RESTITUTION FOR FRAUDULENT CONVEYANCES

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INTRODUCTION

The problem which this article discusses is the situation when a recipient of a fraudulent conveyance, being a transfer of property made by a debtor with intent to defraud creditors,[1] disposes of or dissipates the property beyond trace of those creditors. The availability of a personal restitutionary remedy for creditors against such a transferee of a fraudulent conveyance would fill a conspicuous gap in the New Zealand law of creditors' remedies.

Fraudulent conveyances occurring prior to bankruptcy are governed by section 60 of the Property Law Act 1952. Section 60(1) makes these voidable, as follows

> (1) Save as provided by this section, every alienation of property with intent to defraud creditors shall be voidable at the instance of the person thereby prejudiced.

Subsection (3) gives a defence to proceedings brought by creditors, the class of persons usually prejudiced, by providing

> (3) This section does not extend to any estate or interest in property alienated to a purchaser in good faith not having, at the time of the alienation, notice of the intention to defraud creditors.

Section 60 is essentially a re-enactment of the original Statute of Elizabeth (13 Eliz c5) of 1571, which provides a rich body of case law on the interpretation of the provision.[2] Moreover, there are comparable modern enactments in England, Canada and Australia.[3] The cases show that where a conveyance is impeached by a creditor's bill,[4] and the transferee of the conveyance cannot rely on the bona fide purchaser defence in subsection (3), typical remedies are for the property to be reconveyed to the debtor's estate to enable execution to be satisfied, or an order for the property held by the transferee to be sold and the proceeds applied to the creditor's debt.

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1 For the law generally as to fraudulent conveyances, see R J Sutton, *Creditors' Remedies in New Zealand* (1978) Ch 5; *18 Halsbury's Laws of England* (4th ed) para 358-389.

2 See *Re Proudfoot* [1960] NZLR 577 at 581.

3 For example, Law of Property Act 1925, s 172 (UK) now repealed by the Insolvency Act 1986 (UK); Fraudulent Conveyances Act 1979 (BC); Fraudulent Preference Act Alb); Conveyancing Act 1919, s 37A (NSW); Property Law Act 1974, s 228 (Qld); Law of Property Act 1936, s 86 (SA).

4 For the nature of a creditor's bill see *Reese River Silver Mining* v *Atwell* (1869) LR 7 Eq 347; *May on Fraudulent and Voluntary Dispositions of Property* (3rd ed 1908) at 306 et seq; *Seton's Judgments and Orders* (7th ed 1912) Vol 3, at 2281.

There is also a recognised jurisdiction for a creditor to trace the property or the proceeds thereof, so long as they remain identifiable, into the hands of the first transferee or subsequent transferees who cannot avail themselves of the subsection (3) defence.[5]

To be more precise then, this article is concerned with the situation when a transferee who is not protected under subsection (3) of section 60, being a volunteer or someone not in good faith and with notice of the fraud, disposes of the property to a protected purchaser or mortgagee, or dissipates it. This problem is particularly acute if the property is money, which by its very nature is readily disposable and difficult to trace. A personal restitutionary remedy, against such a transferee, for which the cause of action accrues upon receipt, would enable recovery by creditors of the value of the property fraudulently conveyed, or at least to the extent of the unjust enrichment of the transferee at the expense of creditors, notwithstanding its subsequent disposal. The possibility that such a remedy may now exist is raised by *Lipkin Gorman* v *Karpnale Ltd,*[6] the most significant English case on the law of restitution.

The *Lipkin Gorman* decision shows explicit recognition by the House of Lords of recovery of money based on the principle of unjust enrichment,[7] although in a quite different factual scenario to fraudulent conveyances. Notwithstanding this, a claim to restitution against someone who has been unjustly enriched at the claimant's expense is a general principle, capable of much wider application. In this case one Cass, a partner in the plaintiff firm of solicitors, had authority to draw from the firm's client bank account. Without the firm's knowledge, he stole a large sum of money from the account and used the money gambling at the defendant casino. The parties agreed that the £154,695 which was lost and the casino won during the gambling was derived from the money stolen from the solicitors. It was clear that the casino acted innocently throughout, having no knowledge of Cass's fraud. The House was unanimous in holding that the solicitors could succeed. Lord Templeman, in giving one of the two leading speeches, affirmed the broad principle that the law imposes an obligation on the recipient of stolen money to pay an equivalent sum to the victim if the recipient has been unjustly enriched at the expense of the true owner.[8] His Lordship further stated[9] that

> an innocent recipient of stolen money will be enriched if the recipient has not given full consideration . . . . a donee of stolen money cannot in good conscience rely on the bounty of the thief to deny restitution to the victim of the theft.

Lord Goff of Chieveley also gave his reasons for decision in a judgment which, with respect, more closely follows principle and authority than,

5 *Re Mouat* [1899] 1 Ch 831; and see generally *Brady* v *Stapleton* (1952) 88 CLR 322 at 336.
6 [1991] 3 WLR 10.
7 Referred to in *Lipkin Gorman* in the antiquated language of an action for money had and received for the plaintiff's use.
8 Supra n 6 at 15; *Fibrosa Spolka Akcyjna* v *Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32 was cited as authority for this principle.
9 Supra n 6 at 16.

perhaps, the more policy motivated judgment of Lord Templeman. Whilst arriving at the same conclusion, his Lordship considered the more technical aspects of the case, such as the fact that the money in question was not paid directly by the plaintiff to the defendant, rather it had been paid to the defendant by the third party Cass. To this extent Lord Goff's judgment is of greater assistance in applying the principle of unjust enrichment to a fraudulent conveyance situation.

Lord Goff made it clear that the solicitors must establish a basis on which they were entitled to the money, that is they must show legal title to the money to obtain restitution.[10] The difficulty facing the solicitors in this respect was Privy Council authority stating that when a partner obtains a bank cheque from a bank which has been given authority by the partnership to do so, but the partner has acted beyond the authority of his or her partners in so doing, the legal property in the cheque vests in the partner.[11] It was held *a fortiori* that this reasoning applies to cash. Nevertheless Lord Goff surmounted this difficulty by holding that it is well established that a legal owner is entitled to trace his or her property into its product, provided that the latter is indeed identifiable as the product of the property. This involves an election or affirmation by the owner of the original property to assert his or her title to the product of the unauthorised act. It can be seen that a decision of this sort is broadly similar to the doctrine of ratification in agency law, and Lord Goff alluded to this.[12] As the money in the solicitors' bank account constituted a chose in action which was the legal property of the solicitors at common law, his Lordship contended that[13]

> the solicitors, as owners of the chose in action constituted by the indebtedness of the bank to them in respect of the sums paid into the client account, could trace their property in that chose in action into its direct product, the money drawn from the account by Cass. It further follows, from the concession made by the respondents, [that if the solicitors can establish legal title to the money in the hands of Cass, that title was not defeated by mixing of the money with other money of Cass while in his hands], that the solicitors can follow their property into the hands of the respondents – when it was paid to them at the club.

It is apparent that this concept of common law tracing of property is different from the more familiar equitable in rem tracing, in that in the context of an in personam restitution action it involves an ex post facto assertion of title to the product of the original property. As a result of tracing in this way, it was found that the money received by the defendant was property belonging to the solicitors, and also that the receipt of this money

10 Ibid at 27; authority for this proposition was the early case of *Clark* v *Shee and Johnson* (1774) 1 Cowp 197; 98 ER 1041. It is also significant that the decision of Lord Goff on this point technically formed a majority view, as whilst Lord Griffith and Lord Ackner agreed with both leading speeches, Lord Bridge expressly agreed with Lord Goff on this aspect.

11 *Union Bank of Australia Ltd* v *McClintock* [1922] 1 AC 240; *Commercial Banking Co of Sydney Ltd* v *Mann* [1961] AC 1.

12 Supra n 6 at 28.

13 Ibid at 28-29.

was both unjust and an enrichment at the expense of the solicitors, hence giving rise to restitutionary liability.[14] *Lipkin Gorman* is also very significant in its express recognition that it is right for English law to have a discretionary defence of change of circumstances in good faith available against restitution claims, but that nothing should be said at this stage to define its scope so as not to inhibit its development on a case by case basis.[15]

Application of Lipkin Gorman to fraudulent conveyances

The issue of concern now is whether or not the reasoning in this decision can be applied to a fraudulent conveyance situation so as to provide defrauded creditors with a restitutionary remedy against a transferee from the debtor who is not a bona fide purchaser. Notwithstanding the obvious efficacy of such a remedy the writer has been unable to find any commonwealth authority granting a personal remedy of this sort, in the absence of legislation providing for such.[16] So to extend and develop *Lipkin Gorman* in order to provide defrauded creditors with a restitutionary remedy may represent a change in the law of countries like New Zealand, where there is no such legislation.

However, what authority there is on this question seems to suggest a contrary view. The most authoritative consideration of the issue appears to be the majority decision of the High Court of Australia in *Brady* v Stapleton.[17] In this case it was held that under 13 Eliz c5 a fraudulent conveyance is effective in passing title unless and until a creditor intervenes, and that the right to avoid a fraudulent conveyance is lost when the property alienated passes to a bona fide purchaser for value without notice of the fraud. Dixon CJ and Fullagar J, forming the majority, suggested, however, that a personal liability on the part of a fraudulent transferee who has on-sold to a bona fide purchaser could arise but only if the transferee sold something to which he or she had no title or if the sale was otherwise wrongful when made. In the view of the majority, this rather vague test would seem to be the sole foundation of restitutionary liability. Accordingly, it was concluded that[18]

> the [transferee] of the fraudulent conveyance had a title, though a defeasible title. The defeasance has, in the event taken place, but it cannot relate back so as to make a sale by the [transferee] wrongful and impose a personal liability on the [transferee].

McTiernan J on the other hand, in dissent, took the view that 13 Eliz c5

14 For a full discussion of the reasoning in *Lipkin Gorman,* see Peter Birks, "The English recognition of unjust enrichment" [1991] 4 Lloyd's Maritime and Commercial Law Quarterly 473.

15 Supra n 6 at 32-34; Lord Templeman also adverted to this matter, ibid at 16, by noting that complications arise if the recipient of stolen money innocently expends it in reliance on the validity of the gift before notice of the victim's claim for restitution is received.

16 For instance *Re Allen and Allen* [1948] 2 DLR 788, applying the Fraudulent Conveyances Act 1936 (BC).

17 (1952) 88 CLR 322.

18 Ibid at 334.

operated only to protect purchasers for value without notice, it did not operate to make good the initial fraudulent conveyance. So the right of a credit or to impeach a fraudulent conveyance was not barred by the bona fide purchaser proviso. His Honour considered that as the plaintiff was unable to trace the proceeds of the sale, he should have a right in personam against the transferee to recover a sum equivalent to those proceeds. With respect, although his Honour did appreciate the justice of the situation in preferring recovery by the plaintiff who would otherwise recover nothing, his reasoning is contrary to the principle espoused by the majority, in that the mere ability to impeach a fraudulent conveyance does not of itself generate a right to claim an equivalent sum of money. It seems clear that some independent legal principle is required to obtain that result.

More recently the Federal Court of Australia has confirmed this approach to the ambit of 13 Eliz c5 in *Noakes* v *Harvey Holmes & Son.*[19] Here Brennan J, for the Court, agreed that a fraudulent conveyance is effective in passing title unless and until a creditor intervenes, and also contended that[20]

> [t]he specific relief which may be given to creditors depends, no doubt, upon the nature of the asset in the hands of the [transferee], and orders may be moulded to give appropriate effect to the creditors' rights as against the [transferee].

This dictum perhaps indicates that no relief can be granted if there is no property at all left in the hands of the transferee. However it is unclear whether this particular point was argued before the Court.

The majority approach in *Brady* v *Stapleton* is also consistent with Canadian authority.[21] By contrast, it has been held in certain American states that a transferee of a fraudulent conveyance may be held liable to account for the value of the property conveyed where it is shown that the property has been disposed of or has been intermingled with other property in such manner that it cannot be identified.[22] The American approach to this problem is a typically pragmatic one, recognising the injustice in depriving creditors of a remedy due to the wrong of a fraudulent transferee in placing the property beyond the reach of execution or of a tracing order. However, it does not seem that these cases were decided expressly on restitutionary principles.

The question now, if it is accepted that the present law is deficient in not providing defrauded creditors with a restitutionary remedy, is whether the principle of unjust enrichment as articulated in *Lipkin Gorman* should be extended to the fraudulent conveyance context, or, alternatively, whether the legislature should take the initiative and provide more exten-

19 (1979) 26 ALR 297.

20 Ibid at 304.

21 *Davis* v *Wickson* (1882) 1 OR 369 at 374; *Masuret* v *Stewart & Lampman* (1892) 22 OR 290 at 297; *Tennant* v *Gallow* (1894) 25 OR 56.

22 See *Douglas Fir Lumber Co* v *Star Lumber Co* 41 ALR 1474 at 1477; *Third Nat Bank of Nashville* v *Keathley,* 242 SW 2d 760 at 769; and the cases collected in *American and English Encyclopedia of Law* (2nd ed 1900) Vol 14, 341.

sive remedies for defrauded creditors, such as those available to the Official Assignee under the Insolvency Act 1967.

It seems clear from the judgment of Lord Goff in *Lipkin Gorman,* and is suggested in *Brady* v *Stapleton,* that for a creditor to maintain an action for restitution against an unprotected transferee, the creditor must establish legal title to the money or other property when it was received by the transferee. This requirement is the major obstacle to overcome as it is trite that a creditor generally only acquires legal title to his or her debtor's property upon execution, and usually has no interest, legal or equitable, prior to this. Moreover, as it appears from the above analysis, section 60(1) of the Property Law Act merely makes a fraudulent conveyance voidable, so a transferee acquires a good title and can pass this on to others before the first transfer is avoided.

Are there any means by which it can be argued that a prejudiced creditor is able to show legal title to the property or the proceeds thereof, before they were transferred to a protected purchaser or otherwise dissipated beyond trace? Certainly a creditor is not in the same position in this respect as the Official Assignee who may obtain title to the debtor's property by virtue of the doctrine of relation back[23] under section 42 of the Insolvency Act. Thus the critical question is whether a particular creditor has sufficient property in the asset conveyed at the relevant time, to generate a claim for restitution based on *Lipkin Gorman.*

To this end it may be argued, closely following *Lipkin Gorman,* that the relationship between debtor and creditor constitutes a chose in action, which is the legal property of the creditor. Therefore a creditor should equally be entitled to trace this property into its product, the property fraudulently conveyed to the transferee, by an ex post facto assertion of title, so as to establish a basis on which the creditor is entitled to the property and thereby obtain restitution. The difficulty with this argument is that it would be hard to show that the property fraudulently conveyed by the debtor was the direct product of the particular chose in action belonging to the suing creditor. In other words, the difficulty is in showing that the transferee was enriched at *that* creditor's expense. This may be less problematic, however, if a creditor brings an action on behalf of all creditors, which may be a prerequisite anyway. In this respect, there is authority stating that 13 Eliz c5 is not solely for the benefit of the unsecured creditor who sues, and that a creditor cannot obtain an order which secures the available property in priority to any other creditors.[24] As a result it seems that a creditor's claim should be made on behalf of all creditors defrauded by the conveyance, which would seemingly enhance the likely success of a claim based on *Lipkin Gorman* by sidestepping this difficulty of establishing enrichment at the expense of a plaintiff creditor.

23 See Sutton, op cit n 1 at 148 et seq.

24 *Reese River Silver Mining Co* v *Atwell,* supra n 4; *Noakes* v *Harvey Holmes & Son,* supra n 19 at 304; but see *May,* op cit n 4 at 311, suggesting that this may not be the case where the plaintiff creditor has obtained an independent judgment or process of execution, although for present purposes this in itself would not show that the property conveyed was the product of the debt giving rise to such a judgment.

If this is so, then an action brought on behalf of all defrauded creditors (if there are more than one) would obviously preclude any advantage obtaining to the diligent creditor who has the initiative to take such proceedings.[25]

The principle underpinning Lord Goff's approach to cases of this kind where the defendant has received a benefit from a third party, that a plaintiff will generally only be able to recover if he or she can assert a right of property in an object whose receipt has enriched the defendant, seems correct.[26] However, an alternative basis for obtaining restitution might be postulated, based on the broad approach of Lord Templeman's judgment in *Lipkin Gorman*. It could be argued simply that a creditor has a right to claim restitution due to the unjust enrichment of the transferee at the creditor's expense, and thus the transferee is, in the words of Lord Mansfield, "obliged by the ties of natural justice and equity to refund the money".[27] Whilst this would provide a compendious solution, it is doubtful whether a court would be willing to entertain it, particularly in light of Lord Goff's more careful analysis and the authorities which support his Lordship's approach.[28]

If the argument outlined above, applying the reasoning of Lord Goff, were accepted, so that a restitution claim is available to a creditor prejudiced by a fraudulent conveyance, it would seem that a defendant would then have a change of circumstances defence available to meet such a claim, as advocated by the House.[29] This defence would provide consistency with the comparable defence provided by section 58(6) of the Insolvency Act 1967, conferred on any person who receives a disposition from a bankrupt which is avoided by the Official Assignee, and who has

> (a) . . . received the property in good faith and has altered his position in the reasonably held belief that the transfer or payment of the property to him was validly made and would not be set aside; and [if]
> (b) In the opinion of the Court it is inequitable to order recovery or recovery in full, as the case may be.

Naturally a transferee who is party to or has knowledge of the fraud on the part of a debtor would not be able to invoke the defence, but it may be particularly helpful in the case of an innocent volunteer, who otherwise would not be protected as a purchaser in good faith under the section 60(3) proviso.

It is anticipated that the various statutory examples[30] of the change of circumstances defence in New Zealand law may provide an analogy for

25 Although this would probably be the most equitable result and is in accordance with the policy of bankruptcy law, it is suggested that such a creditor ought to be allowed reimbursement of costs and expenses in prosecuting the suit.
26 Lord Goff of Chieveley and Gareth Jones, *The Law of Restitution* (3rd ed 1986) 58, 64-65.
27 *Moses* v *Macferlan* (1760) 2 Burr 1005 at 1012.
28 Supra n 10; and see the cases collected in Goff and Jones, op cit n 26 at 64.
29 Supra n 15, and accompanying text.
30 Insolvency Act 1967 ss 55(3), 58(6); Judicature Act 1908 s 94B; Companies Act 1955 s 311A(7).

its application to the common law context of fraudulent conveyances, considering the caution shown in *Lipkin Gorman* to not define the scope of the defence.[31] However, it is noted that to date this defence has received a fairly narrow interpretation requiring detriment to be suffered by the defendant before it is inequitable to order recovery.[32] It seems reasonably well settled that the mere spending of money or dissipating of property will not give rise to a detrimental change of position as a result of receiving the property.[33] Accordingly, it might be preferable not to use the statutory examples of the defence as an analogy, but to develop a common law defence to a common law remedy on a case by case basis, as suggested by the House of Lords.

The case for reform

If the arguments outlined above, facilitating restitution for creditors on the basis of *Lipkin Gorman,* appear too tenuous to apply to the different factual context of fraudulent conveyances, or to be advocating legislation rather than adjudication by the court, it is submitted then that it is at least apposite briefly to state the case for reform.

Undoubtedly as a matter of policy there is real mischief in the denial of a remedy to creditors when an unprotected transferee from a fraudulent debtor disposes or dissipates beyond trace the property or its proceeds to someone who is protected under section 60(3). As has been mentioned above, it seems hard to justify as a matter of principle the provision of a restitutionary remedy for the Official Assignee (who acts on behalf of all creditors during bankruptcy), but not for the same body of creditors prior to a supervening bankruptcy, who may be equally prejudiced by a fraudulent conveyance. Indeed one would hope that both the courts and the legislature should look with favour upon the rights of defrauded creditors and afford them every remedy to defeat devices which defraud them of their rightful claims.

It might be responded to this, pragmatically, that in most cases the more extensive remedy available to the Official Assignee under section 58(2)(b) of the Insolvency Act 1967, to obtain an order for payment of 'such sum, not exceeding the value of the property when the disposition was set aside", is sufficient. This is because resort to section 60 of the Property Law Act would normally be unnecessary unless the debtor is unable to pay his or her debts without recourse to the property fraudulently conveyed, so a conveyance would seldom if ever be impeached unless the debtor has in fact become insolvent, and thus can be adjudicated bankrupt. Moreover, if a fraudulent conveyance, being an act of bankruptcy, has occurred within three months prior to adjudication, the Official Assignee's title will relate back by virtue of section 42 of the Insolvency Act to allow, inter alia, a restitutionary remedy.

31 Supra n 15, and accompanying text.

32 See *MacMillan Builders Ltd* v *Morningside Industries Ltd,* unreported, Court of Appeal, 12 September 1986, CA 100/85, a case interpreting s 311A(7) of the Companies Act 1955.

33 See the discussion in Goff and Jones, op cit n 26 at 694, criticising the wording of the New Zealand provisions and suggesting a more generous approach to the defence.

Notwithstanding the force of these responses, it is submitted that they do not provide sufficient reason to refuse to amend section 60 of the Property Law Act. Surely there must be occasions when a creditor would prefer to have recourse to the value of property fraudulently conveyed than have his or her debtor made bankrupt. This is likely to be the case if the debtor was not yet at the point of insolvency and was able to drip-feed creditors, but was in grave risk of becoming insolvent at some stage, or if a creditor wished to steal a march over other creditors, although it is likely such action giving one creditor priority would not be permitted, as indicated above.[34] Furthermore, where there is only one creditor of any significance, an action for restitution against an unprotected transferee, subject to a change of circumstances defence, would indeed be preferable to both creditor and debtor than the expensive, lengthy and demeaning bankruptcy administration. It is recognised, however, that failure to satisfy such a judgment would make bankruptcy inevitable.

Reform of section 60 of the Property Law Act to allow a restitutionary remedy would give New Zealand law consistency with Canadian legislation[35] and with the Insolvency Act 1986 (UK), which gives the court a wide discretion to order any person to pay a sum to any other person, as it thinks fit for restoring the position to what it would have been if the transaction had not been entered into.[36] In contrast to this wide discretionary approach, it is curious that under the equivalent Insolvency Act provision, section 58(2)(b), the court is restricted to making an order "not exceeding the value of the property when the dispoition was set aside, as the Court thinks proper". There is a problem here, and it is hoped that such restrictive wording is avoided if new legislation is drafted. The problem is that if a transferee has disposed of the property or dissipated its proceeds, then there may be no property retained at the time of setting aside the transfer (and therefore it would seem, no value) so presumably no sum can be ordered to be paid. Such a result would be unduly restrictive, especially when a transferee is party to the debtor's fraud. Clearly such a restriction would undermine the policy considerations suggested above, and is unnecessary when a transferee in good faith may have a change of circumstances defence available under section 58(6) of the Insolvency Act. Although section 58(3) allows the court for the purpose of giving effect to any order under subsection (2) to make such further order as it thinks fit, it is questionable whether this would authorise a departure from the unambiguous wording of section 58(2)(b). However, another view is that section 58(2) could be considered to be of purely procedural import and so does not limit substantive remedies available to the Official Assignee, such as restitution.

34 Supra n 24, and accompanying text. Presumably in such a situation the court could direct representative proceedings to be brought on behalf of all defrauded creditors, on the application of any party or intending party, under R 78 of the High Court Rules.

35 See for example, Fraudulent Conveyances Act 1979 (BC); Fraudulent Preference Act (BC); Assignments and Preferences Act (Ont); Fraudulent Preference Act (Alb).

36 Insolvency Act 1986 (UK) ss 423-425.

It is pleasing to note that the New Zealand Law Commission has also adverted to these issues, suggesting that, and calling for submissions as to whether, section 60 of the Property Law Act should allow for "recovery of compensation from a person who has received the benefit of the prejudicial conveyance in circumstances where the property cannot be recovered".[37]

To conclude, it is submitted that if a common law action for restitution against an unprotected transferee of a fraudulent conveyance is not possible, or is perhaps not practical, as may be the case, section 60 of the Property Law Act 1952 ought to be amended or replaced to provide for such. Preferably this reform should allow recovery on a more expansive, or at least more certain, basis than is presently the case under section 58(2)(b) of the Insolvency Act 1967, so as to allow recovery whether or not the property or its proceeds have been disposed of at the time the conveyance is avoided. This remedy should be subject to a change of circumstances defence for a transferee in good faith who has altered his or her position in reliance on the validity of the transfer, although again, perhaps on a more expansive basis than the existing statutory provisions. It is submitted that providing the court with some degree of discretion, perhaps similar to that conferred by the Insolvency Act 1986 (UK), would enable the court to best do justice in the circumstances of a particular case.

37 Preliminary Paper No 16, *The Property Law Act 1952* (July 1991).