PROPRIETARY RELIEF FOR ENRICHMENT BY WRONGS: SOME REALISM ABOUT PROPERTY TALK

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I. INTRODUCTION

Is it proper to declare a constructive trust in favour of a plaintiff seeking to recover profits which a defendant made in breach of a duty owed to the plaintiff? A doctrine which entitles plaintiffs to proprietary relief over the profits of a wrong gives plaintiffs rights to assets which they neither previously owned nor acquired with the consent of the former owner. This outcome is difficult to reconcile with the traditional understanding that the judiciary merely enforces and does not create property rights. In this article, the jurisprudence of 'enrichment by wrongs'[1] provides a case study of the manner in which certain basic ideas about property shape our legal discourse.

Section II of the article explores the prevalence and influence of the understanding that property rights are absolute, and of the perception that property represents a fundamental limitation on judicial creativity rather than a product of that creativity. An understanding of the law requires a study of the assumptions

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1 A convenient expression developed by Professor Peter Birks; see P Birks, *Introduction to the Law of Restitution*, Clarendon Press (revised 2nd ed, 1989) p 6.

that both inform and constrain those responsible for its interpretation and development.[2] Even if we no longer necessarily embrace the vision of the society from which such venerable notions derive, the structure they impose on our law and our legal thinking remains.[3] These understandings constrain us in our interpretation and development of the substance of the law - the function performed by particular doctrines. Just as profound is the influence these assumptions have on the form of our law - the way in which we conceptualise judicial action in the terms of legal abstractions. For where judicial action is difficult to reconcile with premises that are hallowed in our legal culture, we are often able to conceptualise that action in a way that makes it appear less threatening.

Sections III to IV examine the most significant doctrinal responses offered by English judges and jurists to the problem in question. The first doctrine I consider is that formulated just over one hundred years ago in *Lister v Stubbs*.[4] There the English Court of Appeal reasoned that it could not declare a constructive trust over moneys paid as a secret commission because this would amount to the creation of new property rights. The Court was at pains to ensure that the substance of the law did not conflict with basic understandings of property and so concluded that the plaintiff was limited to personal remedies. An objection to this approach is that on occasion, notwithstanding deeply felt ideas about the inviolability of property, justice may require a readjustment of the parties' proprietary rights. Secondly, I examine Professor Peter Birks' "proprietary-base" theory. Birks applauds *Lister v Stubbs* but reinterprets that decision in an analysis designed to explain the availability of proprietary relief generally.[5] However, Birks' approach is unsatisfactory because in attempting to provide a logical conceptual synthesis, it overlooks the distorting influence that assumptions about property rights exercise in this area. Finally, I consider the case of *AG for Hong Kong v Reid*.[6] Through an elaborate combination of formal devices, the Privy Council in this case provided for proprietary relief for profits made in breach of a fiduciary relationship. The Court assuaged its sense that some fundamental legal postulate was being transgressed by conceptualising the basis for relief in terms which denied that a readjustment of property rights was being countenanced. However, the doctrine which has developed to justify the outcome in *Reid* has certain logical constraints imposed upon it by the concepts from which it was fashioned by the Court. These constraints are liable to dictate outcomes that are anomalous when compared with the normative justifications which motivated the Privy Council.

Sections VI and VII examine the development of a different approach to property and proprietary remedies. Firstly, I analyse the treatment of issues in this area in North American law in the light of the legal realist movement. I argue that

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2 P Stein, "Notions of Property and Contract in Eighteenth Century Scottish Law" (1963) *Jur Rev* 1 at 1.

3 *Ibid* at 1, 12-13. On the influence of natural law and political theory on the common law understanding of property, see A Gambaro, "Property" in A Candian, A Gambaro and B Pozzo, *Property, Propriété, Eigentum* (1992) 1 at 24-35, 97-138.

4 (1890) 45 Ch D 1.

5 P Birks, note 1 *supra*, p 378.

6 [1994] 1 AC 324.

the rejection of absolutist understandings about property and contract were at the heart of the rise of a new legal methodology in which formalism was replaced with a more openly prescriptive style of legal argument. This led to an on-going debate regarding the legitimacy of proprietary remedies - a debate which is quite different in character to the treatment of the issue in England. I then examine trends in Australian law which suggest a departure from the conventional English approach, toward an understanding closer to that found in North America. These developments suggest a willingness of the courts to engage in a more frankly normative approach to legal justification. In this way we may be able to transcend unquestioned assumptions inherited from another age and accept responsibility for defining the meaning of property.

II. PROPERTY RIGHTS IN ENGLISH LEGAL THOUGHT

The argument advanced in this article is that much which is perplexing in the jurisprudence of proprietary remedies can be understood when we appreciate the constraints imposed by the notions of property which underlie our law. The law in this area cannot be explained without first comprehending the meaning ascribed to, and the function performed by, 'property' in our legal discourse. Obviously, a full account of the meaning of property in our legal consciousness merits more space than can be devoted to it here. In this context, I can offer no more than a sketch of the major developments of political and legal theory which contributed to our understanding of property, along with a few examples of how this understanding manifests itself in practice. The case study of the law of enrichment by wrongs may then be regarded as a fuller exploration, in a specific context, of the effect that the orthodox paradigm of property has on the substantive law.

Our understanding of private property largely reflects English political ideology of the seventeenth and the eighteenth centuries. The premises of this ideology provided the framework for the rationalisation of judge-made law, which took place in the eighteenth and nineteenth centuries.[7] While leading theorists often disagreed about the origin of property, they were largely unanimous in their understanding that 'property' connoted an owner having the sole right over the use and disposal of a particular object and freedom from expropriation.[8] Leading theorists also agreed that the protection of property was the primary object of government.[9]

Giving content to the idea that property was 'inviolable' was the notion that property may be acquired only in a limited number of ways.[10] Unowned objects

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7 The most detailed account is P Atiyah, *The Rise and Fall of Freedom of Contract*, Oxford University Press (1979).

8 See for example, J Locke, *Two Treatises of Government*, Clarendon Press (1988) Book II, § 139, p 360; D Hume, *A Treatise of Human Nature*, Cambridge University Press (1978) p 514; A Smith, *The Wealth of Nations*, Everyman (1910) pp 222-38.

9 W Blackstone, *Commentaries on the Laws of England* (1765-69, reprinted 1979) Vol I, pp 120, 134-5; A Smith (RL Meek, DD Rapheal and PG Stein (eds)), *Lectures on Jurisprudence*, Clarendon Press (1762, reprinted 1978) p 6; J Locke, *ibid*, § 123, p 350; D Hume, *ibid*, p 491.

10 W Blackstone, *ibid*, p 200; A Smith, *ibid*, pp 13-14.

may be acquired by occupation. Where the assets of one person are integrated with those of another, property may be obtained by accession. Rights may be lost through prescription, which ensures security of title by providing a limitation period for claims.[11] The only other means by which rights in a thing could be transferred between private citizens was by consent - according to the law of contract and succession. Property might come into the hands of the state in one of two ways. Where an individual committed a grave crime he or she may be deemed to have forfeited his or her property to the state.[12] In addition, the legislature may expropriate the property of its citizens but only if it provides compensation. Moreover, intoned Blackstone, "this is the execution of a power which the legislature indulges with caution, and which nothing but the legislature can perform."[13]

According to this understanding, property places fundamental constraints on judicial action; it is not for the courts to interfere with extant property rights by creating new proprietary interests. Thus conceived, property performs a dual function as a boundary. Property delineates a sphere of freedom for the individual, within which the state may not encroach. In addition, property limits judicial power by drawing a boundary which separates the role of the courts from that of the legislature - a line between the legal and the political. According to this vision, the province of the judiciary is limited to the protection and enforcement of a pre-existing set of entitlements and consensual transfers of those entitlements.[14] The judiciary is concerned with corrective justice, while distributive justice remains the preserve of the legislature.[15] This understanding of property gives meaning to the distinction made between ownership and obligation in English law - a distinction which assumes great significance in bankruptcy.[16] While owners can choose to alienate existing rights, new rights cannot be created by the courts.[17]

This understanding can be best witnessed at work in cases where the judiciary is asked to deal with proprietary entitlements in a manner which conflicts with the orthodox paradigm. Here the courts will invoke notions of property to provide normative guidance in the resolution of a dispute over rights to use and enjoy

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11 A Smith, note 9 *supra*, p 36. In fact, prescription was often described in terms of a 'presumed lost grant' or implied agreement to suggest that it fell within the ambit of consensual transfer of title. Philosophical discussions of the doctrine pointed to the original owner's acts as evidence of a tacit abandonment so that the person in possession of the land could base their claim on occupation by first possession; see for example, S Pufendorf, *On the Duty of Man and Citizen*, Cambridge University Press (1989) p 89; W Blackstone, note 9 *supra*, pp 263-6.

12 W Blackstone, note 9 *supra*, p 267.

13 W Blackstone, *ibid*, p 135.

14 The role of property in this understanding of the law in the context of the formation of the American Constitution and in constitutional jurisprudence of the United States is well explained in J Nedelsky, *Private Property and the Limits of American Constitutionalism*, University of Chicago Press (1990).

15 An attempt to explicitly elaborate such an understanding of the law from a Kantian perspective can be found in E Weinrib, *The Idea of Private Law*, Harvard University Press (1995).

16 B Nicholas, *An Introduction to Roman Law*, Clarendon Press (1962) pp 99-103; R Goode, "Ownership and Obligation in Commercial Transactions" (1987) 103 *LQR* 433.

17 This is the understanding which informs the reasoning in *Lister v Stubbs*, note 4 *supra*; see also, footnotes 37-48 *infra* and accompanying text.

resources. In *Shelfer v City of London Electric Lighting Co*[18] the English Court of Appeal heard an appeal from the decision of Kekewich J in the High Court to deny injunctive relief to the plaintiff, the use and enjoyment of whose land was being interfered with by the defendant's electricity generating operation. The plaintiff had been limited, instead, to an award of damages to compensate him for his loss. The widespread use of the injunction in nuisance cases was still less than a century old and the scope of the remedy had yet to be decisively determined.[19] The Court of Appeal upheld the appeal, concluding that limiting the plaintiff to damages would amount to taking his property rights. Lord Justice Lindley observed: "Expropriation, even for a money consideration, is only justified where Parliament has sanctioned it."[20] Yet, it is apparent that the Court was able to conclude that to have refused the plaintiff an injunction would have involved a violation of his property rights only by assuming that those rights were absolute.

Similarly, more recently, in *Gissing v Gissing*[21] the House of Lords rejected a wife's claim for an equitable proprietary interest in the matrimonial home which was legally owned by her husband. Lord Morris argued: "Any power in the court to alter ownership must be found in statutory enactment."[22] Once again the nature of 'property' and its role in delineating the province of the judiciary from that of the legislature was assumed without discussion - a feature which suggests that the classic liberal understanding of property has a place in our legal consciousness as an immutable truth.

This is the problem which faces the justification of proprietary relief for enrichment by wrongs. The award of a constructive trust over the proceeds of wrongdoing represents a departure from the orthodox paradigm of property. In the case above, the person supplying the bribe or secret commission intended it to benefit the fiduciary and this was also the fiduciary's intention. Thus it is only by imposing an outcome inconsistent with the will of the parties' that the bribe becomes the property of the principal. Even if it is regarded as arising automatically, the plaintiff's property interest is not obtained by consent. The property interest created in this way is acquired in a manner contrary to accepted modes of acquisition.

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18 (1895) 1 Ch 287. See C Rotherham, "The Allocation of Remedies in Nuisance: An Evaluation of the Judicial Approach to Awarding Damages in Lieu of an Injunction" (1989) 4 *Canta LR* 185.

19 For an account of the development of nuisance law in England in the nineteenth century, see McLaren, "Nuisance Law and the Industrial Revolution - Some Lessons from Social History" (1983) 3 *OJLS* 155.

20 (1895) note 18 *supra* at 316.

21 [1971] AC 886.

22 *Ibid* at 898.

III. *LISTER V STUBBS* AND THE OWNERSHIP/OBLIGATION DISTINCTION

A. Secret Commissions and the Limits of Proprietary Relief

In *Lister v Stubbs*[23] the plaintiff company sued a former employee for accepting secret commissions in return for arranging contracts with suppliers. The plaintiff sought an injunction restraining the defendant from dealing with investments made with the commissions, arguing that any gain obtained by the defendant from abusing his position as fiduciary was held on trust for his principal. The Court of Appeal responded that the defendant's liability was purely personal. Lord Justice Lindley concluded that to have held that the defendant was a constructive trustee would have involved "confounding ownership with obligation."[24]

Lord Justice Lindley's reasoning supposes a fundamental distinction between ownership and obligation. This is premised on the classic understanding that the law protects existing property rights and does not create new ones. In *Lister v Stubbs*, the secret commissions were given to the defendant by a third party. The basis of the plaintiff's case was not that he had a pre-existing title to the money in question but that the law ought to vest the ownership of the commissions in him. The Court regarded this claim as misconceived. It accepted the view of the trial judge, Stirling J, that the principal was entitled to a constructive trust order only if the principal was seeking money which he owned before any wrongful act was committed by the fiduciary.[25] In the absence of a pre-existing title the plaintiff's claim had to be based on principles of obligation - a claim for personal relief.

B. Policy Concerns Behind the Principle in *Lister v Stubbs*

A striking feature of the judgments delivered by Cotton and Lindley LJJ was the considerable sympathy expressed for the plaintiff's claim.[26] Lord Justice Lindley's rejection of the plaintiff's claim appears to have been driven, not by any sympathy with the defendant's position, but principally by his unease with the consequences of granting proprietary relief beyond the interests of the parties before the Court. In particular, he commented:

> One consequence, of course, would be that, if Stubbs were to become bankrupt, this property acquired by him with the money ... would be withdrawn from the mass of his creditors and handed over bodily to Lister. Can that be right?[27]

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23 Note 4 *supra*.

24 *Ibid* at 15.

25 *Ibid* at 9-11.

26 *Ibid* at 14, per Cotton LJ; and at 14-16, per Lindley LJ.

27 *Ibid* at 15. More difficult to comprehend is the other policy justification that Lindley LJ advanced against the recognition of proprietary rights. He commented:

> Another consequence of that would be that, if the appellants are right, Lister could compel Stubbs to account to them, not only for the money with interest, but for all the profits which he might have made by embarking in trade with it. Can that be right?

This reasoning conflicts with Lindley LJ's suggestion that: "If we were to accede to this application, I don't think that Stubbs could complain." In any event it is not clear why Lindley LJ believed that profits made from investing the secret commission would be recoverable in a proprietary claim but not in a personal action. Perhaps he was of the view that the fact that the profits were derived by using ill-gotten gains was

Thus, Lindley LJ seized upon the distinction between ownership and obligation as a means of preventing injustice in bankruptcy.

C. Divergence Between the Formal Principle and Policy Concerns

This part considers how well the principle formulated by Lindley LJ gives effect to the normative rationales to which he adverted. In this context, a doctrine delimiting the availability of proprietary relief may be said to be *under-inclusive* where it allows such relief to be granted in situations in which, considered in terms of the normative considerations which motivated it, it is unmerited.[28] Such a doctrine is *over-inclusive* where it denies a proprietary remedy when such relief is, in the same terms, merited. While a degree of over and under-inclusiveness is the inevitable cost of providing formal standards which limit decision-making officials' inquiries into particular facts (thus lowering administrative costs and restricting officials' discretion) it is difficult to justify divergence between a doctrine and its normative foundations for any other reason.

(i) The Ownership/Obligation Doctrine as Over-inclusive

How well does the formal principle that Lindley LJ evoked coincide with the policy concerns he expressed? One cause for concern is that the doctrine does not rest on that distinction which potentially offers a principled basis for differentiating those claims that merit priority from those which do not. Defendants may be unjustly enriched either "*by subtraction*" or "*by wrongs*".[29] Where a claim is made for enrichment "by subtraction" the defendant's gain is equal to the plaintiff's loss. In terms of moral desert, the plaintiff in such a situation has a more compelling case for relief.[30] On the other hand, actions for enrichment "by wrongs" assert that the defendant's enrichment represents a profit derived from a wrong against the plaintiff, without relying on evidence that the plaintiff has suffered loss. Justifying relief in these cases is more problematic. While a rigid division between ownership and obligation would preclude proprietary relief for enrichment by wrongs, it would also deny such relief in some cases of enrichment by subtraction. Indeed there is a good argument that secret commissions involve enrichment by subtraction.[31] A supplier is willing to pay a particular price in order to get a contract. In economic terms, a company tendering for a supply contract will be indifferent as to whether the price extracted from it is

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outweighed by the consideration that they were the product of defendants' labour and consequently would be regarded as irrecoverable in a personal action for reasons of causation or remoteness. He may have thought that, in contrast, the mechanical approach taken in tracing claims would have ensured that the plaintiff was entitled to anything that was the product of its property. Yet, it is not clear that the issue would really be dealt with so differently in the two types of actions; A Burrows, *The Law of Restitution*, Butterworths (1991) pp 411-12.

28 This method of analysis derives from P Atiyah and R Summers, *Form and Substance in Anglo-American Law*, Clarendon Press (1987) p 13.

29 P Birks, note 1 *supra*; See also *Restatement of Restitution 2d, Tentative Draft No 1* (1983) at 7.

30 L Fuller and W Purdue, "The Reliance Interest in Contract Damages" (1936) 46 *Yale LJ* 52; E Sherwin, "Constructive Trusts in Bankruptcy" (1989) *University of Illinois Law Review* 297 at 329.

31 Interestingly, this suggests that secret commission cases should be regarded as being fundamentally different from many bribes cases, whereas they have generally been treated as essentially the same.

paid to the contracting company (either by accepting a lower price or offering more for the same price) or to the employee arranging the contract (by giving a commission). This means that, where a secret commission is paid, the company tendering for a supply contract would have been prepared to settle for a price which is higher than the price for which it actually contracted by at least the amount of the secret commission. Thus, those taking secret commissions take a cut from their employers' profits. If one accepts that claims for enrichment by subtraction merit priority, it follows that proprietary relief is appropriate in cases involving secret commissions.[32]

Another problem with Lord Justice Lindley's doctrine is that it is not well adapted to dealing with cases where proprietary relief is sought for reasons other than priority. Consider *Keech v Sandford*,[33] a case in which a trustee had purchased a lease for his own benefit after the lessor had declined his request to renew it for the benefit of the beneficiary. Lord King LC found that the trustee held the lease on constructive trust and ordered him to assign it to the beneficiary.[34] This was so even though the beneficiary did not have a subsisting interest in the property - a fact which suggests that *Keech v Sandford* collides with the principle stated in *Lister v Stubbs*. Yet, the two decisions may be distinguished on the grounds that a proprietary remedy was especially important in *Keech v Sandford* and that it is unlikely that Lord King LC was faced with any of the policy considerations which subsequently troubled Lindley LJ in *Lister v Stubbs*. The plaintiff in *Keech v Sandford* had previously enjoyed a lease over the property in question and, for this reason, it is likely to have had special significance for him.[35] It would consequently have been an affront to the plaintiff had the errant trustee been permitted to enjoy the benefit of the lease. Moreover, the effect of the court order was such that, while the trustee was forced to transfer the lease, the plaintiff was obliged to pay for it. Consequently, the provision of proprietary relief would not have effected a significant devaluation in the net worth of the defendant's

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32 Of course the question in *Lister v Stubbs*, note 4 *supra*, was more difficult, because proprietary relief was sought in respect of investments made using the secret commission - raising issues regarding causation and remoteness of damage. However, if one accepts that restitution by subtraction claims merit priority, it follows that in *Lister v Stubbs* it would have been appropriate to give the plaintiff, at least, a lien over the investments to the value of the secret commission.

33 (1728) 22 ER 629.

34 Compare with TG Youdan, "The Fiduciary Principle: the Applicability of Proprietary Remedies" in T Youdan (ed), *Equity Fiduciaries and Trusts* (1989) 93.

35 Margaret Radin has argued that, while much of what we own is essentially fungible and prized by us only for its exchange value, certain objects have a special role in the development of our identity and, for this reason, merit, and indeed often do receive, special treatment in our legal system; see M Radin, "Property and Personhood" (1982) 34 *Stanford LR* 957. Similar considerations may justify the relief given in quasi-matrimonial property cases; see E Sherwin, note 30 *supra*. Outside England, courts have allowed proprietary relief without insisting on a pre-existing title; see for example, C Rotherham, "The Contribution Interest in Quasi-Matrimonial Property Disputes" (1991) 4 *Canta LR* 407. Thus the New Zealand Court of Appeal's conclusion in *Attorney General for Hong Kong v Reid* [1992] 2 NZLR 385 that *Lister v Stubbs* was good law is difficult to comprehend. In the previous decade, the same Court had developed a doctrine providing relief in quasi-matrimonial cases - largely ignoring any requirement for a pre-existing proprietary interest; see C Rotherham, "The Redistributive Constructive Trust: 'Confounding Ownership and Obligation?'" (1992) 5 *Canta LR* 84 at 92-8.

estate and so would not have prejudiced the defendant's creditors in the event of insolvency.

It might be argued that the doctrine in *Lister v Stubbs* is justified, despite the fact that it dictates results which are over-inclusive, relative to the policy concerns to which Lindley LJ referred. According to this view, maintaining a rigid division between ownership and obligation by regarding property interests as absolutely inviolable will lower administrative costs and promote certainty. Yet, on balance, such a restriction would seem too extreme to be justified. Allowance should be made for exceptions to the principle in *Lister v Stubbs*. However, such allowance should be made provided it is possible to indicate relatively easily identified categories in respect of which a rule allowing judicial interference with property rights would be justified.

D. The Premises and Methodology Underlying the Principle in *Lister v Stubbs*

(i) The Paradigm of Absolute Property Rights

As mentioned, Lindley LJ was disturbed by the practical consequences of awarding a constructive trust.[36] He argued that the repercussions of such an order suggested that the plaintiff's argument was contrary to legal principle. He then deduced the nature of the principle violated, commenting:

> "[i]t appears to me that those consequences show that there is some flaw in the argument. If by logical reasoning from the premises conclusions are arrived at which are opposed to good sense, it is necessary to go back and look again at the premises and see if they are sound. I am satisfied that they are not sound - the unsoundness consists in confounding ownership with obligation."[37]

Lord Justice Lindley's view reflects the understanding, characteristic of his period, that any error in legal argument can be traced back to a failure to advance logically by deduction from axiomatic first principles.[38] However, it should not be inferred that Lindley LJ and his fellow judges opportunistically seized upon a formal principle in order to imbue that outcome which they considered fair with an

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36 See note 27 *supra* and accompanying text.

37 Note 4 *supra* at 15.

38 For a helpful discussion of this tendency see: P Atiyah, note 7 *supra* at 351-3. Lord Justice Lindley typified a tendency prevalent among nineteenth century lawyers viewing law as a systematic science. As the son of a Professor of Botany, Lindley LJ was very likely influenced by the nineteenth century ideal of science. Indeed, he translated Thibaut's *System de Pandektenrechts*, while still in his twenties, an indication of his familiarity with and empathy for the rigorous legal science of the German Pandecists. This suggests an involvement with the importation of continental legal concepts and methodology which has been identified as one of the leading causes of the systematic rationalisation of English common law in the nineteenth century; see
A Simpson, "Innovation in Nineteenth Century Contract Law" in *Legal Theory and Legal History*, Hambledon Press (1987) p 273; and P Atiyah, *ibid*, p 399. Lord Justice Lindley was part of the explosion of treatise writing which was integral to this process of rationalisation, contributing a leading text on the law of partnership, published in 1860. Lord Justice Lindley was the pupil master of Frederick Pollock, who became one of the greatest of the writers in the textbook tradition and who credited Lindley LJ for teaching him that "the law ... is neither a trade nor a solemn jugglery, but a science"; see R Sugarman, "Legal Theory, the Common Law Mind and the Making of the Textbook Tradition" in W Twining (ed) *Legal Theory and the Common Law*, P Blackwell (1986) 26 at 36. Lord Justice Lindley's efforts were rewarded by his promotion to the House of Lords in 1900.

aura of legality. Both members of the Court giving judgments indicating that to give the plaintiff the remedy it sought would do no injustice in the particular case before them.[39] Indeed, Cotton LJ was of the view that in "the circumstances of the case, it would be highly just to make the order." Nonetheless both Judges felt constrained to find for the defendant. Unlike that of Lindley LJ, the judgment of Cotton LJ did not delve into questions of policy. His finding was firmly based on the conclusion that finding for the plaintiff would have involved the recognition of a "new and wrong principle".[40]

The conclusion of Stirling J at first instance that the proper question was, "Whose money was it before the wrongful act?" and the distinction between ownership and obligation as relied upon by the Court of Appeal, rest on assumptions regarding property that prevailed in the nineteenth century. According to this view, the judiciary enforces pre-existing property rights and the consensual bargains of individuals; it does not create new property rights. The prohibition of judicial interference with property rights was in harmony with the contemporary judicial attitude that combined a faith in classic liberal philosophy with a conservative belief in the importance of property rights to the preservation of the English social order.[41] It was an understanding to which both Lindley J and Stirling J were to allude on occasions during their careers on the Bench.[42]

It is unfortunate that the Court of Appeal based the decision upon an abstract principle, rather than pragmatically constructing a rule to implement its policy concerns. Doctrines based on the inviolability of property do not get to the heart of the issues of justice involved in claims for priority in bankruptcy.[43] Subsequent focus on the ownership/ obligation distinction has tended to deflect discussion from the key issue of the merit of plaintiffs' claims for priority, to an almost metaphysical debate on the nature of property rights.

Lord Justice Lindley's conclusion that the plaintiff in *Lister v Stubbs* was "confounding ownership and obligation" has an intuitive appeal. The notion that private property rights are inviolable seems so obvious so as not to require further explanation. Yet as a matter of logic, this argument fails in the absence of evidence that the common law is committed to a policy which prohibits any interference with private property rights. It is this assumption that provides the major premise for the syllogism upon which the Court implicitly relied. When one searches for such evidence, one is likely to find the courts' assumption of a fundamental distinction between ownership and obligation naive. Exchange-

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39 See footnotes 26-7 *supra* and accompanying text.

40 Note 4 *supra* at 14.

41 See for example, P Atiyah, note 7 *supra*, pp 235-6, 374.

42 For example, Lindley LJ invoked such assumptions in *Shelfer v City of London Electric Lighting Co*, note 18 *supra*, see also footnote 19 *supra* and accompanying text) and in *Wheaton v Maple Co* [1893] 3 Ch 48 where he refused to allow prescriptive easements against leaseholds. On the latter, see P Sparkes, 'Establishing Easements Against Leaseholds' (1992) *Conv* 167 at 170. Subsequently, as a member of the Court of Appeal, Stirling LJ cited *Lister v Stubbs* to limit to a personal remedy an insurer claiming subrogation with respect to a damages award given in favour of a client which it had already indemnified; *Stearns v Village Main Reef Gold Mining Co* (1905) 10 Com Cas 89 (discussed by A Burrows, note 27 *supra*, p 82).

43 See footnotes 29-35 *supra* and footnotes 51-3 *infra* and accompanying text.

product tracing, for example, involves a court overriding a defendant's property rights in an object and allowing a plaintiff to claim title over something which he or she did not previously own. It is inconsistent with the conventional understanding of property as the static ownership of a 'thing'. Tracing into substitutes is not permitted in civil law jurisdictions precisely because a rigid conceptual separation is maintained between ownership and obligation.[44] The English Judiciary's acceptance of this practice reveals as misconceived the assumption that the sanctity of property provides a natural distinction between ownership and obligation.[45]

IV. BIRKS' "PROPRIETARY BASE" THEORY

A. The Concept

In an attempt to provide an interpretation of *Lister v Stubbs* which is consistent with the law of tracing, Professor Peter Birks has argued that what is needed for proprietary relief is not a continuing title but a subsisting "proprietary-base".[46] According to this analysis, it is enough that the plaintiff once had a property interest. The law of tracing is regarded as providing rules which determine whether and in what circumstances this 'proprietary-base' 'survives'. While he recognises that the effect of tracing is to create a new property interest, Birks argues that this is permitted only where the plaintiff had a prior proprietary interest and where there is some connection between the asset in respect of which the plaintiff once enjoyed an interest, and that asset in respect of which he or she now claims proprietary relief. According to this argument, as the plaintiff in *Lister v Stubbs* had never owned the secret commission received by the defendant, it could not point to a proprietary-base and its claim had to fail.[47]

B. Policy Concerns

To the extent that Birks is motivated by policy considerations rather than a quest for conceptual synthesis, he demonstrates a concern that proprietary rights "must not be lightly conceded" in view of their importance in insolvency.[48] Subsequently, Professor Roy Goode has vigorously espoused the merits of the

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44 See A Gambaro, note 3 *supra*, pp 7-9.

45 For a discussion of the relationship between tracing and absolutist understandings of property, see C Rotherham, "The Metaphysics of Tracing" (1996) *Osgoode Hall LJ*, (forthcoming). The ownership/obligation distinction has also failed to be consistently observed in other areas where the courts have been prepared to enforce contracts against third parties. For a discussion of this issue in the context of the tort of interference with contractual relations and the enforcement of charter party contracts against third parties, see Lauchterpacht, "Contracts to Breach a Contract" (1936) 52 *LQR* 494. More recently, the issue has arisen in the context of contractual licences; see K Gray, *Elements of Land Law*, Butterworths (1993) pp 914-27; J Dewar, "Licenses and Land Law: An Alternative View" (1986) 49 *Modern Law Review* 741.

46 P Birks, note 1 *supra*, p 378.

47 *Ibid.*

48 *Ibid*, pp 387-9.

proprietary-base notion as a basis for limiting the potential of the constructive trust and other forms of proprietary relief to work injustice in bankruptcy.[49]

C. Divergence Between the Formal Principle and Policy Concerns

As with Lindley LJ's approach, the 'proprietary-base' analysis is poorly designed to deal with the policy concerns that motivate its proponents. Once again, axiomatic notions of property govern the availability of proprietary relief instead of more relevant distinctions.[50] For instance where the plaintiff has actually been deprived of something, Birks argues that a plaintiff is entitled to trace into investments to obtain proprietary relief over assets which have a value exceeding those of which he or she was originally deprived.[51] Contrary to the opinion which Birks has expressed elsewhere, this conclusion suggests that tracing involves following title, rather than focusing on value.[52] In addition, Birks suggests that, even if there was no subtraction from the plaintiff's wealth, the fact that profits have been wrongly earned as a result of misusing a plaintiff's property may satisfy the requirement of a "proprietary-base" and entitle the plaintiff to proprietary relief.[53] This conclusion is consistent with an essentialist view of property that any profits derived from the use of an object must belong to the owner of that object. Yet why should the distinction between those wrongs which breach property rights and wrongs which breach personal rights be determinative? It is not obvious that cases of enrichment resulting from the former type of wrongs present a stronger claim to priority than those flowing from the latter.

D. Assumptions Underlying Birks' Theory

It is apparent that Birks does not regard proprietary rights as completely inviolable. Where plaintiffs' property rights have been violated they may elect to 'follow' the title they had in relation to object one and assert it over object two, thus defeating the defendants' title to object two. On the other hand, Birks maintains that any other mode of non-consensual redistribution of property rights is illegitimate. One flaw with Birks' approach is that, by seeking an analysis which is consistent with reality, it concedes too much. The 'proprietary-base' theory simply does not have the intuitive appeal of a theory based on the notion of property as absolute. In Birks' theory, the line between ownership and obligation begins to blur. Ultimately it begs the question: If property is less than inviolable, why is a "proprietary-base" a necessary pre-requisite for proprietary relief?

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49 RM Goode, "Ownership and Obligation in Commercial Transactions" (1987) 103 *LQR* 433; RM Goode, "Property and Unjust Enrichment" in A Burrows (ed), *Essays on the Law of Restitution* (1995) 215; "The Recovery of Directors' Improper Gains" in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations*, Clarendon Press (1992) 135.

50 Thus, in his criticism of the proprietary-base theory, Sir Peter Millett suggests that the dichotomy of enrichment by subtraction and enrichment by wrongs offers a "more sophisticated" basis for determining the availability of proprietary relief; P Millett "Bribes and Secret Commissions" (1993) *Restitution Law Review* 7 at 14.

51 P Birks, note 1 *supra*, p 366.

52 Compare with P Birks, "Mixing and Tracing" (1992) 45(2) *CLP* 69 at 86.

53 Note 1 *supra*, p 474.

Further, Birks' analysis does not concede enough to explain judicially developed doctrines which permit interference with property rights doctrines such as proprietary estoppel and subrogation. Birks' error is to assume that the *substance* of the positive law can be reduced to a logical schema. He fails to appreciate the relationship which legal fictions, evidential devices, and the approach to the development and manipulation of abstract legal concepts (in order to justify judicial action), have to assumptions which inform our vision of the law, such as the notion of absolute property rights. Fictions and other obfuscatory devices suppress the reality that the law is being developed in ways which are inconsistent with premises that a legal culture regards as fundamental. They ensure that, at the level of *formal* expression, the law adheres to these premises.[54] In the words of Fuller, "the fiction is the cement that is always at hand to plaster together the weak spots in our intellectual structure."[55] In this way, fictions and similar contrivances allow the law to function in ways which diverge from ideals which a legal culture would like to regard as inviolable.[56]

V. DEDUCING OWNERSHIP FROM OBLIGATION: *AG FOR HONG KONG V REID*

A. The Principle in *Reid*

After holding a series of positions of considerable responsibility in Hong Kong's legal administration, the respondent was convicted under the Prevention of Bribery Ordinance and ordered to make restitution of HK $12.4 million. The appellant alleged that Reid had acquired three properties in New Zealand with the proceeds of bribes. The appellant then argued that, because these properties were purchased with the proceeds of a breach of the fiduciary duty, they were held by Reid on trust for the Hong Kong Government.[57] However, following *Lister v Stubbs*, the New Zealand High Court found that Reid's obligation to make restitution was purely personal. Similarly, the New Zealand Court of Appeal concluded that it was obliged to follow *Lister v Stubbs*.[58] The Privy Council upheld the appeal.[59]

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54 Fuller notes that premiseless law would be fictionless law, for "the necessity for fiction will vary directly with the number and flexibility of the postulates assumed" in L Fuller, *Legal Fictions,* Stanford University (1967) p 51.

55 *Ibid.*

56 For a discussion of discussion of strategies for dealing with clashes of ideals through subterfuge in other contexts, see G Calabresi and P Bobbit, *Tragic Choices*, Norton (1978) p 18, and G Calabresi, *Ideals, Beliefs and Attitudes and the Law*, Syracuse University (1985) pp 87-114.

57 The constructive trust argument was made in this case because the Hong Kong Government sought to demonstrate that it had an interest in property sufficient to enable it to lodge caveats against dealing on the titles of those properties prior to a full civil trial on the matter.

58 [1992] 2 NZLR 385. See C Rotherham (1992), note 35 *supra*; J Evans and P Watts "Constructive Trusts and the Authority of English Decisions in Other Commonwealth Jurisdictions"(1992) *NZ Recent LR* 302.

59 Note 4 *supra.*

The Privy Council decision, delivered by Lord Templeman, was primarily based on extra-judicial reasoning previously developed by Sir Peter Millett.[60] The obligation of fiduciaries to account to their principals for any unauthorised profit made from their position as fiduciaries, is well established. However, in order to establish that the liability of the fiduciary was proprietary in nature, the Privy Council in *Reid* employed two legal fictions. Firstly, the Court argued that "false fiduciaries" were estopped from denying that they received the bribe for the benefit of their principals. To this was applied the equitable maxim 'equity considers done that which ought to have been done.' From this, it was argued that it followed that, "[A]s soon as the bribe was received ... the false fiduciary held the bribe on a constructive trust for the person injured."[61]

B. Policy Concerns

(i) The Interests of Creditors

In both Sir Peter Millett's article and the Privy Council's opinion in *Reid*, it was denied that the interests of third party creditors were relevant in determining the availability of proprietary relief. Millett, when arguing against limiting proprietary claims to cases of unjust enrichment by subtraction, commented:

> [I]t is illogical. If proof of loss is necessary at all, it should be necessary to found liability [and not to determine the availability of remedies]. The fact that it is unnecessary shows that the law's purpose is not compensatory. Moreover, the distinction makes the nature of the remedy depend on the consequences *to the plaintiff*, whereas the usual objection to the proprietary remedy is based upon its effect on the creditors *of the defendant*.[62]

Millett's argument is misconceived. Firstly, a conclusion that relief should be available to reverse enrichment by wrongs, in no way logically implies that the relief granted should be proprietary. The questions of liability and the type of remedy available can properly be treated as distinct.[63] Thus, proprietary recovery is generally not available in contract or tort. It is no more illogical to limit constructive trust relief than it is to restrict, for example, the availability of specific performance in contract. Secondly, the claim that it is improper to base a distinction on the nature of the plaintiff's claim is equally mistaken. Where priority in insolvency is concerned, the key issue is the relative merits of the plaintiff's and creditors' claims.[64] Therefore, it follows that the strength of the plaintiff's claim will always be a relevant consideration.

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60 P Millett, note 50 *supra*.

61 Note 4 *supra* at 331. This passage might of course be criticised for its used of the expression "injured". Liability follows from the breach of duty; proof of injury is not necessary or relevant.

62 P Millett, note 50 *supra* at 14.

63 J Coleman, "Corrective Justice and Wrongful Gain" (1982) 11 *Journal Leg Stud* 421 at 425.

64 Millett's approach is clearly inconsistent with this understanding. Thus he asserts:
Either the plaintiff is entitled to a proprietary remedy or he is not. If he is then the insolvency of the defendant is not a sufficient reason for withholding it from him; the defendant's creditors should be in no better position than the defendant himself, note 50 *supra* at 10. This may be contrasted with the view of Jones that, "it is the ground of the plaintiff's claim that should be of paramount importance. The scope of the proprietary remedy should also depend on such factors as whether the contest is between the plaintiff and a solvent or insolvent defendant..."; in R Goff and G Jones in G Jones (ed), *The Law of Restitution*,

In *Reid*, the Privy Council did not even attempt to counter the policy arguments against proprietary relief. Instead it concluded that:

> The unsecured creditors cannot be in a better position than their debtor. The authorities show that the property acquired by a trustee ... belong[s] in equity to the cestui que trust and not to the trustee personally whether he is solvent or insolvent.[65]

Accordingly, the Court argued that the authorities established that the respondent had a proprietary interest and therefore prevailed in insolvency. This assertion is unconvincing, particularly when one considers that the New Zealand Court of Appeal had also used the argument of "settled authority" to justify their refusal to investigate issues of policy, but had relied on the opposing line of precedent and found for the other party. In any event, the Privy Council is able to reconsider the law in a particular area. In this instance, no explanation was given for its disinclination to do so. The traditional justification of an institutionalised reliance on the doctrine in question could carry little weight here.[66] The law was too unclear to induce reliance and, in any event, parties do not plan their affairs around breaches of fiduciary relationships.

C. Divergence Between Formal Principle and Policy Concerns

(i) The Principle in Reid as Over-inclusive

The Privy Council concluded in *Reid* that a constructive trust arises the moment a profit is made in breach of a fiduciary duty. Logically, this implies certain dubious consequences. Consider a situation where A employs B who is given a secret commission in gold bullion by C. B sells the bullion to D, who is aware of the circumstances in which it was obtained. According to *Reid*, the moment B receives the bullion, he or she holds it on trust for A. Under normal tracing principles, A could argue that B has received the proceeds in exchange for trust property (the bullion) and elect to follow his or her equitable title in the bullion into the proceeds of the sale. This election requires that A give up equitable ownership of the bullion. *Reid*, however, suggests that A has a more profitable alternative. A, by relying on the rule in *Reid*, may focus on the fact that, in selling the bullion, B (once again) was attempting to profit from trust property. Following *Reid*, the moment B receives them, B holds the proceeds of the bullion sale on trust for A. This property interest arises automatically without any need for A to exercise any power of election. The fact that D is holding trust property (the bullion) then becomes a separate issue. The result is that A does not have to elect between B and D in enforcing title; both are liable as constructive trustees. Yet A's case for proprietary relief against both parties is very weak. A is regarded as suffering a further wrong to his or her property (B's profit) and a subtraction (the bullion taken by D) only because of the rule in *Reid* which dictated that the bullion became trust property the moment it was handed over. To make D liable as a

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Sweet & Maxwell (4th ed, 1993) 101. For a similar view, see P Maddaugh and J McCamus, *The Law of Restitution*, Canada Law Book (1990) p 95.

65 Note 1 *supra*, p331.

66 See for example, the discussion of the development of the doctrine of *stare decisis* in the House of Lords since the 1967 practice statement recognising the Court's right to overturn its own decisions in A Paterson, *The Law Lords*, Macmillan (1982).

constructive trustee of the bullion would be very harsh on potential creditors. D's estate can have been swelled by the transaction only to the extent that D did not pay B the full market value for the bullion. Given that the only relationship A ever had with the bullion was jurally constructed and arose without regard for the parties' intentions, this situation does not present a compelling case for relief. It is unlikely that the Privy Council wished to provide for this consequence. However the internal logic of the doctrine employed appears to demand it.

(ii) The Principle as Under-inclusive

Reid threatens to breathe new life into the much criticised rule that there must be a pre-existing fiduciary relationship before a proprietary remedy can be claimed. At present, English authority maintains that a fiduciary relationship is a pre-condition for tracing into substitutes.[67] Nonetheless, it is likely that the English courts will accept the view of leading scholars[68] and that of leading courts in other common law jurisdictions, including Australia[69] that this pre-condition is unsound and allow those with legal title to trace in equity. However, *Reid* suggests that a fiduciary relationship may now be a pre-requisite for the award of constructive trust relief in enrichment by wrongs cases. The property interest in *Reid* arose only as the result of the intricate set of presumptions and maxims which were said to follow from the nature of the parties' fiduciary relationship. Accordingly, the *Reid* principle is not available to justify proprietary relief where there is no such relationship. Actions to recover profits made from breaches of duties arising at common law, under statute and from non-fiduciary equitable obligations are likely to be restricted to personal claims.[70] If it is true that third party creditors have no legitimate interest in the proceeds of wrongs and that it is more equitable that the wronged plaintiff should have priority, then it is difficult to understand why proprietary relief should not be available for all wrongs. The normative arguments advanced by Millett and the Privy Council apply equally to all cases of enrichment by wrongs. The restriction of proprietary relief to cases involving breaches of fiduciary duty, as opposed to other duties - a restriction which is inherent in the formal doctrine constructed in *Reid* - is without foundation as a matter of justice.

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67 This has been the received wisdom in England since *Re Diplock* [1949] Ch 465 which interpreted *Sinclair v Brougham* [1914] 2 Ch 356 as establishing this position. This interpretation was accepted as authoritative recently by the Court of Appeal in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1994] 1 WLR 938; see S Evans, (1994) *Conv* 395. The approach taken by Goulding J in the High Court in *Chase Manhatten Bank NA v Israel-British Bank (London) Ltd* [1981] 1 Ch 105 is difficult to regard as consistent with principles of *stare decisis*.

68 See for example, P Birks, note 1 *supra*, pp 380-5. See also, R Goff and G Jones, note 64 *supra* at 83-6.

69 See for example, *Newton v Porter* (1877) 69 NY 133; *LAC Minerals Ltd v International Corona Resources Ltd* [1989] 2 SCR 574; *Hospital Products v United States Surgical Corp* (1984) 156 CLR 41; *Elders' Pastoral Ltd v The Bank of New Zealand* [1989] 2 NZLR 180.

70 It is possible of course that the courts might seek to develop an alternative analysis to justify awarding proprietary relief in such circumstances. However, in developing such an approach the courts would be forced to address issues they were at great pains to suppress in *Reid*; see footnotes 89-92 *infra* and accompanying text. For this reason, such reform is, for the moment, unlikely.

D. The Premises and Methodology Underlying *Reid*

Courts seldom construct legal institutions simply on the basis of perceived societal needs.[71] Rather, common law development is heavily influenced by the extent to which jurists are able to manipulate existing legal concepts to achieve the result for which they are striving.[72] In so doing, jurists seek what Lon Fuller termed "doctrinal bridges" to bring an established legal institution to bear on a perceived social problem to which that institution has not previously been applied.[73] By developing the law through existing conceptual apparatus, a connection is sought with the past, which belies the originality of the outcome.[74] Thus, in *Reid* proprietary relief was justified in terms of that well-established legal institution, the fiduciary relationship and an equitable maxim of some antiquity.[75]

(i) The Evidential Presumption

> [T]he Court in cases of this kind does not proceed on the basis of punishment, but treats the trustee as having received such a bribe not on his own behalf, but on behalf of and as agent for the trust estate.

So commented Kekewich J in *Re Smith*,[76] another involving a bribe. Yet is this presumption anything other than a rather stilted way of describing a duty, coupled with a liability for any breach of that duty? The presumption was developed at the turn of the century, at a time when the conceptual foundations of unjust enrichment had not been developed and restitution was not understood as providing a principled basis for relief.[77] The courts employed such devices as "doctrinal bridges"; these devices allowed the courts to utilise concepts they readily understood, such as trusteeship. Another device employed was the presumption that the principal had been damaged to the amount of the bribe, so

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71 See generally, A Watson, *Society and Legal Change*, Scottish Academic Press (1977) and A Watson, "Legal Change: Sources of Law and Legal Culture" in *Legal Origins and Legal Change*, Hambledon Press (1991) 69 at 82-94.

72 Thus Milsom observes that change in law is brought about largely through reclassification: "[t]he life of the law" he comments, "has been in the abuse of its elementary ideas. If the rules of property give what now seems an unjust answer, try obligation; and equity has proved that from the materials of obligation you can counterfeit the phenomena of property. If the rules of contract give what now seems an unjust answer, try tort"; SFC Milsom, *Historical Foundations of the Common Law*, Butterworths (2nd ed, 1981) p 6.

73 L Fuller, "American Legal Realism" (1934) 82 *University of Pennsylvania Law Review* 429 at 441-2. See also K Llewellyn, "Through Contract to Title and a Bit Beyond" (1938) 15 *NYULQR* 159 at 181.

74 Fuller notes that in employing a fiction a judge is "himself [sic]... often acting under the influence of some half-articulate philosophy of law which seems to him to justify the change if it takes place under the apparent sanction of old formulas, when it would not be justified otherwise"; see L Fuller, note 54 *supra*, p 7.

75 This tendency is apparent in the work of Peter Millett, note 50 *supra*. While Millett did advance normative justifications for the imposition of proprietary relief, he assumed that there had to be fundamental legal principles which determined the outcome. Thus after completing his policy analysis he commented: "It would, however, be deeply unsatisfying if the availability of a proprietary remedy could be explained only on the grounds of policy" at 17. As already mentioned, Lindley LJ's judgment in *Lister v Stubbs* was premised on the same presumption; see footnote 37 *supra* and accompanying text.

76 [1906] 1 Ch 71 at 77, cited in P Millett, note 50 *supra* at 21.

77 P Atiyah, note 7 *supra*, p 455; D Stevens, "Restitution, Property and the Cause of Action in Unjust Enrichment" (1989) 39 *University of Toronto Law Journal* 258 at 286.

that the action could be framed as compensatory.[78] Now that restitution has gained acceptance as a branch of the private law,[79] we can afford to be wary of such tools. Presumptions and related devices disguise the foundation of punishment and deterrence which underlies the imposition of liability in this context. Moreover, they divert attention from key issues of justice, such as the interests of third party creditors. It was only by relying on an obfuscatory analysis of the basis for relief that the Privy Council in *Reid* was able to reason that a constructive trust arose automatically. Where the basis of liability in bribery cases is described more realistically, the foundation for the automatic proprietary interest disappears. This demonstrates that the evidential presumption relied upon by Millett and the Privy Council is a slight and opportunistic basis for justifying proprietary relief.

(ii) Equity Regards as Done that Which Ought to Have Been Done

In his classic study of legal fictions, Lon Fuller referred to the maxim in question and commented that "[h]appily such 'short dark maxims' are not so common as they once were."[80] To Fuller, fictions of this type were the tools of "undeveloped systems of law."[81] Writing in the United States in 1930, Fuller assumed that American legal culture had attained a state of sophistication such that it no longer needed to resort to such primitive devices. He regarded such expressions as obscure and inadequate attempts to describe legal reality and as without real explanatory value. He commented, "[f]or particulars I must look elsewhere."[82] Fuller's view is borne out in the context of *Reid*. What are the limits of this maxim? Using specific performance as an analogy in his discussion of the maxim, Sir Peter Millett speaks of the remedy being available "provided there is no bar" and "in appropriate circumstances".[83] This demonstrates that liability cannot be deduced directly from the maxim. The questions of what might amount to a "bar" to relief and what are "appropriate circumstances" for giving relief must be decided in order to determine the remedy's availability. This must be true for the constructive trust as much as it is for specific performance. While the general rule is that specific performance will be available where damages would not be an adequate remedy, most commentators who have considered the question have agreed that the fact a defendant is insolvent is not an acceptable reason for giving specific relief.[84] Indeed, some commentators argue that the remedy of specific performance should not be issued so as effectively to prefer one

78 See for example, Slade J in *Industries & General Mortgage Co Ltd v Lewis* [1949] 2 All ER 573 at 578; cited in P Millett, note 50 *supra* at 21.

79 See the House of Lord's acceptance of unjust enrichment as a general principle in *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548.

80 L Fuller, note 54 *supra*, p 34.

81 Indeed Fuller, in seeking a comparison for the fiction in question, comments: "[f]or example in the jurisprudential language of a tribe of east Africa, the statement 'woman is a hyena' is intended as an expression of the notion of woman's legal incapacity"; *ibid.* Maine, had earlier expressed similar sentiments: "Fictions ... have had their day ... It is unworthy of us to effect an admittedly beneficial object by so rude a device..."; H Maine, *Ancient Law*, Dent and Dutton (1861) p 27.

82 *Ibid.*

83 P Millett, note 50 *supra* at 19-20.

84 HC Horack, "Insolvency and Specific Performance," (1917-18) 31 *Harv L Rev* 702.

creditor in insolvency.[85] Potential prejudice to third parties should equally be a consideration in determining the availability of the constructive trust. In considering the maxim 'equity regards that as done which ought to be done,' the Privy Council might have had regard to the maxim that 'no fiction shall be allowed to work an injury.'[86]

The Privy Council's approach is at odds with the historical background of equitable maxims. The substantive law was not deduced from equitable maxims. To the contrary, equitable maxims were derived from the law by a process of induction in the eighteenth century.[87] These maxims are, at best, broad statements of principle, too indeterminate to be applied to particular factual situations to dictate specific legal outcomes. The maxim in question is so vague that it can only be understood against the background of the particular doctrines said to exemplify it. Generally, it has been used to explain a group of doctrines which provide for the legal recognition and enforcement of consensual transactions, despite some want of formality or the non-occurrence of a contemplated event.[88] In *Reid*, a stronger justification was needed to support the extension of the maxim in order to impose a liability to which the defendant had never consented.

(iii) Obscuring Interference with Property Rights

Jurists are often tempted to reason from formalistic premises. This is particularly so when they would rather not deal with the implications arising from an open exploration of the particular normative issues raised by the outcome which they are endeavouring to justify. This is especially likely to be so when the sought after result conflicts with a premise which is fundamental to the legal vision accepted (explicitly or tacitly) by a legal culture.[89] As mentioned, the award of a constructive trust in the context of enrichments by wrongs puts into question the conceptual distinction made in private law between ownership and obligation. The notion that the distinction between ownership and obligation is based on fundamental legal principles is made comprehensible by the axiomatic understanding that courts do not create new property rights - the only way in which property can be acquired or lost is through consensual transfer.

Arguments from formal legal premises and circuitous property based reasoning law serve to suppress the reality of this departure from the orthodox understanding of property rights.[90] The notion that the proprietary interest arises automatically

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85 See for example, A Corbin, *Corbin on Contracts*, vol 5A (1964) § 1156, cited in R Sharpe, *Injunctions and Specific Performance*, Canada Law Book (1983) p 284.

86 W Blackstone, *Commentaries on the Law of England III* 43, cited in L Fuller, note 54 *supra*, p 50.

87 RP Meagher, WMC Gummow and JRF Lehane, *Equity: Doctrines and Remedies*, Butterworths (3rd ed, 1992) p 71.

88 *Ibid*, p 94.

89 Note 54 *supra*, pp 51-3.

90 Birks argues that the judiciary favours an approach which provides for automatic vesting of equitable title because they are wary of discretionary readjustment of property rights; P Birks, "Proprietary Rights as Remedies" in P Birks (ed), *The Frontiers of Liability*, Oxford University Press (1994) 214 at 218. Yet, this cannot provide a satisfactory explanation for the judicial approach in this area. Firstly, as American constructive trust scholarship indicates, the issue of whether the device arises automatically and whether the courts have a discretion are distinct. It would be quite possible to hold that the courts have no discretion in determining whether the remedy applies and still conclude that the constructive trust only arises when

suggests that the court is not involved in the process and thus seems more consistent with the classic liberal understanding of the private law - the understanding that the judiciary merely enforces existing proprietary relationships and enforces consensual transfers. This necessarily involves a conscious exercise in subterfuge.[91] However, it is clear that English Courts are not comfortable with openly recognising that they are creating and adjusting property rights. Because of what it disguises, the characterisation of the constructive trust as arising automatically is more comforting than an interpretation which permits the courts a discretion to give relief.

Where the courts seek to justify the non-consensual readjustment of property rights what is sought is a "doctrinal bridge" allowing them to reconstruct the line between obligation and ownership and so preserve the vision of property which underlies the orthodox understanding of the common law. Thus, the Privy Council in *Reid* constructed a legal doctrine which suppresses the reality that the outcome of that case is inconsistent with the orthodox paradigm of property.[92] The doctrine developed in *Reid* provides that the principal becomes equitable owner automatically by virtue of the combined operation of an evidential presumption and an equitable maxim. As a result, the constructive trust is treated as a natural consequence of the fiduciary relationship. The profits earned from the wrong automatically become the property of the principal without any apparent judicial intervention. In this way, the symbolic power of property as setting limits on judicial intervention is maintained. While the supposedly fundamental boundary between ownership and obligation apparently remains, its position has subtly shifted.

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declared by the court. Secondly, elsewhere the courts allow themselves a wide discretion over remedies that readjust property rights. An example is equitable estoppel (compare the discretionary approach to estoppel, favoured by the English Court of Appeal in *Crabb v Arun District Council* [1976] 1 Ch 179 at 188 with Birks' disapproval of judicial discretion for remedies for estoppel; P Birks, note 1 *supra*, pp 290-3

91 Note 54 *supra* at 26-7.

92 In *Reid* the Privy Council carefully avoided any discussion of the argument that, by ignoring the distinction between ownership and obligation, it was interfering with property rights. Lord Templeman's judgment described Lindley LJ's argument in the following terms: "[i]t is said that if the fiduciary is in equity a debtor to the person injured, he cannot also be a trustee of the bribe..." (at 331). This is a misleading characterisation of the principle expounded in *Lister v Stubbs* suggesting that it was in substance merely an objection to concurrent liability. Further evidence of judicial reluctance to face the issue is the House of Lords' judgment in *Lord Napier and Ettrick v Hunter* [1993] AC 713. Lord Justice Dillon, in the Court of Appeal, had been persuaded that declaring that an indemnified insured holds any damages paid by the tortfeasor as constructive trustee for the benefit of the insurer was precluded by *Lister v Stubbs;* note 4 *supra* at 718. While *Lister v Stubbs* was cited once again in argument before the Lords (note 4 *supra* at 720-2) it was not even mentioned in their judgments.

VI. THE LEGACY OF REALISM: THE REMEDIAL CONSTRUCTIVE TRUST IN NORTH AMERICA

A. The Function of the Constructive Trust in North American Law

In the United States the constructive trust is widely available as a remedy for unjust enrichment.[93] The *Restatement of Restitution* provides that:

> [a] constructive trust is imposed upon a person in order to prevent his unjust enrichment. To prevent such unjust enrichment an equitable duty to convey the property to another is imposed upon him.[94]

American Courts were prepared to declare a constructive trust over profits made from a breach of fiduciary duty long before English Courts overruled *Lister v Stubbs*.[95] Moreover, the American approach is such that the remedy is not restricted to cases involving breaches of fiduciary duty. For instance, the constructive trust is used to redistribute the profits of breaches of non-fiduciary duties.[96] It is, however, important to note that in American law, the constructive trust is regarded as a discretionary remedy. This gives rise to the possibility of developing an approach toward the exercise of this discretion which takes account of questions of justice in insolvency.

B. The Treatment of Proprietary Relief in Formalist Legal Discourse

(i) Denial of the Interests of Creditors

The jurist who has most influenced American constructive trust law is Austin W Scott, an eminent Harvard trusts scholar and one of the commentators for the *Restatement of Restitution*. Scott commented that "[i]t is immaterial that the wrongdoer is insolvent, for his creditors, not being purchasers for value, are not entitled to any interest in the claimant's property or product."[97] This argument is circular. The statement that the disputed assets are the plaintiff's property, while presented as the justification of the court's decision, is in reality the conclusion - a method of argument subsequently ridiculed by the realists as "transcendental nonsense".[98] Scott's approach assumes that the designation of the assets in

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93 See Cardozo LJ's dicta from *Beatty v Guggenheim Exploration Co* (1991) 225 NY 380 at 386; AW Scott, "The Constructive Trust" (1955) 71 *LQR* 39.

94 W Seavey, *The Restatement of Restitution*, American Law Institute (1937), see commentary to § 160, p 642.

95 *Ibid* at § 190. More specifically, and in contrast to the finding in *Lister v Stubbs*, Seavey states: "Where a fiduciary in violation of his duty to the beneficiary receives or retains a bonus or commission or other profit, he holds what he receives upon a constructive trust for the beneficiary," also, see for example, *US v Carter* 217 US 286 at § 197. *Freshhaker v Blum* (1910) 109 F 2d 543 at 546 (bank officer receiving a commission for a loan holding that money on trust for the bank).

96 Thus the remedy is often given for breaches of confidence, see *Hunter v Shell Oil Co* (1952) 198 F 2d 485. Admittedly the American courts are more prepared to treat such interests as property and some cases are dealt with on the basis that the defendant has profited from the misapplication of the defendant's property, for example *Diamond v Oreamuno* (1969) 248 NE 2d 910. However other American decisions simply focus on the fact there has been a breach of duty, see for example *Pratt v Shell Petroleum Corp* (1938) 100 F 2d 833 .

97 AW Scott, *The Law of Trusts*, Little Brown (3rd ed, 1967) p 3571 at § 508. See also the similar view expressed in the *Restatement of Restitution*, note 94 *supra* at § 202, comment (e) at 822.

98 FS Cohen, "Transcendental Nonsense and the Functional Approach" (1935) 35 *Colum L Rev* 809. See also A Ross, "Tû-Tû" (1957) 70 *Harv L Rev* 812 at 822-5. Examples of the same circuitous approach can still

question as the property of the plaintiff is uncontroversial. This is obviously not always so. In the case of profits earned from a breach of a duty, a plaintiff will not have had a pre-existing proprietary right in the assets in question. The issue then is a normative one: should the plaintiff be held to be the owner of those assets?

The tendency to employ proprietary justifications for new legal developments was prevalent in the formative period of American restitution law. The *Restatement of Restitution* was in many ways unique among the Restatements in that it sought to capture a field of law which was somewhat controversial and ill-formed. Much work remained to be done in formulating the theoretical framework as well as the substantive doctrines of restitution. In a sense there was nothing to restate. The 'Statement of Restitution' would perhaps have been a more accurate description. The task of the commentators was to justify disparate doctrines in terms of restitutionary theory. As Felix Cohen observed, "property" is one of the "magic 'solving words' of traditional jurisprudence".[99] The argument that something is the property of the claimant, seems to have more power than a justification based on concepts of personal obligation. Professor George Palmer referred to the judicial tendency to justify relief on the basis of equitable ownership, even in instances where relief is apparently available at common law and the plaintiff is not seeking the advantages of proprietary relief. He noted:

> It is a striking fact nonetheless that judges often seem to find it easier to reach and rectify an unjust enrichment by describing the recipient of the enrichment as a constructive trustee, even though the judgment entered is one for money and can be obtained at law in quasi contract. The constructive trust idea stirs the judicial imagination in ways that *assumpsit, quantum meruit,* and the other terms associated with quasi contract have never quite succeeded in duplicating.[100]

Despite the insistence that the constructive trust was a remedy for unjust enrichment, the device was never entirely reduced to remedial status. It retained characteristics of a substantive right, such as automatic vesting. This tended to deflect commentators from examining the constructive trust in terms of unjust enrichment and assessing its validity as a remedy conferring priority in insolvency.

(ii) Obscuring Interference with Property Rights

Scott insisted that the equitable ownership interest of a claimant seeking restitution arose automatically upon the occurrence of an unjust enrichment. This made the interest appear to be more akin to a subsisting property right than a simple remedy. Yet at the same time, Scott recognised the constructive trust as

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be found in English legal writing today. Thus Goode argues that the approach which he advocates, which requires that the plaintiff must have a proprietary-base in order to have an automatic property interest, is "not only logical but responsive to policy considerations, for to require D to make over that which never belonged to him but was always beneficially owned by P does not diminish D's estate and thus has no impact on his creditors..."; RM Goode, "Property and Unjust Enrichment" in A Burrows (ed), note 49 *supra,* p 220. Once again property is presented as having normative force when it is in reality a conclusion. For similar reasoning, see also AJ Oakley, "Proprietary Claims and their Priority in Insolvency" (1995) 54 *CLJ* 374 at 377.

99 FS Cohen, *ibid* at 820.

100 GE Palmer, *Law of Restitution,* Little Brown (1978) vol I § 1.3.

essentially remedial[101] and concluded that it was within the courts' discretion to refuse to give effect to this interest.[102] The debate over the point at which the constructive trust takes effect is rather bizarre. The constructive trust is not an observable physical phenomenon. Rather, it is a purely juridical construct. As such it arises whenever the courts say it does. Why then did Scott insist on the counter-intuitive notion that the plaintiff's proprietary interest arises automatically? One explanation is the attractive notion of the law being based on pre-legal rights which the courts recognise rather than create. The notion of transcendental legal principles underlying the common law is exemplified by Story J's judgment in *Swift v Tyson*[103] in the mid-nineteenth century. Justice Story concluded that the Federal Judiciary, when resolving a commercial dispute, was not bound by interpretations of the common law made by the judiciary of the state in which the dispute arose. Instead the federal courts were permitted to apply "general principles of the common law".[104]

In addition, Scott's background is consistent with a belief in the law as a logical system based on certain axiomatic principles. Scott's formative years were in the heyday of the ideal of legal science in America. After first completing a degree in mathematics, Scott graduated in 1910 from Harvard Law School, the heartland of this orthodoxy.[105] The very fact of Scott's involvement in the Restatement project points to his methodological tendencies. The Restatements are often depicted as the last stand of the Langdellian conception of legal science.[106] The very notion of explicating the disparate rules of quasi-contract and equitable remedies in terms of a system ordered by the notion of unjust enrichment was an archetypal example of Langdellian legal science. It is not surprising that the leading figure in the academic systematisation of the law of restitution prior to the *Restatement* was Langdell's protégé, William Keener.

What is more, Scott's work on the theoretical foundations of proprietary relief took place in the era of the *Lochner* Court when the inviolability of property and freedom of contract were articles of faith for American legal orthodoxy.[107] The remedial constructive trust presented a clash between the principle of private

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101 WA Seavey and AW Scott, "Restitution" (1938) 54 *Law Quarterly Review* 29 at 41. Palmer describes Scott's justification as "an unwarranted confusion of constructive trust with express trust... demonstrating the ambivalence of the Restatement in moving from a remedial theory of constructive trust to a 'title' theory"; GE Palmer, *ibid* at § 2.14 at 184.

102 AW Scott, note 97 *supra*, vol 5 at 3416.

103 (1842) 16 Pet 1.

104 See for example, MJ Horwitz, *The Transformation of American Law 1780-1860*, Harvard University Press (1977) p 245.

105 On Scott, see AE Sutherland, *The Law at Harvard: A History of Ideas and Men*, Belnap Press (1967) at 219. For a discussion of Harvard's contribution to legal formalism, see WP LaPiana, *Logic and Experience: The Origin of Modern American Legal Education*, Oxford University Press (1994).

106 WP LaPiana, *ibid*, p 164.

107 In *Lochner v New York* (1905) 198 US 45, the Supreme Court concluded that a statute restricting working hours in bakeries was in breach of the Fourteenth Amendment as a violation of the liberty of contract. In the other landmark decision of this era, *Adkins v Children's Hospital* (1923) 261 US 525, a minimum wage for women was struck down for the same reason. See for example, JW Ely, *The Guardian of Every Other Right: The Constitutional History of Property Rights*, Oxford University Press (1992) pp 101-18; MJ Horwitz, note 104 *supra*, pp 145-51.

property and that of unjust enrichment. If a reconciliation of these principles was not possible, Scott was liable to take comfort in the characterisation of the constructive trusts as automatic. The view that the constructive trust arises when declared reinforces the judicial role in determining the allocation of the resources in question. With the acknowledgment of judicial choice comes the responsibility to justify its exercise. In contrast, the automatic vesting approach suppresses the appearance that the doctrine in question readjusts property rights. It gives, instead, an appearance that courts take a passive role in reinforcing pre-existing rights.

C. Realism About the Nature of Proprietary Relief

With the advent of legal realism the tide turned against Scott. Within two years of the *Restatement* the received wisdom of American legal culture had been dramatically revised. That the belief in general principles had become untenable was signalled the following year when *Swift v Tyson* was overturned by the Supreme Court in *Erie RR v Tompkins*.[108] The year the *Restatement of Restitution* was published came the 'constitutional revolution,' most decisively marked by the Supreme Court's departure from *Adkins* in *West Coast Hotel v Parish*.[109] The legal realists embraced the notion that legal rights are socially constructed and celebrated the role of the jurist in shaping the law. As property came to be understood in these terms, the notion of absolute property rights lost much of its force and appeal.[110] Thus American jurists are unlikely to be concerned with the notion that they might be 'confounding ownership and obligation.'[111] Property is regarded as 'a bundle of rights' rather than as absolute ownership.[112] Accordingly, a sharp distinction between ownership and obligation is not tenable.[113]

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108 (1938) 304 US 64.

109 (1937) 300 US 379. For a discussion of the combined effect of the change in constitutional approach and the growth of the regulatory state on the private law, see BA Ackerman, *The Reconstruction of American*, Harvard University Press (1993) pp 6-22.

110 Seminal realist scholarship suggesting a fundamental revision of the understanding of property includes: R Hale, "Rate Making and the Revision of the Property Concept" (1922) 22 *Colum L Rev* 209; M Cohen, "Property and Sovereignty" (1927) 13 *Cornel LQ* 8; A Bearle and G Means, *The Modern Corporation and Private Property*, Commerce Clearing House (1932) pp 333-9. See also M J Horwitz, note 104 *supra*, pp 160-7.

111 The distinction between obligation and ownership is not lost on the American Judiciary. In relation to Federal legislation providing sanctions against mail fraud, courts have refused to convict in circumstances where defendants have profited from abuses of office or breaches of other duties. The view has been taken that the legislation was designed to deal with taking of property and did not extend to situations where profits were made by violating "intangible rights". See *McNally v US* (1987) 107 S Ct 2875, 97 L Ed 2d 292; *US v Ochs* (1988) 842 F 2d 515.

112 See for example, BA Ackerman, *Private Property and the Constitution*, Yale University Press (1977) p 26; TC Grey, "The Disintegration of Property" in JR Penncock and JW Chapman (eds) *Nomos XXII: Property* (1980) 69 at 81. An expression of this understanding in American constitutional law can be found in Holmes J's development of the concept of regulatory takings in *Pennsylvania Coal Co v Mahon* (1922) 260 US 393. There, Holmes J also cautiously concluded that some incidents of property were "enjoyed under implied limitation." According to this view, it would not be regarded as a taking of property if the state destroyed these incidents pursuant to a legitimate exercise of its power to regulate for the public good. This line of thought recently found expression in Kennedy J's opinion in *Lucas v South Caroline Coastal Council* (1992) 112 S Ct 2886 at 2903. A similar understanding may also be found in private law jurisprudence. In *State v Shack* (1971) 277 A 2d 369, Weintraub J commented (citing a passage from PJ Rohan (ed) *Powell's Real Property*, Little Brown and Co (1970) at 493-4) "[a]n owner must expect to find

Unmoved by the concerns which had motivated Scott, the next generation of restitution scholars had little sympathy for his approach to constructive trust theory. Few American commentators have been content with Scott's conceptualisation of the nature of the constructive trust; most concluding instead that the plaintiff's interest arises only when ordered by the court.[114] Precedent in the United States was divided before the *Restatement*,[115] as it has been since.[116] In Canada there has also been an acceptance of the constructive trust as a redistributive remedy.[117] Thus, in *LAC Minerals v Corona Resources Ltd (LAC Minerals)*,[118] the Supreme Court of Canada awarded a constructive trust over profits made from a breach of confidence. The Court rejected the argument that the proprietary claim should fail because the plaintiff had never owned the proceeds.[119] Moreover, the Court was prepared to grant the remedy despite the majority's finding that the parties had not been in a fiduciary relationship. The contrast with the approach of the Privy Council in *Reid* is evident. The Court in *LAC Minerals* was not perturbed by the notion that the constructive trust was being used to create a new property right, rather than to enforce a right that arose automatically. Thus, La Forest J commented:

> [I]t is not the case that a constructive trust should be reserved for situations where a right of property is recognised. That would limit the constructive trust to its institutional function, and deny to it the status of a remedy, its more important role. Thus it is not in all cases that a pre-existing right of property will exist when a

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the absoluteness of his property rights curtailed by the organs of society, for the promotion of the best interests of others for who these organs also operate as protective agencies."

113 See C Rotherham (1992), note 35 *supra*.

114 See for example, GE Palmer, note 100 *supra*, p 171 and supplement (1990) 10; GG Bogert, *The Law of Trusts and Trustees: A Treatise Covering the Law Relating to Trusts and Allied Subjects Affecting Trust Creation and Administration with Forms*, Veron Law Book Co (2nd ed,1960) p 472. Interestingly, Professor Andrew Burrows, a leading English restitution scholar, asserts that Scott was 'forced' to acknowledge that the constructive trust arose automatically, thus pointing to an apparent fundamental contradiction in the United States approach; A Burrows, note 27 *supra*, p 40. However, the rejection of automatic vesting by other American jurists suggests that any contradiction is to be found in Scott's work, rather than in the concept of the remedial constructive trust. Scott was only 'forced' to reason as he did by his own methodological biases (see footnotes 105-6 *supra* and accompanying text) and in order to avoid certain policy issues that inevitably arise in this context.

115 Supporting Scott's position was *Kemp v Elmer Co* (1932) 56 F 2d 657. Favouring the opposite view was *Smith v Township of Au Gres* (6th Cir, 1906) 150 F 257.

116 Supporting the view expressed in the *Restatement* is *United States v Fontana* (1981) 528 F Supp 137. The opposing position is taken in *Papazian v American Steel and Wire Co of New Jersey* (1957) 155 F Supp 111. Consider also the conceptualisation of the remedy by the court in *International Refugee Organisation v Maryland Drydock Co* (4th Cir, 1949) 179 F 2d 284:

> [A] constructive trust is not a title to or lien upon property but a mere remedy to which the equity resorts in granting relief against fraud; and it does not exist so as to affect the property held by a wrongdoer until it is declared by a court of equity as a means of affording relief.

Authorities in federal bankruptcy courts are divided but generally favour the position adopted by Scott in the *Restatement*; see EL Sherwin, "Constructive Trusts in Bankruptcy," (1989) *University of Illinois Law Rev* 297 at 328. Recently the Canadian Supreme Court narrowly favoured Scott's approach: *Rawluk v Rawluk* (1990) DLR (4th) 161.

117 See for example, *Pettkus v Becker* (1980) 117 DLR (3d) 257.

118 (1989) 61 DLR (4th) at 14.

119 Consequently the Court did not consider it necessary to find that there was property in information in order to award the plaintiff a proprietary interest.

constructive trust is ordered. The imposition of a constructive trust can both recognise and create a right of property.[120]

D. Disquiet Regarding the Effect of the Constructive Trust in Insolvency

Recognising the circuity of Scott's reasoning, commentators began to doubt the justice of awarding proprietary remedies in bankruptcy.[121] Perhaps the most articulate expression of these concerns came from John Dawson. While Dawson, like Scott, was a Harvard Professor, the differences between the scholarship of the two are stark. Dawson was very much a realist who challenged the classical legal thinking in private law.[122] In contrast to Scott's reductionism, Dawson's work was comparative and historical, emphasising the historically and socially contingent forces which shape the law in different legal cultures.[123] Analysing constructive trust law, Dawson concluded, "we have created a monster".[124]

Dawson noted the unfortunate tendency to conceive of the proprietary interest associated with constructive trust relief as automatic. He observed:

> Our courts have been misled in this whole field, not so much by the direct appeal of an unjust enrichment principle as by a conception of equitable ownership, the product of an essentially new and questionable remedy. Seduced by this conception, they have refused to draw distinctions, to weigh various kinds of equities, or to consider the unjust gain they inevitably produce at the expense of other creditors.[125]

Critics were similarly ill-disposed to that other device for giving priority in insolvency, the equitable lien. Justice Holmes regarded the reasoning generally given to justify the provision of the remedy as vacuous.[126] Another jurist commented "the equitable lien is a dangerous and elusive enemy of the law of preference".[127] Such disquiet regarding the consequences of proprietary relief has been expressed perhaps most strongly and unanimously with regard to relief for enrichment by wrongs. Most commentators reflecting upon the matter subsequent to the *Restatement of Restitution* have concluded that, in this context, the constructive trust should "abate" in bankruptcy.[128]

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120 *Ibid* at 50.

121 For example, JP Dawson, *Unjust Enrichment: A Comparative Analysis* (1956); FR Lacey, "Constructive Trusts and Equitable Liens in Iowa" (1954) 40 *Iowa Law Review* 107.

122 See for example, Dawson's widely cited article, "Economic Duress: An Essay in Perspective"(1947) 45 *Michigan Law Review* 253.

123 This understanding, while apparent in his treatment of the law of restitution, note 121 *supra*, is best exhibited in his classic work, *The Oracles of Law*, University of Michigan Law School (1968).

124 Note 121 *supra*, p 30.

125 *Ibid*, p 32.

126 Thus in *Sexton v Kesser* (1912) 225 US 90 at 90-8, Justice Holmes commented: "... the phrase equitable lien may not carry the reasoning further or do much more than express the opinion of the Court that the facts give a priority to the party said to have it"; cited in J Phillips, "Equitable Liens - A Search for a Unifying Principle" in NE Palmer and E McKendrick (eds), *Interests in Goods* (1993) 635 at 653.

127 JA McLaughlin, "Amendment of the Bankruptcy Act" (1927) 40 *Harv L Rev* 341 at 389, referred to in Phillips, *ibid.*

128 E Sherwin, "Constructive Trusts in Bankruptcy," (1989) *University of Illinois Law Review* 297 at 346.

VII. RECONSTRUCTING PROPERTY?: PROPRIETARY REMEDIES IN AUSTRALIA

There are signs that Australian legal culture is moving away from the constraints of the classic paradigm and fostering a more overtly normative discourse than that found in England. Perhaps the most striking developments concern the determination of property rights in the context of quasi-matrimonial relationships. Here the approach of the Australian judiciary suggests a willingness to readjust proprietary entitlements beyond conventionally imposed limits without recourse to obfuscatory legal reasoning. In *Muschinski v Dodds*[129] and *Baumgartner v Baumgartner*[130] the Australian High Court developed a doctrine for providing relief in the context of quasi-matrimonial relationships. The Court moved beyond the approach which has constrained English jurisprudence in this context: the search for some evidence of an agreement to share entitlement to the property in question.[131] Instead the Court argued that parties in relationships akin to marriage should be treated as partners in a joint-endeavour entitled to a division of the fruits of their relationship in accordance with their contributions.[132]

Australian courts have shown a greater tendency than their English counterparts to have regard to the interests of third parties. One way the courts have done this is to take into account certain interests beyond those of the parties before the court, in determining whether proprietary relief is available. In *Daly v The Sydney Stock Exchange Limited*[133] the High Court was asked to impose a constructive trust over monies loaned after a stockbroker, in what was found to be a breach of fiduciary duty, failed to disclose to the plaintiff its precarious financial position. Chief Justice Gibbs found the concerns which Lindley LJ expressed for creditors in *Lister v Stubbs* compelling and concluded that the plaintiff should be restricted to personal relief.[134]

A second way in which Australian courts have taken account of the interests of third parties involves the reassessment of the nature and effect of proprietary relief. In this regard, Professor Robert Austin has observed that the "courts are ... making orders which break up" the "set bundle of proprietary consequences" which had hitherto characterised constructive trust jurisprudence.[135] This is well illustrated in the quasi-matrimonial property case law. In elaborating the new doctrine in his seminal opinion in *Muschinski v Dodds*, Deane J was not content to justify the relief given on the basis of an examined assertion that the assets in question belonged to the plaintiff. Discussing the origins and functions of the constructive trust, Deane J argued that it:

> has not outgrown its formative stages as an equitable remedy and should still be seen as constituting an *in personam* remedy attaching to property which may be moulded and adjusted to give effect to the application and interplay of equitable principles in

129 (1986) 160 CLR 583.
130 (1987) 164 CLR 137.
131 See for example, C Rotherham (1991), note 35 *supra*.
132 *Muschinski v Dodds* (1986) 160 CLR 583 at 619.
133 (1986) 160 CLR 371.
134 *Ibid* at 379, per Gibbs CJ (Wilson and Dawson JJ concurring).
135 RP Austin, "The Melting Down of the Remedial Trust" (1988) 11 *UNSWLJ* 66 at 67.

> the circumstances of the particular case. In particular, where competing common law or equitable claims are or may be involved, a declaration of constructive trust by way of remedy can properly be so framed that the consequences of its imposition are operative only from the date of judgment or formal court order or from some other specified date.[136]

In *Re Osborn*,[137] a husband had transferred properties, formerly owned exclusively by himself, to himself and the respondent (his de facto wife) as joint tenants. This transfer was subsequently challenged as a preference when the respondent's husband became bankrupt. The respondent argued that she was in fact entitled to an equitable proprietary interest at an earlier date and that this interest would have entitled her to priority in bankruptcy in any event. In the Federal Court, Pincus J was reluctant to recognise such an interest. He noted Deane J's observations in *Muschinski v Dodds* and commented:

> There is a degree of inconvenience attaching to the laying down of a rule which would require the trustee, in a case of this sort, to conduct an elaborate investigation of and perhaps litigate about the history of a relationship to determine whether property which is, on the face of it, divisible among the creditors is truly so divisible... [K]eeping in mind the remedial character of the doctrine, I do not think that the court should declare a constructive trust in circumstances of this sort, to operate at a date prior to bankruptcy.[138]

This approach is in stark contrast to the view that Sir Justice Peter Millett expressed extra-judicially that: "[E]ither the plaintiff is entitled to a proprietary remedy or he is or not."[139] Indeed, what Austin refers to as the "meltdown of the remedial constructive trust" may result in a shift in the meaning of property in Australia.

VIII. CONCLUSION: SOME REALISM ABOUT PROPRIETARY RELIEF

A. The Limits and Price of Formalism

Assumptions about property that were developed in another era and that gave modern private law its structure are still with us. The decision in *Lister v Stubbs*, Professor Birks' "proprietary-base" doctrine and the decision in *Reid* illustrate three different ways in which those assumptions can effect the form and substance of the law.

The decision in *Lister v Stubbs* was influenced by unexamined notions of property. A determination regarding property rights is a decision as to how and in whose favour the state will use its coercive power - as such it demands justification. Allocating property rights on the basis of premises drawn from classic liberal political theory is not a recipe for good law. Moreover, the reality is that in many areas, the law corresponds with these premises in form only. This is an indication that these assumptions are not as intuitively satisfying as they once

136 Note 132 *supra* at 615.
137 (1989) 91 ALR 135.
138 *Ibid* at 142.
139 P Millet, note 50 *supra* at 10; see also note 64 *supra*.

were and suggests it is time that they were openly reconsidered. Unfortunately this is not what happened in *Reid*.

Birks' scholarship demonstrates the difficulty facing a jurist interpreting the area. Birks sought substantive rationality through conceptual synthesis. To this end he developed the "proprietary-base" concept in order to explain contradictions in legal doctrine which were apparent when viewed at a substantive level. However, the 'proprietary-base' notion lacked intuitive appeal and it is not surprising that the Privy Council in *Reid* ignored it. *Reid* instead affirmed, that in this context at least, insofar as they are interested in rationalisation, English courts are more concerned with form than substance.

Reid was a typical example of an effort to evade the rigours of the orthodox paradigm without necessitating its reconsideration. The wisdom that the "progeny" of equity "must be legitimate - by precedent out of principle"[140] leads to efforts to rationalise outcomes as the consequence of exercises in deduction from formal premises found in the existing law. The danger is that, in being hidden from view, the normative concerns which motivate a court are not fully examined. The dangers of formalism become even more apparent in the context of the subsequent application and development of these new doctrines manufactured from old notions. A particular doctrine might have been reasonably well tailored to meet the normative concerns underlying the area in which it was developed. Subsequently, the extension of a particular institution to a new area is often inspired by the promise of providing justice in the specific situation before the court. However, these borrowed concepts have their own logic which is liable to impose constraints which correlate imperfectly with the policy concerns which arise in the new contexts into which they are transplanted.[141] In his work on proprietary remedies, Professor David Stevens describes this tendency for technical legal discourse to lose connection with underlying normative considerations as "the dark side of legal positivism".[142] The result is dysfunctional law. This phenomenon is illustrated by the use of the fiduciary concept in *Reid* to provide a justification which dictates results inconsistent with the normative considerations which motivated the rule.[143] *Reid* demonstrates that, even adopting a formalistic approach, the judiciary can continue to "counterfeit the phenomena of property" from "the materials of obligation".[144] But at what cost?

The anxiety about judicial involvement in the creation of property rights in this context has suppressed open and considered discussion of the normative foundations for relief. It is less likely that the courts would intervene in this context if they accepted responsibility to hear argument on, and give justification for, the departure from the orthodox paradigm of property rights. It is reasonable

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140 *Cowcher v Cowcher* [1972] 1 WLR 425 at 430, per Bagnall J.

141 See "Legal Change: Sources of Law and Legal Culture" in A Watson, note 71 *supra*, p 82; SFC Milsom, "Reason in the Development of the Common Law" (1965) 81 *LQR* 491 at 498; D Stevens, "Restitution, Property and the Cause of Action in Unjust Enrichment: Getting By With Fewer Things", Part I (1989) 39 *University Toronto Law Journal* 258, especially at 277-8.

142 *Ibid* at 278.

143 See footnote 67 *supra*.

144 SFC Milsom, note 72 *supra*, p 6.

to think that there is a better chance of making good law if we insist on open discussion of normative issues rather than continuing to jump through intricate doctrinal hoops. Developments in North American and Australian jurisprudence suggest a way forward.

B. Toward a New Understanding of Property

The unwillingness to acknowledge that our law provides for the creation and readjustment of property rights may have something to do with the thought that, once this is accepted, the designation of something as property would no longer foreclose arguments concerning entitlement to resources. The concern is that such an approach would cause the distinction between ownership and obligation to collapse. According to this fear, once it is recognised that rights over resources amount to relationships of obligation between the 'owner' and other individuals but never to complete dominion - that all proprietary rights are qualified - 'property' loses its power to resolve legal controversy.

Yet departures from the orthodox paradigm of property need not result in ownership losing its meaning. Ownership may be regarded as conventional - its boundaries created by the courts, rather than determined by some unstated libertarian conception of absolute and inviolable property rights. Obviously, if the concept is to mean anything, there will have to be consequences that customarily arise with the allocation of property rights. If there is to be any distinction between ownership and obligation, these consequences will generally include the rule that property cannot be expropriated and that property confers priority in insolvency. However, through convention we might establish exceptions where, in the interests of justice, property interests may be readjusted and/or the ordinary consequences of property will not apply.

The division between ownership and obligation is inevitably socially constructed. To deny the use of property as a remedy on the basis that to do so confuses ownership with obligation is unconvincing. There are many instances in which property rights are non-consensually readjusted.[145] The fundamental shortcoming of much of the enrichment by wrongs jurisprudence is not the over-stepping of the divide between ownership and obligation but the failure to provide a justification for the divergence from orthodox notions of property as involving

145 Other examples include: (i) the equitable defence of bona fide purchaser for value; see FH Lawson and B Rudden, *The Law of Property*, Clarendon Press (2nd ed, 1982) p 58; (ii) the prevention (by estoppel) of the owner of a good from asserting his or her rights as against a bona fide third party purchaser (now codified in s 21(1) of the *Sales of Goods Act* (1979)); see J Nicholson, "Owning and Owing: In what circumstances will the Responsibilities of Ownership Preclude or Postpone the Assertion of the Rights of an Owner?" (1988) 16 *MULR* 784 at 785-99; (iii) tracing; see note 44 *supra* and accompanying text; (iv) the subrogation of guarantors to secured claims which the creditor has against the principal debtor; see A Burrows, note 27 *supra*, p 85; (v) the protection by means of an equitable lien of an insurer's claim to settlement moneys paid to an indemnified plaintiff; see *Lord Napier & Ettrick v Hunter* [1993] AC 315 and the discussion by A Burrows, *ibid*, pp 81-2; (vi) proprietary estoppel, at least insofar as it is available to remedy those expectations raised unintentionally by the defendant rather than those encouraged by promise. Relief in the former situation is contemplated by the broad approaches favoured by Oliver J in *Taylor Fashion Ltd v Liverpool Victoria Trustees Co Ltd* [1982] QB 133 at 147; Deane J in *Commonwealth v Verwayen* (1990) 95 ALR 231 at 347-9; Richardson J in *Gillies v Keogh* [1989] 2 NZLR 327 at 344-7; and § 90 of the *Restatement of Contract 2d* (1977).

the enforcement of pre-existing and inviolable rights. Rather than disguising such divergence in a discourse of denial we ought to build a justificatory theory for the qualification of property rights. It is preferable that our law of property reflect a vision of social order that is the product of open debate.