

THE REMEDIAL RESTITUTIONARY PROPRIETARY REMEDY: AN EVALUATION OF THE EXTENT TO WHICH PREFERENTIAL RECOVERY SHOULD BE AVAILABLE FOR THE RECOVERY OF MONEY

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I. PRELIMINARY: THE RECOGNITION OF THE REMEDIAL RESTITUTIONARY PROPRIETARY REMEDY

Some 30 years ago Goff and Jones challenged orthodox legal thinking by suggesting, “that equitable proprietary rights may be granted to prevent unjust enrichment.”¹ They argued that “[e]ach case should be considered on its merits to decide whether the claimant should have the additional benefits which proprietary rights afford.”² *In Re Goldcorp Exchange Ltd (In Rec)*³ the Privy Council, adopting the formulation advanced in *Goff and Jones, The Law of Restitution*,⁴ accepted that the courts can create a remedial restitutionary proprietary right, pursuant to which a plaintiff, is “deemed to have retained equitable title” to money in a defendant’s possession.⁵

This remedy is all about the conferment of preferential treatment upon a plaintiff. As such it raises two issues. The first issue is, in what circumstances should the courts be willing to deem that the plaintiff has retained equitable title. The second issue is, the nature or extent of this preferential treatment. Assume that acting under the influence of a mistake you pay me the sum of \$1,000.00 twice. Unaware of your mistake, I use the second and mistaken payment to purchase a painting of an unknown painter. That painter subsequently becomes fashionable and the painting is now worth \$10,000.00. *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd*⁶ suggests that preferential recovery may be available. But what form should this take? Should you receive an equitable charge (i.e. a security interest) over the painting for the value of your mistaken payment? Or should you be able to transform the deemed equitable ownership of the money into equitable ownership of the painting — something now worth \$10,000.00?⁷

It is this second issue, “What is the extent to which preferential treatment should be conferred?” which this article addresses. It is submitted that significant guidance is provided by a number of existing remedies for the recovery of money. In Part II the preferential treatment which is associated with the recovery of trust money is examined. This examination reveals that there are both several forms which preferential treatment may take and several approaches to tracing.

* I would like to thank Mr J M Hanan for his comments on a draft of this article.

1 R Goff and G Jones, *The Law of Restitution* (1st ed, 1966) 43.

2 *Ibid.*

3 [1994] 3 NZLR 385 (PC).

4 G Jones, *Goff and Jones, The Law of Restitution* (4th ed, 1993) 94 (hereafter referred to as “*Goff and Jones*”).

5 *Supra*, note 3 at 404 per Lord Mustill.

6 [1981] Ch 105.

7 See generally Andrew Burrows, *The Law of Restitution* (1993) 36-38; *Goff and Jones op cit*, note 4 at 95-98.

The common law claim for “money had and received” may also confer a degree of preferential treatment. This preferential treatment is especially dealt with in Part III. Similarities and fundamental differences in respect of the preferential treatment which is available for the recovery of trust money and the recovery of one’s money⁸ are here examined. The resulting comparison culminates in Part IV and a general consideration of the preferential treatment which on the authorities, can now be inferred and it is submitted, should be available with a remedial restitutionary proprietary remedy.

II. PREFERENTIAL TREATMENT AND THE RECOVERY OF TRUST MONEY

1. Introduction

(a) *The application of existing tracing rules and presumptions*

Preferential treatment for the recovery of money is usually associated with the recovery of trust money from an insolvent trustee and/or a trustee who has breached the terms of the trust. One solution is to regard the equitable title which the Privy Council suggests is deemed to have been retained, as if it were a pre-existing equitable interest and apply the existing equitable tracing rules and presumptions. There are some attractions with this solution. Nevertheless the indiscriminate application of these rules and presumptions is inappropriate. They were developed to protect a beneficial owner against a dishonest and usually insolvent trustee. They may not be appropriate outside that context.⁹ Indeed, *Re Goldcorp Exchange Ltd* contains Lord Mustill’s warning, that it is “unprofitable [to consider the application of tracing rules] without a clear understanding of when and how the equitable interest arose, and of its nature.”¹⁰ Confirmation that the specific circumstances surrounding a claim to trace are important is provided by the fact that Equity distinguishes the ‘dishonest’ recipient of trust money from the ‘innocent’ voluntary recipient thereof.¹¹

(b) *Guidance which the equitable tracing rules can provide*

The remedial restitutionary proprietary remedy should be regarded as an evolution in the recognition of proprietary interests and the conferment of preferential recovery. A moment’s reflection reveals how the preservation of one’s property provides an attractive rationale for conferring preferential recovery.¹² While the passage of time may have given credence or legitimacy to earlier judicial decisions as to the recognition of,¹³ or continuation of,¹⁴ proprietary interests (and the associated preferential treatment), it certainly appears that these decisions were motivated by

8 “One’s money” refers to the situation in which the plaintiff is the legal owner of the money and he or she is asserting that ownership against another.

9 *Goff and Jones*, op cit, note 4 at 83.

10 *Supra*, note 3 at 405 per Lord Mustill.

11 *Sinclair v Brougham* [1914] AC 398, 442-3.

12 As Professor Grey has commented, “[t]he value-laden mystique generated by appeals to ‘property’ exerts a powerful ... moral leverage.” Kevin Grey, “Property in Thin Air” [1991] CLJ 252,305.

13 Two examples are the equitable interest of a purchaser of land: *Phillips v Silvester* (1872) LR 8 Ch App 173, *Clarke v Ramuz* [1891] 2 QB 456; and the vendors lien: *Mackreth v Symmons* (1808) 15 Ves Jr 329; 33 ER 778.

14 Consider the general rule that if a person entrusts his or her property to an agent to be sold, the purchase monies become the property of the principal: *Foley v Hill* (1848) 2 HL Cas 28.

policy reasons. The language of ‘property’ was more often than not simply a mechanism to implement these considerations. Policy decisions are displayed in the recent cases of *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd*,¹⁵ *A-G for Hong Kong v Reid*,¹⁶ and *Napier v Hunter*.¹⁷ Underlying the existing equitable tracing rules and presumptions are policy considerations which are equally applicable to the remedial restitutionary proprietary remedy. For this reason, while their indiscriminate application may be inappropriate, they may provide significant guidance.

It is fairly evident that there are three specific factors which have been instrumental and which are relevant for the development of the remedial restitutionary proprietary remedy. These are:

- (i) the nature of the preferential treatment sought;
- (ii) the ability to identify what has happened to the money; and
- (iii) the relationship between the plaintiff and the immediate recipient of the money.

2. An Overview

To summarise, the ‘law’ has gone to considerable lengths to protect equitable interests against insolvent trustees and/or trustees who have breached the terms of their trust. This has been achieved through the development of three general responses, virtually hardened into rules. The first rule (and the rule which provides the basis for protection against a trustee’s insolvency) is that should the trustee become insolvent, equitable ownership of trust property does not pass to the Official Assignee (or equivalent).

The next two rules arise when trustees are in breach. The first of these rules is premised upon the fiction that the misappropriation of trust money and its employment in the acquisition of an asset can be transformed into an authorised alteration in the composition of the trust property.¹⁸ Equity’s second response is to recognise that the beneficiary’s equitable interest in the trust property survives the transfer of the legal title to those who are unable to plead bona fide purchaser for value without notice.

These responses are relatively easy to understand but the way they apply and relate to one another is not so easy; indeed, they may be “highly technical and often irrational”.¹⁹ The problem is trying to rationalise cases when so many of the results appear to be so different.²⁰ But why has this occurred? It would seem that part of the cause arises from the existence of different preferential treatments which an aggrieved party may seek. Three clear situations stand out:

15 [1986] 1 WLR 1072 (PC). The availability of an equitable charge over the assets of an insolvent bank trustee.

16 [1994] 1 NZLR 1 (PC). The imposition of a constructive trust so as to facilitate the preferential recovery of bribes paid to a fiduciary.

17 [1993] 1 All ER 385 (HL). The imposition of an equitable lien over the proceeds of a settlement so as to facilitate the recovery of money by an insurer.

18 *Re Hallett’s Estate, Knatchbull v Hallett* (1879) 13 Ch D 696 (CA), 709.

19 *Goff and Jones*, op cit, note 4 at 86.

20 A classic example is provided by *Re Hallett’s Estate* supra, note 18 and *Re Oatway Hertslet v Oatway* [1903] 2 Ch 356.

- (i) when the defendant is insolvent (“the insolvency preference”);
- (ii) when the defendant has profited (“the profit preference”). An example is when a breaching trustee has used ‘trust’ money to acquire an asset. The beneficiary can normally claim equitable ownership of that asset with the result that if it’s value has appreciated the beneficiary acquires the increased value too;²¹ and
- (iii) when the defendant is not the immediate wrongdoer but a subsequent party (“the subsequent recipient preference”). An example is when a beneficiary seeks to recover trust money from a party who was given it by the trustee.

A claim for preferential treatment may also be a combination of all or some of these preferences.

When one closely examines these forms of preferential treatment it becomes clear that there is a hierarchical approach in respect of the courts willingness to confer them. This is important for the remedial restitutionary proprietary remedy.

3. The insolvency preference claim

From an early stage in the development of the bankruptcy laws, it was recognised that trust property administered by an insolvent trustee should not be available for distribution amongst creditors. What is interesting is the extent to which the courts, when subsequently confronted with the problem of insolvent trustees who have misappropriated trust money, have developed sophisticated tracing rules and presumptions to identify trust property.²²

The term “direct substitution” tracing will be used to refer to the situation in which there is undisputed evidence that the trust money now resides in another specific and identified form. This situation is straightforward. Assuming only trust money has been used to acquire the asset, the beneficiary “may either take the property itself [i.e. assert equitable ownership of that property] or claim a lien on it for the amount of the [trust] money expended in the purchase [i.e. assert an equitable security over it].”²³ The former remedy is not available, however, if mixed funds have been used.²⁴

But what if there isn’t such evidence, for instance, if the trust money has been mixed in a bank account? An immediate difficulty is evidentiary, determining the identity of the withdrawals. Is it trust money? Non-trust money? Or a combination? The mixed bank account cases provide evidence of the court’s willingness to confer the insolvency preference upon a beneficiary. The ability to identify the trust money has been extended beyond the direct substitution approach. In some situations a more relaxed factual association between the trust money and a surviving asset is sufficient. As *Re Oatway*²⁵ displays, the fact that trust funds were

²¹ *In re Hallett’s Estate*, *ibid*; *Sinclair v Brougham* *supra*, note 11.

²² Recognising that this process was not so much concerned with the recovery of one’s property but the conferral of preferential treatment at the expense of the trustee’s unsecured creditors, Sir George Jessel MR provided the now orthodox justification for it. He asserted baldly that “[n]o human being ever gave credit to a man on the theory that he would misappropriate trust money, and thereby increase his assets.” *In re Hallett’s Estate* *ibid*, at 730.

²³ *Sinclair v Brougham* *supra*, note 11 at 442 per Lord Parker.

²⁴ *Ibid*.

²⁵ *Supra*, note 20.

in the bank account at the time of a withdrawal is regarded as being sufficient to justify the conferral of a charge over any asset acquired with those funds. It is presumed that trust money has contributed towards the purchase of this asset.

In that case, although the fund had been extinguished, one of the earlier withdrawals had been used to acquire a parcel of shares. Applying a “mechanical interpretation”²⁶ of the *Hallett* presumption of an honest trustee who withdraws his or her money first,²⁷ the trust fund would have been regarded as extinguished. Joyce J responded by taking the view that this presumption required that the shares be regarded as representing the trust fund.²⁸ It is presumed that trust money survives in any asset acquired with the mixed fund. Indeed, it may be argued that the beneficiary can assert a charge for the amount of the trust money originally mixed in that bank account over both the bank account and any asset acquired with proceeds from that account.²⁹ *Re Oatway* further suggests that this charge is for the value of the trust money deposited in the mixed bank account, as opposed to the value of the trust money which may have been used in the purchase. This approach to tracing is referred to as “presumed substitution” tracing.

The presumed substitution approach is favourable to the beneficiary. In some situations, however, it may not be favourable enough. There may be evidence that the trustee’s assets have increased as a result of the misapplication of trust money, but insufficient evidence associating the trust money with the acquisition of any particular asset. In *Sinclair v Brougham*³⁰ approximately £10.7 million of depositors’ money had been mixed with approximately £1 million of shareholders’ assets in the operation of what was an ultra vires banking business. The nature of the business, the amount of money and the number of transactions was such that neither the direct substitution nor the presumed substitution approaches to tracing were capable of identifying the depositors’ money. As a matter of fact, however, the depositors’ money must have contributed towards the acquisition of the approximately £12 million of assets which was then owned by the insolvent business. Given this graphic evidence of an accumulation in assets which could not be explained by reference to only the shareholders’ funds, it is not surprising that the House of Lords held that the depositors could ‘trace’ their money into these assets. This approach to tracing will be referred to as one of “surviving enrichment”. Its focus is not on the acquisition of any specific asset with trust money but whether in the final analysis trust money must have been used to acquire the assets.

²⁶ *Goff and Jones*, op cit, note 4 at 87.

²⁷ The initial solution to this problem was the “first in first out” rule developed by Sir William Grant MR in *Devaynes v Noble; Clayton’s Case* (1816) 1 Mer 572; 35 ER 781 at 608-610; 793. In *re Hallett’s Estate*, supra, note 18 at 727, Jessel MR postulated the notion of a presumptively honest trustee and applied it to trustees who if not actually dishonest, have breached the trust. He observed that a trustee who in breach of trust has mixed moneys with his or her own, “cannot be heard to say that he [or she] took away the trust money when he [or she] had a right to take away his [or her] own money.”

²⁸ *In re Oatway* supra, note 20 at 360.

²⁹ Support for this argument is provided by Lord Parker’s observation in *Sinclair v Brougham*, supra, note 11 at 442, that “[t]he trustee is precluded by his own misconduct from asserting any interest in the property until ... [the trust money extended in its purchase] has been refunded.” While this observation appears to have been made in the context of one asset acquired with mixed money, it is submitted that it accurately reflects the position.

³⁰ *Ibid.*

The high-water mark of this favouritism is *Space Investments Ltd.*³¹ Pondering the situation where a bank trustee makes an unauthorised loan of trust money to itself, mixes that money and subsequently becomes insolvent, Lord Templeman considered that the inability to specifically identify the trust money would not be fatal. He observed:

Equity allows the beneficiaries, or a new trustee appointed in place of an insolvent bank trustee to protect the interests of the beneficiaries, to trace the trust money to all the assets of the bank and to recover the trust money by the exercise of an equitable charge over all the assets of the bank. Where an insolvent bank goes into liquidation that equitable charge secures for the beneficiaries and the trust priority over the claims of the customers in respect of their deposits and over claims of all other unsecured creditors. This priority is conferred because the customers and other unsecured creditors voluntarily accept the risk that the trustee bank might become insolvent and unable to discharge its obligations in full. On the other hand, the settler of the trust and the beneficiaries interested under the trust, never, accept any risks involved in the possible insolvency of the trustee bank.³²

It is important to recognise that Lord Templeman was considering the situation where it is a matter of pure conjecture whether the trust money has been absorbed into the trustee's assets, employed in the acquisition of any surviving asset, or simply dissipated. As a matter of policy, however, Lord Templeman considers that the beneficiary should be accorded preferential treatment through the medium of a charge. Such tracing shall be referred to as "protective presumed retention". While his Lordship's views were applied by Cooke P in *Liggett v Kensington*,³³ when that case came before the Privy Council, Lord Mustill reiterated the orthodox view that tracing is defeated by evidence that the trust funds have in fact been dissipated, for instance by being paid into an overdrawn account.³⁴ The views of Lord Mustill were subsequently followed in *Bishopsgate Investment Management Ltd (In Liq) v Homan*.³⁵

4. The profit preference

While claims for an insolvency preference may be the most common form of preferential treatment which a beneficiary may seek, it is not the only form. A beneficiary may also seek to recover the profit which the trustee has made through the successful 'investment' of the trust moneys in an appreciating asset ("the profit preference"). The foundation for this preference is the general prohibition against a trustee dealing with the trust property for personal benefit. Any trustee engaging in such unauthorised activities is required to account to the beneficiary for the resulting profit. In some situations this personal remedy may be elevated into a right of property and it is with such situations that this section is concerned.

The classic situation in which a profit preference is available occurs when there is direct evidence that the trustee has acquired the appreciating asset solely with trust money. In such situations the beneficiary can assert equitable ownership of that asset and thereby gain the full benefit of the appreciation.³⁶ Underlying the elevation of the personal remedy into a right

³¹ *Supra*, note 15.

³² *Ibid.*, at 1074.

³³ [1993] 1 NZLR 257 (CA).

³⁴ *Re Goldcorp Exchange Ltd* *supra*, note 3 at 405.

³⁵ [1994] 3 WLR 1270 (CA).

³⁶ *Phipps v Boardman* [1976] 2 AC 46 (HL) suggests that the trustee may have a claim for reimbursement of expenses and an allowance but see *Guinness Plc v Saunders* [1990] 2 WLR 324 (HL).

of property is the fiction that the breach of trust can be transformed into an authorised act which was done by the trustee in execution of his or her duties. As Lord Templeman noted in *A-G for Hong Kong v Reid*, equity considers as done that which ought to be done.³⁷

If the trustee is insolvent, the profit preference can be amalgamated with the insolvency preference so as to confer preferential recovery upon the beneficiary, not only for the original value of the trust fund but also for the profit. Reid provides a recent example of this. There bribes received by a fiduciary were invested in the purchase of farm land. Underlying the conferral of this double preferential treatment is the policy that the trustee's unsecured creditors should be in no better position than the trustee was in.³⁸

An interesting aspect of the profit preference is that the courts appear to have adopted a conservative approach to its availability. This should be contrasted to the courts' apparent willingness to confer the insolvency preference so as to facilitate the recovery of the original value of the trust money. Especially is this conservatism apparent where not all the moneys used are trust money. Clearly the beneficiary cannot assert full equitable ownership of the appreciating asset. Subject to the trustee recovering his or her contribution to the purchase price, however, it can be argued that as a sanction against the trustee's breach of trust all the profit should go to the beneficiary. While for many this may be an attractive argument, it does not appear to have been accepted. With the exception of an unusual Australian decision,³⁹ there is, at the most, general judicial support for the view that the beneficiary and trustee share the resulting profit proportionate to their respective contributions.⁴⁰ There is even some suggestion that the beneficiary is only entitled to assert a security interest over the property for the value of the trust money employed in its acquisition.⁴¹

Even in those cases in which the courts have acknowledged that the beneficiary can recover a proportion of the profit, there appears to be a reluctance to find that the trust money has in fact been used. Consider *Re Tilley's Will Trusts*.⁴² Mrs Tilley was the executrix and life tenant of her husband's estate. In breach of trust she deposited trust money into her personal bank account. Over the ensuing years she used the funds from this account and a pre-arranged overdraft facility to acquire a number of houses. Following her death the reversionary beneficiaries of the late husband's estate sought to recover a share of the profit. While Ungood-Thomas J considered that as a general rule the mere use of trust money in the acquisition of another asset should entitle the beneficiaries to a proportionate share of the resulting profit (if any), he held that in the circumstances of this case this rule was inapplicable. But why? Ungood-Thomas J advanced a number of reasons, including: the fact that the trust moneys "bore a small proportion to the purchase price"; Mrs Tilley's "ample overdraft facilities"; the innocent breach of trust; a finding that Mrs Tilley

37 *Supra*, note 16 at 4.

38 *Ibid.*

39 *Australian Postal Corporation v Lutak* (1991) 21 NSWLR 584. See also *Paul A Davies (Australia) Pty Ltd (In Liq) v Davies* [1983] 1 NSWLR 440.

40 *Re Tilley's Will Trusts* [1967] 2 WLR 1533 and *Scott v Scott* (1962) 109 CLR 649 (HC Aust).

41 *Re Hallett's Estate supra*, note 18 at 709.

42 *Supra*, note 40.

never intended to use this money with which to acquire the property; and that “the trust moneys were not invested in properties at all but merely went in reduction of Mrs Tilley’s overdraft which was in reality the source of the purchase-moneys.”⁴³ While there is some judicial support for the last justification,⁴⁴ clearly some of these reasons are inconsistent. One is left with the suspicion that his Honour was of the view that the recovery of the original value of the trust money would sufficiently remedy the breach of trust.

Mixed funds give rise to two difficulties for a beneficiary seeking the profit preference. The first difficulty is evidentiary. Was it trust monies which were used in the purchase? It was to address such problems in the context of the insolvency preference, that the presumed substitution approach was developed. While a presumption as to the perpetuation of the trust money has been used to justify the conferment of the insolvency preference, it can be argued that such a presumption is insufficient to justify the availability of the profit preference. After all, unless there is clear proof of a direct contribution, the division of any profit must be arbitrary.⁴⁵

The second difficulty is one of legal logic. This suggests that any equitable interest claimed by the beneficiary in respect of the after acquired asset can only be one of a security interest. At outset the beneficiary only held a security interest over the mixed fund. So logically, this interest could not grow into something larger. Certainly not into an actual ‘ownership’ interest. But consider the example of the trustee who deposits \$150.00 of misappropriated trust money into his account in which there is an existing credit balance of \$100.00. He subsequently withdraws \$100.00 and buys an asset with it. The remaining \$150.00 is dissipated on good living. *Re Oatway*⁴⁶ suggests that if the trustee is insolvent the beneficiary can assert a charge over the asset for the trust money and that charge will be for \$150.00. It follows that if the shares appreciate up to \$150.00 all the profit will be the beneficiary’s pursuant to the charge. If this is a true interpretation of *Re Oatway* it appears then that Equity is willing to confer the benefit of the appreciation upon the beneficiary to the extent that this is necessary to restore the value of the trust money.

5. Subsequent recipient preference

(a) Overview

The vulnerability of the equitable interest to destruction is due to the fact that the trustee, as the legal owner of the trust property, is able to transfer legal title to others (“subsequent recipients”). The judicial response has been to recognise that the equitable interest may survive this transfer. If the subsequent recipient has not given any consideration for the trust

⁴³ *Ibid*, at 1545-1546.

⁴⁴ *In Re Registered Securities Ltd* [1991] 1 NZLR 545 (CA) Somers J at 554 considered that “as a matter of logic” the deposit of trust money into an overdrawn bank account precluded the possibility of any further tracing. See also *Re Goldcorp Exchange Ltd* *supra*, note 3 at 222.

⁴⁵ While a “rolling charge” approach may address this criticism, in many situations its application may be impractical. The rolling charge solution “involves treating credits to a bank account made at different times and from different sources as a blend or cocktail with the result that when a withdrawal is made from that account it is treated as a withdrawal in the same proportions as the different interests in the account ... bear to each other at the moment before the withdrawal is made.” *Barlow Clowes International (In Liq) v Vaughan* [1992] 4 All ER 22 (CA), 35 per Woolf LJ.

⁴⁶ *Supra*, note 20.

property or if he or she has had ‘notice’ of the trust, his or her legal ownership is subject to the pre-existing equitable interest. An interesting aspect of this response is the steps which the courts have taken to determine the extent of the subsequent recipient’s liability. The immediate difficulty confronting the courts is that the recipient may have dissipated the trust money. In response to such concerns the courts have developed two specific remedies. These are the “knowing receipt” and the “Tracing” remedies.

A degree of overlap exists but these remedies are fundamentally different. The Tracing Remedy is directed at the donee of a gift or the purchaser of money who, while not having ‘knowledge’ that its transfer was in breach of trust, had ‘notice’ of the trust. The focus of the knowing receipt remedy, however, is on those subsequent recipients who are guilty of a want of probity or honesty. A defendant of the former must simply restore the identifiable surviving money. But because of his or her knowledge, the defendant of the latter is invariably punished. He or she suffer the “full burdens of trusteeship”.⁴⁷

The existence of this claim for preferential recovery and the development of two, quite different remedies with which to implement it, is of further significance for the remedial restitutionary proprietary remedy. It suggests that knowledge of a pre-existing relationship is an important factor in determining the liability of parties outside of the relationship.

(b) *The Tracing Remedy*

While the knowing receipt remedy is perhaps the best known⁴⁸ of these two remedies, the Tracing remedy, being an application of the general response noted above, provides a foundation upon which the former remedy builds. For that reason the Tracing remedy is considered first.

Regarded by some as an application of the law of priorities,⁴⁹ this remedy is based on the fact that a pre-existing equitable interest may survive the transfer of legal title to another. *Sinclair v Brougham*⁵⁰ confirms its application to money and that the trust money in the possession of the subsequent recipient can be further protected through the application of tracing rules. Because the recipient is innocent of wrongdoing, he or she is obliged to return only the identifiable trust money which remains in his or her possession.⁵¹

While the ability to trace the trust money is an integral component of the Tracing remedy, it is significant that the rules and presumptions which are applied are more sympathetic towards the interests of the subsequent recipient than those which are applicable to the express trustee and the

47 *In re Montagu's Settlement Trusts* [1987] 2 WLR 1192, 1200 per Sir Robert Megarry V-C.

48 As Professor Rickett has observed, “[s]tranger liability has historically been divided into ‘knowing receipt’ and ‘knowing assistance’ categories.” CEF Rickett, “Strangers as Constructive Trustees in New Zealand” (1991) 11 OJLS 598, 601. See also JK Maxton, “Equity” [1990] NZ Recent Law Review 89, 91-92.

49 RP Austin, “Constructive Trusts”, from Finn (ed) *Essays in Equity* (1985) 214-215 and M Cope *Constructive Trusts* (1992) 380-381.

50 *Supra*, note 11. See also *Re Diplock* [1948] 1 Ch 465 at 536-537.

51 *Sinclair v Brougham* *ibid* at 442-3 per Lord Parker. See also *In re Montagu's Settlement Trusts* *supra*, note 47 at 1203. It may be argued that “justice between the parties” (*O'Sullivan v Management Agency and Music Ltd* [1985] Ch 428, 468 per Fox LJ) demand that the innocent third party should have a claim for an allowance to reflect his or her skill and labour in preserving the trust property and/or increasing its value.

knowing recipient.⁵² Nevertheless, the Tracing remedy has the potential to confer both recovery in excess of the trust money so received⁵³ and preferential recovery should the subsequent recipient be insolvent.

(c) *The knowing receipt remedy*

In its classic form the knowing receipt remedy becomes available when the subsequent recipient receives for his or her own benefit, trust money which he or she ‘knows’⁵⁴ is trust money and which has been transferred to him or her in breach of trust.⁵⁵ Once liability is determined, the subsequent recipient becomes personally liable to repay the value of the trust money so received.⁵⁶ Equity also imposes “the full burden of trusteeship”⁵⁷ upon the subsequent recipient.⁵⁸ Not only is the money deemed to be held on trust for the beneficiary but the same tracing rules and presumptions which apply to express trustees are available to the beneficiary.⁵⁹ As with the Tracing remedy, the availability of tracing confers the ability to acquire both insolvency and profit preferences against the subsequent recipient.

6. Guidance for the remedial restitutionary proprietary remedy

The preceding examination has displayed the extensive steps which the courts have been prepared to go in conferring preferential treatment for the recovery of trust money. While the indiscriminate application of this preferential treatment to the remedial restitutionary proprietary remedy may be inappropriate, it can provide significant guidance for that remedy. Indeed, the preceding examination is immediately useful for disassociating the availability of preferential treatment from claims for preferential recovery on the defendant’s insolvency. While the primary motivation for the development of the remedial restitutionary proprietary remedy has been to obtain an insolvency preference, subsequent calls for preferential treatment may not be so restricted.⁶⁰ The preceding examination also shows that the courts are more willing to confer preferential treatment when the claim is one for the insolvency preference. For example through the

⁵² In contrast to the express trustee or knowing recipient, the ‘innocent’ subsequent recipient who mixes trust money with his or her own money in the acquisition of a depreciating asset, for instance, does not bear the loss alone; the loss is shared *pari passu*. *Sinclair v Brougham* *ibid* at 442-3 per Lord Parker; *In re Diplock* *supra*, note 50.

⁵³ This would occur when the defendant has used the trust money (and only that money) to acquire another asset which has subsequently appreciated in value.

⁵⁴ There is considerable disagreement amongst members of the judiciary and academics as to the degree of knowledge which is required.

⁵⁵ The knowing receipt remedy is also available in those circumstances in which an innocent third party “acquires [knowledge] subsequent to such receipt and then deals with the property in a manner inconsistent with the trust.” In this situation the knowing receipt remedy applies in respect to the trust money in the third party’s possession at the time he or she receives the knowledge. *Karak Rubber Co Ltd v Burden (No 2)* [1972] 1 WLR 602 at 632-633 per Brightman J. See also *In re Montagu’s Settlement Trusts* *supra*, note 47 at 1198.

⁵⁶ *In re Montagu’s Settlement Trusts* *ibid*, at 1203.

⁵⁷ *Ibid* at 1200 per Sir Robert Megarry V-C.

⁵⁸ The third party’s “in personam liability for a breach of trust is the same as an express trustee, that is the [third party], like a trustee, is liable to place the trust in the same position as it would have been if no breach had been committed and matters such as causation, foreseeability and remoteness are usually irrelevant in the calculation of the loss.” Cope, *op cit*, note 49 at 360-361. See also C Harpum, “The Stranger as Constructive Trustee” (1986) 102 LQR 114, 119. Indeed, as Mr Harpum notes at 267, some would argue that all that occurs in this situation is that the knowing recipient becomes a trustee of the original trust.

⁵⁹ *Sinclair v Brougham* *supra*, note 11 at 442-443.

⁶⁰ The learned author of *Goff and Jones* suggests that in appropriate circumstances a plaintiff should be able to recover any profit made by the defendant, *op cit*, note 4 at 95-98.

application of a more extensive approach to identifying trust money. To summarise. The ability to identify what has happened can vary from:

- (i) direct evidence (the “direct substitution” approach); to
- (ii) presumptions (the “presumed substitution” and “protective presumed retention” approaches); to
- (iii) evidence of a surviving accretion to the defendant’s overall wealth (the “surviving enrichment” approach).

The availability of the other preferential claims, however, appear to depend upon factual evidence of the application or receipt of the trust money. Before the profit preference is available, direct evidence of the use of the trust money in the acquisition of the asset appears to be required; presumed contributions as provided by the presumed substitution and presumed protective retention approaches being insufficient. While the approach to tracing to a subsequent recipient does not appear to have been the subject to judicial deliberation, a restrictive approach also appears to be warranted. Since the knowing receipt and Tracing remedies may impose a potential liability upon a subsequent recipient who may be quite innocent of any wrongdoing, as a matter of policy, there should be positive evidence of the transfer. The use of presumptions alone would be inappropriate. Support for such a restrictive approach is inherent in both the ‘notice’ and knowledge requirements of the Tracing and knowing receipt remedies.

Underlying this ‘hierarchy’ of the courts willingness to confer the particular forms of preferential treatment, there appears to be a recognition that the policy arguments in favour of conferring preferential treatment, (which is always at the expense of another), are strongest when the preference is directed at restoring the value of the trust money.

As was recently emphasised by *A-G for Hong Kong v Reid*,⁶¹ the underlying relationship is also important. Preferential treatment has been created and developed especially to reinforce and protect that relationship. Indeed, in *Reid* the fiduciary relationship between the parties was sufficient to justify the conferral of an insolvency preference with respect to the recovery of bribes; property which never belonged to the plaintiff Government. The importance of the underlying relationship may explain the focus given to the insolvency preference. Repeatedly the courts have emphasised that it is the trustee’s fundamental obligation not to misappropriate trust money, or mix it with another’s money. It also explains the availability of the profit and subsequent recipient preferences.

Finally, the creation of two, quite different remedies with which to implement the subsequent recipient preference, is significant. Not only does it indicate potential concerns in respect of the imposition of liability upon another party, but it reinforces the significance of the underlying trust relationship. When a recipient knows that the money was derived from a breach of trust, he or she is treated as if he or she was the original trustee. This may provide guidance to the remedial restitutionary proprietary remedy in determining whether a defendant, who knew of the circumstances surrounding the payment and which establish the right of recovery should be treated differently from a defendant who had no such knowledge.

61 *Supra*, note 16.

III. PREFERENTIAL TREATMENT AND THE CLAIM FOR MONEY HAD AND RECEIVED⁶²

1. Overview

Another existing remedy which may provide guidance in the development of the remedial restitutionary proprietary remedy is the claim for "money had and received". What is particularly significant about this claim is that, while its approach to the conferral of preferential treatment is fundamentally different from the recovery of trust money, it displays some important similarities.

The suggestion that a common law personal remedy, by which money is "recoverable as [if it were] a debt",⁶³ may assist in determining the extent of the preferential treatment, may be puzzling to some. Such a reaction comes about because the traditional distinction between "personal" remedies and "proprietary" remedies is overdone.⁶⁴ A claim for money had and received culminates in an order for the payment of a sum of money. Nevertheless, in the context of the recovery of one's money,⁶⁵ this claim is in fact protecting the plaintiff's legal ownership of that money.⁶⁶ It is in this context that this claim may confer preferential recovery.⁶⁷

The recovery of one's money raises similar issues of preferential treatment as are raised with the recovery of trust money and the remedial restitutionary proprietary remedy. Assume that I steal a \$100.00 bank note from you and I am insolvent. If you can specifically identify your bank note in my possession (for instance by reference to its serial number) should you be treated as if you are one of my unsecured creditors and as such be entitled only to participate in the distribution of my assets or should you be able to recover that note or its equivalent value? What if I placed a winning bet with the stolen money, should your recovery be limited to the value of the stolen money or should you also be able to recover the profit as well? What if I had given this bank note to another person, should you be able to recover it or its value from that party? It is because of the similarity of these that a consideration of the claim for money had and received can provide guidance.

⁶² For a general overview of this claim and its potential to facilitate the preferential recovery of money see SR Scott, "The Recovery of Money — Recognising the Potential of the Claim for Money Had and Received" (1994) 8 OLR 239.

⁶³ *Sinclair v Brougham* supra, note 11 at 414 per Viscount Haldane LC.

⁶⁴ As Professor Maitland has noted, the personal/proprietary classification does not "fit the native stuff." Maitland, *The Forms of Action at Common Law* (1962) 74.

⁶⁵ See above at note 8.

⁶⁶ Money is fascinating; while an integral part of our everyday lives it is easy to forget some of its characteristics. For the purpose of this article, the most important characteristic of money is that it can be regarded as property. When money takes its traditional form of bank notes and coins, this proprietary attribute is readily apparent. It is true that an owner of a bank note or coin usually values it for its purchasing power as opposed to its intrinsic value. It is also true that one's ownership of a bank note or coin is relatively vulnerable; money is one of the principal exceptions to the general rule of *nemo dat*; legal title pass to those who acquire possession thereof, "fairly and honestly upon a valuable and bona fide consideration". *Miller v Race* (1758) 1 Burr 542; 97 ER 398 at 457-8; 401 per Lord Mansfield. Implicit in this last characteristic, however, is the acknowledgment that bank notes and coins can be regarded as items of property which are capable of ownership.

⁶⁷ The claim may culminate in "a result [which is] akin to priority" S Khurshid and P Matthews, "Tracing Confusion" (1979) 95 LQR 78, 78. Alternatively, a remedy which "may not be less effective than equity's lien ..." *Goff and Jones*, op cit, note 4 at 78 note 34.

2. The genesis of preferential treatment — the claim against subsequent recipients

The common law has adopted a fundamentally different approach to conferring preferential recovery than that adopted by Equity. Preferential recovery of one's money is achieved at common law through the imposition of strict personal liability upon the recipient of another's money to repay the value of that money.⁶⁸ While the resulting personal obligation survives the loss of the original money, it is, of course, vulnerable to the defendant's insolvency. It is in this situation that the proprietary attributes of money become important. Not only may the plaintiff's ownership of the money survive its physical transfer to the immediate recipient (i.e. the thief or the finder) but it may also survive its physical transfer to a subsequent recipient. I steal your \$100.00 bank note and give that bank note to a friend. Clearly I never acquired legal ownership. And irrespective of my friend's bona fides, since he or she gave no consideration for the money, the currency exception to the nemo dat rule does not apply so as to divest you of your ownership.⁶⁹ You can bring a claim for money had and received against the subsequent recipient.

*Clarke v Shee and Johnston*⁷⁰ is an example. The plaintiff's clerk had received money for which he was liable to account to the plaintiff. He used some of the money, however, to purchase lottery tickets from the defendants.⁷¹ As Lord Mansfield observed, "the money and notes which [the clerk] paid to the defendants [were] the identical notes and money of the plaintiff."⁷² Having identified his money as having been received by the defendants, the plaintiff was able to successfully bring a claim for money had and received against them.

It is this combination of: (a) the ability to bring this remedy against all recipients of one's money; and (b) the fact that liability arises from the receipt and not the retention of that money, which provides the means by which this 'personal' remedy is able to confer a measure of preferential treatment.⁷³

There are two particularly interesting aspects about this remedy. First the cases in which preferential treatment has been conferred have been "very rare".⁷⁴ Secondly it appears that the cases in which the courts have been prepared to confer preferential treatment have been restricted to situations in which the immediate recipient of the money has become insolvent.

68 For a recent judicial reiteration of this characteristic see *Agip (Africa) Ltd v Jackson* [1992] 4 All ER 451 (CA), 463.

69 Ownership of bank notes and coins pass to those who acquire possession thereof "fairly and honestly upon a valuable and bona fide consideration". *Miller v Race* supra, note 66 at 457-8; 401 per Lord Mansfield.

70 (1774) 1 Cowp 197; 98 ER 1041.

71 While the defendant gave 'value' for this money by issuing the lottery tickets, this value did not constitute good consideration; the transaction being contrary to the Lottery Act 1772.

72 Supra, note 70 at 200; 1043.

73 As Professor Goode explains: "Each movement of the asset from one recipient to another ... brings into existence a distinct personal right of [the owner] against that recipient and a distinct new duty of account by the recipient to [the owner]; and since the recipient, having once incurred a personal duty by his receipt of the asset, cannot thereafter shuffle it off by a dealing inconsistent with [the owner's] rights but on the contrary will infringe such rights by that dealing, it follows that [the owner's] ... rights against the successive recipients are not alternative but cumulative." Goode, "The Right to Trace and its Impact in Commercial Transactions" (1976) 92 LQR 360, 369-370.

74 *Goff and Jones* op cit, note 4 at 3.

3. The subsequent recipient preference

While examples may be rare, *Lipkin Gorman v Karpnale Ltd*⁷⁵ confirms its availability. That case involved a claim by the plaintiff firm of solicitors to recover money which had been misappropriated from its client account by one of its partners (one Cass) and unsuccessfully gambled by him at the defendant club. By being able to trace 'their' money from the bank's chose in action, through the hands of Cass, to the defendant club, the plaintiffs were able to pursue this claim against the defendant club.

Two reasons explain the rarity of these claims. The first is that the subsequent recipient will often acquire legal title. Deprived of his or her legal title, the plaintiff (and now former owner) is unable to sue the subsequent recipient; and is restricted to pursuing a claim against the initial recipient of the money. The second and probably more important reason is the associated evidentiary problems. The difficulty is to identify what the immediate recipient does with the money. When the money is kept distinct from other money this process is relatively easy. Problems arise if the money is mixed. It appears that in the eighteenth century the courts of common law when confronted with the problem of tracing money adopted the tracing rules which Chancery had then developed.⁷⁶ When compared to the existing "modern [Equitable] doctrine"⁷⁷ of tracing these rules appear conservative and constrained by "quaint and artificial restrictions".⁷⁸ The common law courts have traditionally approached tracing "in a strictly materialistic way"⁷⁹ analogous to the direct substitution approach developed by Chancery. Applying what has been referred to as an 'exchange-product' theory of tracing, the common law courts have required that there be evidence of a direct substitution of the plaintiff's money for an asset before they would regard the new asset as belonging to the plaintiff.

One of the most important cases for common law tracing is *Taylor v Plumer*.⁸⁰ While Lord Ellenborough CJ recognised that money could be followed at common law, he expressed the then orthodox equitable limitation that this right ceases once the money is mixed with other money.⁸¹ Nowadays when the greatest store of 'money' may well be the bank account, such a limitation automatically imposes a considerable constraint upon the ability to trace one's money.⁸² It is submitted that underlying such

⁷⁵ [1991] 1 WLR 10. See also *Banque Belge Pour L'Etranger v Hambrouck* [1921] 1 KB 321 (CA).

⁷⁶ This process is apparent in *Scott v Surman* (1742) Willes 400; 125 ER 1235 and *Taylor v Plumer* (1815) 3 M & S 562; 105 ER 721. See *Scott*, op cit, note 62 at 256-8.

⁷⁷ *Re Hallett's Estate* supra, note 18 at 708 per Jessel MR.

⁷⁸ *Nimmo v Westpac Banking Corporation* [1993] 3 NZLR 218 (HC), 238 per Blanchard J.

⁷⁹ *Re Diplock* supra, note 50 at 518 per Lord Greene MR.

⁸⁰ Supra, note 76. For a recent examination of this case, see Lionel D Smith "Tracing in Taylor v Plumer: Equity in the Court of Kings Bench" [1995] LMCLQ 240.

⁸¹ Supra, note 76 at 575; 726.

⁸² *Jackson v Anderson* (1811) 4 Taunt 23; 128 ER 235 suggests that if a plaintiff's money is mixed in a bank account and another person receives all the 'money' in that account, the plaintiff can trace his or her 'money' to that recipient. The plaintiff's agent had consigned to his principal 1969 Spanish Dollars (which belonged to the plaintiff). It appears that these coins had been mixed with a quantity of other Spanish Dollars belonging to the defendant who innocently exchanged all the coins for English pounds. Mansfield CJ held that the intermixture had no effect on the defendant's liability in trover — having disposed of all the dollars, the defendant had disposed of those belonging to the plaintiff.

conservatism has been a fear of imposing absolute liability upon voluntary⁸³ innocent subsequent recipients of another's money.⁸⁴

To fulfil its function as a means of exchange, money must be able to circulate freely. To do this recipients must be confident, not only that they will acquire ownership, but that they will not face liability for their receipt of another's money. Plainly, to remove these fears, currency was made an exception to the *nemo dat* rule.⁸⁵ Similar fears apply to the voluntary innocent subsequent recipient. The response of Equity via the Tracing remedy, suggests that the imposition of liability for the value of the money remaining, may be appropriate. Imposition of liability for the value of the money received, however, can be seen as being both too drastic and if, say, the rule in *Clayton's Case*⁸⁶ is used to determine when the plaintiff's money is withdrawn from the bank account, arbitrary.⁸⁷ The conservatism of the common law to tracing mixed money, can be seen as a means to protect the voluntary innocent subsequent recipient in a period in which there was no "change of position" defence.⁸⁸

On reflection, it will be realised that the approach of the common law to tracing money is not too dissimilar to the equitable Tracing and knowing receipt remedies. The most extensive tracing rules and presumptions associated with "the modern [Equitable] doctrine" of tracing are applied when the insolvency preference is being sought, not when a claim is being made against a subsequent recipient. Indeed, these rules and presumptions are inappropriate when recovery against a subsequent recipient is being sought. Is it surprising, therefore, that the common law courts have continued with a conservative approach to tracing money when confronted with a claim against a subsequent recipient? In defence of the common law's conservation, it may be that its critics have not been comparing 'like' situation with 'like'?

In *Lipkin Gorman*,⁸⁹ however, the House of Lords has recognised both the existence of a change of position defence and its significance on the

83 In the sense that they had not given any consideration for the money.

84 Scott, *op cit*, note 62 at 258-60.

85 See *Miller v Race* *supra*, note 66 at 457; 401.

86 *Devaynes v Noble; Clayton's Case* *supra*, note 27.

87 Support for this argument is contained within the judgment of Millet J in *Agip (Africa) Ltd v Jackson* [1992] 4 All ER 385 (Ch). At 400 (and in an attempt to limit the significance of the decision of the Court of Appeal in *Banque Belge Pour L'Etranger v Hambrouck*; *supra*, note 75 — a case which provides some support for the ability of the common law to trace through a bank account), his Honour suggested:

"[That case] is no authority for the proposition that [money had and received] lies against a subsequent transferee who has parted with the money, and I doubt that it does. At this remove the action begins to take on the aspect of a proprietary claim rather than the enforcement of a personal right to account. Should it be sought to impose personal liability on a person who has parted with the money, recourse can be made to equity, which has developed appropriate principles by which such liability can be determined. The alternative is to expose an innocent transferee who has dissipated the money to a claim at law where none would exist in equity and to make that liability depend on the fortuitous circumstances that the money had not been mixed with other money prior to its receipt by him." [1992] 4 All ER 385 at 400 per Millet J.

Concern for imposing strict common law liability upon third parties may also underlie the suggestion by Millet J that the common law can not trace a telegraphic transfer. Professor Birks suggests that this limitation "is barely intelligible except as part of a concerted attack on the strict common law liability." "Misdirected Funds: restitution from the recipient" [1989] 3 LMCLQ 296, 340.

88 The concern for innocent recipients is also apparent in Lord Goff's observations in *Lipkin Gorman* *supra*, note 75 at 28 on tracing to the effect that "it cannot be relied upon so as to render an innocent recipient a wrongdoer."

89 *Ibid.*

development of the law. Indeed, their Lordships willingness to recognise a more expansive approach to tracing at common law, than the orthodox legal approach would suggest is possible, may be attributable to this defence. It will be recalled, that a dishonest partner had withdrawn cash from Lipkin Gorman's client account for the purpose of continuing his gambling. Applying two earlier decisions of the Privy Council,⁹⁰ Lord Goff held that the dishonest partner became the legal owner of the cash on its withdrawal from the bank. Nevertheless, Lipkin Gorman was successful. But if the cash legally belonged to the dishonest partner, how could it also legally 'belong' to Lipkin Gorman? While recognising that Lipkin Gorman had to establish a basis on which it was entitled to this money, Lord Goff was of the opinion that to do so, it did not have to show that the money was its legal property; it was only "a general rule" that the necessary basis could be so established.⁹¹ The necessary proprietary base in this case was held to be the original chose in action between the solicitors and their bank.⁹² In essence, Lipkin Gorman could trace their interest in the chose in action into some sort of interest in the money which legally belonged to the dishonest partner and which he 'gave' to the defendant club.⁹³

Counsel in *Lipkin Gorman* had reached agreement as to the amount of the plaintiff's money received by the defendant. It is interesting to surmise what would have been the result if no such agreement had been made and one assumes that Cass had mixed this money (approximately £323,000) with his own (approximately £20,000). Factually the level of Cass's gambling was such that there can be no doubt that the Club received the plaintiff's money. If *Lipkin Gorman* has started a more expansive approach to tracing, albeit one focusing upon factual evidence of the receipt of another's money, then the ability of the claim for money had and received to confer preferential recovery upon the plaintiff may increase.

4. The insolvency preference

The ability to acquire an insolvency preference through the claim for money had and received is premised upon the plaintiff having a solvent defendant. In *Lipkin Gorman*, for instance, the immediate recipient (Cass) was insolvent. By being able to trace their money to a solvent subsequent recipient (the defendant club) and by bringing a personal claim against that recipient, the plaintiffs were able to circumvent Cass's insolvency and (subject to the change of position defence) recover their money.

What about the situation in which the plaintiff can still identify his or her money in the possession of the insolvent immediate recipient? Is an insolvency preference available? The 'personal' form which this remedy takes suggests that the plaintiff is relegated to being an unsecured creditor. In this situation, however, the plaintiff's money must be received by whoever is administering the insolvent's affairs, i.e. the Official Assignee

⁹⁰ *Union Bank of Australia Ltd v McClintock* [1922] 1 AC 240 and *Commercial Banking Co of Sydney Ltd v Mann* [1961] AC 1.

⁹¹ *Supra*, note 75 at 27.

⁹² *Ibid* at 29.

⁹³ Another recent case displaying a similar judicial approach in focusing upon the "reality" of the situation is *Agip (Africa) Ltd v Jackson* *supra*, note 68 at 462. See also *Reid v Rigby & Co* [1894] 2 QB 40.

(or equivalent). Can that person be regarded as a subsequent recipient against whom this is available? There is academic support for this.⁹⁴

Moreover, judicial support is provided by *Scott v Surman*.⁹⁵ Jonathan Scott and Francis Richardson consigned a quantity of tar to their agent — Richard Scott (Jonathan's brother). Richard sold the tar, receiving in return two promissory notes and the discharge of his own debt to the purchaser. Richard then became bankrupt and the defendant assignees received both the money due on the promissory notes and a bounty paid by the government for the tar's importation. The plaintiffs successfully brought a claim against the defendants in respect of this money and the bounty.⁹⁶ As Willes CJ observed:

The general rule is that if a man receive money which ought to be paid to another or to apply to a particular purpose to which he does not apply it, this action will lie as for the money had and received. ... To apply this general rule to the present case. The assignees having received this money which belongs to the plaintiffs and ought not to be applied to pay the bankrupt's debts, and they ought to have paid it to the plaintiffs, and not having done so, this action will lie against them for so much money had and received to the use of the plaintiffs.⁹⁷

Assuming that a personal claim can be brought against the Official Assignee, there is still the evidentiary difficulty of showing that the plaintiff's money remains identifiable. Because the Official Assignee receives all the insolvent's assets, the courts may be willing to adopt a more robust approach to tracing. Clearly direct evidence (and, if the earlier observations in respect to *Lipkin Gorman v Karpnale Ltd* are accepted, factual evidence) should suffice. Evidence of increased assets, similar to the "surviving enrichment approach" considered earlier may also suffice.

5. The profit preference

So far the availability of preferential treatment has turned upon the plaintiff showing that a subsequent recipient has received his or her money. What about the situation in which the immediate recipient uses the money to acquire an asset with. Can the plaintiff claim an ownership interest in that substitute asset? And if so, if that asset has appreciated in value, can he or she get the benefit of that appreciation? Theoretically such a claim would appear possible.

*Taylor v Plumer*⁹⁸ provides a measure of support. The defendant had authorised his stock-broker (one Walsh) to uplift funds from his bank and invest those funds in the purchase of Exchequer Bills. Contrary to these instructions Walsh used some of these funds to acquire American shares and stock. Next he exchanged part of these funds for notes of smaller denomination and using some of these replacement notes, purchased a quantity of bullion. But before Walsh could leave the country he was caught by the defendant's attorney and made to surrender the shares, stock

94 Khurshid and Matthews, *op cit*, note 67 at 78; RA Pearce, "A Tracing Paper" (1976) 40 Conv 277, 284; M Scott, "The Right to 'Trace' at Common Law" [1965-66] WALR 463. For a contrary view, however, see D Cuthbertson "Tracing at Common Law — Myth or Reality?" (1968) 8 UWALR 402.

95 *Supra*, note 76. See also *Whitecomb v Jacob* (1711) 1 Salk 160; 91 ER 149.

96 Because this money could be identified as directly attributable to the promissory notes and the bounty, which in turn were directly attributable to the importation and sale of the tar, the plaintiffs could substitute their proprietary interest in the tar for the money received by the defendants.

97 *Scott v Surman supra*, note 76 at 403-405; 1237-8.

98 *Supra*, note 76.

and bullion. The plaintiffs, as Walsh's assignees in bankruptcy, unsuccessfully commenced proceedings in trover against the defendant. The Court held that as the defendant could trace his money into these chattels, he had a better right to them than the plaintiffs. As Lord Ellenborough CJ observed:

It makes no difference in reason or law into what other form, different from the original, the change may have been made, whether it be into that of promissory notes for the security of the money which was produced by the sale of the goods of the principal, ... or into other merchandise, ... for the product of or substitute for the original thing still follows the nature of the thing itself, so long as it can be ascertained to be such, and the right only ceases when the means of ascertainment fail⁹⁹

If the plaintiff can assert an interest in the substitute asset, on general principles a claim for its appreciated value, as opposed to its acquisition value, may be possible.

Notwithstanding the theoretical ability for such a claim some suggest that it should be restricted to special circumstances. For instance Professor Lawson. Here he is discussing *Taylor v Plumer*:

[That case is] clearly a pretty odd piece of law [I]t is obviously a fiction to say that what my agent has in breach of faith bought with my money is mine. According to all ordinary common law ideas it should be his and I should only have a personal action against him, that is to say, I should only be able to prove in his bankruptcy for its value. Nowhere else does the common law treat a fund as a single entity, which can be recovered as such.¹⁰⁰

There is another general objection. Such claims abrogate the plaintiff's original right to recover the value of the money received. So are inconsistent. Although the application of defences, such as the change of position defence, may reduce the amount recovered, the value received should constitute the upper limit of recovery. Immediate support for this objection is provided by the fact that unlike a trustee, a recipient of another's money, for instance a thief or a finder, is under no duties of investment with respect to that money. It was submitted earlier that it is the existence of such duties of investment which forms the basis of the profit preference available against a trustee.

It may be that *Taylor v Plumer* is only authority for the ability to trace money into a substitute asset when the defendant is insolvent (or to advance an even more conservative interpretation, when he or she is an insolvent agent)¹⁰¹ and the aim is to facilitate the recovery of the value of the plaintiff's money (i.e. on insolvency preference) as opposed to the conferment of a true profit preference.

Irrespective of the width of *Taylor v Plumer*, the ability to trace one's money into an asset should only be available where there is clear evidence of a direct substitution of the plaintiff's money for the asset. This restrictive approach should apply for the simple reason that the availability of a charge has not been recognised by the courts of the common law.

⁹⁹ Ibid, at 575; 726.

¹⁰⁰ FH Lawson Remedies of English Law 2nd ed (1980) 149. See also Sutton, "Tracing" [1982] NZLJ 67, 72 and Smith, op cit, note 80. Notwithstanding such objections, it may be that such extended ideas of ownership are not foreign to the common law. See Scott, op cit, note 62.

¹⁰¹ Professor Lawson, for instance, suggests that in *Taylor v Plumer* the court was responding to the development of bankruptcy laws, "so as to prevent the agent's misconduct from swelling the funds at the disposal of the trustee in bankruptcy." Lawson, Loc cit.

6. Guidance for the remedial restitutionary proprietary remedy

The claim for money had and received provides an interesting comparison with the preferential treatment which is available in the context of the recovery of trust money. In both situations the courts are protecting a pre-existing 'proprietary' interest. In both situations there is a focus on the insolvency preference. But the approach to preferential treatment is fundamentally different.

One reason for this difference may be the trust relationship. Because of the early association of the claim for money had and received and preferential treatment with insolvent agents (and the associated agency/fiduciary relationship), it is tempting to discount the importance of the trust relationship for preferential recovery. This association cannot be ignored. But, since the underlying rationale of the claim against a subsequent recipient is to protect one's ownership of money, no pre-existing relationship is necessary. Preferential treatment should be available even if the immediate recipient is a thief or a finder. Indeed, in *Lipkin Gorman* despite the immediate recipient being a partner of the plaintiff firm, the House of Lords did not regard this as being important in determining the claim.

Turning to the remedial restitutionary proprietary remedy, in most situations there will be no pre-existing relationship between the plaintiff and immediate recipient. Obviously there is a similarity between the remedial restitutionary proprietary remedy and the claim for money had and received. But the narrow approach to preference associated with the latter raises doubts about the more generous way the equitable tracing rules and presumptions have been applied. Just as the indiscriminate application of the equitable tracing rules and presumptions has been warned against, a similar warning should also be made with respect to the indiscriminate application of the tracing rules and presumptions associated with the claim for money had and received. It is to be remembered the restitutionary remedy is implemented through the grant of an equitable interest. Indiscriminate expansion of the tracing rules may be inappropriate, but the greater flexibility of equitable interests would seem desirable. In particular the device of the 'charge', so that the all or nothing approach of the common law is avoided.

IV. PREFERENTIAL TREATMENT AND THE REMEDIAL RESTITUTIONARY PROPRIETARY REMEDY

So what specific preferential treatment should the remedial restitutionary proprietary remedy be able to confer and in what situations? To consider the example given at the commencement of this article — a mistaken payment being used to acquire a painting — should the insolvency preference be available and if so should this be in conjunction with the profit preference? Alternatively, if instead of buying the picture I had given the money to a friend, should the subsequent recipient preference be available?

The learned authors of Goff and Jones suggest that where the plaintiff can specifically identify the money in the possession of the immediate recipient, the plaintiff should be entitled to receive an insolvency preference, albeit one limited to the value of the mistaken payment. If the immediate recipient is both solvent and knew of the facts which form the

basis of the plaintiff's restitutionary claim, however, they consider that the profit preference should be available.¹⁰²

As we have seen with respect to the recovery of trust money, claims for the insolvency preference receive the most sympathetic reaction; indeed, the aim of providing such a preference may explain why the courts of common law recognised that money could be traced. The development out of this area has been integral to the development of the whole approach for the remedial restitutionary proprietary remedy. One can readily agree with Goff and Jones as to the availability of the insolvency preference. But the possibility of the profit preference appears to turn more on the defendant's knowledge.

Plainly there are two significant inter-relating underlying factors. These factors are the underlying rationale for restitutionary relief and the relationship between the parties.

1. Underlying considerations

(a) *A restitutionary remedy*

Except when restitutionary remedies are being used to protect pre-existing property rights (for instance the recovery of your \$100 bank note which I have stolen) or against "wrongdoers" (i.e. dishonest fiduciaries or the recipients of confidential information who do not honour that confidence — the so-called restitution 'for wrongs'), the essence of the restitutionary claim is that the defendant has been enriched at the expense of the plaintiff. The defendant is obliged to restore (subject to defences) the enrichment. So inherent in the restitutionary claim is the premise, that the value of the enrichment originally received should constitute the upper limit of relief. To quote Mr Burrows on orthodox theory, "unjust enrichment by subtraction is concerned with the highest common amount of causally related loss and gain: that is, the gain of the defendant to be reversed must be caused by an equivalent loss to the plaintiff."¹⁰³

Assume for instance that as a result of a causal mistake¹⁰⁴ I pay you \$100.00 or that there has been a total failure of consideration for my payment of \$100.00 to you. I have a claim for \$100.00; this being the value of the enrichment conferred upon you at my expense. With the exception of the potential availability of the change of position defence, what you

¹⁰² *Goff and Jones*, op cit, note 4 at 95-98. Irrespective of the defendant's knowledge Professor Jones considers that to grant the profit preference against an insolvent defendant "would give [the plaintiff] a windfall at the expense of the defendant's general creditors." For this reason he would restrict the availability of the profit preference to the situation in which the defendant is solvent.

¹⁰³ Burrows, op cit, note 7 at 19. As Professor Birks has recognised the "normal measure of restitution is 'value received'." Introduction to the Law of Restitution (Paperback ed 1989), 385. At 401 while he subsequently argues that there should be a personal claim for the value surviving of the enrichment and acknowledges that logically this measure of relief should potentially be able to facilitate the recovery of a profit (i.e. when the enrichment can be identified in an appreciating asset), he suggests that, "except [as] against a defendant guilty of misconduct, a court might take the view that, as between the two bases on which enrichment can be said to survive, a personal claimant could use only 'fixed input' and not 'proportionate share'. The phenomenon of inflated recovery in the second measure would then cease to arise for that type of claim."

¹⁰⁴ On orthodox theory a causal mistake, as opposed to a fundamental mistake, is insufficient to stop title to the money passing to you. The proprietary attributes of money had and received is therefore unavailable to confer any preferential treatment, Burrows, *ibid*, at 4. See Scott, op cit, note 62 at 263 for a criticism of this particular conservatism.

subsequently do with that money is immaterial to your liability. Irrespective of whether you have profitably invested that money (say in the acquisition of shares which have since doubled in value) my 'personal' restitutionary claim against you will be to recover \$100.00; the value of the money received by you and no more.

(b) The underlying relationship

The general requirement of "a correlation between a loss of the plaintiff and a gain of the defendant"¹⁰⁵ is not only justified by the general principle of unjust enrichment but also by the fact that this is a fresh relationship. There is no pre-existing definitive relationship which imposes any duties with respect to this enrichment.

This enables a comparison to be drawn with the pre-existing trust relationship which both governs the response of Equity to the recovery of trust money and explains the extent to which certain forms of preferential treatment (i.e. the insolvency and subsequent recipient preferences) are available, and the availability per se of the profit preference. With the recovery of both trust money and one's own money (at common law) a pre-existing proprietary interest is being protected. But it is only in respect of the recovery of trust money that there is a pre-existing relationship imposing positive duties. Further support for the importance of a pre-existing relationship is provided by the reasoning of the Judicial Committee in *A-G for Hong Kong v Reid*;¹⁰⁶ that the fiduciary's duty is not to "obtain and retain a benefit in breach of duty".¹⁰⁷ In that case the receipt by a fiduciary of a bribe, justified preferential treatment.¹⁰⁸

(c) Consequences

(i) Non-availability of the profit preference

It is submitted that the underlying restitutionary rationale for relief and the absence of pre-existing duties owed by the defendant to the plaintiff are fundamental factors in determining the availability of preferential treatment. The general focus on restoring what would otherwise constitute a loss to the plaintiff and an enrichment to the defendant, suggests that the value of the original enrichment should constitute the maximum amount of recovery.

Admittedly this conclusion is questioned by the Tracing remedy. It provides some support for the availability of the profit preference even though there is no relationship between the plaintiff and subsequent recipient. To the extent that the beneficiary can identify the trust money he or she can recover it. Inherent in this remedy, therefore, is the ability to confer a profit preference. But is this an appropriate comparison? With the Tracing remedy, the principal object of the tracing process is to identify the trust property in the 'innocent' defendant's possession. It is only to the extent that it can be so identified that it is recoverable. The ability to profit arises as an offshoot of the tracing process and not as a deliberate policy

¹⁰⁵ Burrows, *ibid*, at 17.

¹⁰⁶ *Supra*, note 16.

¹⁰⁷ *Ibid* at 4 per Lord Templeman.

¹⁰⁸ While this preferential recovery was at the expense of the unsecured creditors, it was considered that they could not be in any better position than their debtor, the dishonest fiduciary.

decision. Indeed, it may only be in the rare situation in which there is evidence of direct substitution of trust money (and only trust money) for an appreciating asset that the possibility of the profit preference arises.¹⁰⁹

The analogy of the Tracing remedy can be further questioned because the remedial restitutionary proprietary remedy is limited by its restitutionary nature. It is simply the restoration of the enrichment which justifies its preference. The rationale of the Tracing remedy, however, is the recovery of one's identified property.

In some situations, however, principally restitution for wrongs, the value of restitutionary relief may bear no correlation to the defendant's loss. A question is whether in those situations the remedial restitutionary proprietary remedy should be available to recover any extra liability. It is submitted that it should not be so. Such a claim will arise when the defendant is insolvent and as is noted in *Goff and Jones*, "[t]o allow [the plaintiff] to capture the benefit gained ... ignore[s] the legitimate interests of the general creditors."¹¹⁰ For this reason, except where there is a pre-existing relationship (for instance a fiduciary relationship), which the law wishes to protect, it seems sensible that the quantum of the insolvency procedure should be restricted to the value of the plaintiff's loss and no more.

(ii) Knowledge

These arguments challenge the suggestion contained within *Goff and Jones* that it is the recipient's knowledge of the circumstances which give rise to the restitutionary claim and justify the profit preference.¹¹¹ This is not to dispute that the defendant's knowledge is relevant. While the value of the original enrichment may constitute the upper limit of restitutionary relief, this value must constitute only the defendant's prima facie maximum liability. This liability, of course, can be further reduced through the operation of defences such as the change of position defence. Subject to the overriding limitation that the loss to the plaintiff provides the maximum level of recovery, it is submitted that it is only the actual value of the defendant's personal liability once these defences are taken into account which should be recoverable. If it is to have an effect, knowledge relates more to the "change of position" defence than to the claim itself.

2. The insolvency preference

The insolvency preference is so associated with the development of the remedial restitutionary proprietary remedy that preference automatically results. But to what extent should this be so? It follows from the earlier

¹⁰⁹ Support for this last observation is provided in *Sinclair v Brougham* supra, note 11. At 442-443 Lord Parker distinguished the trustee and knowing recipient from the innocent recipient. While the innocent recipient of trust money may not be able to assert any priority against the beneficiary, upon restoration of the trust money there is no misconduct to preclude him or her from asserting ownership of the asset. In contrast, the trustee who mixes trust money in the acquisition of an asset has to recognise the right of the beneficiary to claim either a security interest or a proportionate ownership interest. If this argument is correct, it reinforces the submission that the potential availability of the profit preference in this situation is not the result of a positive judicial policy decision but arises as a consequence of the association of this remedy with tracing. In any event, should it be held that the plaintiff can receive the profit preference against an innocent recipient of trust money, there must be a strong case for the conferral of a generous allowance upon him or her for his or her investment services.

¹¹⁰ *Goff and Jones*, op cit, note 4 at 734.

¹¹¹ *Ibid* at 95-98.

submission that the insolvency preference should culminate in a charge over the identified ‘money’ (or its substitute product) as opposed to an ownership interest. Furthermore the charge is for the value of the enrichment originally received by the recipient at the plaintiff’s expense. If the insolvency preference is so restricted the real issue becomes what is the correct approach to tracing the money so as to determine the preference.

In situations, such as the introductory example, where there is evidence of a direct substitution of the mistaken payer’s money and only that money for another asset there should be no difficulty. This is the obvious situation for preferential recovery. The mistaken payer should be entitled to assert a charge over any after acquired asset for the value of the money deemed to have gone into it. Notwithstanding the earlier conclusion, some may argue that in this situation the mistaken payer should be able to assert ‘ownership’ of the substitute asset. Support for this argument is provided by the approach to the recovery of trust money. Nevertheless it is submitted that the comparison is not appropriate. As already mentioned, in the trust situation the trustee has definitive duties to follow, i.e. the duties to invest and not to personally profit. It is to reinforce these duties that the trustee is presumed to have invested the money in the substitute asset on behalf of the trust. In the context of an insolvency, however, the remedial proprietary remedy is simply imposed to reinforce the plaintiff’s personal remedy. For these reasons the value of the money mistakenly paid should be the upper limit for recovery.

It is submitted that the situation in which there is no evidence as to what the recipient has done with the money (just that the money has been absorbed into his or her assets and it is pure conjecture as to whether the value of the money survives or has been dissipated), is equally as clear. The availability of preferential recovery is dependant upon a “protective presumed retention” approach. But this approach depends on a policy decision that there should be a guarantee of preferential recovery, irrespective of whether that enrichment survives. So framed, the rejection of this approach is self-evident. After all, the protective presumed retention approach was specifically designed to protect the beneficiary against a breach of trust. Irrespective of whether the plaintiff accepted any risk of insolvency,¹¹² it is submitted that the availability of this protection should not be extended to this situation; to do so would be both to elevate the deemed equitable interest to that of a pre-existing interest and equate the policy rationale underlying the preferential recovery of an unjust enrichment (i.e. that the insolvent’s creditors would otherwise be unjustly enriched) to the same rationale as protecting the trust relationship. In any event the courts have retreated from this approach in determining the rights of beneficiaries.¹¹³

Falling between these two extremes to tracing, there is the “presumed substitution” and the “surviving enrichment” approaches. When should

112 Acceptance of risk is an argument which has been advanced to determine whether remedial restitutionary proprietary relief should in any given situation be potentially available. The principal advocate of this approach is Professor Paciocco, “The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors” (1989) 68 Can Bar Rev 315. See SR Scott, “The Remedial Constructive Trust in Commercial Transactions” [1993] LMCLQ 330,341-349 for a modified version of this approach.

113 See above at note 33.

these apply? Views will differ as to the appropriateness of the first. It will be recalled that this approach was developed in the context of determining withdrawals by the trustee from a mixed bank account and in some respects it can be seen as a forerunner of the “protective presumed retention” approach. The criticisms which apply to that approach must apply equally to the presumed substitution approach. Supporters of its application, however, can point to the fact that the recipient is *prima facie* liable to repay the value of enrichment so received. It is only to the extent that he or she can identify what has subsequently happened that a change of position defence may be available. Since the onus of proof in this situation is on the recipient to show the dissipation of the money,¹¹⁴ it may be argued that a similar onus should apply in respect to the remedial restitutionary proprietary remedy. Applying this argument to the situation of the deposit of the mistaken payment in a bank account, it would be presumed that the payment survives in that account or in any asset acquired with funds from that account. This would only be subject to the recipient (or his or her unsecured creditors) showing a destruction of that money or part thereof through the operation of the change of position defence. The imposition of a charge over the appropriate assets would facilitate the recovery of the original enrichment less any dissipation by the defendant.

Turning to the surviving enrichment approach to tracing, it will be recalled that it is premised upon the fact that there is evidence that the defendant’s total assets must have increased as a result of the receipt of the enrichment. Cases in which there is such evidence will be rare. When they do arise, however, it is submitted that to the extent of the surviving enrichment preferential recovery should be available.

What about the situations in which the substitute asset depreciates in value? It is submitted that the depreciated value should constitute the upper level for preferential recovery. Why? There are two principal reasons. Firstly, preferential recovery is premised on identity, therefore logically the value of the identified asset or surviving enrichment should not be exceeded. The second argument relates to the change of position defence. As with the recovery of trust money, the mistaken plaintiff still has a personal claim against the defendant. This may be worthless in reality but it is still there. Unlike the claim in respect of the trustee, however, the claim against the defendant is subject to the change of position defence. In some situations, at least, the depreciation in the value of the substitute asset will be because of a change of position constituting a defence.¹¹⁵ Where this is the situation it is submitted that preferential recovery should not exceed the value of the personal claim.

What about the situation in which there is direct evidence that ‘mixed’ funds have been employed in the acquisition of a depreciating asset? Should the contribution of the defendant’s own money preclude the availability of preferential recovery for the recovery of the plaintiff’s money? This does not seem fair. If the rationale for personal recovery and preferential recovery, is the fact of the recipient’s enrichment, this rationale is not destroyed just by the fact of the transformation of the enrichment into

¹¹⁴ While the dissipation of the enrichment is a prerequisite to the availability of the change of position defence, dissipation per se does not justify its availability. See generally *Lipkin Gorman* supra, note 75 at 35.

¹¹⁵ See Lord Templeman’s example of the car in *Lipkin Gorman* *ibid* at 16.

a mixed form. The evidence of the application of the plaintiff's money should justify some (or proportionate) preferential recovery. Views will differ, as may be expected, to the extent of that preferential recovery. Just as in the recovery of trust money there are two possible solutions. One solution (and the solution applicable to the trustee) is to preclude the trustee from asserting any interest in the asset until the other money is restored. The other solution (and the solution applicable to the Tracing remedy) is to distribute the value of the depreciated asset in proportion to the respective contributions. Since the defendant is under no positive duties of investment in respect of the enrichment it is submitted that the latter solution is preferable. It also meets the objection that there ought not be a windfall for the plaintiff at the expense of the defendant's unsecured creditors.

3. The subsequent recipient preference

What if the recipient gives the mistaken payment to another, should the mistaken payer have a right of recovery against the subsequent recipient? In this situation both the claim for money had and received and the Tracing remedy can be used to support such a remedy. In both situations it would seem that the innocent subsequent recipient of another's money can become subject to an obligation to restore it. One crucial difference between the remedial restitutionary proprietary remedy and these remedies, however, is that the latter remedies are protecting pre-existing proprietary interests. The immediate recipient knows or should know of that interest or at least the existence of such an interest. Until such time as the recipient of the mistaken payment becomes aware of the mistake, however, he or she will regard him or her self as the absolute owner of the money. In addition, in all usual circumstances the subsequent recipient should have no reason to question the ability of the transferor to transfer the money to him or her. Unless the remedial restitutionary remedy is to be used to guarantee recovery of the unjust enrichment there appears to be no reason for conferring a general right of recovery as against an innocent subsequent recipient. This is not to deny, however, that the subsequent recipient preference should never be available.

There is a case for the availability of such a preference in certain situations, the strongest of which is when the subsequent recipient knows of the circumstances surrounding the mistaken payment. Whether it is appropriate in other situations is questionable. Admittedly the availability of the subsequent recipient preference in some but not all situations may appear to unduly complicate matters. The existence of the tracing and knowing receipt remedies, however, confirm that the circumstances surrounding the receipt by a subsequent recipient are important in determining his or her liability. They also demonstrate a recognition that a subsequent recipient's liability can depend on his or her degree of knowledge.

V. CONCLUSION

Determining the nature and extent of preferential treatment which should be available pursuant to the remedial restitutionary proprietary remedy raises a number of difficult and contentious issues. Irrespective of agreement as to the specific conclusions reached, it is submitted that examinations such as undertaken in this article will be important, not only

for revealing the aims and concerns which have influenced the courts in the development of the existing rules for preferential treatment but also for revealing the aims and concerns which it is submitted will influence them with respect to the remedial restitutionary proprietary remedy. The overriding influence, however, must be the underlying restitutionary rationale of this remedy. It is this influence which supports the application of the insolvency preference, subject to evidence of a surviving enrichment, but questions the availability of the profit preference.