THE REDISTRIBUTIVE CONSTRUCTIVE TRUST: "CONFOUNDING OWNERSHIP WITH OBLIGATION"?

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I. INTRODUCTION

There are two schools of thought regarding the relationship between the constructive trust and the concept of property.[1] The first, associated with English jurists, views the constructive trust and tracing as part of the substantive law of property, providing rules which recognise and protect existing property rights. Those who subscribe to this view claim that the constructive trust is not a remedy in the true sense.[2] The rights that it confers arise automatically. A declaration that a constructive trust exists merely recognises these rights, it does not create them. An alternative view, generally adopted by American jurists, is that the constructive trust operates free of the general law of property, as a remedy for unjust enrichment. This means the courts may in some instances use the constructive trust to redistribute property. Those favouring the second view tend to conclude that the property interest associated with the constructive trust is created only when declared.[3]

This first part of this article evaluates the two approaches in the light of the use of the constructive trust in different jurisdictions. It concludes the ownership/obligation distinction can only be regarded as fundamental to English constructive trust law if one accepts legal fictions at face value. The reality is that in English law, in some circumstances, the constructive trust functions to redistribute proprietary entitlements. The view of the writer is that the divergences in approach between jurisdictions are in some part attributable to different attitudes towards the concept of property.

1 Discussed in S Scott, "The Constructive Trust and the Recovery of Advance Payments – *Neste Oy v Lloyds Bank PLC*" (1991) 14 NZULR 375; Glover, "Equity, Restitution and the Proprietary Recovery of Value" (1991) 14 UNSW Law Journal 247 at 266; Youdan, "The Fiduciary Principle: The Applicability of Proprietary Remedies" in Youdan (ed) *Equity, Fiduciaries and Trusts* (1989) 93.

2 Thus in *Snell's Principles of Equity* 27th ed (1973) Megarry and Baker (eds) at 572 described the constructive trust and tracing under the heading "spurious equitable remedies" and suggested that "[t]hese are not so much remedies as part of the process of establishing the substantive rights of the parties". Similarly you will not find the constructive trust in Spry, *Equitable Remedies* 3rd ed (1984).

3 E.g. Waters, "The Constructive Trust in Evolution: Remedial and Substantive" (1991) Estates and Trusts Journal 334; Palmer *The Law of Restitution* (1978) Vol 1 171 and supplement (1990) 10; Bogert, *The Law of Trusts and Trustees* 2nd ed (1979) para 472. This may be contrasted with the view of Scott who, while concluding that the device was generally available to remedy unjust enrichment, argued that the constructive trust arises automatically, although it only takes effect when and if declared by the court in its discretion: *The Law of Trusts* 3rd ed (1967) vol 5 at 3416. The issue is well discussed in the judgment of McLachlin J in *Rawluk v Rawluk* (1990) 65 DLR (4th) 161 at 184-186. The differing views among those who recognise the redistributive potential of the constructive trust are of little significance. The availability of the remedy is regarded by all of these commentators as discretionary. Thus, Scott recognises that the courts may deny a remedy by refusing to declare an existing constructive trust. Furthermore, it is accepted that the point at which the constructive trust takes effect is also within the court's discretion. Those who argue that the constructive trust only arises when declared argue that it may take effect retrospectively: Bogert, above, at 472 and Lord Denning in *Hussey v Palmer* [1972] 1 WLR 1286 at 1290. Whatever a court's view as to when the trust arises, a remedy will be available. On the other hand, the nature of the relationship between constructive trust and property is of great significance as it has the potential to place a fundamental limitation on the availability of the remedy. Thus the most important issue regarding the nature of the constructive trust is not whether it is substantive or remedial but whether it can be redistributive.

The constructive trust is then considered in the light of recent New Zealand developments. In the 1980's the New Zealand Court of Appeal developed the constructive trust as a broad remedy. While the issue was not explicitly addressed, the constructive trust was not limited to protecting existing proprietary rights. It was also used to create new entitlements. In 1991 in *The Attorney General for Hong Kong v Reid*[4] the court was required to deal directly with the much discussed ownership/obligation dichotomy in the law of constructive trusts. This article argues that the court's decision in *Reid* is irreconcilable with the approach it pursued in recent years. The outcome of this is likely to be confusion regarding the principles underlying the area, resulting in uncertainty over the availability of the constructive trust.

Finally it is asked whether the ownership/obligation distinction can be justified on the basis of policy or considerations of justice. Other grounds for restricting proprietary relief are considered. It is concluded that the law as it stands is arbitrary and a more principled basis for restricting the operation of the constructive trust should be sought.

II. Obligation and Ownership: the Relationship between the Constructive Trust and the Concept of Property

1. The English approach: protecting existing proprietary rights

(a) Lister v Stubbs

The decision of *Lister v Stubbs*[5] focused on the relationship between the constructive trust and the concept of property in English law. The plaintiff company sued an employee who had accepted secret commissions in return for making contracts with a supplier. Some of the money had been invested in real estate and other investments. The plaintiff sought an injunction restraining the defendant from dealing with this property. It argued that the defendant held the property obtained from the abuse of his position on trust for the plaintiff. However the English Court of Appeal held that the defendant's liability was personal: a duty to account for profits. Lindley LJ concluded that to hold the defendant liable to the plaintiff by way of constructive trust would involve "confounding ownership with obligation."[6]

Commentators frequently claim that *Lister v Stubbs* was wrongly decided and that the defendant should have been held to be a constructive trustee.[7] Goff and Jones argue that there is a distinction between constructive trusts which enforce pre-existing property entitlements and those which create interests de novo.[8] They argue that *Lister v Stubbs* fails to take account of this distinction. However that decision still has its supporters. Professor Birks contends that to be entitled to a constructive trust a plaintiff must have a "proprietary base" upon which to found a constructive trust.[9] He argues that this requirement was absent in *Lister v*

4 [1992] 2 NZLR 385.
5 (1890) 45 Ch D 1.
6 Ibid. at 15.
7 Consider this passage from *Reid* above, note 4, at 13
"Certainly *Lister & Co v Stubbs* has its academic detractors (eg Underhill & Hayton, *Law Relating to Trusts and Trustees* (14th ed) 305; Oakley, *Constructive Trusts* (2nd ed) 56; Goff and Jones *The Law of Restitution* (3rd ed) 657; *Jacobs' Law of Trusts in Australia* (5th ed) para 1323; Youdan (editor) *Equity, Fiduciaries & Trusts* 97 and 223 (and many others could be added)."
8 *The Law of Restitution* (3rd ed, 1986) at 60-61
9 *An Introduction to the Law of Restitution* (1989 revised edn) at 378. Thus, he takes the view

Stubbs.[10] To put it simply: the plaintiff was never the owner, either legally or equitably, of the money in question before it came into the hands of the defendant. The plaintiff was asking the court to create an ownership interest by declaring a constructive trust. The court responded that the constructive trust operates to recognise existing ownership interests, not to establish new ones.

While the court in *Lister v Stubbs* drew a distinction between obligation and ownership, in other situations where courts have traditionally awarded constructive trusts such a rigid contrast is more difficult to maintain. One has only to consider that most famous of constructive trust cases, *Keech v Sandford*.[11] In that case a trustee bought a lease for his own benefit after the vendor refused to renew the lease to the trust estate. It was held that the trustee held the property on trust for the beneficiary of the estate. Where was the plaintiff's proprietary base? The lease had expired, meaning he no longer had a proprietary interest. In this context the constructive trust operates to create new property rights rather than simply to protect existing ones.[12]

Another leading academic, Professor Goode, favours the restrictive approach taken in *Lister v Stubbs* because of the injustice the constructive trust may cause in insolvency.[13] Building on Birks' work, he argues that the plaintiff can establish the requisite proprietary base by either proving that the benefit was obtained from the use of the plaintiff's property (an orthodox tracing claim) or establishing that the benefit was one which the defendant was under a duty to acquire for the plaintiff and hold as a fiduciary.[14] It might be argued in a case such as *Keech v Sanford* that, because the constructive trust arose immediately on the conflict of interest, the property never belonged to the defendant. Thus the constructive trust was not used to redistribute property but rather to ensure that the defendant never owned the property. Nevertheless once the latter category of constructive trusts is taken into account the line between ownership and obligation appears rather finer than that portrayed by Birks. If the courts are prepared to hold that fiduciaries who obtain property which they were supposed to have acquired for others become mere trustees of that property, could not they equally hold that persons unjustly enriched in breach of their fiduciary obligations to others cannot own the fruits of their wrongs?

that where "the defendant's breach of duty is not a misapplication of [the plaintiff's] property... it is very doubtful that the plaintiff can assert a right in rem in the surviving enrichment." Ibid at 388.

10 Ibid. at 389.

11 (1728) Sel Cas t King 61; 22 ER 629

12 One view is that *Keech v Sandford* may be explained on the basis that a practice had grown up whereby leases were invariably renewed so that tenants were effectively regarded as having a right to renew: Cretney, "The Rationale of *Keech and Sandford*" (1969) 33 Conveyancer 161. Recently it has been argued that, as a consequence, the trustee can be regarded as having taken trust property: Youdan, op cit, at 96. The reasons underlying the court's decision are difficult to assess 250 years later. Cretney notes at 162 that the report of the case does not even mention whether the lease was customarily renewable (a point which his argument hinges upon). In any event Youdan's argument appears misconceived. It is clear that the courts would not enforce the "right" of renewal against the lessor: *Lee v Vernon* (1776) 5 Bro PC 10; Cretney, ibid at 164. The court did not formally argue that the option to renew was the beneficiary's property. Cretney's point is that in *Keech v Sandford* the fiduciary's duty was particularly strict because in the eighteenth century there was a strong expectation that leases would be renewed. In other circumstances the duty should not be so onerous and liability should depend upon abuse of position. Contrary to Youdan's conclusion, Cretney specifically argues that the trustee's liability as a constructive trustee does not depend upon some evidence of an interceptive subtraction: ibid at 175.

13 "Ownership and Obligation in Commercial Transactions" (1987) 103 LQR 433. The debate over the constructive trust in insolvency is considered below, text accompanying nn 73-91.

14 Ibid. at 443.

(b) Legal fictions and functional reality: the tracing rules

It may be observed that the formal English view of the role of the constructive trust is a misleading one, maintained only by legal fictions. A functional analysis presents a different picture.[15] La Forest J in *Lac Minerals v Corona* commented that where tracing is involved it is arguable that the courts are creating rights of property rather than recognising existing ones.[16] Equity's tracing rules consist of a series of fictions which determine when a plaintiff may assert a proprietary interest in an object. While these rules are designed to ensure that a remedy of ownership will be available, they are framed to suggest that the court is doing no more than recognising existing interests. Often the constructive trust can only be said to be protecting existing interests because the tracing rules provide that those interests subsist despite the fact that the subject matter which the plaintiff originally owned has been exchanged or mixed with other property.[17] The concept of property is employed because courts wish to confer upon the plaintiff the benefits of ownership, not because the subject matter of the constructive trust can be said to "belong" to the plaintiff in any intrinsic way. In this context, the ruling that something is held for the plaintiff on constructive trust is essentially a conclusion reached for instrumental reasons rather than an essential part of the court's reasoning.[18]

The constructive trust arising in conjunction with tracing is very much a redistributive one. The assertion that it functions to protect existing property interests ignores reality. This is relatively simple to demonstrate. As mentioned, tracing allows a plaintiff to follow a property interest through an exchange transaction so that the plaintiff may claim equitable ownership of the product of the exchange. This allows for a constructive trust to be imposed. Can this sensibly be regarded as protecting existing ownership interests? Why should a plaintiff be regarded as owner of something that he or she never actually possessed? Strikingly, English courts have been willing to award constructive trusts based on tracing claims in situations analogous to *Lister v Stubbs*. Thus where the defendant uses the plaintiff's property to make a profit English courts have indicated that the defendant holds that gain as a constructive trustee for the plaintiff.[19] Yet the plaintiff never owned the profits and the provision of proprietary relief in these circumstances is open to the same objections that were raised in *Lister v Stubbs*. Why then should the plaintiff's remedy in these circumstances not be limited to a personal liability to account? Why should it matter that the profits were made from an abuse of the plaintiff's property rights as opposed to other rights?[20]

15 See Cohen, "Transcendental Nonsense and the Functional Approach" (1935) 35 Col LR 809.

16 (1989) 61 DLR (4th) 14.

17 Orthodox doctrine generally conceives of tracing operating through the title descending through various transactions: see eg Gummow, "Unjust Enrichment, Restitution and Proprietary Remedies" in Finn (ed) *Essays on Restitution* (1990) 47 at 73. Birks argues that the conventional theory is illogical and that at best the plaintiff has a mere "right to trace", op cit, at 70 and 92. Thus it may be seen that Birks does not consider the constructive trust to be part of the substantive law of property in the same way that other commentators do. This makes Birks' requirement of a proprietary base rather perplexing.

18 See eg Cohen, op cit, at 815; Sutton, "Quasi Contract: Lost Cause or Current Issue?" (1990) 7 OLR 336 at 344; Stevens, "Restitution, Property and the Cause of Action in Unjust Enrichment: Getting By with Fewer Things" (1939) 39 U of Tor LJ 258; Hammond, "Quantum Physics, Econometric Models and Property Rights to Information" (1981) 27 McGill LJ 47 at 57.

19 *Re Tilley's Will Trusts* [1967] Ch 1179.

20 In this context, we find that Birks, so approving of the distinction between obligation and ownership, is an advocate of tracing into profits to award proprietary relief. It appears that Birks regards the availability of proprietary relief in this context as a logical result of the application

An additional advantage of tracing claims is that they allow the plaintiff a cause of action against more than one defendant. Plaintiffs may claim a constructive trust over property taken from them or may trace their proprietary interest into the exchange product of any subsequent transactions. For example, where property beneficially owned by A is sold in breach of trust by B to C, who is aware of A's interest, A may claim a constructive trust against C in respect of the original property or over the proceeds of sale held by B. Yet, before the matter is litigated it would seem strange to say that the plaintiff is the equitable owner of both the proceeds and the original property. After all, the plaintiff can only enforce the remedy against one of the parties and must elect which. The trust does not take effect until the court declares it. In this instance the better view is that the court is giving a remedy rather than recognising a property right which has subsisted despite exchanges.[21]

It may be seen that the constructive trust law can only be regarded as protecting existing property interests if one accepts fictional rules for the identification of property at face value. Legal fictions ensure that the conceptual purity of the English property paradigm remains intact. Yet the formal explanation of the law in this context does nothing to explain how the law actually functions. In reality, in some situations at least, in English law the constructive trust functions to create new property interests. Thus, the divide between the English and American approaches is rather narrower than is sometimes suggested.

2. A different approach: the constructive trust as a redistributive remedy.

(a) The United States

In contrast United States courts have made the constructive trust widely available as a remedy to cure unjust enrichment.[22] The *Restatement of Restitution* provides

> 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.[23]

This approach severs the link between the constructive trust and general principles of property. Consequently American courts are prepared to

of principles of transactional tracing: op cit, at 366.

21 Birks, above, n 17. The issue is of significance to the criminal law. In *A-G's Reference (No1 of 1985)* [1986] QB 491 a charge of theft was brought against a person who had made a profit by breaching a fiduciary duty owed to his employer. It was argued that when the accused subsequently dealt with the profits he committed theft because the money was held on constructive trust for his employer. The charge was dismissed following *Lister v Stubbs* on the basis that no constructive trust was created. The decision suggests that a charge of theft could succeed against a constructive trustee in a tracing context. If A's property is stolen by B and sold to C there is no question that B is liable for theft and that C may be liable for receiving. However, if a descending title analysis was adopted further theft charges might be available. A could trace his property into the money for which it was exchanged and claim a constructive trust over these proceeds. Accordingly B could be charged with theft when he dealt with the proceeds. B would be liable in the same way for dealing with the proceeds of every subsequent exchange transaction. Alternatively, or possibly in addition, if C sells the received property on and deals with the proceeds of that sale she could be guilty of theft. Subsequent holders of the object originally stolen could be guilty of theft in the same way. To regard the constructive trust as conferring a descending title in this way has strange consequences. Such complications do not arise if the constructive trust is viewed as essentially remedial, conferring not property but a mere right to claim a proprietary remedy, at least where tracing is involved.

22 See Cardozo's dicta from *Beatty v Guggenheim Exploration Co* 225 NY 380 (1919) 386, below, text accompanying n 55. Scott, "The Constructive Trust" (1955) 71 LQR 39.

23 Commentary to section 160 at 642.

award a constructive trust in situations where it might be argued they have confused ownership with obligation. The *Restatement* provides that any property acquired as the result of a breach of a fiduciary duty is held on constructive trust.[24] More specifically, and in contradistinction to the finding in *Lister v Stubbs*, it 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.[25]

In addition the remedy has been used to reassign property obtained by breaches of rights normally regarded as personal, for example breach of confidential information.[26]

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".[27] This suggests that rather than confusing ownership and obligation the American courts have chosen to allow the constructive trust to perform a wider role than it is permitted in English law.

(b) Developments in other jurisdictions

It may be noted that other major commonwealth jurisdictions have in recent years shown a tendency to develop the constructive trust's redistributive function. There has been some criticism of *Lister v Stubbs* in Australian Courts. In addition the Australian High Court took a redistributive approach in the area of *de facto* spouses' property rights in *Muschinski v Dodds*.[28] The dicta of Deane J involved some discussion of the institution/remedy distinction, concluding that the constructive trust performed both functions. However there was no discussion of the ownership/obligation distinction, suggesting that the significance of the debate over the nature of the constructive trust was not fully grasped. The *Muschinski v Dodds* approach for redistributing property among de facto spouses was adopted by the Australian High Court in *Baumgartner v Baumgartner*.[29] It remains to be seen whether the Australian courts will favour a redistributive approach in other areas. The relationship between obligation and ownership has been discussed in too little depth to draw any firm conclusions in this respect. However, given that leading local commentators are critical of *Lister v Stubbs*[30] and Australia is now free of the Privy Council it is possible that the redistributive potential of the constructive trust will be recognised.

The trend towards the use of the constructive trust as a broad remedy has been particularly noticeable in Canada. In the domestic sphere in

24 Section 190.

25 Section 197. See eg *US v Carter* 217 US 286 (1910) *Freshhaker v Blum* 109 F 2d 543, 546 (bank officer receiving a commission for a loan holding that money on trust for the bank).

26 *Hunter v Shell Oil Co* 198 F 2d 485 (1952). 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, eg *Diamond v Oreamuno* 248 NE 2d 910 (1969). However other American decisions simply focus on the fact there has been a breach of duty, eg *Pratt v Shell Petroleum Corp* 100 F 2d 833 (10th Cir 1938).

27 *McNally v US* 107 S Ct 2875, 97 L Ed 2d 292 (1987); *US v Ochs* 842 F 2d 515 (1st Cir. 1988).

28 (1985) 160 CLR 583.

29 (1987) 164 CLR 137.

30 Jacobs, above, n 7; Maher, Gummow and Lehane, *Equitable Doctrines and Remedies* 2nd ed (1984) at 541; Ford and Lee, *Law of Trusts* (1990) 1012-1013.

Pettkus v Becker[31] the Supreme Court gave the plaintiff an interest in property legally owned by the defendant on the basis of contributions conferred in the expectation of a return of which the defendant ought to have been aware. In *Lac Minerals*, in the commercial environment, a constructive trust was awarded despite the absence of a proprietary base.[32] La Forest J's judgment in that case contains perhaps the best judicial discussion of the function of the constructive trust and its relationship with property law principles. A constructive trust was awarded to remedy a breach of confidence. In the past proprietary relief might have been declined for either of at least two reasons, (a) the lack of a fiduciary relationship[33] or (b) the lack of property in confidential information,[34] so that, following *Lister v Stubbs*, the fact that the plaintiff never owned the proceeds claimed would mean that the proceeds could not be traced and be made the subject of a constructive trust. Both these restrictions were considered and rejected. In concluding that it was not necessary to characterise confidential information as property 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 recognized. That would limit the constructive trust to its institutional[35] 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 constructive trust is ordered. The imposition of a constructive trust can both recognize and create a right of property.[36]

Of the major common law jurisdictions only England has denied the constructive trust a redistributive function. It is suggested below that this may change in the near future as part of a sweeping rationalisation of the law of restitution undertaken by the House of Lords, led by Lord Goff.

31 (1980) 117 DLR (3d) 257.

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

33 It has been argued that the relationship required to found a breach of confidence is a type of fiduciary relationship. In *Lac Minerals* a majority (Sopinka, McIntyre and Lamer JJ) concluded that there was no fiduciary relationship. However it was also held by a majority (La Forest, Lamer and Wilson JJ) that a constructive trust was available for breach of confidence.

34 This was the reasoning of Sopinka J in *Lac Minerals*, ibid at 75; see also *United States Surgical Corp v Hospital Products International Pty Ltd* [1983] 2 NSWLR 157. Birks discusses *Lac Minerals* and the availability of constructive trust relief for breach of confidence in a case note: (1990) LMCLQ 460.

35 A particularly unhelpful word. The term conveys quite different meanings depending on the context in which it is used. The term is a popular one with sociologists and was often used by American legal realists. It has been used with great frequency in constructive trust literature eg Waters, *The Constructive Trust* (1964); Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors" (1989) 68 Can Bar Rev 315; *Chase Manhatten* [1981] Ch 105 and *Muschinski v Dodds* (1985) 160 CLR 583. The word was first used in this context by Roscoe Pound who commented that the constructive trust was a remedial institution rather than a substantive institution ("The Progress of Law" (1920) 33 Harv LR 420 at 421). It appears that Pound used the term to mean no more than "an established practice". His comment suggests that regardless of the function of the trust it was indeed an institution. Yet other commentators have referred to the traditional English conception of the constructive trust as being "institutional" as opposed to the "remedial" American model. What is meant by institution in this context is unclear. In *Muschinski v Dodds*, ibid at 614 Deane J treats the word as "connoting a relationship which arises and exists under the law independently of any order of a court" (probably the same meaning that Pound ascribed to "substantive").
In some circumstances it may be appropriate to regard the constructive trust as arising without the court's intervention. For instance in contracts for the sale of land it is a well established rule that after the contract is made but before title passes the vendor is the constructive trustee of the land for the purchaser. The legal relationship between the parties is clearcut. However, where entitlement to proprietary relief depends upon an exercise of the court's discretion and/or an election of remedies by the plaintiff, it makes little sense to regard the constructive trust as being "institutional" in this way. The logical and practical difficulties in treating constructive trusts established in conjunction with tracing claims as arising independently of a court order are considered above, text accompanying nn 15-21.

36 (1989) 61 DLR (4th) 14 at 50.

(c) Different Visions of Property

The English and the American approaches to the constructive trust demonstrate quite different interpretations of the concept of property. The English reluctance to make the constructive trust more widely available may be linked to the perception of property rights as absolute and inviolable.[37] Any thought of judicial redistribution of property entitlements was an anathema. The constructive trust served not as a simple remedy but as a means of protecting the established institution of property. In this way the constructive trust was viewed not as a remedy but as part of the law of property. The device was only available to protect existing property interests. To use it to redistribute entitlements would have been inconsistent with the English property paradigm.[38]

While the American legal system places considerable importance on the concept of property,[39] the judiciary takes a different approach to its role in determining entitlements. A greater degree of judicial intervention is countenanced. The protection conferred by ownership is generally more qualified.[40] Most importantly for the purposes of this article, property may be redistributed if it has been gained at another's expense or if it was shared in the course of a relationship in which the parties lives were inextricably integrated.[41]

37 A good example of this is the English Court of Appeal decision in *Shelfer v City of London Electric Lighting Co* [1895] 1 Ch 287. There the court refused to apply Lord Cairns' Act to give damages in lieu of an injunction to close down a noisy public utility. The court concluded that to award damages would be buying the plaintiff's property rights. Lindley LJ, just five years after delivering his judgment in *Lister v Stubbs*, concluded that "[e]xpropriation, even for a money consideration, is only justified when Parliament has sanctioned it." Consequently the court required defendants seeking to escape injunctive relief to meet criteria which are virtually impossible to satisfy. See 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. See also statements in the House of Lords in *Gissing v Gissing* [1971] AC 886 involving a wife's claim for an interest in the matrimonial home by way of constructive trust. Lord Morris concluded at 898 that "[a]ny power in the court to alter ownership must be found in statutory enactment".

38 Honore refers to this as "the basic model – a single human being owning, in the full liberal sense, a single material thing": "Ownership" in Guest (ed), *Oxford Essays in Jurisprudence* 107 at 147. Honore argues that property is best analysed in terms of this model.
In a recent essay JW Harris observes that English "doctrinal prescription" dictates that "fully fledged" interests in land must have certain characteristics. As well as involving some defined right to enjoyment and transmissibility, such interests must "enjoy general protection against all comers": JW Harris, "Legal Doctrine and Interests in Land" in Eekelaar and Bell, *Oxford Essays in Jurisprudence* (3rd series) 167 at 182-183. Harris refers to the "doctrinal strain" resulting from some recent developments in property law such as interests arising from estoppel. The strain identified arises because it is not clear that the resulting interests have all the characteristics necessary for a "fully fledged" interest in land. I would suggest that this is minor compared with the "doctrinal strain" which would result from recognising the redistributive constructive trust, which threatens all property interests by providing that property is not absolutely protected from "all comers". In some situations property will be redistributed against the owner's will. The redistributive constructive trust cannot be assimilated into English law without changing its doctrinal paradigm of property.

39 Demonstrated by the recognition of property rights in the 14th Amendment of the American constitution (property not to be taken without due process of the law).

40 See eg Philbrick, "Changing Conceptions of Property in Law (1938)" 86 U Pa L Rev 691; Horwitz, "The transformation in the Conception of Property in American Law, 1780-1860" (1972) 40 U Chi L Rev 248. To some degree this may be attributed to Hofeldian analysis which views property as a collection of rights, privileges, powers and immunities (Hohfeld's terminology) which do not invariably occur concurrently and are best understood in the context of the relationship between an owner and particular persons (not necessarily the world at large), rather than between the owner and that which is owned: Hohfeld, "Some Fundamental Legal Conceptions as Applied in Judicial Reasoning" (1913) 23 Yale LJ 16 and (1917) 26 Yale LJ 710. For an assessment of Hohfeld's impact upon American property law see Vandervelde, "The New Property of the Nineteenth Century: The Development of the Modern Concept of Property" (1980) 29 Buffalo LR 325 at 359 onwards.

41 E.g. *Pickens v Pickens* (1986) 490 So 2d 872 (Miss SC). See Rotherham, "The Contribution

Property is a legal construct. There are no natural boundaries for the use of ownership as a remedy. Those who are prepared to use the constructive trust as a remedy outside those circumstances conventionally recognised in English law cannot blithely be dismissed as confusing ownership with obligation. They might just as properly be regarded as reconstructing the concept of property. The English and the United States treatment of the issue simply represent two possible approaches. A decision as to which should be favoured ought to be determined on the basis of an analysis of policy implications and not abstract principles.

III. The New Zealand Court of Appeal's Development of the Constructive Trust.

1. The development of a remedial approach

Recently the New Zealand Court of Appeal has shown a consistent tendency to develop the redistributive potential of the constructive trust. This has been apparent in cases determining the property rights of *de facto* spouses upon separation. The traditional approach taken in England requires evidence of an actual common intention between the parties to share the ownership of the property in question.[42] A constructive trust is given to prevent one party unconscionably reneging on the informal agreement.[43] In this way the court gives effect to the parties' intentions. Intervention in other circumstances is viewed as improper.[44]

The courts in New Zealand have been prepared to give relief in situations where none would be available in England. The absence of a common intention to share the property is not a bar to relief. In *Pasi v Kamana*[45] it was indicated that the proper test involved asking whether a reasonable person in the shoes of the claimant would have expected an interest. Relief may be given even if neither of the parties had actually given any thought to the question of respective individual legal entitlements during the relationship.[46]

In New Zealand plaintiffs will receive a share of the property in proportion to their contributions to the relationship.[47] While there has been the suggestion that there must be a causal connection between the property in issue and the plaintiff's contributions, this requirement tends to be ignored.[48] It is not a matter of identifying an existing proprietary interest and following it into the defendant's property. It is clear that no formal tracing exercise is entered into. The fact that the claimant did not have what would traditionally be regarded as a proprietary base in the property in question is no bar to relief.[49] There can be no doubt that the courts are

Interest in Quasi-Matrimonial Property Disputes''(1991) 4 Canta LR 407 at 418.

42 *Lloyds Bank v Rosset* [1990] AC 107.

43 Ford and Lee *Principles of the Law of Trusts* (2nd edn) (1990) 1036 and 1043.

44 Allowing intent based constructive trusts is consistent with the right to alienate property, a privilege which is an integral part of the concept of property; Honore, op cit, at 120 and Harris, op cit, at 183. Consequently, allowing proprietary relief in these circumstances is consistent with the English paradigm of ownership.

45 [1986] 1 NZLR 603 at 605.

46 *Pointon v Baines* (unreported, CP 213/87, 15 August 1991, Thorp J).

47 *Oliver v Bradley* [1987] 1 NZLR 586 at 590. See Rotherham, op cit, n 41, at 417.

48 *Pasi v Kamana* [1986] 1 NZLR 603. While the nexus requirement is often referred to in Canada it is apparent it takes very little to fulfil it. An understanding of how easily this requirement may be satisfied may be gleaned from *Herman v Smith* (1984) 34 Alta LR (2d) 90; *Sorochan v Sorochan* (1986) 29 DLR (4th) 1 and *Rosenich v Rosenich* (1989) 75 Alta LR (2d) 327.

49 Thus the New Zealand Court of Appeal made it clear that all contributions were to be taken into account: *Oliver v Bradley* [1987] 1 NZLR 586 at 490.

involved in the redistribution of property; the constructive trust is used to create new ownership interests.

While there was some reason to think that the developments in de facto property division cases would be unique to that context,[50] this has not proven to be the case. Any doubt that the constructive trust in New Zealand can be redistributive should have been dispelled following *Elders v BNZ*.[51] In that case BNZ, encouraged by Elders, lent money to a third party farmer. The loan agreement, in addition to giving the bank a charge over land, equipment and stock, provided that, in the absence of a direction to the contrary from the bank, all proceeds of stock sales were to be paid to BNZ. The court concluded that the bank's right to proceeds did not amount to an assignment of a chose in action. It was a purely contractual right. Elders, acting as agents for the farmer, sold some of the stock that were subject to the charge. It then retained the bulk of the proceeds of sale to satisfy the farmer's indebtedness to it. BNZ argued that, pursuant to the loan agreement, it was entitled to the proceeds and that Elders held the money as constructive trustee for the bank. Elders countered that the BNZ's claim to proceeds, being purely contractual, was a matter between the bank and the farmer and one which could not affect Elder's right to a set-off. Nevertheless, the court found that Elders held the money as constructive trustee for the bank. The decision was notable for the court's willingness to make the proprietary remedy widely available. The court held that the existence of a fiduciary relationship was not a necessary pre-condition for constructive trust relief.[52] Somers J concluded that the constructive trust is a device

> ...for imposing a liability to account on persons who cannot in good conscience retain a benefit in breach of their legal or equitable obligations. Its extension or evolution may not have come to an end.[53]

Cooke P referred to Cardozo J's often cited statement from *Beatty v Guggenheim Exploration Co.*

> A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.[54]

Elders is open to criticism because the constructive trust was used to enforce contractual rights against a third party.[55] Furthermore, the court appeared to justify its finding of unconscionability on the basis of substantive fairness rather than procedural impropriety. In addition the absence of any application of unjust enrichment theory is lamentable. Whatever the merits of the decision, it appeared that New Zealand had chosen the American approach in preference to the English. In relation to the proceeds

50 There is New Zealand Court of Appeal dicta supporting this view eg Cooke J in *Hayward v Giordani*, [1983] NZLR 140 at 148. Canadian commentators suggest that special considerations apply which justify using the constructive trust generously in this area: Paciocco, op cit, at 325. It has also been suggested that it will be easier to satisfy the requirements of the Canadian test for unjust enrichment in this context: *Murray v Roty* (1983) 147 DLR (3d) 438 at 444.

51 [1989] 2 NZLR 180.

52 Cooke P, ibid at 185, made no attempt to find a fiduciary relationship, noting Goff and Jones' (op cit, at 77) observations that the requirement of a fiduciary relationship as a pre-condition for tracing was illogical. Somers J, ibid at 193, also cited Goff and Jones although his earlier finding that a fiduciary relationship existed, ibid at 192, suggests his rejection of the fiduciary requirement might be regarded as obiter.

53 Ibid. at 193.

54 225 NY 380 (1919) 386.

55 Gummow, op cit, at 59-60; Watts and Kos *Unjust Enrichment: The New Cause of Action* (1990) NZLS seminar at 35.

of sale BNZ was in a creditor-debtor relationship with the third party; it did not own those proceeds. Nevertheless the court was prepared to grant BNZ an ownership interest on the basis that reasonable persons in the shoes of the parties would have thought that Elders were obliged to hold the proceeds for BNZ. The use of the device in this case and the court's sweeping dicta appeared to establish the place of the redistributive constructive trust in New Zealand law.

The decision went to the Privy Council which dismissed the appeal on the grounds that the agreement between the Bank and the farmer did indeed amount to an assignment of a chose in action.[56] As a result of the Chattels Transfer Act 1924, Elders had constructive knowledge of the charge and took the proceeds subject to it. The Privy Council did not comment on the Court of Appeal's findings on constructive trust principles, which suggests that these remain authoritative.

2. AG of Hong Kong v Reid[57]

(a) The decision

The first respondent, Charles Reid, was formerly in charge of the Hong Kong commercial crime unit. Following an investigation he was convicted under the *Prevention of Bribery Ordinance* of being in control of assets for which he could not account legitimately. Pursuant to section 145 of the *Land Transfer Act* 1952 the appellant sought to lodge a caveat in New Zealand over two properties owned by Reid and his wife jointly and another legally owned by the second respondent, Molloy, on trust for the Reids. The Hong Kong government claimed that these properties were purchased with funds obtained from bribes accepted by Reid while its employee. In order to be able to lodge a caveat it had to convince the court that it was arguable that the appellant had a proprietary interest in the property in question.[58] The case turned on whether the appellant had a beneficial interest in the property by way of constructive trust. At first instance Penlington J in the High Court concluded that the appellant did not have an arguable case. The stumbling block for the Hong Kong government was *Lister & Co v Stubbs*.[59]

56 [1990] 1 WLR 1478.

57 [1992] 2 NZLR 385.

58 The case raises some interesting questions relating to foreign ownership. The *Overseas Investment Regulations* 1985 provide "Except with the Minister [of Finance], it shall not be lawful for any overseas person to enter into any contract or transaction or make any arrangement, whether orally or in writing, for the acquisition of..." rural property. In *Reid* two of the properties in question were large orchards. If the Hong Kong government succeeded in its argument and became the beneficial owner of the orchards it would not appear that it would have been in breach of the regulations, as its interest would have been created by the court apart from the parties' intentions. Nonetheless, a declaration of a constructive trust raises policy questions and might be deemed contrary to the spirit of the regulations. This problem might be solved by proceeding on the basis that, as an equitable remedy, the constructive trust is discretionary. The remedy might be refused in this case and an equitable lien awarded instead, giving the plaintiff a mere charge over the property.

59 It might be asked whether the court had to decide whether *Lister v Stubbs* was good law. Arguably there is a logical contradiction in the plaintiff's claim that it had a caveatable interest on the one hand and that they were entitled to a constructive trust despite the absence of a proprietary base. It would seem that all the plaintiff had was a right to claim a proprietary interest. This interest might be regarded as a mere equity, rather than an equitable interest: *Merbank Corporation Ltd v Cramp* [1980] 1 NZLR 721; Everton "Equitable Interests and Equities – In Search of a Pattern" (1976) 40 Conv 209 at 221. It is unlikely that mere equities are caveatable under section 138 of the Land Transfer Act 1952 (which requires an arguable case that a person is entitled to or beneficially interested in any land, estate or interest): see Wallace and Grbich, "A Judge's Guide to Legal Change in Property: Mere Equities Critically Examined"(1979) 3 UNSW LJ 175 at 194.

In *A-G for Hong Kong v Reid* the Court of Appeal of New Zealand thought that *Lister v Stubbs* represents the law in England.[60] While *Lister v Stubbs* has been subjected to much academic criticism and there is case law which is difficult to reconcile with the decision,[61] it has been reaffirmed in recent years, for example by the English Court of Appeal in *A-G's Reference (No 1 of 1985)*.[62] The court then considered whether it ought to accept the invitation of the counsel for the appellant and not follow the decision. It was noted that there was no argument that there were any local conditions calling for a different approach in New Zealand. Rather the court was asked to reject *Lister v Stubbs* on the basis that it was anomalous and contrary to developments in the law of constructive trusts. It was not prepared to accept the submission, concluding that in the absence of special conditions it was the court's responsibility to follow settled principle. Consequently it was held that the liability of the respondents was personal.

(b) Lister v Stubbs as "settled principle"

The Court of Appeal, following the judgment of Lord Scarman in *Tai Hing Cotton Limited v Liu Chong Hing Bank*[63] expressed the view that, in the absence of special local conditions, it is obliged to apply the English law where it was settled.[64] The application of the rule in this case is dubious. *Tai Hing* may be distinguished on the basis that it involved House of Lords' authority. Lord Scarman's comments were made in the context of a discussion of how the Privy Council and the New Zealand Court of Appeal should treat House of Lords' authority. Where English Court of Appeal authority is involved should our courts not be prepared to take a different approach if they view it proper? Even if the court's interpretation of Lord Scarman's dicta is technically correct, it might be observed that this argument could equally have applied to the Court's earlier constructive trust decisions.[65]

When is an area of law settled? While *Lister v Stubbs* has been followed in England since the case was decided its future may not be secure. The English law of restitution is going through a new phase. At the forefront of this process is Lord Goff, whose vision of restitution featured in the text he co-authored with Professor Jones is proving to be a self-fulfilling prophesy. In *Lipkin Gorman v Karpnale* the House of Lords concluded that unjust enrichment is the basis of restitution.[66] That case also saw the change of position defence, which Lord Goff has long championed, recognised for the first time. The English courts' failure to treat the constructive trust as a remedy freely available to cure unjust enrichment is perhaps the most significant of Goff and Jones' criticisms of the law of restitution remaining to be addressed. A move to the United States approach may be imminent.

60 [1992] 2 NZLR 385 at 390-392.

61 In particular the House of Lords decision of *Boardman v Phipps* [1967] 2 AC 46. There a trustee used information gained from his position to make profitable investment. In concluding that the profits were made in conflict of interest and had to be disgorged it is not entirely clear whether the court was contemplating a proprietary remedy. Lord Wilberforce's judgment suggests that they were and some commentators favour such an interpretation eg Gummow, op cit, at 70. Other writers suggest that the type of remedy was not in issue and the case offers no authority on this point eg Birks, op cit, at 388. The New Zealand Court of Appeal took the latter view in *Reid* [1992] 2 NZLR 385 at 391.

62 [1986] QB 491.

63 [1986] AC 80 at 108.

64 [1992] 2 NZLR 385 at 391.

65 Above, text accompanying nn 42-55.

66 [1991] 3 WLR 10.

It may be that the New Zealand Court of Appeal's characterisation of *Lister v Stubbs* as "settled principle" results from the classic English positivist view of the nature of the common law as a set of rules consisting of past judicial decisions.[67] This static model of the law offers no adequate explanation for legal change. This may be contrasted with the American "prediction theory" championed by Oliver Wendell Holmes and members of the realist movement. Holmes took the view that the law was essentially a matter of prediction, previous decisions were only useful insofar as they provided an indication of what the courts were going to do in the future.[68] If the New Zealand Court of Appeal had taken a realist approach to the issue and asked whether *Lister v Stubbs* would be upheld by English courts in the future *Reid* might have been decided differently.

The "settled principle" argument has rarely been used by the New Zealand Court of Appeal since it was expounded by Lord Scarman. The court has been consistently innovative in recent years. When challenged it has been reversed by the Privy Council with some frequency. This suggests that the court has been readily prepared to part ways with English law. Appeals to the Privy Council are sufficiently rare to make it tempting to take a different view to English law in the expectation that its decisions will not be challenged. Given this, it may be difficult to predict the circumstances in which the "settled principle" argument will be applied. There is a danger that the rule may be used by the Court of Appeal as a device allowing it to escape a full discussion and justification of their decisions in controversial situations. All this tends to suggest that it is unsatisfactory that the Privy Council remains our final court of redress. For instance, should that court decide how we are to provide a remedy for *de facto* couples upon dissolution? The availability of the constructive trust as a property redistributing device is essentially a policy decision. Surely the merits of the argument can be better appreciated by the New Zealand judiciary than the English bench.

Relying on its duty as "an intermediate appellate court" not to depart from a "settled principle of law" may simply mark a change to a more conservative approach for a Court of Appeal which has suffered more than its share of reversals at the hands of the Privy Council in recent years. Leave has been given for the decision to be appealed to the Privy Council.[69] Ironically, whilst the New Zealand Court of Appeal decided the case on the basis of established English authority, recent developments suggest that the appeal stands a good chance of success.[70]

3. Reconciling Reid with earlier Court of Appeal decisions

The "settled principle" rule also begs the question as to what amounts to a principle. Certainly *Lister v Stubbs* stands for more than the proposition that a fiduciary who takes a secret commission or bribe is only personally liable. The rationale underlying the decision concerns the scope of the constructive trust, based on the obligation/ownership distinction. The case has come to stand as authority for the view that the constructive

67 The standard contemporary model remains that outlined in Hart, *The Concept of Law* (1960).

68 Holmes, "The Path of Law" (1896-97) 10 Harv LR 457; Wu, "The Juristic Philosophy of Justice Holmes" (1923) 21 Mich LR 523; Cardozo, *The Growth of Law* (1924) 44-55.

69 [1992] 2 NZLR 394.

70 Of course the appeal may not be heard if the Hong Kong government can satisfy their personal claim in the interim and see no advantage is pursuing a proprietary remedy. In any event even if the Privy Council is inclined to overturn *Lister v Stubbs* the question of whether the interest claimed is caveatable will remain: above n 59.

trust operates to protect existing ownership interests and not to create new ones. This must be the "principle" for which the case stands. As already noted there is a body of New Zealand Court of Appeal authority inconsistent with this principle.

A striking feature of the New Zealand Court of Appeal's treatment of this area is its failure to recognise underlying issues of principle. Thus in extending the reach of the constructive trust in the 1980's there was no discussion of the ownership/obligation distinction; the court did not refer to *Lister v Stubbs*. In *AG v Reid* no mention was made of *Elders* or its decisions in the area of de factos' property rights.

If in *AG v Reid* the court had simply taken the approach favoured in *Elders* and asked whether Reid in good conscience could have retained the property in question, there is little doubt that the Hong Kong government would have succeeded in its claim. Reid had obtained a benefit in breach of his legal and equitable obligations to the Hong Kong government. If *Elders* was followed the proper conclusion would have been to hold him liable as a constructive trustee. Instead there was no attempt to apply the dicta from *Elders* to the facts of *Reid*. The result is that New Zealand now has two Court of Appeal decisions which are irreconcilable.

To some extent the about face may be attributed to the membership of the court in *Reid*. Absent from the court were the two judges who delivered judgments in *Elders*. Sir Edward Somers, a well regarded equity lawyer, retired in the interim. Sir Robin Cooke, the President of the court, who was at the centre of all its major constructive trust decisions in recent years, was also missing. In their absence the court was quick to emphasise the absence of precedent expressly overruling *Lister v Stubbs*. Little attention was given to arguments of principle. The court was willing to accept that *Lister v Stubbs* should stand despite the fact that its underlying rationale is inconsistent with the approach taken in earlier New Zealand Court of Appeal decisions.

Perhaps the most logical conclusion is that the belated recognition of the principle established in *Lister v Stubbs* has the effect of reversing the trend established in the last decade. This would mean that the decisions from this period cannot be regarded as good law. However it is most unlikely that the New Zealand Court of Appeal will turn its back on the redistributive constructive trust so readily. As a result the law in this area in New Zealand has lost the coherence it appeared to be developing. It may be redistributive in some contexts and restrictively orthodox in others.

It is likely that the courts will continue to use the constructive trust to create new property rights in the domestic sphere, where the use of the remedial constructive trust is well established. The availability of the remedy in these cases can only be justified pragmatically on the basis of considerations particular to this environment.[71] Outside this context it is less certain when proprietary relief will be available. Will other breaches of fiduciary duty, for example the taking of corporate opportunities by company officers or other enriching wrongs, such as the abuse of confidential information, be sanctioned through the constructive trust?[72] With-

71 In *Lac Minerals*, above, n 16, at 75, Sopinka J distinguished cases such as *Pettkus v Becker*, above, n 31, on the basis that a "special relationship" was involved. La Forest J was of the view that no such relationship was necessary: ibid at 51.

72 A formalistic response available is to extend the bounds of property to include information and other intangible rights. The difficulty is knowing where to draw the line. Cases such as *Lister v Stubbs* and *Reid* might even be regarded as involving the misapplication of property, allowing the plaintiff to trace into the proceeds derived from that property. It could be argued that there is property in employment relationships, or at least that opportunities arising in that context are

out a clear indication of the proper function of the constructive trust it is difficult to know. The availability of proprietary relief may be unpredictable, with the law developing in an ad hoc fashion. There is a risk of law in this area taking on a schizophrenic character and becoming a collection of disparate rules without a common underlying rationale.

IV. Is the Ownership/Obligation Distinction Defensible?

1. The need for restricting proprietary relief in cases of insolvency

In *Lister v Stubbs* Lindley LJ focused on the dangers of awarding the constructive trust over profits earned through a wrong.[73] In particular, the interests of the defendant's creditors were considered. Where a constructive trust is awarded the subject matter of the trust is effectively removed from the pool of assets available to general (unsecured) creditors.[74] Where the defendant is insolvent, the contest becomes one primarily between plaintiffs and creditors.[75] If the constructive trust is awarded lightly general creditors will be unfairly prejudiced.

In the past creditors' interests have often been accorded little attention. The view was taken that a reduction in the pool of assets available for distribution was simply one of the risks of insolvency. Creditors could not complain if they were prejudiced because of a constructive trust being awarded, for they had failed to take the opportunity to protect their interests by requiring some form of security.[76] However, more recently the development of devices such as the retention of title clause and the *Quistclose* trust have encouraged commentators to consider the provision of proprietary relief in insolvency generally.[77]

2. The argument for limiting constructive trust to cases of unjust enrichment by subtraction

Defendants may be unjustly enriched in one of two ways.[78] First the defendant may be enriched by taking or receiving a benefit which was held by or was on its way to the plaintiff (enrichment by subtraction). In this situation the defendant's gain will correspond to the plaintiff's loss. Alternatively the defendant may profit from committing a wrong against the plaintiff (enrichment by a wrong). In this situation the defendant's gain need not reflect any loss incurred by the plaintiff. In fact the plaintiff may have suffered no material loss.[79]

the employer's property, or that secret commissions and bribery involve breaches of confidence and the information used is the employer's property. A difficulty with this is that it could have unfortunate ramifications beyond the law of restitution, eg in the issue of theft of information in criminal law: see Hammond, "The Legal Protection of Ideas" (1991) 29 Osgoode Hall LJ 93 at 109 and references cited therein at n 46.

73 Above, n 16, at 15.

74 Secured creditors are likely to be regarded as bona fide purchasers for value: Paciocco op cit at 321.

75 Palmer op cit Vol 1 at 183; Paciocco op cit at 321; Goode op cit at 444.

76 Restatement of Restitution section 160 comment f. Also see Scott *The Law of Trusts* (3rd ed 1967) at section 508. In a patently circular argument the author concludes "It 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."
The voluntary assumption of risk argument cannot be used to justify giving constructive trustees priority over all unsecured creditors. Some creditors such as those who have obtained judgment against the defendant in contract or tort actions never had the opportunity to protect themselves against the risk of the defendant becoming insolvent: Paciocco op cit at 325

77 Goode op cit.

78 The distinction has long been recognised in American law: *Restatement of Restitution* section 160 comment d. The distinction is central to Birks' analysis of restitution.

79 Birks op cit at 41.

In cases of enrichment by subtraction the case for relief is particularly compelling in terms of corrective justice as the plaintiff's loss is matched by the defendant's gain.[80] In contrast, where a constructive trust is sought over profits earned from a wrong, relief is principally motivated by considerations of punishment and deterrence – the desire to prevent defendants benefiting from their wrongdoing. The primary desire is to prevent the defendant retaining the enrichment, not to compensate the plaintiff for any loss suffered.[81] If the defendant is insolvent there is no question of him or her retaining the enrichment, for if the plaintiff is not able to claim it will be shared by creditors. Consequently the justification for giving a plaintiff priority in insolvency is not as strong.[82] For this reason it has been argued that the advantages of proprietary relief should be restricted to situations involving enrichment by subtraction.[83]

3. Does this argument justify the ownership/obligation distinction?

Does the policy argument for limiting the constructive trust to enrichment by subtraction claims provide a basis for the ownership/obligation distinction? It would seem not. Restricting constructive trusts to protecting existing ownership interests does not ensure that the remedy is available only in respect of subtraction claims. As already mentioned, as a matter of reality, the English law at present allows for the creation of new interests through the tracing fiction.[84] The additional recovery advantage is recognised as an important aspect of the remedy.[85] Thus a constructive trust will be available over profits earned from a wrong if they are made by using the plaintiff's property. As a result of arbitrary tracing rules, prejudice to third parties occurs with some frequency in cases involving following a pre-existing proprietary interest through various transactions.[86]

Moreover there are some instances of enrichment by subtraction where constructive trust relief will not be available. These involve cases of interceptive subtraction – where the benefit received by the defendant would have come into the plaintiff's hands but for the defendant's interception.[87] In these circumstances it would seem that a constructive trust will not be available in English law if the enrichment was never actually owned by the plaintiff.[88] Thus the constructive trust has never been used in actions for account.[89]

80 Fuller and Purdue, "The Reliance Interest in Contract Damages" (1936) 46 Yale LJ 52 at 56.

81 This point is well made by Stevens, op cit at 271 and 279-280.

82 Paciocco op cit at 350 argues that in a restitution for wrongs case plaintiffs cannot object to being denied a proprietary claim: "After all the plaintiff's only real claim to such profits is that the defendant should not have them." If this is so than there is no reason why the plaintiff's personal claim to profits should not also abate in insolvency. The fact that this is seldom advocated suggests that the rationale for allowing a plaintiff's claim to profits earned as a result of a breach of his or her rights is not limited to punitive and deterrent considerations alone.

83 Stevens ibid at 279-280; Paciocco op cit at 349-350.

84 Above, text accompanying nn 15-21.

85 Stevens op cit at 292.

86 Eg the rule in *Re Hallet's estate* [1880] 13 Ch D 696 which provides that where trustees have trust money in a personal account and make withdrawals it must be assumed that they take out their own money first. In addition the "first in first out" rule in *Claytons* case may also in some circumstances work injustice. Neither of the rules consider the cause of the withdrawal eg whether the defendants are increasing their expenditure because they regard the plaintiff's money as a windfall. See Osterle, "Deficiencies of the Resitutionary Right to Trace" (1983) 68 Cornell LR 172 at 203-208.

87 Birks op cit at 133.

88 An interceptive subtraction argument has never been used to found a constructive trust in English law. In a recent note, see above n 34, Birks criticises the Canadian Court of Appeal's decision in *Lac Minerals*, without commenting on the fact that La Forest J (at 45) based his decision on Birks' own theory of interceptive subtraction.

89 Interestingly *Elders v BNZ* has been characterised as involving a proprietary relief for account:

Thus it may be seen that the subtraction/wrongs distinction cannot be used to justify the law as it stands. At present the constructive trust is governed by formal rules of property and not considerations of policy or corrective justice. English courts will order a constructive trust in some cases of enrichment by a wrong and will not award that remedy in all instances of enrichment by subtraction.

4. An alternative view: accretion to the defendant's assets as the fundamental justification for constructive trust relief.

In any event it is not clear that the subtraction/wrongs distinction represents the most appropriate basis for restricting proprietary relief. It may be argued that unjust enrichment claims generally present a compelling case for proprietary relief because the defendant's assets have been swelled at the plaintiff's expense. Consequently the plaintiff should have priority over other creditors who cannot demonstrate this.

Even if a restitution for wrongs claim does not present as compelling a case for relief as one relying on an enrichment by subtraction claim, it is nonetheless different from contract and tort claims in that the defendant's assets have been increased and this may be viewed as justification for giving plaintiffs priority. *Lister v Stubbs* has been criticised on the basis that in a case of unjust enrichment by a wrong the plaintiff has a better claim to a benefit gained at his expense than do unsecured creditors, who would be enjoying a windfall if it was made available for distribution.[90] There is some strength in the argument. However it assumes that the "windfall" – the profits earned as a result of the wrong – actually resulted in a higher level of funds being available for distribution. The justification loses its force where defendants, spurred on by their new wealth, give away or squander their resources. Consequently it may be argued that, in insolvency, proprietary relief should only be allowed if and to the extent that it can be shown that the unjust enrichment has resulted in an increase in the pool of assets available for distribution.

Indeed it could well be that the only adequate justification for awarding a constructive trust in insolvency where there is an enrichment by subtraction is an accretion to the defendant's assets. While the fact that the defendant's enrichment is matched by a loss suffered by the plaintiff is a compelling justification for relief vis-a-vis the defendant, it is not so persuasive in the insolvency context where the contest is essentially between the plaintiff and general creditors. The creditors have also suffered loss and if the plaintiff cannot demonstrate that his or her misfortune has resulted in an increase in the assets available for distribution then giving priority by awarding proprietary relief seems unwarranted.

In terms of third party creditors' interests the law is at present arbitrary. Significant reform is necessary before English law develops a consistent and coherent basis for limiting the constructive trust. Rather than arbitrarily restricting the instances in which a constructive trust is available, a preferable solution may be to develop principles governing priority in insolvency which adequately take account of the interests of third party creditors. Thus it has been suggested that plaintiffs should be entitled to

Fardell and Fulton "Constructive Trusts – A New Era" (1991) NZLJ 90 at 93. While the court did not analyse the case in this way, it can be argued that the defendant benefited through an interceptive subtraction (under the terms of the contract the proceeds of the stock sale was to go to the plaintiff).

90 Maudsley, "Proprietary Remedies for the Recovery of Money" (1959) 75 LQR 234 at 244-245.

priority in insolvency only to the extent that it can be said that the general creditors would be unjustly enriched if the assets in question were available for distribution.[91]

V. Conclusion

In *Lister v Stubbs* the English Court of Appeal took the opportunity to expound a principle which they viewed as fundamental: the constructive trust operates to protect existing ownership interests and not to create new ones. This is one possible view as to the appropriate scope of the constructive device. To some degree it has been favoured because it is consistent with the paradigm of property favoured in English law. A different approach has been taken in the United States where the constructive trust in some situations may have the effect of redistributing proprietary entitlements. This approach is consistent with the more flexible conception of property which has come to be accepted in American jurisprudence. The redistributive potential of the constructive trust received explicit approval in the Canadian Supreme Court recently. It warrants serious consideration in this country.

Unfortunately in *AG for Hong Kong v Reid* the New Zealand Court of Appeal did not take the opportunity to reflect on the role of the constructive trust. Instead the court accepted that it was bound by English authority. Considering the pace of recent changes in the law of restitution, it may be that the place of *Lister v Stubbs* is not as secure in English law as the court assumed. Even if the decision can be said to be settled law in England, in recent years the New Zealand Court of Appeal has departed from the principle it established. The difficulty now faced is how the decision in *Reid* can be reconciled with the innovative approach consistently taken during the 1980's. It is unlikely that our courts will reject the redistributive potential of the constructive trust altogether. If this is the case the notion that the constructive trust is available only to protect existing proprietary rights should be rejected. The principle is difficult to support, given the fact that, even in English law, the constructive trust functions as a redistributive remedy in some contexts.[92] Those who would restrict the availability of the constructive trust because of its effects in insolvency should look for a more coherent basis for limiting the remedy.

91 Sherwin, "Constructive Trusts in Bankruptcy" (1989) U of Illinois LR 297.
92 Above, text accompanying nn 15-22.