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**A SUGGESTED APPROACH**

1. Proceed with caution. Imposing proprietary interests should be a minority sport. It is inconsistent with *pari passu* distribution and it distorts basic principles of property law.

2. Try to avoid imposing a proprietary interest unless:

   (a) the asset concerned is one originally owned by the claimant or the substitute for that asset; and

   (b) the transaction concerned is non-consensual.

3. In other types of case, consider if the order should be a discretionary remedy between the parties, in which event it should not be imposed if the defendant is insolvent or if it would affect third party rights.

Less is more.
The thesis of this paper is that the courts should try to avoid imposing proprietary interests in insolvencies. It distorts pari passu distribution. And it plays havoc with settled principles of property law.

CLASSIFICATION

The first task is to decide where this topic fits in the taxonomy of the law. Is it a matter of insolvency law, the law of restitution, or property law? This is not just an idle academic exercise. It is important because it affects the way in which we look at the question.

Let us start with insolvency law. One of the basic principles of insolvency law is that it takes the debtor as it finds him. That is a principle which has been very clearly expressed recently by the High Court of Australia in International Air Transport Association v Ansett Australia Holdings. One of the consequences of this approach is that property owned by someone other than the debtor does not fall within the insolvency estate. This has been a fundamental principle of insolvency law since at least the early eighteenth century.

What is happening here is that insolvency law is recognising pre-existing proprietary interests. It is not of itself creating them. If it interferes at all, it is to cut them down. So, for instance, proprietary interests created in the period running up to the insolvency proceedings may be capable of being set aside as a result of claw-back provisions in insolvency legislation. It does this in order to encourage pari passu distribution.

Although it does not itself impose proprietary interests, insolvency law is relevant to the question because it is the background against which proprietary interests are imposed. The imposition of proprietary interests in an insolvency sits uneasily with that most basic of

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1 For a more detailed discussion of the issues raised in this paper, see Calnan, Proprietary Rights and Insolvency (Oxford University Press, 2010) and Imposing Proprietary Rights [2004] RLR 1.


3 Burdett v Willett (1708) 2 Vern 638.
Insolvency principles - the principle that the assets of a debtor are to be applied in accordance with the scheme of distribution set out in the insolvency legislation. This broadly provides for the debtor's assets to be applied in payment pari passu of his liabilities at the time of the insolvency. Formally, the imposition of a proprietary interest may not contravene the pari passu sharing provisions because the asset concerned is taken outside the estate of the debtor. But, in substance, the imposition of proprietary interests does distort their operation.

Proprietary interests are imposed in a wide variety of situations, but they are frequently imposed in cases of restitution. If, for instance, a person makes a payment to a debtor by mistake, and the debtor subsequently enters into insolvency proceedings, the claimant may argue that he is entitled to a proprietary claim. There is generally no doubt that a personal claim is available in such cases. The difficult question is whether there is also a proprietary claim.

Writers on the law of restitution frequently argue that the law of restitution can establish not only whether the claimant has a personal claim against the defendant, but also whether he has a proprietary claim. A moment's reflection shows that this cannot be correct. A consensual proprietary interest is created by contract, but it is not just contract law which determines whether a proprietary interest exists. It is a matter of property law. And restitution must work in the same way. It is for the law of restitution to establish whether a personal claim is available. But whether a proprietary claim exists must be a matter of property law.

There can also be conflicts between the law of restitution and insolvency law. It is frequently said that, unlike a contractual claimant, a restitutionary claimant has not taken the risk of the debtor's insolvency, and therefore that his claim should rank ahead of the contractual claimant. But that is not how insolvency law works. For very good practical reasons, it has decided that the fairest and most efficient method of applying the assets of a debtor amongst its unsecured creditors is by pari passu distribution. Whether the debtor took the risk of insolvency is neither here nor there.

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5 This was acknowledged by a strong House of Lords in Foskett v McKeown [2001] 1 AC 102 at 109, 115 and 127.
6 See Goff and Jones (above), Chapter 37.
It must, therefore, be property law which determines whether or not a proprietary interest can be imposed.

**PRINCIPLES**

If the imposition of proprietary interests is a matter of property law, the next question is to determine the relevant principles of property law which should be applied. There are two key requirements. The first is obvious: there must be an identifiable asset over which the proprietary interest can be created. The second is that there must be a reason why the law should impose the proprietary interest. In consensual transactions, the law creates proprietary interests over identifiable assets because that is what the parties intend. In equity, that is frequently the only requirement of the creation of a consensual proprietary interest although, at common law, there are frequently other requirements. In the case of non-consensual proprietary interests, what is it which replaces intention as the reason for creating the proprietary interest?

The starting point is the necessity to distinguish between the common law and equity. The requirements for the creation of a proprietary interest are fundamentally different in equity than they are at common law.

The main determinant of the imposition of a proprietary interest at common law is that the claimant has possession of the asset over which the proprietary interest is to be created.

Equity has a much broader conceptual basis for the imposition of proprietary interests: the maxim that equity treats as done that which ought to be done. If a person ought to grant a proprietary interest over an asset in favour of another person, equity can turn that personal obligation into a proprietary interest as a result of this maxim. But, of itself, that takes us very little further. When should the maxim be applied?

It is suggested that there are three key principles:

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8 *Tailby v Official Receiver* (1888) 13 App Cas 523.

9 Such as registration at an asset registry in the case of land, ships and aircraft or on a share register in the case of shares.

10 This is the reason for the creation of possessory liens over goods, and of title by adverse possession of land.
• Proprietary interests are rarely imposed, particularly in an insolvency.
• A proprietary interest is much more likely to be imposed over an asset originally owned by the claimant, or over an asset which is substituted for that asset, than over any other type of asset.
• A proprietary interest is more likely to be imposed in a non-consensual transaction than in a consensual one.

Is there an identifiable asset?

It is self-evident that a proprietary interest can only be created over an identifiable asset. As Lord Mustill said in Re Goldcorp Exchange11: “It is the very nature of things … that it is impossible to have a title to goods, when nobody knows to which goods the title relates.”. And what is true of goods is true of any other asset.

In my experience, very many attempted proprietary claims fall at this hurdle. There may never have been an identifiable asset over which a proprietary interest could be created. And, if there was initially such an asset, it may no longer exist or it may have come into the hands of somebody who has a better right to it. Two examples can illustrate the principle.

The first comes from New Zealand: Fortex Group v McIntosh12. In that case, the company had a pension scheme under which it deducted employees’ contributions from their salaries and it also had an obligation to make certain payments itself into the scheme. It got into financial difficulties and, for about a year before it went into insolvency proceedings, it did not pass on the deductions to the pension fund, nor did it make its own contributions. Employees claimed a proprietary interest over the company’s assets in its insolvency proceedings. The claim failed.

As far as the unpaid contributions were concerned, the reason it failed was that there simply never had been an asset which could become the subject of a proprietary interest. The company had not made its contributions, and therefore there was nothing over which a proprietary interest could be established.

The position was different in relation to the deductions from employees’ salaries. Here, there was initially an asset which could be the subject of a proprietary claim. But the money deducted from employees’ salaries had been paid into an overdrawn bank account. As a result, the claim to that money also failed. The bank received the money for value and without notice of the equitable proprietary claim, and therefore the effect of the payment into the overdrawn account was that the asset had ceased to exist.

The second example is *Space Investments v Canadian Imperial Bank of Commerce Trust Co.*[^13^]. In that case, a bank was the trustee of various settlements which authorised it to deposit money with itself. It did so, but then went into insolvent liquidation. The beneficiaries claimed that the trust continued and that they were therefore entitled to a proprietary interest over the assets of the bank in priority to its unsecured creditors. The Privy Council held that the beneficiaries did not have any proprietary interest in the assets of the bank. The trust fund was a debt owing by the bank, which ranked *pari passu* with its other debts.

The *Space Investments* case is really a statement of the obvious. A person can have a proprietary interest over an asset, but not over a liability. If, as is commonly the case, a bank trustee is entitled to deposit money with itself, the effect of the arrangement is that it ceases to hold an asset on trust for the beneficiaries, but, instead, becomes a debtor for an equivalent amount. That does not affect the personal fiduciary duties of the trustee, but it does mean that the beneficiaries have no proprietary interest in the assets of the bank.

**Why should equity impose a proprietary interest?**

I will concentrate in this paper on equitable proprietary interests because they are imposed much more frequently than legal interests, and most of the difficulties which have been encountered in practice in recent years have involved equitable claims.

There is no doubt that equity has a conceptual basis by which it can create proprietary interests - whether consensual or non-consensual. That is the maxim that equity treats as done that which ought to be done.

In spite of the uncertainty which it can engender, this maxim is one of the major strengths of our commercial law. The ability to create an equitable interest over any type of asset without

undue formality is what distinguishes the common law systems from many civil law ones. Its importance in commercial transactions is difficult to over-estimate. It is particularly important in financial transactions, where the ability to take security in a straightforward way over present and future assets has assisted in the provision of finance to businesses.

The problem with the maxim is that it can be applied, and has been applied, in circumstances where there was no intention to create a proprietary interest. It is, therefore, necessary to establish what it is, in a non-consensual transaction, which is sufficiently powerful to replace the need for an intention to create a proprietary interest. There are, I would suggest, three important principles.

*Proceed with caution*

The first principle is that proprietary interests should not lightly be imposed. The importance of the maxim is that it enables equity to transform a contractual obligation into a proprietary interest. That would be anathema to most civil law jurisdictions. It is a useful concept in consensual transactions, but to use it too frequently in non-consensual transactions would be to erode yet further the important distinction between personal and proprietary rights. In Lord Lindley’s words, it would confound ownership with obligation\(^{14}\).

Even in consensual transactions, the principle is not always applied\(^{15}\). If the slate were clean, there would have been much to be said for simply refusing to apply the principle at all in relation to non-consensual transactions. We have gone beyond this point, but that is not a reason for continuing to extend the use of the maxim.

The other important consideration is that proprietary interests are of most importance in an insolvency. It would be a clear breach of the *pari passu* sharing provisions if the court were to impose a remedial constructive trust in an insolvency. To do so would be to prefer one creditor over the others\(^{16}\). That does not prevent a court from recognising that a proprietary interest has been created before the insolvency proceedings. But, although this is not a breach of the letter of the *pari passu* sharing principle, it certainly offends its spirit. And that is why it needs to be treated with caution.

\(^{14}\) *Lister & Co v Stubbs* (1890) 45 ChD 1, 15.

\(^{15}\) For instance, in *Re Wait* [1927] 1 Ch 606.

\(^{16}\) *Re Polly Peck International* [1998] 3 All ER 812.
Original, substitute and unconnected assets

The second principle is that a proprietary interest is much more likely to be imposed over an asset originally owned by the claimant, or over an asset which is substituted for that asset, than over any other type of asset. This principle is not the subject of any clear authority, but it is implicit in the circumstances in which the courts have imposed proprietary interests.

A distinction can be drawn between three types of asset:

- an original asset - i.e. an asset originally owned by the claimant which is now the hands of the defendant;
- a substitute asset - i.e. an asset which is the product of an asset previously owned by the claimant; and
- an unconnected asset - i.e. any other type of asset.

If the law is to impose a proprietary interest over an asset, I would suggest that it is most likely to do so over an original asset or a substitute asset. That is not to say that it is impossible for equity to create a proprietary interest over an unconnected asset, but simply that there seems to be much less justification for doing so. There is a much weaker nexus between the claimant and the asset, and therefore a less compelling reason for imposing a proprietary, rather than just a personal, remedy.

Consensual and non-consensual transactions

The final principle is that it is more likely that a proprietary interest will be imposed in a non-consensual transaction than in a consensual one. If the parties could have agreed that a proprietary interest was to be created, it must be more difficult for the court to impose one than in a transaction where no such agreement could have been entered into. An example can illustrate the point.

Assume that the claimant is the owner of an asset which he delivers to the defendant to be held on behalf of the claimant, but the defendant wrongfully sells the asset and receives the proceeds. The claimant did not expect this to happen and therefore could not have
bargained for a proprietary interest in the proceeds. In such a case, it is understandable that a court might decide to impose a trust over the proceeds\textsuperscript{17}.

Then change the facts slightly. Assume that the claimant had authorised the defendant to dispose of the asset. In this case, it is difficult to see why the court should impose a trust over the proceeds. It might have been a term of the contract that the claimant should have a proprietary interest, or the intention to create such an interest might be implied from the surrounding facts\textsuperscript{18}. But, if the claimant has not expressly or impliedly bargained for a proprietary interest over the proceeds, there is no reason why the court should impose one in his favour.

With these principles in mind, it is now time to look at some examples of the circumstances in which the courts have imposed proprietary interests in practice - and to see the extent to which they have complied with these principles.

**PRACTICE**

This is a big topic. In the time available, I will briefly look at four examples, each of which is worth a paper in itself:

- Example 1: wrongful disposal of another person’s asset.
- Example 2: mistaken transfer of an asset.
- Example 3: breach of fiduciary duty.
- Example 4: equitable security interests.

**Example 1: wrongful disposal of another person’s asset**

A owns a taxi. He allows B to operate it. B sells the taxi to C for cash without obtaining A’s permission. What are A’s remedies?

A has a personal claim against B for converting his taxi, but he also has two potential proprietary claims. In the first place, A may be able to recover his original asset - the taxi -

\textsuperscript{17} And of course they do: *Re Hallett’s Estate* (1880) LR 13 ChD 696.

\textsuperscript{18} As in *Re Fleet Disposal Services* [1995] BCC 605.
from C. He remains the owner of the taxi and, if he can find it, he has a proprietary claim in relation to it at common law unless the defendant can establish a better title.

A may also be able to claim a proprietary interest in the substitute asset - the proceeds of sale held by B. In limited circumstances, he might have the ability to do so at common law. In practice, however, he is more likely to succeed in an equitable tracing claim.

The claim to the car is straightforward. A is its owner. The claim to the proceeds is more tricky. When C paid them to B he doubtless intended B to own them. At common law, that is generally the end of the matter. Title vests in the person whom the transferor intends it to vest in. But equity looks, not at the relationship between C and B, but at the relationship between B and A. If B ought to hold identifiable proceeds on behalf of A, then equity will treat as done that which ought to be done and will impose a trust on them.

The equitable principle is that if:

- A has a proprietary interest (whether legal or equitable) in an asset (the original asset); and
- B wrongfully disposes of the original asset in return for another asset (a substitute asset),

then A will be granted an equitable proprietary interest in the substitute asset by operation of law.

Perhaps the most famous illustration of this principle is the decision of the English Court of Appeal in *Re Hallett's Estate*. In that case, Mr Hallett, who was a solicitor, held certain Russian bonds as a bailee for his client, Mrs Cotterill. Mr Hallett wrongfully sold the bonds and paid the proceeds into his general account with his bank. The Court of Appeal held that Mrs Cotterill was entitled to a proprietary interest in the substitute asset, and was therefore entitled to trace into the bank account.

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19 The extent (and indeed the existence) of the right to trace at common law is still unclear, and was confused further by the decision of the House of Lords in *Lipkin Gorman v Karpnale* [1991] 2 AC 548.

20 *Commercial Banking Co of Sydney v Mann* [1961] AC 1.

21 (1880) LR 13 ChD 696.
There are still some issues which are not entirely free from doubt, such as what is meant by a “wrongful” disposition and whether a fiduciary relationship is a pre-requisite of the proprietary claim. But there is no doubt about the basic principle that if B wrongfully disposes of A’s asset, then A has an equitable proprietary interest in the substitute asset if it can be identified. In practice, the main problem is identifying the substitute asset. The rules are complicated, and are not entirely free from doubt. They are also very favourable to the claimant. But they are beyond the scope of this paper.

It is not a self-evident truth that if I wrongfully dispose of your asset, you become the beneficial owner of the substitute asset. But, if the law is to impose proprietary interests, this is a strong case. It is a non-consensual transaction and, even more importantly, the asset over which the claimant obtains a proprietary interest is the substitute for his own asset.

Example 2: mistaken transfer of an asset

A transfers an asset to B under a transaction which is the subject of a vitiating factor, such as mistake or misrepresentation. Does A have a proprietary claim against B? Unlike Example 1, the law here is very unclear. In principle, the answer depends on the answer to three further questions:

- Has A retained title (i.e. legal and beneficial title) to the asset?
- If not, has A retained beneficial title to the asset even though legal title to it has vested in B?
- If not, can A recover legal or beneficial title by disclaiming the transaction once he has discovered the vitiating factor?

There is no simple answer to any of these questions. The case law is confused and contradictory, and it is growing. I cannot look in detail at the cases, but I would like to suggest a way through the thicket.

Retaining title

The first question is whether A has retained title to an identifiable asset in B’s hands. This is a common law question. In most cases, A will have intended to transfer title to B, and therefore B will become the owner of the asset. And this is the case even if A’s intention was induced by mistake or misrepresentation or by any other vitiating factor.
There are certain limited circumstances in which A might be able to establish that a mistake as to identity meant that he did not intend to pass title to B. These cases are rare, but they do exist, and a recent English example is the decision of the House of Lords in *Shogun Finance v Hudson*\(^{22}\).

An example in an insolvency context is *Re Reed, ex parte Barnett*\(^{23}\). Reed, who was an undischarged bankrupt, carried on business as a wine merchant under the name “Joseph Reed & Sons” in Plymouth. His brothers carried on a similar business, also in Plymouth, under the name “Reed Brothers & Co”. Reed ordered wine from Barnett, a wine merchant in London. Barnett had previously dealt with Reed Brothers & Co, and despatched the wine to Reed in the mistaken belief that he was dealing with that firm. Reed’s trustee in bankruptcy took possession of the wine, and Barnett claimed it from him. Bacon CJ decided that Barnett had intended to sell the wine to Reed’s brothers, not to Reed himself. Accordingly, title to the wine did not pass to Reed; it remained with Barnett, who was therefore able to recover the wine from Reed’s trustee in bankruptcy.

This is an unusual situation. It is a rare case in which it will be possible for the transferor to establish that he did not intend to pass title to the transferee. But that is not necessarily the end of the story. Even if title has passed, it might be possible for the transferor to rescind the contract and thereby recover title.

**Rescission**

Assume that A transfers an asset to B as a result of B’s misrepresentation. Title passes from A to B. A then discovers the misrepresentation. A can then rescind the contract and the effect of the rescission is to revest title to the asset in A. In the limited cases in which rescission is available at common law, the title which revests in A is legal title. If rescission is only available in equity, then it is beneficial title which revests in A.

Even more importantly for A, his right to rescind is itself a proprietary interest (a “mere” equity\(^{24}\)), and so he can exercise it even after B has gone into insolvency proceedings. In *Re*
Eastgate, A sold goods to B on credit. B had no intention of paying for them. B then committed an act of bankruptcy, following which A rescinded the contract for fraudulent misrepresentation and recovered the goods. The bankruptcy related back to the act of bankruptcy, and the question arose whether A was entitled to retain the goods which he had recovered, or whether they fell into B’s estate, and were therefore available to his trustee in bankruptcy. It was held that A was entitled to retain the goods. A had a proprietary interest even before rescission, which bound B’s trustee in bankruptcy.

This does seem very generous to A, at the expense of B’s other creditors.

Trust

The remedy of rescission is available in the case of certain vitiating factors, such as misrepresentation. But it is not available if A makes a mistake which is not induced by B. The question which the courts have had to grapple with in such cases is whether, even though title to the asset has passed to B, A has “retained” a beneficial interest in it or, to be more precise, whether B ought to hold it on trust for A. The cases here are a minefield, and there are too many to discuss. Suffice it to say that we have no clear guidance from the courts on the answer to the question.

In principle, what should the answer be? If A transferred an asset to B as a result of a vitiating factor, should B have to hold it on trust for A? There is certainly a very strong body of opinion that he should. It has been given voice by the US courts in Re Berry and by Goulding J in the English High Court in Chase Manhattan Bank v Israel-British Bank. As Judge Chambers QC said in Papamichael v National Westminster Bank:

“I fancy that most people who had been paid too much change would regard the excess as belonging to the mistaken payer. Similarly, where a bank accidentally credits an account with money not due to the account holder, (mild schadenfreude apart) most people would regard the credit as being that of the bank … [I]t is obvious

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27 (1906) 147 Fed 208.
28 [1981] Ch 105. A recent Australian example is Wambo Coal v Ariff [2007] NSWSC 589, although here the payment was made after the insolvency, which raises different considerations from the normal type of case.
that someone who pays money by mistake stands on a different footing from a supplier
who knowingly takes the risk of non-payment and often obtains security against that
danger."

I find it hard to see the logic of this approach. There is no question of the payee being able
to keep the money. The only question is whether the right of recovery is personal or
proprietary. Nor is it to the point to say that a person who pays money by mistake does not
take the risk of non-payment, and therefore should be treated differently. That is not how
insolvency law works.

It is easy to criticise the logic of such statements, but it is hard to deny that the sentiments
expressed by the judge probably represent the views of a significant proportion of lawyers,
let alone of laymen. There does seem to be a very strong sense of moral outrage at the idea
that, if you pay money to me by mistake, you have to stand in line with my other creditors
- surely it remains “your money”.

The problem with this approach is its relationship with the remedy of rescission. It has been
seen that, where the transfer was made as a result of a misrepresentation, the transferor can
rescind. The fundamental difficulty with allowing an equitable proprietary interest to be
imposed is that to impose it in cases where rescission is available would be logically
inconsistent with the requirements of rescission; and that to do so in those cases where
rescission is not available, would be to give a better remedy to someone who has made his
own mistake than would be given to someone whose mistake has been induced by another.

This point needs a little further elaboration. If A transfers an asset to B as a result of a
misrepresentation by B, A may be able to rescind the contract. Until rescission, he retains an
equity in the asset. On rescission, he regains legal or beneficial title to the asset. It would be
entirely inconsistent with the cases on rescission if A’s mistake in transferring the asset to B
as a result of B’s misrepresentation resulted in A retaining beneficial title to the asset. It is
clear from the cases that he does not. He retains an equity, and only on rescission does
beneficial title re vest in him.

If, on the other hand, A transfers an asset to B as a result of a mistake by A which has not
been caused by B, rescission is not available. It would not be logically inconsistent with the

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30 In New Zealand, the effect of section 7 of the Contractual Remedies Act 1979 is that rescission is no longer available for
misrepresentation. It should therefore be easier to run the argument that the defendant holds the asset on trust for the claimant.
The doctrine of rescission to decide that A retained beneficial title in the asset in such a case, but it would be a surprising result to give A a greater interest in the asset where B has not caused A’s mistake than where B has.

**A suggested approach**

In principle, therefore, A should only have a proprietary claim if:

- he has retained legal title to the asset (which is unlikely); or
- he can rescind the contract.

In any other case, A’s remedy should be personal.  

Whether the courts will adopt this approach is, of course, an entirely different matter ……

This is not as strong a case for the granting of a proprietary remedy as the first example, but it is certainly stronger than the next two examples. Here, the asset in question is the very asset which was transferred by the claimant and, although it was transferred as a result of a consensual transaction, it was the subject of a vitiating element. But, whatever the justification for such an equitable proprietary remedy in the abstract, it sits very uneasily with the law concerning rescission.

**Example 3: breach of fiduciary duty**

A director of a company obtains a profit in breach of fiduciary duty. There is no doubt that he is accountable for it in the sense that he must pay an equivalent amount to the company. The question is whether, in addition, he holds it on trust for the company. There are clearly some major issues of identification involved in imposing a proprietary interest. But, assuming they can be overcome, does the company have an equitable proprietary interest in the asset concerned?

This is a very different type of case from the first two examples. The asset concerned is not one which was originally owned by the claimant or a substitute for that asset. It is an asset with which the claimant has had no prior involvement - an unconnected asset.

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31 There are additional difficulties with imposing a proprietary interest where the asset transferred is money, but there is no room to discuss those in this paper.
The starting point, therefore, is to find a justification for imposing a proprietary interest over an unconnected asset. There is no doubt that the claimant has a right to obtain the profit from the defendant in a personal claim. And the measure of recovery could include the additional profit which the defendant has made from it, if it were thought appropriate to do so. The question is whether, in addition, the claimant should have a proprietary remedy. This needs to be tested in an insolvency, which is the one situation in which it will really make a difference whether the claim is personal or proprietary. One view is that to grant a proprietary claim would be to upset the basic pari passu sharing principle of insolvency law. The alternative view is that the claimant ought to have priority in an insolvency because the nature of his claim is different from those of ordinary unsecured creditors.

There are two lines of authority. In one, a proprietary remedy is granted. In the other, it is not. Judges have tried to reconcile them, but in truth they are irreconcilable. We have to choose.

The personal approach is epitomised by the decision of the English Court of Appeal in *Lister & Co. v Stubbs*[^32^]. Lister & Co. employed Stubbs to buy materials for the purpose of their business. He bought materials from Varley & Co., who paid him a secret commission. Lister & Co. alleged that Stubbs had retained some of the cash and had invested the rest in property. They brought a claim against Stubbs to recover the money remaining in his hands, to obtain an account and transfer of the proceeds into their name and for the appointment of a receiver in the meantime. They then applied for an interlocutory injunction to restrain Stubbs from dealing with the property. Stirling J refused to grant the application, and his decision was upheld by a strong Court of Appeal. They considered carefully the proprietary effect of the transactions involved and they decided that the bribe was not Lister & Co.’s money. Their remedy was a personal claim to recover an equivalent amount.

The proprietary approach is epitomised by the decision of the Privy Council, on appeal from the New Zealand Court of Appeal, in *Attorney General for Hong Kong v Reid*[^33^]. An agent had received a bribe which, for the purpose of the proceedings, it was assumed could be traced to property in New Zealand. The agent’s principal claimed an equitable proprietary interest in the property. The New Zealand Court of Appeal held that the principal did not

[^32^]: (1890) 45 ChD 1.
have one, relying on *Lister v Stubbs*\(^{34}\). The Privy Council held that he did. Lord Templeman considered that *Lister v Stubbs* was wrongly decided - in particular because it failed to take account of the fact that the fiduciary should account for the bribe as soon as he received it and that equity therefore treated as done that which ought to be done.

For a time, it was thought that *Reid* had settled the matter. But there has recently been a fight-back by those favouring a personal remedy, and then a riposte by those in the proprietary camp. The current state of play can be illustrated by two appellate decisions - one in England and the other in Australia.

In *Sinclair Investments v Versailles Trade Finance*\(^{35}\), the English Court of Appeal had to consider whether a company could have a proprietary claim against a fraudulent director in circumstances where he had made a profit out of his fiduciary position. The interesting point about this case is that the defendant was insolvent, so that it really mattered whether the claim was personal or proprietary.

The Court of Appeal decided that the claimant only had a personal claim, not a proprietary one. The principal judgment was given by Lord Neuberger MR. He reviewed the authorities and the principles involved and decided that he was bound to follow the decision of the English Court of Appeal in *Lister & Co v Stubbs*, rather than that of the Privy Council in *Reid*. More importantly, he also preferred the reasoning in *Lister & Co v Stubbs* to that in *Reid*. Much of the reasoning in *Reid* seemed to beg the question, and it gave insufficient weight to the potentially unfair consequences to the interests of the defendant’s other creditors.

That has not settled the matter. There was a fight-back, almost immediately, by the Federal Court of Australia in *Grimaldi v Chameleon Mining (No. 2)*\(^{36}\). This was an obiter decision of Finn, Stone & Perram JJ, and bears all the hallmarks of Paul Finn’s equity scholarship. The court considered that *Lister & Co v Stubbs* placed an anomalous limitation on what they considered to be the general understanding of the Australian courts that a constructive trust could be imposed over a bribe and its proceeds. They found the approach of the English Court of Appeal in *Sinclair* to be unconvincing and considered the reasoning in *Lister & Co v

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\(^{34}\) (1890) 45 ChD 1.  
\(^{35}\) [2011] 3 WLR 1153.  
\(^{36}\) (2012) 287 ALR 22.
Stubbs to be “consequentialist”. To deny a constructive trust would be to privilege a dishonest fiduciary.

So where does that leave us? I would suggest that the problem with the proprietary approach is that the maxim that equity treats as done that which ought to be done does not apply in every case in which a claimant has a claim against the defendant in relation to a particular asset. Even in a consensual transaction, it is not every type of case in which the maxim is applied. It would therefore be surprising if it applied across the board in a non-consensual case. If it is to be applied, there needs to be a very strong reason to do so.

It is one thing to say that an asset previously owned by the claimant, or a substitute for that asset, should be held on trust for the claimant. It is something quite different to require the defendant to hold an unconnected asset on trust unless he has undertaken to do so.

The courts have yet definitively to decide whether a constructive trust should be imposed in such a case. I would like to think they can resist the temptation to do so. Although the transaction is non-consensual, there is no connection between the claimant and the asset. To grant a proprietary remedy would be to prefer the claimant over the defendant's other unsecured creditors.

The temptation may be too great to resist. If so, it would help if the courts were to recognise that what they are doing when they are imposing a constructive trust on a fiduciary is that they are exercising a discretion as to the remedy to be granted as a result of the breach of duty. They have a choice whether to order the payment of money or to impose a constructive trust. When they do impose a trust, it is the court order which creates the interest. They are not declaring the existence of an existing proprietary right. The are granting a discretionary remedy.

There is no doubt that the imposition of constructive trusts in tracing cases is a matter of the law of property. They are not discretionary. But, in the case of breach of fiduciary duty, lessons can be learned from the approach of the Supreme Court of Canada to remedial constructive trusts and of the House of Lords to proprietary estoppel.

If the court considers that it is appropriate for a proprietary remedy to be granted where there is a breach of fiduciary duty, it should be recognised that what the court is doing is granting a particular type of remedy between the parties. The advantage of doing this would be to recognise that the proprietary interest concerned is created at the time of the court order.
The court should not grant the court order if that would prejudice third parties who have obtained a proprietary interest in the asset in the meantime, or if the defendant is insolvent.

**Example 4: equitable security interests**

Gibbs CJ was surely right when he said, in *Hewett v Court*[^37]:

“It would be difficult, if not impossible, to state a general principle which would cover the diversity of cases in which an equitable lien has been held to be created.”

Two examples can illustrate the problems caused. The first is *Hewett v Court* itself[^38]. In that case, a builder of pre-fabricated houses agreed to construct a house for a customer and to deliver it to the customer’s land. The price was to be paid in instalments, and the contract provided that the house remained the property of the builder until the price had been paid in full. The builder became insolvent and allowed the customer to take the unfinished house on payment of the value of the work done. The builder then went into liquidation, and the liquidator contended that this transaction constituted a voidable preference. The customer asserted an equitable lien over the house to secure the progress payments under the contract and, on this basis, argued that the transaction did not constitute a preference because the customer obtained no more than he was entitled to under the lien.

By a majority of three to two, the High Court of Australia decided that the customer did have an equitable lien over the house and accordingly the transaction with the builder was not a preference.

I find it hard to see why the customer had a lien in this case. He was effectively paying in advance for a house to be built. It was a consensual arrangement. He could have bargained for security if he had wanted it. He did not do so. Indeed, the builder had retained title until payment in full. The customer had not previously owned the house, and nor was it a substitute for an asset of his which had wrongfully been disposed of. It carries equitable intervention a very long way for a proprietary remedy to be imposed in such a case.


The other example is *Lord Napier and Ettrick v Hunter*[^39]. In that case, Lloyd’s names had taken out stop loss insurance policies. Claims were made by the insureds in respect of underwriting losses, and their claims were paid by the insurers. The majority of the losses had arisen as a result of the underwriting on a particular syndicate. The insureds sued the managing agents of that syndicate and the claim was settled by the payment of almost £116m to the insureds’ solicitors. The insurers claimed that they had an equitable proprietary interest in the money and therefore that it could not be dispersed until they had been paid. Saville J and the English Court of Appeal dismissed the claim, but it succeeded in the House of Lords.

Lord Browne-Wilkinson justified the decision on the basis of the maxim that equity treats as done that which ought to be done. He decided that the insured must repay the insurer “out of the moneys received in reduction of the loss”[^40]. I would suggest that it is a surprising decision. Equity does, in some cases, treat as done that which ought to be done, but what ought to have been done in this case? It was clearly necessary to require the insureds to repay the insurer because the insureds would otherwise have recovered more than their loss. But there was no reason to require them to do so out of the very money received from the third parties. The case is nevertheless authority for the proposition that an equitable lien will be imposed in favour of insurers in these circumstances, even though the contract of insurance makes no reference to it.

These two cases surely go too far. They were consensual transactions. The asset concerned was unconnected with the claimant. The claimant could have bargained for security but did not. But the court nevertheless imposed a proprietary claim. It is perhaps not without relevance that these cases both involved security interests. The courts do seem to be readier to impose security interests than outright interests.

**CONCLUSION**

I suggested at the start of this paper that the courts should try to avoid imposing proprietary interests in insolvencies. Even from this brief discussion, it can be seen that they are a long way from achieving that goal.

[^40]: [1993] AC 713, 752.
For the future, I would suggest three simple propositions which could guide decisions:

4 Proceed with caution. Imposing proprietary interests should be a minority sport. It is inconsistent with pari passu distribution and it distorts basic principles of property law.

5 Try to avoid imposing a proprietary interest unless:

(c) the asset concerned is one originally owned by the claimant or the substitute for that asset; and

(d) the transaction concerned is non-consensual.

6 In other types of case, consider if the order should be a discretionary remedy between the parties, in which event it should not be imposed if the defendant is insolvent or if it would affect third party rights.

Less is more.