

CASE NOTES

WESTDEUTSCHE LANDESBANK GIROZENTRALE v ISLINGTON LBC*

RESTITUTION, TRUSTS AND COMPOUND INTEREST

I INTRODUCTION

The long-awaited judgment of the House of Lords in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* is a surprising anticlimax. The plaintiff bank was claiming restitution of money paid under a void contract and the case involved two pressing problems in the developing law of restitution: proprietary claims and compound interest. The curious way in which the case was argued in the House of Lords meant that neither issue received the attention it deserved. As Lord Goff stated, 'If restitution lawyers are hoping to find in your Lordships' speeches broad statements of principle which may definitively establish the future shape of this part of the law, I fear that they may be disappointed.'¹ Mixed with this disappointment is a measure of surprise, for Lord Browne-Wilkinson's speech contains *obiter dicta* on the nature of trusts which, if accepted, would lead to a dramatic reformation of that area of law.

II FACTS AND JUDGMENTS

The *Westdeutsche* case involved an interest-rate swap agreement in which the parties made reciprocal loans to each other of £25 million, one at a fixed rate of interest and the other at a floating rate. After it was discovered that the agreement was *ultra vires* the council,² the bank brought an action against the council to recover the difference between the £2.5 million paid by the bank and the £1.35m paid by the council during the supposed validity of the agreement. Hobhouse J and the Court of Appeal held that the council was personally liable at common law for that sum as money had and received, plus simple interest under s 35A of the Supreme Court Act.³ They also held, relying on *Sinclair v Brougham*,⁴ that the bank had an equitable proprietary claim to the money, which entitled it to compound interest in equity.

* [1996] 2 All ER 961 (HL) ('*Westdeutsche*') (Lord Goff, Lord Browne-Wilkinson, Lord Slynn, Lord Woolf, Lord Lloyd); varying [1994] 4 All ER 890 (Hobhouse J).

¹ [1996] 2 All ER 961, 970.

² *Hazell v Hammersmith and Fulham LBC* [1992] 2 AC 1.

³ [1994] 4 All ER 890.

⁴ [1914] AC 398 ('*Sinclair*').

Leave to appeal to the House of Lords was granted with respect only to the amount of interest payable. In a surprise move, the Law Lords indicated that they would be willing to reconsider *Sinclair* and argument revolved around the correctness of that decision. All five members of the Appellate Committee decided that *Sinclair* was either incorrect or inapplicable and that the bank did not have a proprietary claim to the money paid. The majority held (with Lords Goff and Woolf dissenting) that the bank was entitled to statutory simple interest only. Four aspects of the judgment are discussed below: proprietary restitution, resulting trusts, trusts in general and compound interest.

III PROPRIETARY RESTITUTION

The recovery of benefits conferred under void contracts has been notoriously difficult. *Sinclair* provided a practical solution to the problem: the contractual promise could not be enforced, directly or indirectly, but the plaintiff could recover any benefits still surviving in the hands of the defendant. That case concerned the winding-up of a building society which had carried on a banking business for many years. Borrowing for the business of banking was *ultra vires* the building society and the contracts with its depositors were void. The House of Lords held that the policy which invalidated the borrowing contracts also prevented the depositors from claiming their deposits as money had and received. However, the depositors were allowed to trace the deposits into the remaining assets of the society and assert an equitable right *in rem*, which ranked equally with the shareholders' claim to distribution of those assets on winding-up. The basis of that equitable proprietary interest was not entirely clear, due to the variety of speeches given by the Law Lords. However, it came to be viewed as a resulting trust responding to a failure of consideration.⁵

It is now recognised that benefits conferred under invalid contracts can be recovered by means of personal restitutionary claims for money had and received, *quantum meruit* or *valebat*.⁶ This relieves much of the pressure which might cause a plaintiff to assert a proprietary claim in this context. However, it does not eliminate that pressure. The insolvency of defendants and the desire for compound interest will continue to make the claim *in rem* attractive to claimants. Also, as Lord Goff recognised in *Westdeutsche*, there may yet be cases in which the policy invalidating the contract stands in the way of the personal restitutionary claim.⁷ Plaintiffs will feel ill-served by the law if their personal claims for restitution are barred (through no fault of their own) and their defendants are

⁵ *Ibid* 421-3; *Westdeutsche* [1994] 4 All ER 890, 962; [1996] 2 All ER 961, 968, 971-2, 994-5; Peter Birks, *An Introduction to the Law of Restitution* (1989) 380-3, 387; Peter Birks, 'Restitution and Resulting Trusts' in Stephen Goldstein (ed), *Equity and Contemporary Legal Developments* (1992) 335, 353-5; P Butler, 'Mistaken Payments, Change of Position & Restitution' in Paul Finn (ed), *Essays on Restitution* (1990) 87, 112; William Gummow, 'Unjust Enrichment, Restitution and Proprietary Remedies' in Paul Finn (ed), *Essays on Restitution* (1990) 47, 82-3, 85.

⁶ *Paul v Pavey & Matthews Pty Ltd* (1987) 162 CLR 221; *Westdeutsche* [1996] 2 All ER 961.

⁷ [1996] 2 All ER 961, 972.

allowed to depart with any portion of the unjust enrichment traceably surviving in their hands.

The pressure for proprietary restitution will drive plaintiffs to achieve it by other means.⁸ The decision that *Sinclair* no longer provides a basis for such a claim merely delays the battle for another day. It will be fought on two fronts: failure of consideration and mistake. First, *Westdeutsche* tells us that a payment under a void contract can be recovered as money had and received because 'the consideration for the payment of the money wholly failed.'⁹ However, failure of consideration can give rise to restitutionary rights *in rem*.¹⁰ The location of the boundary between those failures of consideration which give rise to proprietary claims and those which do not is yet to be identified and plaintiffs will seek to have it drawn in their favour.

Secondly, a payment under a void contract is made both for a consideration which fails and because of a mistaken belief in the validity of the contract.¹¹ Mistakes do give rise to restitutionary rights *in rem*¹² and plaintiffs will turn to that ground of recovery if the failure of consideration does not. The bank in *Westdeutsche* was operating under a mistake of law, for which restitution is not yet generally available in England. The rule barring recovery for mistake of law has been overturned in Australia,¹³ New Zealand,¹⁴ Canada¹⁵ and Scotland.¹⁶ England is likely to follow suit before long.¹⁷ The day will come when a court will have to decide whether a plaintiff, who has paid money or transferred property under a void contract, has a proprietary interest in that money or property (or its substitute) as a result of the mistake of law.

IV RESULTING TRUSTS

The Court of Appeal in *Westdeutsche* followed *Sinclair* to conclude that a payment under a void contract gives rise to a resulting trust. The Law Lords were unanimous in their rejection of that conclusion. Lord Browne-Wilkinson suggested that resulting trusts arise (i) only in the traditional categories of apparent

⁸ See Peter Birks, 'Trusts Raised to Reverse Unjust Enrichment' [1996] *Restitution Law Review* 3, 15.

⁹ [1996] 2 All ER 961, 993 (Lord Browne-Wilkinson).

¹⁰ See, eg, *In re Ames' Settlement* [1946] Ch 217; *In re Nanwa Gold Mines Ltd* [1955] 1 WLR 1080; *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567; *Neste Oy v Lloyds Bank PLC* [1983] 2 Lloyd's LR 658; *Muschinski v Dodds* (1985) 160 CLR 52; *Re EVTR* [1987] BCLC 646.

¹¹ *Rover International Ltd v Cannon Film Ltd* [1989] 1 WLR 912; Keith Mason and John Carter, *Restitution Law in Australia* (1995) 331.

¹² See, eg, *Craddock Brothers v Hunt* [1923] 2 Ch 136; *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105; *Blacklocks v JB Developments (Godalming) Ltd* [1982] Ch 183.

¹³ *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353.

¹⁴ Judicature Amendment Act 1958 (NZ) s 94A.

¹⁵ *Air Canada v British Columbia* (1989) 59 DLR (4th) 161.

¹⁶ *Morgan Guaranty Trust Co NY v Lothian Regional Council* (1995) *Scottish Law Times* 299.

¹⁷ See *Woolwich Equitable Building Society v IRC* [1993] AC 70, 164, 192; Law Commission (Eng), *Restitution: Mistakes of Law and Ultra Vires Public Authority Receipts and Payments*, No 227 (1994).

gifts and trusts which fail and (ii) because the parties have a common intention to create a trust. These ideas are difficult to reconcile with a large number of existing cases of resulting trust.

First, there are many cases which do not comfortably fit the mould of either traditional category of resulting trust. *Quistclose* trusts provide the most notable examples.¹⁸ When money is loaned to be used for a specific purpose, the borrower holds that money in trust for the lender if the purpose cannot be achieved. The trust for the lender is recognised as a resulting trust,¹⁹ however there is no apparent gift and the specific purpose is not a failed express trust.²⁰ The *Quistclose* cases are best understood as resulting trusts responding to a failure of consideration (ie the failure to use the money for the specified purpose). It is too late to confine resulting trusts to their traditional categories and there is no convincing reason for doing so. The events which give rise to resulting trusts occur in other contexts and only an artificial restriction can prevent them from arising in those contexts. As Lord Goff said, in relation to the issue of compound interest:

Where jurisdiction is founded on a principle of justice, I would expect that the categories of case where it is exercised should be regarded not as occupying the whole field but rather as emanations of the principle, so that the possibility of the jurisdiction being extended to other categories of case is not foreclosed.²¹

Secondly, the theory that resulting trusts depend on an intention to create a trust²² can explain a majority of the resulting trust cases, but it cannot explain them all. There are many cases where any intention to create a trust would be impossible,²³ contrary to the evidence²⁴ or unenforceable.²⁵ The competing theory, that resulting trusts respond to the lack of intention to benefit the recipient, can and does explain all existing cases of resulting trust. Moreover, Lord Browne-Wilkinson's novel suggestion that resulting trusts arise from a common intention to create a trust is even harder to reconcile with existing case law. There are too many cases where one of the parties was ignorant of the arrangement²⁶ and, in *Vandervell v IRC*,²⁷ it was clear that the parties involved did not want to create a resulting trust.

Lord Browne-Wilkinson first suggested that resulting trusts depended on the common intention of the parties in *Tinsley v Milligan*.²⁸ In that case, both parties

¹⁸ Named after *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567.

¹⁹ *Re EVTR* [1987] BCLC 646; *Westdeutsche* [1996] 2 All ER 961, 990.

²⁰ See Peter Millett, 'The Quistclose Trust: Who Can Enforce It?' (1985) 101 *Law Quarterly Review* 269, 275-6.

²¹ *Westdeutsche* [1996] 2 All ER 961, 976.

²² See William Swadling, 'A New Role for Resulting Trusts?' (1996) 16 *Legal Studies* 110.

²³ See, eg, *Ryall v Ryall* (1739) 26 ER 39; *Goodfellow v Robertson* (1871) 18 Grants Chancery Reports (Can) 572.

²⁴ See, eg, *Vandervell v IRC* [1967] 2 AC 291; *Brown v Brown* (1993) 31 NSWLR 582.

²⁵ See, eg, *Hodgson v Marks* [1971] Ch 892.

²⁶ See, eg, *Ryall v Ryall* (1739) 26 ER 39; *Birch v Blagrave* (1755) 27 ER 176; *Childers v Childers* (1857) 44 ER 810; *In re Vinogradoff* [1935] WN 68; *In re Muller* [1953] NZLR 879.

²⁷ [1967] 2 AC 291.

²⁸ [1994] 1 AC 340, 371.

had contributed to the purchase of a home in the plaintiff's name. The intentions of both parties were relevant to the issue of a resulting trust because they had both provided consideration for the purchase.²⁹ However, Lord Browne-Wilkinson relied on cases of constructive trust to conclude that a common intention was required.³⁰ His lordship's *obiter dictum* in *Westdeutsche* mingles the requirements for resulting and constructive trusts, possibly because of the confusion generated by the variety of speeches in *Pettitt v Pettitt*³¹ and *Gissing v Gissing*³² and Lord Diplock's statement in the latter case that it was unnecessary to distinguish between resulting, implied and constructive trusts because they were all exempt from the requirement of writing.³³

The resulting trust is the subject of a forthcoming book,³⁴ in which these issues are explored in greater depth. The book accepts the conclusion that the resulting trust does not arise in *Westdeutsche*, but not for the reasons expressed by Lord Browne-Wilkinson. The future of proprietary restitution is bound inextricably to the law of trusts. The vast majority of commentators see the constructive trust as the link, possibly because of the important and influential American *Restatement of Restitution*.³⁵ However, there has never been a satisfactory explanation of why that role is not (at least in part) filled by the resulting trust. The cursory treatment of that question in *Westdeutsche* means that it is merely delayed to be faced another day.

V TRUSTS IN GENERAL

Of possibly greater concern to judges and lawyers are Lord Browne-Wilkinson's comments, in *Westdeutsche*, on the nature of all trusts:

Since the equitable jurisdiction to enforce trusts depends upon the conscience of the holder of the legal interest being affected, he cannot be a trustee of the property if and so long as he is ignorant of the facts alleged to affect his conscience, i.e. until he is aware that he is intended to hold the property for the benefit of others in the case of an express or implied trust, or, in the case of a constructive trust, of the factors which are alleged to affect his conscience.³⁶

This suggestion, if acted upon, would have a drastic effect on the law relating to the creation and enforcement of equitable proprietary interests. Lord Browne-Wilkinson does say that an equitable proprietary interest, once created, 'will be enforceable in equity against any subsequent holder of the property ... other than a purchaser for value of the legal interest without notice.'³⁷ However, it is

²⁹ See *Cowcher v Cowcher* [1972] 1 WLR 425, 431; *Calverley v Green* (1984) 155 CLR 242, 251; *Muschinski v Dodds* (1985) 160 CLR 583, 589.

³⁰ *Grant v Edwards* [1986] Ch 638; *Lloyds Bank PLC v Rosset* [1991] 1 AC 107.

³¹ [1970] AC 777.

³² [1971] AC 886.

³³ *Ibid* 905.

³⁴ Robert Chambers, *Resulting Trusts* (Oxford University Press) (forthcoming).

³⁵ American Law Institute, *Restatement of the Law of Restitution* (1937).

³⁶ [1996] 2 All ER 961, 988.

³⁷ *Ibid*.

difficult to understand how this can be reconciled with his view that the 'jurisdiction to enforce trusts depends upon the conscience of the holder of the legal interest being affected'.³⁸ Why is the conscience of an innocent volunteer recipient of trust property affected? What distinguishes that person from an innocent volunteer who receives property in circumstances which would, but for the lack of notice, give rise to a resulting or constructive trust?

The timing of the creation of equitable proprietary interests is crucial for a number of important issues, such as risk, insurance, entitlement to income, tax liability, limitation periods, transfer and transmission of property interests, right to caveat and priority of competing claims. This cannot be left to vague measures of conscience.³⁹ The ensuing confusion and incentive to litigate would be intolerable. The law of trusts has been progressing, slowly but surely, towards a clearer understanding of the variety of events which create trusts. Only some of those events include wrongdoing on the part of trustee, such as a breach of fiduciary duty. Many others, such as a detrimentally relied upon common intention to share the family home or a transfer of property by mistake, do not. In all cases, notice will be relevant to the various defences available to the alleged trustee, such as bona fide purchase or change of position. However, a notice requirement should not be appended to the creation of trusts by events which have nothing to do with the conduct of the trustee.

VI COMPOUND INTEREST

This is the most curious part of the judgment. The House of Lords had granted the council leave to appeal the award of interest only and yet that issue was not fully argued. It was accepted that simple interest was payable by statute and the appeal turned on whether compound interest was available in equity. *Hobhouse J* and the Court of Appeal held that compound interest was payable because the bank had an equitable right *in rem* in addition to its common law right *in personam*. In the House of Lords, the council was prepared to accept that the bank had an equitable property interest, but the Law Lords themselves challenged that assumption.

The question then arose whether compound interest might be payable on the council's personal obligation to make restitution. However, this was left hanging because 'the council was not prepared to spend further money on the appeal, whereupon it took no further part in the proceedings'.⁴⁰ Lords Goff and Woolf, dissenting, held that compound interest would be payable on the personal restitutionary claim, but the majority was reluctant to follow that route in the absence of argument on behalf of the council. So it seems that the council won its appeal by refusing to take part.

A great stumbling block to the bank's claim for interest was occasioned by Parliament's intervention in the area. The Law Reform (Miscellaneous Provi-

³⁸ *Ibid.*

³⁹ See Peter Birks, above n 8, 20.

⁴⁰ [1996] 2 All ER 961, 975 (Lord Goff); see also 1000-1, 1017, 1019.

sions) Act 1934 (UK), which was enacted following a report of the Law Revision Committee,⁴¹ expressly excluded 'the giving of interest upon interest'.⁴² In 1978, The Law Commission recommended changes to the 1934 Act, but rejected a statutory discretion to award compound interest.⁴³ This resulted in an addition to the Supreme Court Act 1981 authorising awards of 'simple interest' only.⁴⁴ Courts of equity are not limited by the statute to awards of simple interest, but have an independent jurisdiction to award compound interest.⁴⁵ Although the Law Commission recommended the preservation of the equitable jurisdiction to award compound interest, this was on the understanding that it was only possible in 'the case in which a person, acting in breach of a fiduciary duty, makes a profit for himself out of the misuse of funds'.⁴⁶

For the Law Lords in the majority in *Westdeutsche*, Parliament's decisions not to expand upon the statutory right to simple interest was a sufficient reason not to expand upon the equitable jurisdiction to award compound interest, at least not without full argument on the issue. Only Lord Lloyd suggested that the change might be undesirable, because a wider discretion to award compound interest would introduce an element of uncertainty:

Disputes which would otherwise be settled on the basis of simple interest would be fought in the hope of persuading the court that an award of compound interest was appropriate.⁴⁷

Lords Goff and Woolf examined the issues at greater length. Lord Goff noted 'that the reported cases on the exercise of the equitable jurisdiction, which are by no means numerous, are concerned with cases of breach of duty by trustees and other fiduciaries'.⁴⁸ From this he concluded that

[t]he power to award compound interest is therefore available to achieve justice in a limited area of what is now seen as the law of restitution, viz where the defendant has acquired a benefit through his wrongful act.⁴⁹

In Lord Goff's opinion, the principle could be applied more generally to cases involving restitution, regardless of whether the benefits were acquired by a wrongful act.

For the dissenting Law Lords, compound interest should be available in equity whenever the plaintiff is entitled to restitution. The key issue is not whether the claim is proprietary or personal, but whether compound interest is needed to achieve full restitution of the benefits received by the defendant.⁵⁰ This is

⁴¹ United Kingdom, *Second Interim Report* (1934) Cmnd 4546; see Law Commission (Eng), *Law of Contract: Report on Interest* No 88 (1978) ¶ 42-4.

⁴² Law Reform (Miscellaneous Provisions) Act (1934) 25 & 26 Geo 5, s 3(1)(a).

⁴³ Law Commission, above n 41, ¶ 85, 150-6.

⁴⁴ Supreme Court Act 1981 (Eng) s 35A.

⁴⁵ See *Tehno-Impex v Gebr Van Weelde Scheepvaartkantoor BV* [1981] QB 648 ('*Tehno-Impex*').

⁴⁶ Law Commission, above n 41, ¶ 154.

⁴⁷ [1996] 2 All ER 961, 1021.

⁴⁸ *Ibid* 976.

⁴⁹ *Ibid* 977.

⁵⁰ *Ibid* 978-81, 1010.

significant. The measure of interest should relate to the measure of the liability on which it depends. If the liability is based on unjust enrichment, then the total judgment, including interest, should equal the total benefit obtained by the defendant at the expense of the plaintiff.⁵¹ Similarly, if the liability is compensatory, the total award should equal the loss caused to the plaintiff by the defendant.

Herein lies the difficulty (if it is one) with the views of Lords Goff and Woolf. There is no reason to limit an expanded jurisdiction to award compound interest to cases of restitution of unjust enrichment. Lord Woolf stated:

[w]hile the equitable jurisdiction was concerned to prevent profit by the recipient of funds to which he was not entitled, the common law was concerned with the loss suffered by the payer of the funds.⁵²

However, compound interest can be awarded in equity for the purpose of providing compensation; for example, where companies are deprived of money needed for business or trustees breach their duty to invest the trust property.⁵³ It has been recognised that simple interest does not provide adequate compensation for the loss of the use of money in modern times.⁵⁴ The views of Lords Goff and Woolf, taken to a logical conclusion, would lead to compound interest becoming the norm.

The historical divide between common law and equity would not be available as an artificial brake on the spreading availability of compound interest. According to Lords Goff and Woolf, compound interest can be awarded through the exercise of equity's auxiliary jurisdiction 'to enable a plaintiff to obtain full justice in a personal action of restitution at common law.'⁵⁵ If one accepts that compound interest should be available for personal claims based on unjust enrichment, there is no logical reason to restrict it to claims arising in equity (notwithstanding the uniquely Australian fear of 'fusion fallacy').⁵⁶ As Lord Goff stated:

The seed is there, but the growth has hitherto been confined within a small area. That growth should now be permitted to spread naturally elsewhere within this newly recognised branch of law. No genetic engineering is required, only that the warm sun of judicial creativity should exercise its benign influence rather than remain hidden behind the dark clouds of legal history.⁵⁷

One important issue, which got lost along the way, was whether Hobhouse J and the Court of Appeal were right to award compound interest even if the bank had a claim *in rem*. If compound interest in equity is restricted to cases in which

⁵¹ See Mason and Carter, above n 11, 950.

⁵² [1996] 2 All ER 961, 1012.

⁵³ *A-G v Alford* (1855) 43 ER 737, 741; *In re Emmet's Estate* (1881) 17 Ch D 142, 149-50; *Wallersteiner v Moir (No 2)* [1975] QB 373, 388.

⁵⁴ *Tehno-Impex* [1981] QB 648, 665; Roger Bowles and Christopher Whelan, 'Interest on Debts' (1985) 48 *Modern Law Review* 229.

⁵⁵ [1996] 2 All ER 961, 979 (Lord Goff).

⁵⁶ See Mason and Carter, above n 11, 963.

⁵⁷ [1996] 2 All ER 961, 980-1.

fiduciaries profit from wrongdoing,⁵⁸ there can be no justification for awarding it against the council, which was an innocent recipient of money paid by mistake or for a consideration which failed. Using the existence of an equitable claim *in rem* as a justification for an award of compound interest is no less artificial than using it as a restriction on such an award. Very little work has been done on the extent of the personal liability of resulting and constructive trustees, but the existence of such a trust does not, by itself, justify the application of all the onerous duties to which express trustees and other fiduciaries are subject.

VII CONCLUSION

Although *Westdeutsche* raised some of the most important issues current in the law of trusts and restitution, a most remarkable appeal to the House of Lords meant that none of them were confronted directly. The limited leave to appeal meant that questions of proprietary restitution and trusts were relegated to the status of collateral issues, while the conduct of the appeal had the same unfortunate effect on the central question of compound interest. We have learned that a payment under a void contract will no longer give rise to a restitutionary claim *in rem*, but do not know where and on what basis to draw the line between that situation and other failures of consideration and mistakes which do give rise to such claims. Similarly, compound interest was not available on the day, but we are left unable to predict what will happen on any future day.

ROBERT CHAMBERS*

⁵⁸ See *O'Sullivan v Management Agency & Music Ltd* [1985] QB 428, 461, 473-4; *Polish Steam Ship Co v Atlantic Maritime Co* [1985] QB 41, 61.

* BEd (Alta), LLB (Alta), DPhil (Oxon); Barrister and Solicitor (Alta); Lecturer, Faculty of Law, University of Melbourne.