WESTDEUTSCHE LANDESBANK V. ISLINGTON
A TEACHING NOTE

This note is intended to be merely an introduction to this very important case for the assistance of students coming to it for the first time.

The main principles to be derived from *Westdeutsche Landesbank* are as follows:-

- Before a trust is created, one should not distinguish between legal and equitable title in property. Until such a trust is created, one should talk only of there being absolute title in the owner of that property.
- Resulting trusts arise in one of two situations: where a contribution has been made to the purchase price of some property, or where a trust has failed to dispose of some part of the equitable interest. It is said that resulting trusts arise carry into effect the common intentions of the parties (although this principle is doubted by many commentators).
- Constructive trusts are imposed by equity on the common law owner of property to prevent her from acting unconscionably in circumstances in which she has knowledge of the factor which is said to affect her conscience.
- No trust will arise in circumstances in which there is no identifiable property which is the subject matter of that trust. Consequently, there will be no equitable proprietary remedy available where the property at issue is unidentified or where that property has disappeared leaving no traceable substitute. The only exception to this rule is the constructive trust imposing personal liability to account for dishonest assistance in a breach of trust. As considered in Introductory, there is an apparent intellectual conflict between the necessity for there to be specific property and Equity's activation in personam to prevent unconscionable action by the common law owner of property.

THE ROLE OF *WESTDEUTSCHE LANDESBANK v. ISLINGTON* IN TRUSTS IMPLIED BY LAW

The decision of the House of Lords in *Westdeutsche Landesbank v. Islington* does appear to constitute one of those landmark decisions which occur in a field once in each generation. In the case of *Westdeutsche*, perhaps that case defines a difference between generations: between traditional trusts law principles and the emerging law of restitution of unjust enrichment. The leading speech of Lord Browne-Wilkinson in *Westdeutsche* constitutes the fundamental statement of, and ideological approach to, the principles upon which such trusts come into existence. It is therefore proposed to set out a short section specifically on the *Westdeutsche* decision to consider not only the points for which the case appears to be authority, but also to place the decision in the context of the more detailed debates which grow from it. This discussion is culled broadly from AS Hudson, *Swaps, Restitution and Trusts* (Sweet & Maxwell, 1999) in which I discuss this case in much greater detail.

The local authority swaps litigation

Westdeutsche constituted a part of an intricate web of litigation which grew out of the decision in the House of Lords in *Hazell v. Hammersmith & Fulham* (1991). It was that decision which held that it was beyond the powers of local authorities to enter into interest rate swaps contracts. Consequently, it was held that any such contracts would be void *an initio* if entered into with local authorities. For the purposes of the law of trusts and of restitution, the question arose: if the contract is held to be void *ab initio*, what entitlement does a payer of money under such a contract have to recover that money (and interest on it) from a local authority in relation to such a contract.

The context of local authority funding

It is worth explaining the commercial background to the transaction in *Westdeutsche Landesbank* to make some sense of the payment flows between the parties. At a time of rigorous rate-capping (controls of the powers of local government to raise money) in the 1980's, the local authorities in the UK were seeking alternative means of raising finance or of manipulating existing financial arrangements. Given that interest rate swaps were, at the material times, off-balance sheet instruments, finance directors were able to use them without any requirement to declare them in annual accounts. This created a potential hidden source of extra funding for those local authorities.

Local authorities were typically paying floating rates of interest on their borrowing. At the same time, interest rates were rising steeply. Therefore, authorities were losing more and more of their fixed budgets on interest repayments. A standard (or, "vanilla") interest rate swap enabled the local authorities to swap their floating rate interest obligations for a fixed rate of interest. This meant that the local authority would pay the fixed rate of interest which it wanted to pay to the bank which had arranged the swap, and in return the bank would pay it a floating rate of interest. The banks' access to large amounts of capital meant that they could make profits on the difference between these two rates. (It is not necessary to go into the detail of these transactions for our purposes. If you are interested, or having trouble sleeping, you can find out more in Hudson, *The Law on Financial Derivatives*, (3rd edition, 2002), especially Part II.)

However, the way the swaps were structured meant that the authority was also opened up to some speculation on interest rate movements. In short, the local authority was betting that interest rates would continue to rise, so that the floating rate which the bank was required to pay to it outstripped the fixed rate of interest which it was paying to the bank. As with all speculation in financial markets, this exposure to market movements could generate profits or result in losses; i.e. that interest rates would fall and the floating rate become lower than the fixed rate the local authority was required to pay out. In the leading case *Hazell v. Hammersmith & Fulham*, Hammersmith & Fulham had lost heavily on these interest rate movements.

It was the auditor for the authority which commenced the action. Hammersmith & Fulham became the lead case, which was unfortunate given that Hammersmith & Fulham had entered into more interest rate swap transactions than all of the other 77 local authorities in the UK put together. Lord Templeman found that there had been about 400 swaps entered into by 77 out of the 450 local authorities at that time. However, in relation to Hammersmith & Fulham,

> '[b]y 31 March 1989 the council had entered into 592 swap transactions and 297 of these were still outstanding. The total notional principal sum involved in all the transactions entered into by the council amounted in the aggregate to £6,052m … These figures distort the position because some swap transactions were a hedge against others. But there is no doubt that the volume of swap business entered into by the council was immense. The council's actual borrowing on that date amounted to £390m, its estimated expenditure for the year ending 31 March 1989 was £85.7m and its quoted budget for that year was £44.6m.'

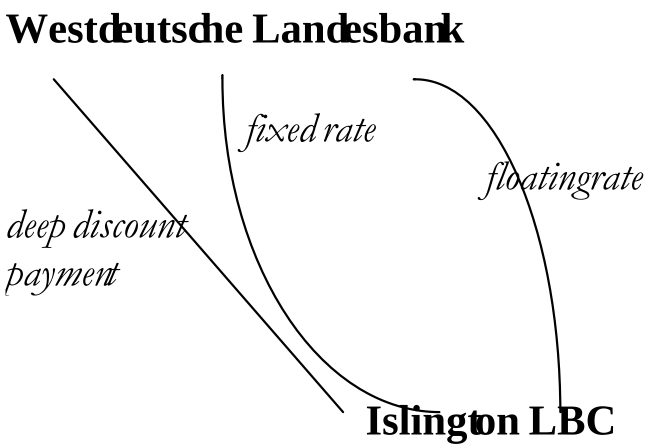
In the context of such a massive exposure compared to such a small level of borrowing and of expenditure, it would have been extremely surprising if the House of Lords had not decided the way it did. Otherwise, it would have fallen to the ratepayers of the borough to make good those amounts owed to the banks. It is also significant to note that this particular authority had entered into far more of these transactions than all of the other authorities put together.

A trick in Westdeutsche

Many of the interest rate swaps, like that in *Westdeutsche*, were 'deep discount' swaps which went beyond the vanilla interest rate structure above. This different structure enabled the local authorities to receive a lump sum (in effect a loan) which was repaid by calibrating the periodical swaps payments owed between them and the banks to repay the capital sum over time. This raised extra debt funding outside the limits of the rate cap.

The facts of *Westdeutsche Landesbank*

The facts of *Westdeutsche* are as follows. Westdeutsche Landesbank ("WDL") paid money to the London Borough of Islington ("I") in performance of the interest rate swap. The transaction had been intended to continue for 10 years. As set out in the diagram below, WDL paid £2.5 million upfront to I by way of what was really a loan. Importantly, there was no express retention of title over that "loan" money because there was no valid contract between the parties. In any event, both parties intended that that I could treat the money as belonging entirely to it. Within 5 years, all of that "loan" money had indeed been spent. Over 10 years, the parties were to make fixed rate and floating rate payments to one another. I was also required to make repayments of the loan as part of its interest payment obligations.



After 5 years, the House of Lords in *Hazell* declared that this transaction was void *ab initio*. Therefore, WDL wanted its money back, with compound interest. The problem was finding the legal basis on which it could do that. Therefore, WDL wished to achieve two things: first, to assert a proprietary right in the money which it had transferred to I 5 years previously and, second, to assert a right to receive compound interest on the money which it had paid to I. To be entitled to compound interest, WDL would have had to have retained some proprietary rights in the money paid to I. To do this, WDL would have been required to prove the existence of some trust implied by law over that money.

It was not at issue between the parties that I would have to return an amount of money to WDL: what was at issue was whether WDL could have been treated as having proprietary rights in the money throughout the life of the transaction and consequently how much money I would have to repay.

WHAT *WESTDEUTSCHE LANDESBANK v. ISLINGTON* DECIDED

Introductory

So much for the precise decision. The more interesting bit, perhaps, is what Lord Browne-Wilkinson said about the nature of the trust.

Before considering the detail of the *Westdeutsche* litigation, it would be useful to set out, briefly, the main points of the decisions in all three courts which considered the issues. In particular, it is important to note that there were many more issues raised in front of Hobhouse J. at first instance than were appealed ultimately to the House of Lords.

Further, it is important to analyse the facts that were found by Hobhouse J. and accepted by the Court of Appeal and the House of Lords in turn.

The decision at first instance

In outline

The broadest range of issues considered by any of the courts were the issues raised at first instance before Hobhouse J.. His lordship held that the doctrine of "failure of consideration" should be understood to be a doctrine of "*absence* of consideration". In the light of the partial performance of the purported contracts over the first 5 years of the transactions, the case was not one of absence of consideration because the failure had not been total. Given this absence of consideration, Hobhouse J. held that moneys received by I were held on resulting trust for WDL because it would be unconscionable to allow I to retain title in that money. Finally, there was no defence of change of position available to the authority because I had already ring-fenced enough money in a separate bank account so that it could meet any judgement awarded to WDL. As a result of the finding of resulting trust, compound interest would be payable.

Isolating a ratio decidendi

A single, precise ratio decidendi of Hobhouse J.'s decision is difficult to isolate. The underlying rationale for the decision appears to have been a belief that it was in some way wrong for the payee to retain moneys which would not have been paid to them if both parties to the contract had known that is was void *ab initio*. The reasons given for the decision by Hobhouse J. straddle a number of different possible analyses, as indicated by the following passage:-

> 'The plaintiff is entitled to recover that sum *either as money had and received by the defendant to the use of the plaintiff or as money which in equity belongs to the plaintiff* and which it is entitled to trace in the hands of the defendant and have repaid it out of the present assets of the defendant. The basis of the plaintiff's claim, whether at common law or in equity, is that the defendant has been *unjustly enriched* at the expense of the plaintiff and that in conscience the defendant must repay to the plaintiff, save in so far as it has already done so, the sum which it received from the plaintiff. The right to restitution arises from the fact that the payment made by the plaintiff to the defendant was made under a purported contract which, unknown to the plaintiff and the defendant, was ultra vires the defendant and wholly void.' [1994] 4 All E.R. 890, 955 [author's emphasis]

The core conviction in this judgement is the obligation borne by I to make some repayment to the bank. What is not immediately apparent from that passage is whether the remedy granted is meant to be based on the restitution of unjust enrichment or the application of equitable principle in the sense outlined by Lord Browne-Wilkinson, and whether it is personal or proprietary in character. All four of those concepts are present in the passage just quoted. What appears from the judgement is that his lordship was reasoning in a teleological way: that is, having decided on the end-point, his lordship progressed through all the possible arguments which would lead to the desired conclusion.

Some problems

The judgement has enormous scope and covers an enormous number of factual and legal issues. However, the more closely it is analysed the more difficult it becomes to unearth a binding, consistent rationale for that result. For example Hobhouse J.'s award of a remedy on grounds of money had and received is a personal remedy, as defined by Lord Goff, whereas the equitable remedy awarded as a result of an equitable tracing claim was proprietary in nature. Further, the claim as allowed, while having a basis in both equity and common law, is nevertheless held to be a restitutionary response to some unjust enrichment.

The Court of Appeal

Counsel for WDL in the Court of Appeal relied heavily upon the decision of the House of Lords in *Sinclair v. Brougham* [1914] AC 398. Indeed, as Leggatt LJ held, the decision of the House of Lords in *Sinclair v. Brougham* required the court to hold in the banks' favour with respect to all of the components of WDL's claim in equity. Approving much of the decision of Hobhouse J. at first instance, Leggatt LJ held that in equity the money paid under the deep discount payment and the interest payments remained the property of WDL throughout the life of the transaction on the basis that the mere receipt by I of money which, in the opinion of the Court of Appeal, 'was not theirs, constituted them fiduciaries'. Consequently, WDL's equitable right in relation to the money held by I remained the property of WDL by means of an equitable charge; and given that I was solvent, WDL was entitled to 'recover in full.'

The House of Lords - (in outline)

Unanimity

The House of Lords was unanimous in holding that neither the lump sum nor any of the interest amounts were to be held on resulting trust. Further, it was unanimous in holding that there would not be constructive trust imposed over the money on the basis that the local authorities did not know that the money had been advanced to them under a void transaction and therefore their consciences had not been affected. At most there was a personal claim in restitution for the amount of money transferred under the void agreement together with simple interest.

Lord Browne-Wilkinson's leading speech

The restatement of the core rules of equity in the leading speech of Lord Browne-Wilkinson in *Westdeutsche* created a test that a proprietary claim based on a constructive trust will only be imposed in circumstances in which the defendant has knowledge of the factor which is alleged to impose the office of trustee on him, thus affecting his conscience. Similarly, a proprietary claim based on resulting trust will only be available where a purported express trust of an equitable interest has failed to allocate the whole of that interest, or where an equitable interest is created by dint of contribution to the purchase price of property.

The decision of the majority is most clearly set out in the speech of Lord Browne-Wilkinson:

> '… a claimant for restitution of moneys paid under an ultra vires, and therefore void, contract has a personal action at law to recover the moneys paid as on a total failure of consideration; he will not have an equitable proprietary claim which gives him either rights against third parties or priority in an insolvency; nor will he have a personal claim in equity, since the recipient is not a trustee.' [1996] 1 A.C. 669, 714

Lord Browne-Wilkinson held in *Westdeutsche* that there could be no retention of any rights in the deep discount payment by WDL because both parties intended that there be an outright transfer of that sum to the authority. Lord Browne-Wilkinson rejected the possibility of a proprietary interest based on constructive trust on the ground that the English model of constructive trust is institutional in nature, operating in response to the trustee's knowledge of some factor which ought to impact on his conscience sufficiently to warrant the imposition of such a constructive trust. On the facts of *Islington* it was found that the authority did not have knowledge of the status of the contract until it was declared to be ultra vires by the courts.

DEBATING THE ROLE OF EQUITY

An historical basis in family trusts

The English principles of Equity were formulated primarily to regulate the conduct of family trusts and rights in homes from the eighteenth century and beyond. The norms which were created in respect of the availability of proprietary rights and compound interest were orientated around domestic, factual situations. As Lord Browne-Wilkinson himself pointed out in *Target Holdings v. Redferns*, those 'traditional trusts rules' sit uncomfortably with the complex, cross-border markets of the late twentieth century. In the financial markets affected by the decisions of the swaps cases, English law is applicable as a means of convenience. Counterparties to such contracts are often not incorporated or organised in England and Wales, but rather have chosen English commercial law rules to govern their contract, are therefore caught up in this web of ancient English cultural norms to do with the allocation of property within families affecting their entitlement to market standard rights in property and commercial rates of return. It is possible that neither party to a contract will ever inter-act physically in England or Wales, they may have no connection with the jurisdiction or currency, but may choose the system of law out of convenience. The status of English law is therefore of extra-territorial importance. In moulding the principles of equity, it is important to recognise that context.

Isolating a variety of conceptual approaches

Prof. Birks has referred to there being little difference between the speeches of Lords Goff and Browne-Wilkinson in the interpretation of the equitable and restitutionary techniques available in *Islington*. Birks is somewhat dismissive of the extent of any change introduced by Lord Browne-Wilkinson ([1996] RLR 3). *Islington* is really a battleground for three generations of lawyers to consider the position of equitable proprietary remedies. It is this author's view that there are in fact three distinct approaches on view, as will emerge throughout Part V.

The first approach is set out in the partially dissenting speech of Lord Goff. There are areas of agreement in it with the leading speech of Lord Browne-Wilkinson. Technically speaking Lord Goff's dissent is only partial - specifically he dissents on the question whether or not compound interest should be made available as a matter of providing justice between the bank and the local authority. Lord Goff preserved the approach of the classical restitution lawyer in looking at problems of restitution of mistaken payments from the analysis of existing precedent and the need to achieve a 'just result' .

The second approach is a modern trusts lawyer's view propounded by Lord Browne-Wilkinson's leading speech. Contrary to Lord Goff's imprecation that the appeal was not the opportunity to re-structure the conceptual underpinnings of the applicable principles of equity and restitution, Lord Browne-Wilkinson decided to undertake exactly such an exercise. As a consequence, the nature and availability of resulting trusts is limited and the availability of proprietary remedies under constructive trusts is re-drawn. The new Browne-Wilkinson code is both purportedly comprehensive in its account of the basics of trusts law and controversial in the detail of some of its revision.

In the inter-generational conflict identified as existing between the various approaches, it is the equity approach which emerged as the one which became law. The third approach is the emerging law of unjust enrichment. While the House of Lords has accepted the existence of a law of unjust enrichment in the wake of *Lipkin Gorman v. Karpnale* and *Woolwich Building Society v. IRC*, it is not clear what form that new development will take. Many commentators see the development of unjust enrichment as a means of displacing existing principles of equity, of the law of property, and many doctrines classically understood as being part of the law of contract or of the law of tort. One message to emerge from *Islington* is that traditional ideas of equity and trusts remain the principal means for dealing with unconscionable conduct and enforcing the claims of beneficiaries against the title-holders of property at common law.

NECESSARILY TANGIBLE PROPERTY

English law can only understand property by retreating to first principles and thinking of all property as being necessarily tangible. Thus in *Westdeutsche* Lord Browne-Wilkinson is required to consider title in the £2.5 million which WDL paid to I at the outset of the transaction. Rather than look to the nature of this property as being numbers held in electronic bank accounts necessarily governed by the law of contract as to banks and their customers, his lordship begins his analysis by considering the status of the money as a "stolen bag of coins".

So, in that eccentric way English lawyers think about money held in electronic bank accounts, it was said in *Westdeutsche* that once a bank account goes overdrawn or the money is spent, that money disappears. This is a money launderer's paradise. Rather than say "if money passes out of a computer-held bank account but its value is still held in some form by the owner of that account, therefore we should treat that person as still having the money", English law actually says "if that electronic money has gone from that account and cannot be traced in its equivalent proprietary form, we must assume it has disappeared". No wonder England has such an affection for mediocre TV magicians if they are so easily convinced by disappearing tricks.

The definition of 'money' is a perennial problem for the lawyer. Indeed it is one that is so intrinsic to many legal conundra that it is rarely addressed explicitly at all. As set out in Dr Mann's exhaustive *The Legal Aspect of Money*, there is a real problem with achieving a comprehensive legal definition of the term. The term 'money' as used by economists and by bankers is equally difficult to pin-point. In the mind of the derivatives professional, money is either physically transferred amounts of foreign exchange, or (more typically) a cash value equivalent recorded on a computer account. The notion of 'value' is perhaps closer to money in this context. It is unusual for there to be real physical settlement of cash in most financial market transactions. Rather, amounts are credited to, or debited from, accounts.

The use of electronic funds transfer is the re-allocation of debts - that is, value held in electronic bank accounts is assigned to other accounts. There is no physical settlement in the sense that is understood by the transfer of tangible chattels like sales of paintings at auction. The settlement of transactions in all foreign currency markets conducted away from the high street, takes place at a virtual level. That is, no physical property ever exists nor is any transferred. Rather, amounts of value represented by electronic bank accounts are transferred. While there is generally an entitlement to claim delivery of notes and coins in respect of the value held in a bank account, it is rare for such delivery ever to take place.

In such a context, English law shows itself slow to understand the nature of the increasingly globalised world around it in which communication and transaction takes place by computer e-mail, fax and phone, rather than in the physical marketplace of the 17th century. The logic of the law of property requires a more sophisticated analysis of the world than is possible within current mores.

THE AVAILABILITY OF PROPRIETARY REMEDIES

Lord Browne-Wilkinson held that there could be no retention of any rights in the deep discount payment by the bank because both parties intended that there be an outright transfer of that sum to the authority. The argument for the imposition of a resulting trust would be that there was no intention to make a voluntary and outright transfer of the property in circumstances where the contract is found to be void ab initio: see Worthington '*Proprietary Interests in Commercial Transactions*' (Oxford, 1996), xi. The radical restitutionary approach ("radical" in the best sense of that term), typified by the work of Prof. Birks in seeking to understand the core rationale for effecting restitution to be a remedy for unjust enrichment by subtraction of that enrichment, is considered expressly by their lordships.

For the most part the radical approach fairs badly before the House of Lords. Prof. Birks has suggested that the role of the resulting trust is primarily restitutionary and that this form of resulting trust should be imposed in cases of mistaken payment or failure of consideration to reverse unjust enrichment: Birks, 'Restitution and Resulting trusts ' in S. Goldstein, (ed.), *Equity and Contemporary Legal Problems* (1992), 335. At the root of both arguments in favour of the use of the resulting trust is the assertion that the most appropriate response is to hold that the equitable interest in the property in question is to be deemed to have remained with the payer - whether that assertion is based on equitable or restitutionary conceptions of justice.

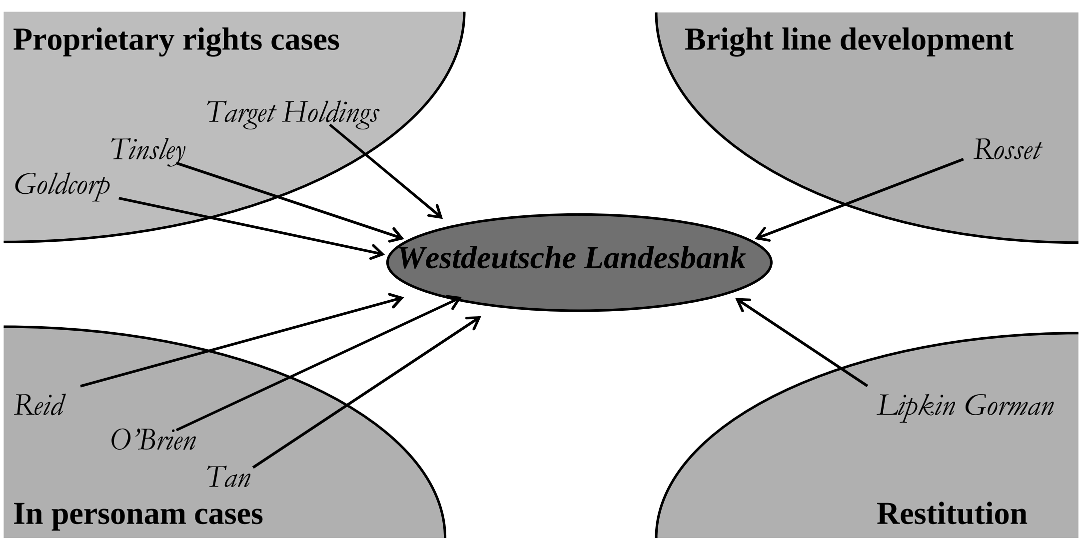
However, it is submitted that these suggestions fall into the trap which Lord Browne-Wilkinson has identified: any intention to create a resulting trust is to be rebutted by the intention at the time of the transfer to make an outright transfer. As his lordship held, there is a difficulty with establishing the role of the resulting trustee from the moment of receipt of the property at a time when there was no knowledge of the trusteeship.

A better approach, not addressed expressly by any of the courts in *Westdeutsche*, would be to extend the common intention constructive trust to commercial situations. Whereas this idea has been restricted to family home trusts, among the competing claims to resulting trusts, unjust enrichment and proprietary estoppel in that context, it is an idea which would appear to sit most comfortably in commercial situations. In seeking to establish the equitable title to property passed under a void contract, it is submitted that the court ought to consider the common intention formed between the parties as to the title to that property. Given Lord Browne-Wilkinson's determination to recognise the intentions of the parties in refuting the possibility of a resulting trust, it would appear appropriate to recognise those intentions when considering the possibility of a constructive trust. This would also appear to address the concerns of Lord Goff and Lord Woolf that justice must be seen to be done and that the confidence of commercial people in the utility of English law must be promoted.

Lord Browne-Wilkinson rejected the possibility of a proprietary interest based on constructive trust on the basis that the English model of constructive trust is institutional in nature, operating in response to the trustee's knowledge of some factor which ought to impact on his conscience sufficiently to warrant the imposition of such a constructive trust. On the facts of *Islington* it was found that the authority did not have knowledge of the status of the contract until it was declared to be ultra vires by the courts.

AN INTRODUCTION TO SOME OF THE ACADEMIC THEMES ARISING FROM THIS CASE

the decision in *Westdeutsche Landesbank* sits at the heart of a number of leading cases decided in the 1990's as a new generation of senior judges have sought to unearth core principles on which to develop equitable institutions and remedies, rather than to apply strict tests in all circumstances. The web of cases might look as follows.



At the centre of this web is the leading case of *Westdeutsche Landesbank*, a decision which had sought to explain the fundamental operation of equity as an exercise in regulating the conscience of the common law owner of property, but which requires a specifically identifiable property before any proprietary remedy will be awarded.

Proprietary rights cases

In the upper left quadrant are those cases, decided or approved by Lord Browne-Wilkinson, which have sought to advance the notion of the creation of proprietary rights which are centred on the necessity of establishing rights in specifically identifiable property. This means that, as in *Goldcorp*, where there is no property which can be specifically identified, the plaintiff will not have any rights against any property belonging to the defendant even though the plaintiff and the defendant had entered into a contract whereby the plaintiff was expressed to entitled to some property. The logic of title to property is followed regardless of the morality of contractual provisions (*Goldcorp*) and regardless of whether the plaintiff has herself dealt illegally with the property over which she is seeking proprietary rights (*Tinsley v. Milligan*). Even where it is not possible to restore the property itself, compensation or a claim for restoration of the value of the trust fund will be based on pre-existing rights in some property (*Target Holdings*).

Intellectually, the claimant is awarded rights in particular property. The rights attach to that property alone, having arisen from contract or purchase. Therefore, a creditor of the bullion exchange in *Goldcorp* could not assert any rights to property which the exchange was contractually bound to provide. This approach achieves a practical fairness between claimants to the estate of an insolvent corporation in that it prevents a claimant who has no right to any particular property, from asserting a claim to any property in preference to other unsecured creditors. In *Westdeutsche* the failure of other approaches to recognise the context of insolvency was asserted by Lord Browne-Wilkinson as among the reasons for rejecting alternative approaches based, *inter alia*, on restitution of unjust enrichment.

***In personam* cases**

The lower left quadrant of the diagram contains those cases which impose obligations as a result of the alternative approach which is based on Equity acting *in personam* to regulate the conscience of the common law owner of property. Thus, in *Reid*, the defendant who received bribes not to prosecute particular criminals, was held to hold those bribes on proprietary constructive trust for the beneficiaries of his fiduciary office because it would have been unconscionable for him to have resisted a claim for breach of fiduciary office at the moment the bribes were received. Consequently, Equity required that the bribes be held on trust from that moment for the beneficiaries of the fiduciary power. What is important is that the claimant-beneficiary is entitled to enforce rights over the bribes even though the beneficiary had never previously had any rights in the money making up those bribes, nor any property resulting from them. The constructive trust is imposed on the basis of the defendant's unconscionable behaviour, regardless of the identity of the property. The real reason for the this rule is a judicial desire to punish the defendant for the wrong which he had committed, rather than as a natural extension of property law rules.

Similarly, *O'Brien* operated on the conscience of the defendant in relation to undue influence in the creation of mortgage rights. The proprietary rights of the mortgagee were restricted, and a form of right in the property created in favour of the successful signatory to the mortgage transaction. The claimant need not have any pre-existing rights in the property. Rather, the undue influence principle operates on the conscience of the defendant mortgagee who has not carried out sufficient investigation into the rights or position of the claimant. The result of that equitable jurisdiction acting in personam on the conscience of the defendant is that the claimant is able to regulate the defendant's proprietary rights. While the property will be sufficiently certain (because it is that property secured by the mortgage) it is not any of the claimant's pre-existing rights in property which founds the claim. Therefore, there is no necessary link between the claim and a proprietary base for the claim as with *Re Goldcorp*.

In both of these cases, proprietary rights are created or restricted to prevent the common law owner of those rights from acting in a manner which would have been unconscionable. And so in *Tan*, personal liability to account as a constructive trustee is imposed on a person who has acted "dishonestly" in procuring a breach of trust. This extended test of dishonesty was extended so far as to be almost a test for "unconscionability", despite the Privy Council's express disavowal of any such test.

What is important is that these rights are not awarded on the basis of any particular property being held in the hands of the defendant. In *Tan* the defendant would necessarily not have had any rights in the property. *Reid* precludes the defendant from retaining any equitable interest in the property and *O'Brien* restricts the mortgagee from exercising property rights. These logic of these claims arises from the plaintiff's ability to assert her property rights against other persons and not from there being any specific property in which those rights are necessarily and inextricably bound up.

Restitution cases

As considered in greater detail in the remainder of this essay, restitution of unjust enrichment requires that there be a pre-existing proprietary base in the property which is to be restored to the plaintiff to reverse an unjust enrichment before the plaintiff is entitled to any such restoration of proprietary rights. In the absence of such a proprietary base in property held by the defendant, the plaintiff is entitled only to a personal claim against the defendant to reverse any unjust enrichment. The right to such a claim depends upon there having been some unjust factor which caused the property to pass from the plaintiff to the defendant. These cases assert a different approach from that taken by *Westdeutsche* and were expressly rejected by Lord Browne-Wilkinson as failing to account for the rights of other parties in situations such as insolvency of the defendant. The language of unjust enrichment is creeping ever further into the language of trusts implied by law and equitable remedies, as considered below. However, the decision of the majority of the House of Lords *Westdeutsche* remains the primary obstacle to the operation of the principle of unjust enrichment in English law.

Bright line cases

There has been a development of ever more rigid tests in many contexts in which Equity operates. This is particularly evident in the House of Lords decision in *Rosset* in relation to common intention trusts of homes. The nature of that decision can be explained as having been delivered by a common lawyer, Lord Bridge, who was concerned to create a clear set of principles to regulate a very significant sociological problem of ownership of the home, rather than being a judgement delivered by a chancery lawyer concerned with the logic of the law of property.

While that might be the explanation for the nature of the decision in *Rosset*, there has been a growth in that type of approach. *Westdeutsche* itself sets out a strict approach to resulting trust and tracing claims, while also returning to the context of underlying principles. Similarly, *Tan* has sought to identify a stricter test for dishonest assistance, along the lines of the older strict liability for exploitation of a fiduciary office under *Keech v. Sandford*. The complexity of the law in this area therefore necessarily encourages judges to re-draw the detail of tests as well as revisiting core principles. The movement of many equitable principles towards strict liability for trustees and intermeddlers with trust property, demonstrates a "bright line" development towards ever-stricter principles.

EXPLORING THESE THEMES

The concretisation of equitable principles

Equity has begun to cement its principles during the 1990's. The English principles of Equity were formulated primarily to regulate the conduct of family trusts and rights in homes from the eighteenth century and beyond. The norms which were created in respect of the availability of proprietary rights and compound interest were orientated around purely domestic situations. As Lord Browne-Wilkinson himself pointed out in *Target Holdings v. Redferns* [1996] 1 A.C. 421, those 'traditional trusts rules' sit uncomfortably with the complex, cross-border markets of the late twentieth century.

In moulding the principles of equity, it is important to recognise context. The development of equitable principles in relation to commercial transactions has seen a greater 'concretisation' of the tests used by the courts and a movement away from the application of general principle to this context. Recent cases, such as *Royal Brunei Airlines Sdn Bhd v. Tan* [1995] 2 A.C. 378 and *Islington*, have typified a judicial desire to impose stricter rules on the nature of equitable responses than are suggested by the list of core equitable principles reproduced in *Snell's Principles of Equity (*, 29th edn., (London, Sweet & Maxwell, 1990) where vaguely poetic and normative prescriptions such as 'coming to Equity with clean hands' have personified equity. Ironically, some areas of the common law such as the tort of negligence have seen an ever greater relaxation of principles, as indicated by cases such as *Caparro v. Dickman* [1990] 2 A.C. 605 and rules as the common law and equity appear to be moving in opposite directions. The question arises then as to the need to re-frame some of these equitable remedies such as knowing receipt and dishonest assistance in terms of strict liability. See, for example, Smith, 'Tracing and Electronic Funds Transfer', in Rose ed., *Restitution and Banking Law* (Oxford, Mansfield Press, 1998), 120, 125; Birks, 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 U.W.A.L.R. 1, 72.

One development in the principles of equity has been the increased rigidity of the tests which the courts are applying, particularly in commercial contexts. This tendency has been particularly discernible in the speeches of Lord Browne-Wilkinson in *Islington* and *Target Holdings* [1996] 1 A.C. 421, and in the speech of Lord Nicholls in *Royal Brunei Airlines v. Tan* [1995] 2 A.C. 378. In each of these cases there is a two-fold development: the solidifying of the appropriate test, and a restatement of the principles on which equity operates. Not only have the tests changed the law but they have moved it towards a greater level of certainty which typifies common law, rather than equitable principles. There is a reduced discretion in the courts to apply equitable remedies. Rather, the House of Lords is seeking to apply more tightly defined policy pronouncements.

Within the terms of the substantive tests that are being applied, however, there remains a broad brush approach to judicial control. While there is an intention to set out clear tests, the manner in which those tests are being applied goes beyond a simple application of those rules. One good example of this development appears in the decision of the Privy Council in *Royal Brunei Airlines v. Tan* ([1995] 2 A.C. 378). In Lord Nicholl's opinion, the principle of dishonesty in *Tan* is broadened far beyond any of the more usual tests of whether or not a person is 'dishonest' *strictu sensu.*

Restitution of an unjust enrichment

The basis of restitution of an unjust enrichment

The principle is beguiling simple in outline. It is said that restitution is concerned to reverse an enrichment of the defendant where that enrichment has been made as a result of some unjust factor. Reversal is achieved by subtraction of the enrichment. In short: "you have made an enrichment at my expense, so give me that enrichment". The form of the enrichment may therefore either be the acquisition of a specific piece of property, or it may be the acquisition of some cash value. The problem for restitution lawyers is therefore whether the remedy ought to be personal or proprietary.

In Chambers' view '[m]oney is the very measure of enrichment ... by contrast benefits in kind are less equivocally enriching ...' The basis for this focus on money is the potential for the property to be devalued. His view is extended to say that the existence of a market in that thing (in which it could be said to have value) is not an issue: the question is the subtraction of value from the plaintiff (Birks, *Introduction to the Law of Restitution*

(Oxford, 1989), 19). For instance, where the plaintiff is seeking a remedy in connection with specific property which has passed to the defendant, what Smith would identify as a following claim (Smith, (1997), 67-104), it is a simple matter of evidence to establish the title of the plaintiff. No question of valuation arises in that sense because the remedy is for recovery of property, regardless of its inherent value (Burrows, (1993), 7). An argument based on lack of value will not obtain, it is said.

Proprietary claims over value

In relation to that question of claims against value, there is a division in restitution between two different measures in which the plaintiff may recover. The first measure is 'value received'; the second measure is "value surviving" (Birks, *Introduction to the Law of Restitution* (Oxford, 1989), 6). As Chambers delineates the subject (*Resulting Trusts* (Oxford, 1997), 105):

> 'First measure claims to the value received are necessarily personal, whereas second-measure claims to the value surviving are usually, but not necessarily, proprietary ... The resulting trust itself always effects restitution in the second measure (of the value surviving), because it can arise "only in respect of something identified as existing in the defendant's hands' (Birks (1989), 85). Like all trusts, it cannot exist unless it is "possible to identify clearly the property which is subject to the trust."' See also (Waters (1984), 117; *Cowcher v. Cowcher* [1972] 1 WLR 425, 430)

Thus the proprietary claim based on the restitutionary resulting trust is necessarily bound by the established rules of equity as to the identity of property. The issue of founding equitable proprietary claims therefore remains central, in the light of a need for a proprietary base.

Westdeutsche Landesbank v Islington **- an ideological battleground between equity and restitution**

The distinction between equity and restitution as played out in Westdeutsche Landesbank v Islington

The stage was set in *Westdeutsche Landesbank v. Islington* for disagreement between the progenitor of the modern law of restitution, Lord Goff, and the new equity lawyer's broom of Lord Browne-Wilkinson. These two had taken different approaches to the appropriate use of equity and of trusts implied by law in decisions such as *Tinsley v. Milligan (*[1994] 1 A.C. 340). The work carried out by Prof. Birks in relation to restitution was considered in close detail by the House of Lords in determining which ideological route is to be favoured in deciding the issues arising from the local authority swaps cases. The approach of Lord Browne-Wilkinson was to apply the traditional law of trusts, whereas the unjust enrichment lawyers have developed a new approach. The detail of the *Westdeutsche* decision has been considered by this writer in much greater detail elsewhere: Hudson, *Swaps, Restitution and Trusts* (1999), 1-249. It would be useful to examine the manner in which restitution would deploy a traditional equitable institution like the resulting trust in manner that differs from traditional equitable principles.

The core of the resulting trust argument in connection with restitution is that the resulting trust is said to constitute the most efficient method of restoring rights in property to their original owner: Birks 'Restitution and Resulting Trusts' in Goldstein, *Equity and Contemporary Legal Developments* (Jerusalem, 1992), 353, at 363-4. It was said that 'the law with regard to resulting trusts is not in doubt', by Lord Reid in *Vandervell v. IRC (*[1967] 2 A.C. 291, 307), ironically in a judgement where Lord Reid was dissenting. In Chambers' opinion, the seeming consensus of understanding of the resulting trusts 'mask[s] a widespread uncertainty about the true nature of the resulting trust. There is no consensus on the principle by which the resulting trust operates, including the fundamental question whether it arises by operation of law or depends on the presumed intention to create a trust.'. The further point raised by Chambers is whether or not the resulting trust 'properly understood, might not be equity's principal contribution to reversing unjust enrichment': Chambers, *Resulting Trusts* (Oxford, 1997), 1.

The basis of the restitutionary approach to the resulting trust requires the defendant to give up to the plaintiff an enrichment which the defendant has received (or its value in money) at the plaintiff's expense: Birks, *Introduction to the Law of Restitution* (Oxford, 1989), 13; also Beatson, *Use and Abuse of Unjust Enrichment* (Oxford, 1991), 1. The elements of this definition are said to fit the resulting trust most closely. Chambers and Birks both acknowledge that these principles will potentially fit a number of different responses, and that closer examination of the resulting trust is therefore necessary. Therefore, Birks requires that two further considerations must be borne in mind. First, the preservation of obligations or property rights which have been created by consent and, second, the preservation of the owner's pre-existing title. It is this pattern of exclusion from the ambit of the resulting trust any other factual circumstance, including the rights of an insolvent's creditors, which caused Lord Browne-Wilkinson to reject the restitutionary conception of the resulting trust in *Islington:* [1996] A.C. 669.

Resulting trusts are generally considered as belonging to the category of subtractive unjust enrichment - that is, an enrichment unjustly realised as a result of some property being taken from the claimant. On this analysis, it is resulting trusts, rather than constructive trusts, which should be applied in cases of subtractive unjust enrichment because the bulk of those cases concern non-voluntary transfers of property.

The question arises then what is meant by 'resulting trust' as opposed to 'constructive trust' or 'express trust'. Particularly, given the growing elision of categories in the caselaw, together with the importance of identifying which category is intended to lead to which remedy. As Chambers considers the distinction the 'resulting trust' classification tells us that the trust property was provided to the resulting trustee by the trust beneficiary and is being returned because the beneficiary did not intend the trustee to receive it beneficially. In contrast, the ‘constructive’ label tells us only that the trust in question was not expressly created by any person other than the court.

The utility of the resulting trust has been questioned by others: notably Lord Browne Wilkinson in *Islington* [1996] 2 All ER 961, 999; Swadling ‘A New Role for Resulting Trusts?’ (1996) 16 Leg. St. 110. Those views are predicated on the basis that the resulting trust has arisen from a presumed but vitiated intention to create an express trust. This is opposed to the views of Chambers and Birks, as set out below, that the resulting trust fulfils some restitutionary function not based on prior intention. Whatever the differences in view, the sceptical thesis has now established itself in the wake of the House of Lords decision in *Islington*.

Weaknesses in resulting trusts as a restitutionary device?

In a somewhat syllogistic approach, Chambers supports Birks’ view that:

> ‘The proof that resulting trusts are restitutionary makes it unnecessary to ask whether they respond to unjust enrichment. If they reverse unjust enrichments, those enrichments are unjust.’ (Birks, *Introduction to the Law of Restitution* (Oxford, 1989), 19, *supra*)

Thus, it is said that a resulting trust will reverse unjust enrichment because anything which a resulting trust reverses is unjust. Clearly that is not always the case. In *Vandervell v. IRC* for example the resulting trust was not imposed on the basis of justice but rather on an institutional basis arising out of the original equitable owner’s right to dispose of the whole of the equitable interest, instead leaving an amount of that interest (represented in that case by an option to repurchase the property) to come back to him on resulting trust. Further, it is not clear that ‘unjust enrichment’ is necessarily the most useful term when considering commercial cases. In the taxonomy of restitution it might be that it would be better to talk about ‘restitution’ and seek the reversal of ‘unjust factors’ or even a category of ‘restitutionary events’ with which to seek the restoration of property to its original titleholder.