Unjust Enrichment: The evolving treatment of indirect benefits

Unjust enrichment claims are often easier to identify in theory than they are in practice due to the complicated way in which many commercial transactions are structured. Identifying the 'winner' and the 'loser' is straight forward enough, but identifying the passage of benefits such that the former can be said to have been enriched at the expense of the latter is not always straightforward. It is perhaps for this reason that the court has historically adopted a conservative approach to claims for unjust enrichment, eschewing remedies in cases where there has not been a direct payment or transfer of value.

This article aims to explore how, in recent years, this traditionally conservative approach has fallen out of favour, with the court moving towards a more pragmatic (some would say sensible) approach to cases based on the indirect provision of benefits. The position has now been reached that whilst direct payments are sufficient they are not necessary.

Rather than provide a detailed commentary of the law on unjust enrichment, this article instead takes as its focus the recent decisions of the Court of Appeal in ***Investment Trust Companies (in liquidation) v Revenue & Customs*** **[2015] EWCA Civ 82,** and the Supreme Court in ***Bank of Cyprus v Melissa Menelaou*** **[2015] UKSC 66.** The former contains contains a neat illustration of the development of the rule over the last three years. The latter does not wholly settle the debate as to the precise ambit of the rule as to indirect benefits - the debate being whether it will only exceptionally provide a remedy, or whether a wider approach is to be preferred, which does not treat indirect benefits as falling into an exceptional category. But it does probably render that debate largely academic: It confirms the Courts should now be more firmly focused on the issue of economic reality overall, rather than a formalistic approach based on whether benefits were received directly or indirectly, and considering, more simply, whether there is a sufficient causal nexus or connection.

ITC v Revenue & Customs – the Facts[1]

The ITCs were all close end investment trusts who had received investment management services which they had understood at the time, but which in fact did not, attract the payment of VAT. Following discovery that VAT had been wrongly charged, the ITCs sought repayment from Revenue & Customs of the VAT they had paid.

Matters were complicated by the fact that (i) none of the tax had been paid directly to the Revenue, it had been paid to the various investment managers; and (ii) of every (notional) £100 that the claimants had paid to the managers, only £75 was passed to the Revenue; the other £25 was deducted by the managers as a set-off for input tax they had paid. The ITCs though sought repayment of the full £100, arguing that HMRC had been unjustly enriched not just by the £75 it received, but also accounting treatment of the £25 input tax.

[1] For the purposes of this article the full background has been slightly truncated to leave out the various elements of EU taxation law that, although fascinating in their own right, have no bearing on common law unjust enrichment claims.

First Instance

The key arguments at first instance revolved around the existence, or otherwise, of the so-called 'direct providers only' rule; i.e. that only the direct provider of the relevant enrichment can bring a claim. Much of the argument focussed on the divergent academic opinions which suggested either an absolute direct providers rule or no such rule all together.

Having pulled together the relevant strands, Henderson J adopted a middle approach, stating at paragraph 67 that:

"...In the first place, I agree with Mr Rabinowitz that there can be no room for a bright line requirement which would automatically rule out all restitutionary claims against indirect recipients. Indeed, Mr Swift accepted as much in his closing submissions. In my judgment the infinite variety of possible factual circumstances is such that an absolute rule of this nature would be unsustainable. Secondly, however, the limited guidance to be found in the English authorities, and above all the clear statements by all three members of the Court of Appeal in Kleinwort Benson Ltd v Birmingham City Council, suggest to me that it is preferable to think in terms of a general requirement of direct enrichment, to which there are limited exceptions, rather than to adopt Professor Birks' view that the rule and the exceptions should in effect swap places ... In my judgment the obiter dicta of May LJ in Filby, and the line of subrogation cases relied on by Professor Birks, provide too flimsy a foundation for such a reformulation, whatever its theoretical attractions may be, quite apart from the difficulty in framing the general rule in acceptable terms if it is not confined to direct recipients."

Henderson J then attempted to elucidate a governing principle for when exceptions to the 'direct providers only' rule should be allowed, stating at paragraph 68 that:

"The real question, therefore, is whether claims of the present type should be treated as exceptions to the general rule. So far as I am aware, no exhaustive list of criteria for the recognition of exceptions has yet been put forward by proponents of the general rule, and I think it is safe to assume that the usual preference of English law for development in a pragmatic and step by step fashion will prevail. Nevertheless, in the search for principle a number of relevant considerations have been identified, including (in no particular order):

a) the need for a close causal connection between the payment by the claimant and the enrichment of the indirect recipient;

b) the need to avoid any risk of double recovery, often coupled with a suggested requirement that the claimant should first be required to exhaust his remedies against the direct recipient;

c) the need to avoid any conflict with contracts between the parties, and in particular to prevent "leapfrogging" over an immediate contractual counterparty in a way which would undermine the contract; and

d) the need to confine the remedy to disgorgement of undue enrichment, and not to allow it to encroach into the territory of compensation or damages."

Applying these principles, Henderson J found that there was a sufficiently close causal connection between the payment of VAT by the ITCs and the receipt of a benefit by HMRC that the latter had indeed been enriched at the expense of the former. The door was therefore opened to broad based exception determined by a qualitative assessment of the causal nexus rather than a narrow legal analysis of the source of payment.

Subsequent Developments in the Court of Appeal

The first instance decision in *ITC v Revenue & Customs* was swiftly followed by three decisions in the Court of Appeal (***Melissa Menelaou v Bank of Cyprus***,[2] ***TFL Management Services v Lloyds Bank***,[3] ***Relfo Ltd v Varsani***,[4]) which all engaged issues of indirect benefits in the context a factually diverse unjust enrichment claims.

Menelaou v Bank of Cyprus was a lender's claim to be subrogated to a vendor's lien. The case was complicated though by the fact that the lender did not actually advance any funds, instead agreeing to release its security on property A (owed by the Menelaou parents) in favour for a security for property B (to be purchased for Melissa from the sale proceeds of property A). Perhaps predictably, the charge on property B turned out to be unenforceable with Melissa's signature having been forged on the deed.

At first instance the Bank's claim failed, the judge ruling that Melissa had not been enriched at its expense as property B had not been purchased with money supplied or owned by the Bank. The Bank had no tracing claim and could not claim to be the direct provider of the benefit that Melissa had received.

This narrow approach was rejected by the Court of Appeal who held that they were able to look at the economic reality of the situation when assessing whether Melissa had been enriched at the Bank's expense.[5] Looking at this economic reality, it was clear that Melissa would not have been obtained property B without the Bank's agreement to release the security on property A. There was therefore a *"sufficiently close causal connection"* between one and the other for a claim in unjust enrichment to be made out.[6]

Interestingly, the Court of Appeal in *Menelaou* did not state that they were applying an exception to the general rule and did not go on to apply the other four relevant considerations that Henderson J had developed. The decision was reached simply on the basis of the causal connection between the Bank's loss and Melissa's gain.

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[2] *Melissa Menelaou v Bank of Cyprus UK Ltd* [2013] EWCA Civ 1960
[3] *TFL Management Services Ltd v Lloyds Bank Plc* [2013] EWCA Civ 1415
[4] *Relfo Ltd (in liquidation) v Varsani* [2014] EWCA Civ 360
[5] See paragraph 36 of the judgment in particular.
[6] See paragraph 42.

The decision was appealed to the Supreme Court[7], and the decision of the Supreme Court is discussed further below.

The next Court of Appeal decision was *TFL Management Services v Lloyds Bank*. This involved slightly unusual circumstances. TFL had brought a claim for sale commission against a third party, which had failed on the basis that the commission was in fact owed to a company over which Lloyds had a debenture. When Lloyds obtained the commissions through the use of its security, TFL brought a claim for the cost of its proceedings against the third party, arguing that Lloyds had been enriched by its (unsuccessful) actions.[8]

The main issue on the appeal concerned the scope of the defence of incidental benefits which prevents a claim where the defendant's enrichment is an incidental benefit of an action taken by the defendant in furtherance of its own interests. This ground having been decided in favour of the claimant, the court went on to consider whether, in the circumstances, and bearing in mind the incidental nature of the benefit, Lloyds could have been said to be enriched at TFL's expense.

Addressing the question of indirect benefits, the Court of Appeal was happy to adopt as their starting point Henderson J's four relevant considerations (as set out above). They were clear the relevant considerations were no more than that; they were not rigid principles such that a failure to comply with one or more would necessarily be fatal.[9] Perhaps more importantly, the Court of Appeal were unwilling to find that the 2½ year gap between the conclusion of the initial litigation and Lloyd' receipt of a benefit prevented a causal connection from being made out.[10]

Relfo Ltd v Varsani was a rather unusual and murky case. One of R's former director's had close links with the family of V. The director caused R to make a transfer of £500,000 into the Latvian bank account of an unrelated company, with the transfer rendering R insolvent. The same day, a Lithuanian company paid the US dollar equivalent of £500,000 into V's bank account. The implication – though no direct proof was found – was that the payment to V had been engineered by the director as part of a wider scheme to make good trading losses caused to V's family.

Although the case was determined on the basis of a proprietary claim to trace the funds from R to V, the decision of the Court of Appeal contains an interesting analysis by Arden LJ of the law relating to indirect benefits. Having analysed the relevant case law, Arden LJ commented at paragraph 95 that the law is moving away from a 'direct providers only' rule with exceptions, and towards a general principle that:

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[7] The appeal was heard on 17th and 18th of June 2015

[8] This is a slight simplification of the facts, the third party having been pursued by another company from whom the rights to any claim against Lloyds were assigned to TFL.

[9] Interestingly, the Court of Appeal cited the view of the editors of Goff & Jones (see paragraph 51) who are usually seen as at the more liberal send of the spectrum so far as indirect claims are concerned. The authors would see reliance on them as opposed to other academics such as Andrew Burrows (whose so-called middle way most closely mirrors the approach of Henderson J in *ITC*) as indicative of the direction in which the Court of Appeal is heading.

[10] Although only decided on summary judgment basis, the authors regard the views of Floyd LJ as illustrative of the broader direction in which the court is moving. Potentially allowing such a significant gap moves us much closer to a 'but for' test of causation.

"Overall the court must find that there is a sufficient link between the formation of the transaction whereby the claimant conferred a benefit on the direct recipient (or was entitled to receive a benefit) and the transaction under which the defendant obtained a benefit to make the enrichment unjust.... Moreover, in deciding whether there is a sufficient link, the court will look at the substance and not the form."

Although these comments were strictly obiter and were not adopted by either Gloster LJ or Floyd LJ (they refused to be drawn on the formulation of general principles) they were not challenged and are, in the writers' view, the correct summary of the current trajectory of the law, as endorsed by the Supreme Court in *Bank of Cyprus v Menelaou*. It is worth stating though that it is clear from all three judgments in *Relfo* that any broadened test will not be as wider as mere 'but for' test of causation; a greater qualitative degree of connection will be required. [11]

ITC in the Court of Appeal

The arguments on appeal were much the same as at first instance. Unfortunately for Revenue & Customs though, the intervening decisions in *Menelaou*, *TFL* and *Relfo* in the Court of Appeal made it almost impossible to argue that Henderson J had taken too liberal an approach.

Following the earlier decisions in *Menelaou*, *TFL* and *Relfo*, the Court of Appeal (Patten LJ giving the leading judgment) had no hesitation in accepting that indirect benefits could be sufficient to found a claim for unjust enrichment.[12] The court were also clear that these three decisions had disavowed previous attempts to produce exhaustive lists of when exceptions would be available in favour of consideration of the facts of individual cases. [13]

Unfortunately though, the Court of Appeal was unwilling to go as far as to lay down comprehensive guidance on when indirect benefits would and would not be sufficient, echoing the earlier reluctance in both *TFL* and *Relfo*. At paragraph 68, Patten LJ explained that he was worried about moving to a general principle prematurely, echoing the comments of Lord Goff in his lecture *"The Search for the Principle"* that the court should guard against *"the temptation of elegance"* because *"the law has to reflect life in all its untidy complexity"*. That said Patten LJ he did not seek to row back from Arden LJ's view in *Relfo* that the various exceptions did indeed seem to be linked by a single underlying principle.[14]

As a concluding point, Patten LJ made clear that whilst the court was able to able to look at the economic and commercial reality of the situation when looking at the causal connection between the expense and the gain, it should take a similarly broad view to other considerations such as the need

[11] See paragraphs 79, 109 and 115.
[12] See paragraph 66 of the judgment of Patten LJ
[13] See paragraph 67
[14] See paragraph 96 of her judgment in *Relfo*

to ensure the unjust enrichment claims did not undermine the contractual relationship between the parties, or seek to leapfrog third parties in a way that would undermine the contract.[15]

Bank of Cyprus v Melissa Menelaou in the Supreme Court

The Supreme Court judgment in *Menelaou* was handed down on 4 November 2016 The Supreme Court dismissed the appeal, and upheld the decision of the Court of Appeal, which recognised a remedy in favour of the bank - namely that it should be entitled to be subrogated to the unpaid vendor's lien. Lord Clarke gave the principal judgment.

At paragraph 18 of his judgment he noted that this was clearly a case of unjust enrichment. He noted that in *Benedetti v Sawiris* [2013] UKSC 50, [2014] AC 938 the Supreme Court recognised that it is now well established that the court must ask itself four questions when faced with a claim for unjust enrichment: (1) Has the defendant been enriched? (2) Was the enrichment at the claimant's expense? (3) Was the enrichment unjust? (4) Are there any defences available to the defendant? See, for example, *Benedetti* at para 10, following *Banque Financière de la Cité v Parc (Battersea) Ltd* [1999] 1 AC 221 per Lord Steyn at 227 (and per Lord Hoffmann to much the same effect at 234).

As to issue (1) the issue of enrichment was not difficult to identify here: Melissa Menleaou had, if no remedy was granted, clearly benefited by the sum freed up by the release of the Bank's security, which helped her to discharge the obligation to pay the vendor of the new property. As to issue (2), was the enrichment at the claimant's expense? This was the critical issue. Lord Clarke thought the answer was plainly yes (paragraph 24). He rejected a formalistic approach (paragraph 26), echoing earlier observations of Lord Steyn in *Banque Financiere*. Those observations were also followed (in the context of the principle of *res inter alios acta* or collateral benefits) by the Court of Appeal in *Lowick Rose LLP v Swynson Ltd* [2015] EWCA Civ 629.

On causation, Lord Clarke rejected the submission that there must be a direct payment by the Bank to Melissa. He held that whilst such a requirement would be sufficient it was necessary because it would make matters too rigid. He confirmed that he considered the test was best simply put as (paragraph 27): "*whether a particular enrichment is at the expense of the claimant depends upon the facts of the case. The question in each case is whether there is a sufficient causal connection, in the sense of a sufficient nexus or link, between the loss to the Bank and the benefit received by the defendant, here Melissa*." He did not finally decide the issue of whether the court approach is a narrow test, with exceptions, or a broader approach, but tentatively suggested there should be no presumption either way (paragraph 32) as to the correct starting point.

Lord Neuberger gave a concurring judgment, and noted that it was difficult to identify a better remedy to remove the unjust enrichment on the facts of the case, though he expressly left open the possibility that the Bank might have had a direct personal claim against Melissa Menelaou.

[15] See paragraph 68.

Lord Carnwath agreed with the decision but arrived at it by a different route: by the application of traditional principles of subrogation and on the basis that there was a clear tracing link, based on principles set out in *Boscawen v Baja*.

Discussion

Following *ITC* and *Menelaou* it could not be clearer that there is no longer a 'direct providers only' rule in unjust enrichment claims, and that the exceptions to the general principle will be based on economic and commercial realities rather than predetermined classes of exceptional cases. Claims may in appropriate circumstances be brought not simply by indirect recipients' of money but also cases where there is the indirect provision of 'value' in the wider sense of the term. This can include both the loss of security by the transferor, and cases where the ultimate transferee does not actually receive money or money's worth.

It remains sensible to approach claims in respect of indirect benefits with more caution than direct benefit cases, but it is not necessary to approach them on the basis they are an exception to the general rule. In determining whether indirect benefits have a sufficient causal link is a question of fact in each case. Whilst treating his observations as to indirect benefits being exceptional with some caution, a useful practical starting point remains the four 'relevant considerations' identified by Henderson J in the *ITC* case. The application of these consideration is though subject to the observations in: (i) *TFL* and *Menelaou* that they are not rigid principles and that a failure to meet more than one will necessarily result in failure; and (ii) *ITC* that if one is considered on a broader basis then the others must be as well; and (iii) that ultimately the test is whether there is *a "sufficient causal connection"* (*Menelaou*).

The Supreme Court has now endorsed a move towards a general principle based on the sufficiency of the causal connection between the transactions giving rise to loss and gain respectively. This is not simply a 'but for test' (albeit some academics, such as Goff & Jones have suggested this route), but one requiring a form of qualitative assessment based on a broader analysis of the economic and commercial realities of the situation.[16]

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[16] This may be said to be a neat counterpoint to the Supreme Court's decision in *Prest v Petrodel Resources Ltd* [2013] UKSC 34, where Lord Sumption adopted the earlier comments of Goff LJ in *Bank of Tokyo Ltd v Karoon (Note)* [1987] AC 45 at 64 that *"we are concerned not with economics but with law."*