

# THE CASE AGAINST THE EQUITABLE LIEN

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*Recent analyses of proprietary remedies have overwhelmingly focused on the constructive trust. This article investigates a less prominent proprietary remedy: the equitable lien. Though the lien is not as intrusive a remedy as the trust, because it insulates a creditor from the consequences of his/her debtor's insolvency, it raises many of the same questions. If a lien is to be justified, there must be some compelling reason for preferring the claims of some general creditors at the expense of others. This article argues that it is very difficult to demonstrate why some creditors are more deserving than others. Excepting a small number of anomalous instances in which the lien can be justified on instrumental grounds, the effect of the equitable lien is to discriminate between creditors whose claims are, in all material respects, indistinguishable.*

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## I INTRODUCTION

An important project in contemporary private law scholarship has been the attempt to develop a principled basis for determining, across a range of claims, which plaintiffs should be awarded a proprietary remedy and which should be restricted to an award of damages. This attempt to place the law of remedies on a more rational footing has not come before time. As Bant observed,<sup>1</sup> the law has largely failed to disclose a coherent rationale for the divergent treatment of seemingly similarly situated plaintiffs. Given that the decision to grant or withhold a proprietary remedy has significant consequences for both the plaintiff and the defendant's general creditors,<sup>2</sup> the failure to explain why apparently like cases are treated differently is a serious deficiency in the law.

To date, the literature on proprietary remedies has principally focused on the constructive trust. Another important, though less prominent, remedy is the equitable lien. As a security right, the lien is not as intrusive or extensive as the constructive trust. Nevertheless, because it insulates the lienee from the consequences of his debtor's bankruptcy, it raises many of the same difficult questions.

Unlike other analyses of the lien,<sup>3</sup> the purpose of this article is not to explain the nature of the lien or to attempt to rationalise what Waters

<sup>1</sup> Elise Bant, 'Trusts, Powers and Liens: An Exercise in Ground-Clearing' (2009) 3(3) *Journal of Equity* 286, 286–8 ('Trusts, Powers and Liens').

<sup>2</sup> The term 'general creditor', which is used throughout the article, indicates a creditor whose claim is neither secured nor enjoys statutory priority under the relevant bankruptcy regime. In this article, 'bankruptcy' refers to any mandatory system of collective debt enforcement and does not reflect the distinction between 'bankruptcy' regimes for natural persons and 'insolvency' regimes for juridical persons.

<sup>3</sup> See, eg, Fiona R Burns, 'The Equitable Lien Rediscovered: A Remedy for the 21<sup>st</sup> Century' (2002) 25(1) *University of New South Wales Law Journal* 1; JC Campbell, 'Some Historical and Policy Aspects of the Law on Equitable Liens' (2009) 83(2) *Australian Law Journal* 97; Sarah Worthington, 'Equitable Liens in Commercial Transactions' (1994) 53(2) *Cambridge Law Journal* 263; David Wright, 'The Place of the Equitable Lien as a Remedy' in Elizabeth Cooke (ed), *Modern Studies in Property Law, Volume 1: Property 2000* (Hart Publishing, 2001) 41; IJ Hardingham, 'Equitable Liens for the Recovery of Purchase Money' (1985) 15(1) *Melbourne University Law Review* 65; John Phillips, 'Equitable Liens: A Search for a Unifying Principle' in Norman Palmer and Ewan McKendrick (eds), *Interests in Goods* (LLP, 2<sup>nd</sup> ed, 1998) 975; Donovan WM Waters, 'Where Is Equity Going? Remedying Unconscionable

described as the ‘themeless rag-bag’<sup>4</sup> of circumstances in which it arises. Instead, it asks whether this form of non-consensual security right can be justified at all. The unavoidable truth about the lien is that it can only be conferred on a plaintiff at the expense of the defendant’s other general creditors. Thus, if the creation of a lien is to be justified, there must be some compelling reason for preferring the claims of some general creditors at the expense of others. The argument advanced in this article is that it is very difficult to demonstrate why some general creditors are more deserving than others. Excepting a handful of anomalous instances in which the lien can be justified on instrumental grounds, the effect of the equitable lien is to discriminate between creditors whose claims are, in all material respects, indistinguishable.

## II OWNERSHIP AND SECURITY

### *A A Brief Introduction to the Equitable Lien*

Though relatively few in number, existing analyses of the equitable lien provide excellent overviews of its nature and origins.<sup>5</sup> Deane J described the equitable lien as

a right against property which arises automatically by implication of equity to secure the discharge of an actual or potential indebtedness. Though called a lien, it is, in truth, a form of equitable charge over the subject property in that it does not depend upon possession and may, in general, be enforced in the same way as any other equitable charge, namely, by sale in pursuance of court order or, where the lien is over a fund, by an order for payment thereout. Equitable lien differs from traditional mortgage in that it does not transfer any title to the property and therefore cannot be enforced by foreclosure. While it arises by implication of some equitable doctrine applicable to the circumstances, its implication can be precluded or qualified by express or implied agreement of the parties. It can exist over land or personalty or both.<sup>6</sup>

Conduct’ (1988) 18(1) *University of Western Australia Law Review* 3, 22–41; Bant, ‘Trusts, Powers and Liens’ (n 1) 303–5.

<sup>4</sup> Waters (n 3) 24. For a familiar list of circumstances, see Campbell (n 3) 98–9.

<sup>5</sup> See especially Burns (n 3).

<sup>6</sup> *Hewett v Court* (1983) 149 CLR 639, 663 (citations omitted) (*‘Hewett’*). Because the lien arises by operation of law, it is excluded from the registration regime created under the *Personal Property Securities Act 2009* (Cth): see at s 8(1)(c).

Unlike its common law counterpart,<sup>7</sup> the equitable lien does not depend on a transfer of possession to the creditor.<sup>8</sup> Equally significantly, and also unlike the common law lien, the equitable lien confers on the lienee, via the intermediary of the court, the power to obtain an order for sale in the event of the debtor's default.<sup>9</sup>

Although the essence of the lien is simple to describe, difficult questions attend its operation. For instance, until the decision of the High Court in *Hewett v Court* ('*Hewett*'),<sup>10</sup> it was unclear whether the lien only applied to transactions that were specifically enforceable in equity.<sup>11</sup> Likewise, though it applies to sales of intangible personalty,<sup>12</sup> it remains unclear whether a lien can apply to contracts for the sale of goods.<sup>13</sup> Whilst these questions are important and, at least in the case of goods, not satisfactorily resolved,<sup>14</sup> they are not the focus of this article. Its purpose is instead to ask the broader question: can the equitable lien be justified at all?

In answering this question, two features of the lien are material. First, because it is a pure security right, the lienee's interest in the encumbered asset is limited to the value necessary to discharge the debt it secures. Unlike a beneficiary under a constructive trust, the lienee is neither entitled to the income generated by the charged asset, nor will she benefit from any increase

<sup>7</sup> See generally Lionel Smith, 'Security' in Andrew Burrows (ed), *English Private Law* (Oxford University Press, 3<sup>rd</sup> ed, 2013) 307, 335 [5.69].

<sup>8</sup> In terms familiar to the Roman lawyer, the lien is a 'pure hypothecation': see Edward I Sykes and Sally Walker, *The Law of Securities: An Account of the Law Pertaining to Securities over Real and Personal Property under the Laws of Australian Jurisdictions* (Law Book, 5<sup>th</sup> ed, 1993) 17–20, 206, 750; Barry Nicholas, *An Introduction to Roman Law* (Clarendon Press, 1977) 152.

<sup>9</sup> See Burns (n 3) 3; *Hewett* (n 6) 663–4 (Deane J).

<sup>10</sup> *Hewett* (n 6).

<sup>11</sup> Such a restriction, if it ever existed, is impossible to justify. The rationale for a decree of specific performance is that the award of money will fail to make the plaintiff whole. By contrast, the rationale for the equitable lien is that the plaintiff deserves, for some reason, security to ensure that the defendant performs her obligation to pay a monetary sum. For discussion, see *Hewett* (n 6) 664–7 (Deane J). See also Campbell (n 3) 119–20.

<sup>12</sup> *Re Stuclej; Stuclej v Kekewich* [1906] 1 Ch 67, 84 (Cozens-Hardy LJ). See also Campbell (n 3) 100.

<sup>13</sup> *Re Wait* [1927] 1 Ch 606, 635–6 (Atkin LJ). Atkin LJ argued that the Sale of Goods legislation constituted a complete code, and thus impliedly excluded any general law remedies, including the unpaid vendor's lien. The lien preserved by the legislation is a species of common law lien that gives an unpaid vendor the right to retain possession of goods. See also *Sale of Goods Act 1923* (NSW) s 43.

<sup>14</sup> Compare, for example, Hardingham (n 3) 77 with Richard Calnan, *Proprietary Rights and Insolvency* (Oxford University Press, 2<sup>nd</sup> ed, 2016) 150 [4.179].

in its value. Secondly, as is the case with the constructive trust, the equitable lien confers effective priority in bankruptcy.<sup>15</sup> As a consequence, the relationship between the lienee and the debtor's other unsecured creditors is perfectly zero-sum. Every dollar that is captured by the lien is a dollar that is not available for distribution amongst other general creditors. Because of its prejudicial effect on other unsecured creditors, it is essential that the law be able to justify the preferential treatment afforded to equitable lienees.

### B *Comparing Equitable Liens and Constructive Trusts*

Equitable liens and constructive trusts share two important characteristics. First, neither is created by the consent of the party whose assets are subjected to these power–liability relationships.<sup>16</sup> Secondly, assuming that the secured asset is more valuable than the outstanding debt, each has the virtue of saving certain creditors from the catastrophic consequences of their debtor's insolvency. It is thus unsurprising that analyses of the equitable lien often commence by comparing it with the constructive trust.<sup>17</sup> The analysis offered below will also commence by comparing the lien with the constructive trust. However, what is stressed is not their similarities, but their differences.

The crucial distinction between the constructive trust and the lien is that between ownership and security.<sup>18</sup> Though trusts can be used as security devices,<sup>19</sup> the interest of a beneficiary under a constructive trust, like the

<sup>15</sup> There is an argument that the term 'priority' should be confined to those creditors whose claims are preferred under the relevant legislative regime: see William Swadling, 'Policy Arguments for Proprietary Restitution' (2008) 28(4) *Legal Studies* 506, 523–4. However, for ease of expression, the term will also be applied to secured creditors whose claims do not, strictly speaking, fall within the system of *pari passu* distribution.

<sup>16</sup> For the classic discussion of the 'power–liability' relationship, see Wesley Newcomb Hohfeld, 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1913) 23(1) *Yale Law Journal* 16, 44–54. For an application of Hohfeld's concept of a power to a trust beneficiary, see *CPT Custodian Pty Ltd v Commissioner of State Revenue (Vic)* (2005) 224 CLR 98, 119 [44] (Gleeson CJ, McHugh, Gummow, Callinan and Heydon JJ). The Court's analysis follows Harris's argument in JW Harris, 'Trust, Power and Duty' (1971) 87 (January) *Law Quarterly Review* 31, 52–3.

<sup>17</sup> See, eg, Wright (n 3) 41; Burns (n 3) 10–12.

<sup>18</sup> This distinction is also noted in American Law Institute, *Restatement (Third) of Restitution and Unjust Enrichment* (2011) § 56 cmt (b) ('R3UE').

<sup>19</sup> See, eg, *Associated Alloys Pty Ltd v ACN 001452106 Pty Ltd (in liq)* (2000) 202 CLR 588. On the divergence between United Kingdom and Australian law on this issue, see the discussion in Kery CF Loi, 'Tracing the Future of *Romalpa* Clauses' (2008) 16 *Restitution Law Review* 76, 83–9.

beneficiary of any bare trust, is ownership.<sup>20</sup> A beneficiary is entitled to the income generated from the trust asset and will benefit from any increase in its value. This is not true of a lienee. Because the lien is a pure security right,<sup>21</sup> the lienee's interest in the encumbered asset is limited to the proceeds of sale equal to the value of the outstanding debt.

This distinction between ownership and security warrants emphasis for the following reason: because the beneficiary under a constructive trust is effectively the owner of the relevant asset, there may be non-bankruptcy reasons for awarding or denying a trust. A trust may be justified because, as a matter of corrective justice, those who are unjustly enriched should make restitution of the very subject matter of the enrichment.<sup>22</sup> Alternatively, a trust may be justified because it is the most effective way of ensuring that a fiduciary disgorges the entirety of any gain made in breach of fiduciary duty.

Consider *Attorney-General (Hong Kong) v Reid*,<sup>23</sup> in which the fiduciary invested the proceeds of bribes into New Zealand real estate. In principle, it would be possible to strip any gains by ordering an account of profits. However, this personal remedy suffers from two weaknesses. First, it requires the court to engage in the potentially difficult exercise of valuing the gain.<sup>24</sup> If the valuation is low, the order will fail to disgorge all the gain. If the valuation is high, the order will be illegitimately punitive.<sup>25</sup> Secondly, because damages

<sup>20</sup> The point made here is simply that such beneficiaries have a power to demand conveyance of the title to the trust assets. This is not to suggest that the concept of 'ownership' accurately describes the interest of all beneficiaries under all trusts. For a useful overview of the competing theories, see Peter Jaffey, 'Explaining the Trust' (2015) 131 (July) *Law Quarterly Review* 377.

<sup>21</sup> *Hewett* (n 6) 663 (Deane J).

<sup>22</sup> See Stephen A Smith, 'The Structure of Unjust Enrichment Law: Is Restitution a Right or a Remedy?' (2003) 36(2) *Loyola of Los Angeles Law Review* 1037, 1057; Robert Chambers, 'Two Kinds of Enrichment' in Robert Chambers, Charles Mitchell and James Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (Oxford University Press, 2009) 242, 267; Matthew Harding, 'Constructive Trusts and Distributive Justice' in Elise Bant and Michael Bryan (eds), *Principles of Proprietary Remedies* (Lawbook, 2013) 19, 21. For a different view, see Elise Bant, 'Rights and Value in Rescission: Some Implications for Unjust Enrichment' in Donal Nolan and Andrew Robertson (eds), *Rights and Private Law* (Hart Publishing, 2012) 609, 619–22.

<sup>23</sup> [1994] 1 AC 324.

<sup>24</sup> For similar observations, see Michael Bryan, 'Constructive Trusts: Understanding Remedialism' in Jamie Glister and Pauline Ridge (eds), *Fault Lines in Equity* (Hart Publishing, 2012) 215, 225.

<sup>25</sup> The distinction between 'deterrence' and 'punishment' should be stressed. When a court orders that a breaching fiduciary be stripped of the fruits of her wrongdoing, the effect of the order is deterrent but not punitive. It simply returns the breaching fiduciary to her pre-

are awarded on a once-and-for-all basis, even if the valuation is accurate, an account of profits cannot guard against subsequent appreciation in the value of the asset acquired in breach of duty.<sup>26</sup> If Reid had merely accounted for the value of the land, any appreciation in the value of New Zealand real estate would have resulted in him making a profit in the long term.

To take another example, whilst it may be appropriate to impose a constructive trust over the proceeds of a bribe or secret commission received in breach of fiduciary obligation,<sup>27</sup> it will be inappropriate to impose a trust over the assets of a business that has prospered due to the efforts of the breaching fiduciary.<sup>28</sup> In cases that are factually analogous to *Warman International Ltd v Dwyer* ('*Warman*'), the remedy is properly limited to an account of profits,<sup>29</sup> which may also be subject to an allowance reflecting the fiduciary's expertise, effort and skill.<sup>30</sup>

Whether the appropriate remedy is personal or proprietary need not turn on considerations that are peculiar to the relationship between the plaintiff

breach position: see *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298, 369–70 [306]–[307] (Heydon JA).

<sup>26</sup> See Darryn Jensen, 'Proprietary Remedies: Distributive or Commutative?' (2014) 38(1) *University of Western Australia Law Review* 1, 22; Samuel Williston, 'The Right to Follow Trust Property when Confused with Other Property' (1888) 2(1) *Harvard Law Review* 28, 29. Because Reid was convicted of a serious criminal offence, it may be that the properties were subject to statutory forfeiture orders in any case.

<sup>27</sup> This issue has caused some divergence between Australian and United Kingdom law. Compare *Grimaldi v Chameleon Mining NL [No 2]* (2012) 200 FCR 296, 422–3 [582]–[583] (Finn, Stone and Perram JJ) ('*Grimaldi*') with *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250, 273–4 [46] (Lord Neuberger PSC for the Court).

<sup>28</sup> A classic fact pattern is *Warman International Ltd v Dwyer* (1995) 182 CLR 544 ('*Warman*'). As the Court noted in *Warman*, 'a distinction should be drawn between cases in which a specific asset is acquired and cases in which a business is acquired and operated': at 560 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ). This distinction was also noted by Nettle J in his Honour's dissenting judgment in *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd* (2018) 92 ALJR 918, 952 [179] ('*Lifeplan*'). Importantly, the decision in *Lifeplan* makes clear that a court can order that the defendant account for the entire capital value of a business: at 942 [120] (Gageler J).

<sup>29</sup> It is, however, important that the monetary award was secured by a charge over the relevant companies' assets: *Warman* (n 28) 570 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ). Significantly, this is the remedy that Mason J would have awarded in *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 107–16.

<sup>30</sup> On the rationale for the allowance, see *Warman* (n 28) 561 (Mason CJ, Brennan, Deane, Dawson and Gaudron JJ). See also Matthew Harding, 'Justifying Fiduciary Allowances' in Andrew Robertson and Tang Hang Wu (eds), *The Goals of Private Law* (Hart Publishing, 2009) 341.

and defendant. As in *Giumelli v Giumelli* ('*Giumelli*'),<sup>31</sup> a monetary award may be substituted for a constructive trust, not because of some redeeming quality in the defendant, but instead because of the unduly prejudicial effect that a proprietary remedy would have on innocent third parties.<sup>32</sup>

These are just some of the many considerations that may lead a court to exercise its discretion to grant or refuse a proprietary award.<sup>33</sup> Whether one agrees with the outcomes in these cases, they are examples of situations in which the exercise of remedial discretion turns on considerations that are unrelated to the solvency of the defendant. Importantly, these considerations do not apply to the award of an equitable lien. Because the lien only ever secures an obligation to pay money, it is *never* relevant to the broader question of whether the court should respond to a breach of duty by ordering a personal or proprietary remedy. Indeed, the grant of the lien presupposes the existence of a personal award.

If the defendant is solvent or comprehensively insured, then the lien, unlike the constructive trust, will not give the plaintiff a superior interest rate, a share in any increase in the value of the encumbered asset, or anything else. It is only of significance if there is a danger that the defendant cannot satisfy the debt, in which case the lien insulates the creditor from the consequences of her debtor's insolvency. Thus, unlike in the case of constructive trusts and other cognate forms of proprietary remedy,<sup>34</sup> the decision to grant or deny an equitable lien should never turn on considerations that apply *inter partes*. Rather, to borrow the nomenclature used in *Restatement (Third) of Restitution and Unjust Enrichment* ('*R3UE*'), the lien is only of significance in 'three-party' cases in which the real defendants are the defendant's unsecured creditors.<sup>35</sup> Given that the law's decision to confer security on one creditor can only come at the expense of these other creditors, the question is, why

<sup>31</sup> (1999) 196 CLR 101 ('*Giumelli*').

<sup>32</sup> *Ibid* 125 [49]–[50] (Gleeson CJ, McHugh, Gummow and Callinan JJ). The remedial outcome in *Giumelli* has also been justified by 'clean break' considerations: see Jensen (n 26) 28.

<sup>33</sup> See the discussion in *Grimaldi* (n 27) 404–5 [510]–[511] (Finn, Stone and Perram JJ). See also Elise Bant and Michael Bryan, 'Defences, Bars and Discretionary Factors' in Elise Bant and Michael Bryan (eds), *Principles of Proprietary Remedies* (Lawbook, 2013) 185, 200–10.

<sup>34</sup> This includes orders such as specific restitution and delivery up.

<sup>35</sup> *R3UE* (n 18) § 55 cmt (c). Bryan has observed that one shortcoming of the 'two-party' and 'three-party' dichotomy is the potential for undiscovered third parties to transform all two-party cases into potential three-party cases: Bryan (n 24) 233–4. A different objection is that all three-party cases are in fact two-party cases. If a defendant is bankrupt, his presence in the proceedings is purely procedural. In such cases, the litigation is a straight fight between the plaintiff and the defendant's unsecured creditors.



should some creditors have the benefit of security rights for which they did not bargain?

One final preliminary point should be made. Some have argued that, as a matter of corrective justice, the bankruptcy of the defendant cannot be a relevant consideration when determining the appropriate remedy. Jensen, for example, has written that

[if a plaintiff is,] as a matter of commutative justice, justified in demanding that a defendant transfer an asset to her, then the claimant's right to the asset ought not to be defeated simply by the fact that the defendant has unsecured creditors whose interest in being paid might be compromised in the event of the defendant's insolvency.<sup>36</sup>

Nothing in the following analysis is inconsistent with Jensen's contention. This is not, however, because of a commitment to corrective justice as the exclusive paradigm of private law adjudication. Rather, it is because, unlike the constructive trust and other forms of specific relief, the lien is only of significance where the value of the personal claims against the defendant exceeds the value of his assets. Equitable liens thus determine how large a slice of the pie each creditor will receive. Whether some general creditors deserve a larger slice than others is the quintessential question of distributive justice.<sup>37</sup>

### III INSTRUMENTAL JUSTIFICATIONS

As is argued in detail in Part IV, it is extremely difficult to justify why, as a matter of desert, one general creditor should succeed at the expense of another. Despite this, there are circumstances in which one can justify the existence of non-consensual security rights. The argument advanced in this section is that, putting aside the relative desert of individual creditors, the existence of the equitable lien can, in limited cases, be justified on the basis that it encourages the creation of certain social goods or makes particular institutional practices possible.

<sup>36</sup> Jensen (n 26) 23.

<sup>37</sup> On the concept of distributive justice, see John Finnis, *Natural Law and Natural Rights* (Oxford University Press, 2<sup>nd</sup> ed, 2011) 165–73.

### A Trustees

Those who act as express trustees have both a personal claim for indemnification against the trust beneficiaries<sup>38</sup> and a lien over the trust property to secure the discharge of liabilities incurred in the administration of the trust.<sup>39</sup>

In simple express trusts, the justification for the lien is easy to appreciate. Because trustees are not officers of a juridical person, but common law owners of the trust property, they are personally liable to those with whom they transact in respect of it.<sup>40</sup> However, unlike most owners, trustees hold the property for the benefit of others and, at least in the canonical case, must act gratuitously.<sup>41</sup> As a basic matter of fairness, trustees should not be left out of pocket for liabilities incurred in the administration of the trust. As Lindley LJ explained, the lien is ‘the price paid by *cestuis que trust* for the gratuitous and onerous services of trustees.’<sup>42</sup> In addition to this general fairness argument, the instrumental argument for the lien is that if trustees were routinely left out of pocket, no one would be willing to undertake the role.<sup>43</sup> If we assume that the trust is a valuable social institution,<sup>44</sup> then the existence of the lien, which is essential to its preservation, is justified on this simple instrumental basis.

<sup>38</sup> *Hardoon v Belilios* [1901] AC 118, 124 (Lord Lindley for the Court).

<sup>39</sup> *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367 (Stephen, Mason, Aickin and Wilson JJ) (*‘Octavo Investments’*); *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, 245–7 [46]–[51] (Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ); *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20, [32] (Kiefel CJ, Keane and Edelman JJ), [83] (Bell, Gageler and Nettle JJ), [139] (Gordon J) (*‘Carter Holt Harvey Woodproducts’*). The lien also applies to executors of wills: see *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 324 (Latham CJ).

<sup>40</sup> See *Octavo Investments* (n 39) 367 (Stephen, Mason, Aickin and Wilson JJ); *Carter Holt Harvey Woodproducts* (n 39) [24] (Kiefel CJ, Keane and Edelman JJ), [129] (Gordon J). See generally JD Heydon and MJ Leeming, *Jacobs’ Law of Trusts in Australia* (LexisNexis Butterworths, 8<sup>th</sup> ed, 2016) 510.

<sup>41</sup> See generally Heydon and Leeming (n 40) 371–2.

<sup>42</sup> *Re Beddoe; Downes v Cottam* [1893] 1 Ch 547, 558.

<sup>43</sup> See Craig Rotherham, *Proprietary Remedies in Context: A Study in the Judicial Redistribution of Property Rights* (Hart Publishing, 2002) 316 (*‘Proprietary Remedies in Context’*); Acting Judge Ronald Sackville, ‘The Trustee’s Right of Indemnity and the Creditor’s Right of Subrogation: The Hardening of Equity’ (2013) 7(1) *Journal of Equity* 34, 39.

<sup>44</sup> See, eg, Penner’s defence of the trust as a facilitative device in JE Penner, ‘An Untheory of the Law of Trusts, or Some Notes towards Understanding the Structure of Trusts Law Doctrine’ (2010) 63(1) *Current Legal Problems* 653, 665–6, 668. See also Hanoch Dagan and Sharon Hannes, ‘Managing Our Money: The Law of Financial Fiduciaries as a Private Law Institution’ in Andrew S Gold and Paul B Miller (eds), *Philosophical Foundations of Fiduciary Law* (Oxford University Press, 2014) 91, 105.

These arguments become less convincing if the trustee does not act gratuitously. Where the trustee is a professional service provider who is remunerated for her services, there is little reason, at least as a matter of fairness, why she should have the benefit of a non-consensual security right over the trust estate. If such trustees want security, they ought to bargain for the creation of a charge over the fund. However, there remains an important justification for the existence of the trustee's lien, and it is one that has nothing to do with a concern for trustees and everything to do with a concern for those who transact with them.

Though by accident rather than design,<sup>45</sup> the trustee's lien is a partial solution to a problem created by the trading trust; the now ubiquitous practice of running a business through a corporate trustee endowed with modest share capital.<sup>46</sup> To borrow Ford's description: 'The fruit of this union of the law of trusts and the law of limited liability companies is a commercial monstrosity. The scope for frustrating creditors is considerable.'<sup>47</sup> Trading trusts present a paradigm example of the problem of ostensible ownership.<sup>48</sup> Those who contract with a company do so on the natural assumption that the company beneficially owns the assets over which it exercises control. However, when a company is also a trustee, that assumption is dangerously incorrect. If the trustee company becomes insolvent then, excepting instances in which a third party acquires title to a trust asset, the company's assets, which belong beneficially to the invisible beneficiaries, are neither liable to execution nor available for distribution amongst its unsecured creditors.<sup>49</sup> Even if a creditor is aware that she is dealing with a trustee, and is cognisant

<sup>45</sup> Silink, for example, has recently argued that creditor protection is incidental to the primary aim of the trustee's right to indemnification, which is to hold the trustee 'harmless' from liability: Allison Silink, 'Trustee Exoneration from Trust Assets: Out on a Limb? The Tension Between Creditor Expectations and the "Clear Accounts" Rule' (2018) 12(1) *Journal of Equity* 58, 87–8. For a different view, see Nuncio D'Angelo, *Commercial Trusts* (LexisNexis Butterworths, 2014) 270–1 [5.129]–[5.130].

<sup>46</sup> See Nuncio D'Angelo, 'The Trust as a Surrogate Company: The Challenge of Insolvency' (2014) 8(3) *Journal of Equity* 299, 301.

<sup>47</sup> HAJ Ford, 'Trading Trusts and Creditors' Rights' (1981) 13(1) *Melbourne University Law Review* 1, 1. In D'Angelo's words, the corporatised trust is a 'jurisprudential hermaphrodite': *ibid.*

<sup>48</sup> See Ford (n 47) 1–2. On the concept of ostensible ownership, see Douglas G Baird and Thomas H Jackson, 'Possession and Ownership: An Examination of the Scope of Article 9' (1983) 35(2) *Stanford Law Review* 175, 179–81.

<sup>49</sup> *Bankruptcy Act 1966* (Cth) s 116(2)(a). See generally Heydon and Leeming (n 40) 510.

of the risks of doing so, it may, for several reasons, be difficult or practically impossible for her to take security over the trust assets.<sup>50</sup>

The trustee's lien ameliorates, though it does not entirely solve, the problems faced by creditors of the trust.<sup>51</sup> Because the trustee's lien belongs beneficially to the trustee company, it is an asset to which its general creditors can be subrogated in the event of its insolvency.<sup>52</sup> The virtue of the trustee's lien is thus not that it benefits the trustee company, but that it acts as a vital conduit between the trust assets and those who extend credit to a trustee company as the public face of a business.<sup>53</sup> As Jessel MR remarked:

The trust assets having been devoted to carrying on the trade, it would not be right that the *cestui que trust* should get the benefit of the trade without paying the liabilities; therefore the Court says to him, You shall not set up a trustee who may be a man of straw, and make him a bankrupt to avoid the responsibility of the assets for carrying on the trade: the Court puts the creditor, so to speak, as I understand it, in the place of the trustee.<sup>54</sup>

It is the nature of all instrumental arguments that they are only as good as the ends they promote. The merit of this justification for the trustee's lien thus depends on the value of the trading trust as an institutional practice. This is a

<sup>50</sup> D'Angelo, *Commercial Trusts* (n 45) 238 [5.36].

<sup>51</sup> The lien ameliorates rather than solves this problem because, even if the lien has not been expressly excluded, a trustee has no right against the fund to discharge liabilities that were improperly incurred: see AW Lockhart, 'Trading Trusts: An Examination of Trustees Liability and Creditors' Rights' (1986) 5(3) *Auckland University Law Review* 313, 321–2. Just as importantly, the lien will not bite where, due to a potentially unrelated breach of trust, the 'clear accounts' rule applies. For a recent analysis of this rule, see Silink (n 45).

<sup>52</sup> *Octavo Investments* (n 39) 367–8 (Stephen, Mason, Aickin and Wilson JJ); *Carter Holt Harvey Woodproducts* (n 39) [34] (Kiefel CJ, Keane and Edelman JJ), [132] (Gordon J).

<sup>53</sup> This is why the trustee's lien should be non-excludable: see *JA Pty Ltd v Jonco Holdings Pty Ltd* (2000) 33 ACSR 691, 713 [86] (Santow J). It also supports the view, recently confirmed by the High Court, that when a trustee is entitled to *exoneration* rather than *reimbursement*, the proceeds of the trustee's lien should be confined to the creditors of the bankrupt in its capacity as trustee and not be made available to creditors generally: see *Carter Holt Harvey Woodproducts* (n 39) [38]–[44] (Kiefel CJ, Keane and Edelman JJ), [91]–[92] (Bell, Gageler and Nettle JJ), [155]–[156] (Gordon J). See also *Re Suco Gold Pty Ltd (in liq)* (1983) 33 SASR 99, 107–9 (King CJ); *Jones v Matrix Partners Pty Ltd* (2018) 354 ALR 436, 454–5 [75]–[78] (Allsop CJ), 475 [197] (Farrell J). The effect of the decision in *Carter Holt Harvey Woodproducts* (n 39) is that the contrary Victorian position, established in *Re Enhill Pty Ltd* [1983] 1 VR 561, must now be considered wrong in law. For a general discussion of this issue, see Heydon and Leeming (n 40) 522; Silink (n 45) 74–80.

<sup>54</sup> *Re Johnson; Shearman v Robinson* (1880) 15 Ch D 548, 552 ('*Re Johnson*'). See also the discussion in Harlan F Stone, 'A Theory of Liability of Trust Estates for the Contracts and Torts of the Trustee' (1922) 22(6) *Columbia Law Review* 527, 528.

contestable question that is beyond the scope of this article. Assuming that businesses will continue to operate through trusts, and in the absence of a creditor's right to proceed directly against the trust assets,<sup>55</sup> the best justification for the trustee's lien is that it prevents a trustee from being used as a 'man of straw'<sup>56</sup> behind whom the assets of a business can be concealed from its creditors.<sup>57</sup>

### B Liquidators and Trustees in Bankruptcy

Although one might entertain doubts about the value of the trading trust as an institutional practice, few would doubt the utility of collective debt enforcement procedures such as personal bankruptcy and corporate insolvency. As Jackson and Baird have long argued, these collective procedures are a desirable response to a 'common pool problem'<sup>58</sup> in which 'first-in-best-dressed' or 'grab' procedures result in inefficient strategic behaviour, duplication of enforcement costs and piecemeal dismemberment of the insolvent's assets.<sup>59</sup>

As is the case with the office of trustee, the role of liquidator or trustee in bankruptcy suffers from an incentive problem. This is not, as in the case of

<sup>55</sup> Such a right exists in United States law, which treats, for certain purposes, trustees as officers who act in a representative rather than a personal capacity: see D'Angelo, *Commercial Trusts* (n 45) 255–7 [5.86]–[5.91].

<sup>56</sup> *Re Johnson* (n 54) 552 (Jessel MR).

<sup>57</sup> A difficult question is whether trust creditors can be subrogated to the trustee's personal right of indemnification so that, unlike equity investors in a limited liability company, trust beneficiaries are subject to unlimited liability. For discussion of this issue, see *ibid* 140–2 [3.74]–[3.78], 150 [3.102]. The potential prejudice to beneficiaries has led the New South Wales Law Reform Commission to recommend that the *Trustee Act 1925* (NSW) be amended so as to exclude, subject to agreement to the contrary, a beneficiary's personal liability to the trustee: New South Wales Law Reform Commission, *Laws Relating to Beneficiaries of Trusts* (Report No 144, May 2018) 10.

<sup>58</sup> See Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press, 1986) 10–11. Common pool problems share the logic of the famous 'Prisoners' Dilemma'. The Prisoners' Dilemma is a two person, non-zero-sum game that famously highlights a paradox of human rationality. Though mutual 'cooperation' represents a better outcome than mutual 'defection', the payoff structure of the game is such that each player will nevertheless choose to defect. In game-theoretic terms, the choice to defect is 'strictly dominant'.

<sup>59</sup> Jackson, *The Logic and Limits of Bankruptcy Law* (n 58) ch 1; Douglas G Baird and Thomas H Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51(1) *University of Chicago Law Review* 97, 100–1; Thomas H Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91(5) *Yale Law Journal* 857, 860–8.

trustees, because liquidators act under full liability but without remuneration. Instead, it is because, unlike other commercial parties, liquidators must act on behalf of a party who cannot pay them. Given that the task of a liquidator is to distribute a fund, the value of which is invariably less than the totality of the claims to it, prioritising the cost of the liquidation is essential if anyone is to be persuaded to undertake the task.<sup>60</sup>

Importantly, whilst the costs of the liquidation or bankruptcy are secured by a lien over the assets of the insolvent company or bankrupt individual,<sup>61</sup> this is not the principal tool by which the law ensures that these costs are paid in full. This end is instead achieved through a statutory scheme that affords *true* priority to the costs of the insolvency or bankruptcy.<sup>62</sup> This distinction between the *de facto* priority generated by equity and the true priority conferred by the statutory regime is important because it makes clear that the liquidator's lien gives the liquidator no additional advantage over the insolvent's general creditors. If the costs of the liquidation exhaust the fund, there is simply nothing to which the lien can attach.

This does not make the lien redundant. It remains significant in disputes between liquidators and secured creditors. If, instead of vindicating its rights outside the bankruptcy process, a secured creditor seeks payment from a fund created by the efforts of the liquidator, a question arises as to who, as between the secured creditor and the liquidator, should prevail if the fund cannot satisfy the claims of both. Resolution of this question depends on the outcome of a priority dispute between the security right of the secured creditor and the lien of the liquidator. In such disputes, the law's answer is to postpone the right of the secured creditor to the lien of the liquidator, whose efforts created the fund.<sup>63</sup> As the High Court recently explained, the rationale for this priority rule is that '[a] secured creditor cannot lay claim to the benefit of realised assets without the costs of their realisation being met'.<sup>64</sup> In instrumental terms, one could equally observe that no one could be persuaded to undertake the task of realising the assets of an insolvent company without the costs of their realisation being met.

<sup>60</sup> A similar argument is made in Swadling, 'Policy Arguments for Proprietary Restitution' (n 15) 510.

<sup>61</sup> The terms 'charge' and 'lien' are often used interchangeably in this context: see *Re Universal Distributing Co (in liq)* (1933) 48 CLR 171, 174–5 (Dixon J) ('*Re Universal Distributing*').

<sup>62</sup> See, eg, *Bankruptcy Act 1966* (Cth) s 109(1)(a).

<sup>63</sup> *Re Universal Distributing* (n 61) 174 (Dixon J); *Stewart v Atco Controls Pty Ltd (in liq)* (2014) 252 CLR 307, 320 [22]–[23] (Crennan, Kiefel, Bell, Gageler and Keane JJ) ('*Stewart*').

<sup>64</sup> *Stewart* (n 63) 318 [16] (Crennan, Kiefel, Bell, Gageler and Keane JJ).

### C Solicitors

A final lien that can be justified on instrumental grounds is the solicitor's lien. Like mechanics who are entitled to an 'artificer's lien' at common law,<sup>65</sup> solicitors have the benefit of a common law lien over their client's papers in order to secure payment of their costs and disbursements.<sup>66</sup> In addition to this 'general lien', solicitors also have an equitable lien over the 'fruits of the litigation',<sup>67</sup> being the damages they recover on behalf of their client.<sup>68</sup> This lien attaches immediately to the fund and does so whether it is in the hands of the plaintiff's or the defendant's solicitors.<sup>69</sup>

On first blush, the solicitor's lien looks suspiciously like an example of George Bernard Shaw's aphorism that, 'all professions are conspiracies against the laity'.<sup>70</sup> Putting aside the anomalous cases of trustees and liquidators, what other service provider gets the benefit of such apparently preferential treatment? Though accountants, for instance, have a common law lien over their client's papers,<sup>71</sup> they do not get the benefit of a lien over the proceeds of their client's tax return.

Traditional explanations for the solicitor's lien do little to dispel this suspicion. Cotton LJ, for instance, opined that '[t]he lien of a solicitor is grounded on the principle that it is not just that the client should get the benefit of the solicitor's labour without paying for it'.<sup>72</sup> Likewise, Lord Kenyon CJ explained that 'the party should not run away with the fruits of the

<sup>65</sup> See generally *Tappendun v Artus* [1964] 2 QB 185, 194–5 (Diplock LJ for the Court).

<sup>66</sup> See *Gavin Edmondson Solicitors Ltd v Haven Insurance Co Ltd* [2018] 1 WLR 2052, 2064–6 [30]–[37] (Lord Briggs JSC, Baroness Hale PSC, Lords Kerr, Wilson and Sumption JJSC agreeing) ('*Gavin Edmondson Solicitors*').

<sup>67</sup> *Ibid* 2056 [2] (Lord Briggs JSC, Baroness Hale PSC, Lords Kerr, Wilson and Sumption JJSC agreeing).

<sup>68</sup> For a recent and comprehensive discussion of the solicitor's lien, see *ibid* 2064–6 [30]–[37] (Lord Briggs JSC, Baroness Hale PSC, Lords Kerr, Wilson and Sumption JJSC agreeing); *Firth v Centrelink* (2002) 55 NSWLR 451, 462–9 [33]–[54] (Campbell J) ('*Firth*').

<sup>69</sup> Thus, if solicitors for the defendant have notice of the lien but pay the client directly, they can, consistently with the law on equitable assignments, be ordered to pay again: see *Welsh v Hole* (1779) 1 Doug 238; 99 ER 155, 155–6 (Lord Mansfield); *Read v Dupper* (1795) 6 Term R 361; 101 ER 595, 596 (Lord Kenyon CJ) ('*Read*').

<sup>70</sup> George Bernard Shaw, *The Doctor's Dilemma* (Floating Press, 2011) 39. For a similar observation, see Rotherham, *Proprietary Remedies in Context* (n 43) 317.

<sup>71</sup> *Woodworth v Comroy* [1976] QB 884, 890 (Lawton LJ).

<sup>72</sup> *Guy v Churchill* (1887) 35 Ch D 489, 491.

cause without satisfying the legal demands of his attorney, by whose industry, and in many instances at whose expence, those fruits are obtained.<sup>73</sup>

It is obvious that a client should not take the benefit of his solicitor's labour and expertise without paying for it. However, this fails as a justification for the lien. Clients have a contractual obligation to pay their solicitor's costs. This obligation is not discharged by the simple expedient of 'running away with the fruits of the cause'.<sup>74</sup> The significance of the lien has nothing to do with the duties owed pursuant to the contractual relationship between solicitor and client. Rather, its significance is that the portion of the fruits of the action required to satisfy the solicitor's outstanding costs is not available for distribution amongst the client's other unsecured creditors in the event of his insolvency.<sup>75</sup>

The question is, why should a solicitor be in a better position than his client's other general creditors? If one were to compare the merits of solicitors against other general creditors, this question would be difficult to answer satisfactorily. After all, the relationship between solicitors and their clients is, at its core, contractual and, like other contracting parties, solicitors are not obliged to represent parties who cannot pay them. The better justification for the lien is that it promotes a social good by encouraging lawyers to provide legal services to impecunious but meritorious clients.<sup>76</sup> In other words, the best justification for the lien is that it is not for the benefit of solicitors, but their prospective clients.

This justification was reaffirmed in a recent decision of the United Kingdom Supreme Court. In a passage that betrays sensitivity to the charge that the lien is a perk invented for lawyers, by lawyers, Lord Briggs, with whom the other members of the Supreme Court agreed, wrote of the lien that

[i]t is a judge-made remedy, motivated not by any fondness for solicitors as fellow lawyers or even as officers of the court, but rather because it promotes access to justice. Specifically it enables solicitors to offer litigation services on credit to clients who, although they have a meritorious case, lack the financial resources to pay up front for its pursuit.<sup>77</sup>

<sup>73</sup> *Read* (n 69) 596.

<sup>74</sup> *Ibid.*

<sup>75</sup> *Firth* (n 68) 464–5 [35] (Campbell J).

<sup>76</sup> See *Ex parte Bryant* (1815) 1 Madd 49; 56 ER 19, 20 (Plumer VC).

<sup>77</sup> *Gavin Edmondson Solicitors* (n 66) 2056 [1]; see also at 2065 [33]–[34] (Lord Briggs JSC, Baroness Hale PSC, Lords Kerr, Wilson and Sumption JJSC agreeing). This case in fact arose



Though the solicitor's lien might be regarded as a 'band-aid' solution to the more fundamental problem caused by the enormous cost of legal proceedings, the importance of access to legal representation is a plausible instrumental justification for prioritising the claims of solicitors at the expense of an impecunious client's other unsecured creditors.<sup>78</sup>

#### IV DESERT-BASED JUSTIFICATIONS FOR THE LIEN

Part III considered instrumental justifications for particular equitable liens. These arguments did not turn on the desert of individual general creditors but on the role of the lien in promoting some good or preserving some institutional practice. The arguments in support of the liens discussed below are not of this character. Vendors of land and insurance companies do not find themselves in the anomalous position of liquidators or trustees who act gratuitously. Whether these liens are justified instead depends on whether the claims of some general creditors are more deserving than others.

##### A *Contracts for the Sale of Land*

If A, the vendor of land, conveys land to B, the purchaser, without receiving the purchase price, A will have a vendor's lien over the land, title to which has passed to B, equal to the value of the unpaid purchase price.<sup>79</sup> Eldon LC explained the 'vendor's lien' in the following terms: 'It goes upon this; that a person, having got the estate of another, shall not, as between them, keep it, and not pay the consideration.'<sup>80</sup> Although it has been largely overshadowed by the vendor-purchaser constructive trust,<sup>81</sup> if B pays A the purchase price

in the context of a scheme intended to reduce the costs of relatively small civil claims: at [5] (Lord Briggs JSC, Baroness Hale PSC, Lords Kerr, Wilson and Sumption JJSC agreeing).

<sup>78</sup> It should be noted that a solicitor who agrees to act for an impecunious client is running the risk that the client's action will either fail, or that any damages recovered will be insufficient to cover the solicitor's costs and disbursements.

<sup>79</sup> *Reliance Finance Corporation Pty Ltd v Heid* [1982] 1 NSWLR 466, 477-8 (Hope JA).

<sup>80</sup> *Mackreth v Symmons* (1808) 15 Ves Jr 329; 33 ER 778, 782.

<sup>81</sup> *Lysaght v Edwards* (1876) 2 Ch D 499, 506 (Jessel MR). For criticism of the trust, see William Swadling, 'The Fiction of the Constructive Trust' (2011) 64(1) *Current Legal Problems* 399; William Swadling, 'The Vendor-Purchaser Constructive Trust' in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (Lawbook, 2005) 463. For a defence of the trust, see PG Turner, 'Understanding the Constructive Trust between Vendor and Purchaser' (2012) 128 (October) *Law Quarterly Review* 582.

before receiving a conveyance of the land, B will have a 'purchaser's lien' over the land to secure A's obligation to make restitution of the purchase price.<sup>82</sup>

Whilst the existence of these liens is undoubted, their basic justification is less clear. As Wynn-Parry J observed of the purchaser's lien:

[A]ll those cases are to be explained by reference to the underlying principle that the right of a purchaser to a lien in such circumstances is tested on the basis that he is to be regarded as a secured creditor. I cannot see how a purchaser has any right to a lien until it can be postulated of him that he is a secured creditor.<sup>83</sup>

The question is, of course, why should the purchaser be regarded as a secured creditor? The right of the vendor and purchaser in these circumstances is to the payment of money. The vendor has an action in debt for the unpaid purchase price. The purchaser has a claim in unjust enrichment for restitution of the executed purchase price. What the law must explain is why these obligations to pay money ought to be secured by a lien over the subject matter of the contract.

Worthington has attempted to explain the lien by reference to the equitable maxim, *equity treats as done that which ought to be done*. She offers the following explanation for the purchaser's lien in cases in which the contract for sale is not, for some reason, specifically enforceable:

Before either party has performed, the maxim introduces no equitable obligations; but once one party has executed the agreed consideration the situation changes. If the purchaser has paid the price, equity does not insist that the vendor transfer the property: the contract is not specifically enforceable. Nevertheless, the conscience of the vendor is bound and dealings with the sale property are restricted: the vendor 'ought' *either* to transfer the property *or* return the purchase money; the choice is really the vendor's, since the contract is not specifically enforceable. ... The minimum equity required to secure the purchaser's position and ensure that the vendor complies with one of these obligations is to impose an equitable lien on the property to secure repayment of the purchase price. This lien protects the purchaser without delivering what was bargained for.<sup>84</sup>

<sup>82</sup> *Rose v Watson* (1864) 10 HL Cas 672; 11 ER 1187, 1192 (Lord Cranworth); *Whitbread & Co Ltd v Watt* [1902] 1 Ch 835, 838–9 (Vaughan Williams LJ).

<sup>83</sup> *Combe v Lord Swaythling* [1947] Ch 625, 628.

<sup>84</sup> Worthington, 'Equitable Liens in Commercial Transactions' (n 3) 266–7 (emphasis in original) (citations omitted).

According to Worthington, the vendor's lien is based on the symmetrical explanation that 'once the vendor has transferred the property, the purchaser 'ought' either to pay the price or return the property, regardless of any other conditions applying to the contract. Again, the choice is really the purchaser's and, again, the minimum equity to compel this choice is a lien.'<sup>85</sup>

Two observations should be made about Worthington's explanation. First, it is based on an unconventional view of the nature of contractual obligations. The orthodox view is that a promisor is under a duty to perform her promise and does not have an option to decline performance on condition that she return the consideration she received as the price of her promise.<sup>86</sup> If a vendor repudiates, she is liable to pay damages for the purchaser's loss of bargain.<sup>87</sup> Whether the purchaser sues for breach of contract, or treats the contract as at an end and seeks restitution of the purchase price on the basis of a total failure of consideration, is his decision to make.<sup>88</sup>

Secondly, Worthington does not explain why the 'minimum equity' required to compel a purchaser to either pay the purchase price or reconvey the property, or a vendor to either convey the property or return the purchase

<sup>85</sup> Ibid 267 (emphasis in original).

<sup>86</sup> Worthington's explanation thus goes beyond Holmes's view that '[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, — and nothing else': Justice OW Holmes, 'The Path of the Law' (1897) 10(8) *Harvard Law Review* 457, 462. It also goes beyond the theory of efficient breach, a theory that has been deplored by Australian courts: see *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* (2009) 236 CLR 272, 286 [13] (French CJ, Gummow, Heydon, Crennan and Kiefel JJ); *Zhu v Treasurer (NSW)* (2004) 218 CLR 530, 574 [128] (Gleeson CJ, Gummow, Kirby, Callinan and Heydon JJ). For a critical discussion of the concept of efficient breach, see Daniel Friedmann, 'The Efficient Breach Fallacy' (1989) 18(1) *Journal of Legal Studies* 1.

<sup>87</sup> In contracts for the sale of land, the purchaser is much more likely to seek, and be granted, specific performance of the contract, rather than damages.

<sup>88</sup> See generally Andrew Burrows, *The Law of Restitution* (Oxford University Press, 3<sup>rd</sup> ed, 2011) 342–4. As Edelman and Bant have noted, in some circumstances it is not even necessary that the contract be terminated by the party seeking restitution: see James Edelman and Elise Bant, *Unjust Enrichment* (Hart Publishing, 2<sup>nd</sup> ed, 2016) 149–50. The question of whether a party who terminates a contract for work and labour following a repudiation can seek restitution, or is restricted to suing for breach of contract, was recently considered in *Mann v Paterson Constructions Pty Ltd* [2019] HCA 32 ('Mann'). Only a minority of the Court, Kiefel CJ, Bell and Keane JJ, expressly rejected the so-called 'rescission fallacy' and held that such a party is restricted to an unliquidated sum for breach of contract: at [30], [50]–[53]; cf at [102] (Gageler J), [170], [188], [190] (Nettle, Gordon and Edelman JJ). Importantly, *Mann* concerned a building contract and the restitutionary claim for a *quantum meruit* in such cases raises issues, particularly the relevance of the contract price, that do not arise in simple sales cases.

price, is the creation of a lien.<sup>89</sup> If a vendor refuses to convey, or a purchaser to reconvey, what compels the payment of money is not a security right, but an order of the court creating a judgment debt. The existence or absence of a security right does not alter the debtor's obligation to pay. It simply determines which of his creditors will swim, and which will sink, in the event that he cannot.

The lien is only important in three-party disputes, in which the judgment debtor is replaced by his general creditors as the real defendants to the action. In such cases, the law must justify why one general creditor should be elevated to the status of a secured creditor at the expense of the others. The maxim that *equity treats as done that which ought to be done* is a tautology that fails to explain why some promisees should be treated more favourably than others.<sup>90</sup>

If, for example, A cuts B's hair and B fails to pay, A has an action in debt against B for the price of the haircut. However, unlike the vendor of land, A cannot secure the debt by a lien over B's head. Given that the purchaser of land and the recipient of the haircut are simply liable to pay money, what makes the vendor of land more deserving than the barber? The only fact that distinguishes the two cases is that, unlike a human head,<sup>91</sup> land is a 'thing' to which a security right can attach. This is not, however, a convincing basis for preferring the claim of one over the other.

Precisely the same argument can be made about the purchaser's lien. If B paid A for a haircut that A failed to perform, B has a claim in unjust enrichment for total failure of consideration. Once again, however, there is no asset to which a lien can attach. Unlike the vendor–purchaser constructive trust, the purchaser's lien simply secures a claim to money and thus cannot be justified on the ground that an award of damages will fail to make the

<sup>89</sup> Worthington, 'Equitable Liens in Commercial Transactions' (n 3) 267.

<sup>90</sup> Worthington has, in other contexts, conceded the limited utility of this particular maxim: see Sarah Worthington, 'Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae' (2013) 72(3) *Cambridge Law Journal* 720, 738–40.

<sup>91</sup> For a macabre exception, see *Doodeward v Spence* (1908) 6 CLR 406.

purchaser whole.<sup>92</sup> In other words, the inadequacy of money cannot justify the award of a proprietary remedy where the plaintiff is only seeking money.<sup>93</sup>

That the maxim *equity treats as done that which ought to be done* fails to disclose an adequate reason for distinguishing between different sorts of contractual promisee is to say nothing of why it should favour any contractual claimant at all. As is discussed below, amongst those who subscribe to the ‘swollen assets’ theory of proprietary restitution, there is a consensus that those who seek restitution on the ground of total failure of consideration should never be awarded a constructive trust because, unlike an involuntary tort creditor, a contractual promisee must be taken to have accepted the risk of his promisor’s insolvency.<sup>94</sup>

A different explanation for the purchaser’s and vendor’s liens is suggested by Calnan. Of the purchaser’s lien, he argues that ‘[i]n a contract for the sale of land, the purchaser’s lien is nothing more than a recognition of the fact that the beneficial interest in the land passes to the purchaser at the time of the contract.’<sup>95</sup> Of the vendor’s lien, he explains that

it is a means of protecting the vendor from the purchaser’s equitable proprietary interest in the land. ... The unpaid vendor’s lien is simply the recognition of the fact that the purchaser’s proprietary interest is limited — until such time as he has paid the price in full, it only secures the repayment of the deposit.<sup>96</sup>

Calnan’s explanation of the purchaser’s lien is doctrinally unconvincing. It makes no sense to say that an equitable security right arises over an asset in favour of someone whom equity already regards as its beneficial owner.<sup>97</sup> Whilst his explanation of the purchaser’s lien is more doctrinally coherent,<sup>98</sup> it

<sup>92</sup> See *Adderley v Dixon* (1824) 1 Sim & St 607; 57 ER 239, 240–1 (Leach VC). For a defence of the traditional view, see Robert Chambers, ‘The Importance of Specific Performance’ in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (Lawbook, 2005) 431, 434–48.

<sup>93</sup> Though note the anomalous position of the vendor of land who, despite her only interest being the price, can seek specific performance: see *Turner v Bladin* (1951) 82 CLR 463, 473 (Williams, Fullagar and Kitto JJ).

<sup>94</sup> See below Part IV(E).

<sup>95</sup> Calnan (n 14) 415 [9.281].

<sup>96</sup> *Ibid* 151 [4.183].

<sup>97</sup> This is not exclusive to equity. As Lord Herschell LC remarked, ‘a man does not have a lien on his own property or a charge either’: *McEntire v Crossley Brothers Ltd* [1895] AC 457, 466.

<sup>98</sup> It should be noted that Calnan is sceptical about the need for the vendor’s lien: see Calnan (n 14) 151 [4.182].

is not so much an argument in favour of the lien as one against the perpetuation of the fiction that the specific enforceability of a contract for the sale of land makes the vendor a 'trustee' for his purchaser.<sup>99</sup>

### B *Contracts for Work and Materials*

Whilst uncertainty remains about the applicability of the lien to contracts for the sale of goods, the decision of the High Court in *Hewett* makes it clear that, at least in Australia,<sup>100</sup> liens can arise in contracts for work and materials. *Hewett* concerned an agreement to purchase a pre-fabricated house. The contract provided that the purchase price would be paid in instalments and that the house would remain property of the builder until payment had been made in full.<sup>101</sup> After the payment of two instalments, but prior to the completion of the house, it became apparent that the company was insolvent.<sup>102</sup> The company subsequently offered to allow the purchaser to take the partially completed house upon payment of the outstanding price.<sup>103</sup> The company's liquidator argued that this arrangement was void as a preference.<sup>104</sup> It was agreed between the parties that if the purchaser could establish that it had an equitable lien over the house to secure repayment of any instalments paid towards the purchase price, the arrangement was not a preference.<sup>105</sup> By a majority of 3:2, the Court decided that a lien existed.

Gibbs CJ held: 'The case is so closely analogous to that of a sale that the principles which entitle the purchaser to a lien are in my opinion applicable.'<sup>106</sup> In a brief judgment, Murphy J concluded: 'A charge such as this will often be necessary to protect consumers, who, unlike traders, cannot be expected to inquire into the solvency of the person with whom they are

<sup>99</sup> See *Tanwar Enterprises Pty Ltd v Cauchi* (2003) 217 CLR 315, 332–3 [53] (Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ); Swadling, 'The Fiction of the Constructive Trust' (n 81) 408–11; Swadling, 'The Vendor–Purchaser Constructive Trust' (n 81) 487–8; Elise Bant and Michael Bryan, 'Specific Restitution without Trusts' (2012) 6(3) *Journal of Equity* 181, 189; Elise Bant and Michael Bryan, 'A Model of Proprietary Remedies' in Elise Bant and Michael Bryan (eds), *Principles of Proprietary Remedies* (Lawbook, 2013) 211, 213.

<sup>100</sup> *Hewett* (n 6) was applied by a United Kingdom court in *International Finance Corporation v DSNL Offshore Ltd* [2007] 2 All ER (Comm) 305; see at 324–7 [56]–[60] (Colman J).

<sup>101</sup> *Hewett* (n 6) 643–4 (Gibbs CJ).

<sup>102</sup> *Ibid* 644 (Gibbs CJ).

<sup>103</sup> *Ibid*.

<sup>104</sup> *Ibid* 652 (Wilson and Dawson JJ).

<sup>105</sup> *Ibid* 660 (Deane J).

<sup>106</sup> *Ibid* 648.

dealing.<sup>107</sup> Deane J, whose judgment has proved most significant, held that an equitable lien will arise when the following, non-exhaustive, conditions are satisfied:

(i) [T]hat there be an actual or potential indebtedness on the part of the party who is the owner of the property to the other party arising from a payment or promise of payment either of consideration in relation to the acquisition of the property or of an expense incurred in relation to it; (ii) that that property ... be specifically identified and appropriated to the performance of the contract; and (iii) that the relationship between the actual or potential indebtedness and the identified and appropriated property be such that the owner would be acting unconscientiously or unfairly if he were to dispose of the property ... to a stranger without the consent of the other party or without the actual or potential liability having been discharged.<sup>108</sup>

His Honour found that those conditions had been satisfied on the facts,<sup>109</sup> concluding that

the company would, adapting the words of the third of the above tests, be acting unconscientiously and unfairly if it were to dispose of that partly completed home to another without the consent of the appellants and without, at the least, repaying to the appellants the money which it had received on the basis that that home would eventually be theirs.<sup>110</sup>

As others have noted, the reasoning of the majority judgments is, for various reasons, flawed.<sup>111</sup> For present purposes, two errors must be highlighted. First, given that all Justices of the Court agreed that the contract was one for work and materials,<sup>112</sup> a requirement that the property be ‘appropriated to the performance of the contract’<sup>113</sup> is juridically incongruous. The concept of ‘appropriation’ applies to sales of goods and determines when title to

<sup>107</sup> Ibid 650–1.

<sup>108</sup> Ibid 668 (citations omitted).

<sup>109</sup> Ibid 669.

<sup>110</sup> Ibid.

<sup>111</sup> See, eg, the criticisms in Sykes and Walker (n 8) 206 and Calnan (n 14) 417 [9.287].

<sup>112</sup> *Hewett* (n 6) 646 (Gibbs CJ), 650 (Murphy J), 656 (Wilson and Dawson JJ), 662 (Deane J). The broader significance of this finding was that it prevented the Court from determining whether the equitable lien can apply to contracts for the sale of goods: see at 647 (Gibbs CJ), 662 (Deane J).

<sup>113</sup> Ibid 668 (Deane J).

unascertained or future goods passes to the purchaser.<sup>114</sup> Although both Gibbs CJ<sup>115</sup> and Deane J<sup>116</sup> were of the view that the contract required the delivery of a *particular* home, given that the contract was one for work and materials, this must be incorrect. In their dissenting judgment, Wilson and Dawson JJ were surely correct to argue that the company's contractual obligations would have been discharged by the delivery of *any* house that complied with the contractual specifications.<sup>117</sup>

Secondly, and more fundamentally, Deane J's test sheds no light on why the company's obligation to make restitution of instalments on the purchase price ought to be secured by a lien over the house. His Honour's test asks whether 'the owner would be acting unconscientiously or unfairly if he were to dispose of the property ... to a stranger without the consent of the other party or without the actual or potential liability having been discharged'.<sup>118</sup> The deficiency in this test is that it focuses on the dictates of conscience *inter partes*. If a purchaser does not receive what she bargained for, the law obliges the vendor to make restitution of the value of any instalments paid towards the purchase price. However, whether that obligation should be secured by a lien is not a question that involves considerations specific to the bilateral relationship between the plaintiff and defendant. Rather, the relevant question is whether there is some compelling reason why this particular creditor's claim is more deserving than those of the promisor's other unsecured creditors.

Not only does Deane J's test fail to direct attention to this question, it is very difficult to conceive of a reason for favouring the claim of a disappointed purchaser of a kit home. In their dissenting judgment, Wilson and Dawson JJ correctly observed:

The insolvency of the company is no reason of itself for placing the appellants in a secured position so as to achieve an advantage over other creditors. The other creditors may have included persons who paid moneys by way of deposit or otherwise for transportable houses but who were unable to identify, or sufficiently identify, a particular house as the one which was being constructed pursuant to the contract between them and the company. No equity dictates

<sup>114</sup> *Sale of Goods Act 1923* (NSW) s 23 r 5(1). See generally MG Bridge, *The Sale of Goods* (Clarendon, 1997) 90–4.

<sup>115</sup> *Hewett* (n 6) 647.

<sup>116</sup> *Ibid* 669–70.

<sup>117</sup> *Ibid* 658.

<sup>118</sup> *Ibid* 668.



that those whose houses had reached a particular point of construction, such as the pitching of the roof, should be preferred in the realization and distribution of the company's assets, to those whose contracts with the company had been performed to a lesser extent.<sup>119</sup>

One could expand this list of creditors to include those who supplied materials on credit and, more significantly, to involuntary creditors, such as tort victims, who never assumed the risk of the debtor's insolvency at all. As is the case with contracts for the sale of land,<sup>120</sup> the equitable lien recognised in *Hewett* confers an unjustified benefit upon some creditors whilst imposing an undeserved detriment on others.

### C *Contracts of Indemnity*

An insurer who indemnifies an insured against loss is subrogated to the rights that the insured has against the third party who, in breach of duty, caused the loss.<sup>121</sup> If the insured successfully pursues or compromises a claim and then receives a payment from the insurer, he must account to the insurer, as money had and received, for any amount that he receives from the insurer in excess of his loss.<sup>122</sup> As Mitchell has explained, the duty to account in such cases cannot be explained as 'subrogation' for the simple reason that there are no extant rights to which the insurer can be subrogated.<sup>123</sup> Rather, it is a manifestation of the principle that the insured is entitled to be indemnified for his loss and not a cent more.<sup>124</sup>

Whatever label we choose to put on the insurer's action, the substance of the matter is that, where the insured recovers against a third party and then receives payment from his insurer of a sum in excess of his loss, he must pay the insurer the value of that excess. At least on first blush, there does not appear to be any reason why the appropriate remedial response to an overpayment should be the creation of proprietary rights. However, the law says otherwise.

<sup>119</sup> Ibid 658.

<sup>120</sup> See above Part IV(A).

<sup>121</sup> See Charles Mitchell, *The Law of Subrogation* (Clarendon Press, 1994) 6.

<sup>122</sup> *Yorkshire Insurance Co Ltd v Nisbet Shipping Co Ltd* [1962] 2 QB 330, 341 (Diplock J). See *ibid* 80–2.

<sup>123</sup> Mitchell (n 121) 67–9.

<sup>124</sup> See *ibid* 68.

In *Lord Napier and Ettrick v Hunter* ('*Lord Napier*'),<sup>125</sup> members of an insured syndicate, known as 'names', suffered substantial losses occasioned by the negligence of its managing agents.<sup>126</sup> The names recovered some, but not all, of its losses from its 'stop loss insurers' and subsequently compromised an action against the negligent agents.<sup>127</sup> Relevantly, the issue confronting the House of Lords was the distribution of the settlement proceeds held by a firm of solicitors. The question was whether the fund should be distributed to each member of the insured syndicate, against whom the insurer would then have to bring individual actions for money had and received, or whether the insurer's entitlement to payment in excess of the insured's loss meant that it had equitable proprietary rights in the fund itself.<sup>128</sup>

Lord Templeman suggested that the issue confronting the insurer was not one of bankruptcy but circuity of action. His Lordship argued:

There are 246 names, some of whom are resident in the United States of America and elsewhere abroad. In order to succeed in an action for money had and received stop loss insurers might be obliged to pursue litigation at considerable expense and subject to considerable delay in a country which knows nothing of an action for money had and received or does not recognise the doctrine of subrogation or confines its civil litigation to the tender mercies of juries who are unsympathetic towards insurers.<sup>129</sup>

Fortunately for the insurer, the House of Lords identified a line of cases according to which any damages received by an insured who has already been indemnified are held on trust for the insurer.<sup>130</sup> Their Lordships modified that line of cases by holding that, due to the onerous obligations of trusteeship, the proprietary interest of the insurer should be limited to an equitable lien.<sup>131</sup> As a matter of precedent, the decision in *Lord Napier* is clearly correct. However, the more fundamental question is why the law responds to a simple issue of overcompensation by the creation of proprietary rights.

<sup>125</sup> [1993] AC 713 ('*Lord Napier*'). For an overview, see WMC Gummow, 'Names and Equitable Liens' (1993) 109 (April) *Law Quarterly Review* 159.

<sup>126</sup> *Lord Napier* (n 125) 728 (Lord Templeman).

<sup>127</sup> *Ibid* 729 (Lord Templeman).

<sup>128</sup> *Ibid*.

<sup>129</sup> *Ibid* 737.

<sup>130</sup> *Ibid* 732–4 (Lord Templeman), 741–2 (Lord Goff), 750–2 (Lord Browne-Wilkinson).

<sup>131</sup> *Ibid* 738 (Lord Templeman), 744–5 (Lord Goff), 752 (Lord Browne-Wilkinson). For an argument that the conferral of a lien was inconsistent with their Lordship's reasoning, see Rotherham, *Proprietary Remedies in Context* (n 43) 281–2.

As Lord Templeman suggested above, one justification for the outcome in *Lord Napier* is procedural in nature. Satisfaction from the extant fund obviates the need for costly and complex litigation in foreign jurisdictions. Whilst the convenience of this solution is undoubted, it does not, of itself, explain why the claim of an insurer should succeed at the expense of an ordinary trade creditor in the event that the insured becomes bankrupt.

Lord Goff acknowledged the bankruptcy implications of the decision, but did not attempt to justify the priority of the insurer.<sup>132</sup> Lord Templeman did attempt to explain why an insurer should succeed at the expense of other unsecured creditors, opining:

Suppose, for example, that a name receives £100,000 from an insurer under a policy, recovers judgment for £130,000 damages from the wrongdoer and the name goes bankrupt before he receives the damages owing £1m and possessing no assets other than assets representing the £100,000 he has received from the insurer and the asset of £130,000 payable by the wrongdoer. In that case, if the argument on behalf of the names is correct, the unsecured creditors of the insured name will benefit by double payment. The stop loss insurers will be in a worse position than an unsecured creditor because the insurers could not resist payment under the policy whereas an unsecured creditor may choose whether to advance moneys or not. In the case of the bankruptcy of the name, the right of the insurer to subrogation will be useless unless equity protects that right.<sup>133</sup>

His Lordship's concern appears to be that, where the insured party is both paid out under the insurance policy and recovers in an action against a third party, his unsecured creditors will be unjustly enriched by the amount of the 'double payment'. It is true that the payment made by the insurer increases the value of the 'pot' available for distribution. However, this is equally true of an unsecured lender. Lord Templeman's analysis is thus only persuasive if he can demonstrate that, unlike an unsecured lender, the insurer did not take an insolvency risk.

As others have also noted,<sup>134</sup> Lord Templeman's 'compulsion' argument is unconvincing. The insurer took an insolvency risk when it voluntarily agreed to underwrite the insured's losses. That a promisor is not able to 'resist' the performance of contractual obligations to which it freely agreed cannot be

<sup>132</sup> *Lord Napier* (n 125) 744.

<sup>133</sup> *Ibid* 737.

<sup>134</sup> See, eg, Mitchell (n 121) 83; Charles Mitchell, Paul Mitchell and Stephen Watterson (eds), *Goff & Jones: The Law of Unjust Enrichment* (Sweet & Maxwell, 9<sup>th</sup> ed, 2016) 684 [21-104]; Rotherham, *Proprietary Remedies in Context* (n 43) 281.

grounds for elevating it to the status of a secured creditor. To borrow Rotherham's words: '[T]he outcome in [*Lord Napier*] is not explicable as anything other than a right arising by operation of law, reflecting a judicial decision to give insurers preferential treatment.'<sup>135</sup>

#### D *Securing a Beneficiary's Claim against a Defaulting Trustee*

When an express trustee breaches trust by, for instance, misapplying trust assets, a beneficiary may either trace into the substitute asset and claim that it represents trust property or, alternatively, bring a personal action against the trustee, compelling him to perform the trust. In the latter case, equity secures the monetary value of that obligation by a lien over the traceable substitute in the hands of the trustee.<sup>136</sup>

The ability of a beneficiary to trace, and subsequently claim, is generally regarded as a core incident of the property right in the original trust asset.<sup>137</sup> It is not, however, obvious why this should be. Because the hallmark of a property right is that it binds 'strangers to its creation',<sup>138</sup> it must be that the right-holder can follow the *res* from hand to hand.<sup>139</sup> However, as Smith himself has observed, it is not essential to the institution of property that a right-holder should also be able to trace into substitutions.<sup>140</sup> The use of the label 'property' here is conclusory and not explanatory.<sup>141</sup> As Rotherham has argued, property is being invoked as a deontological concept in order to shield tracing from consequentialist objections, the most important being its effect on the unsecured creditors of the bankrupt trustee.<sup>142</sup>

<sup>135</sup> Rotherham, *Proprietary Remedies in Context* (n 43) 280.

<sup>136</sup> *Foskett v McKeown* [2001] 1 AC 102, 130 (Lord Millett) ('*Foskett*'); *Re Hallett's Estate; Knatchbull v Hallett* (1880) 13 Ch D 696, 709 (Jessel MR) ('*Re Hallett's Estate*').

<sup>137</sup> *Foskett* (n 136) 109 (Lord Browne-Wilkinson); Peter Millett, 'Proprietary Restitution' in Simone Degeling and James Edelman (eds), *Equity in Commercial Law* (Lawbook, 2005) 309, 325.

<sup>138</sup> William Swadling, 'Property: General Principles' in Andrew Burrows (ed), *English Private Law* (Oxford University Press, 3<sup>rd</sup> ed, 2013) 173, 174 [4.03].

<sup>139</sup> Arianna Pretto-Sakmann, *Boundaries of Personal Property: Shares and Sub-Shares* (Hart Publishing, 2005) 105–6, 166.

<sup>140</sup> Lionel D Smith, *The Law of Tracing* (Clarendon Press, 1997) 17–18.

<sup>141</sup> Andrew Burrows, 'Proprietary Restitution: Unmasking Unjust Enrichment' (2001) 117 (July) *Law Quarterly Review* 412, 418. For discussion of the factors that may be relevant in determining whether a plaintiff should have a right in a substitute asset, see Bant and Bryan, 'Specific Restitution without Trusts' (n 99) 199–202.

<sup>142</sup> Craig Rotherham, 'The Metaphysics of Tracing: Substituted Title and Property Rhetoric' (1996) 34(2) *Osgoode Hall Law Journal* 322, 323–4; Craig Rotherham, 'Proprietary Relief for

One explanation for the beneficiary's ability to trace into and claim substitute assets is that it follows from the inherent power of a right-holder to retrospectively waive breaches of duty.<sup>143</sup> The classic statement is that of Jessel MR, who held:

The modern doctrine of Equity as regards property disposed of by persons in a fiduciary position is a very clear and well-established doctrine. You can, if the sale was rightful, take the proceeds of the sale, if you can identify them. If the sale was wrongful, you can still take the proceeds of the sale, in a sense adopting the sale for the purpose of taking the proceeds, if you can identify them.<sup>144</sup>

Importantly, even if we accept that 'ratification' explains a beneficiary's proprietary interest over substitute assets, it does not explain why, in the event that the beneficiary decides to 'falsify' the account and treat the transaction as a breach of trust,<sup>145</sup> her personal claim against the defaulting trustee should be secured by a lien over the substitute asset.

The beneficiary's two remedial options are based on two distinct normative claims. Where she chooses to trace and claim, her claim is based on her assertion that 'that thing belongs to me'. The asset is not available for distribution amongst the trustee's creditors by application of the general principle that one's estate in bankruptcy does not include rights that belong to others.<sup>146</sup> However, when a beneficiary chooses to compel the trustee to perform the trust according to its terms, her claim is based on the very different normative claim: 'You have breached your duty to me.' Whilst the

Enrichment by Wrongs: Some Realism about Property Talk' (1996) 19(2) *University of New South Wales Law Journal* 378, 396–7.

<sup>143</sup> Dale A Oesterle, 'Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9-306' (1983) 68(2) *Cornell Law Review* 172, 186–8. For a different view, see Lionel Smith, 'Philosophical Foundations of Proprietary Remedies' in Robert Chambers, Charles Mitchell and James Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (Oxford University Press, 2009) 281, 302–3. Smith argues that the proprietary effect is explicable on the basis that the trustee cannot deny that he holds the substitute property on trust, because this would be tantamount to permitting the trustee to plead his own breach of duty as defence. This explanation does not confront the issue that, in many cases, tracing is only invoked because the trustee is bankrupt, in which case the contest is really between the beneficiary and the trustee's unsecured creditors.

<sup>144</sup> *Re Hallett's Estate* (n 136) 708–9. See also Simon Evans, 'Rethinking Tracing and the Law of Restitution' (1999) 115 (July) *Law Quarterly Review* 469, 478.

<sup>145</sup> *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681, 732 [168] (Lord Millett NPJ).

<sup>146</sup> *Bankruptcy Act 1966* (Cth) s 116(2)(a). For a brief overview of this principle, see Peter Watts, 'Constructive Trusts and Insolvency' (2009) 3(3) *Journal of Equity* 250, 252–4.

trustee plainly has an obligation to restore to the fund the value of that which was wrongly taken out, why should that personal obligation be secured by a lien over an asset in which the beneficiary, by the very nature of her claim, disclaims any interest?<sup>147</sup>

One potential justification for affording priority to the trust beneficiary was offered in *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* ('*Space Investments*').<sup>148</sup> *Space Investments* concerned a settlement that permitted the trustee bank to place trust money on deposit with itself. When the bank was subsequently wound up, the question was whether the funds which the bank deposited with itself were still impressed with a trust and thus belonged to the beneficiaries in equity.<sup>149</sup> The Privy Council held that although, in the normal case, a beneficiary could trace into and claim misapplied trust property, the express power of the trustee to deposit trust money with itself meant that the beneficiaries were unsecured creditors who had to prove in the insolvency.<sup>150</sup> In delivering the advice of the Privy Council, Lord Templeman explained the usual priority of beneficiaries on the ground that

customers and other unsecured creditors voluntarily accept the risk that the trustee bank might become insolvent and unable to discharge its obligations in full. On the other hand, the settler of the trust and the beneficiaries interested under the trust, never accept any risks involved in the possible insolvency of the trustee bank. On the contrary, the settler could be certain that if the trusts were lawfully administered, the trustee bank could never make use of trust money for its own purposes and would always be obliged to segregate trust money and trust property in the manner authorised by law and by the trust instrument free from any risks involved in the possible insolvency of the trustee bank. It is therefore equitable that where the trustee bank has unlawfully misappropriated trust money by treating the trust money as though it belonged to the bank beneficially ... then the claims of the beneficiaries

<sup>147</sup> The beneficiary cannot both maintain an action for breach of trust and claim beneficial ownership of the substitute asset, because this would require her to simultaneously affirm and deny a breach of trust. In order for her claim to be internally consistent, she must elect between these two options.

<sup>148</sup> [1986] 1 WLR 1072.

<sup>149</sup> *Ibid* 1073 (Lord Templeman for the Court).

<sup>150</sup> *Ibid* 1075–6 (Lord Templeman for the Court).

should be paid in full out of the assets of the trustee bank in priority to the claims of the customers and other unsecured creditors of the bank.<sup>151</sup>

What is notable about Lord Templeman's reasoning is that the beneficiary's claim to priority is not based on the normative claim that she 'owns' the trust property or its traceable substitute. Rather, her priority is justified by the claim that the settlor never accepted the risk of the trustee bank's insolvency *because* the trustee has a duty to segregate the trust funds.<sup>152</sup>

With respect, there are two problems with this analysis. First, merely being an involuntary creditor of the bankrupt debtor is insufficient to justify priority.<sup>153</sup> If it were, then the claims of tort creditors should be preferred to those of the general body of creditors, but they are not.<sup>154</sup> The second problem concerns the basis on which Lord Templeman argued that trust beneficiaries are involuntary creditors of the trustee. On his Lordship's account, a settlor does not expose a beneficiary to the risk of the trustee's insolvency *because* the trustee has a duty to segregate the trust money. This cannot be an argument for priority because it is one that can be made by any creditor of the trustee whose claim is founded on a breach of duty. The creditor who has an action in contract would not have to prove in the trustee's insolvency if the trustee had not breached his duty to perform his contractual promise. The victim of the trustee's negligent driving would not be lining up with the trustee's general creditors if the trustee had not breached his tortious duty to take reasonable care whilst driving his car.

If a beneficiary's power to trace into and claim some substitute asset can be explained as an incident of a property right, then the priority of the beneficiary is justified on the basis that one's estate in bankruptcy does not include rights that belong to other people. The 'that is mine' normative justification for priority does not, however, support the creation of a lien where the beneficiary chooses to treat an unauthorised transaction as a breach of duty. If the beneficiary seeks an account in the common form and falsifies the account, there is no ground for affording her personal claim priority over those of the trustee's other general creditors.

<sup>151</sup> Ibid 1074.

<sup>152</sup> Oakley, for instance, approves of Lord Templeman's reasoning, but does so on the basis of the beneficiary's pre-existing property right: AJ Oakley, 'Proprietary Claims and Their Priority in Insolvency' (1995) 54(2) *Cambridge Law Journal* 377, 381, 385. This is not, however, the argument being made by Lord Templeman in the extract above.

<sup>153</sup> See Rotherham, *Proprietary Remedies in Context* (n 43) 84–6.

<sup>154</sup> See Hanoch Dagan, 'Restitution in Bankruptcy: Why All Involuntary Creditors Should Be Preferred' (2004) 78(3) *American Bankruptcy Law Journal* 247, 249.

### E *Proprietary Restitution*

The basic structure of a claim in unjust enrichment is that, due to the presence of some recognised ‘unjust factor’, the recipient of some rights or value comes under a liability to make restitution to the person at whose expense those rights or that value was received.<sup>155</sup> Importantly, this structure does not determine either whether the enrichee’s liability to make restitution should be personal or proprietary or whether a personal liability should be secured by a lien. Nevertheless, the reporter for *R3UE* writes:

Equitable lien is commonly employed as a means to afford more complete relief to the restitution claimant in what is ostensibly a two-party contest ... The rationale for awarding this supplemental remedy — over and above the money judgment for unjust enrichment to which the claimant is entitled — is not stated explicitly in the decisions, but it may generally be inferred. Claimants in equitable lien cases can usually trace what were formerly their assets into specific property in the hands of the recipients. The manner in which the assets have been incorporated or commingled ... prevents the claimants from retaking their property or its product via constructive trust; but it is felt to be unjust that the recipients should have the continued possession and enjoyment of the property in question without accounting to the claimants for their visible contribution. Equitable lien allows the claimant to compel a resolution by judicial sale, if the recipient does not satisfy the liability in restitution with a money payment.<sup>156</sup>

According to this explanation, the equitable lien is ordered because it is the ‘next best remedy’ when a trust cannot be ordered. The flaw in the passage above is the suggestion that a plaintiff’s ability to identify her ‘visible contribution’ to the defendant’s estate justifies a proprietary remedy. If a plaintiff can identify either her asset or its traceable substitute in the defendant’s hands, then she can simply claim it. No issue of a lien arises. Indeed, as Swadling has maintained, if title does not pass, no claim in unjust enrichment arises because the plaintiff cannot show that the defendant has been enriched *at her expense*.<sup>157</sup> If title has passed, her ability to point to

<sup>155</sup> Burrows, *The Law of Restitution* (n 88) 26–7.

<sup>156</sup> *R3UE* (n 18) § 56 cmt (d).

<sup>157</sup> William Swadling, ‘Ignorance and Unjust Enrichment: The Problem of Title’ (2008) 28(4) *Oxford Journal of Legal Studies* 627, 642–3. This point is controversial. Others argue that claims in unjust enrichment do not always require the passing of title: see, eg, Edelman and Bant (n 88) 58–9; Burrows, *The Law of Restitution* (n 88) 194–8. At the very least, Swadling’s argument demonstrates the supplementary role of unjust enrichment: see Ross Grantham



her former assets in the defendant's hands demonstrates that he has been enriched at her expense, but does not, without more, entitle her to a proprietary remedy.<sup>158</sup>

This doctrinal criticism does not, of course, answer the broader question of whether the law ought to *create* proprietary rights in favour of the unjust enrichment creditor. It may be that there are persuasive reasons for obliging the recipient to return the very thing he received. For instance, an order for specific restitution would obviate the need for what might be a difficult, speculative and expensive valuation exercise in a thin market.<sup>159</sup> Alternatively, such an order might be appropriate where there is no market substitute for an asset transferred pursuant to, for instance, a mistake of fact, and the plaintiff wants restitution of the asset rather than its value.<sup>160</sup>

However, even though there may be sound non-bankruptcy reasons for declaring the recipient a constructive trustee of some rights, this does not justify the creation of a lien. As was stressed in Part II, if the defendant is solvent, the existence of the lien is of no benefit to the plaintiff. It only becomes vital if the defendant is impecunious, in which case we have a three-party case, the true defendants to which are the defendant's general creditors. In these cases, the question is whether there is some reason for preferring the claim of the plaintiff to that of the defendant's unsecured creditors.

The most persuasive argument justifying the priority of unjust enrichment plaintiffs is the 'swollen assets' thesis.<sup>161</sup> Priority under this thesis relies on the satisfaction of two necessary and jointly sufficient conditions.<sup>162</sup> The first

and Charles Rickett, 'On the Subsidiarity of Unjust Enrichment' (2001) 117 (April) *Law Quarterly Review* 273, 289–91.

<sup>158</sup> For discussion of the relationship between property and unjust enrichment, see Charlie Webb, 'Property, Unjust Enrichment, and Defective Transfers' in Robert Chambers, Charles Mitchell and James Penner (eds), *Philosophical Foundations of the Law of Unjust Enrichment* (Oxford University Press, 2009) 335, 354–8; Stephen Smith, 'The Restatement of Liabilities in Restitution' in Charles Mitchell and William Swadling (eds), *The Restatement Third: Restitution and Unjust Enrichment* (Hart Publishing, 2013) 227, 232, 243, 246.

<sup>159</sup> Though, as others have noted, this does not of itself explain why the unjust enrichment claimant ought also to have priority in insolvency: see Mitchell, Mitchell and Watterson (n 134) 928 [37–15].

<sup>160</sup> Bant and Bryan, 'Specific Restitution without Trusts' (n 99) 192–3, 198; Bant and Bryan, 'A Model of Proprietary Remedies' (n 99) 215, 217–19.

<sup>161</sup> David M Paciocco, 'The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors' (1989) 68(2) *Canadian Bar Review* 315, 332; Emily L Sherwin, 'Constructive Trusts in Bankruptcy' [1989] (2) *University of Illinois Law Review* 297, 335–6; Burrows, 'Proprietary Restitution: Unmasking Unjust Enrichment' (n 141) 426–7.

<sup>162</sup> Craig Rotherham, 'Policy and Proprietary Remedies: Are We All Formalists Now?' (2012) 65(1) *Current Legal Problems* 529, 533 ('Policy and Proprietary Remedies'); Mitchell, Mitchell

condition is that the plaintiff must be an involuntary creditor in the sense that he never took the risk of the defendant's insolvency. This requirement thus excludes disappointed contracting parties who seek restitution for total failure of consideration.<sup>163</sup> Such parties are considered to have taken the risk of their promisor's insolvency and must therefore prove in the insolvency.<sup>164</sup> As Lord Sumption JSC, with whom the rest of the Supreme Court agreed, recently observed: 'The right to the restitution of money paid on a consideration which has wholly failed is simply a process of contractual readjustment, giving rise like the contract itself to purely personal obligations.'<sup>165</sup> The second condition is that the enrichment received by the defendant must have increased or 'swollen' her assets. Satisfaction of this second and jointly sufficient condition is what distinguishes unjust enrichment plaintiffs from other involuntary creditors, such as tort victims, who do not enjoy favourable treatment in bankruptcy.

The concern at the heart of the swollen assets theory is to prevent the defendant's general creditors from being unjustly enriched at the plaintiff's expense.<sup>166</sup> Importantly, if this argument justifies priority for unjust enrichment plaintiffs, then priority is best created through the imposition of a lien rather than a constructive trust. Take, as a useful archetype, the facts in *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* ('*Chase Manhattan*'), in which the plaintiff made a mistaken payment of USD2 million to the payee, which subsequently became insolvent.<sup>167</sup> Goulding J held that the payee received the mistaken payment subject to an immediate

and Watterson (n 134) 929 [37-17]. For an opposing view, see Swadling, 'Policy Arguments for Proprietary Restitution' (n 15) 526. Importantly, the argument advanced by the proponents of this thesis is not that 'contribution of value' and 'no insolvency risk' are independently weak arguments that become stronger in the aggregate. Rather, it is that, whilst each is a necessary but independently insufficient condition, together they are jointly sufficient conditions for the award of a proprietary remedy.

<sup>163</sup> See, eg, *Re Wait* (n 13) 640 (Atkin LJ).

<sup>164</sup> Rotherham, 'Policy and Proprietary Remedies' (n 162) 533-4; Burrows, *The Law of Restitution* (n 88) 177.

<sup>165</sup> *Angove's Pty Ltd v Bailey* [2016] 1 WLR 3179, 3193 [30] (Lord Neuberger PSC, Lords Clarke, Carnwath and Hodge JSC agreeing) ('*Angove's*'). Significantly, this case overruled the influential, though controversial, decision of Bingham J in *Neste Oy v Lloyds Bank plc* [1983] 2 Lloyds Rep 658 ('*Neste Oy*'): *Angove's* (n 165) 3193 [30]-[31]; cf at 3193 [32]. In *Neste Oy*, it was held that when a payment is received in circumstances in which the consideration for which it was made was bound to fail, the payment is held on trust by the recipient for the benefit of the payer.

<sup>166</sup> Sherwin, 'Constructive Trusts in Bankruptcy' (n 161) 329, 339.

<sup>167</sup> [1981] Ch 105, 114 (Goulding J).

constructive trust in favour of the plaintiff,<sup>168</sup> thus safeguarding the payer from the consequences of the payee's insolvency. Putting aside the 'retention fallacy' in Goulding J's reasoning,<sup>169</sup> the outcome in *Chase Manhattan* has been justified on the swollen assets theory of proprietary restitution.<sup>170</sup>

If the existence of a trust is not a prerequisite for the award of compound interest,<sup>171</sup> there is no reason why the mistaken payer ought to be a trust beneficiary rather than a lienee. Adapting the facts of *Chase Manhattan*, imagine that the recipient had, without notice of the mistake, used the payment to purchase shares that subsequently appreciated in value. By application of orthodox tracing rules, the plaintiff could claim the shares as the traceable substitute of the money held by the payee on trust for its benefit. However, the absence of correspondence between the plaintiff's loss and the defendant's gain in this situation means that such a result would go far beyond reversing an unjust enrichment.

If 'swollen assets' is a plausible argument for preferring the claims of unjust enrichment plaintiffs over the defendant's other general creditors, then the imposition of a lien, rather than a constructive trust, is the appropriate remedy. The broader question, however, is whether the swollen assets theory provides a convincing basis for elevating the claims of unjust enrichment claimants in the first place. There are two reasons to believe that it does not.

The first reason concerns the requirement that the plaintiff has 'swelled' the assets of the defendant. To succeed, the plaintiff must be able to demonstrate that the value of the enrichment is present in the defendant's estate at the time of his bankruptcy. As others have noted, whether the claimant can do this is often a matter of fluke.<sup>172</sup> So, for instance, a claimant might fail to satisfy this identification requirement because the enrichment

<sup>168</sup> Ibid 119–20, 127–8.

<sup>169</sup> On which, see *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 706 (Lord Browne-Wilkinson) ('*Westdeutsche*').

<sup>170</sup> See, eg, Gareth Jones, 'Remedies for the Recovery of Money Paid by Mistake' (1980) 39(2) *Cambridge Law Journal* 275, 276.

<sup>171</sup> This issue has become more complex since a unanimous United Kingdom Supreme Court in *Prudential Assurance Co Ltd v Revenue and Customs Commissioners* [2018] 3 WLR 652 overruled its previous decision in *Sempra Metals Ltd v Inland Revenue Commissioners* [2008] 1 AC 561. This is unfortunate because, as was the case in *Westdeutsche* (n 169), it encourages plaintiffs to invoke the trust formula for no other reason than to obtain an order for compound, rather than simple, interest.

<sup>172</sup> See, eg, Steven Walt and Emily L Sherwin, 'Contribution Arguments in Commercial Law' (1993) 42(4) *Emory Law Journal* 897, 905, 950; Emily Sherwin, 'Why *In Re Omegas Group* Was Right: An Essay on the Legal Status of Equitable Rights' (2012) 92(3) *Boston University Law Review* 885, 895 ('Why *In Re Omegas Group* Was Right').

took the form of the receipt of services that left no identifiable value. Alternatively, it may be that the value of the enrichment was dissipated, leaving no traceable substitute. Indeed, one might point to those who make a mistaken payment to a recipient who can satisfy the change of position defence. The problem here is not that the swollen assets thesis cannot distinguish between unjust enrichment plaintiffs and other creditors. Rather, it is that it provides no basis for distinguishing between more or less fortunate unjust enrichment plaintiffs.

One might argue that this criticism does not justify the uniform treatment of all involuntary creditors, but only compels the conclusion that unjust enrichment plaintiffs ought to share *pari passu* in the ring-fenced pool of value that they contributed to the bankrupt's estate. However, this argument is met by a second, and more fundamental, objection to the swollen assets thesis. This objection concerns the sufficiency of 'asset swelling' as a means of distinguishing unjust enrichment creditors from other sorts of involuntary creditors. Dagan has written:

One interpretation of this swollen asset theory focuses on the causal link between a restitution claimant's loss and the assets available for distribution in the debtor's bankruptcy, insisting that it would be unfair to allow the debtor's other unsecured creditors to get a higher dividend due to that claimant's misfortune. But a similar sense of unfairness exists respecting tort victims given the causal link between their loss and the size of the debtor's estate. The debtor's estate is augmented to the extent of their just compensation, and it seems unfair for the debtor's other unsecured creditors to benefit from these victims' misfortune of not being able to collect what is their due from the debtor prior to its bankruptcy.<sup>173</sup>

Dagan's argument appears to be that the swollen assets thesis turns on a specious distinction between the assets and liabilities sides of the ledger. Take the following examples:

- 1 Jane, who has assets to the value of \$50,000, receives a mistaken payment from John of \$10,000. Given her liability to make restitution, her net position after receiving the payment remains at \$50,000. If, in the event of Jane's insolvency, John's claim is not secured by lien, \$60,000 will be available for distribution amongst Jane's general creditors. If it is secured by a lien, that figure will fall to \$50,000.

<sup>173</sup> Dagan (n 154) 270–1.

- 2 Jane, who has assets to the value of \$50,000, negligently injures John, causing \$10,000 in loss. Given her liability to compensate John, her net position is \$40,000. If, in the event of her insolvency, John's claim is not secured by a lien, \$50,000 will be available for distribution amongst her unsecured creditors. If it is secured by a lien, that figure will fall to \$40,000.

Proponents of the swollen assets theory point to the bottom line as the basis on which to distinguish these two categories of involuntary claimant.<sup>174</sup> Their argument is that, unlike in the tort case, allowing the unjust enrichment creditor to recover 100 cents in the dollar is justified because it does not make the other creditors any worse off. The value of assets available for distribution remains the same as it was prior to the receipt of the mistaken payment. By contrast, allowing the tort claimant to recover 100 cents in the dollar reduces, by \$10,000, the amount otherwise available for distribution.

Though it appears sensible, the argument outlined above is circular. We can only conclude that allowing the unjust enrichment creditor to recover 100 cents in the dollar will not make the other creditors worse off if we assume the very thing that this argument is supposed to prove; namely, that the other creditors have no entitlement to share in the value of the mistaken payment.

The relevant question is, why do the other creditors have no such entitlement? The answer given by the swollen assets theorist is that the other creditors have taken an insolvency risk. However, precisely the same argument can be made by tort creditors. If, as Dagan argues,<sup>175</sup> the underlying meta-norm is creditor autonomy, the fact that tort creditors need not demonstrate a correspondence between their loss and the defendant's gain is irrelevant to the moral strength of their claim to priority.<sup>176</sup>

For Dagan, the logical consequence of the inability to distinguish between unjust enrichment and tort claimants is not a reason to deny priority to the former but to extend it to the latter.<sup>177</sup> So, is this a good argument for securing the claims of unjust enrichment *and* tort creditors by a lien over the assets of the bankrupt? The answer to this question is 'no'.

<sup>174</sup> See, eg, Vanessa Finch and Sarah Worthington, 'The *Pari Passu* Principle and Ranking Restitutionary Rights' in Francis Rose (ed), *Restitution and Insolvency* (Mansfield Press, 2000) 1, 11 n 42, 16.

<sup>175</sup> Dagan (n 154) 272–3.

<sup>176</sup> Indeed, it is possible that a defendant's negligence resulted in a gain insofar as it saved her the cost of taking reasonable precautions. The important point is simply that demonstrating a gain on the part of the wrongdoer is not an ingredient of the tort of negligence.

<sup>177</sup> Dagan (n 154) 274.

A basic pillar of bankruptcy law is that proprietary rights obtained outside bankruptcy are respected inside bankruptcy.<sup>178</sup> Of itself, this principle says nothing about whether such rights were created by consent or operation of law.<sup>179</sup> If, for instance, the dictates of conscience *inter partes* entitles a de facto partner to a beneficial interest in the family home,<sup>180</sup> that interest ought to bind her partner's trustee in bankruptcy. However, the argument of those whose claim to priority is based on the swollen assets thesis is importantly different. Their claim to a proprietary right is not based on considerations that are peculiar to the relationship between the plaintiff and defendant, but on the ground that the mandatory system of debt enforcement ignores the superior merit of their claim vis-à-vis the other general creditors.

Whilst securing the claim of involuntary general creditors may well promote creditor autonomy, prioritising claims based on 'desert' fits awkwardly in a mandatory system of collective debt enforcement that specifies those creditors whose claims are to be preferred,<sup>181</sup> and rateably distributes whatever remains.<sup>182</sup> Although it may appear to be rough justice, ignoring the often contestable<sup>183</sup> merits of individual general creditors is a pragmatic concession to the costs of the bankruptcy and is central to the statutory regime.<sup>184</sup> As Calnan writes: 'The real advantage of the *pari passu* sharing principle is not that it provides perfect justice but that it enables there to be a distribution of the assets of the debtor amongst his creditors in a reasonably

<sup>178</sup> Alison Clarke, 'Security Interests as Property: Relocating Security Interests within the Property Framework' in JW Harris (ed), *Property Problems from Genes to Pension Funds* (Kluwer Law International, 1997) 118, 122; Ewan McKendrick (ed), *Goode on Commercial Law* (Penguin Books, 4<sup>th</sup> ed, 2010) 907; *Bankruptcy Act 1966* (Cth) s 54L.

<sup>179</sup> See Rotherham, 'Policy and Proprietary Remedies' (n 162) 562.

<sup>180</sup> See, eg, *Baumgartner v Baumgartner* (1987) 164 CLR 137.

<sup>181</sup> *Bankruptcy Act 1966* (Cth) s 109.

<sup>182</sup> *Ibid* s 108.

<sup>183</sup> For example, as Paciocco intimates, is an unjust enrichment plaintiff really more deserving than a small trade creditor who could not, realistically, have taken security?: see Paciocco (n 161) 325. Others have argued that the question of distributive merit in bankruptcy is the sole preserve of the legislature: see, eg, Peter Birks, 'The Law of Restitution at the End of an Epoch' (1999) 28(1) *University of Western Australia Law Review* 13, 55–6; Swadling, 'Policy Arguments for Proprietary Restitution' (n 15) 520–2.

<sup>184</sup> See Lusina Ho, 'Proprietary Remedies for Unjust Enrichment: Demystifying the Constructive Trust and Analysing Intentions' in Charles Mitchell and William Swadling (eds), *The Restatement Third: Restitution and Unjust Enrichment* (Hart Publishing, 2014) 209, 214.

fair and straightforward (and therefore cost-effective) way.<sup>185</sup> The argument made here is reminiscent of Mummery LJ's objection to the remedial constructive trust.<sup>186</sup> However, unlike Mummery LJ's argument, this objection to the lien is not that it is inconsistent with the statutory scheme because it is 'remedial' in character. Rather, it is that awarding a lien on the basis of an unjust enrichment plaintiff's superior 'deserts' is inconsistent with the pragmatic compromise that constitutes a fundamental feature of the compulsory statutory scheme.<sup>187</sup>

Though the rateable division of losses has an undoubted moral salience,<sup>188</sup> it may nevertheless be possible to conceive of a more ethically appealing system of bankruptcy. Whether the costs of administering a more nuanced system would be prohibitive is an obvious objection, but one that need not be ventilated here.<sup>189</sup> What is important is that Dagan's proposal constitutes such a substantial departure from the basic compromise underlying the present bankruptcy law that, as he himself concedes, it could only be achieved by statutory intervention.<sup>190</sup>

#### F *Proprietary Estoppel*

A more promising argument for the lien can be made in cases of proprietary estoppel in which, adopting McFarlane's taxonomy,<sup>191</sup> the promise, representation or acquiescence relates to an interest in land. In such cases, Australian

<sup>185</sup> Calnan (n 14) 41 [1.166]. See also Anthony Duggan, 'Proprietary Remedies in Insolvency: A Comparison of the Restatement (Third) of Restitution & Unjust Enrichment with English and Commonwealth Law' (2011) 68(3) *Washington and Lee Law Review* 1229, 1246.

<sup>186</sup> *Re Polly Peck International plc [No 2]* [1998] 3 ER 812, 826–7 (Mummery LJ).

<sup>187</sup> This argument is true even if, consistently with Mokal's argument, *pari passu* distribution is actually the exception rather than the rule. This is because, as Mokal argues, where so little remains after distributions to preferred creditors, the only effect of any costly attempt to rank general creditors according to the merits of their respective claims is to ensure that none get anything: see Rizwaan Jameel Mokal, 'Priority as Pathology: The *Pari Passu* Myth' (2001) 60(3) *Cambridge Law Journal* 581, 613–14.

<sup>188</sup> See Jackson, *The Logic and Limits of Bankruptcy Law* (n 58) 30.

<sup>189</sup> Sherwin, for instance, argues that courts should ideally assess the merits of individual creditors: Sherwin, 'Why *In Re Omegas Group* Was Right' (n 172) 895, 897. Sherwin's suggestion places insufficient weight on the costs of such an endeavour.

<sup>190</sup> Dagan (n 154) 275–6.

<sup>191</sup> Ben McFarlane, *The Law of Proprietary Estoppel* (Oxford University Press, 2014) 2–11 [1.03]–[1.23].

courts appear to have largely abandoned the ‘minimum equity’<sup>192</sup> approach in favour of a default position, according to which the defendant must make good the expectation that his conduct created in the plaintiff.<sup>193</sup> If, for example, the defendant made a non-contractual promise that he will convey a fee simple interest in land to the plaintiff, on which the plaintiff relied to her detriment, the default remedy will be a declaration that the defendant holds the land on trust for the plaintiff, together with appropriate orders directing conveyance of the interest.

Despite this approach, there are circumstances in which a court will exercise its discretion and substitute a personal for a proprietary award. The exercise of this discretion will often turn on the degree to which a proprietary award will intrude upon the interests of third parties. In *Giumelli*, for instance, the High Court declined to order proprietary relief because of its effect on innocent family members who improved and resided on the disputed land. Instead, it ordered that the plaintiff be paid the value of the land, secured by a lien over it.<sup>194</sup>

In *Sidhu v Van Dyke*, the defendant, with whom the plaintiff was having a relationship, promised that he would subdivide the disputed land and gift the plaintiff one of the plots as a home in which to live and raise her child.<sup>195</sup> In reliance on this promise, the plaintiff neither pursued full-time employment nor sought a property settlement from her ex-husband.<sup>196</sup> However, the gift was never made.<sup>197</sup> In the New South Wales Court of Appeal, it was held that, in the ordinary course of events, the court would order the defendant to convey the land to the plaintiff.<sup>198</sup> However, because such an order would unduly prejudice the defendant’s wife, who was a co-owner of the undivided

<sup>192</sup> See, eg, the language in *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387, 405 (Mason CJ and Wilson J), 419 (Brennan J); *Commonwealth v Verwayen* (1990) 170 CLR 394, 416 (Mason CJ), 429–30 (Brennan J), 439 (Deane J).

<sup>193</sup> See, eg, *Sidhu v Van Dyke* (2014) 251 CLR 505, 527 [77], 530 [85] (French CJ, Kiefel, Bell and Keane JJ) (*‘Sidhu’*); *Donis v Donis* (2007) 19 VR 577, 582–3 [18]–[19] (Nettle JA) (*‘Donis’*). It is questionable whether this change in approach will make any practical difference. As Robertson has demonstrated, practical difficulties in calculating a plaintiff’s reliance loss mean that courts have long adopted the expectation measure as the default remedial position: see Andrew Robertson, ‘The Reliance Basis of Proprietary Estoppel Remedies’ (2008) 72(4) *Conveyancer and Property Lawyer* 295, 295–6.

<sup>194</sup> *Giumelli* (n 31) 125 [49]–[51] (Gleeson CJ, McHugh, Gummow and Callinan JJ). See also *Morris v Morris* [1982] 1 NSWLR 61, 63–4 (McLelland J).

<sup>195</sup> *Sidhu* (n 193) 512–15 [3]–[22] (French CJ, Kiefel, Bell and Keane JJ).

<sup>196</sup> *Ibid* 512 [8], 513 [12] (French CJ, Kiefel, Bell and Keane JJ).

<sup>197</sup> *Ibid* 514 [21] (French CJ, Kiefel, Bell and Keane JJ).

<sup>198</sup> *Van Dyke v Sidhu* (2013) 301 ALR 769, 795 [137] (Barrett JA).



lot, the appropriate order was an award of equitable compensation.<sup>199</sup> Barrett JA, with whom Basten JA and Tobias AJA agreed, held that the quantum of relief was not to be measured by the value of the detriment suffered by the plaintiff, but the value of the land promised by the defendant.<sup>200</sup> A majority of the High Court upheld this order, holding that, ‘no reason has been identified by the appellant to conclude that good conscience does not require that the appellant be held to his promises.’<sup>201</sup>

For present purposes, the relevant question is, if it is appropriate to hold the defendant to the assumed state of affairs, but propriety relief is refused, should the order to pay money be secured by a lien? The argument in favour of awarding the lien is that it is the closest approximation of the remedy the court would have granted had there been no competing third party interests. This is because, if the defendant cannot satisfy the personal award, the lien ensures that the plaintiff will at least receive the value of the land, which can then be used to purchase land which, though not identical, may be sufficiently similar to that promised to her.

This appears to be a powerful argument. Why should a fluke of circumstance, such as the domestic circumstances of some relative of the defendant, determine whether the plaintiff is either a beneficial owner or an unsecured creditor who collects a few cents in the dollar? There is, however, a flaw in this argument. That is, the reason for awarding the ‘first best’ remedy of a constructive trust in these cases is not the solvency of the defendant, but considerations of conscience that depend upon the relationship between the plaintiff and defendant. As Nettle JA remarked in *Donis v Donis*:

[T]he remedy relates to the understanding of the parties and the expectation that has been encouraged. Prima facie the estopped party can only fulfil his or her equitable obligation by making good the expectation which he or she has encouraged. The estopped party, having promised to confer a proprietary interest on the party entitled to the benefit of the estoppel, and the latter having acted upon the promise to his or her detriment, is bound in conscience to make good the expectation.<sup>202</sup>

<sup>199</sup> Ibid 795 [138]–[139] (Barrett JA).

<sup>200</sup> Ibid 795 [139]–[140] (Basten JA agreeing at 771 [1], Tobias AJA agreeing at 797 [148]).

<sup>201</sup> *Sidhu* (n 193) 530 [86] (French CJ, Kiefel, Bell and Keane JJ).

<sup>202</sup> *Donis* (n 193) 582–3 [19] (citations omitted).

Though the award of a constructive trust will have the significant benefit of insulating the plaintiff from the consequences of the defendant's insolvency, it is not the reason why the defendant should be held to his representation.

If a court determines that an order to pay money is the appropriate remedy, the question of whether that award should be secured by a lien depends upon the plaintiff's relative desert when compared to the defendant's other unsecured creditors. The problem with the 'next best remedy' argument is that it cannot distinguish a claim in proprietary estoppel, in which the plaintiff seeks an interest in land, from a claim for breach of contract, in which the promisee seeks an order for specific performance. If, in the latter case, a court declines to grant specific performance on some discretionary ground, such as its effect on a third party,<sup>203</sup> the promisee is not therefore entitled to have her award of damages secured against the promisor's assets.<sup>204</sup> That the plaintiff in estoppel seeks an interest in land is not a sound basis on which to extend her more favourable treatment.

Importantly, even if this 'next best remedy' argument were convincing, it does not justify those cases in which a 'mistaken improver's' personal claim has been secured by a lien over the improved land.<sup>205</sup> The basic position in Anglo-Australian law is captured in Bowen LJ's famous dictum:

The general principle is, beyond all question, that work and labour done or money expended by one man to preserve or benefit the property of another do not according to English law create any lien upon the property saved or benefited, nor, even if standing alone, create any obligation to repay the expenditure. Liabilities are not to be forced upon people behind their backs any more than you can confer a benefit upon a man against his will.<sup>206</sup>

If B misreads a plan of subdivision and mistakenly installs a pool in a plot of land belonging to A, A is not, without more, liable to make restitution of the

<sup>203</sup> See generally ICF Spry, *The Principles of Equitable Remedies: Specific Performance, Injunctions, Rectification and Equitable Damages* (Lawbook, 9<sup>th</sup> ed, 2014) 193–209.

<sup>204</sup> Likewise, where there are multiple creditors, the insolvency of the promisor cannot be grounds for specific performance, though an award of damages is, very obviously, inadequate: see HC Horack, 'Insolvency and Specific Performance' (1918) 31(5) *Harvard Law Review* 702, 705–6, 711.

<sup>205</sup> See, eg, *The Unity Joint Stock Mutual Banking Association v King* (1858) 25 Beav 72; 53 ER 564; *Cooper v Phibbs* (1867) LR 2 HL 149; *Cadorange Pty Ltd (in liq) v Tanga Holdings Pty Ltd* (1990) 20 NSWLR 26 ('Cadorange').

<sup>206</sup> *Falcke v Scottish Imperial Insurance Co* (1886) 34 Ch D 234, 248. See also *Lumbers v W Cook Builders Pty Ltd (in liq)* (2008) 232 CLR 635, 663 [80] (Gummow, Hayne, Crennan and Kiefel JJ).

value of the pool to B.<sup>207</sup> Respect for A's freedom of choice means that she must be able to subjectively devalue the enrichment to zero.<sup>208</sup> In order to succeed, B would need to prove that, for instance, A acquiesced in his mistake.<sup>209</sup>

Even if B could prove acquiescence, this would not justify the imposition of a lien over A's land. The tendency to award a proprietary remedy in these circumstances is attributable to the natural, though erroneous, temptation to focus on any increase in value of the defendant's land. For instance, *Snell's Equity* notes:

A particular question arises where the basic order of the court will be that A should pay B a sum of money: should A's duty to do so be secured by a charge on A's land? The courts' approach does not appear to be consistent, and there has been little discussion of the relevant principles. *If B's reliance does not consist of having increased the value of A's land, it is not obvious why B should gain the advantages over unsecured creditors of A entailed by a charge.*<sup>210</sup>

However, even if B has increased the value of A's land, why should that entitle B to priority over A's unsecured creditors? Precisely this issue arose in *Cadorange Pty Ltd v Tanga Holdings*.<sup>211</sup> Tanga expended money improving land belonging to Cadorange, a related company, in the mistaken belief that it

<sup>207</sup> For a neat illustration of this principle, see *Brand v Chris Building Co Pty Ltd* [1957] VR 625, 628–9 (Hudson J). See also *Blue Haven Enterprises Ltd v Tully* [2006] 4 LRC 658, 665 [20] (Lord Scott). For analysis, see Ben McFarlane, 'Unjust Enrichment, Rights and Value' in Donal Nolan and Andrew Robertson (eds), *Rights and Private Law* (Hart Publishing, 2012) 581, 588–90; McFarlane, *The Law of Proprietary Estoppel* (n 191) 38–9 [2.50]. Tang, on the other hand, argues that a claim in unjust enrichment should lie if the owner has been incontrovertibly benefited, and satisfaction of the claim would not require the owner to sell his land: Tang Hang Wu, 'An Unjust Enrichment Claim for the Mistaken Improver of Land' (2011) 75(1) *Conveyancer and Property Lawyer* 8. United States law appears to take a dramatically different approach, allowing the improver to either recover the value of the improvements or to purchase the improved land: see Stewart E Sterk, 'Property Rules, Liability Rules, and Uncertainty about Property Rights' (2008) 106(7) *Michigan Law Review* 1285, 1320–1.

<sup>208</sup> See Peter Birks, *An Introduction to the Law of Restitution* (Clarendon Press, 1985) 109–14. For discussion of the concept of subjective devaluation, see *Benedetti v Sawiris* [2014] AC 938, 955–62 [12]–[34] (Lord Clarke JSC, Lords Kerr and Wilson JJSC agreeing), 985–8 [110]–[119] (Lord Reed JSC).

<sup>209</sup> See *Lavery v R & I Bank of Western Australia Ltd* (Supreme Court of Western Australia — Full Court, Malcolm CJ, Franklyn and Owen JJ, 7 September 1995) (Malcolm CJ, Franklyn J and Owen J agreeing).

<sup>210</sup> Ben McFarlane, 'Estoppel' in John McGhee (ed), *Snell's Equity* (Sweet & Maxwell, 33<sup>rd</sup> ed, 2015) 299, 352 (emphasis added) (citations omitted).

<sup>211</sup> *Cadorange* (n 205).

would soon become owner of the land.<sup>212</sup> Cadorange subsequently went into liquidation.<sup>213</sup> Tanga sought, and was granted, a lien over the land securing repayment of its expenditure.<sup>214</sup> The effect of the lien was to secure Tanga's claim at the expense of Cadorange's unsecured creditors. Young J justified the imposition of the lien on the following basis:

[I]t is in this case unconscionable for the liquidator to hold onto the proceeds of sale, *including the increment caused by the claimant's efforts*, without compensating the claimant ... if there is an inter-company transaction which engenders an expectation that a contract will in due course be completed, and pursuant to that expectation a company in the group expends money on land belonging to another company in the group and then that other company goes into liquidation and the liquidator sells the land with the benefit of those improvements, it would be against the conscience of the company in liquidation to take advantage of the windfall without compensating the company which expended the money. Accordingly, in my view, an equitable lien exists.<sup>215</sup>

As the emphasised portion of this extract makes clear, Young J believed that the imposition of the lien was necessary in order to prevent the insolvent company, and by extension its unsecured creditors, from sharing in the increase in the land's value attributable to the claimant's contribution to it. The question is, should the claimant be entitled to that increase in value?

The answer is 'no'. There is no conceptual difference between a claim in 'proprietary estoppel' based on the defendant's acquiescence and a claim in unjust enrichment in which the objection from subjective devaluation is overcome by, for instance, evidence of the enrichee's free acceptance.<sup>216</sup> Whether one speaks of the 'enrichment' of the defendant or the 'detriment' suffered by the plaintiff, the quantum of the award should not reflect the increase in value of the land but the reasonable value of the plaintiff's services.

<sup>212</sup> Ibid 28–9 (Young J).

<sup>213</sup> Ibid.

<sup>214</sup> Ibid 39–40 (Young J).

<sup>215</sup> Ibid 40 (emphasis added).

<sup>216</sup> Though he does not make this particular argument, Low has also noted the connection between the concepts of free acceptance and acquiescence: see Kelvin FK Low, 'Nonfeasance in Equity' (2012) 128 (January) *Law Quarterly Review* 63, 86. It should be noted that free acceptance remains a controversial concept. As Burrows correctly argues, it proves nothing more than the enrichee's indifference to the benefit: see AS Burrows, 'Free Acceptance and the Law of Restitution' (1988) 104 (October) *Law Quarterly Review* 576, 579–80. See generally Burrows, *The Law of Restitution* (n 88) 56–9.

As Lord Scott remarked, if a locksmith unlocks a cupboard containing treasure, the owner of the cupboard will be enriched by the value of his services, and not the value of its contents.<sup>217</sup> The same applies in cases of mistaken improvements to land. The detriment suffered by the claimant is not the increase in value of an asset that it never owned, but the value of the services it provided in the mistaken belief that it did.

Because the land is not the appropriate locus of the inquiry, a lien can only be justified if there is some reason to favour the plaintiff over the defendant's other unsecured creditors.<sup>218</sup> In the case of mistaken improvement, the best argument, analogously with the mistaken payer, is the 'swollen assets' thesis. However, as was argued above,<sup>219</sup> this argument ultimately fails as a basis on which to prefer the claims of involuntary creditors.

## V CONCLUSION

The purpose of this article is not to develop a unified theory of the equitable lien, but to question whether this non-consensual security right can be justified at all. The answer offered is that, except for a limited number of instances in which it can be justified on instrumental grounds, the zero-sum nature of the lien means that it confers an unwarranted advantage on some creditors whilst imposing an undeserved burden on others.

In many instances, the utility of demonstrating a deficiency in some legal rule or institution is negated by the author's failure to propose a suitable replacement. This is not so with the equitable lien. Where the lien fails to treat like creditors alike, the answer is not to fashion a replacement remedy, but to abandon it and replace it with precisely nothing at all. Though the equitable lien is doubtless a remedy of ancient lineage,<sup>220</sup> its provenance is not, without more, a reason to preserve it. Historical explanations do not suffice as justifications. In the law of remedies, as elsewhere, whilst there is merit in being consistent, there is no merit in being consistently wrong.

<sup>217</sup> *Cobbe v Yeoman's Row Management Ltd* [2008] 1 WLR 1752, 1773 [41]. See also Robert Stevens, 'Three Enrichment Issues' in Andrew Burrows and Lord Rodger of Earlsferry (eds), *Mapping the Law: Essays in Memory of Peter Birks* (Oxford University Press, 2006) 49, 53–4.

<sup>218</sup> See McFarlane, *The Law of Proprietary Estoppel* (n 191) 429 [7.30], 462–3 [7.121]–[7.122]; Susan Bright and Ben McFarlane, 'Proprietary Estoppel and Property Rights' (2005) 64(2) *Cambridge Law Journal* 449, 474–5.

<sup>219</sup> See above Part IV(E).

<sup>220</sup> See the discussion in Burns (n 3) 4–6.