BEYOND THE WATERSHED:
RESTITUTION IN THE NINETIES

INTRODUCTION

1. Restitution as a subject of separate study is a modern phenomenon, although the content of the body of law that bears that name is in some cases as old as the common law itself. But although the various strands can be identified going back many years, the first systematic study of the study was provided by the first edition of Goff & Jones "The Law of Restitution" in 1966. The work immediately became authoritative, is now in a fifth edition and the most recent addition to the Common Law Library series. The current edition opens with the statement that "The law of restitution is the law relating to all claims, quasi-contractual or otherwise, which are founded upon the principle of unjust enrichment".[1]

2. The concept of unjust enrichment has come to be accepted as the unifying principle underlying the law of restitution, although the phrase itself is not used at all in some of the older cases. In a celebrated dictum in the leading older case of **Moses v. Macferlan** ,[2] for example, speaking of the action for money had and received, Lord Mansfield said that "the gist of this kind of action is, that the defendant, upon the circumstances of the case, is obliged by the ties of natural justice and equity to refund the money". Of this much cited dictum, the editor of Goff & Jones comments that "We have only to substitute 'make restitution' for the last three words of his statement to make it appropriate to the whole law of restitution."[3]

3. Lord Mansfield's dictum, although gaining general acceptance, did not escape criticism, Hamilton LJ remarking in 1913 that "whatever may have been the case 146 years ago, we are not now free in the twentieth century to administer that vague jurisprudence

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1. Goff & Jones, The Law of Restitution, (5th ed.) (1998), page 3.

2. (1760) 2 Burr. 1005, 1012.

3. Goff & Jones, op. cit, at page 13.

which is sometimes attractively styled 'justice as between man and man'".[4] Across the Atlantic, however, the publication in 1927 by the American Law Institute of the "Restatement of the Law of Restitution: Quasi contracts and Constructive Trusts" brought together for the first time the common law and equitable components of the subject and in section 1 firmly established the theoretical underpinnings of the modern law: "A person who has been unjustly enriched at the expense of another is required to make restitution to the other".[5] The restatement was soon relied on in the English appellate courts[6] and its influence and that of unjust enrichment analysis were clearly evident in the important case of **Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour Ltd.**,[7] in which Lord Wright's much cited dictum provides a convenient starting point for all modern restitution discussions:

> "My Lords, the claim in the action was to recover a prepayment of £1000 made on account of the price under a contract which had been frustrated. The claim was for money paid for a consideration which had failed. It is clear that any civilized system of law is bound to provide remedies for cases of what has been called unjust enrichment or unjust benefit, that is to prevent a man from retaining the money of or some benefit derived from another which it is against conscience that he should keep. Such remedies are generically different from remedies in contract or in tort, and are now recognized to fall within a third category of the common law which has been called quasi-contract or restitution."[8]

4. Nevertheless, Lord Diplock was still able to comment in 1978 in **Orapko Manson Investments Ltd.**[9] that "there is no general doctrine of unjust enrichment recognised in English law. What it does is to provide specific remedies in particular cases of what might be classified as unjust enrichment in a legal system that is based upon the civil law". This,

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4. Baylis v. Bishop of London [1913] 1 ch. 127, 140; the reference is to another dictum of Lord Mansfield in Sadler v. Evans (1766) 4 Burr. 1984, 1986.

5. See "Casebook on Restitution", by Gerard McMeel, Blackstone Press (1996), page 11.

6. See, for example, United Australia Ltd. v. Barclays Bank Ltd. [1941] AC 1.

7. [1943] AC 32

8. ibid, page 61; see also per Viscount Simon LC at pages 46 - 47

9. [1978] AC 95

notwithstanding the revolutionary impact that the first and subsequent editions of Goff & Jones, "a truly magisterial account of English precedent,"[10] was having on the subject. It is against this background that I come to "the watershed" of my title, that is, the landmark decision of the House of Lords in 1991 in **Lipkin Gorman (a firm) v. Karpnale Ltd. and another**,[11] up to that point the most far-reaching decision on the subject in the twentieth century and certainly one of the three or perhaps four most important decisions of the decade.

THE PRIMACY OF UNJUST ENRICHMENT

5. In **Lipkin Gorman** a man whose name was Cass, a partner in a firm of solicitors, was a compulsive gambler and a thief. He stole a considerable sum of money (£223,000) from his firm's clients' account and gambled most of it away at the licensed casino of the Playboy Club. After paying back some of his winnings into the clients' account, the net loss to the firm was £154,695 and the issue in the case was whether the firm was entitled to recover that amount from the Playboy Club. A strong and unanimous House of Lords (Lords, Bridge, Templeman, Griffiths, Ackner and Goff) held that it was, Lord Templeman (who delivered one of the two leading judgments) expressly relying on Lord Wright's famous dictum in the **Fibrosa case**.[12] The basis of the decision that the casino was obliged to return the firm's net loss to it was that the casino was unjustly enriched by having received it. The decision is therefore an express acknowledgement in the modern law of "unjust enrichment as the organising principle underlying causes of action in restitution."[13] In his usual plain and direct style, Lord Templeman described the outcome that the facts of the case dictated in this way:[14]

"When Cass lost and paid £154,695 to the club as a result of gaming

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10. McMeel, op. cit., page 22

11. [1992] 4 All ER 512

12. ibid at page 517

13. McMeel, op. cit., at page 19

14. [1992] 4 All ER 512, 522

> contracts, he made to the club a completed gift of £154,695. The club received stolen money by way of gift from the thief; the club, being a volunteer, has been unjustly enriched at the expense of the solicitors from whom the money had been stolen and the club must reimburse the solicitors".

Lord Goff, who delivered the other leading judgment, stated the following:[15]

> "I accept that the solicitors' claim in the present case is founded upon the unjust enrichment of the club, and can only succeed if, in accordance with the principles of the law of restitution, the club were indeed unjustly enriched at the expense of the solicitors. The claim for money had and received is not, as I have previously mentioned, founded upon any wrong committed by the club against the solicitors. But it does not, in my opinion, follow that the court has carte blanche to reject the solicitors' claim simply because it thinks it unfair or unjust in the circumstances to grant recovery. The recovery of money in restitution is not, as a general rule, a matter of discretion for the court. A claim to recover money at common law is made as a matter of right; and even though the underlying principle of recovery is the principle of unjust enrichment, nevertheless, where recovery is denied, it is denied on the basis of legal principle".

6. **Lipkin Gorman** also broke new ground in its acceptance of the defence of "Change of position" as being available to a claim to restitution based on unjust agreement and I will return to this aspect of the matter at paragraph 46 below. In the subsequent case of **Woolwich Building Society v. Inland Revenue Commissioners** (No. 2)[16] the sweep and scope of the **Lipkin Gorman** principle was confirmed (though, curiously, the case while cited in argument is not referred to at all in the judgments of their Lordships[17]). The Revenue issued a demand under the Income Tax (Building Societies) Regulations 1986 to the plaintiff building society for payment of tax amounting to nearly £57 million on interest and dividends paid to investors over a particular six month period. The plaintiff disputed the validity of the regulations, but paid the amount of the assessment while at the same time instituting proceedings by way of judicial review. When these proceedings were concluded in the plaintiff's favour, at first instance, the Crown repaid the capital sum with interest from

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15. ibid at page 532

16. [1992] 3 All ER 737

17. See [1993] AC 70, 73

the date of the decision, pending an appeal. When the Crown's appeal was ultimately dismissed, the plaintiff continued with its action for recovery of interest on the capital sum from the dates on which payments had been made (the amount of the assessment had been paid by the plaintiff in three instalments). It was held in the House of Lords that money paid by a subject to a public authority in the form of taxes or other levies pursuant to an ultra vires demand by the authority was prima facie recoverable forthwith by the subject as of right at common law together with interest thereon, regardless of the circumstances in which the tax was paid, since common justice required that any tax or duty paid by the citizen pursuant to an unlawful demand be repaid, unless special circumstances or some principle of policy required otherwise. It followed that when the plaintiff paid the amount under the ultra vires regulations it immediately acquired a right to be repaid the amount so paid and was entitled to interest on the payments from the date they were made.

7. The majority decision in the case[18] involved reinstating the authority of 2 nineteenth century judgments[19] and applying dicta of Atkin LJ and Dixon CJ:[20] Lord Goff stated that "the central question in the present case is whether your Lordships' House, deriving their inspiration from the example of those two great judges, should rekindle that fading flame and reformulate the law in accordance with that principle." His Lordship concluded that the House could and should do so. As the judgment of Lord Browne-Wilkinson demonstrates, the decision rested squarely on the principle of unjust enrichment:

> "Although as yet there is in English law no general rule giving the plaintiff a right of recovery from a defendant who has been unjustly enriched at the plaintiff's expense, the concept of unjust enrichment lies at the heart of all the individual instances in which the law does give a right of recovery."[21]

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18. Lords Keith and Jauncey dissented

19. Steele v. Williams (1853) 8 Exch 625, 155 ER 1502 and Hooper v. Exeter Corp (1887) 56 LJ QB 457

20. In A-G v. Wilts United Dairies Ltd. (1921) 37 TLR 884, 887 and Mason v New South Wales (1959) 102 CLR 108, 117

21 [1992] 3 All ER 737, 780

His Lordship went on to cite Lord Wright's dictum in the **Fibrosa** case with approval and to describe the facts in the instant case as "the paradigm of a case of unjust enrichment."[22]

8. In Lord Slynn's view, it would have been "quite unacceptable in principle that the common law should have no remedy for a taxpayer who has paid large sums or any sum of money to the Revenue when those sums have been demanded pursuant to an invalid regulation and retained free of interest pending a decision of the courts."[23]

9. This case consolidates the authority of **Lipkin Gorman** as a watershed in the law of restitution: unjust enrichment is the underlying principle which provides the touchstone against which all restitutionary claims may be assessed. While it is true that many, perhaps most, restitutionary claims have to do with the recovery of money - whether paid under mistakes of fact, law[24] or generally under ineffective transactions such as void or frustrated contracts - the modern law recognises the recoverability of other benefits conferred by reason of, for instance, undue influence or duress. The remedies of subrogation, rectification and rescission have also been treated as aspects of the law of restitution. The decisions in **Lipkin Gorman** and **Woolwich** in fact presaged a decade of extraordinary activity in the courts on the subject in all its variety and more than occasional complexity and I hope that the survey which follows captures in some small way the vibrancy of this area of the law that is even now (perhaps even moreso), after the watershed, still in an extended phase of development and growth.

UNDUE INFLUENCE

9. It is settled law that a person who has been induced to enter into a transaction by the undue influence of another (the wrongdoer) is entitled to set aside that transaction as against the wrongdoer. Such undue influence is either actual or presumed.[25]. In **Bank of Credit**

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22. [1992] 3 All ER 737, 780

23. ibid, at page 787

24. see paragraph 33, infra

25. see [1993] 4 All ER 417, per Lord Browne-Wilkinson at page 423

and Commerce International SA v. Aboody.[26] the Court of Appeal adopted the following classification, which the House of Lords subsequently approved in the leading case of **Barclays Bank plc v O'Brien**:[27]

"*Class 1*: *actual undue influence*. In these cases it is necessary for the claimant to prove affirmatively that the wrongdoer exerted undue influence on the complainant to enter into the particular transaction which is impugned.

Class 2: presumed undue influence. In these cases the complainant only has to show, in the first instance, that there was a relationship of trust and confidence between the complainant and the wrongdoer of such a nature that it is fair to presume that the wrongdoer abused that relationship in procuring the complainant to enter into the impugned transaction. In class 2 cases therefore there is no need to produce evidence that actual undue influence was exerted in relation to the particular transaction impugned: once a confidential relationship has been proved, the burden then shifts to the wrongdoer to prove that the complainant entered into the impugned transaction freely, for example by showing that the complainant had independent advice. Such a confidential relationship can be established in two ways, viz:

Class 2A. Certain relationships (for example solicitor and client, medical advisor and patient) as a matter of law raise the presumption that undue influence has been exercised.

Class 2B. Even if there is no relationship falling within class 2A, if the complainant proves the de facto existence of a relationship under which the complainant generally reposed trust and confidence in the wrongdoer, the existence of such relationship raises the presumption of undue influence. In a class 2B case therefore, in the absence of evidence disproving undue influence, the complainant will succeed in setting aside the impugned transaction merely by proof that the complainant reposed trust and confidence in the wrongdoer without having to prove that the complainant exerted actual undue influence or otherwise abused such trust and confidence in relation to the particular transaction impugned."

10. In the **Barclays Bank** case, Lord Browne-Wilkinson expressly recognised a "special tenderness of treatment"[28] to wives as being applicable in this area as a result in part of the fact that "the sexual and emotional ties between the parties provide a ready weapon for undue

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26. [1992] 4 All ER 955, 964

27. [1993] 4 All ER 417, 423

28. ibid at page 424

influence."[29] For his part, his Lordship was prepared to accept that the risk of undue influence affecting a voluntary disposition by a wife in favour of a husband is greater than in the ordinary run of cases where no sexual or emotional ties affect the free exercise of the individual's will.[30] His Lordship was also prepared to extend the same considerations to all other cases in which there is "an emotional relationship between cohabitees ... whether heterosexual or homosexual".[31] In relation to the guarantee by one cohabitee of the debts of the other, his conclusion was as follows:[32]

"I can therefore summarise my views as follows. Where one cohabitee has entered into an obligation to stand as surety for the debts of the other cohabitee and the creditor is aware that they are cohabitees: (1) the surety obligation will be valid and enforceable by the creditor unless the suretyship was procured by the undue influence, misrepresentation or other legal wrong of the principal debtor; (2) if there has been undue influence, misrepresentation or other legal wrong by the principal debtor, unless the creditor has taken reasonable steps to satisfy himself that the surety entered into the obligation freely and in knowledge of the true facts, the creditor will be unable to enforce the surety obligation because he will be fixed with constructive notice of the surety's right to set aside the transaction; (3) unless there are special exceptional circumstances, a creditor will have taken such reasonable steps to avoid being fixed with constructive notice if the creditor warns the surety (at a meeting not attended by the principal debtor) of the amount of her potential liability and of the risks involved and advises the surety to take independent legal advice.

I should make it clear that in referring to the husband's debts I include the debts of a company in which the husband (but not the wife) has a direct financial interest.

The decision of this case

Applying those principles to this case, to the knowledge of the bank Mr and Mrs O'Brien were man and wife. The bank took a surety obligation from Mrs O'Brien, secured on the matrimonial home, to secure the debts of a company in which Mr O'Brien was interested but in which Mrs O'Brien had no direct pecuniary interest. The bank should therefore have been put on inquiry as to the circumstances in which Mrs O'Brien had agreed to stand as surety for the debt of her husband. If the Burnham branch had properly carried out the instructions from Mr Tucker of the Woolwich branch, Mrs O'Brien would have been informed that she and the matrimonial home were potentially liable for the debts of a

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29. ibid

30 ibid

31. ibid at page 431

32. ibid at pages 431 - 432

company which had an existing liability of £107,000 and which was to be afforded an overdraft facility of £135,000. If she had been told this, it would have counteracted Mr O'Brien's misrepresentation that the liability was limited to £60,000 and would last for only three weeks. In addition according to the side letter she would have been recommended to take independent legal advice.

Unfortunately Mr Tucker's instructions were not followed and to the knowledge of the bank (through the clerk at the Burnham branch) Mrs O'Brien signed the documents without any warning of the risks or any recommendation to take legal advice. In the circumstances the bank (having failed to take reasonable steps) is fixed with constructive notice of the wrongful misrepresentation made by Mr O'Brien to Mrs O'Brien. Mrs O'Brien is therefore entitled as against the bank to set aside the legal charge on the matrimonial home securing her husband's liability to the bank.

For these reasons I would dismiss the appeal with costs."

11. In **CIBC Mortgages plc v. Pitt,**[33] in a judgment delivered immediately after the **Barclays Bank** judgment, the House of Lords went on to hold that, in a case where actual undue influence was proved, there was no requirement on the claimant to go on to prove "manifest disadvantage"to the claimant, as would be required in a case of presumed undue influence. As Lord Browne-Wilkinson observed:[34]

> "Actual undue influence is a species of fraud. Like any other victim of fraud, a person who has been induced by undue influence to carry out a transaction which he did not freely and knowingly enter into is entitled to have that transaction set aside as of right".

However, the House of Lords refused to set aside the transaction vis-á-vis the plaintiff bank in this case since, although the wife had established actual undue influence by her husband, the plaintiff had no actual or constructive notice of it and there was nothing to indicate that the loan was anything other than a normal advance to a husband and wife for their joint benefit.[35]

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33. [1993] 4 All ER 433

34. ibid at page 439

35. ibid at page 441

12. **Barclays Bank and CIBC Mortgages** are the two leading cases of the decade in this area. However, there have been many variations on the central theme that they describe, perhaps reflecting, as Lord Browne-Wilkinson observed in the former case "the rapid changes in social attitudes and the distribution of wealth which have recently occurred."[36] **Cheese v. Thomas**[37] is an unusual case, turning on a relationship other than man and wife. In 1990 the plaintiff, who was then 86 years of age, and the defendant, who was his great nephew, agreed to buy a house for £83,000 for the purpose of providing a home for the plaintiff for the rest of his life. The plaintiff contributed £43,000 to the purchase price and the defendant contributed £40,000 by means of a building society mortgage. The house was purchased in the defendant's sole name and it was agreed that the plaintiff would live there until his death and it would thereafter belong to the defendant. The defendant failed to keep up the mortgage payments and the plaintiff, who felt that his security was threatened, sought repayment of the £43,000 and brought proceedings against the defendant claiming, inter alia, that the transaction should be set aside on the ground of undue influence. At first instance, it was held that the transaction was manifestly disadvantageous to the plaintiff and the judge ordered that the house be sold and the proceeds of sale divided between the parties in the same proportions in which they had contributed to the purchase price before the building society mortgage was repaid. The house, which had suffered a deep decline in value, was in fact sold at a loss for £55,000.00. The plaintiff appealed from the judge's order, contending that he was entitled to have restored to him the benefits he had passed to the defendants under the impugned transaction regardless of the fall in value of the property. He wished, in other words, a return to him of the full sum of £43,000 that he had contributed. The defendant on the other hand cross-appealed from the finding that the transaction was manifestly disadvantageous to the plaintiff. The Court of Appeal dismissed both appeals, holding that when a court ordered restitution, its basic objective was to restore the parties, as closely as possible, to their original positions, consequent upon cancelling a transaction which the law would not permit to stand. Justice required that each party should be returned as near to his original position as was possible and that the defendant should not be required

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36. [1993] 4 All ER 417, 422

37. [1994] 1 All ER 35

to shoulder the whole of the loss brought about by the fall in the market value. It followed that each party should get back a proportionate share of the net proceeds of the house and the judge had accordingly correctly decided the proportions in which the proceeds should be divided. On the other hand, the transaction was clearly disadvantageous to the plaintiff, so the cross-appeal was also dismissed.

13. Sir Donald Nicholls V-C (as he then was), who delivered the judgment of the Court of Appeal, described the case as "a most unfortunate case ... which ought never to have seen the door of a court."[38] The court clearly had a difficulty working its way through how to achieve restitution in circumstances in which the transaction (which it found to be manifestly disadvantageous to the plaintiff[39]) had to be set aside and the parties restored as closely as possible to their original positions. Given the dramatic fall in value of the house, the crucial question, therefore, was who should bear the loss: the judge held, and the Court of Appeal agreed, that the parties should bear the loss equally. The learned Vice-Chancellor summarised the position in this way:[40]

> "The basic objective of the court is to restore the parties to their original positions, as nearly as may be, consequent upon cancelling a transaction which the law will not permit to stand. That is the basic objective. Achieving a practically just outcome in that regard requires the court to look at all the circumstances, while keeping the basic objective firmly in mind. In carrying out this exercise the court is, of necessity, exercising a measure of discretion in the sense that it is determining what are the requirements of practical justice in the particular case.
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> What is true of profits must also be true of losses. In the ordinary way, when a sum of money is paid to a defendant under a transaction which is set aside, the defendant will be required to repay the whole sum. There may be exceptional cases where that would be unjust. This may the more readily be so where the personal conduct of the defendant was not open to criticism. Here, having heard the parties give evidence, the judge acquitted Mr Thomas of acting in a morally reprehensible way towards Mr Cheese. He described Mr Thomas as an innocent fiduciary. Here also, and I return to this feature because on any view it was an integral element of the

38. ibid at page 37

39. ibid at pages 38 - 39

40. ibid at pages 42 - 43

transaction, each party applied money in buying the house. In all the circumstances, to require Mr Thomas to shoulder the whole of the loss flowing from the problems which have beset the residential property market for the last year or two would be harsh. That is not an outcome a court of conscience should countenance."

14. **TSB Bank plc v. Camfield and another**[41] was a straightforward application of the **Barclays Bank** principle, the Court of Appeal holding that where a wife was induced to execute a charge over the matrimonial home to meet the husband's debts by his innocent misrepresentation that the liability under the charge would not exceed a specified amount, whereas the charge in fact provided security for an unlimited liability, and the creditor was fixed with constructive notice of the husband's misrepresentation because it had failed to take reasonable steps to ensure that the wife understood the charge, the charge would be set aside in its entirety and could not be partially set aside or set aside on terms that it was a valid security for the specified amount for which the wife thought she was at risk. Since, on the evidence, the wife would not have entered into the charge if she had known its true nature and since her ignorance in this regard resulted from the bank's failure to take reasonable steps to see that she was properly advised, the charge was set aside in its entirety. The judgment of Roch LJ demonstrates the truly restitutionary nature of the remedy:[42]

"Mrs. Camfield is entitled to be placed in the position she would have been in had the misrepresentation not been made and had she been made aware of the true nature of the legal charge.

This conclusion is not one which need strike terror into the hearts of banks and other lenders, for they can avoid a situation where their legal charge is liable to be rescinded by taking the simple steps indicated in O'Brien's case: in other words, by following good banking practice."

15. On the other side of the line, **Banco Exterior International SA v Thomas**[43] is an example of a case in which the presumption of undue influence was held to have been

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41. [1995] 1 All ER 951

42 ibid at page 961

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rebutted on the evidence. In that case, a lady living in straitened financial circumstances, agreed to a suggestion from a gentleman, who was a close personal friend, that he would pay her a regular income if she would guarantee his borrowing and provide her house as security for an expansion of his business.

His bank, in accordance with its standard practice, required her to obtain legal advice, which she did, and she in due course executed a guarantee and a legal charge whereby she guaranteed her friend's indebtedness to a limit of £75,000 and charged her home as security for that indebtedness. In order to complete the transaction, the deeds to the property had to be obtained from the lady's former solicitor, who advised her strongly against it and informed the bank of his views by telephone. He also advised the bank by letter that, despite his strong advice to the contrary, the lady had decided to proceed. The debt turned bad and the bank commenced action against the lady which, after her death, was defended by her executors on the ground that the transaction should be set aside because of undue influence. The Court of Appeal held that it was no part of the bank's business to enquire into the lady's personal affairs, but merely to ensure that she knew what she was doing and wanted to do it, having received independent legal advice about the nature and effect of the transaction. This had been done, in addition to which the lady had received strong advice from her own former solicitor, in the face of which she went ahead with the transaction. Accordingly, the bank did not have constructive notice of any undue influence and any such presumption had been rebutted. Judgment was therefore given for the bank.

16. The duty of a bank to an intended surety with regard to independent legal advice came in for careful scrutiny in the Court of Appeal in the case of **Credit Lyonnais Bank Nederland NV v Burch**[44]. In that case a junior employee of a company was asked by the major shareholder, her boss, to provide security to a bank for an increased overdraft to the company, by giving a second charge over her flat and an unlimited "all moneys" guarantee. She signed the mortgage document in the presence of her boss at the office of the bank's solicitors, but she was at no time informed by him or the bank of the extent either of the

44. [1997] 1 All ER 144

company's present indebtedness or of the overdraft facility being granted. The bank's solicitors did write to her pointing out that the guarantee was unlimited both in time and amount and advising her to seek independent legal advice before entering into the transaction, but she did not do so. The company later went into liquidation and, in proceedings seeking possession of the employee's flat, the bank contended that it had discharged its duty to her by urging her to seek independent legal advice and that it was not responsible for the consequences of her choosing not to do so.

17. Both the trial judge and the Court of Appeal held that the transaction had to be set aside, applying the **Barclays Bank** decision. The transaction was so manifestly disadvantageous to the defendant, in that without knowing the extent of the indebtedness involved she had committed herself to a liability far beyond her means and risked the loss of her home and personal bankruptcy to help a company in which she had no financial interest and of which she was only a junior employee, that the presumption of undue influence on the part of her boss was irresistible. The bank had not taken reasonable steps to avoid being fixed with constructive notice of that undue influence, since neither the potential extent of her liability had been explained to her nor had she received independent advice. It was not sufficient for the bank's solicitors to tell her that the guarantee was unlimited since without being informed of the amount of the company's indebtedness to the bank or the extent of the overdraft facility being granted she was in no position to assess the significance of the guarantee being unlimited. Nor was it sufficient for the bank's solicitors to advise her to seek independent legal advice since, in the circumstances, the bank was required to ensure that she obtained independent advice. The bank was aware that the relationship between the parties was that of employer and employee and should have been aware that it was capable of developing into a relationship of trust and confidence with the attendant risk of abuse. The fact that the employee chose not to seek legal advice should have alerted the bank to the possibility that she was in fact acting under the undue influence of her boss.

18. Millett LJ (as he then was) described the transaction as one which "cannot possibly stand" and which, "in the traditional phrase 'shocks the conscience of the court'".[45] His Lordship went on to point out that where, as in this case, there is a relationship like that of employer and junior employee which is easily capable of developing into a relationship of trust and confidence, the nature of the transaction may be sufficient to justify the inference that such a development has taken place. And, "where the transaction is so extravagantly improvident that it is virtually inexplicable on any other basis, the inference will be readily drawn."[46] As to legal advice, his Lordship pointed out that "It is not a panacea" and went on to make some important statements of principle, the profound effect of which is difficult to convey by abridgement and which are therefore set out in full:[47]

> "I think that there has been some misunderstanding of the role which the obtaining of independent legal advice plays in these cases.
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> It is first necessary to consider the position as between the complainant and the alleged wrongdoer. The alleged wrongdoer may seek to rebut the presumption that the transaction was obtained by undue influence by showing that the complainant had the benefit of independent legal advice before entering into it. It is well established that in such a case the court will examine the advice which was actually given. It is not sufficient that the solicitor has satisfied himself that the complainant understands the legal effect of the transaction and intends to enter into it. That may be a protection against mistake or misrepresentation; it is no protection against undue influence. As Lord Eldon LC said in *Huguenin v Baseley* (1807) 14 Ves 273 at 300, [1803-13] All ER Rep 1 at 13: "The question is, not, whether she knew what she was doing, had done, or proposed to do, but how the intention was produced."
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> Accordingly, the presumption cannot be rebutted by evidence that the complainant understood what she was doing and intended to do it. The alleged wrongdoer can rebut the presumption only by showing that the complainant was either free from any undue influence on his part or had been placed, by the receipt of independent advice, in an equivalent position. That involves showing that she was advised as to the propriety of the transaction

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45. ibid, at page 152

46. ibid at page 155

47. ibid at pages 156-7

by an adviser fully informed of all the material facts (see *Powell v Powell, Brusewitz v Brown, Permanent Trustee Co of New South Wales Ltd v Bridgewater* [1936] 3 All ER 501 at 507 and *Bester v Perpetual Trustee Co Ltd* [1970] 3 NSWLR 30 at 35-36.

Some of those cases were concerned with the equity to set aside a harsh and unconscionable bargain rather than one obtained by the exercise of undue influence, but the role of the independent adviser, while not identical, is not dissimilar. The solicitor may not be concerned to protect the complainant against herself, but he is concerned to protect her from the influence of the wrongdoer. The cases show that it is not sufficient that she should have received independent advice unless she has acted on that advice. If this were not so, the same influence that produced her desire to enter into the transaction would cause her to disregard any advice not to do so. They also show that the solicitor must not be content to satisfy himself that his client understands the transaction and wishes to carry it out. His duty is to satisfy himself that the transaction is one which his client could sensibly enter into if free from improper influence; and if he is not so satisfied to advise her not to enter into it, and to refuse to act further for her if she persists. He must advise his client that she is under no obligation to enter into the transaction at all and, if she still wishes to do so, that she is not necessarily bound to accept the terms of any document which has been put before her but (where this is appropriate) that he should ascertain on her behalf whether less onerous terms might be obtained.

It is next necessary to consider the position of the third party who has been put on enquiry of the possible existence of some impropriety and who wishes to avoid being fixed with constructive notice. One means of doing so is to ensure that the complainant obtained competent and independent legal advice before entering into the transaction. If she does so, and enters into the transaction nonetheless, the third party will usually escape the consequences of notice. This is because he is normally entitled to assume that the solicitor has discharged his duty and that the complainant has followed his advice. But he cannot make any such assumption if he knows or ought to know that it is false."

19. **Dunbar Bank plc v Nadeem**[48] restates and applies the rule that a person who can prove the exercise of actual undue influence by another is entitled to have the transaction set aside without proof of manifest disadvantage,[49] but that such proof is required where the

48. [1998] 3 All ER 876

49. CIBC Mortgages plc v. Pitt, supra

exercise of undue influence is only presumed.[50] In this case, another husband and wife case, it was held that the conduct of the husband was not unconscionable and that such influence as he had exercised "was not undue".[51] The judgment of Morritt LJ contains some important observations, albeit obiter in the light of the outcome of the case, on the obligation of a party seeking rescission to make restitution of any advantage derived from the transaction.[52]

20. In **Royal Bank of Scotland plc v. Etridge (No 2) and other appeals**[53] the Court of Appeal delivered a single judgment in eight conjoined appeals all having to do with the role of undue influence in cases involving husbands and wives and financial institutions. The Court, after a full review of the relevant principles, laid down a set of propositions "quasi-legislative style",[54] to be applied in such cases:

> Where a bank seeks to enforce its security against a wife who claims to have been induced by her husband's undue influence or misrepresentation to charge the matrimonial home by way of security, the following principles apply in determining whether the bank is able to rely on the fact that the wife received legal advice before entering into the charge to rebut the presumption of undue influence and imputed or constructive notice thereof and whether the bank ought to have been put on inquiry to ascertain whether the wife was subject to her husband's undue influence.
>
> (1) Where the wife deals with the bank through a solicitor, whether acting for her alone or for her husband, the bank is ordinarily not put on inquiry and is not required to take any steps at all. Instead the bank is entitled to assume that the solicitor has considered whether there is sufficient conflict of interest to make it necessary for him to advise her to obtain independent legal advice and it is not necessary for the bank to ask the solicitor to carry out his professional obligation to give proper advice to the wife or to confirm that he has done so.

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50. Bank of Credit & Commerce v Aboody, supra

51. [1998] 4 All ER 876, per Millett LJ at page 884

52. ibid, at page 887

53. [1998] 4 All ER 705

54. [1998] All ER Annual Review 404

(2) Where the wife does not approach the bank through a solicitor, it is normally sufficient if the bank has urged her to obtain independent legal advice before entering into the transaction, especially if the solicitor provides confirmation that he has explained the transaction to the wife and that she appeared to understand it.

(3) When giving advice to the wife the solicitor is acting exclusively as her solicitor, regardless of whether he is unconnected with the husband or the wife or acts as the husband's solicitor or has agreed to act in a ministerial capacity as the bank's agent at completion. The bank is entitled to expect the solicitor to regard himself as owing a duty to the wife alone when giving her advice regardless of who introduced the solicitor to the wife and asked him to advise her or who is responsible for his fees. If the solicitor accepts the bank's instructions to advise the wife, he stills acts as her solicitor and not the bank's solicitor when he interviews her.

(4) The bank is not fixed with imputed notice of what the solicitor learns in the course of advising the wife even if he is also the bank's solicitor, since such knowledge is not acquired by him in his capacity as the bank's solicitor.

(5) The bank is entitled to reply on the fact that the solicitor undertook the task of explaining the transaction to the wife as showing that he considered himself to be sufficiently independent for this purpose and it is not required to question the solicitor's independence, even if it knows that he is also the husband's solicitor.

(6) The bank is under no obligation to question the sufficiency of the solicitor's advice, and is not put on further inquiry by the fact that the solicitor was asked only to explain the transaction to the wife and ensure that she understood it and was not asked to see that she was sufficiently independent of her husband. Nor is the bank put on inquiry by the fact that the confirmation provided by the solicitor is similarly limited.

(7) No importance should be attached to the fact that the solicitor has not provided the bank with full or adequate confirmation that he has followed his instructions. Where the Bank has asked a solicitor to explain the transaction to the wife and he fails to confirm that he has done so, the bank is not entitled to assume that he has. At most the bank is then put on inquiry whether the solicitor has explained the transaction and takes the risk that he has not done so if it fails to make further inquiry; but if he has in fact advised the wife; the bank is then not affected by its failure to obtain confirmation from him to take effect.

(8) When advising the wife, the solicitor obviously owes her a duty of care and may also owe the bank a corresponding duty of care

notwithstanding that he is not also acting for the bank, since although in many respects the wife and the bank have conflicting interests they have a common interest in ensuring that the wife does not enter into the transaction without informed consent and free from the undue influence of her husband.

(9) Although the bank is normally entitled to assume that a solicitor who is asked to advise the wife will discharge his duties fully and competently and will not restrict himself to giving an explanation of the transaction and satisfying himself that she appears to understand it, the bank cannot make any such assumption if it knows or ought to know that it is false. If the bank is in possession of material information which is not available to the solicitor, or if the transaction is such that no competent solicitor could properly advise the wife to enter into it, the fact that the wife has been advised by the solicitor will not prevent the bank from being fixed with constructive notice.

(10) The test is ultimately whether at the time value is given and in the light of all the information in the bank's possession, including its knowledge of the state of the account, the parties' relationship and the availability of legal advice to the wife, there was still a risk that the wife entered into the transaction as the result of her husband's undue influence or misrepresentation.

21. It has been suggested that this restatement of the relevant principles ought to be understood "as imposing a code of conduct on the particular kind of transaction in which the value of family assets, above all the matrimonial home, [has been] released into the cut-throat world of business."[55]

22. Finally on this aspect of my survey, **Barclays Bank plc v Boulter and another**[56] was, as Lord Hoffman observed, "an unusual appeal to come before your Lordships' House",[57] raising as it did a point of pleading. In that case, the wife's pleading did not expressly say that the bank had actual or constructive notice of the misrepresentation and undue influence, though it did allege facts which, according to the **Barclays Bank** case, could, if known to the bank, give rise to constructive notice. The bank maintained that the

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55. ibid

56. [1999] 4 All ER 573

57. ibid at page 515

pleading was insufficient to permit the wife to rely on the constructive notice point. Lord Hoffman dealt with the matter as follows:

> "Ordinarily, I would regard such a pleading as inadequate. I certainly do not think that the mere fact that a reference to a fact is tucked away in some pleaded document to which the bank was a party should normally, without any express reference to that fact, be capable of being taken as an allegation that the bank had notice of that fact. The purpose of the pleadings is to define the issues and give the other party fair notice of the case which he has to meet. Concealed and referential allegations do not perform this function. But the circumstances of this case were exceptional in that it had been made quite clear at the earlier hearing that Mrs Boulter would be relying on constructive notice. In view of what Lord Browne-Wilkinson had said in *Barclays Bank plc v O'Brien* about the difficulties facing an allegation of agency such as was pleaded in para 7 of Mrs Boulter's defence, the bank cannot seriously have thought that Mrs Boulter was abandoning the defence of constructive notice. It was in practical terms her only defence. So the pleading point was, against that background, technical in the highest degree. The Bank knew perfectly well what case it had to meet. Its counsel made it clear that whether or not the pleadings were amended, he was ready to deal with the question of constructive notice and would not require the trial to be adjourned.
>
> Equally, it may be said, counsel for Mrs Boulter had only to make a formal amendment to satisfy the judge's ruling. Why were both sides reluctant simply to proceed to try the case on its merits? The reason is the effect which an amendment might have had upon costs. Mr Coney was concerned that even if he succeeded upon his amended defence, the bank might ask that Mrs Boulter pay all the costs up to date of the amendment, on the ground that she had succeeded upon a new point. The judge expressed doubt about whether this would be the case, but the point was not argued and Mr Sullivan for the bank said nothing to reassure Mr Coney. So both sides took their stand upon the formal rules of pleading. In my view, reading the pleadings against the background known to the parties and having regard to their purpose, no amendment was required."

RESTITUTIONARY CLAIMS AND ILLEGAL CONTRACTS

23. In 1993 I had concluded a paper on matrimonial property disputes,[58] delivered in this forum, with a reference to the decision of the Court of Appeal in **Tinsley v Milligan**,[59] commenting that it demonstrated the continued relevance of the established principles "in the growing area of property disputes between unmarried couples". The case had, of course, an additional unusual feature in that the parties were Miss Tinsley and Miss Milligan. It was in fact destined for the House of Lords and provided in the end an important decision on the impact of illegality on restitutionary claims.[60] The parties bought a house together. They took out a mortgage and the balance of the purchase money was provided by them in equal shares. However, the title to the house was transferred into the sole name of Miss Tinsley, so that Miss Milligan could represent to the Department of Social Security that she had no stake in the house or in the business which the parties ran from it and was therefore eligible for benefits. After a time, they quarrelled and Miss Tinsley moved out. She then gave Miss Milligan notice to quit and subsequently claimed possession of, and asserted ownership to, the house. Miss Milligan counterclaimed for an order for sale, and a declaration that the property was held by Miss Tinsley upon trust for the two of them in equal shares. The House of Lords, by a bare majority, allowed the counterclaim and granted the declaration, thus rejecting the submission (which the minority accepted) that Miss Milligan should be denied relief because she did not come to equity with clean hands and consequently was precluded from asserting that she enjoyed an equitable interest in the property. The basis of the decision was that where property interests were acquired as a result of an illegal transaction a party to the illegality could recover by virtue of a legal or equitable policy interest if, but only if, she could establish her title without relying on her own illegality, even if it emerged that the title on which she relied was acquired in the course of carrying through an illegal transaction. Lord Browne-Wilkinson concluded as follows:[61]

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58. "The Resolution of matrimonial property disputes: an overview", delivered April 2, 1993

59. [1992] 2 All ER 291

60. [1993] 3 All ER 65

61. ibid at page 91

> "The respondent established a resulting trust by showing that she had contributed to the purchase price of the house and that there was a common understanding between her and the appellant that they owned the house equally. She had no need to allege or prove why the house was conveyed into the name of the appellant alone, since that fact was irrelevant to her claim: it was enough to show that the house was in fact vested in the appellant alone. The illegality only emerged at all because the appellant sought to raise it. Having proved these facts, the respondent had raised a presumption of resulting trust. There was no evidence to rebut that presumption."

24. In **Tribe v Tribe**,[62] the Court of Appeal was able to find for the plaintiff even though he had transferred, for a consideration which was never paid, shares in a private company into the name of the defendant, his son, thereby giving rise to the presumption of advancement (cf. **Tinsley v Milligan**). It was held that a transferor for an illegal purpose was nevertheless entitled to withdraw from the transaction before any part of the illegal purpose had been carried into effect and, having done so, give evidence of the illegality in order to rebut the presumption and recover the property as an exception to the general principle that no court would lend its aid to one who founded his action on an illegal act. On the facts, it was clear that the plaintiff was able to rebut the presumption of advancement by clear evidence of his intentions and, since he had not in fact defrauded any creditor, he could recover the shares.

INTEREST RATE SWAPS

25. Much judicial time was spent in the decade under review on the litigation that arose as a sequel to the decision of the House of Lords in **Hazell v. Hammersmith & Fulham London Borough Council and others.**[63] That case decided that a local authority had no power to enter into "interest rate swap" transactions and that the many such transactions which had in fact been entered into were accordingly void. In the 1980's there appeared in the world of international finance a new "swap" market, comprising interest rate swaps, currency swaps and asset swaps. The swap market assisted traders and other men of business

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62. [1995] 4 All ER 236

63. [1991] 1 All ER 545

"to solve financial problems arising out of variations in interest rates and currency exchange rates, different taxation regimes and rates of inflation and different creditworthiness."[64] The transactions in the swap market impugned in the **Hazell** case were not carried out in order to enable local authorities to borrow or to enable them to choose to borrow at a fixed rate rather than a variable rate or vice versa. Rather, the transactions were undertaken in the hope that the burden of interest payable in respect of borrowings by local authorities would be mitigated by profits from swap contracts whereby the authorities successfully forecast movements in interest rates. If an authority swapped from a fixed interest rate to a variable interest rate, it gained if, after the swap, interest rates went down, but lost if interest rates rose. Similarly, if the authority swapped from variable interest to fixed interest it gained if, after the swap, rates went up and lost if they went down.[65] A swap was, in essence, a wager and the simplest form of a swap contract may be described as follows:[66]

> "an agreement between two parties by which each agrees to pay the other on a specified date or dates an amount calculated by reference to the interest which would have accrued over a given period on the same notional principal sum assuming different rates of interest are payable in each case. For example, one rate may be fixed at 10% and the other rate may be equivalent to the six-month London Inter-Bank Offered Rate (LIBOR). If the LIBOR rate over the period of the swap is higher than 10% then the party agreeing to receive "interest" in accordance with LIBOR will receive more than the party entitled to receive the 10%. Normally neither party will in fact pay the sums which it has agreed to pay over the period of the swap but instead will make a settlement on a "net payment basis" under which the party owing the greater amount on any day simply pays the difference between the two amounts due to the other."

26. Swaps, though highly speculative, were enormously popular, particularly with "rate capped" local authorities. Once they were declared by the House of Lords to be ultra vires and void, a raft of litigation followed to allocate losses and gains. Restitution was the name of the game and it gave rise in particular to two of the most important decisions of the

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64. ibid, per Lord Templeman at page 549

65. See the account of Lord Templeman at page 550

66. See [1990] 3 All ER 33, 63

decade. The first was **Westdeutsche Landesbank Girozentrale v Islington London Borough Council,**[67] a case in which the plaintiff bank had entered into a 10 year interest rate swap agreement with the defendant local authority commencing on June 18, 1987. The interest payments, which were payable half-yearly, were calculated on a notional principal sum of £25 million by reference to the difference between the fixed rate of interest (payable by the bank) and the floating London Inter-Bank Offered Rate ("LIBOR"), (payable by the local authority). Additionally, the bank agreed to pay the local authority a lump sum of £2.5 million on the commencement date as the first of the fixed rate payments. By June 1989 the local authority had made four payments to the bank under the swap agreement, totalling £1,354,474. As a result of the decision in the **Hazell** case that interest rate swaps were ultra vires, the bank brought an action against the local authority claiming inter alia repayment of £1,145,525 being the amount of the initial lump sum payment of £2.5 million, less payments made by the local authority, and interest from April 1, 1987. The judge held that the bank was entitled to recover the principal plus compound interest and the issue on appeal to the House of Lords was whether the award of compound interest was sustainable.

27. It was held that it was not, as in the absence of agreement or custom the court had no jurisdiction to award compound interest either at law or by statute[68] and therefore, in a common law action for money had and received, the bank was entitled to recover only simple interest. Moreover, in the absence of fraud, courts of equity had never awarded compound interest except against a trustee or other person owing fiduciary duties in cases where the award was in lieu of an account of profits improperly made by the trustee. The local authority, as a recipient of money under a contract subsequently found to be void for mistake or as being ultra vires, did not hold the money under a resulting trust, and there was no other basis on which it could be regarded as owing fiduciary duties to the bank in relation to the upfront payment of £2.5 million.

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67. [1996] 2 All ER 961

68. In England, the power to award interest is now to be found in section 35A of the Supreme Court Act 1981, which is the successor to the Law Reform (Miscellaneous Provisions) Act 1934

28. It was also held (by a majority) that a claim for money had and received under an ultra vires contract was a personal action based on the total failure of consideration; it was not based on an implied contract or on an equitable proprietary claim. Notwithstanding the strength of the bank's moral claim to receive full restitution, it would not be appropriate to develop the law by awarding compound interest on the ground that equity could act in aid of the common law. It followed that the bank was entitled only to simple interest on the principal sum from June 18, 1987.

29. The case is of interest for several reasons. Firstly, it overruled the longstanding authority of **Sinclair v Brougham**,[69] by holding that "a claimant for moneys paid under an ultra vires, and therefore void, contract has a personal action at law to recover the moneys paid as on a total failure of consideration; he will not have an equitable proprietary claim which gives him either rights against third parties or priority in an insolvency; nor will he have a personal claim in equity, since the recipient is not a trustee."[70] Secondly, it emphasises that restitution in a case such as this is based not on any "equitable proprietary claim" but on "a principle of justice, being designed to prevent the unjust enrichment of the defendant."[71] And thirdly, Lord Browne-Wilkinson issued a salutary warning "against the wholesale importation into commercial law of equitable principles inconsistent with the certainty and speed which are essential requirements for the orderly conduct of business affairs."[72]

30. The four leading judgments in this case, two in dissent, are all of exceptional quality and deserve to be - and no doubt will be - read whenever any aspect of their subject matter comes up for consideration in the future.

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69. [1914] AC 398 (described by Lord Browne-Wilkinson as "a bewildering authority" - [1996] 2 All ER 961, 966)

70. [1996] 2 All ER 961, 966, per Lord Browne-Wilkinson

71. ibid at page 980, per Lord Browne-Wilkinson

72. ibid at p. 987

31. The **Westdeutsche** case was a case of an "open" swap, that is, a case in which the period prescribed in the agreement had not expired by the time the courts had declared its invalidity. **Guinness Mahon & Co. Ltd. v. Kensington & Chelsea Royal London Borough Council** [73] was a case of a "closed" swap, that is, a case in which, by the time of the declaration of invalidity, the swap agreement had in fact been fully performed. The local authority had borrowed £5 million from a building society for five years at an interest rate of 11.625% per annum. Over the same period, the local authority agreed with the bank that at the expiration of each successive period of 6 months the bank would pay to the local authority sums equal to the interest payments to be made by it to the bank for that period and it would pay to the bank interest at a floating rate on a notional loan of £5 million for the same period. Thus, if the prescribed floating rate was less than 11.625%, the local authority would receive from the bank more than it paid and vice versa. In this case, the 5 year period of the agreement ended in late 1987, by which date, when all the swaps had been effected, the local authority had received from the bank some £384,409 more than it had paid: in other words, on this swap, the local authority had wagered successfully.

32. The bank brought this action to recover the amount "overpaid" and the Court of Appeal held that they were entitled to succeed: there was no principle which could justify a distinction between an open and a closed swap. In both cases, any money paid had been paid pursuant to a contract which was void ab initio and was therefore recoverable as a payment made for a consideration that had wholly failed. Morritt LJ summarised his reasons in the following propositions:[74]

> "(1) A contract which is ultra vires one of the parties to it is and always has been devoid of any legal contractual effect.
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> (2) Payments made in purported performance thereof are necessarily made for a consideration which has totally failed and are therefore recoverable as money had and received ...

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73. [1998] 2 All ER 272

74. ibid at pages 284 - 285

(3) A party to an apparent swap contract which is void because ultra vires one party is entitled so to recover the amount by which what he paid exceeds what he received whether or not the apparent contract has been completely performed for there is a total failure of consideration whether it is regarded as entire or severable.

(4) The fact that the swap contract, though ultra vires and void, has been fully performed does not constitute a defence or bar to the recovery of the net payment as money had and received for the recipient had no more right to receive or retain the payment at the conclusion of the contract than he did before.

(5) Proposition (1) is not disputed. Propositions (2) and (3) are established by the decision of the Court of Appeal in the Westdeutsche case and supported by dicta in the House of Lords in the same case. Proposition (4) is inherent in that decision and those dicta and is a necessary corollary of the principle of ultra vires and the purpose for which it exists".

33. At paragraph 26 above, I had referred to the interest rate swap fiasco, as it ultimately turned out to be, as providing the basis for two of the great cases of the decade. The **Westdeutsche** case was the first. The second was, of course, that other landmark, the decision of the House of Lords in **Kleinwort Benson Ltd. v Lincoln County Council and other appeals**[75]. This was a decision with regard to four separate cases in which the appellant bank sought recovery of moneys paid under closed swaps subsequently declared to be invalid. In addition to the swaps being closed, the actions were brought outside of the normal 6 years limitation period for the recover of money paid under a mistake and the bank therefore sought to rely on section 32(1)(c) of the Limitation Act 1980 (UK), which provided that where an action was for relief from the consequences of a mistake "the period of limitation shall not begin to run until the plaintiff has discovered the ... mistake ... or could with reasonable diligence have discovered it."[76] In this case, as the argument for the bank ran, given the history of the interest rate swap litigation, the "mistake" was only discovered upon the decision in the **Hazell** case in 1991, within the limitation period, and the action was therefore maintainable. But it was patent that that was a mistake of law, as to which the old

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75. [1998] 4 All ER 513

76. ibid at page 524

rule in **Bilbie v Lumley**[77] had on a long line of authority been held to preclude recovery of money paid under a mistake of law, though money paid under a mistake of fact had always been recoverable.[78] The mistake of law rule, though entrenched, had come under increasing criticism and the latest edition of Goff & Jones, under the rubric "The Future", summarised the position as it then appeared to be:[79]

> As long ago as 1948 the Privy Council held that the common law rule that money paid under mistake of law was irrecoverable was overridden by the clear language of the Indian Contract Act. More and more common law jurisdictions have enacted legislation which provides that relief shall not be denied simply because the mistake was one of law rather than fact. The Supreme Court of Canada now accepts that the "distinction between mistake of fact and law should play no part in the [common] law of restitution". The High Court of Australia has reached a similar conclusion, as have the Appellate Division of the Supreme Court of South Africa and the Inner House of the Court of Session. The Supreme Court of Israel rejected the distinction between mistakes of fact and law in 1969.
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> Neither Parliament nor the House of Lords has yet said that the rule that *ignorantia juris non excusat* is no longer part of English law. It is true that there are dicta of their Lordships in *Woolwich Building Society v. Inland Revenue Commissioners* that money paid under a mistake of law, in pursuance to a demand from a public authority, is recoverable. And, as significantly, in *FMC plc v. Intervention Board of Agricultural Produce* the European Court of Justice has held, in a decision binding on English courts, that a "rule of national law, by virtue of which a sum paid to a public authority under a mistake of law may be recovered only if it was paid under protest manifestly fails to satisfy" the conditions that it "may not be less favourable than those governing similar domestic actions and may in no circumstances be so framed as to render virtually impossible or excessively difficult the exercise of rights conferred by Community Law ..." It remains to be seen whether this decision will be limited to claims for the recovery of money from a public authority, or whether it will be interpreted to mean that the *ignorantia juris* rule manifestly conflicts with the rights conferred by Community Law, whatever the context of the plaintiff's claim.

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77. (1802) 2 East 469

78. See Goff & Jones, op. cit, chapters 4 and 5

79. ibid, pages 236 - 239

The English Law Commission and Commonwealth Law Commissions unite in their condemnation of the non-recovery rule. In its Report, *Restitution: Mistakes of Law and Ultra Vires Public Authority Receipts and Payments,* the English Law Commission proposes the enactment of a Bill which includes this central provision:

> "2. The classification of a mistake as a mistake of law or as a mistake of fact shall not of itself be material to the determination of a mistake claim; and no such claim shall be denied on the ground that the alleged mistake is a mistake of law".

As the High Court of Australia recognised in *David Securities Pty. Ltd v. Commonwealth Bank of Australia*, there are defences to a restitutionary claim grounded on mistake of law even if a rule comparable to clause 2 of the Law Commission's Bill one day becomes law. Indeed, it may be necessary to recognise defences which are unique to a claim based on mistake of law. For example, in many jurisdictions where a mistake of law is no bar to recovery, a restitutionary claim will fail if payment has been made pursuant to a statutory provision subsequently repealed. Similarly, it should fail if made in reliance on a judicial decision subsequently overruled in independent litigation. It is unlikely that an English court will conclude that the payer was mistaken on such facts. The declaratory theory of judicial law-making is surely dead. But, to remove uncertainty, the English Law Commission proposes in its draft Bill that

> "3. (1) An act done in accordance with a settled view of the law shall not be regarded as founding a mistake claim by reason only that a subsequent decision of a court or tribunal departs from that view.
>
> (2) A view of the law may be regarded for the purposes of this section as having been settled at any time notwithstanding that it was not held unanimously or had not been the subject of a decision by a court of tribunal."

It is to be hoped that an English court will never be tempted to follow the example of the South African courts and deny recovery if the payer is "inexcusably slack". Such a test is open to a number of objections: it is hopelessly vague; gross negligence does not bar a claim grounded on mistake of fact; and the good faith recipient's interest in the stability of his receipt should be adequately protected by a generous application of the defence of change of position.

34. In **Kleinwort Benson v. Lincoln County Council** the House of Lords held that the moment had arrived, deciding that:

(1) The mistake of law rule should no longer form part of English law since a blanket rule of non-recovery, irrespective of the justice of the case, could not sensibly survive in a rubric of the law of restitution based on the principle of unjust enrichment coupled with the defence of change of position. The law should now recognise that there was a general right to recover money paid under a mistake, whether of fact or law, subject to the defences available in the law of restitution such as the defence of change of position, which had to be proved in fact if the payee was to justify the retention of money which would otherwise be repayable on the ground that the payee had been unjustly enriched.

(2) There was no principle of English law that payments made under a settled understanding of the law which was subsequently departed from by judicial decision were not recoverable in restitution on the ground of mistake of law. The fact that payment was made under a settled understanding of the law was not a proper defence to a claim for restitution and the contrary view was based on the incorrect theory that a payment made on such a basis was not made under a mistake at all. When money was paid under a view of the law later proved to be erroneous the money was paid over under a mistake of law since the payer believed when he made payment that he was bound to do so, and if subsequently it appeared on the law held to be applicable at the date of payment that he was not bound to do so he was entitled to recover the amount paid.

(3) It was no defence to a claim for restitution of money paid or property transferred under a mistake of law that the defendant honestly believed, when he learnt of the payment or transfer, that he was entitled to retain the money or property. Such a defence was too wide and would exclude the right of recovery in a very large proportion of cases including eg where the mistake was shared by both parties. If the right to recover money paid under a mistake of law on the ground of unjust enrichment was recognised by the common law it would be an error immediately to recognise so wide a defence which would effectively nullify that right. The proper course was to identify particular sets of circumstances which, as a matter of principle or policy, led to the conclusion that recovery should not be allowed.

(4) There was no principle of English law that money paid under a void contract was not recoverable on the ground of mistake of law because the contract was fully performed. In the case of interest rate swap transactions which were closed and had subsequently been declared to be ultra vires it would be wrong for the ultra vires transaction to be made binding on the local authority merely on the ground that it had been completed, since to do so would be to give effect to a contract which public

policy had declared void.

(5) Section 32(1)(c) of the Act applied in the case of an action for recovery of money paid under a mistake of law. The effect of s 32(1)(c) was that where the provision applied the cause of action might be extended for an indefinite period to time. Since the banks had paid the money in question to the local authorities under a mistake of law and since s 32(1)(c) applied to all mistakes, whether of fact or law, it followed that the facts pleaded by the bank disclosed a cause of action in mistake and should not be struck out.

Per Lord Goff of Chieveley. The law as declared by a judge is the law applicable not only at the date of his decision but is retrospectively applicable at the date of the events which are the subject of the case before him and of the events of other similar cases which may thereafter come before the courts even though the events in question occurred before the judge's decision. The situation may be different where the law is subject to legislative change, which takes effect from the moment it becomes law and is only retrospective in effect to the extent that the legislative instrument specifically provides. Judicial development of the law should not in that respect be placed on the same footing as legislative change.

35. Lord Goff's dazzling judgment in the case has received widespread approbation, Lord Browne-Wilkinson, who dissented in the result, if not on the law, describing it as "yet another major contribution to the law of restitution."[80] Lord Hoffman's tribute in the same case was unusually fulsome:[81]

"My Lords, it is no mere form of words to say that I have had the privilege of reading in draft the speech of my noble and learned friend Lord Goff of Chieveley. It is, if I may be allowed respectfully to say so, one of the most distinguished of his luminous contributions to this branch of the law".

36. The main issue which separated the minority[82] from the rest was whether abolition

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80. [1998] 4 All ER 513, 517

81. ibid at page 552

82. Lords Browne-Wilkinson and Lloyd

of the mistake of law rule, which all of their Lordships were agreed was desirable, should be left to the legislature, and Lord Browne-Wilkinson's powerful dissent emphasised the following:[83]

> "... if, at the date of payment, the law was settled by clear judicial authority, then a payment in accordance with such law was not made under a mistake of law even if the law has subsequently been changed by later judicial decision"

37. In **Nurdin v Peacock**[84] (not a swaps case) the effect of the decision in the **Kleinwort Benson** case was described by Neubeger J as "far-reaching"[85]. Though, as that learned judge observed, "the law has now been placed on a far more attractive basis by the House of Lords ... it is perhaps inevitable that this important and, if I may say so, welcome change in the law will result in fresh questions to be resolved".[86]

38. **Kleinwort Benson Ltd. v. Glasgow County Council**[87], is an interesting discussion in the House of Lords on choice of law (between England and Scotland) in a swaps case, which need not detain us (save to observe that Lord Goff was as active in this as in all other aspects of the judicial debate of the nineties).

SUBROGATION

39. The doctrine of subrogation is well known in the context of the law of insurance: an insurer is said to be subrogated to the rights of the insured to recover against a culpable third party as a result of its having paid the insured's losses pursuant to the policy. In insurance contracts, it is often said to arise from the express or implied agreement of the parties and

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83. ibid at page 521

84. [1999] 1 All ER 941

85. ibid, at page 954

86. ibid, at page 955

87. [1997] 4 All ER 641

this has been stated to apply as well in a number of different situations.[88] In **Boscaven v. Bajwa**[89], a building society had agreed to make an advance on mortgage to a purchaser of property and paid the money to the solicitors acting for them and the purchaser to hold on behalf of the building society until paid over against a first legal charge on the property. The solicitors paid it over to the vendor's solicitors to hold to their order pending completion, but the latter used the money in advance of completion to pay off the vendor's mortgage to another building society. In fact, completion never took place: the vendor failed to convey to the purchaser and the building society whose money had been advanced obtained no legal charge or other security. It claimed to be subrogated to the rights of the building society whose mortgage had been paid off. It is clear that there was no common intention that the vendor, whose mortgage had been paid off, should grant any security to the paying building society. So that, as Millett LJ pointed out,[90] "the factual context in which the claim to subrogation arises is a novel one which does not appear to have arisen before but the justice of its claim cannot be denied".

40. In **Banque Financiére de la Cité v Parc (Battersea) Ltd and others**[91], Lord Hoffman described Millett LJ's judgment in the **Boscaven** case as "a valuable and illuminating analysis of the remedy of subrogation."[92] It was held that although questions of intention might be relevant to the question of whether or not enrichment had been unjust, it was a mistake to regard the availability of subrogation as a remedy to prevent unjust enrichment as turning entirely on intention, whether common or unilateral. As Lord Hoffman commented:[93]

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88. See, for instance, Orakpo v. Manson Investments Ltd. [1977] 3 All ER 1, 20, per Lord Keith. See also Lord Napier & Ettrick v Hunter [1993] AC 713

89. [1995] 4 All ER 769

90. ibid at page 782

91. [1998] 1 All ER 737

92. ibid at page 746

93. ibid at page 747

> "Such an analysis has inevitably to be propped up by presumptions which can verge upon outright fictions, more appropriate to a less developed legal system than we now have. I would venture to suggest that the reason why intention has played so prominent a part in the earlier cases is because of the influence of cases on contractual subrogation. But I think it should be recognised that one is here concerned with a restitutionary remedy and that the appropriate questions are therefore, first, whether the defendant would be enriched at the plaintiff's expense; secondly whether such enrichment would be unjust and thirdly, whether there are nevertheless reasons of policy for denying a remedy. An example of a case which failed on the third ground is *Orakpo v Manson Investments Ltd* [1977] 3 All ER 1, [1978] AC 95, in which it was considered that restitution would be contrary to the terms and policy of the Moneylenders Acts."

41. The House of Lords accordingly allowed the appeal of a bank whose funds had been used (without security) to repay part of a second loan from another bank, and held that the paying bank was entitled to be subrogated to the rights of the paid bank under its charge to the extent that its money had been used to repay the debt secured by that charge. To do otherwise would have been to permit the debtor to be unjustly enriched at the expense of the paying bank. The case is of importance in its recognition of subrogation as essentially a remedy (despite traditional reference to it as a right[94]) and its location by Lord Hoffman "squarely within the law of unjust enrichment".[95] The following passage from Lord Clyde's brief judgment puts it equally well:

> "My Lords, the basis for the appellants' claim is to be found in the principle of unjust enrichment, a principle more fully expressed in the Latin formulation, nemo debet locupletari aliena jactura. The principle is equitable in the sense that it seeks to secure a fair and just determination of the rights of the parties concerned in the case. But it is not a principle which is entirely discretionary in its application so as to enable a court in any case to withhold a remedy where all the necessary elements for its satisfaction have been established, although there may be circumstances where on grounds which may be described as grounds of public policy a remedy may be refused. Without attempting any comprehensive analysis, it seems to me that the principle requires at least that the plaintiff should have sustained a loss

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94. See per Millett LJ in Boscaven - "Subrogation is a remedy, not a cause of action", [1995] 4 All ER 769, 777, and per Lord Hoffman in Banque at page 749

95. All ER Annual Review 1998 411

through the provision of something for the benefit of some other person with no intention of making a gift, that the defendant should have received some form of enrichment, and that the enrichment has come about because of the loss. The loss may be an expenditure which has not met with the expected return. The remedy may vary with the circumstances of the case, the object being to effect a fair and just balance between the rights and interests of the parties concerned. The obligation to provide the remedy does not rest on any contractual basis but on the general principle of the common law and it may find its expression in a variety of circumstances."

RECTIFICATION

42. In **Commission for the New Towns v Cooper (GB) Ltd**[96] the Court of Appeal held that the remedy of rectification could be granted on the basis of unconscionable conduct in circumstances where one of the parties to a contract intended the other to be mistaken as to the terms of this agreement and diverted his attention from discovering the mistake by false and misleading statements, with the result that he in fact made the very mistake intended, notwithstanding that the former did not actually know but merely suspected that the latter was mistaken and that it could not be shown that the mistake was induced by any misrepresentation. In these circumstances, equity required that the contract be rectified on the basis of the defendant's unconscionable conduct. The defendant's conduct, as Stuart-Smith LJ observed,[97] "is unconscionable and he cannot insist on performance in accordance with the strict letter of the contract".

SOME CASES IN WHICH THE REMEDY WAS NOT GRANTED

43. In **CTN Cash & Carry Ltd. v Gallaher Ltd.**[98] the plaintiff paid a bill to the defendant at its insistence, despite the plaintiff not accepting its liability to pay. It was in fact paid after the defendant made it clear that, unless it was paid, the plaintiff's credit facilities would be withdrawn. The plaintiff sued to recover the amount of the payment, on the ground that it had been paid under duress, namely the threat to stop its credit facilities in future

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96. [1995] 2 All ER 929

97. ibid at page 946

98. [1994] 4 All ER 714

dealings. The Court of Appeal rejected the claim, holding that although in certain circumstances a threat to perform a lawful act coupled with a demand for payment might amount to economic duress, it would be difficult, though not necessarily impossible, to maintain such a claim in the context of arms' length commercial dealings between two trading companies, especially where the party making the threat bona fide believed that its demand was valid. Any extension of the categories of duress to encompass 'lawful acts duress' in a commercial contract in pursuit of a bona fide claim would be a radical move with far-reaching implications. As Steyn LJ observed,[99] "Outside the field of protected relationships, and in a purely commercial contract, it might be a relatively rare case in which 'lawful act duress' can be established". Sir Donald Nicholls V-C agreed, though he did "confess to being a little troubled at the outcome."[100]

44. In **Halifax Building Society v Thomas and another**,[101] a mortgagor obtained a 100% mortgage advance from a building society to finance the purchase of a flat, having made fraudulent misrepresentations as to his identity and creditworthiness (he called himself by the name of an acquaintance and gave that person's earnings as his own). He soon fell into arrears and, in the course of proceedings to realise its security, the building society discovered his true identity. It proceeded with the sale, recouped what was due to it, realised a surplus of £10,500 and commenced the instant proceedings for a declaration that it was entitled to retain the surplus for its own use and benefit. The claim failed, the Court of Appeal holding that the law does not afford a restitutionary remedy to a secured creditor, such as the building society, which had elected not to avoid the mortgage but to affirm it and had successfully exercised its powers of sale. The wrongdoing of the mortgagor in this case did not translate into his unjust enrichment at the expense of the building society, whose rights against him were purely contractual.

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99 ibid at page 719

100. ibid

101. [1998] 4 All ER 673

45. In **Portman Building Society v Hamlyn Taylor Neck** (a firm)[102], a building society claimed to recover from a firm of solicitors a payment made to it under the mistaken belief that the property being acquired from the mortgage proceeds was to be used for residential purposes only. After the firm had paid over the funds to the vendor and after the mortgagor had defaulted on his payments, the society discovered that the premises were in fact being used as a guest house and brought these proceedings against the firm to recover the mortgage moneys as having been paid under a mistake of fact. The Court of Appeal held that the claim failed: although mistake might make it unjust for a defendant who had been enriched at the plaintiff's expense to retain the benefit of his enrichment, the mere fact that a payment was made by mistake was not itself sufficient to justify a restitutionary remedy if the recipient had not been enriched at all. Moreover, the obligation to make restitution had to flow from the ineffectiveness under which the money was paid and not from any mistake or misrepresentation which induced it: in the instant case, the firm had in fact applied the funds in accordance with the building society's instructions, that is, to pay the vendor in exchange for the purchaser's mortgage in favour of the society and it had accordingly not been enriched at all by the payment to it.

DEFENCES

46. The **Lipkin Gorman** case established for the first time that it is a good defence to a claim for restitution based on the unjust enrichment of the defendant for the defendant to show that he has changed his position in good faith in circumstances that would make it inequitable for him to be called upon to make restitution, or alternatively full restitution. However, the mere fact that the defendant has spent the money, in whole or in part, does not of itself render it inequitable that he should be called upon to repay, as the expenditure might have in any event been incurred by him in the ordinary course of things. Both the examples given by Lord Goff[103] are of the payee of moneys paid under a mistake of fact or by a thief giving the money, or part of it, in good faith to charity and, although his Lordship expressly refrained from saying anything "to inhibit the development of the defence on a case by case

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102. [1998] 4 All ER 202

103. [1992] 4 All ER 512, 533

basis, in the usual way,"[104] the very examples he allowed himself suggest that the availability of the defence may require special facts.

47. In **Kleinwort Benson Ltd. v Birmingham County Council**[105], the Court of Appeal considered the defence of "passing on" (or "windfall gain"). This is a defence which has been raised in Canada, Australia and the United States in the context of claims for overpaid tax. In such cases the defence has been raised when the plaintiff taxpayer has passed on the burden of the tax to his own customers and he will be under no obligation to reimburse them if he succeeds in recovering the tax which he has paid. In such a case, it can be said that restitution to him of the overpaid tax will result in a windfall gain for him, "or conversely, that the benefit to the taxing authority even if it is properly regarded as 'unjust enrichment' has not been at the taxpayer's expense"[106] The Court held that the defence was not available to the local authority in this swaps case, whose obligation was to repay the amount received which it was unjust that it should keep, without reference to any "hedging" arrangements which the bank may have made to eliminate or minimise its overall losses on the transaction.

RESTITUTION IN THE NINETIES - THE UNFINISHED AGENDA

48. I have already pointed out that in the **Westdeutsche** case, the House of Lords rejected an "equitable proprietary claim"as the basis for a claim in restitution.[107] However, Lord Browne-Wilkinson did not seem hostile to the concept of the "remedial constructive trust" developed in the United States and Canada as a means by which the court, by way of remedy, imposes a constructive trust on a defendant who knowingly retains property of which the plaintiff has been unjustly deprived. However, his Lordship left this, as a "satisfactory road forward ..., to be decided in some future case when the point is directly in issue".[108] In **Re**

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104. ibid at page 534; see also per Lord Bridge at page 516

105. [1996] 4 All ER 733

106. ibid at pages 738-9, per Evans LJ

107. see para. 29, supra

108. [1996] 2 All ER 961, 999

Goldcorp Exchange Ltd. (in receivership)[109], Lord Mustill in the Privy Council had commented on the analogous "remedial restitutionary right" that although they "may prove in the future to be a valuable instrument of justice they cannot in their Lordships' opinion be brought to bear on the present case"[110]. Most recently, however, in **Re Polly Peck International plc (in administration) (No 2)**[111], the Court of Appeal firmly rejected the availability of a remedial constructive trust in insolvency proceedings which would have the effect of amending or modifying the statutory scheme applicable on an insolvency. The logic of the court's position would, indeed, apply even outside of insolvency to deny the possibility of a remedial constructive trust in English law: interfering with priorities in insolvency is, after all, merely one form of interfering with vested rights.[112] The restitution editors of the All ER Annual Review for 1998 conclude that despite the dicta of Lord Browne-Wilkinson in the **Westdeutsche** case, "the Court of Appeal's exposure of its true nature must surely mean that it will never be admitted, neither as a means of restitution for moneys nor as a species of restitutionary response to unjust enrichment."[113] Time only will tell.

49. With regard to damages for breach of contract, the general rule is that they are compensatory, not restitutionary, "that is to say, they are measured by the loss of the plaintiff and not by the gain to the defendant."[114] In the case of **Attorney-General v Blake**,[114] Lord Woolf MR suggested that the traditional view that this rule admits of no exceptions "may not long survive"[115], endorsing the earlier view of Lord Bingham MR in **Jaggard v Sawyer**[116]

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109. [1994] 2 All ER 806

110. ibid at pages 826 - 7

111. [1998] 3 All ER 812

112. see All ER Annual Review 1998 416

113. ibid

114. Attorney-General v Blake [1998] 1 All ER 833, 844 per Lord Woolf MR

115. ibid

116. [1995] 2 All ER 189, 202

that the judgments in **Surrey County Council v Bredero Homes Ltd.**[117] (in which the court refused to countenance the possibility of awarding restitutionary damages for breach of contract) might "not be the last word on the subject". In Lord Woolf's view, "If the court is unable to award restitutionary damages for breach of contract, then the law of contract is seriously defective ... the law is now sufficiently mature to recognise a restitutionary claim for profits made from a breach of contract in appropriate circumstances."[118] The Court of Appeal concluded that restitutionary damages should be available in exceptional cases. Again, time only will tell.

CONCLUSION

50. There remains, of course, material that has not been covered in this already overlong survey. **Attorney-General for Hong Kong v Reid**,[119] for instance, is an important decision in the Privy Council in which it was held that a fiduciary acting dishonestly and criminally who accepts a bribe and thereby causes loss and damage to his principal must also be a constructive trustee and must not be allowed by any means to make a profit from his wrongdoing. Although cast in the language of trusts, this is equally a response in the language of restitution. **Goss v Chilcolt**,[120] Another decision in the Privy Council confirms that the old requirement of total failure of consideration has now been reinterpreted to mean that the plaintiff cannot obtain restitution without giving up, or giving credit for, any benefit which he has received in exchange: there cannot be restitution without counter-restitution And there are others.[121]

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117. ([1992] 3 All ER 705

118. [1995] 1 All ER 833, 845

119. [1994] 1 AC 324

120. [1997] 2 All ER 110

121. See, for instance, Lloyds Bank plc v Independent Insurance Co. Ltd. [1999] 1 All ER (Comm) 8 and Tang Man Sit (deceased) v Capacious Investments Ltd. [1996] 1 All ER 193 on the question of election

51. The judicial energy demonstrated by all the decisions of the last decade has been fuelled by the monumental work of at least two great judges at the height of their powers. I am referring, of course, to Lords Goff and Browne-Wilkinson, who, even when on opposite sides of a decision, have paraded a magesterial command of the subject matter. Lord Goff, in particular, has been expressly conscious of the greater freedom of a supreme court "to mould, and remould, the authorities to ensure that practical justice is done within a framework of principle."[122] In the years ahead, the decisions in the nineties clearly foreshadow the accession to judicial leadership in the area of restitution by Lords Woolf, Bingham, Nicholls, Slynn, Hoffman and Millett. In our courts, the authority of **Lipkin Gorman** was expressly accepted by Paul Harrison J (as he then was) in **Dextra Bank & Trust Co. v Bank of Jamaica**[123] and it is to be hoped that restitution, a powerful tool against injustice in a variety of circumstances, will see further developments in this jurisdiction in the future.

52. Finally, while I was preparing this paper, it was brought to my attention that the late Mr. Justice Courtenay Orr had delivered a paper at a seminar for judges on the weekend of February 25 - 27 this year entitled "Restitution, not damages; recent developments and cases". It was, as would have been expected from him, learned and thorough. I wish to dedicate this paper, with affection and humility, to his memory.

C. DENNIS MORRISON
June 16, 2000

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122. [1996] 2 All ER 961, 966 (the Westdeutsche case)

123. CL 1993/D046, judgment delivered October 16, 1997, pages 64 - 5