RESTITUTION REMEDIES

TRACING AND RESTITUTION: WESTDEUTSCHE LANDESBANK GIROZENTRALE V ISLINGTON LONDON BOROUGH COUNCIL

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The decision of the House of Lords in *Hazell v Hammersmith and Fulham London Borough Council* ([1992] 2 AC 1) caused flurries in Australia as well as in its home jurisdiction. To practitioners, and bankers, used to dealing with bodies for which the *ultra vires* doctrine has been abolished by sections 160 and 161 of the *Corporations Law* it was a salutary reminder that there are bodies with which banks deal, often in a very substantial way, to which the doctrine applies in all its rigour: these include, here as well as in the United Kingdom, local councils; they also include statutory corporations of many kinds and a select group of private sector corporations (the best known being, no doubt, Westpac Banking Corporation, incorporated by the *Bank of New South Wales Act* 1850, not under the *Corporations Law* or its predecessors). The decision was a reminder, also, that courts may not be by any means zealous to find that a body has power to enter into a transaction of a particular kind, even if modern commercial practice may seem to demand that it have the power, still less if not much more can be said than that everyone else, of the same general character as the body concerned, does it.

Westdeutsche Landesbank (Hobhouse J, 12/2/93, unreported; Court of Appeal, 17/12/93; *The Times*, 30/12/93) was one of a number of cases begun, between local authorities and parties which had entered into swap transactions with them, to clear up the debris left by *Hazell* and to determine where the loss resulting from the authorities' lack of power to enter into the swaps should fall. It was one of a small number of those cases selected as test cases; *Westdeutsche Landesbank* was, in fact, two sets of proceedings, one between that bank and the Borough of Islington, the other between Kleinwort Benson and the Borough of Sandwell. Together, the circumstances of the swap transactions between the two authorities and those banks raised a number of issues concerning personal restitutionary remedies, rights to trace and defences the determination of which might be expected to determine also the outcome of a number of other cases waiting in the wings.

FACTS

The *Islington* case involved a single interest rate swap contract between the Authority and Westdeutsche. It was entered into, and substantial payments were made under it, before the decision in *Hazell*. It was still on foot, and a number of payments remained to be made, when the Divisional Court decided that a local authority had no power to enter into swaps, whether or not for the purpose of hedging an actual liability ([1990] 2 QB 697, a decision ultimately upheld by the House of Lords). No further payments were made after the decision of the

Divisional Court: at that time the amount of the payments made by the bank substantially exceeded the amount of those made by the Authority. The bank, when it entered into the contract, did not, of course, know of the Authority's lack of power: the bank knew that local authorities were significant participants in the swap market, and assumed that they would not participate if there was any doubt about their power to do so. The Authority claimed to have taken various steps — ie changed its position — on the footing that the swap was effective: the steps related to the way in which it prepared its accounts, and particularly the way in which it treated its entitlement to a housing subsidy payable by the central government.

The Sandwell action concerned four swaps. One had been fully performed when the Divisional Court made its decision; under another the payments made by the Authority exceeded those made by the bank. One of the swaps, because of the dates on which payments had been made, raised a question under the *Statute of Limitations*. Otherwise, the issues raised in the Sandwell action were similar to those to which the *Islington* case gave rise.

THE DECISION

Hobhouse J held that, under each of the swap contracts, the party which had paid the greater amount was entitled to recover, with interest, the difference between that amount and the sum of the payments made by the other party. That entitlement arose both at common law, as money had and received, and in equity through the doctrine of tracing. On the facts, no defence of change of position had been made out. The *Islington* case went on appeal, and the Court of Appeal upheld the decision of Hobhouse J on both grounds. Apparently a further appeal, to the House of Lords, is likely.

COMMON LAW: MONEY HAD AND RECEIVED

Hobhouse J held (at 62) that the banks could not recover on the basis of mistake because the operative mistake was one of law, not fact: the English courts have not taken the step taken by the High Court in *David Securities Pty Ltd v Commonwealth Bank of Australia* ((1992) 175 CLR 353): *Woolwich Building Society v IRC (No 2)* ([1993] AC 70; see at 164 per Lord Goff of Chieveley). Neither could they recover on the basis of total failure of consideration: the reason was that they had received (under most of the swaps at least) part of what they had bargained for (the councils had made some payments): *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* ([1943] AC 32); but see the comments in *David* (*supra* at 382, 383) about cases where the consideration is severable. They were able to recover, however, on the basis of absence, rather than failure, of consideration: that is, money paid under an *ultra vires* contract is paid for no consideration and is recoverable by the payer as money had and received: unless to order repayment would amount, in substance, to enforcement of the *ultra vires* contract — as it would if moneys lent *ultra vires* were ordered to be repaid (*Sinclair v Brougham* [1914] AC 398). Particular support was found for this proposition in a series of eighteenth and nineteenth century annuity cases. The cases had arisen from a statute which required the registration of certain contractual annuities; if the registration requirements were not exactly followed, the contracts were void. The effect of the decisions was that payments made both ways, under contracts thus avoided, were recoverable as money had and received: Hobhouse J regarded as particularly significant *Shove v Webb* ((1787) 1 TR 732) and *Hicks v Hicks* ((1802) 3 East 17).

Having considered those and some more modern authorities, Hobhouse J laid down the following broad proposition, in a passage approved by Leggatt LJ in the Court of Appeal:

> "In my judgment the correct analysis is that any payments made under a contract which is *void ab initio*, in the way that an *ultra vires* contract is void, are not contractual payments at all. They are payments in which the legal property in the money passes to the recipient but in equity the property in the money remains with the payer. The recipient holds the money as a fiduciary for the payer and is bound to recognise his equity and repay the money to him. This relationship and the consequent obligation have been recognised both by courts

> applying the common law and by Chancery courts. The principle is the same in both cases: it is unconscionable that the recipient should retain the money. Neither mistake nor the contractual principle of total failure of consideration are the basis for the right of recovery."

The rather more conservative approach of Dillon LJ in the Court of Appeal was that the House of Lords had held, in *Woolwich Equitable Building Society v IRC* ([1993] AC 70) that money paid for no consideration, where a gift was not intended, was recoverable as money had and received; money paid under an *ultra vires* swap contract was paid for no consideration; no gift was intended; therefore the money was recoverable.

As to defences:

(a) Hobhouse J held (undoubtedly correctly) that although the banks could not recover, independently of absence of consideration, on the ground of mistake (because the mistake, if there was one, was a mistake of law, not fact) the circumstance that the transaction was induced by a mistake of law did not prevent recovery on any other basis on which, on the evidence, restitution might be available. In other words, if there was no foundation for a claim for money had and received but mistake, and the only inducing mistake was one of law, then the claim could not succeed; but if there were another independent basis for such a claim, then the fact that, additionally, the transaction was induced by a mistake of law would not be a defence to the claim.

(b) His Lordship held, also undoubtedly correctly, that a defence that the payments by the banks were voluntary payments — that is, that the payments were made in the knowledge that the contracts might be void — could not, on the facts, succeed.

(c) In *Lipkin Gorman v Karpnale* ([1991] 2 AC 548) the House of Lords had held that a defence of change of position was available to a claim for restitution of money had and received (since *David Securities*, *supra*, it is, of course, clear that the defence is available to such a claim in Australia as well). Hobhouse J held, however, that nothing done by Islington following the execution of the swap contracts was sufficient to provide a basis for the defence. There was no identifiable substantial expense incurred by the council which would not, but for the contracts, have been incurred; and the accounting treatment by the council of the results of the swap contracts, which, the council claimed, gave rise to detriment was improper and would have to be reversed in any event.

The reports of the Court of Appeal proceedings at present available do not indicate what argument, if any, was devoted to those defences on the appeal. They are not discussed in the judgments — an indication, perhaps, with which it would be easy enough to sympathise, that they had been abandoned as hopeless.

TRACING IN EQUITY

Tracing in equity is by no means an easy or straightforward topic. A series of propositions may, however, be stated and they may form a convenient point of departure for a discussion of the way in which *Westdeutsche* deals with tracing.

1. Typically. a right to trace in equity arises where someone holding money or property in a fiduciary capacity misapplies it. Thus, *Re Hallett's Estate* ((1880) 13 ChD 696) involved a solicitor who mingled a client's funds with his own; *Re Diplock* ([1948] 1 Ch 465) involved a distribution by executors who, ignorant of the invalidity of the residuary disposition in the will by which they were appointed, distributed the residuary estate to bodies who had no right to it; *Scott v Scott* ((1962) 109 CLR 649) had to deal with a situation where a trustee had mixed trust funds with his own.

2. These are not, however, the only circumstances which can give rise to a right to trace. Such a right can arise where several persons contribute to a fund which is to be

applied for a particular purpose, and fulfilment of the purpose does not exhaust the fund. *Re British Red Cross Balkan Fund* ([1914] 2 Ch 419) is a typical case in this category: a fund was raised for the relief of distress resulting from the Balkan wars; at the end of the war surplus funds remained.

3. There are other, more difficult, cases as well. In *Sinclair v Brougham* ([1914] AC 398) people who had deposited money with a building society which carried on, beyond power, a banking business were held entitled to trace their money into the assets remaining in the hands of the liquidator of the society after its trade creditors had been paid. Then, in *Chase Manhattan Bank v Israel-British Bank* ([1981] 1 Ch 105), Goulding J held that a bank which had mistakenly paid twice an amount which it owed another bank was entitled to trace the second payment into funds in the hands of the liquidator of the other bank and (in effect) claim those funds, to the extent of the amount paid, as its own.

4. Lord Parker insisted, in *Sinclair v Brougham* (at 441, 442), that a right to trace arose in equity only where there was a fiduciary relationship between the parties to the transaction which began the events giving rise to the tracing claim. The Court of Appeal, in *Diplock* (see particularly at 540, 541), adopted this proposition as part of the ratio of *Sinclair v Brougham*, although no member of the House of Lords, other than Lord Parker, had stated it (for an Australian assertion of the same proposition, see *Southern Cross Commodities Pty Ltd v Ewing* (1988) 14 ACLR 39 at 46 per White J). In *Sinclair v Brougham* itself Lord Parker held that there was a fiduciary relation between the agents of the society (its directors), who carried on the *ultra vires* business purportedly on its behalf, and the depositors. In *Chase Manhattan* Goulding J held that a fiduciary relationship coexists with a common law claim for money had and received: particularly, that one to whom money is paid under a mistake of fact is the fiduciary of the payer. At first glance, this seems rather an extension of the fiduciary principle into areas in which it is not usually to be found. Plainly, before (in *Sinclair*) a deposit was made, there could have been no fiduciary relationship between the directors and the depositor unless, by coincidence, such a relationship arose from other circumstances; equally plainly, in *Chase Manhattan*, there was no fiduciary relationship between the two banks before the mistaken payment was made. If one existed, it arose as a result of the transaction (deposit or payment) and must, presumably, have arisen because the payment, in the circumstances in which it was made, resulted in legal title to the money passing to the payee, but so as to leave at least some equitable interest in the payer. That separation of the legal and equitable interests may itself be said to give rise to a fiduciary relationship: where legal and equitable titles are separated it is usually true that the holder of the legal interest is the fiduciary of the holder of the equitable interest. But, if all this is true, it is not very informative to say that an initial fiduciary relationship is a necessary foundation of a right to trace: if a sufficient fiduciary relationship arises whenever a transaction separates legal and equitable titles, one must know what transactions have that effect; and *Sinclair v Brougham* is not particularly helpful as to the principle by which one who deposits money with a body carrying on an *ultra vires* banking business retains an equitable interest in the deposited money; nor is *Chase Manhattan* particularly instructive about why it is that one who pays under a mistake of fact retains an equitable title to the money paid.

5. The value of a tracing claim is, of course, that it is a proprietary claim. It permits the claimant to assert a title to the fund or asset into which his or her money or property can be traced; the claim will find a place within the order of priority of interests in the property; but it will always — or at least usually — rank ahead of unsecured creditors of the party holding the fund or asset. Thus, in *Chase Manhattan*, the particular value of the right to trace over the common law claim for money had and received was that it enabled the payer to assert title to property in the hands of the liquidator of the payee rather than merely to prove as an unsecured creditor in the winding up.

6. An obvious consequence of the proprietary aspect of the right to trace is that it must be possible to identify the property to which represents, wholly or in part, the money or property of the claimant. Hence the rules which have developed about tracing where,

for instance, a trustee has mixed trust funds with his or her own funds: where some of the mixed fund has been applied in acquiring identifiable property which can be found in the hands of the trustee (or in some circumstances — see below — in the hands of a third party) and other parts of it dissipated so as to be incapable in fact of tracing further, the trust fund is taken to have been used to acquire the property, not to have been dissipated: *Re Hallett's Estate*, *supra*; *Re Oatway* ([1903] 2 Ch 356); so, also, if so much of the mixed fund is dissipated that less is left than the amount of the trust fund originally paid in, what is left is taken to be trust money; but if the trustee then pays in further money of his (or her) own, that remains personal, not trust, money: *Roscoe v Winder* ([1915] 1 Ch 62); *Lofts v MacDonald* ((1974) 3 ALR 404). Hence also the principle, asserted in *Re Diplock*, that where an innocent third party has used what would otherwise have been traceable funds on improvements on the third party's own land the right to trace ceases: see at 546-548.

7. There is, however, apparently a somewhat obscure qualification to that "obvious consequence", and it is one which was thought to be directly relevant in *Westdeutsche*. It arises from *Sinclair v Brougham*, and is to the effect that in some circumstances it is possible to trace into the general assets of a defendant rather than (or in addition to) being able to trace into a particular asset or fund. In *Sinclair v Brougham* money had been received by the society from both shareholders and depositors; this had happened over a considerable period. Trade debts had been incurred and paid; deposits had been withdrawn. In the end, shareholders and depositors were held, without any process of identifying any assets as representing any particular money paid in, to have equally ranking claims to the remaining assets. The order of the House of Lords was, however, explicitly subject to the right of any claimant to prove, if possible, that his of her money could be traced into a particular asset in the hands of the liquidator. History does not reveal whether any claimant actually did so: it seems rather unlikely that any could, or would find it worthwhile to try. What is evident, however, is that if a claimant successfully did so, the claim would have ranked, as to the asset concerned, ahead of the "class" rights to trace into all the remaining assets.

8. That qualification, however, does not put in doubt the general proposition that a tracing claim is proprietary in nature. But two questions arise: what is the nature of the equitable interest to which it gives rise, and, if there are (as in most cases there will be) competing claims to the property concerned, where does the tracing claim fit in the order of priorities? In principle, the former question can be answered with relative ease. If the claimant's property can be found in its original form, unmixed, or if it can be traced, unmixed, into identifiable property, then the claimant can (subject to issues of priority) simply claim title to the property. If, however, the claimant's money has been mixed with money or property of others, the claimant has a charge over the blended fund (or property) securing the repayment, with interest, of his or her funds: *Re Diplock* (at 545-547); but, in Australia at least, it seems that the claimant is not limited to a charge but (particularly where the claimant's money, mixed with a defaulting trustee's own money, has been invested in an appreciating asset) may elect to assert a proportionate ownership interest in the asset. See *Scott v Scott* ((1962) 109 CLR 649); *Brady v Stapleton* ((1952) 88 CLR 322); *Stephens Travel Service v Qantas Airways Ltd* ((1988) 13 NSWLR 331 at 346, 347); cf *Re Tilley's Will Trusts* ([1967] Ch 1179).

9. Priorities are considerably more difficult. It is clear, of course, that where property, otherwise traceable in equity, has come into the hands of a *bona fide* purchaser of the legal estate who acquired that estate without notice of the equitable interest, the legal estate prevails, as does the title of one whose claim is derived from that estate. It is almost equally clear (but subject to complications — see below — arising out of the possibility of a defence of change of position) that a volunteer takes title subject to the interest of the person entitled to trace and that, at least where the property remains unmixed, this is so whether or not the volunteer is "innocent". Presumably, in accordance with the ordinary equitable priority rules, the position of one who takes an equitable interest only, but for value, is substantially the same as that of a volunteer. However, *Re Diplock* seems to establish, following the view of the Court of Appeal about what was said in *Sinclair v Brougham*, that where an innocent volunteer (ie one

who takes without notice of the tracing claim) mixes the claimant's money or property with the claimant's own the volunteer and the claimant have equally ranking claims against the mixed fund and property in which it is invested. Where the mixed fund takes the form of a realisable investment, the investment (or so much of it as remains) is to be treated as subject to a charge enforceable by sale, the proceeds being shared by the claimant and the volunteer in the proportions in which their funds contributed to its acquisition. Where, however, the mixed fund takes the form of money in a bank account, title, as between claimant and volunteer, is ascertained by applying *Clayton's Case* (*Devaynes v Noble* (1816) 1 Mer 572): see *Diplock* (at 545-547, 554). As we have seen, *Diplock* holds that, where the claimant's money has been used to make improvements on the volunteer's land, the volunteer prevails — ie, takes free of the tracing claim. It may be — see below — that this is now to be regarded as an instance where change of position is to be regarded as a "defence" to a tracing claim.

As is perhaps too obvious to require stating, it cannot be claimed of those propositions that they are a comprehensive statement of the rules about tracing in equity. They may, however, suffice as an introduction to a commentary on the way in which tracing is dealt with in *Westdeutsche*. But, before coming to that, it is probably desirable to make some introductory comments about personal claims in equity.

EQUITABLE PERSONAL CLAIMS

It is important to remember that personal, as well as proprietary, claims exist which have their origin in principles of equity as well as personal claims the origin of which is in the common law. Equitable personal claims can, and often do, arise in circumstances where the claimant can also assert a proprietary claim to an asset into which his or her money or property can be traced. *Re Diplock*, after all, involved a personal as well as a proprietary claim; it was the (successful) personal claim of the next of kin against the charities with which the House of Lords, on appeal, was almost exclusively concerned: *Ministry of Health v Simpson* ([1951] AC 251). The House of Lords held that the next of kin (who were entitled to the residuary estate) were entitled to restitution from the charities to which the residuary estate had, wrongly, been paid. The House held that the right existed although the mistake under which the charities had been paid was a mistake of law; that the fact that the charities had spent the money was, of itself, no defence (little encouragement, here, for the proponents of a defence of change of position in this context); that the next of kin must first exhaust their remedies against the executors (it was held that they had); and that, statutes of limitation apart, the only factor which might bar such a claim was conduct — particularly conduct amounting to laches — on the part of the claimant. The House of Lords left open, however, the question whether such a personal claim was available outside the context in which it had arisen, that of a deceased estate (as to which, see P Birks, "Trusts in the Recovery of Misapplied Assets: Tracing, Trusts and Restitution" in E McKendrick, ed, *Commercial Aspects of Trusts and Fiduciary Obligations*, Oxford 1992, 149 at 160).

There are, of course, other well known kinds of equitable claims which are often available in this context: particularly, claims based on knowing receipt and knowing assistance, usually taken to have their origin in *Barnes v Addy* ((1874) LR 9 Ch App 244). A very obvious comment is that if the *Diplock* principle is to extend beyond cases of wrong payments, or overpayments, by legal personal representatives and is to coexist with the "knowing receipt" category, a good deal of boundary definition, or harmonisation, remains to be done.

The point of all this is that *Westdeutsche*, if sense is to be made of it, needs to be seen against a complex background of legal and equitable principles and remedies. What has *Westdeutsche* added to the picture?

WESTDEUTSCHE AND EQUITY

Hobhouse J held that the banks were able to recover in equity, as well as at law, on the basis that they could trace, into the general assets of the councils, the payments they had made.

This conclusion was founded largely on *Sinclair v Brougham*. His Lordship's reasoning may be summarised as follows:

(a) The *Sinclair v Brougham* principle in equally applicable where the defendant is solvent and trading as where it is insolvent and in liquidation. "The problem is whether or not the equitable right to repayment ever existed and whether it continues to have efficacy at the time that the remedy is sought...it is absurd to suggest that had the society in *Sinclair v Brougham* been solvent the House of Lords would not have recognised the right of the plaintiffs to recover the payments..." (at 37).

(b) The right to trace (and recover) depends on the existence of a fiduciary relationship; when the council officers received the banks' money under the *ultra vires* transactions they received it (by analogy with the position of the directors in *Sinclair v Brougham*) as fiduciaries. "The fiduciary relationship comes into existence at the time that the payee receives the money" (at 45, 72).

(c) The right to trace (and recover) depends secondly on "the ability to trace the payment into the assets of the recipient (or his representative) as they exist at the time of trial" (at 70). But, where the defendant is shown to have mixed the plaintiff's money with its own, the onus is on the defendant to identify, in the mixed fund or assets representing it, the defendant's own property. In other words, tracing remains possible unless the defendant can show that the plaintiff's money has been dissipated, or has disappeared. Islington had not attempted to do so (no evidence had yet been given in the Sandwell action). "The position may be different where the claimant is seeking to share in the increased value of assets which the fiduciary has acquired...or, where there are competing claims on an inadequate fund, the claimant is having to assert his right to a prior claim on that fund, or is asserting his right to have some equitable proprietary right over some individual asset" (at 74).

(d) The bank accounts of the Islington Council into which Westdeutsche's money had been paid had, since the last of the payments was made, been overdrawn; thus, if one were to look only at the bank accounts, the bank's money had all been paid out and, consistently with authority, could not be held to have been replaced by later deposits of money belonging to the council. But that did not end the matter, unless it appeared that the bank's money had been dissipated so as no longer to be traceable. In fact, at all times since the payments had been made, the council had had assets of a value greater than the amount of the payments made by the bank. Thus, the money paid out of the bank accounts had not been dissipated, but could still be found in the council's assets (at 75-77).

(e) The right of the bank was a right to "the equitable remedy of tracing" and thus to a charge on the general assets of the council. Because those assets were more than sufficient to discharge the charge, the bank was entitled to an order that the council pay to the bank the amount by which the payments made by the bank under the swap exceeded the amount of those made by the council (at 77. As Professor Birks has pointed out, incidentally, tracing is not a remedy: it is a process which, in certain cases where it can be applied to identify property, may entitle a plaintiff to an equitable — or in some circumstances legal — remedy: loc cit at 157, 158).

(f) One distinct curiosity of a charge over a defendant's general assets, of the sort to which Westdeutsche was held to be entitled, is that (apparently), unlike a right to claim, through tracing, a proprietary interest in a particular asset (which thus ceases to be one of the general assets of the defendant), it does not deprive assets subject to it of their character as "general assets"(at 43); does it follow that this charge has the unusual characteristic that it gives its holder no priority over general creditors?

(g) "The equity may be lost or become qualified by change of circumstances or the intervention of third parties or third party interests or by the lapse of time. Further payments between the same parties in respect of the same transaction clearly affect the equity, just as, in my judgment, they affect the claim for money had and received.

In the present case where there have been cross-payments in respect of the same swap, reverse payments *pro tanto* reduce or reverse the pre-existing equity. Since the payments were made pursuant to the same void transaction, they fall to be looked at together and there is no equity in respect of one payment independent of the equity in respect of the others"(at 72).

(h) A plaintiff's right to a charge over general assets into which, in accordance with the principles stated by his Lordship, the plaintiff's money can be traced may be defeated by a defence of change of position; he took Lord Goff's treatment of the defence in *Lipkin Gorman*, (*supra* at 579, 580) as generally applicable to claims based upon restitution for unjust enrichment (at 77, 87). His Lordship held, however, that the defence failed, on the facts, as to the equitable claim based on tracing just as it failed in relation to the common law claim.

It is fair to say that the reasoning of Hobhouse J raises a number of issues of novelty, difficulty and importance. Comments on some of them are offered below. In those circumstances one may be excused a degree of respectful disappointment with the judgments of the Court of Appeal. They deal at some length with the one issue on which the court differed from Hobhouse J — the question of the date from which Westdeutsche should be held to be entitled to interest — and in an almost cursory way with the difficult questions of legal and equitable principle which the case raised. Leggatt LJ gave a judgment agreeing fully with Hobhouse J on the common law claim; he dealt with the proprietary claim in equity as follows (Lexis, at 14, 15):

> "All of the components of the bank's claim in equity were viewed in a sense favourable to the bank by the House of Lords in *Sinclair v Brougham* (*supra*) with the result that:
>
> (1) In equity the money remained the property of the bank;
>
> (2) Mere receipt by Islington of money which was not theirs constituted them fiduciaries;
>
> (3) The bank's equitable right in relation to the money in Islington's hands which remained the bank's was in the nature of an equitable charge; and
>
> (4) Since Islington is solvent, the bank can recover in full."

The judgment of Dillon LJ (which deals with the topic at pages 7 and 8) is little less brief. His Lordship cites the speech of Viscount Haldane LC in *Sinclair v Brougham* for the proposition that in equity the property in the money paid remained in Westdeutsche; thus the court could declare a charge; and *Re Diplock* had held *Sinclair v Brougham* to be authority for the proposition that a sufficient fiduciary relationship existed between the depositors and the directors by reason of the fact that the purposes for which the depositors handed over their money were incapable of fulfilment. "So interpreted *Sinclair v Brougham* is a direct parallel to the present case. Thus in equity also the bank is entitled to the return of the balance of £2.5m." Kennedy LJ agreed with both Dillon LJ and Leggatt LJ.

SOME COMMENTS

Of what particular practical importance is this somewhat complex and academic law to bankers and their lawyers? To that question there seem to be at least two answers.

One is that banks have a concern with the consequences of transactions, particularly but not only loans, which ultimately turn out to have been entered into *ultra vires*. A consequence of *Westdeutsche*, if it is followed, is that the rule that a loan is irrecoverable if the borrower lacks power to borrow it is, in substance, no longer the law. Hobhouse J cited the observation of Viscount Haldane LC in *Sinclair v Brougham* (at 414) that to "hold that a remedy will lie *in personam* against a statutory society, which by hypothesis cannot in the case in question

have become a debtor or entered into any contract for repayment, is to strike at the root of the doctrine of *ultra vires* as established in the jurisprudence of this country." Thus, if relief *in personam* by way of a judgment for payment of money is, in effect, the enforcement of an *ultra vires* contract (as it is in the case of a loan) that relief cannot be granted. Contracts of loan, therefore, remain an exception to the general proposition stated by Hobhouse J that money paid under a void contract is recoverable by the payer as money had and received (*Westdeutsche* at 59). But, if the decision on tracing is correct, this hardly matters. The lender retains an equitable interest in the money, because the purpose of the payment — a loan — cannot be fulfilled. The retention of that interest gives rise to a fiduciary relationship between payee (intended borrower) and payer (intending lender). The payer therefore has a general charge on the assets of the payee; that charge subsists, apparently, in relation to the fluctuating assets of the payee from time to time unless their value falls to zero before the charge is enforced; and the method of enforcement of the charge, at least where the payee remains solvent, is simply an order for repayment of the money. It does not matter, it seems, that this conclusion involves doing, with minimal indirection, what cannot be done directly. Counsel for Islington "objected that this conclusion produces a result in the present case which is little different from the recognition of a personal remedy against Islington. In a case where there are no competing equities and no question of insolvency I find nothing surprising in this result. Indeed it is the appropriate result..."(at 76).

The second answer to the question posed above is that bankers and their lawyers have, as has the commercial community generally (a cynic might add, as has the community generally, if only they knew it), an interest in the development of the law in a way which accords with principle, is reasonably predictable and tends to make sense of difficult and conflicting authority rather than exacerbate the difficulties. *Westdeutsche*, at least so far as it deals with equitable relief, does not, it is suggested, meet these criteria.

Perhaps the fundamental problem with the case is that, while it is possible to find, in *Sinclair v Brougham*, support for virtually everything Hobhouse J says, and while a literal reading of at least some of the speeches in *Sinclair v Brougham* may support his Lordship's conclusion, that reading, it is suggested, takes a notoriously difficult case so far that the result is very difficult to reconcile either with principle or with other authority. Academic writers have pointed out the difficulties and obscurities in *Sinclair v Brougham* (see, especially, Goff and Jones, *The Law of Restitution*, 4th ed 1993, at 84ff); and, in *Re Diplock* the Court of Appeal, bound by what the House of Lords had decided, felt constrained to say (at 518): "We should, however, be lacking in candour rather than showing respect if we refrained from saying that we find the opinions in *Sinclair v Brougham* in many respects not only difficult to follow but difficult to reconcile with one another." It is, perhaps, a pity that Hobhouse J not only firmly excluded from consideration authorities which had been cited to him from other common law jurisdictions (see at 34) but made no reference to academic writing.

Some of the major specific difficulties are:

1. *Sinclair v Brougham* apart, the cases on equitable tracing all involve circumstances in which a plaintiff is able to follow property in which, in equity, he or she has an interest, into property in the hands of someone else and, if nothing has happened to give the defendant a prior claim, to assert a continuing equitable interest in it. By "property", *Sinclair v Brougham* again apart, what is meant here is particular property, not the general assets of the defendant. If there really is a right to trace into general assets of a defendant, solvent or insolvent, why, it may be asked, has no previous case recognised it? Why, for instance, did the Court of Appeal in *Diplock* agonise over the application of *Clayton's* case to a charity's bank account or over the issue of whether a plaintiff could trace money into improvements made on an innocent volunteer's land if (the defendants presumably being solvent) a charge over general assets would have done? Is there (to ask the same question in another way) any reason why a plaintiff who fails to trace his or her money into specific property should not be able to fall back on a charge over the defendant's general assets? None appears from the judgments of Hobhouse J or the Court of Appeal.

2. What exactly is the effect, and particularly what is the priority, of the general charge? It appears, as we have seen, that it is supposed to rank after general creditors (it should be pointed out, in passing, that this question did not arise in *Sinclair v Brougham*: there it was agreed that the general creditors would be paid first). But what is a charge that ranks after general creditors other than an unsecured claim for the payment of money? It is, of course, true that *Diplock* establishes that where a plaintiff's money is traced into property (ie specific property) in the hands of an innocent volunteer the charge will usually rank *pari passu* with the claim of the volunteer to recover his or her own contribution to the property; but it does not follow (and it would be surprising if it were the case) that, if the volunteer is insolvent, the general creditors are to be paid, ahead of the plaintiff, out of the plaintiff's share.

3. Perhaps more importantly, for what reason of policy, legal principle or authority should the law develop such a strange creature? A general invocation of the *Judicature Act* (see Hobhouse J at 33) surely will not do. If (as appears to be the case) the effect of the charge is to give what is in substance a personal remedy, it is not needed if the common law now provides an equivalent one. Is it not a work of supererogation for equity, after the *Judicature Act*, to labour to bring forth a remedy where the common law has found one which is perfectly adequate? If it is objected that in some cases — especially a contract of loan — the common law does not provide a remedy the retort surely should be that common law should be re-examined and, if the reasons of principle or policy which led to the denial of a remedy are found no longer to be persuasive, developed appropriately (as happened, for example, in *David Securities*). To say that the legal policy which, for instance, prevents recovery by way of personal remedy in cases of mistake of law must be held still to stand, but that this does not really matter because equity, by some innovative distortion of its proprietary remedies, will do what the common law will not cannot be justified by reference to the *Judicature Act* or anything else: it is, it is respectfully suggested, the sort of nonsense that rightly brings the law into disrepute.

4. Yet a further problem with the general charge is that it adds, in another respect, a new layer of complexity to an already baffling area of the law. The common law provides personal restitutionary remedies; as we have seen, this is an area of the law where there have been significant recent developments both here and in England. Equity in certain circumstances provides personal restitutionary remedies: particularly, there is the *Barnes v Addy* line of authority (knowing receipt and knowing assistance — the subject of a substantial paper at this conference two years ago) and there is the *Diplock* personal remedy, which may be limited to cases where an executor or administrator misapplies property of a deceased estate. How does the new equitable remedy, whose sphere of operation substantially overlaps, at least, those of the common law remedies and the *Barnes v Addy* principle, fit into the picture? Is an innocent volunteer, who has received misapplied money but who lacked the notice needed to enliven *Barnes v Addy* and who holds no specific property into which the money can be traced, now personally liable by way of tracing into general assets? That may not in all circumstances be an unjust result (which is, perhaps, really to say that the knowing receipt limb of *Barnes v Addy* may have developed an excessive bias in favour of defendants); but, it is suggested, that problem, if problem it is, is not best solved by introducing a new, overlapping, remedial device. (As to the need to harmonise the overlapping personal remedies, see Peter Birks, *loc cit*, at 159, 160).

5. As we have seen, Hobhouse J proceeded on the basis that the entitlement of a plaintiff to claim a proprietary interest by way of tracing (apparently either into specific property or into the defendant's general assets) could be defeated by a defence of change of position. It is true, as Goff and Jones point out (*The Law of Restitution*, 4th ed, 91), that in *Diplock* the Court of Appeal approved two examples of what might be regarded as a change of position defence: one was the case where an innocent volunteer uses misapplied money to make improvements on land, the other the case where the innocent volunteer uses the misapplied money to discharge debts. Perhaps all that can usefully be said about this is that the caution both of the High Court in *David Securities* and of Lord Goff in *Lipkin Gorman*, as to any attempt to lay down precise limits for

such a defence, is well justified. That is particularly so in the case of proprietary relief, where the fact that what the plaintiff claims is an interest in property necessarily brings into operation the rules as to priorities both as between legal and equitable interests and as between competing equitable interests. If there is to be — as seems likely and as *Diplock* in effect held — a defence of change of position, there is a good deal of work to be done on the boundaries between that defence and the established priority rules. For example, to what extent is change of position by a defendant the obverse of postponing conduct by the plaintiff? (as to this, see, again, Peter Birks, *loc cit*, at 161-163).

6. There remains the vexed question of the need, in order to establish a proprietary foundation from which to trace, to prove a fiduciary relationship. It is suggested, for what it is worth, that this fertile source of confusion (and it may be said, distortion) is best dealt with (as Goff and Jones argue: *The Law of Restitution*, 4th ed, at 84ff) by eliminating the requirement rather than (as Professor Birks suggests: *An Introduction to the Law of Restitution*, 1989 at 378ff) by giving the word "fiduciary" in this context the meaning "trust like", ie as encompassing any situation where the plaintiff never completely disposed of the property both at law and in equity. It may be confessed that the result of taking one of those courses may be little different from adopting the other; certainly in England it seems clear that only the House of Lords can eliminate the requirement.

CONCLUSION

It would be wrong to be unduly carping. Counsel and judges work under considerable pressure and are subject to constraints of time. The questions to which the facts in *Westdeutsche* gave rise have baffled judges, commentators and practising lawyers for many years. The areas of the law with which the case deals are, however, as Hobhouse J recognised, greatly in need of reconsideration and, particularly, harmonisation. It is a pity, therefore, that the judgments do not display the rigour that the case demanded (in this respect they are by no means unique). To ask for rigorous analysis (even to deplore *general* invocations — the emphasis is deliberate — of the *Judicature Act*) is not the equivalent of seeking to maintain the status quo or to adopt the attitude of King Canute; indeed, the reverse is true. It is, particularly, to ask that courts, in developing legal principle, should keep clearly in mind both where it has come from and where it is going and not overlook the context (of related principles) in which the principle under consideration is set.

It is to be hoped that an appeal in *Westdeutsche* is heard by the House of Lords. The development of the principles on which equitable restitutionary relief is granted — both personal and proprietary — has reached a point where consideration by an ultimate appellate court is clearly needed.

Meantime, it would probably not be unfair to ask a critical commentator to make some constructive suggestions as to the course which the law might take. The following — in which there is little that is original — are offered:

1. There should be no disguised personal remedy in the form of a right to trace into general assets: *Sinclair v Brougham* is an anomaly and should be allowed to remain anomalous: like Lord Mersey's unruly dog (*G & C Kreglinger v New Patagonia Meats & Cold Storage Co Ltd* [1914] AC 25) it should be restrained from wandering into places where it ought not to be. Thus, a plaintiff who, in accordance with established principle, cannot trace into specific property should not be able to claim any remedy in equity on the basis of tracing.

2. A fiduciary relationship, as commonly understood, should not be a prerequisite to a tracing claim. It should be a prerequisite that the plaintiff had a proprietary right or interest, of a kind recognised by equity, in property which, when the claim is made, can be found in traceable form in the hands of the defendant.

3. Given the overlapping common law remedies (on the basis of money had and received) and given also the *Barnes v Addy* principle, there is no need to extend the *Diplock* personal remedy beyond the area in which it has been held to apply, viz the case where an executor or administrator misapplies property in a deceased estate. Neither authority nor principle requires its extension; it also should be kept securely chained to its kennel.

4. Despite its traditional place in the law of constructive trusts, *Barnes v Addy* (both limbs of it) provides *in personam* relief in cases where someone has knowingly received property which is held subject to a fiduciary obligation or knowingly participates in a breach of fiduciary duty. This should be regarded (and developed) as the basis of equitable intervention in cases of the sort we have been considering. There are difficult questions, particularly, about the kind of notice which is to be regarded as sufficient and also, perhaps, about defences which demand the attention, in an appropriate case, of a court of ultimate appeal. Much has been written on this subject: and, as it is a subject which was dealt with exhaustively at this conference two years ago (see *Banking Law and Practice, 9th Annual Conference*, 1992 at 223) perhaps one may be excused, now, if one leaves it at that.