

The law in relation to constructive trusts law equity essay

Law



Introduction" English law provides no clear and all embracing definition of a constructive trust. Its boundaries have been left deliberately vague, so as not to restrict the courts by technicalities in deciding what the justice of a particular case may demand"[1]. However, a constructive trust is imposed by courts for it to be useful to a party which was unjustly dispossessed of their rights due to someone who obtained or kept legal right to property in order for him to unlawfully acquire wealth or to provoke interference. It can also be characterized as a " remedial institution which equity imposes regardless of actual or presumed agreement or intention... to preclude the retention or assertion of beneficial ownership of property to the extent that such retention or assertion would be contrary to equitable principle"[2].

CircumstancesThe first circumstance where constructive trusts are applied is where fiduciaries have breached their duty of loyalty. The scope is for a fiduciary not to have conflicts between his interests with duty, as illustrated in *Bray v Ford*[3]. From the cases of *Re Coomber*[4]and *English v Dedham Vale Properties*[5]it can be seen that fiduciary relationships are varied, with new types likely to occur occasionally. As explained in *Reading v AG*[6], this type of relationship arises when one party, the principal, delegates a job for the other, the fiduciary. Millet J described a fiduciary as " someone who has undertaken to act for or on behalf of another in a particular manner in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is... loyalty"[7]. A fiduciary will be liable as a constructive trustee in various situations. The first example is when a fiduciary receives remuneration to which he is not entitled and can be seen in the case of *Guinness v Saunders*[8]. Here an executive who

negotiated in the name of a company in a takeover auction wanted the court to pay him for his efforts. The House of Lords wondered whether the court should give such payments, especially since this could be seen as an involvement of the court in the company's administration. It could be argued that the executive had a conflict of interests, when he asked to be paid for his services. Moreover, the requested sum depended upon the amount of money that his company had to pay in the takeover process. The second example is when a fiduciary makes a transaction in his name, instead of doing so on the principal's behalf. *Keech v Sandford*[9] is the case which decided that trustees cannot profit from trusts. A trustee wanted to renew a lease for a beneficiary, but the lessor did not agree and the trustee kept the lease. The Court asked the trustee to keep the lease for the beneficiary, although there was no conflict of interests. The case of *Regal (Hastings) v Gulliver*[10] confirmed the same principle from *Keech*, but in another context - the use of the no conflict rule to company directors. Another example is when a fiduciary takes advantage of confidential information for his purpose. This is illustrated by *Boardman v Phipps*[11] where it was held that the solicitor and one of the beneficiaries were punishable as constructive trustees for making profits during the process. The defendants lost the earnings that they made from investing their money and increasing the profit of the trust. The fourth example is when a fiduciary receives a bribe. *Lister v Stubbs*[12] is the authority for the proposal that the principal has the right to state that the fiduciary keeps the illegal gain in a constructive trust for the principal only when he wants to salvage the money accepted by the fiduciary by doing a breach of fiduciary obligation. The second example

illustrates a debtor/creditor relationship between the fiduciary and the principal, instead of a trustee/beneficiary relationship. However, in *AG for Hong Kong v Reid*[13], the Privy Council held that upon accepting bribe, Reid invested it in a property in New Zealand. It was believed that Reid used a constructive trust to hold the property, therefore making it available for a proprietary claim. However, this interpretation is not flawless and a decision in an English court may not be necessarily binding. In the case of *Daraydan Holdings v Solland Interior*[14], the High Court concluded that a fiduciary who accepted an inducement became a constructive trustee and was liable for the money he had received. The separation between a personal liability to account and the obligation of a constructive trust can be important in two scenarios: if the fiduciary would become insolvent, the principal could control the other creditors of the fiduciary regarding the property included in the constructive trust, but this would not be the property which depends on a liability to account; if the property value would be increased while being under the possession of the fiduciary, the principal would be entitled to ask for the benefit of this increase, if this was to be held on constructive trust but not if there is only a personal liability to account. The second circumstance is that of unconscionable conduct. The case of *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*[15] proved to be fundamental as because of it, the court might decide that the defendant has the right of property on a constructive trust if he obtained it from the claimant in situations where he might be described as acting unconscionably. Here, the plaintiff bank gave money to the defendant local authority pursuant to an interest rate swap agreement which was nullified.

The bank asked for their money back. Lord Browne-Wilkinson wondered if the defendant placed the money on a constructive trust. The Court of Appeal in *Rochefoucauld v Boustead*[16] held that the "trust which the plaintiff has established is clearly an express trust... one which the plaintiff and defendant intended to create. The case is not one in which an equitable obligation arises although there may have been no intention to create a trust"[17]. However in recent cases, the constructive trust approach has been favorable. Such a case is *Lys v Prowsa Developments*[18] where it was held there was a constructive trust as the intention was to make an express declaration of trust. The Court decided to grant a decree of specific performance to Lys party depending on the case facts. In *Muschinski v Dodds*[19], the Court saw that a constructive trust was created. This case involved a de-facto couple living in the man's house. They made various house improvements for which the woman paid, but then the couple broke up. The High Court decided that the man had the house on constructive trust for both himself and the woman, the proportions being equal to their contributions. Thus, as the trust was not made when the improvements were made, the woman did not breach her duty. The third circumstance is the situation given by the case of *Re Rose*[20] and is a controversial type of constructive trust. Here, Mr Rose decided to transfer one set of shares to his wife and another to his wife and another woman on trust, having done the appropriate forms. The only formality was for the company to accept the transfer; however, this action was not dependent on Mr Rose. The court held that he in fact successfully transferred the fair interest in the respective shares to his wife, after the completion of all the paperwork. Thus, the

principle was that in the situations where the owner wants to transfer part of that property to another, a trust will be created which would favour the recipient after the transferor has made all the agreements that were required of him. This type of constructive trust is important as the formalities for creating a trust can be avoided if all the formalities expected from the transferor were concluded. What is more, although the classification of this type of trust is not "straightforward"[21], it has been argued that this is a constructive trust instead of an express trust as it does not require all the official procedures that would be expected for an express trust, since no title has been conferred in a trustee[22]. Mr Rose intended offer the property as a gift, meaning that the trust is made against the parties' intentions, thus being described as "a result of a constructive trust by operation of law"[23]. Consequently, it followed the labelling of this principle as an unacceptable form of dealing with property: the Court of Appeal agreed that the rights of the transferee are unreasonable if they are based on the fact that the transferor did not recognize the transfer of title in equity. The fourth circumstance is the *Pallant v Morgan*[24] position, and it is said that the principle from this case is "the basis of the constructive trust considered in this section in relation to unconscionable actions between parties to joint ventures"[25]. The case was about the two neighbours, each wanting to bid for a particular piece of land at auction. Morgan proposed that it was possible to buy the land at a cheaper price if one of them would make an offer and then they would share the property. However, they could not reach a consensus at the time of the auction. Therefore, Pallant did not make an offer based on this agreement. Morgan was able negotiate for a good price,

but did not want to share the property. Thus, Morgan was compelled to form an agreement with Pallant, where they would make a proper division. If this was not possible, Morgan was supposed to sell the property and pay half of the money to Pallant. The most important illustration of this principle took place in *Banner Homes Group Plc v Luff Development Ltd*[26]. Here, two rival building companies have reached an agreement where they would not enter in an auction against each other for land purchases. As it turns out, one of them did enter such an auction without informing the second company. The first company had made the situation worse by presuming that the second company would expect it to honour the agreement. They did not inform the second party of their intention to bypass the agreement and buy the property. It was held that the defendant kept the company shares through a constructive trust for both itself and the claimant. All the requirements for recognising the trust were fulfilled; the arrangement was made so that the claimant should not obtain the property for itself, and so any act of the defendant which did not respect the agreement would render the defendant powerless in acquiring the property for itself. The fifth circumstance refers to a disposition of trust property in a breach of trust. An example of this is the case of *Buttle v Saunders*[27] where the principle was that a trustee has to invest so that he may maintain or increase his trust assets. Another example is the case of *Re Londonderry's Settlement*[28]. This case concerned the duty of trustees to provide information to beneficiaries. The Court of Appeal held that there was no need for disclosure of reasons, because it could cause family strife, fruitless litigation or make the trustees' role impossible. It was held in the *Londonderry* case that they had the right as they were the

ultimate owners in equity of the trust property. This is wrong as beneficiaries have no rights of access to the trust property but merely rights to whatever benefits of the trust property the terms dictate. The better view is that the rights flow from the beneficiaries' right to make the trustee account for his stewardship of the trust. It has been heavily criticised and possibly doubted by *Schmidt v Rosewood Trust Ltd*[29]. Is there a unifying underlying theory? There have been numerous debates on the topic of whether resulting trusts form a single category and whether all the examples of resulting trusts are governed by the same principle. Although it has been suggested by Megarry J in *Re Vandervell's Trusts (No 2)*[30] that automatic and resulting trusts are significantly different, there have been attempts in order to clarify that all trusts have a unifying principle, an example being the necessity to put in effect the common intentions of the parties as suggested by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*[31]. Other attempts have been made to try and find a principle that would include all the circumstances of constructive trusts. An important observation was made by Cardozo J in *Beatty v Guggenheim Exploitation Co*[32] stating that " the constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee"[33]. Lord Diplock also stated that a constructive trust is created " whenever the trustee has so conducted himself that it would be inequitable to allow him to deny to the cestui que trust a beneficial interest in the land acquired"[34]. Nonetheless, statements such as these explain "

almost nothing as to when and why constructive trusts arise and certainly fail to identify some common or defining feature of constructive trusts"[35]. Firstly, to state that constructive trusts occur where " the holder of the legal title may not in good conscience retain the beneficial interest"[36]is the equivalent in saying that constructive trusts appear when justice demands them - making it awfully vague. The important question is when these courts believe that justice expects a defendant to keep a property which was conferred in him on trust for another person. Furthermore, if we would ask ourselves why it would not be fair for a defendant to retain the property for himself, there would be several reasons for us to think that justice encourages the imposition of trusts. As mentioned above, several constructive trusts have been created to stop people with malicious intents from taking advantage of the unlawful activity; some are trying to avert unfair enrichment by invalidating transfers, while others validate the responsibility of the defendant. All these trusts are required in order for justice to be made, but they also point out the differences between these cases and reasons for why trusts are imposed. Therefore, merely references to justice and fairness are not sufficient for discrimination. Another issue would be that these kinds of statements cannot distinguish between constructive, express and resulting trusts. Any trust is created because, according to the law, the rightful owner of the title should not keep the property for himself. Thus, mentioning the constructive trusts as having their roots in ethics or justice does not only fail to reveal why trusts arise, but also makes this class of trusts undistinguishable from other trust classes. This kind of statements may give the wrong impression that courts have no

restrictions in imposing trusts whenever they see fit. Although some people would support this idea, the statement itself is unclear regarding the constructive trusts and the power that the courts possess. Conclusion Despite the efforts to determine a single unifying theory behind the concept of constructive trusts, these attempts either include some (if not all) express and resulting trusts or they are ambiguous and present only differences which appear between different constructive trusts. Thus it can be seen that there is no unifying principle that could sum up all constructive trusts, instead, constructive trusts can be viewed as a "catch-all class"[37] which comprises of a variety of cases not included in the express and resulting trust categories. As a result, the right way to tackle a constructive trust is to consider other constructive trusts which are recognized by the English law and asking the following question: which facts would be needed for a trust to come into being and what would be the principles behind the law that would impose a trust based on those facts? This way, each instance of a constructive trust can only be analyzed on a case by case basis.