

THE AVAILABILITY OF PROPRIETARY RESTITUTION IN CASES OF MISTAKEN PAYMENTS

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ABSTRACT. *This article is concerned with the availability of “proprietary restitution” in cases of mistaken payments. It is argued that the mistake of the claimant is an insufficient justification for proprietary restitution, but a close analysis of the case law demonstrates that the presence of additional factors can justify the availability of proprietary restitution in specific circumstances. The basis of proprietary restitution is to be found in the breach of a duty which arises separately from the claim for unjust enrichment. The significant contribution of this article is the analysis that knowledge merely creates a duty to maintain the fund until restitution is made, and that knowledge cannot establish the breach of this duty. Importantly, breach of this duty is established by a second condition which is demonstrated by the wilful misconduct of the recipient. It is this conduct which justifies the imposition of the constructive trust. By adopting this analysis, the proprietary claim in the context of mistaken transfers can be classified as forming part of the law of wrongs, rather than the law of unjust enrichment.*

KEYWORDS: *restitution, mistaken payment, proprietary claim.*

I. INTRODUCTION

One of the unsettled questions in the law of restitution is whether proprietary restitution will be available as a response to a claim for unjust enrichment in cases of mistaken payments.¹ The importance of proprietary restitution is that it enables a claimant to assert rights over substitute assets and importantly to gain priority in insolvency. A major difference between this article and the current literature is that the article does not argue that the answer to this question necessarily lies in unjust enrichment or even

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¹ A. Burrows, “The English Law of Restitution: A Ten-Year Review” in J. Neyers, M. McInnes, and S. Pitel (eds.), *Understanding Unjust Enrichment* (Oxford 2004), 23.

unconscionability (although, admittedly, it could be classified as falling within the latter). Instead, it is argued that a recipient's knowledge of the claimant's mistake gives rise to a duty to maintain the fund in favour of the claimant. That duty supplements (but does not replace) the pre-existing and separate personal claim of restitution for unjust enrichment. This duty will be broken when the recipient has acted in a way that can be described as wilful misconduct, namely a deliberate breach or acting with reckless indifference.² The relevant response to a breach of this duty is a proprietary claim over any of the traceable proceeds of the original payment. In this way, proprietary restitution would fall into the classification of restitution for wrongs.³ Therefore, in the context of mistaken transfers, a proprietary claim requires, firstly, knowledge *and*, secondly, the wilful misconduct of the recipient.⁴ Admittedly, other writers have previously argued that knowledge can be sufficient.⁵ However, the difficulty of identifying knowledge as the sole criteria is that in some cases the recipient has knowledge, but proprietary restitution is nevertheless unavailable.⁶ By adding the requirement that the recipient must act with wilful misconduct, it will be demonstrated that the existing case law can be properly reconciled and that, finally, a predictable pattern emerges in the case law. More importantly, it provides a more balanced approach to the availability of constructive trusts by precluding their availability by default in all instances of mistaken transfers, whilst at the same time recognising that the constructive trust should still be available where the behaviour of the recipient calls for the court's intervention.

II. THE NEED FOR A NEW ANALYSIS

There are two points to address at this stage: firstly, the scope of the issues which are addressed in this article and, secondly, the need for this analysis. The focus of this article is on the availability of proprietary restitution, in the form of a constructive trust, in response to claims arising from mistaken payments. This includes cases of non-induced mistakes,⁷ as well as fraudulently induced transfers.⁸ Although Birks argued that there existed a wider category of vitiated consent transfers which would include cases of "ignorance" (in essence referring to cases of unauthorised transfers), these cases

² *Armitage v Nurse* [1998] Ch. 241, 252, per Lord Millett.

³ P. Birks, *An Introduction to the Law of Restitution*, revised ed. (Oxford 1989), 313; P. Birks, "Rights, Wrongs, and Remedies" (2000) 20 O.J.L.S. 1, 31–32. This is discussed at the text to note 105 below.

⁴ E.g. *Getronics v Logistic & Transport Consulting* (Q.B., 30 April 2004). See also *Deutsche Bank AG v Vik* [2010] EWHC 551 (Comm), at [4], per Burton J.

⁵ B. McFarlane, *The Structure of Property Law* (Oxford 2008), 305–07. Somewhat tentative support is evident in G. Virgo, "The Role of Fault in the Law of Restitution" in A. Burrows and Lord Rodger (eds.), *Mapping the Law: Essays in Memory of Peter Birks* (Oxford 2006), 92–94.

⁶ *Fitzalan-Howard v Hibbert* [2009] EWHC 2855 (Q.B.); *Pertemps Recruitment Partnership Ltd. v HMRC* (2011) UKUT 272 (TCC).

⁷ E.g. *Chase Manhattan Bank NA v Israeli-British Bank (London) Ltd.* [1981] Ch. 105.

⁸ E.g. *Commerzbank Aktiengesellschaft v IMB Morgan plc* [2004] EWHC 2771 (Ch); [2005] 2 All E.R. (Comm) 564.

do not form the focus of the analysis in this article.⁹ It will be further explained that the key issue in cases of mistaken transfers is that the claimant has made a conscious decision to transfer the money to the recipient – an element which is absent in cases of “ignorance”.¹⁰ It is also worth noting that there is some authority to support the proposition that some mistakes are so fundamental that they prevent legal title from passing to the recipient.¹¹ Examples are mistakes of identity, where property is transferred to the wrong person,¹² or mistakes of the property itself, where the wrong form of property is transferred.¹³ These situations are also outside of the scope of this article, for two reasons. Firstly, Swadling has effectively demonstrated that the authority for mistakes of identity, *R v Middleton*,¹⁴ cannot stand in light of other authorities.¹⁵ Secondly, mistakes relating to the identity of the property itself will rarely have relevance in cases of mistaken payments, as the principle would only apply where the transferor intended to transfer something other than money.¹⁶ For these reasons, proprietary restitution for mistaken payments will nearly always require the availability of a beneficial interest under a trust.

The second issue to address is why there is a need for a new approach to the question of proprietary restitution in the context of mistaken transfers. As Sherwin has argued, any theory of the law, unless it is presented as a purely normative account, should “fit” with the decisions of the courts.¹⁷ It is argued in this article that none of the current theories of proprietary restitution provide a satisfactory “fit” with the decisions of the courts, whereas the approach presented in this article has the benefit of reconciling the case law in this area. As will be seen, three of the main theories of proprietary restitution for mistaken payments focus on the intentions of the transferor. This means that, for these writers, the relevant element is the intent of the claimant at the moment of the transfer. Yet, if this was the case, the mechanism through which proprietary restitution would be effected would be via a resulting trust, rather than via a constructive trust. Constructive trusts, generally, focus on the position of the constructive trustee, hence the judicial references to the “conscience” of the constructive trustee.¹⁸ In contrast, resulting trusts generally respond to the state of mind

⁹ Birks, *An Introduction to the Law of Restitution*, p. 140.

¹⁰ See text following note 155 below. This distinction is drawn from R. Grantham and C. Rickett, “Property and Unjust Enrichment: Categorical Truths or Unnecessary Complexity” (1997) 5 N.Z.L. Rev. 668, 684. E.g. *Lipkin Gorman v Karpnale* [1991] 2 A.C. 548.

¹¹ G. Virgo, *The Principles of the Law of Restitution*, 2nd ed. (Oxford 2006), 585–89.

¹² *R v Middleton* (1873) L.R. 2 C.C.R. 38.

¹³ *R v Ashwell* (1885) 16 Q.B.D. 190.

¹⁴ *R* (1873) L.R. 2 C.C.R. 38.

¹⁵ W. Swadling, “Unjust Delivery” in A. Burrows and Lord Rodger (eds.), *Mapping the Law: Essays in Memory of Peter Birks* (Oxford 2006), 292–94.

¹⁶ *Ibid.*, at pp. 294–96.

¹⁷ E. Sherwin, “Restitution and Equity: An Analysis of the Principle of Unjust Enrichment” (2001) 79 Tex.L.Rev. 2083, 2107.

¹⁸ P.J. Millett, “Restitution and Constructive Trusts” (1998) 114 L.Q.R. 399, 400.

of the transferor.¹⁹ Chambers has indeed argued that proprietary restitution in response to mistaken payments is effected through resulting trusts.²⁰ In this section, it will be demonstrated that it is important to move past this claimant-centred view of the creation of property rights and to take a wider perspective that recognises the role of the defendant's knowledge and their behaviour. Once it is accepted that proprietary restitution for mistaken payments operates under a constructive trust, it should also be possible to accept a constructive trust that responds to the state of mind and the actions of the recipient.

A. The View that Unjust Enrichment Can Never Lead to Proprietary Restitution

It is first necessary to consider the arguments made by those who propose that the question of proprietary restitution depends on whether or not the transferor intended to transfer title to the recipient. For the most part, these writers take the view that a claim for unjust enrichment will normally result in an action for personal restitution, and that a constructive trust is only available where the claimant bases their claim on a "want of title" which is seen as a separate action.²¹ These writers generally accept that proprietary restitution will be available for cases of unauthorised transfers, although they would distinguish an unauthorised transfer from cases of mistake where the claimant has made a conscious decision to make the transfer.²² The significance of this is that those who have adopted this approach have generally argued that constructive trusts will rarely, if ever, be available for mistaken transfers.²³ A number of these writers accept that a proprietary interest may arise as a result of rescinding a fraudulently induced transfer, although even then it is apparent that these writers are not entirely convinced by this possibility.²⁴ This rescission analysis is considered further on in this article.²⁵ For present purposes, this section will focus on the views of Swadling who would restrict proprietary restitution to cases of unauthorised transfers, leaving the deceived or mistaken transferor with merely a personal claim for restitution.²⁶ Swadling's approach rests on the premise that unjust enrichment and property are discrete and exclusive categories, without any overlap. Importantly, Swadling argues

¹⁹ R. Chambers, *Resulting Trusts* (Oxford 1997), 222–24.

²⁰ *Ibid.*, at pp. 23–25.

²¹ Millett, "Restitution and Constructive Trusts", pp. 415–16. Another way of phrasing this is the "vindication of property rights"; G. Virgo, "What is the Law of Restitution About?" in W.R. Cornish et al. (eds.), *Restitution Past, Present and Future: Essays in Honour of Gareth Jones* (Oxford 1998), 312–16.

²² Virgo, *The Principles of the Law of Restitution*, pp. 585–89; P. Millett, "Proprietary Restitution" in S. Degeling and J. Edelman (eds.), *Equity in Commercial Law* (Sydney 2005), 320.

²³ *Ibid.*, Virgo, at pp. 585–89; *ibid.*, Millett, at p. 320.

²⁴ Virgo, *The Principles of the Law of Restitution*, p. 613; *ibid.*, Millett, at p. 321.

²⁵ See text to note 53 below.

²⁶ W. Swadling, "Ignorance and Unjust Enrichment" (2008) 28 O.J.L.S. 627, fn. 92. Another academic who shares this view is R. Calnan, *Proprietary Rights and Insolvency* (Oxford 2010), at [4.15] onwards.

that where the claimant has authorised a transfer, title to the money will pass to the recipient regardless of whether the transfer was made under a mistake or was induced by deception.

There are two reasons for departing from Swadling's refusal to accept the possibility of proprietary restitution in cases of mistake. The first reason relates to the question of how the views of Swadling "fit" with the case law. Swadling concedes that this position is one that would involve regarding some of the existing case law as wrongly decided.²⁷ This can be demonstrated by considering how the courts have actually been applying proprietary restitution in cases of fraudulently induced transfers. For example, it is evident that the claim would provide priority in insolvency as demonstrated by *Commerzbank Aktiengesellschaft v IMB Morgan plc*, where many of the claimants had apparently been unaware that they had been the victims of fraud.²⁸ Despite the fact that there were insufficient funds to repay all of the creditors, the claimants who could show that they were victims of fraud were awarded proprietary claims.

The second reason for departing from Swadling's general proposition that proprietary claims are not available for mistaken payments or fraudulently induced transfers is that the passing of title does not preclude a new equitable title from coming into existence in response to other factors. For Swadling, the focus is solely on the actions of the claimant as under his approach it is only where the claimant has not intended to transfer the money to the recipient that proprietary restitution will be available to protect the title of the claimant.²⁹ In other words, by focusing purely on the intention of the claimant, it precludes any consideration of the behaviour of the recipient in the establishment of a proprietary interest. One can agree with Swadling's argument that a mistake or a fraudulently induced transfer will normally be effective to defeat the original title of the transferor, but that does not need to lead to the conclusion that a new title for the transferor cannot be created in the appropriate circumstances.

B. Unjust Enrichment Theorists

In sharp contrast to the position taken by Swadling, a number of unjust enrichment scholars have argued that proprietary restitution is, or at least should be, available for claims arising from unjust enrichment.³⁰ Notably, in the context of mistaken payments, the question of proprietary restitution under the unjust enrichment approach is claimant-orientated as

²⁷ *Ibid.*, Swadling, at p. 642, fn. 92; also *ibid.*, Calnan: "[i]f the issue were free from authority, one might ask why he should be able to [establish a claim for proprietary restitution]", at para. [4.75].

²⁸ *Commerzbank Aktiengesellschaft* [2004] EWHC 2771 (Ch); [2005] 2 All E.R. (Comm) 564.

²⁹ Swadling, "Ignorance and Unjust Enrichment", p. 628.

³⁰ P. Birks, *Unjust Enrichment* (Oxford 2005), 192; A. Burrows, *Understanding the Law of Obligations: Essays on Contract, Tort and Restitution* (Oxford 1998), 67.

it focuses on the absence of the claimant's fully informed consent.³¹ The oft-cited decision in *Chase Manhattan* is purportedly an example of proprietary restitution for unjust enrichment.³² The facts are well known; the claimant bank mistakenly paid \$2 million to the defendant bank, which then entered liquidation before the money was repaid. Goulding J. concluded that the money was held under a trust as the transferor retained an equitable interest in the money. As mistake is a recognised "unjust factor", this decision has been used to support the proposition that proprietary restitution is generally available for other unjust factors, except in cases where the unjust factor is a subsequent failure of consideration.³³

The problem with arguing that *Chase Manhattan* establishes the general availability of proprietary restitution for mistaken transfers is that it is not reflected in the case law.³⁴ One such example is *Fitzalan-Howard (Norfolk) v Hibbert*, where the recipient entered administration before there was an opportunity to repay a mistaken payment.³⁵ In other words, this case appears to be very similar to *Chase Manhattan*. Tomlinson J. explained that the issue of whether proprietary restitution was available was a "difficult" one, but that it was not necessary to conclusively deal with the issue as it had not been argued by the claimant.³⁶ Nonetheless, Tomlinson J.'s judgment indicated that proprietary restitution would not be available from the outset, and moreover that the success of such a claim would depend on the state of mind and the actions of the defendant after the payment was received.³⁷ In another recent decision, *Pertemps Recruitment Partnership Ltd. v HMRC*,³⁸ Arnold J. concluded that mistaken payments, which were received by a recruitment agency, formed part of the assets of the recipient company. The clients who had made these payments did not have any proprietary interest in the mistaken payments, and would only have been entitled to a personal claim for restitution.

Admittedly, one may take the view that the more recent case law is wrong. Nevertheless, if the *Chase Manhattan* decision does stand for the general availability of proprietary restitution in cases of unjust enrichment, a workable model needs to be developed to explain when it is and is not available. In Birks' earlier writings, he conceded that the availability of

³¹ On this general trend of claimant-centred justifications in the theory of unjust enrichment; S. Hedley, "The Empire Strikes Back? A Restatement of the Law of Unjust Enrichment" (2004) 28 *Melbourne Univ.L.Rev.* 759, 767.

³² *Chase Manhattan Bank NA* [1981] Ch. 105.

³³ A. Burrows, "Proprietary Restitution: Unmasking Unjust Enrichment" (2001) 117 *L.Q.R.* 412, 423–28; Birks, *Unjust Enrichment*, p. 192.

³⁴ Burrows notes that the general availability of trusts in response to unjust enrichment would have a significant impact on the current state of law; Burrows, *Understanding the Law of Obligations*, pp. 67–68.

³⁵ *Fitzalan-Howard* [2009] EWHC 2855 (Q.B.).

³⁶ *Ibid.*, at para. [50]. The claim was instead for dishonest assistance, but the presence of a trust was necessary for the success of the claim.

³⁷ "If a constructive trust does arise, it can only be from the point at which the conscience of the recipient is affected", at [49].

³⁸ *Pertemps Recruitment Partnership Ltd.* (2011) UKUT 272 (TCC), at [82]–[83].

proprietary restitution had “never been clearly stated”.³⁹ Even today, the issue remains unsettled.⁴⁰ Birks, for example, advocated what he referred to as the “pro-proprietary future” whereby proprietary restitution would be available for all cases of vitiated transfers.⁴¹ This would arguably be a case of “proprietary overkill”, particularly when commentators such as Swadling and Calnan have objected to the availability of proprietary restitution even in cases of fraudulently induced payments.⁴² Another leading unjust enrichment lawyer, Burrows, has presented a more restrained approach that would allow proprietary restitution where the claimant has not “taken the risk of insolvency”, which would operate in cases such as mistaken payments or fraudulent transfers but not in others such as failure of consideration.⁴³ However, as a test for determining when proprietary restitution would be available, it does not seem to provide sufficiently clear guidance. One could argue that someone takes the risk of insolvency the second that they pay their money over to another individual, even if the transfer was induced by a fraudster. As Duggan explains, “it could just as plausibly be argued that the risk of fraud is an incident of contracting”.⁴⁴ A transferor whose consent is vitiated because they were operating under a mistaken belief always takes at least some risk, even where proprietary restitution will be available, as the money might not be recoverable if, for example, it has been transferred into an overdrawn account.⁴⁵

Moreover, there are cases of failure of consideration where one could argue that the claimants did not consciously take the risk of insolvency. In particular, in cases involving consumer purchases, there is very little room for a consumer to negotiate a contract whereby they will stand as a secured rather than an unsecured creditor.⁴⁶ Accordingly, Chambers has stated that “[i]t is not obvious why a provider who believes ‘that the recipient will perform his part of the bargain’ is any more of a risk-taker than a mistaken payer”.⁴⁷ As a justification for providing proprietary restitution,

³⁹ Birks, *An Introduction to the Law of Restitution*, p. 378. See also R. Chambers, “Constructive Trusts in Canada” (1999) 37 Alberta L.R. 173: “[t]he law has had difficulty working out precisely why and when an unjust enrichment will generate a trust”, p. 219.

⁴⁰ A. Burrows, “The Relationship between Unjust Enrichment and Property” in S. Degeling and J. Edelman (eds.), *Unjust Enrichment in Commercial Law* (Sydney 2008), 333–34.

⁴¹ Birks, *Unjust Enrichment*, p. 192. Similarly, Chambers, *Resulting Trusts*, pp. 108–09 and A Burrows, “Restitution of Mistaken Enrichments” (2012) 92 B.U.L.Rev. 767, 786.

⁴² Swadling, “Ignorance and Unjust Enrichment”, p. 641; Calnan, *Proprietary Rights and Insolvency*, at [4.126]. Virgo also states that this would provide “excessive protection” in *The Principles of the Law of Restitution*, p. 574.

⁴³ A. Burrows, *The Law of Restitution* (Oxford 2011), 176–79.

⁴⁴ A. Duggan, “Proprietary Remedies in Insolvency: A Comparison of the Restatement (Third) of Restitution & Unjust Enrichment with English and Commonwealth Law” (2011) 68 Wash. & Lee L. Rev. 1229, 1253.

⁴⁵ E.g. *Shalson v Russo* [2003] EWHC 1637 (Ch); [2005] Ch. 281.

⁴⁶ The idea that one could describe consumers as “taking the risk of insolvency” seems hard to reconcile with a case such as *Re Farepak Food and Gifts Ltd.* [2006] EWHC 3272 (Ch); [2008] BCC 22, at [2], where Mann J. referred to the “considerable disappointment and disadvantage” of consumers when the company in question had become insolvent.

⁴⁷ Chambers, *Resulting Trusts*, p. 235.

this would imply that a proprietary claim could be available in other claims of unjust enrichment, which is not supported by the current case law and could also operate to the detriment of others whose claims may be just as deserving as the mistaken payer. Obviously, it would be impractical and would fundamentally change the nature of insolvency law if claimants were afforded proprietary restitution for subsequent failures of consideration.⁴⁸ However, it is hard to see how the mistaken payer has any more justification to have the benefit of proprietary restitution except for the elementary fact that there are likely to be many less mistaken payers than those who would seek restitution on other grounds.⁴⁹

An additional problem with the unjust enrichment approach is that the principle of “taking the risk of insolvency” could just as easily be reinterpreted as a justification for *not* providing proprietary restitution in cases involving mistaken payments. This is demonstrated by Sherwin, who states that removing the proceeds of a mistaken payment from the assets of the defendant could impact on others who have certainly not taken the risk of insolvency.⁵⁰ For example, “[i]f C is a tort creditor, C has taken only the risks inherent in interacting with other human beings”.⁵¹ Since there may very well be other creditors who have not taken the risk of insolvency, this undermines the preference given to the mistaken payer by the unjust enrichment approach. Burrows has previously referred to the “the somewhat tangled English position on proprietary restitution for mistake”⁵² and, given the issues created under the “taking the risk of insolvency” approach, a clearer justification needs to be found before one can explain when proprietary restitution should be available for mistaken payments.

C. The “Rescission” Analysis

An alternative approach which seeks to explain the availability of proprietary restitution is the rescission analysis. This approach was first adopted by Millett J. in *El Ajou v Dollar Land Holdings plc*⁵³ and more recently by Rimer J. in *Shalson v Russo*⁵⁴ and Etherton J. in *London Allied Holdings Limited v Lee*.⁵⁵ The rescission approach has found academic support from Häcker.⁵⁶ Häcker describes this as the power model of “proprietary

⁴⁸ Burrows, “Restitution of Mistaken Enrichments”, p. 786.

⁴⁹ See also Millett, “Proprietary Restitution”, p. 322.

⁵⁰ E. Sherwin, “Why *In Re Omegas Group* Was Right: An Essay on the Legal Status of Equitable Rights” (2012) 92 B.U.L.Rev. 885.

⁵¹ *Ibid.*, at p. 895. Also Duggan, “Proprietary Remedies in Insolvency”, p. 1244.

⁵² Burrows, “Restitution of Mistaken Enrichments”, p. 788.

⁵³ *El Ajou v Dollar Land Holdings plc* [1993] 3 All E.R. 717, although similar reasoning was applied by Atkin L.J. in *Banque Belge pour l’Etranger v Hambrouck* [1921] 1 K.B. 321, 332.

⁵⁴ *Shalson* [2003] EWHC 1637 (Ch); [2005] Ch. 281, at [122].

⁵⁵ *London Allied Holdings Ltd. v Lee* [2007] EWHC 2061 (Ch), at [276].

⁵⁶ B. Häcker, “Proprietary Restitution after Impaired Consent Transfers: A Generalised Power Model” (2009) 68 C.L.J. 324. See also E. Bant, “Reconsidering the Role of Election in Rescission” (2012) 32 O.J.L.S. 467.

restitution”, where the order for proprietary restitution originates from the claimant’s decision to rescind the original transfer.⁵⁷ As with the proprietary analysis favoured by Swadling, and also the unjust enrichment analysis, the rescission approach seeks to justify an order for proprietary restitution by focusing on the position of the claimant. The idea behind rescission is that title to the money passes to the recipient, but the transferor has a power to ask for the return of the money. According to Häcker, up until the transfer is rescinded, the transferor enjoys a “mere equity” in the asset, meaning that the title can be defeated by any subsequent equitable interests. Once rescission is made, the effect of rescinding the transfer is that it permits the claimant to trace their interest into substitute assets and provides priority in insolvency (supposedly even where rescission occurs after insolvency).⁵⁸

The first concern that can be raised against this rescission analysis is that it provides an apparently simple answer to the question of proprietary restitution, but one which may ultimately create more uncertainty in this area of law. As Worthington has noted, “[a]lmost every aspect of rescission is now contentious”.⁵⁹ For example, it has been questioned whether rescission responds to the choice of the claimant or to the order of the court.⁶⁰ Another issue of uncertainty concerns the nature of the claimant’s interest. Whereas Häcker contends that rescission gives rise to a “mere equity” before rescission,⁶¹ others have taken the view that a “trust” is imposed from the outset.⁶² Furthermore, the adoption of the rescission analysis does not provide a concrete answer to one of the key issues in this area of law. Notably, Häcker’s model does not provide any clear solution to the vexing question of whether or not proprietary restitution is available for non-induced mistaken payments. In fact, Häcker has contended that this is one of the benefits of the power model.⁶³ Given the importance of establishing a clear set of rules for the availability of proprietary restitution in cases of mistaken transfers, it is questionable whether the lack of a clear answer to the main issue where there continues to be disagreement can, in fact, be regarded as beneficial.

⁵⁷ *Ibid.*, Häcker, at pp. 339–41.

⁵⁸ *Lonrho plc v Fayed (No 2)* [1992] 1 W.L.R. 1, 12, per Millett J.; D. Fox, *Property Rights in Money* (Oxford 2008), at [6.53]–[6.59].

⁵⁹ S. Worthington, “Reviewing Rescission: Real Rights or Mere Possibilities” (2003) 1 *Insolvency Lawyer* 14, 14.

⁶⁰ J. O’Sullivan, “Rescission as a Self-Help Remedy: A Critical Analysis” (2000) 59 *C.L.J.* 509, 528; Fox, *Property Rights in Money*, at [6.64]–[6.66].

⁶¹ Häcker, “A Generalised Power Model”, p. 351. Also Worthington, “Reviewing Rescission”, pp. 19–20, 22; Bant, “Reconsidering the Role of Election in Rescission”, p. 483; Fox, *Property Rights in Money*, pp. 230–32; *Independent Trustee Services Ltd. v GP Noble Trustees Ltd.* [2012] EWCA Civ 195; [2012] 3 W.L.R. 597, at [53], per Patten L.J.

⁶² Chambers, *Resulting Trusts*, pp. 171–84; *El Ajou* [1993] 3 All E.R. 717, 734, per Millett J.

⁶³ Häcker, “A Generalised Power Model”, p. 357: “[o]ne advantage of the power model is that it does not present a black-or-white choice in the matter of proprietary restitution.”

The rescission analysis is also likely to create unnecessary uncertainty in the identification of title to money. It has already been explained that the case law does not support proprietary restitution in all instances of mistake,⁶⁴ but there is also a significant problem in treating the transferor's interest as a "mere equity" from the outset. As noted above,⁶⁵ in a recent tax dispute, it was held that mistaken payments are to be regarded as belonging to the recipient.⁶⁶ The transferors of the overpayments merely would have had a general claim for personal restitution. This might seem to accord with the rescission analysis, as it suggests that the transferor's interest is a "mere equity", and therefore title to the transferred money does not fall back into the transferor's assets until rescission. However, it is arguable that, for tax purposes, a "mere equity" would appear to be regarded as forming part of the assets of the transferor. Worthington takes this view of *Vandervell v IRC*, and would seem to regard the interest in the transferor's option to repurchase those shares as constituting a "mere equity".⁶⁷ In *Vandervell*, the House of Lords held that the transferor had not fully divested himself of his beneficial interest in the shares as the trustees enjoyed an option to repurchase the shares. This option simply represented the ability to enforce the return of the shares, in essence operating no differently from the "mere equity" advocated by Häcker. This conclusion is also supported by *Jerome v Kelly*, where the House of Lords concluded that, for tax purposes, the vendors of a piece of land had not fully disposed of their interests until the completion of the contract as the contract could have been rescinded before completion.⁶⁸ If that is the case, the rescission analysis results in a legal paradox. For example, a fraudulent payment would be regarded as forming part of the assets of the recipient, as well as at the same time forming part of the transferor's assets. This is why the rescission analysis is problematic, as in many cases it is important to determine at any given point of time which party has the best "title" to money. In short, the rescission analysis is likely to cause more complications than solutions in this area.

The second concern is whether the authorities support the proposition that rescission for mistaken or fraudulently induced transfers will always provide the claimant with priority in cases where rescission occurs after insolvency.⁶⁹ This is due to the simple fact that most of the cases which have

⁶⁴ See text to note 34 above.

⁶⁵ See text to note 38 above.

⁶⁶ *Pertemps Recruitment Partnership Ltd.* (2011) UKUT 272 (TCC).

⁶⁷ *Vandervell v IRC* 1967] 2 A.C. 291; S. Worthington, *Proprietary Interests in Commercial Transactions* (Oxford 1997), 212.

⁶⁸ *Jerome v Kelly* [2004] UKHL 25; [2004] 1 W.L.R. 1409, at [36]–[37], per Lord Walker.

⁶⁹ See P. Watts, "Birks and Proprietary Claims" in C. Rickett and R. Grantham (eds.), *Structure and Justification in Private Law: Essays for Peter Birks* (Oxford 2008), 375–76; W. Swadling, "Rescission, Property and the Common Law" (2005) 121 L.Q.R. 122; Millett, "Proprietary Restitution", p. 320, fn. 31.

supported the proprietary effect of rescission in cases of insolvency have involved either land or chattels, not money.⁷⁰ There are two possible explanations for the lack of proprietary restitution in cases of rescinded money transfers. Calnan has commented that “rescission can only have a personal, and not a proprietary, effect in the case of payments of money”.⁷¹ Calnan’s reasoning is that, in bank transfers, the debiting and crediting of accounts means that the recipient does not receive the same thing that was transferred from the claimant. If rescission is concerned with returning the parties to their original position, then it will be impossible when money is substituted or mixed – a view which was shared by Lord Mustill in *Re Goldcorp*.⁷² The second explanation comes from Millett L.J., writing extra-judicially.⁷³ According to Millett, it may be the case that the rules on rescission are subject to the same restriction that applies to other equitable doctrines such as specific performance, which would only operate where the subject matter of rescission consists of unique property. If so, that would preclude rescission from having any proprietary effect in cases involving money transfers. This restriction would provide a serious defect in the rescission analysis, particularly as Millett L.J. is the same judge who introduced the rescission analysis in the earlier case of *El Ajou*.⁷⁴ Indeed, except for recent cases that would have been decided in the same way under the approach presented in this article, rescission after insolvency does not appear to have a proprietary effect in cases involving money transfers. Importantly, where the subject matter of rescission has been in the form of a money transfer, the authorities suggest that the claimant will not enjoy priority where rescission is made after insolvency. For example, this was one of the arguments made by the claimants in *Re Goldcorp*.⁷⁵ In *Goldcorp*, the Privy Council rejected the possibility that rescission could provide the transferor with an interest which could take priority in insolvency.⁷⁶ Furthermore, if we turn our attention to the impact of rescission in the context of money paid in return for shareholdings, cases such as *Tennent v City of Glasgow Bank* further demonstrate that the claimant certainly does *not* gain priority unless rescission precedes the act of insolvency.⁷⁷ Since there are clear examples of

⁷⁰ E.g. *In re Eastgate; Ex p. Ward* [1905] 1 K.B. 465.

⁷¹ Calnan, *Proprietary Rights and Insolvency*, at [4.105].

⁷² *Re Goldcorp* [1995] 1 A.C. 74, 102: “[w]hat the customers would recover on rescission would not be ‘their’ money, but an equivalent sum”, per Lord Mustill.

⁷³ Millett, “Restitution and Constructive Trusts”, p. 416. Also Millett, “Proprietary Restitution”, p. 321.

⁷⁴ *El Ajou* [1993] 3 All E.R. 717. Notably, although Millett J. had discussed the possibility of rescission in *El Ajou*, A.J. Oakley notes that Millett later indicated that this was merely for the purposes of establishing a personal claim for knowing receipt, and that “different considerations would have arisen had an equitable proprietary remedy been sought”, “Restitution and Constructive Trusts: Commentary” in W.R. Cornish et al. (eds.), *Restitution, Past, Present and Future* (Oxford 1998), 229.

⁷⁵ *Re Goldcorp* [1995] 1 A.C. 74.

⁷⁶ *Ibid.*, at pp. 102–03.

⁷⁷ *Tennent v City of Glasgow Bank* (1879) 4 App. Cas. 615: “if the company has become insolvent . . . a wholly different state of things appears to me to arise . . . The repudiation of shares which, while the company was solvent, would not or need not have inflicted any injury upon creditors must now of

proprietary restitution in the context of mistaken transfers providing priority in insolvency before the claimants have had an opportunity to rescind, this would highlight a serious limitation of the rescission analysis.⁷⁸

It should be noted that, just as cases such as *Re Goldcorp* and *Tennent* are problematic for the rescission analysis,⁷⁹ they may appear to be problematic for the proprietary restitution analysis in this article.⁸⁰ If one party misleads the transferor into believing that a contract will be performed in a way that will provide a secured investment, but fails to take the necessary steps to do this, then it would appear to fulfil the requirements of a mistaken transfer coupled with the inevitable knowledge and wilful misconduct of the recipient.⁸¹ This is arguably what happened in *Re Goldcorp* and proprietary restitution was not available. The appropriate solution to this issue can be found in the significance of the contract and the circumstances surrounding the transfer. Whilst the contract is capable of being performed, there is no possibility of proprietary restitution.⁸² This reflects what could be labelled the “subsidiarity” of claims for restitution,⁸³ by preventing a claim of proprietary restitution from arising whilst the contract is still capable of being performed.⁸⁴ This does not mean that a claimant cannot bring the contract to an end and then make a claim for proprietary restitution, but it does preclude proprietary restitution until the contract has in fact been rescinded.⁸⁵ One can demonstrate this by comparing *Re Goldcorp* to cases such as *Halley v Law Society* and *Campden Hill Ltd. v Chakrani*, where the contracts were never capable of being performed.⁸⁶ In the latter two cases, proprietary restitution was available before the claimants attempted to terminate the contracts. Although this may appear to be the same reasoning as used in the rescission analysis, it should be noted that the still performable contract is the reason why proprietary restitution is not available. Importantly, the analysis presented here provides an

necessity inflict a serious injury on creditors”, 622, per Earl Cairns L.C. The case law indicates that rescission must occur *before* insolvency or the winding-up of the company; *Mycock v Beatson* (1879) 13 Ch. D. 384.

⁷⁸ E.g. *Commerzbank Aktiengesellschaft* [2004] EWHC 2771 (Ch); [2005] 2 All E.R. (Comm) 564.

⁷⁹ *Re Goldcorp* [1995] 1 A.C. 74; *Tennent* (1879) 4 App. Cas. 615.

⁸⁰ This criticism is noted by P. Birks in “Trusts Raised to Reverse Unjust Enrichment: The *Westdeutsche Case*” (1996) 4 R.L.R. 1, 21.

⁸¹ A way around this may be to treat these cases as examples of mispredictions, which would preclude even a personal claim in restitution, as demonstrated by *Dextra Bank v Bank of Jamaica* [2002] 1 All E.R. (Comm) 193. However, it is accepted in cases such as *Tennent* that the claimant could have effectively rescinded before the insolvency of the company.

⁸² *Re Goldcorp* [1995] 1 A.C. 74, 102–03, per Lord Mustill; *Eldan Services Ltd. v Chandag Motors Ltd.* [1990] 3 All E.R. 459, 462.

⁸³ C. Rickett and R. Grantham, “On the Subsidiarity of Unjust Enrichment” (2001) 117 L.Q.R. 273.

⁸⁴ See Virgo, *The Principles of the Law of Restitution*, p. 610. E.g. *Lonrho plc* [1992] 1 W.L.R. 1, 11–12.

⁸⁵ Compare *Tennent* (1879) 4 App. Cas. 615 with *Reese River Silver Mining Co. Ltd. v Smith* (1869–70) L. R. 4 H.L. 64.

⁸⁶ *Halley v Law Society* [2003] EWCA Civ 97; [2003] W.T.L.R. 845, at [47]–[48], per Carnwarth L.J.; *Campden Hill v Chakrani* [2005] EWHC 911. Also, the possibility of a proprietary claim where a contract was never capable of being performed was described as a “viable” argument by Ward L.J. in *Maqsood v Mahmood* [2012] EWCA Civ 251, at [40].

explanation of why, in cases where the contract can still be performed, the act of rescinding the contract must occur before the recipient becomes insolvent.⁸⁷ Thus, the live contract is a bar to proprietary restitution and an act of rescission merely removes the limitation provided by a contract that can still be performed.

D. The Views of Lord Browne-Wilkinson and McFarlane

Finally, it is necessary to discuss Lord Browne-Wilkinson's dicta in *Westdeutsche Landesbank Girozentrale v London Islington Borough Council*, which has more recently found support from McFarlane.⁸⁸ This provides a significant departure from the above approaches to proprietary restitution by focusing on the defendant's position, rather than the position of the claimant. In *Westdeutsche*, Lord Browne-Wilkinson indicated that proprietary restitution is available in cases where the recipient is aware of the defect in transfer.⁸⁹ This is evident by two comments made by Lord Browne-Wilkinson in *Westdeutsche*, both of which have proven controversial.⁹⁰ The first comment was his Lordship's suggestion that "when property is obtained by fraud equity imposes a constructive trust on the fraudulent recipient".⁹¹ Admittedly, this seems to circumscribe the equitable tracing rules, although this argument will be dealt with further on by demonstrating that the courts are merely paying "lip service" to these rules and in practice they are not applied by the courts.⁹² The second comment by Lord Browne-Wilkinson was that, if the recipient of a mistaken payment realises that the money was paid under a mistake, they are bound by conscience to hold that money for the claimant.⁹³ This has undoubtedly been a controversial statement, as Birks and Chambers have argued that this should not be followed on the basis that it would create uncertainty.⁹⁴ McFarlane has sought to defend Lord Browne-Wilkinson's approach in *Westdeutsche*, stating that three propositions can be drawn.⁹⁵ First, the transaction must involve B's loss of a right and A's acquisition of a right. This would be covered by a transfer of title to money. Second, there is no legal basis for A to have the benefit of the right. In cases of mistaken payments and fraud, this can be

⁸⁷ *Tennent* (1879) 4 App. Cas. 615.

⁸⁸ *Westdeutsche Landesbank Girozentrale v London Islington Borough Council* [1996] A.C. 669, 689–90; B. McFarlane, "Trusts and Knowledge: Lessons from Australia" in J. Glistler and P. Ridge (eds.), *Fault Lines in Equity* (Oxford 2012); McFarlane, *The Structure of Property Law*, pp. 305–12.

⁸⁹ *Westdeutsche Landesbank Girozentrale* [1996] A.C. 669, 716.

⁹⁰ *Ibid.*, at p. 716. Ward L.J. described this proposition as merely "tentative" and not part of the ratio of *Westdeutsche* in *Magsood* [2012] EWCA Civ 251, at [37]. It has also been questioned by Rimer J. in *Shalson* [2003] EWHC 1637 (Ch); [2005] Ch. 281, at [110].

⁹¹ *Ibid.*, *Westdeutsche Landesbank Girozentrale*, at p. 716.

⁹² See text to note 166 below.

⁹³ *Westdeutsche Landesbank Girozentrale* [1996] A.C. 669, 715.

⁹⁴ Birks, "Trusts Raised to Reverse Unjust Enrichment", pp. 19–20; Chambers, *Resulting Trusts*, p. 208. See also Watts, "Birks and Proprietary Claims", p. 363.

⁹⁵ McFarlane, "Trusts and Knowledge", p. 173. Also McFarlane, *The Structure of Property Law*, pp. 305–12.

demonstrated by showing that B's intention was vitiated. Thirdly, A must know that he has acquired the right and the facts which show that there is no legal basis for A to continue to enjoy the benefit of the right.

One complication with this suggestion is that knowledge on its own seems insufficient as a reason for justifying proprietary restitution.⁹⁶ For example, it is notable that in *Cox v Paxton*, Lord Chancellor Eldon indicated that knowledge of the circumstances would not be sufficient to establish a claim for proprietary restitution.⁹⁷ In *Cox*, a clerk had embezzled money from the claimants and invested the money in insurance policies which were now in the hands of the defendants. His Lordship stated that the defendant's knowledge of the clerk's actions meant that the "morality of it is obvious: but that cannot be the foundation of a rule in Equity".⁹⁸ Swadling provides another example by referring to Diplock L.J. in *Port Line Ltd. v Ben Line Steamers Ltd.* where it was stated that "notice . . . is a shield not a weapon of offence. It protects an already existing equitable interest from being defeated by a purchaser for value without notice. It is not itself the source of an equitable right".⁹⁹ Furthermore, there is case law that demonstrates knowledge alone is insufficient to establish proprietary restitution. In *Fitzalan-Howard v Hibbert*¹⁰⁰ and *Pertemps v HMRC*,¹⁰¹ the recipients had knowledge that they had received a mistaken payment. Nevertheless, proprietary restitution would not have been available despite the knowledge of the recipient. This does not mean that knowledge is irrelevant in determining proprietary restitution. Indeed, most of the discussion in the case law illustrates that the state of mind of the recipient is of central importance when identifying whether proprietary restitution will be available.¹⁰² The problem is that the Lord Browne-Wilkinson/McFarlane analysis is missing an integral ingredient; in other words, knowledge is a necessary but not sufficient requirement.¹⁰³ The case law can only be understood once we recognise that it is also necessary to show that the recipient has breached the duty that is established by knowledge.

III. WHY PROPRIETARY RESTITUTION SHOULD RESPOND TO THE STATE OF MIND AND THE ACTIONS OF THE DEFENDANT

The position taken in this article is that the case law has developed along the lines set out by Lord Browne-Wilkinson, with an additional requirement

⁹⁶ P. Birks, "The Role of Fault in the Law of Unjust Enrichment" in W. Swadling and G. Jones (eds.), *The Search for Principle: Essays in Honour of Lord Goff of Chieveley* (Oxford 1999), 271–74.

⁹⁷ *Cox v Paxton* (1810) 17 Ves. Jr. 329.

⁹⁸ *Ibid.*, at p. 331.

⁹⁹ *Port Line Ltd. v Ben Line Steamers Ltd.* [1958] 2 Q.B. 146, 167. Swadling, "Ignorance and Unjust Enrichment", fn. 92.

¹⁰⁰ *Fitzalan-Howard* [2009] EWHC 2855 (Q.B.).

¹⁰¹ *Pertemps Recruitment Partnership Ltd.* (2011) UKUT 272 (TCC).

¹⁰² See text to notes 175–178 below.

¹⁰³ For example, Mann J. in *Re Farepak Food and Gifts Ltd.* [2006] EWHC 3272 (Ch), at [39]: "[i]t is not just the pricking of the conscience that gives rise to the constructive trust; there is something more."

being that the defendant has acted with wilful misconduct. That explains why proprietary restitution is not available in cases where the recipient has knowledge but has not acted improperly.¹⁰⁴ Thus, the central argument of this piece is that knowledge, and wilful misconduct, are integral factual elements in establishing the claim for proprietary restitution in the context of mistaken transfers. In terms of classifying the claim for proprietary restitution in cases of mistaken payments, this claim falls under the law of wrongs. This follows from Birks' definition of "wrongs", which is that a wrong is the breach of a legal duty.¹⁰⁵ This analysis is important, as elements such as knowledge and wilful misconduct are unnecessary to establish a personal claim of restitution for mistaken payments,¹⁰⁶ so we need to be able to identify a separate cause action if these elements are to have any legal significance. The appropriate categorisation for the claim lies in the law of wrongs through the identification of a duty which is breached by the recipient. The possibility of a wrong-based claim against recipients of mistaken payments finds some support in the recent decision in *Santander UK plc v National Westminster Bank plc*.¹⁰⁷ For the purposes of establishing "Norwich Pharmacal orders" (which is an order made against innocent third parties who are involved in possible wrongdoing in some way),¹⁰⁸ Birss J. described the receipt of mistaken payments by the customers of the defendant bank as an "equitable wrong".¹⁰⁹ This conclusion appears problematic; as Birks contended, the defendant's unjust enrichment is not a wrong.¹¹⁰ However, on the analysis presented here, a mistaken payment can potentially give rise to an "equitable wrong" in appropriate cases. This was very much the issue in *Santander*, as the claimant bank had sought orders against account holders who had been informed that they had received mistaken payments but had not responded to the requests for repayment.¹¹¹ There was something more than mere receipt of a mistaken payment which could provide an arguable case that the actions of the recipients can be regarded as the actions of a wrongdoer.¹¹² Moreover, this analysis also emphasises that the duty created by knowledge does not simply recreate the general obligation to make personal restitution.

¹⁰⁴ *Fitzalan-Howard* [2009] EWHC 2855 (Q.B.) and *Pertemps Recruitment Partnership Ltd.* (2011) UKUT 272 (TCC).

¹⁰⁵ See note 3 above. Birks also noted that a breach of duty has a "whiff of blameworthiness", which would readily apply to the breach of duty set out in this article; Birks, "Rights, Wrongs, and Remedies", p. 31.

¹⁰⁶ Birks, "The Role of Fault in the Law of Unjust Enrichment", pp. 236–39; and Virgo, "The Role of Fault in the Law of Restitution", pp. 84–85.

¹⁰⁷ *Santander UK plc v National Westminster Bank plc* [2014] EWHC 2626 (Ch).

¹⁰⁸ *Norwich Pharmacal v Customs and Excise* [1974] A.C. 133, at [12], per Lord Reid.

¹⁰⁹ *Santander UK plc* [2014] EWHC 2626 (Ch), at [25]–[26].

¹¹⁰ "Unjust enrichment is, always, a not-wrong", Birks, "Rights, Wrongs, and Remedies", p. 28.

¹¹¹ *Santander UK plc* [2014] EWHC 2626 (Ch), at [24]–[25].

¹¹² To bring into play this principle, the claimant merely needs to show an arguable case that wrongdoing has occurred; P. Matthews and M. Hodge, *Disclosure* (Sweet & Maxwell 2012), 3.06–3.07.

Following this, the classification of the claim for proprietary restitution in the context of mistaken payments requires two elements. Firstly, the establishment of a duty to maintain the fund until restitution is made. This arises through the knowledge of the recipient. Secondly, the breach of this duty is established through the wilful misconduct of the recipient's duty to maintain the fund, which is appropriately classified as falling within the law of wrongs. This section will demonstrate that this perspective is also supported by established principles of private law.

A. Knowledge

There are two reasons for accepting the relevance of knowledge in the context of proprietary restitution for mistaken payments. Firstly, although knowledge alone does not create proprietary rights in equity,¹¹³ it is apparent that knowledge can be integral in establishing rights in equity. The most obvious example is the personal claim for knowing receipt (or, to use its more recent nomenclature, “unconscionable receipt”), whereby knowledge is an integral element in establishing personal liability for the receipt of trust property.¹¹⁴ Even when this has been reformulated as unconscionable receipt, the emphasis is still on the extent of the recipient's knowledge.¹¹⁵ Admittedly, Birks has argued that knowing receipt is essentially the equitable version of unjust enrichment, with knowledge being relevant to the defence rather than the cause of action.¹¹⁶ Nevertheless, the vast majority of the case law on knowing receipt has emphasised the knowledge element as a key ingredient in the cause of action rather than the defence.¹¹⁷ Another action in equity that requires knowledge, at least to some degree, is dishonest assistance.¹¹⁸ Dishonest assistance is not founded on unjust enrichment, as the defendant need not be enriched, and is more commonly referred to as a wrong-based claim.¹¹⁹ Although in *Royal Brunei Airlines v Tan* it was stated by Lord Nicholls that “‘knowingly’ is better avoided as a defining ingredient of the principle”, nonetheless when his Lordship defined the requirement of dishonesty it was stated that “[a]n honest person would have regard to the circumstances *known* to him”.¹²⁰ Whilst the above actions are personal claims, they do show that the defendant's knowledge can be one of the necessary ingredients in establishing causes of action in equity.

¹¹³ See text to note 96.

¹¹⁴ *Bank of Credit and Commerce International (Overseas) Ltd. v Akindele* [2001] Ch. 437, 455, per Nourse L.J.

¹¹⁵ *Ibid.*, at p. 455, per Nourse L.J.: “The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt.”

¹¹⁶ Birks, *Unjust Enrichment*, pp. 157–58.

¹¹⁷ *Arthur v Attorney General of the Turks and Caicos Islands* [2012] UKPC 30, at [31], per Etherton L.J.

¹¹⁸ *Royal Brunei Airlines v Tan* [1995] 2 A.C. 378.

¹¹⁹ Lord Nicholls, “Knowing Receipt: The Need for a New Landmark” in W.R. Cornish et al. (eds.), *Restitution, Past, Present and Future* (Oxford 1998), 243–44.

¹²⁰ *Royal Brunei Airlines* [1995] 2 A.C. 378, 390, emphasis added.

Secondly, there is considerable authority which indicates that knowledge creates an equitable duty when it operates in the context of a mistaken transfer. For example, there is a well established line of authority which establishes that financial institutions have an equitable duty to disclose information in assisting the recovery of the proceeds of mistaken transfers.¹²¹ Moreover, there is also authority to support the proposition that the recipient who has knowledge of the mistaken transfer also owes an equitable duty to the claimant. In the Privy Council opinion in *Colonial Bank v Exchange Bank of Yarmouth*, Lord Hobhouse took the view that “when the defendants were told that a mistake was made, an equity was fastened upon them not to alter the position of the fund until the mistake could be repaired”.¹²² In an earlier case, *Freeman v Jeffries*, Bramwell B. also made reference to a “duty of repayment” which would only arise when the defendant had notice of the mistake.¹²³ Similarly, in *Ashmole v Wainwright*, Lord Denman stated that “as to equity, when the defendants had received such notice as they did, both from the attorney and from the language of the particulars, it was their duty to pay back the sums which they had no right to retain”.¹²⁴ A final example is provided by Rowlatt J. in *H Clapham v JB Culucundis*.¹²⁵ Although the claim before the court was one for personal restitution for a mistaken payment, the judge discussed the possibility of proprietary restitution. It was stated that, if the recipient had knowledge of the mistake, then the money would have represented “a fund in his hands that he would have had to hand back in specie”.¹²⁶ There is more than enough support to establish that a separate duty, not based on unjust enrichment, arises when a recipient has knowledge that the payment was made under a mistake.

A final comment concerns the role of knowledge. It is important to clarify the degree of knowledge that is required. It was stated by Chambers Q.C. in *Papamichael v National Westminster Bank plc* that actual knowledge is required.¹²⁷ Furthermore, Virgo has argued that a restrictive approach should be adopted in regards to proprietary restitution for mistaken transfers, “because of the adverse effect they have on the defendant’s creditors”.¹²⁸ This would also explain why proprietary restitution

¹²¹ *Mediterranean Raffineria Siciliana Petroli SpA v Mabanafit GmbH* (CA, 1 December 1978); *Bankers Trust Co. v Shapira* [1980] 1 W.L.R. 1274; *A. v C. (1)* [1981] Q.B. 956; *Santander UK plc* [2014] EWHC 2626 (Ch).

¹²² *Colonial Bank v Exchange Bank of Yarmouth* (1885) 11 App. Cas. 84, 91.

¹²³ *Freeman v Jeffries* (1868–69) L.R. 4 Ex. 189, 200.

¹²⁴ *Ashmole v Wainwright* (1842) 2 Q.B. 837, 845.

¹²⁵ *H Clapham v JB Culucundis* (1921) 7 Lloyd’s Rep. 42, 43.

¹²⁶ *Ibid.*, at p. 43. Also see *Attorney General’s Reference (No 1 of 1983)* [1985] Q.B. 182, 189 where Lord Lane C.J. stated that “there was a legal obligation on the respondent to restore that value to the receiver when she found that the mistake had been made”.

¹²⁷ *Papamichael v National Westminster Bank plc* [2003] EWHC 164 (Comm); [2003] 1 Lloyd’s Rep. 341, at [230].

¹²⁸ Virgo, *The Principles of the Law of Restitution*, p. 611.

will not arise in cases where the recipient has a genuine belief that they are entitled to keep the payment.¹²⁹ In contrast, Collins J. in *Commerzbank* indicated that the test for determining the availability of proprietary restitution was the same as the one used to establish knowing receipt.¹³⁰ This would have the benefit of harmonising knowledge for both personal and proprietary claims in equity, although that would appear to translate the requirement of knowledge into a requirement of unconscionable receipt. This would prove controversial, as Birks rejected any role for “conscience” in establishing claims for proprietary restitution on the basis that it would be “too vague”.¹³¹ Indeed, there is much to be said for avoiding a term which does not help us to identify the factual circumstances in which proprietary restitution is available.¹³² Nevertheless, given the use of “unconscionability” in the application of the defence of change of position in unjust enrichment claims, it may be an inevitable consequence that there will always be an element of flexibility in determining the required state of mind of the recipient in cases of restitution.¹³³ It is suggested in this article that the better view would be to require knowledge, whilst also accepting that knowledge can be inferred, particularly where the recipient has gone to some lengths to keep the money out of the hands of the claimant. This is because the courts may be reluctant to find that a recipient has acted with the same level of knowledge that would be required to show dishonesty, due to the stigma that this finding creates.¹³⁴ Furthermore, in many cases, it may be difficult to show actual knowledge, so it would avoid prolonging litigation if it was possible to establish proprietary restitution by a pragmatic inference that the recipient knew that the money should have been repaid. An example is *Getronics*, where Master Whitaker inferred knowledge without direct evidence.¹³⁵ At the very least, it should be possible to infer knowledge for the purposes of proprietary restitution and this would avoid the uncertainty that could be created by the role of unconscionability.

B. Wilful Misconduct

The immediate issue is to explain why the breach of the duty should require wilful misconduct and not a different standard such as negligence. A

¹²⁹ *Eldan Services Ltd.* [1990] 3 All E.R. 459, 462; *Deutsche Bank v Vik* [2010] EWHC 551 (Comm), at [32], per Burton J. This would also explain how the approach in this article can be reconciled with the unavailability of proprietary restitution in *Westdeutsche Landesbank Girozentrale* [1996] A.C. 669.

¹³⁰ *Commerzbank Aktiengesellschaft* [2004] EWHC 2771 (Ch); [2005] 2 All E.R. (Comm) 564, at [36].

¹³¹ Birks, “The Role of Fault in the Law of Unjust Enrichment”, p. 273.

¹³² See e.g. when Birks referred to the role of unconscionability as a “fifth wheel on the coach” in “Trusts Raised to Reverse Unjust Enrichment”, p. 20.

¹³³ *Niru Battery Manufacturing v Milestone Trading Ltd.* [2003] EWCA Civ 1446; [2004] Q.B. 985, at [157], per Clarke L.J. See Virgo, “The Role of Fault in the Law of Restitution”, p. 88.

¹³⁴ This appeared to have been a concern in *Glen Dimplex Home Appliances Ltd. v Smith* [2011] EWHC 3392 (Comm), at [55].

¹³⁵ *Getronics* (Q.B., 30 April 2004), at [18].

negligence standard was suggested in the recent case of *Fitzalan-Howard* by Tomlinson J. where the judge indicated that the point in time when a constructive trust would arise “might be the point at which he could reasonably be required to have acted”.¹³⁶ It is contended in this article that the standard of wilful misconduct is more appropriate than a negligence standard. This is because the adoption of a standard of “wilful misconduct” avoids an inconsistency. If the carelessness of the claimant is not sufficient to establish proprietary restitution, then it is difficult to see why mere carelessness of the recipient should be sufficient.

The adoption of the phrase wilful misconduct in this context borrows from the terminology used in *Armitage v Nurse*, where Millett L.J. discussed the meaning of this term in the context of breach of trust.¹³⁷ Behaviour can be described as “wilful misconduct” when the individual “either consciously takes a risk that loss will result, or is recklessly indifferent whether it will or not”.¹³⁸ There are two benefits provided by adopting this language in determining breaches of the duty identified in this article. One benefit is that this is a phrase that the courts are already familiar with and there is a body of case law that can be used to assist in determining whether or not a recipient has acted with wilful misconduct. But the most important benefit, as will be seen in the penultimate section below, is that this analysis provides the best “fit” with the case law. A clear example would be where the transfer was induced by fraud. In these cases, the recipient will have knowledge and it will be evident that, from the moment of receipt, the recipient is treating the fund as their own with no intention to make restitution.¹³⁹ Another example would be making an immediate transfer to another person or another bank account of the same amount which has been received.¹⁴⁰ A final example where wilful misconduct may arise is where a recipient knows that the immediate return of the money is a pressing concern, and has sufficient time to make restitution, but makes no attempt to return the money before personal restitution becomes impossible.¹⁴¹

In many cases, knowledge and wilful misconduct will go hand in hand, but they are not always conterminous. This is important for two reasons. For one, the additional element of wilful misconduct provides a higher degree of certainty by focusing on the actions of the recipient. This requirement will often provide an identifiably observable moment in time when

¹³⁶ *Ibid.*, at para. [49].

¹³⁷ *Armitage* [1998] Ch. 241.

¹³⁸ *Ibid.*, at p. 252. *Spread Trustee Co. Ltd. v Hutcheson* [2011] UKPC 13; [2012] 2 A.C. 194, at [54]–[55], per Lord Clarke.

¹³⁹ See *Gladstone v Hadwen* (1813) 1 M. & S. 517, 526, per Lord Ellenborough: “the property may be considered as having passed from the defendant to Sill and Co.: but if it did, it was under such circumstances as a Court of Equity on a bill filed would have directed the property to be restored.”

¹⁴⁰ E.g. *Pendray Sousa v Parselt Ltd.* (Ch, 25 April 1980).

¹⁴¹ This is the explanation provided in this article for *Chase Manhattan Bank NA* [1981] Ch. 105.

proprietary restitution arises, which otherwise would be difficult to identify if the question was merely about the state of mind of the recipient. The second reason for separating knowledge and wilful misconduct in this way is that the breach of the recipient's duty provides a much stronger justification for the availability of proprietary restitution than knowledge alone does. This is important, as an obvious objection to the argument presented in this article would be that proprietary restitution takes the money out of the hands of any third party creditors.¹⁴² According to Swadling and Birks, such an objection would not be one that the courts should concern themselves with; that is a question for the legislature, and here we are dealing with questions of who is entitled to property.¹⁴³ Nevertheless, if one does accept the relevance of the impact of proprietary restitution on other parties, it should be noted that there is a long tradition in the courts of equity of recognising proprietary rights in response to wrongful acts, such as fraud or more generally criminal acts.¹⁴⁴ The principle has always been clearly stated that no one (not even creditors) should benefit from the fraud of another,¹⁴⁵ as stated by Lord Eldon in *Huguenin v Baseley*: "I should regret, that any doubt could be entertained, whether it is not competent to a Court of Equity to take away from third persons the benefits, which they have derived from the fraud, imposition, or undue influence, of others."¹⁴⁶ Although the wilful misconduct of the recipient's duty to maintain the fund should not necessarily be regarded as an instance of fraud, there is at least some support for the proposition that it deserves similar treatment. For example, deliberately taking advantage of a claimant's error has previously been described as being "equivalent to fraud",¹⁴⁷ and it has been stated that equity would intervene "where one party to the transaction, being at the time cognizant of the fact of the error, seeks to take advantage of it".¹⁴⁸ The wilful misconduct of the recipient is not the same as acting fraudulently in the strictest sense, but it would fit within the wider concept of "equitable fraud", which includes "any breach of the sort of obligation which is enforced by a court that from the beginning regarded itself as a court of conscience".¹⁴⁹

¹⁴² Duggan, "Proprietary Remedies in Insolvency", p. 1269; Sherwin, "Why *In Re Omegas Group* Was Right", p. 895.

¹⁴³ See C. Rotherham, "Policy and Proprietary Remedies: Are We All Formalists Now?" (2012) 65 C.L.P. 529.

¹⁴⁴ Many of the cases here could give rise to criminal liability, even the deliberate attempt to keep a mistaken payment (Theft Act 1968, s. 5(4)).

¹⁴⁵ E.g. *Re Empire Assurance Corporation* (1870–71) L.R. 6 Ch. App. 469, 473, per James L.J.

¹⁴⁶ *Huguenin v Baseley* (1807) 14 Ves. Jr. 273, 289.

¹⁴⁷ *May v Platt* [1900] 1 Ch. 616, 623, per Farwell J., in discussing the case of *Garrard v Frankel* (1862) 30 Beav. 445.

¹⁴⁸ *Garrard* (1862) 30 Beav. 445, 451, per Sir John Romilly M.R. See also *Broughton v Hutt* (1858) 3 De G. & J. 501, 505, per Knight Bruce L.J.; and *Ward & Co. v Wallis* [1900] 1 Q.B. 675, 678, per Kennedy J.

¹⁴⁹ *Pitt v Holt* [2012] Ch. 132, at [165], per Lloyd L.J. Also *Nocton v Lord Ashburton* [1914] A.C. 932, 954, per Viscount Haldane L.C.; and *Kitchen v Royal Air Force Association* [1958] 1 W.L.R. 563, 573, per Lord Evershed M.R.

It is argued here that the appropriate response to the recipient's wilful misconduct is the recognition of a claim for proprietary restitution.¹⁵⁰ One reason why proprietary restitution is appropriate is that there needs to be a distinction between the consequences of the breach of duty and the pre-existing and separate right of the claimant to restitution for unjust enrichment. If the failure to maintain the fund simply created another personal claim against the recipient, this would make the duty almost empty of content as it would have little practical benefit given the pre-existing claim for restitution on the basis of unjust enrichment. If knowledge and wilful misconduct are to have practical significance, the legal response must be stronger than merely providing another personal claim against the recipient. Another reason for the proprietary response is that it flows from the nature of the duty. Knowledge creates a primary right for the claimant to have the fund maintained until personal restitution is made. The primary right does not itself establish a right to have the return of the specific money that was transferred,¹⁵¹ so there would not be a breach of duty if the recipient repaid the claimant with money from a separate source and retained the direct proceeds of the mistaken payment.¹⁵² Importantly, it is the breach of the primary right that brings into play the secondary right; if the recipient will not maintain the fund until restitution is made, the court will do the next best thing and impose a constructive trust over the traceable proceeds of the mistaken payment. As Smith has noted, "Equity . . . routinely turns an obligation relating to a particular asset into a kind of proprietary right".¹⁵³ This idea that a breach of a duty can create a proprietary response is reflected in the recent Supreme Court decision in *FHR European Ventures LLP v Cedar Capital Partners LLC*, where a constructive trust was recognised for profits made in breach of a fiduciary's duty to their principal.¹⁵⁴ It is only an incremental step to further develop these authorities so that proprietary restitution applies not just to fraud and breaches of fiduciary duty, but to any cases where the recipient's actions would be relevant in demonstrating wilful misconduct of their duty to preserve the money received.

IV. WHY PROPRIETARY RESTITUTION SHOULD NOT BE AVAILABLE FOR ALL MISTAKEN PAYMENTS

The focus of this article has been with cases where the claimant is operating under a mistaken belief. In the preceding section, it was argued that the

¹⁵⁰ A similar view is adopted in T. Etherton, "The Role of Equity in Mistaken Transactions" (2013) 4 T.L.I. 159, 169.

¹⁵¹ Therefore, proprietary restitution in this context does not equate to specific performance, which would enforce a primary right to have the specific property conveyed.

¹⁵² By analogy, see *Ex p. Kelly & Co.* (1879) 11 Ch. D. 306.

¹⁵³ L. Smith, "Fusion and Tradition" in S. Degeling and J. Edelman (eds.), *Equity in Commercial Law* (Sydney 2005), 33.

¹⁵⁴ *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45; [2014] 3 W.L.R. 535, at [46].

appropriate explanation for proprietary restitution in the context of mistaken transfers is that a duty arises upon knowledge and that this duty is breached when the recipient acts with wilful misconduct. The corollary of that argument is that the mistaken transfer should not, on its own, be a justification for proprietary restitution. This proposition is not one that, at present, is shared by unjust enrichment lawyers, for whom the fault of the claimant is only relevant in establishing the “unjust factor” which is required as part of the unjust enrichment test. In other words, for unjust enrichment lawyers, the claimant’s error is the *reason* for restitution, not a reason for limiting the right to restitution.¹⁵⁵ Nevertheless, a closer inspection of the case law reveals that the fault of the claimant does play a central role in the initial availability of proprietary restitution. The mistake of the claimant is undoubtedly a legally significant fact and, although it may provide a reason for personal restitution, we should also recognise that it provides a reason for weakening the protection given to claimants by restricting them to a personal claim, unless there is another justification for proprietary restitution. Whereas the current approach of most commentators is to reject the relevance of the claimant’s fault, it is argued here that elements of fault are important when it comes to the question of proprietary restitution. We can see the impact of the claimant’s mistake by observing what happens in cases where there is no evidence of a mistake. When there is a lack of evidence about the reason for a transfer, the standard approach is that proprietary restitution will be available under a “resulting trust”.¹⁵⁶ Swadling has made the point that, in essence, the resulting trust fills an evidential gap relating to the transferor’s intention – an evidentiary gap that simply does not exist in the case of a mistaken payment.¹⁵⁷ In such cases where there is no evidence of mistake, the claimant will have the benefit of proprietary restitution through the mechanism of the resulting trust.

Furthermore, the relevance of the claimant’s error is demonstrated by the fact that a “proprietary response” will normally be available when the mistake is made by another person who also has control over the claimant’s money, as in the case of executors or trustees. Take, for example, a mistaken transfer of property under a will, where the intended beneficiary can trace money into the hands of recipients and into substitute assets.¹⁵⁸ The same would apply where a trustee mistakenly transfers trust assets.¹⁵⁹ Those cases can be contrasted with *Re Horne*, described by Warrington J. as a “somewhat curious case”.¹⁶⁰ In *Re Horne*, a claim for payment was made by the family of the trustee, who had also been one of the

¹⁵⁵ Virgo, “The Role of Fault in the Law of Restitution”, p. 101.

¹⁵⁶ *Seldon v Davidson* [1968] 1 W.L.R. 1083.

¹⁵⁷ W. Swadling, “Explaining Resulting Trusts” (2008) 124 L.Q.R. 72, 79.

¹⁵⁸ *Re Diplock* [1948] Ch. 465; *Re Brown* (1886) 32 Ch. D. 597.

¹⁵⁹ *Re Robinson* [1911] 1 Ch. 502, 513.

¹⁶⁰ *Re Horne* [1905] 1 Ch. 76.

beneficiaries. The trustee had overpaid his brothers whilst failing to take his full entitlement and his estate was looking to reclaim the overpayments from the brothers. Warrington J. stated that no such claim could be made and that “[a]ny equity that he might have had in his character of beneficiary is displaced by the fact that he is himself responsible for the mistake which has been made”.¹⁶¹ A significant difference, therefore, between the claimant in the case of mistaken payments by a fiduciary and a mistaken payment by the claimant is that, in the latter, the claimant is at least in part responsible for the error, whereas in the former the error will not normally be attributable to the claimant.¹⁶² Another example of the importance of determining whether the error is attributable to the claimant or someone else is the decision of the Court of Appeal of Barbados in *Quarry Products Ltd. v McClurg*.¹⁶³ In that case, the claimants had agreed a life insurance policy for one of its managers, but the insurance company mistakenly recorded the manager rather than the claimants as the beneficiary of the insurance policy. It was held that the proceeds of the insurance money were held under a trust on behalf of the claimants.

Furthermore, if one looks at the development of the equitable rules of tracing, they were developed in the context of cases where responsibility for the transfer would very often be attributed to someone other than the claimant. For example, in *Re Hallett's Estate*, Jessel M.R. explained that the equitable rules on tracing were applicable in cases involving fiduciaries, and even provided an example of a mistaken mixture of trust funds as an instance where equitable tracing would be readily available.¹⁶⁴ Thus, it is implicit that, by requiring the presence of a fiduciary relationship, the proprietary response developed by the courts of equity operated in circumstances where someone other than the claimant was responsible for the transfer of the property which was the subject of the claimant's beneficial interest. This is very important in explaining why the proprietary response of equity should not be available for all mistaken payments. Whereas modern unjust enrichment theorists generally reject the relevance of the claimant's fault, the courts of equity have traditionally regarded the presence or absence of the purported beneficiary's fault as one of the most important factors in determining whether or not to provide the claimant with a proprietary response from the outset. When a claimant makes a mistaken payment, and the error is attributable to the claimant, there is no immediate justification for a proprietary response. If this analysis is accepted, the clearest justification for the development of the equitable rules on tracing is not

¹⁶¹ *Ibid.*, at p. 81.

¹⁶² An exception to this rule is where the mistake is made by an agent acting on behalf of the principal, and in this type of case the agent's actions can be attributed to the principal; *Colonial Bank* (1885) 11 App. Cas. 84. See Virgo, *The Principles of the Law of Restitution*, p. 108.

¹⁶³ *Quarry Products Ltd. v McClurg* (1967) 10 W.I.R. 524.

¹⁶⁴ *Re Hallett's Estate* (1880) 13 Ch. D. 696, 711.

the presence of the fiduciary duty itself, but rather the underlying premise of identifying which claims were deserving of protection. This is why the claimant's error alone does not provide a sufficient justification for proprietary restitution and explains why it is necessary to show a more compelling reason for the application of the equitable rules on tracing. As stated above,¹⁶⁵ there is sufficient support to demonstrate that an equitable duty arises when the recipient has knowledge of the mistake, and the enforcement of this duty provides an alternative justification for the application of the equitable rules on tracing. This proposition is further discussed in the following section.

V. CLARIFYING THE OPERATION OF THE PROPRIETARY RESTITUTION APPROACH

To restate the proposition in this article: proprietary restitution will be possible in cases of mistaken payments only where the recipient has knowledge of the defect in transfer, which establishes a duty to maintain the fund, coupled with the wilful misconduct of the recipient in the performance of this duty. The result is that a claimant can assert rights over substitute assets and gain priority in insolvency.

A. The Tracing Issue

One possible problem with the availability of proprietary restitution in cases of mistaken transfers is that the law of tracing involves two interlinked set of "illusory rules", both of which would limit the ability of a claimant to trace payments. The two set of illusory rules are, firstly, that at common law one cannot trace into mixtures and, secondly, that the alternative method of tracing in equity is only available where there has been an initial fiduciary relationship. The shortcomings of these rules must be dealt with before we can achieve clarity in this area of law.

The first illusory rule is that, at "common law", it is only possible to trace into substitute assets and that the tracing process comes to an end once the money has been mixed with other money.¹⁶⁶ "Equitable tracing", on the other hand, has no such problem tracing money into mixtures. Although the equitable tracing rules are more favourable than the common law rules, the second illusory rule is that equitable tracing is only available in limited circumstances. In *Re Diplock*, Lord Greene stated that equitable tracing is only available where there is an initial fiduciary relationship, such as

¹⁶⁵ See text following note 121 above.

¹⁶⁶ *Shalson* [2003] EWHC 1637 (Ch); [2005] Ch. 281, at [110], per Rimer J.; *London Allied Holdings Ltd.* [2007] EWHC 2061 (Ch), at [256], per Etherton J.; *Solomons v Williams* (Ch, 23 May 2001); *Bank Tejarat v Hong Kong and Shanghai Banking Corp.* [1995] 1 Lloyd's Rep. 239, 245, per Tuckey J.; the limits of common law tracing were also mentioned recently in *FHR European Ventures LLP* [2014] UKSC 45; [2014] 3 W.L.R. 535, at [44], per Lord Neuberger.

in a trust or agency situation.¹⁶⁷ It is contended in this article that these illusory rules should give way to a unified set of tracing rules that applies to mixtures of money even in the absence of any fiduciary duty. In fact, there are clear indications in the more recent case law that money *can* be traced into mixtures even where there has not been any initial fiduciary duty.¹⁶⁸ A recent example is *Barclays Bank plc v Kalamohan*, where Proudman J. concluded that a mistaken transfer which had been received by a customer of the claimant bank was held under trust.¹⁶⁹ In other words, it would be possible to trace through mixtures. According to the judge, the defendant “was acting in breach of fiduciary duty and the moneys were received by or on behalf of the defendants in circumstances where it would be unconscionable for them to retain them”.¹⁷⁰ This conclusion was reached despite the fact that the defendant was not acting in a genuine fiduciary capacity, but was merely a customer of the claimant bank.¹⁷¹ As Norman has previously noted, it is questionable “whether it is desirable to keep on conjuring up fiduciary relationships in this fashion”.¹⁷² Arguably, the courts are merely paying “lip service” to the requirement of a fiduciary relationship, which is misleading and is bound to lead to wider confusion about the “fiduciary” concept.¹⁷³ In light of decisions such as *Kalamohan*, it must now be acknowledged that one can trace money into mixtures even when there is no initial fiduciary relationship.¹⁷⁴ This conclusion is not just reached on the basis of *Kalamohan*.¹⁷⁵ Other recent examples include *Commerzbank AG v IMB Morgan plc*,¹⁷⁶ *Getronics v Logistic & Transport Consulting*,¹⁷⁷ and *Bank of Ireland v Pexxnet*.¹⁷⁸ In each of these cases, the claimant’s

¹⁶⁷ *Re Diplock* [1948] Ch, 465, 530, per Lord Greene.

¹⁶⁸ *Foskett v McKeown* [2001] 1 A.C. 102, 128–29, per Lord Millett, and 113, per Lord Steyn. Also *Trustee of the Property of FC Jones and Sons (a Firm) v Jones* [1997] Ch. 159, 170, per Millett L.J.; and *Bracken Partners Ltd. v Gutteridge* [2003] EWHC 1064 (Ch), at [31], per Leaver Q.C. This position has now been adopted in Canada; *B.M.P. Global Distribution Inc v Bank of Nova Scotia* (2009) S.C.C. 15 (Sup Ct (Canada)), at [85], per Deschamps J.

¹⁶⁹ *Barclays Bank plc v Kalamohan* [2010] EWHC 1383 (Ch), at [24]. It is not clear from the case report whether the money was actually mixed.

¹⁷⁰ *Ibid.*, at para. [74].

¹⁷¹ The conclusion that the customer was a fiduciary seems difficult to reconcile with *Foley v Hill* (1848) 2 H.L. Cas. 28.

¹⁷² H. Norman, “Tracing Proceeds of Crime” in P. Birks (ed.), *Laundering and Tracing* (Oxford 1995), 111.

¹⁷³ See also L.D. Smith, *The Law of Tracing* (Oxford 1997), 128; and S. Hedley, *A Critical Introduction to Restitution* (London 2001), 299.

¹⁷⁴ A similar statement was made by Spector J. in *In re Dow Corning Corp* 192 BR 428 (Bankr. Ed. Mich. 1996). When referring to the finding of a fiduciary relationship in *Chase Manhattan Bank NA* [1981] Ch. 105, Spector J. stated that “the holding, in actuality, seems to dispense with the requirement”, at 431.

¹⁷⁵ *Kalamohan* [2010] EWHC 1383 (Ch).

¹⁷⁶ *Commerzbank Aktiengesellschaft* [2004] EWHC 2771 (Ch); [2005] 2 All E.R. (Comm) 564.

¹⁷⁷ *Getronics* (Q.B., 30 April 2004). Although it is not explicitly stated that the money was mixed, this case involved overcharges so it is implicit that the mistaken payments would have been mixed with money that could not be recovered upon the moment of receipt. Also, *Bank Tejarat* [1995] 1 Lloyd’s Rep. 239, 248, per Tuckey J.

¹⁷⁸ *Bank of Ireland v Pexxnet* [2010] EWHC 1872 (Comm), at [56]–[57]. Although the courts in *Shalson* [2003] EWHC 1637 (Ch); [2005] Ch. 281, *London Allied Holdings Ltd.* [2007] EWHC 2061 (Ch), and *Banque Belge pour l’Etranger* [1921] 1 K.B. 321 applied a rescission analysis, these cases (1) illustrate

money could be traced, even in the absence of any initial fiduciary relationship and irrespective of any mixing that occurred.¹⁷⁹

It is not just in cases of fraud where we see the courts allowing claimants to trace through mixtures, regardless of whether there has been a breach of fiduciary duty. This is worth noting as Fox has argued that tracing will not be available for most mistaken payments as, according to Fox, the money will only be traceable *after* the recipient has knowledge.¹⁸⁰ Applying this reasoning, unless the recipient is aware of the mistake from the outset, the claimant would not be able to trace the money if it is mixed before the recipient knows about the defect in transfer.¹⁸¹ If this is the correct interpretation of the case law, it would mean that proprietary restitution could still arise in most cases of fraudulently induced transfers but proprietary restitution would rarely be available in other cases of mistaken payments. However, this does not correlate with *Chase Manhattan Bank NA v Israeli-British Bank (London) Ltd.*, or the more recent decision in *Getronics v Logistic & Transport Consulting*.¹⁸² In *Getronics*, there was some doubt whether the recipient had induced a mistaken payment, but Master Whittaker still proceeded on the basis that the recipient was unaware of the defect in transfer until *after* it had received the mistaken payment. Nonetheless, the money could still be traced through subsequent mixtures.¹⁸³ To explain the availability of tracing in cases like *Getronics*, it is important to keep in mind that in tracing the claimant is seeking to trace assets that are “causally and transactionally” linked to their original property.¹⁸⁴ That process is not made impossible merely because the initial proprietary interest of the claimant comes to an end upon receipt. There are two issues here; identifying the property in question, which is achievable through tracing, and then asserting a proprietary right under a constructive trust, which is established through a proprietary claim. To put the argument another way, if A makes a gift of £100 to B, who then mixes the money with other funds in B’s bank account, the usual response is that A cannot trace the money. But, if *Foskett v McKeown* is correct, and the tracing rules are rules of evidence, that is not the appropriate way of analysing the situation.¹⁸⁵ The more appropriate analysis is that A can trace, but that would

that one can trace into mixtures without the existence of an initial fiduciary relationship and (2) would have been decided in the same way under the approach that is proposed in this article.

¹⁷⁹ Support can also be found in *Friends Provident v Hillier Parker May & Rowden* [1997] Q.B. 85, 106, per Auld L.J.; *Deutsche Bank AG* [2010] EWHC 551 (Comm), at [32], per Burton J.; *Halley* [2003] EWCA Civ 97; [2003] W.T.L.R. 845, at [45]–[47]; *Re Farepak Food and Gifts Ltd.* [2006] EWHC 3272 (Ch); [2008] B.C.C. 22, at [39]–[40], per Mann J.; *Campden Hill Ltd.* [2005] EWHC 911, at [74], per Hart J.

¹⁸⁰ Fox, *Property Rights in Money*, at [5.144].

¹⁸¹ *Ibid.*, at para. [5.146].

¹⁸² *Chase Manhattan Bank NA* [1981] Ch. 105; *Getronics* (Q.B., 30 April 2004).

¹⁸³ *Ibid.*, at paras. [17], [23].

¹⁸⁴ *Relfo Ltd. (In Liquidation) v Varsani* [2014] EWCA Civ 360, at [60], per Arden L.J.; and *Foskett* [2001] 1 A.C. 102, 128, per Lord Millett.

¹⁸⁵ *Ibid.*, at p. 113, per Lord Steyn; p. 120, per Lord Hope; and p. 128, per Lord Millett.

ultimately prove to be pointless. As Sheehan has explained, “[t]racing is linked to no particular cause of action. Indeed we can trace even if we have no cause of action”.¹⁸⁶ This is further evidenced by the fact that the courts are prepared to trace mistaken payments even in cases where it has not been fully established that the claimant does in fact have a proprietary right to recover the money.¹⁸⁷ Therefore, it is more appropriate to separate questions of tracing from questions of whether the claimant actually does have a proprietary interest. To do otherwise would be to conflate the evidentiary process with the cause of action.¹⁸⁸ Moreover, in a mistaken payment, the claimant at least has an initial interest in the money before payment. Although the claimant’s original title to the mistaken payment ends at the point of the transfer, there is at least a point in time where there is an identifiable sum of money from which the tracing process can begin.¹⁸⁹ The ability to trace this money does not become impossible so long as we have a starting point where we can identify an initial fund that we are seeking to trace. Support for this analysis can be found in *El Ajou*, which concerned the tracing of money paid through accounts in jurisdictions that do not recognise the trust concept.¹⁹⁰ Although Millett J. rejected the relevance of the location of the accounts, his judgment indicated that tracing would not be defeated even where the claimant could not assert an equitable charge over each account that the money passed through. To quote Millett J.; “[a]n English court of equity will compel a defendant . . . to treat assets in his hands as trust assets if, having regard to their history and his state of knowledge, it would be unconscionable for him to treat them as his own.”¹⁹¹ So long as there is a fund in the hands of the recipient that is “causally and transactionally” linked to the original mistaken payment, then the claimant should not be denied the benefit of proprietary restitution where there has been a breach of the recipient’s duty.

B. Defences and Personal Claims Arising from Proprietary Restitution

The final issues that remain to be clarified are, firstly, the relevant defences to a claim for proprietary restitution and, secondly, the nature of any personal claim that arises as an alternative to proprietary restitution. In relation to the first point, when talking about an initially innocent recipient who subsequently obtains knowledge and who has acted with wilful misconduct, there is no need for any separate defences to proprietary restitution because

¹⁸⁶ D. Sheehan, *The Principles of Personal Property Law* (Hart 2011), 234–35.

¹⁸⁷ E.g. *Mediterranean Raffineria Sicilliana Petroli SpA* (CA, 1 December 1978); *Bankers Trust Co.* [1980] 1 W.L.R. 1274; *A. v C* [1981] Q.B. 956; *Santander UK plc* [2014] EWHC 2626 (Ch).

¹⁸⁸ See also Smith, *The Law of Tracing*, pp. 11–14.

¹⁸⁹ This could arguably be called a “proprietary base”, although Birks argued that an “undestroyed” proprietary base is needed to be present at the moment of receipt; P. Birks, “Overview: Tracing, Claiming and Defences” in Birks (ed.), *Laundering and Tracing* (Oxford 1995), 312.

¹⁹⁰ *El Ajou* [1993] 3 All E.R. 717.

¹⁹¹ *Ibid.*, at p. 737.

sufficient protection is already “built-in” (so to speak) in the requirements of knowledge and wilful misconduct. Moreover, under the approach here, proprietary restitution requires the availability of a pre-existing right to restitution under unjust enrichment, so if the money is transferred to a second innocent recipient before proprietary restitution arises, then the claimant will normally be restricted to a personal claim for restitution against the initial recipient.¹⁹² The only uncertainty is what happens with innocent recipients who subsequently receive the traceable proceeds after proprietary restitution arises. To clarify, once the duty is breached and proprietary restitution arises, the fund is no different to any other form of trust and can be followed and traced into the hands of subsequent recipients. If the continued existence of the proprietary claim was restricted to cases where the fund is still in the hands of a wrongdoer, it would only serve to repeat the complications created by the “mere equity” analysis. Furthermore, from a practical perspective, in most cases the reason why the money has been transferred to a subsequent recipient is inextricably linked with the deliberate breach of duty that has justified the imposition of the trust in the first place.¹⁹³ In complicated cases of fraud, where the money is transferred between multiple accounts, it would be too onerous to require a claimant to demonstrate that each recipient had the requisite knowledge and had acted with wilful misconduct. In light of this, the most appropriate means of buffering the impact on third party recipients is to ensure that innocent recipients are provided with sufficient defences. In regard to innocent recipients, the claim for proprietary restitution can be defeated by a good faith purchaser.¹⁹⁴ It also seems that change of position may also be available to a party who relies on the payment in good faith,¹⁹⁵ although there is some doubt about this.¹⁹⁶ As the operation of proprietary restitution in the context of mistaken transfers depends on wrongdoing, it would be preferable to make the change of position defence available to innocent recipients in addition to the defence of purchasing in good faith. This would limit the impact of proprietary restitution on innocent recipients and creditors.

In relation to the second issue, it is evident that proprietary restitution does not preclude a personal claim as an alternative, as demonstrated by the decision in *Jones v Churcher*.¹⁹⁷ It is also apparent that personal claims

¹⁹² It has been suggested that a claim can be made against secondary recipients where there is a “sufficient link” between the original payment and the payment to the second recipient; *Relfo Ltd. (In Liquidation)* [2014] EWCA Civ 360, at [69]–[99], per Arden L.J.

¹⁹³ E.g. *Getronics* (Q.B., 30 April 2004).

¹⁹⁴ *Foskett* [2001] 1 A.C. 102, 128, per Lord Millett.

¹⁹⁵ Hart J. recognised this was a “controversial” point in *Camden Hill* [2005] EWHC 911, at [84]. The reasoning of Morris Q.C. *Armstrong DLW GmbH v Winnington Networks Ltd.* [2012] EWHC 10 (Ch); [2013] Ch 156, at [103], provides tentative support for the availability of change of position defence.

¹⁹⁶ Although *Foskett* [2001] 1 A.C. 102 involved pre-existing beneficial interests, Lord Millett rejected “change of position” generally as a defence to a claim based on an equitable interest. It should be noted though that this was an obiter comment, at 129.

¹⁹⁷ *Jones v Churcher* [2009] EWHC 722 (Q.B.); [2009] 2 Lloyd’s Rep. 94.

in this context could be framed using the language of both “knowing receipt” and “unjust enrichment”.¹⁹⁸ In most scenarios, the language used makes little difference to the outcome of the case. The requirements of knowing receipt are satisfied by the “unconscionable” receipt of a third party, which would also normally preclude the availability of the change of position defence for the purposes of a claim in unjust enrichment.¹⁹⁹ The main relevance of the terminology is whether an innocent third party recipient of the fund after proprietary restitution has been triggered would be liable where they no longer retain the traceable proceeds of the claimant’s money, but are nonetheless still enriched. In the one case where this was relevant, the court seems to have taken the view that there was no claim on the basis of continuing enrichment. In *Bank of America v Arnell*,²⁰⁰ money had been transferred under a counterfeit cheque to the account of a company owned by the first defendant, who then transferred this money to his personal account. The first defendant then sent the money to the account of the fourth defendant, who had innocently received the money. The fourth defendant initially retained £750 but then spent this money on general expenses. Therefore, she would not have had any personal liability under knowing receipt, but she would have been liable under unjust enrichment as an ordinary expenditure, such as this, would not constitute a change of position.²⁰¹ Despite her continuing enrichment, no order was made for her to pay the claimant £750. Again, since the operation of proprietary restitution in the context of mistaken transfers is primarily concerned with preventing wrongdoing, it is preferable to adopt the position that buffers the impact on innocent parties. Therefore, as *Arnell* demonstrates, there should be no liability for continuing enrichment once proprietary restitution is triggered and it would thus be preferable to classify any personal claim against subsequent recipients as based on knowing (or unconscionable) receipt.²⁰²

VI. HOW THIS APPROACH PROVIDES THE BEST “FIT” WITH THE CASE LAW

A. Examples where the Requirements of Proprietary Restitution Were Present

The requirements of knowledge and wilful misconduct are readily satisfied in cases where the recipient has fraudulently induced the transfer.²⁰³ In

¹⁹⁸ *Relfo Ltd. (In Liquidation)* [2014] EWCA Civ 360, at [1], per Arden L.J.

¹⁹⁹ *Niru Battery Manufacturing* [2003] EWCA Civ 1446; [2004] Q.B. 985, at [157], per Clarke L.J.; Virgo, *The Principles of the Law of Restitution*, p. 710.

²⁰⁰ *Bank of America v Arnell* [1999] Lloyd’s Rep. Bank 399.

²⁰¹ *Lipkin Gorman* [1991] 2 A.C. 548, 580.

²⁰² Another reason for adopting knowing receipt is that the burden of proof in establishing the state of mind of the subsequent recipient is placed on the claimant rather than the defendant.

²⁰³ E.g. *Commerzbank Aktiengesellschaft* [2004] EWHC 2771 (Ch); [2005] 2 All E.R. (Comm) 564.

cases of fraud, where the recipient has knowledge from the outset, all of their subsequent dealings with the mistaken payment will be coloured by that fraudulent motive. From the moment of receipt, it will be evident that the recipient will be treating the money as their own without intending to make restitution. This establishes the basis for proprietary restitution. However, proprietary restitution would not arise from the outset where a fraudster induces the payment to be received by a separate innocent party.²⁰⁴ Whilst the award of proprietary restitution is justified on the basis of wrongful conduct, the key is not the presence of *any* wrongful conduct (which would make the principle too wide in application), but rather the wrongful conduct of the recipient.

The more controversial proposition is that the recipient's knowledge and wilful misconduct can also provide the basis for proprietary restitution for instances of non-induced mistaken payments. It is at this point that we can return the focus to the decision in *Chase Manhattan*.²⁰⁵ In *Chase Manhattan*, the claimant had mistakenly paid money to the recipient, who entered into liquidation before the money was returned. Although the reasoning in Goulding J.'s judgment needs to be rejected in light of the analysis presented in this article, it cannot be ignored that the outcome of the decision was regarded as correct by Lord Browne-Wilkinson in *Westdeutsche*.²⁰⁶ The benefit of the approach adopted in this article is that the facts of *Chase Manhattan* would allow a claim for proprietary restitution if one accepts that the recipient not only had knowledge but had also acted with wilful misconduct in performing their duty to maintain the fund. In *Chase Manhattan*, it was concluded by Goulding J. that the recipient had knowledge of the mistake for nearly an entire month before petitioning for a winding up order. Under the approach presented in this article, this would establish the initial duty to maintain the fund until restitution was made. Following the central premise of this article, however, more would be required than mere knowledge of the mistake to constitute a breach of this duty. It is contended that, on the reported facts, the recipient's actions should have been sufficient to be regarded as wilful misconduct. The recipient was already in financial difficulty at the time of receiving the mistaken payment; indeed, it was noted by Goulding J. that the impending bankruptcy of the recipient bank was known to its employees.²⁰⁷ The inaction of the recipient, in the circumstances, provides the basis for a breach of their duty to maintain the fund. The case of *Re Thellusson* is a

²⁰⁴ E.g. *Pearce v Lloyds TSB Bank plc* [2001] EWCA Civ 1907; and *Citibank NA v Brown Shipley & Co. Ltd.* [1991] 2 All E.R. 690.

²⁰⁵ *Chase Manhattan Bank NA* [1981] Ch. 105.

²⁰⁶ *Westdeutsche Landesbank Girozentrale* [1996] A.C. 669, 715.

²⁰⁷ The financial difficulties of the recipient are documented in *R. v Landy* [1981] 1 W.L.R. 355 (CA), 357–61, per Lawton L.J.; and *Israel-British Bank (London) Ltd. v Federal Deposit Insurance Corp.* 536 F.2d 509 (2d Cir. 1976).

useful illustration of how the failure to take positive steps to protect someone else's rights to recover money would call for the intervention of equity.²⁰⁸ In that case, a recipient had arranged a loan with the claimant. Atkin L.J. concluded that the recipient's subsequent knowledge of his impending bankruptcy meant that he "ought as a just man then to have restored the money".²⁰⁹ This was because the recipient would be aware that "the money would go straight into the possession of the Official Receiver, and that the sweeping away of his assets in bankruptcy would make it impossible for him to comply with his covenant to repay".²¹⁰ There is a similar issue in *Chase Manhattan*. The recipient had sufficient knowledge of the mistaken payment and knowledge of the dire financial position which made the winding up the company an imminent eventuality. Moreover, the failure to make restitution during the month between the knowledge and the winding-up order made the possibility of personal restitution impossible. This is for the simple reason that, when a winding-up order is made, any attempt to return the money would in any case be void.²¹¹ As a result, it should be possible to regard the actions of the recipient in *Chase Manhattan* as constituting "wilful misconduct". To further illustrate this, in *Lewis v Great Western Railway Company*, the court had to deal with the term "wilful misconduct" in relation to the defendant's duty to carry the claimant's goods. In defining the nature of the duty, Brett L.J. stated that "if he does, or omits to do something which everybody must know is likely to endanger or damage the goods, then it follows that he is doing that which he knows to be a wrong thing to do".²¹² Applying this reasoning by analogy, if one accepts the existence of a duty to maintain the fund to ensure restitution of the mistaken payment, *Chase Manhattan* is a good example of a recipient failing to act in circumstances where continued inaction of the recipient was clearly going to endanger the fund.²¹³

The decision in *Chase Manhattan* was also applied by Dillon J. only a year later in the unreported case of *Pendray Sousa v Parselt Ltd.*, in finding a constructive trust in relation to a series of overpayments.²¹⁴ Although Dillon J. at one point seemed to conclude that the overpayments were held under constructive trust from the outset, the availability of the

²⁰⁸ *Re Thellusson* [1919] 2 K.B. 735. Although both Warrington L.J., at 751, and Duke L.J., at 753, appeared to conclude that the claimant had been operating under a mistake of fact, Atkin L.J. appeared to indicate that the real issue was the frustration of the loan agreement, at 765. Notably the award in that case allowed the claimant to recover the money even after bankruptcy, but Warrington L.J. approved previous case law which denied that the money was subject to a trust, at 747–48.

²⁰⁹ *Ibid.*, at p. 765, per Atkin L.J.

²¹⁰ *Ibid.*

²¹¹ Section 227 of the Companies Act 1948. The same position is true under Insolvency Act 1986, s. 127. See Watts, "Birks and Proprietary Claims", p. 374.

²¹² *Lewis v Great Western Railway Company* (1877) 3 Q.B.D. 195, 211.

²¹³ Although it is in a very different context, *Lloyd v McMahon* [1987] A.C. 625 also demonstrates that the failure to act in sufficient time where the defendant is aware there is a need to act can be appropriately regarded as wilful misconduct.

²¹⁴ Chancery Division, 25 April 1980.

constructive trust can be better justified by applying the approach in this article. In *Pendray Sousa*, the first defendant had received a number of overpayments. It was concluded that the first defendant had knowledge of the overpayments and had little intention of returning the money. Subsequently, the recipient transferred this money into two bank accounts that belonged to another defendant. This transfer was described as having the purpose of taking the monies “further away” from the claimants and, moreover, that the transfer was “a device to assist Mr Parsons in cheating Mr George Pendray and keeping the money away from him”.²¹⁵ On the basis of the defendant’s actions, Dillon J. concluded that this money was fixed with a constructive trust – a conclusion that can only make sense if it is recognised that there was not a constructive trust available from the outset but that a constructive trust had arisen at a later point in time, namely when the first defendant breached their duty by attempting to keep the money out of the reach of the claimant.

The analysis presented in this article is further reflected in the aforementioned *Getronics* case.²¹⁶ Firstly, it was concluded that the defendants must have known at some point that the payments were made under a mistake.²¹⁷ Secondly, and importantly, the money was then paid to two other companies which were owned by the initial recipients. As with *Pendray Sousa* above, these transfers constituted a deliberate attempt to prevent the claimant from recovering the money by taking the funds further from the reach of the claimant. This supports the proposition that proprietary restitution is available in cases of mistaken payments where the recipient has knowledge that the money was paid under a mistake and has acted with wilful misconduct in their duty to maintain the fund.

B. Examples where these Requirements Were Absent

The reliability of this analysis is further demonstrated by returning to *Fitzalan-Howard v Hibbert*.²¹⁸ As noted earlier, this case is similar to *Chase Manhattan* except for the fact that the court was unprepared to find that the mistaken payment was held under a constructive trust.²¹⁹ In *Fitzalan-Howard*, a substantial sum was mistakenly paid to the recipient, who was notified of the mistake. The defendant had an opportunity to repay the money, but there was no obvious need for urgency. A few days later, the defendant’s creditors withdrew their support and the bank applied its rights of set-off against the account where the mistaken payment had been received – an event which had not been anticipated by the

²¹⁵ *Ibid.*

²¹⁶ *Getronics* (Q.B., 30 April 2004).

²¹⁷ *Ibid.*, at para. [18].

²¹⁸ *Fitzalan-Howard* [2009] EWHC 2855 (Q.B.).

²¹⁹ See text to note 35 above.

defendants.²²⁰ Although knowledge was present before this event, the defendant had not foreseen the exercise of the bank's right of set-off nor the fact that personal restitution would become impossible in this event.²²¹ This provides a significant distinction with *Chase Manhattan* where in that case the delay was much longer and the defendant was fully aware of the impending bankruptcy but failed to take any steps to return the money.

Furthermore, in *Pertemps v HMRC*,²²² it again makes sense that the mistaken payments were not regarded as being subject to proprietary restitution. The recipient did have knowledge that it had received mistaken payments, but was fully prepared to return the money to its agents. In *Pertemps*, there were no circumstances which made immediate repayment a pressing concern, and the recipient had taken steps to ensure that sufficient money would be available for claims by the agents. There was, thus, no act of wilful misconduct to justify treating the money as being subject to proprietary restitution.

VII. CONCLUSION

The analysis presented here is consistent with the developing case law in this area and demonstrates that knowledge in cases of mistaken transfers is a necessary but not sufficient condition for proprietary restitution. A study of the case law reveals that proprietary restitution in cases of mistaken transfers requires knowledge, as well as the wilful misconduct of the recipient in failing to maintain the fund. At present, most of the theories focus on the intention of the claimant as the sole factor in determining whether or not proprietary restitution is available. Those theories do not fit the pattern of the cases, and also end up providing an "all or nothing" approach; according to those theories, either proprietary restitution should always be available for mistaken transfers or it should never be available for mistaken transfers. However, there will be cases where an error by the claimant is a reason for precluding proprietary restitution just as there will be cases where, despite the error of the claimant, the behaviour of the recipient calls for the availability of proprietary restitution. Although Lord Browne-Wilkinson's suggestion in *Westdeutsche* that a constructive trust arises upon the knowledge of the recipient has the benefit of making the defendant's state of mind relevant, this article has argued that more should be needed to establish proprietary restitution. Knowledge alone seems an insufficient justification for proprietary restitution, and there is subsequent case law that cannot be reconciled with that approach. The suggestion in

²²⁰ *Fitzalan-Howard* [2009] EWHC 2855 (Q.B.), at [38], per Tomlinson J.

²²¹ *Ibid.*, at para. [38].

²²² *Pertemps Recruitment Partnership Ltd.* (2011) UKUT 272 (TCC).

this article is that knowledge creates a duty to make restitution, and that proprietary restitution of the traceable proceeds is a response to the breach of that duty. The key element in identifying the breach of this duty, and thus the availability of proprietary restitution, is that it can be demonstrated that the recipient acted with wilful misconduct in the performance of their duty. That provides a clearer justification, which not only fits with the patterns of the case law, but furthermore fits the principles and precedents established by the courts of equity.