claim'.[119] He moves on to say:

> Unless a court has already impressed a constructive trust upon certain assets or a legislature has created a specific statutory right to have particular kinds of funds held as if in trust, the claimant cannot properly represent to the

[114] Ibid 330.
[115] Ibid 336.
[116] Ibid 345.
[117] Ibid 349.
[118] 16 F 3d 1443 (1994) ('*Re Omegas*').
[119] Ibid 1449.

> bankruptcy court that he was, at the time of the commencement of the case, a beneficiary of a constructive trust held by the debtor.[120]

His Honour determined that Kentucky law (the relevant State law) is uncertain as to whether the creditor-debtor relationship may give rise to a constructive trust. He states that a constructive trust is fundamentally at odds with the general goals of the *Bankruptcy Code*. Batchelder J suggests that constructive trusts have no place in bankruptcy:

> To permit a creditor, no matter how badly he was 'had' by the debtor, to top off a piece of the estate under a constructive trust theory is to permit that creditor to circumvent completely the code's equitable system of distribution.[121]

Sherwin's concerns with the interests of other creditors were clearly a concern of the 6th Circuit.[122] This decision appears to have prima facie excluded constructive trusts from the bankruptcy setting.

Kull, who has been appointed the reporter for the Restatement (Third) Restitution, argues that because the subject of restitution is not addressed by the *Bankruptcy Code*, the topic has become confused and haphazard, leading to the poor decision in *Re Omegas*.[123] One of the core points made by Kull in his article is that the *Bankruptcy Code* is not an exhaustive piece of legislation, but operates against a backdrop of the pre-existing law. For him, the problems with the constructive trust in bankruptcy largely stem from the fact that judges and lawyers have forgotten this simple fact and treat the *Code* as if it were exhaustive. Kull suggests that the *Bankruptcy Code* and constructive trusts are not at odds with one another because of the element of ownership involved in the constructive trust remedy. Fundamentally, this is where Kull's perspective differs from that of Sherwin. In short, for Kull the restitution claimant who succeeds in bankruptcy prevails over the general creditors because he or she is not merely a creditor, but an owner. He or she is an owner because the law allows him or her to avoid the transfer by which the assets in question got into the debtor's hands.

[120] Ibid.

[121] Ibid 1453.

[122] Although the Court seemed to take these worries in a direction and to an extent not intended by Sherwin. For example, the Court seemed to indicate the complete prohibition of the constructive trust from bankruptcy. However, Sherwin never indicated this possibility. This appeared to be the Court's own views.

[123] Kull, above n 105.

Kull argues emphatically that while the constructive trust is a remedy, it is not merely a remedy.[124] The constructive trust is still a trust. When the constructive trust is awarded, the court is passing judgment on a pre-existing legal dispute. The award of a constructive trust means that the court is deciding that the claimant has a right to ownership of the specific assets superior to that of the person with possession and legal title. This right of ownership precedes judicial acknowledgment. Kull's arguments can be evidenced in some cases since *Re Omegas*,[125] and his concerns, paired with the arguments of Sherwin, paved the way for some interesting decisions in American courts of appeal.

Despite the 6th Circuit's attempt to exclude the constructive trust from bankruptcy in *Re Omegas*, the same court decided in *Re Morris*[126] that in special circumstances, the constructive trust is needed in bankruptcy proceedings. In this case, Poss lent money to Morris to purchase land. Poss also lent money to Morris to construct a building on part of the property. Poss leased two and a half acres from Morris, and Morris leased the building from Poss over 15 years to pay off the loan. These agreements were entered into in an effort to minimise Poss's tax. Without Poss's knowledge, Morris took out a secured loan with a mortgage over the property. Morris defaulted on the loan repayments and Poss secured judgment in the amount of $152,050.17 plus interest against Morris. After all of this had transpired, Morris filed for voluntary bankruptcy under Ch 13 of the *Bankruptcy Code*, and Poss failed to file a proof of claim as required. Poss sought from the bankrupt's estate: (1) a determination that he had first preference on the property (to the value of $160,417.07); (2) specific performance of the conveyance of the property pursuant to the court order; (3) avoidance of a transfer of 750 shares of stock to Morris' son; and (4) the imposition of a constructive trust on the shares. In the State court, Yost J held that Poss had a contractual right only, and was therefore limited as a usual creditor.

The 6th Circuit held that in relation to a constructive trust, State law determines the interests of the parties. The court specifically stated:

> With regard to a constructive trust, we have been clear that this section does not authorise bankruptcy courts to recognise a constructive trust based on a

[124] Kull very clearly joins the debate on the nature of the constructive trust in the United States. Fundamentally, he views it as more than just a remedy. He has recent support for this position in G G Bogert, D H Oaks and H R Hansen, *Cases and Text on the Law of Trusts* (7th ed, 2001) 641. This complicates the somewhat simplistic picture of the position in the United States on this issue.

[125] See, for example, *Re Dow Corning Corporation*, 192 BR 428 (1996).

[126] 260 F 3d 654 (2001).

> creditor's claim of entitlement to one; rather, s 541(d) only operates to the extent that State law has impressed property with a constructive trust prior to its entry into bankruptcy.[127]

The court moved on to say that in *Re Omegas*, no State court proceedings prior to the bankruptcy had determined a constructive trust, and the State law itself was not clear on whether a constructive trust is available. The court clarified its position on constructive trusts:

> Since deciding *Omegas* we have clarified several relevant points. We have recognised that imposition of a constructive trust might be appropriate when property in bankruptcy was not subject to distribution to creditors and so did not implicate the rationale of ratable distribution ... We have also recently made clear that *Omegas Group* addressed the relatively common situation in which a creditor with a claim arising in the ordinary course appeals to the bankruptcy court for preferential treatment.[128]

Unlike *Re Omegas,* the case in *Re Morris* was not typical on its facts. As State law determines the award of a constructive trust, Ohio law is what is considered in this case. In Ohio, the constructive trust is a 'remedy used by courts for the prevention of fraud, unjust enrichment or other inequitable conduct'.[129] Real property falls within the jurisdiction of the court of equity because of the inherent inadequacy of a legal remedy. The court decided that because Morris had an equitable duty to convey the property, a constructive trust arose by operation of law.[130] In this case it was obvious that the intimacy of the agreement and the blatant unfairness of the defendant's actions were what caused the 6th Circuit to decide in this manner. The fact that there were not other creditors in a similar position to Poss is also of significance. This decision, paired with the decision in *Re Omegas*, shows that prima facie constructive trusts are against the principles of the *Bankruptcy Code*. However, the court is willing to award a constructive trust where it is just to do so in all of the circumstances of the case.

Gretchko and Hamilton's article, 'Constructive Trust on Real Estate Hits Paydirt in the Sixth Circuit',[131] discusses the 6th Circuit's decision in *Re*

[127] Ibid 666.

[128] Ibid.

[129] Ibid 667. Note that the court included as a way of achieving a constructive trust 'other inequitable conduct'. This would clearly indicate that in Ohio, at least, the constructive trust is not just triggered by unjust enrichment. It is fair to ask how the Canadian case of *Korkontzilas v Soulos* (1997) 146 DLR (4th) 214 would have been decided in this jurisdiction.

[130] 260 F 3d 654, 668 (2001).

[131] L S Gretchko, 'Constructive Trust on Real Estate Hits Paydirt in the Sixth Circuit' (2001) 20(9) *American Bankruptcy Institute Journal* 10.

Morris. The authors articulate the appeal of a constructive trust to an unsecured creditor, but suggest that:

> Constructive trusts are inimical to the Bankruptcy Code's priority scheme because they result in some creditors receiving special treatment as they effectively move from 'last in line' to 'first in line'.[132]

The authors state that after *Re Omegas*, the 6th Circuit cleared its position to allow constructive trusts only under limited circumstances. In *Re Morris* (a real estate dispute), the 6th Circuit relaxed its position on constructive trusts to reach the 'right result':[133]

> Substantively, *Morris* is an important departure from the court's clear attempt to discourage unsecured creditors from claiming that the debtor's bad acts require the bankruptcy court to impose a constructive trust ... *Morris* did not require a formal pre-petition judicial decision declaring the existence of the constructive trust.[134]

Clearly, the authors suggest that *Re Morris* is relaxing the stance the 6th Circuit made in *Re Omegas*. The need for equity in the commercial setting is in some circumstances imperative.

The concerns with other creditors, which were not present in *Re Morris*, appear to have held sway in *Re Foster*.[135] In this case, the claims of similarly situated creditors were what led the 10th Circuit to deny relief in the form of a constructive trust. Under Colorado law (the relevant State law), the constructive trust is a judicially created equitable remedy applied to prevent unjust enrichment. To obtain a constructive trust, the claimant must (a) show fraud or mistake in the acquisition of property and (b) be able to trace the property. The bankruptcy court for the District of Colorado held that the funds that the debtor transferred to the investor were subject to a constructive trust, and did not constitute estate property for transfer avoidance purposes. The court of appeal reversed the decision. Baldcock J disagreed with the tracing rule of the lowest intermediate balance in this case. His Honour stated:

> In a bankruptcy proceeding, the bankruptcy court must weigh the claims of the remaining creditors before employing an equitable fiction such as the lowest intermediate balance rule. The court did not determine if the equities supported the use of the tracing fiction.[136]

[132] Ibid 29.

[133] Ibid.

[134] Ibid 32.

[135] 275 F 3d 924 (2001).

[136] Ibid 928.

The 10th Circuit seems to be following the pattern set by the 6th Circuit in *Re Morris*, where the constructive trust will only be awarded in special circumstances.

Re Foster reveals the reluctance of the American courts to award a constructive trust in bankruptcy where the claimant merely has an unsecured claim and is trying to establish ownership of property of the estate. Kenney[137] argues that this reluctance is necessary to avoid one party elevating its claims over other similarly situated creditors, 'thereby doing violence to the fundamental element of equality of treatment among similarly situated creditors'.[138] These arguments share many of the concerns articulated by Sherwin some time earlier. The role of equity in the commercial setting raises concerns with certainty in a complex area of law and business.

Newman J also revealed this caution in awarding a constructive trust where other creditors (or fraud victims) were similarly situated. The case of *SEC v Credit Bancorp Ltd*[139] leaves the award of a constructive trust open for special circumstances, but reaffirms the 6th and 10th Circuit decisions to disallow a constructive trust where other creditors are similarly situated to the claimant.

The debate over the role of the constructive trust in bankruptcy continues. The American courts of appeal, while prima facie stating that the constructive trust runs against the principles of the *Bankruptcy Code*, have refused to exclude the remedy from the bankruptcy setting. Equity's age old argument that there are some situations where flexibility of remedy is required appears to ring true. While some commentators state that the commercial setting requires certainty, there are some situations where certainty would create an unfair result. The position in America currently is that prima facie the constructive trust will not be awarded in bankruptcy where creditors are similarly situated to the claimant. However, if the claimant can show his or her equity to be over and above that of other creditors, the constructive trust remains a remedy that can be awarded to exclude property from the bankrupt's estate under s 541(d).

Conclusion

Much controversy surrounds the employment of equitable remedies in the commercial context in both Canada and America. No remedy demon-

[137] B F Kenney, 'Constructive Trusts: A Response' (2001) 19(10) *American Bankruptcy Institute Journal* 10.

[138] Ibid 20.

[139] 290 F 3d 80 (2002).

strates this more aptly than the constructive trust. While in both jurisdictions proprietary remedies, and, in particular, the constructive trust, have been used as remedies in the commercial context, the principles underlying their application nevertheless remain unclear. At the heart of the debate in both jurisdictions is the conflict between a perceived need for certainty in the commercial context, particularly in the bankruptcy setting, and a competing need to prevent an unfair result that may ensue without the use of the constructive trust.

In American bankruptcy cases, the prima facie position is that the constructive trust will not be awarded, as it appears to be contrary to the policy rationale of the *Bankruptcy Code* to allow one creditor to circumvent the code's system of asset distribution using a constructive trust. However, several circuits in the United States have nonetheless awarded a constructive trust, but only in limited circumstances of unjust enrichment, provided there are no creditors similarly situated to the plaintiff. The Canadian judiciary has displayed a greater willingness to utilise the constructive trust in a commercial setting, and has used the constructive trust both where there has been unjust enrichment and where the defendant has acquired property by committing a wrongful act. In both jurisdictions, a constructive trust will not be imposed without considering whether 'good conscience' dictates that another remedy is available, or without taking into account third party interests. The Canadians share the American concern to protect third parties' rights and require good reason for subordinating creditors' rights to those of the plaintiff, both in cases of unjust enrichment and where the defendant has committed a wrongful act. In cases of unjust enrichment, in both jurisdictions an enrichment and corresponding deprivation is considered as between both the defendant and plaintiff a threshold question. Following this, a comparison is made between the plaintiff and other creditors to see whether the plaintiff should be set apart from other creditors who would be unjustly enriched by enlargement of the defendant's asset pool.

As the constructive trust is only available (apparently) in the United States in cases of unjust enrichment, property rights are always at stake in these cases. Before a constructive trust can be awarded, it is a requirement that property or visibly traceable products of the property represent the unjust enrichment. Nevertheless, the equities of the case must still be weighed up before a constructive trust will be awarded. In sharp contrast to the American position, Canadian case law demonstrates that ascertainable property is not critical to the imposition of the constructive trust, since the wrongful act might be grounded in a variety of principles, such as tort or fiduciary duties. Isolating a property right is, however, highly advantageous, since when a property right is at stake, proprietary remedies may be available as of right. However, when other non-property

rights are at stake, a proprietary remedy may still be awarded, but only if the equities of the case dictate that justice can only be done by its imposition. At the beginning of this article a concern with the Australian legal system was identified. This concern was uncertainty over how to apply proprietary remedies in a commercial context. Out of results reflected in this article, several conclusions regarding a common approach can be reached:

1. Both Canada and the United States use proprietary remedies in commercial settings, including bankruptcy.
2. However, the courts in these two jurisdictions, similar to courts in England and Australia, demonstrate a sensible reluctance to allow proprietary remedies in commercial contexts.
3. Although it is not completely clear how proprietary remedies are reached (both jurisdictions seem to agree that one way to achieve such remedies includes unjust enrichment), in both jurisdictions it seems to involve some balancing of the interests of the proprietary remedy claimant and the unsecured creditors. Where it is possible, a different remedy will be ordered. This is McLachlin J's fourth point in *Korkontzilas v Soulos*,[140] and it explains the use of the equitable lien in both *Lord Napier and Ettrick v Hunter*[141] and *Giumelli v Giumelli*.[142] In *Giumelli v Giumelli*, Gleeson CJ, McHugh, Gummow and Callinan JJ held that:

> 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.[143]

Their Honours cited *Bathurst City Council v PWC Properties Pty Ltd*[144] and *Napier v Hunter*[145] to support this statement. At the heart of *Giumelli v Giumelli* was the question of 'whether sufficient weight was given by the [lower court] to the various factors to be taken into account, including the impact upon relevant third parties.'[146] With reference to this, their Honours cited McLachlin J in *Korkontzilas v Soulos*. Perhaps this primary concern with the interests of unsecured creditors is the point of commonality between all the jurisdictions that

[140] (1997) 146 DLR (4th) 214.
[141] [1993] AC 713 ('*Napier v Hunter*').
[142] (1999) 196 CLR 101.
[143] Ibid [10].
[144] (1998) 157 ALR 414, 425-6.
[145] [1993] AC 713, 738, 744-5, 752.
[146] (1999) 196 CLR 101, 115.

are being considered. As Worthington has noted, much of Professor Goode's work[147] has been a reaction to the belief:

> that unsecured creditors are receiving a raw deal ... because of the growth in unprincipled awards of proprietary restitutionary remedies to competing claimants.[148]

This concern with the impact of proprietary remedies upon third parties is the point of commonality between all these varied jurisdictions.

4. The 'tailorability'[149] of proprietary remedies is vital to property's role as a remedy. The notion of tailorability is part of the necessary flexibility of utilising property as a remedy. The flexibility of the commencement date of the constructive trust may be evidence of its tailorability. The tailorability of the equitable proprietary remedy of subrogation was also demonstrated in the House of Lords decision in *Banque Financiere de la Cite v Parc (Battersea) Ltd.*[150] The same is true with the equitable proprietary remedy of the equitable lien. Both English[151] and Canadian[152] cases involving equitable liens have permitted proportional claims against surplus value of the sold asset exceeding the amount of the defendant's claim. However, an equitable lien will be ordered, but without such generous features, where the claimant has engaged in some relevant wrongdoing. The versatility of the equitable lien has been demonstrated in the Canadian case of *International Corona Resources Ltd v LAC Minerals Ltd.*[153] There the Ontario Court of Appeal ruled that despite the fact that the defendant held the property on constructive trust for the plaintiff, the defendant was entitled to an equitable lien related to the costs it had incurred in

147 Which includes 'Proprietary Restitutionary Claims', above n 7; 'Property and Unjust Enrichment', above n 29; and 'The Recovery of a Director's Improper Gains: Proprietary Remedies for the Infringement of Non-Proprietary Rights' in McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (1992).

148 S Worthington, 'Three Questions on Proprietary Restitutionary Claims' in W Cornish et al (eds), *Restitution: Past, Present and Future* (1998). See also A J Oakley, 'The Precise Effect of the Imposition of a Constructive Trust' in S Goldstein (ed), *Equity and Contemporary Legal Developments* (1992) 451-6.

149 This term was used by Wright, 'Proprietary Remedies and the Role of Insolvency', above n 10. This term means the minor modification of an existing remedy.

150 [1999] 1 AC 221. On this point, see C Mitchell, 'Subrogation, Unjust Enrichment and Flexibility' [1998] *Restitution Law Review* 144, 148-9. The effect of this tailorability may be to limit the general nature of the 'propertiness' of this remedy.

151 *Hussey v Palmer* [1972] 1 WLR 1286 and *Re Tilley's Will Trusts* [1967] Ch 1179.

152 *BC Teachers' Credit Union v Betterly* (1975) 61 DLR (3d) 755 and *Benjamins v Chartered Trust Co* (1965) 49 DLR (2d) 1.

153 (1987) 44 DLR (4th) 592. The Ontario Court of Appeal's judgment was affirmed on this point by the Supreme Court in (1989) 61 DLR (4th) 14.

improving the land. The Court so held 'in light of the reality that the expenditure made by [the defendant] to make the property productive inevitably would have been required on the part of [the plaintiff] had there been no breach of the constructive trust.'[154] In granting the constructive trust, the Court held that it possessed the power to 'relieve the constructive trustee from full liability where to refrain from doing so would, in all the circumstances, be inequitable.'[155]

In America, Laycock,[156] echoing the sentiments of Dobbs,[157] observes that the lien is an order imposed by the court in circumstances similar to those of a constructive trust.[158] In addition, there are cases that show some flexibility in the nature and extent of an equitable lien. In *Re Erie Trust Co*,[159] the order of an equitable lien was limited to the amount of 'actual losses' suffered by a plaintiff due to the fact that the defendant was insolvent. The court was prepared to limit the amount although misappropriated funds had been used to acquire property that had appreciated. The imposition of a constructive trust would lead to the plaintiff capturing the gains. In the case of an insolvent defendant, this would lead to fewer funds being available to unsecured creditors. *Robinson v Robinson*[160] held that the lien is a remedy and not a property right, in that one could not get a lien to secure other debts.[161] The case also supports the view that the equitable lien can be used to limit the claim of a plaintiff to the amount of their actual loss.

The American case of *Jones v Sacramento Savings & Loan Association*[162] clearly indicates the tailorability of the equitable lien. An important characteristic of the equitable lien is the ability to foreclose upon the property and recover the money due from those funds. However, in *Jones v Sacramento Savings & Loan Association*, where neither party was very culpable, the court tailored the equitable lien so that it did not have this foreclosure characteristic. This characteristic

154 (1987) 44 DLR (4th) 592, 661.

155 Ibid.

156 D Laycock, *Modern American Remedies: Cases and Materials* (2nd ed, 1994).

157 D Dobbs, *Handbook on the Law of Remedies* (2nd ed, 1993) vol 1.

158 Laycock, above n 156, 582.

159 191 A 613 (Pa, 1937).

160 429 NE 2d 183 (Ill App, 1981).

161 Here, the debts due to an estranged wife for maintenance were supposedly secured through the imposition of a lien over the husband's award in a proprietary estoppel case. The plaintiff, the estranged wife, was also awarded equitable relief in the same proprietary estoppel suit as the husband, and the lien was imposed for debts other than those that arose in the present circumstances. This was held to be invalid.

162 56 Cal Rptr 741 (Cal App, 1967).

was excluded in order to prevent 'undue hardship' to the party that owned the property.[163] Tailorability of proprietary remedies is essential to their usefulness as remedies.

5. The search should be for the most 'appropriate' remedy. A primary determinant of what is the 'appropriate' remedy is the obligation that has been breached. For example, an obligation based on a legal wrong can have different remedial consequences compared to an obligation based on unjust enrichment. With the doctrine of precedent, the nature of the obligation simply expands the remedies available to the courts. The experience of the United States and Canada with proprietary remedies is important to our judiciary for the correct application of these rare but powerful remedies.

[163] Ibid 747.