Third edition

A SOURCEBOOK ON EQUITY & TRUSTS IN AUSTRALIA

M W Bryan
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M S Donald
V J Vann

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A Sourcebook on Equity and Trusts in Australia presents a selection of relevant cases and instructive commentary to introduce students to the study of Australian equity and trusts law. Designed to follow the structure of the third edition of *Equity and Trusts in Australia*, it can also be used as a freestanding casebook.

Cases and primary legal materials have been carefully selected to guide students through the real-world application of legal principles. The third edition has been fully updated to discuss recent landmark decisions, including *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd* (2018) 265 CLR 1, *Smethurst v Commissioner of Police* [2020] HCA 14 and *Caron v Jahani (No 2)* [2020] NSWCA 117.

Extracts are accompanied by detailed commentary, and additional notes and discussion questions throughout each chapter enhance and test students' understanding of complex cases and issues.

Written by a team of experienced authors, *A Sourcebook on Equity and Trusts in Australia* offers an accessible introduction to the application of equity and trusts law.

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Shaftsbury Road, Cambridge CB2 8EA, United Kingdom

One Liberty Plaza, 20th Floor, New York, NY 10006, USA

477 Williamstown Road, Port Melbourne, VIC 3207, Australia

314–321, 3rd Floor, Plot 3, Splendor Forum, Jasola District Centre, New Delhi – 110025, India

103 Penang Road, #05–06/07, Visioncrest Commercial, Singapore 238467

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www.cambridge.org

Information on this title: www.cambridge.org/highereducation/isbn/9781009073912

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First published 2016

Second edition 2020

Third edition 2023

Cover designed by Anne-Marie Reeves

Typeset by Lumina Datamatics Ltd

Printed in China by C & C Offset Printing Co., Ltd, September 2022

A catalogue record for this publication is available from the British Library

A catalogue record for this book is available from the National Library of Australia

ISBN 978-1-009-07391-2 Paperback

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Preface

A constant flow of case law on equity and trusts has necessitated the revision of nearly every chapter of this edition. Recent decisions meriting lengthy extracts include *Smethurst v Commissioner of Police* [2020] HCA 14 on injunctions and *Caron v Jahani (No 2)* [2020] NSWCA 117 on the intermediate balance rule in tracing. The last decision is a reminder that decisions of intermediate appeal courts remain an important source of equity jurisprudence. Where differences between State and Territory law are relevant – for example, with respect to provisions of trustee legislation – notes to extracted cases explain the differences.

Like its predecessor, this edition has been designed as a companion to *Equity and Trusts in Australia*, third edition, published by Cambridge University Press in 2022. Students will derive the greatest benefit from working with both books, but this Sourcebook has been designed as a freestanding teaching resource for equity teachers and students who prefer to work only from primary legal materials. Like the textbook, the Sourcebook has been written with the conviction that an understanding of equitable doctrine must rest on a secure knowledge of the principles that inform the award of equitable remedies – hence the early chapters devoted to an analysis of the principles governing the award of equitable relief.

The authors' policy on gender neutrality is to vary the pronouns 'she' and 'he', and the possessive adjectives 'his' and 'hers'.

The authors would like to thank equity and trusts teachers, as well as reviewers of individual chapters, for their feedback. The willingness of equity and trusts teachers to share their experiences of teaching with the Sourcebook is greatly appreciated. We all acknowledge the professionalism, patience and resourcefulness of Lucy Russell, Emily Baxter and their colleagues at Cambridge University Press.

We have endeavoured to state the law as at 1 December 2021.

M W Bryan, S E Degeling, M S Donald and V J Vann

9 March 2022

Acknowledgements

The authors and Cambridge University Press would like to thank the following for permission to reproduce material in this book.

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s 14, 657

Victoria

Charities Act 1978

s 7M, 404

Goods Act 1958

ss 27–31, 197

Limitation of Actions Act 1958

s 5(8), 126

Property Law Act 1958

s 53, 206

s 53(1)(a), 389, 636

s 53(1)(b), 389

s 53(1)(c), 228

s 134, 225

s 172, 399

s 199, 196

Supreme Court Act 1986

s 38, 56

Supreme Court (Judicature) Act 1883, 9

Supreme Court (General Civil Procedure) Rules 2005

r 54.02, 496

Trustee Act 1958

s 5, 457

ss 6–8, 460

s 12D, 473

s 36(1), 510

s 48, 515

s 51, 637

s 63, 428, 656

s 63A, 428, 656–7

s 63A(1)(d), 657

s 67, 507

s 68, 512

Wrongs Act 1958

s 24, 511

Western Australia

Property Law Act 1969

s 20, 225

s 34, 206, 636

s 34(1)(a), 228, 389

s 34(1)(b), 389

s 34(1)(c), 228, 389

s 89, 399

Supreme Court Act 1880, 9

Trustees Act 1962

s 17, 457

ss 18–20, 460

s 26C, 473

s 36, 510

s 71, 482

s 75, 507

s 76, 512

s 77, 515

s 89, 656

s 90, 657

s 90(2), 657

s 92, 496

s 94, 503

s 102, 404

New Zealand

Trusts Act 2019

s 35, 446

United Kingdom

Australian Courts Act 1828

s 11, 10

s 24, 10

Chancery Amendment Act 1858, 52, 56, 57, 59

Conveyancing Act 1882

s 3, 196

Ecclesiastical Leases Act 1571, 7

Fraudulent Conveyances Act 1571, 399

Judicature Act 1873, 10–12, 55

s 25, 12

s 25(1)–(10), 12

s 25(11), 9, 12

Judicature Act 1875, 55

Judicial Trustees Act 1896

s 3, 504

Law of Property Act 1925

s 53(1)(a), 232

s 53(1)(b), 232

s 53(1)(c), 232

Limitation Act 1980

s 21, 125

s 38(1), 125

Married Women's Property Act 1882, 207

New South Wales Act 1823, 10

Senior Courts Act 1981

s 50, 56

Statute of Charitable Uses 1601

Preamble, 404, 405

Statute of Frauds 1677, 206, 390, 394, 590

s 3, 228, 389

s 7, 389

s 9, 389

Statute of Limitations 1623, 350

Statute of Uses 1535, 348

Trustee Act 1925, 125

s 68(17), 125

Variation of Trusts Act 1958, 656

International instruments

Hague Convention on the Laws Applicable to Trusts and on their Recognition

art 2, 344

Abbreviations

References to 'the *Trustee Act*' are to the trustee legislation of each State and Territory, namely:

Trustee Act 1925 (ACT)

Trustee Act 1925 (NSW)

Trustee Act 1980 (NT)

Trusts Act 1973 (Qld)

Trustee Act 1936 (SA)

Trustee Act 1898 (Tas)

Trustee Act 1958 (Vic)

Trustees Act 1962 (WA)

For example, a reference to 'NSW s 14' is a reference to s 14 of the *Trustee Act 1925* (NSW).

Part A

Introduction

1

An overview of equity

1.1 Introduction

1.2 Definition

1.3 History

1.4 The maxims of equity

1.1 Introduction

Equity is a chameleonic word, taking its colour from the context in which it is used. For the purposes of this Sourcebook, equity refers to the principles, doctrines and remedies applied by Australian courts exercising the jurisdiction of the English Court of Chancery prior to the enactment of judicature legislation which reformed the structure of the court system in the mid-nineteenth century (see [1.3.3b]). Equity, in this sense, is intelligible without having to acquire an understanding of legal history, but the understanding will be deeper if that history is known. This chapter identifies some of the landmarks of that history.

The final section summarises some of the more common equitable maxims. The student will occasionally encounter them when reading the cases, and should consider their value in applying equitable doctrine to the circumstances of an individual case.

1.2 Definition

1.2.1 Dictionary definition

1.2.1a *Macquarie Dictionary* and *Thesaurus Online*

equity/ ˈekweti/ (say ˈekwuhtee) *noun (plural* equities)

(1) the quality of being fair or impartial; fairness; impartiality.

(2) that which is fair and just.

(3) *Law*

(a) the application of the dictates of conscience or the principles of natural justice to the settlement of controversies.

(b) a system of jurisprudence or a book of doctrines and rules developed in England and followed in other common law countries, serving to supplement and remedy the limitations and the inflexibility of the common law.

(c) an equitable right or claim.

Note

This book is concerned with meanings 3(a)–(c) above. Consider the relationship between these meanings and meanings 1 and 2 above. Reflect also on the relationship (and occasional tension) between 3(a) and 3(b).

1.2.2 Philosopher and jurist

1.2.2a Aristotle, *Nicomachean Ethics*, tr WD Ross (Oxford University Press, 1908) *Book V: Moral Virtue*

Chapter 10: Equity, a corrective of legal justice

And this is the nature of the equitable, a correction of the law where it is defective owing to its universality. In fact this is the reason why all things are not determined by law. That about some things it is impossible to lay down a law, so that a decree is needed … It is plain, then, what the equitable is, and that it is just and is better than one kind of justice. It is evident also from this who the equitable man is; the man who chooses and does such acts, and is no stickler for his rights in a bad sense but tends to take less than his share though he has the law on his side, is equitable, and this state of character is equity, which is a sort of justice and not a different state of character.

1.2.2b *Earl of Oxford's Case* (1615) 1 Ch Rep 1, 6; 21 ER 485, 486

Lord Ellesmere LC

The Cause why there is a Chancery is, for that Mens Actions are so divers and infinite, That it is impossible to make any general Law which may aptly meet with every particular Act, and not fail in some Circumstances.

The Office of the Chancellor is to correct Mens Consciences for Frauds, Breach of Trusts, Wrongs and Oppressions, of what Nature soever they be, and to soften and mollify the Extremity of the Law, which is called *Summum Ius*.

Note

Aristotle and Lord Ellesmere justified equity on the ground that it modifies the law where the inflexible application of legal rules causes injustice in individual cases. When studying the individual equitable doctrines, consider whether this is a convincing justification for equitable intervention.

Question

Is equity still needed now that legislation can remedy defects in the law?

1.3 History

1.3.1 Origins

1.3.1a JH Baker, *An Introduction to English Legal History* (Oxford University Press, 4th ed, 2002) 99–102

The Chancery *(cancellaria)* began as the royal secretariat, housed in the king's chapel. In origin it was no more a court of law than the Exchequer, but was a department of state descended from the Anglo-Saxon scriptorium where royal writs and charters were drawn and sealed. The head of department, the chancellor, had the custody of the great seal of England, which was used to authenticate the documents which his clerks prepared. Royal grants of property, privilege, dignity or office, charters, writs and commissions, all had to 'pass the seal' in Chancery. The original writs of the common law emanated from the same department, and through them the chancellor was associated with the ordinary administration of justice.

The chancellor has always been primarily an officer of state and a minister of the Crown. Most medieval chancellors were also bishops, or even archbishops. Some chancellors, notably Cardinal Wolsey (1515–29) and Lord Clarendon (1658–67), were prime ministers in all but name … Yet the majority of chancellors have been lawyers and until 1875 spent most of their time sitting in court …

The chancellor's English jurisdiction, so called because the bills and pleadings were written in the vernacular tongue, grew not from the departmental work of the Chancery but from the jurisdiction of the king's council to deal with bills of complaint. We have seen that in the fourteenth century bills addressed to the king in council, complaining of interference with the common law, were passed on to the judges. Later in the century bills of this kind were addressed to the chancellor alone, whose function in such cases was not to dispense justice so much as to facilitate its achievement in other courts, to serve as 'a convenient clearing-house for all kinds of business transacted elsewhere' (Sayles, 76 *Selden Society* lxxi, lxxix). The jurisdiction was still that of the council, and the chancellor was – by a kind of fiction – deemed to be acting on behalf of 'the king and his council in Chancery.' By the time of Richard II (1377–1399), a further development had occurred. Bills increasingly sought a specific remedy from the chancellor himself, irrespective of whether proceedings were pending at common law, and it is evident that the chancellor had begun to issue process and grant decrees in Chancery instead of sending the petition elsewhere. … Decrees were at first made in the name of the king in council, and then by the 'court', sometimes reciting the presence of judges and king's serjeants, councillors and advisers; but during the fifteenth century the chancellor came to issue decrees in his own name. In making such decrees, medieval councillors or chancellors did not regard themselves as administering a system of law different from the law of England. They were reinforcing the law by making sure that justice was done in cases where shortcomings in the regular procedure, or human failings, were hindering its attainment by due process. They came not to destroy the law, but to fulfil it (FW Maitland, *Equity* (1909) 17).

1.3.1b Petition c 1417–1424, No 117 from WP Baildon (ed), *Select Cases in Chancery* (Selden Society, 1896) vol 10

To the most reverend and most gracious Father in God, the Bishop of Durham, Chancellor of England,

Humbly beseecheth your continual orator, Thomas Messendyn the younger, that whereas Thomas Messendyn his father enfeoffed Richard Pierson, parson of the church of Hatcliffe, John West, parson of the church of Bradley, John Barneby of Barton the younger, and John See of Little Coates, of certain land and tenements in the town of Healing in the County of Lincoln, to the value of £10 a year, on condition that the said enfeoffees should enfeoff the said suppliant in the lands and tenements aforesaid when he should come to the age of 18 years; and now the said suppliant is of the age of 18 years and more, and he hath many times requested the said feoffees to enfeoff him in the said lands and tenements according to the wish and condition of his said father; and they do utterly refuse, and say that they will hold the said lands and tenements to their own use: May it please your most gracious Lordship to grant certain writs to send for the said feoffees on certain pains by you to be limited, to answer before you in the Chancery, and to declare wherefore they will not enfeoff the said suppliant according to the wish and condition aforesaid; for God and in way of charity; considering, most gracious Lord, that the said suppliant can have no recovery at common law.

Note

This is a translation of a petition written in French. The arrangement said to have been created by the supplicant's father was the use. The use was the early form of trust and, in modern terminology, the complaint is one for breach of trust: land was conveyed to various persons (the feoffees) on condition that they conveyed it to the complainant (enfeoffed him) when he was 18. The petition requests the Chancellor to investigate the allegation that the feoffees retained the land for themselves instead of keeping their promise to convey it to the complainant.

1.3.2 Conflict between common law and equity

1.3.2a Joshua Getzler, 'Patterns of Fusion' in Peter Birks (ed), *The Classification of Obligations* (Clarendon Press, 1997) 175

Sometime in the early 1530s, two centuries after the inception of Chancery's jurisdiction in equity, the Lord Chancellor of England invited the common law judges to dinner. Sir Thomas More's purpose in throwing this entertainment was to discuss the judges' vehement objections to the Chancery's practice of issuing common injunctions, which forbade plaintiffs from pursuing unconscionable claims in the common law courts. Sir Thomas, himself a skilled common lawyer and the first such to sit on the Woolsack, suggested that Chancery would desist from intervening if only the law courts would exercise their discretion to 'mitigate and reform the rigour of the law'. But the judges refused, as More later recounted, because 'they may by the verdict of the jury cast off all quarrels from themselves upon them, which they account their chief defence' [WF Roper, *The Lyfe of Sir Thomas More* (ed EV Hitchcock, London 1935) 44–5]. At this time came perhaps the fateful step towards the splitting of legal and equitable jurisdictions in England. When the common lawyers refused to admit the broadest range of factual evidence into curial deliberations, and then to develop legal tests and principles to sift such an expanded admission of evidence and guide the jury, they thereby ensured the survival and growth of the ameliorating Chancery jurisdiction. For the rest of the sixteenth century litigants flocked to the Chancery and the other prerogative courts of equity, and their business came to rival that of the common law courts, whose business relatively declined.

1.3.2b *Earl of Oxford's Case* (1615) 1 Ch Rep 1; 21 ER 485

In the late sixteenth century chancellors began issuing orders, known as common injunctions, restraining plaintiffs from executing a judgment obtained at common law where the judgment had been obtained unconscionably. In *Finch v Throckmorton* (1597) 118 Selden Soc 441 the common law judges resolved that this kind of 'intermeddling' in common law matters should be prohibited. However, Thomas Egerton, appointed Chancellor by King James I as Lord Ellesmere, continued the practice of issuing common injunctions. The common law judges, led by Coke CJ, released litigants who had been imprisoned for disobeying the injunctions.

The issue was brought to a head in this case involving land owned by Magdalene College, Cambridge. The land was initially sold to Queen Elizabeth I and leased, the lease eventually being held by Warren. The College later took the view that the original sale was void under the Ecclesiastical Leases Act 1571 and instead leased the land to Smith. Warren brought an action of ejectment at common law to evict Smith. Coke CJ held that the original transfer of land was void and that Smith could not be evicted. The Earl of Oxford, claiming to be owner of the land following a resale of the land by Elizabeth I, later reopened the case in Chancery before Lord Ellesmere. Smith refused to respond to the equity suit and was committed to prison for contempt of court. At the same time Lord Ellesmere granted a common injunction against the enforcement of any common law judgment to release Smith from prison.

The matter was referred to King James I in the Privy Council. He issued a declaration affirming the injunction, stating that 'it properly belongeth to our princely office to take care and provide that our subjects have equal and indifferent justice ministered to them; and that when their case deserveth to be relieved in course of equity by suit in our Court of Chancery, they should not be abandoned and exposed to perish under the rigour and extremity of our laws, we … do approve, ratifie and confirm, as well the practice of our Court of Chancery' (D Kerly, *An Historical Sketch of the Equitable Jurisdiction of the Court of Chancery,* 1890, 114).

1.3.3 Reform and renewal

1.3.3a Charles Dickens, *Bleak House* (first published 1853)

London, Michaelmas Term lately over, and the Lord Chancellor sitting in Lincoln's Inn Hall. On such an afternoon, if ever, the Lord High Chancellor ought to be sitting here – as here he is – with a foggy glory round his head, softly fenced in with crimson cloth and curtains, addressed by a large advocate with great whiskers, a little voice, and an interminable brief, and outwardly directing his contemplation to the lantern in the roof, where he can see nothing but fog. On such an afternoon, some score of members of the High Court of Chancery bar ought to be – as here they are – mistily engaged in one of the ten thousand stages of an endless cause, tripping one another up on slippery precedents, groping knee-deep in technicalities, running their goat-hair and horse-hair warded heads against walls of words, and making a pretence of equity with serious faces, as players might. On such an afternoon, the various solicitors in the cause, some two or three of whom have inherited it from their fathers, who made a fortune by it, ought to be – as are they not? – ranged in a line, in a long matted well (but you might look in vain for Truth at the bottom of it), between the registrar's red table and the silk gowns, with bills, cross-bills, answers, rejoinders, injunctions, affidavits, issues, references to masters, masters' reports, mountains of costly nonsense, piled before them.

Well may the court be dim, with wasting candles here and there; well may the fog hang heavy in it, as if it would never get out; well may the stained glass windows lose their colour, and admit no light of day into the place; well may the uninitiated from the streets, who peep in through the glass panes in the door, be deterred from entrance by its owlish aspect, and by the drawl languidly echoing to the roof from the padded dais where the Lord High Chancellor looks into the lantern that has no light in it, and where the attendant wigs are all stuck in a fog-bank! This is the Court of Chancery; which has its decaying houses and its blighted lands in every shire; which has its worn-out lunatic in every madhouse, and its dead in every churchyard; which has its ruined suitor, with his slipshod heels and threadbare dress, borrowing and begging through the round of every man's acquaintance; which gives to monied might the means abundantly of wearying out the right; which so exhausts finances, patience, courage, hope; so overthrows the brain and breaks the heart; that there is not an honourable man among its practitioners who would not give – and who does not often give – the warning, 'Suffer any wrong that can be done you, rather than come here!'

Note

It is generally agreed that *Bleak House* is set in or about 1827, when Lord Lyndhurst had just succeeded Lord Eldon as Chancellor. On the nineteenth-century reforms to Chancery, see M Lobban, 'Preparing for Fusion: Reforming the Nineteenth Century Court of Chancery' (2004) 22 *Law and History Review* 389, 565; P Polden, 'The Court of Chancery 1820–1875' in *The Oxford History of the Laws of England* (Oxford University Press, 2010) vol XI, 646–91; MJ Leeming, 'Five Judicature Fallacies' in JT Gleeson et al (eds), *Historical Foundations of Australian Law* (Federation Press, 2013) 169.

1.3.3b *Judicature Act 1873* (Imp)

Section 25(11)

Generally, in all matters not hereinbefore particularly mentioned, in which there is any conflict or variance between the Rules of Equity and the Rules of the Common Law with reference to the same matter, the Rules of Equity shall prevail.

1.3.3c *Law Reform (Law and Equity) Act 1972* (NSW)

Section 5: Rules of equity to prevail

In all matters in which there was immediately before the commencement of this Act or is any conflict or variance between the rules of equity and the rules of common law relating to the same matter, the rules of equity shall prevail.

Note

The delayed introduction of judicature legislation in New South Wales has arguably had a significant effect on the development of equitable doctrine in Australia. Most other States adopted the Judicature Act model not long after it was enacted in England: *Judicature Act 1876* (Qld); *Supreme Court Act 1878* (SA); *Supreme Court Civil Procedure Act 1932* (Tas); *Supreme Court (Judicature) Act 1883* (Vic); *Supreme Court Act 1880* (WA). The relevant legislation for the Territories is the *Supreme Court Act 1933* (ACT) (s 33 being the equivalent of s 25(11) above) and the *Supreme Court Act 1979* (NT) (s 68 reproduces s 25(11)).

Queensland and South Australia had pioneered innovative models of fusion prior to the adoption of the English model: see B McPherson, *The Supreme Court of Queensland* (Butterworths, 1989) 138; G Taylor, 'South Australia's Judicature Act Reforms of 1853' (2001) 22(1) *Journal of Legal History* 55.

Question

Did the judicature legislation remove the defects of Chancery identified by Charles Dickens in *Bleak House?* If not, what defects was the legislation intended to remove?

1.3.3d Keith Mason, 'Fusion: Fallacy, Future or Finished?' in S Degeling and J Edelman (eds), *Equity in Commercial Law* (Thomson Reuters, 2005)

In 1765, William Blackstone in his *Commentaries on the Laws of England,* formulated the general law rule of reception of English law into 'settled' colonies, which all Australian colonies were later presumed to be. He proclaimed that 'all the English laws then in being … [were] immediately there in force'. This principle was qualified by the statement that the colonists carried with them 'only so much of the English law as is applicable to their own situation and the condition of an infant colony'. The uncertain operation of Blackstone's rule had led to difficulties in New South Wales by the 1820s, but no one doubted that the general law of England (including Chancery

law) was part of the colonists' inheritance. Ellis Bent, who was Judge-Advocate during Governor Macquarie's time, granted equitable relief where appropriate, although he had no specific statutory authority to do so. The Civil Supreme Court created under the second *Charter of Justice* in 1814 was declared among other things to be a Court of Equity having equitable jurisdiction.

Section 24 of the *Australian Courts Act 1828* (Imp), which applied in Australia by paramount force, was applicable to New South Wales as well as Tasmania, Victoria, Queensland and the Australian Capital Territory as they later emerged out of New South Wales. It provided that all laws and statutes in force in England on 25 July 1828 were to be applied 'so far as the same can be applied'. The Supreme Court of New South Wales founded in 1823 (which continues to this day) was a creature of statute and the royal prerogative. Its statutory parent was the *New South Wales Act 1823*. The 1823 Act declared it lawful for the King to establish a court of judicature styled 'the Supreme Court of New South Wales'. The Act defined the principal jurisdictions of the Court, largely by reference to English models. Jurisdiction at common law was assimilated to the civil and criminal authority of the Judges of Kings Bench, Common Pleas and Exchequer in England. As a court of equity, the Supreme Court was to have the equitable jurisdiction exercised by the Lord High Chancellor within England. In 1828, this last grant of jurisdiction was supplemented by adding 'and all such acts matters and things can or may be done by the said Lord High Chancellor within the realm of England in the exercise of the common law jurisdiction to him belonging' (*Australian Courts Act 1828* s 11). This neatly makes my point that procedural and remedial fusion in England started long before the *Judicature Act 1873* (UK).

For New South Wales the systems of common law and equity were never, as in England, to be administered by separate courts, but always by one and the same Supreme Court. But procedures and doctrines remained distinctive. A single judge wearing his equity wig could issue a common injunction directed at the prosecution or enforcement of common law proceedings or judgments pending before one of his brethren or in the Supreme Court generally.

The 19th century judges in New South Wales were well aware that law and equity were different systems, each with their different procedures. Certainly by the 1840s any thought of adopting a single procedure was abandoned. English court dress, precedents and practice came to be followed with as much rigour as colonial conditions allowed. The Privy Council also curbed centrifugal tendencies, as elsewhere throughout the Empire. English reforming statutes were followed and adopted for use within the single Supreme Court. In 1850, the Full Court of the Supreme Court of New South Wales in *Bank of Australia v Murray* ((1850) 1 Legge 612) declined to grant any relief to a plaintiff who had proceeded by bill in equity instead of at common law. There the matter rested until the Queenslander Sir Samuel Griffith became the first Chief Justice of the High Court of Australia in 1903.

The substantive and procedural rules pertaining to matters on the common law and equity 'sides' of the Supreme Court of New South Wales operated in separate and seldom intersecting spheres, albeit administered by a single Supreme Court. The size of the Court never rose above seven in the 19th century. The shortage of judges skilled in equity and mid-century delays in handling equity matters actually encouraged moves to differentiate the Equity side of the Court. A Primary (later Chief) Judge in Equity was designated. There was even a proposal to create a separate building for Equity. The fusion reforms of the English *Judicature Act 1873* were resisted, although the judiciary and profession were divided on the issue.

… Echoes of the nineteenth, twentieth and twenty-first century debates about fusion and its consequences surfaced as early as the first volume of the Commonwealth Law Reports.

In *McLaughlin v Fosbery* ((1904) 1 CLR 546) the High Court refused to overturn an order of the New South Wales Chief Judge in Equity staying all proceedings on an action for damages for assault and false imprisonment. The underlying dispute related to the confinement of the appellant, a lunatic, on the basis of an order by his committee. The High Court held that the Supreme Court ought to have stayed proceedings in the exercise of its inherent jurisdiction to stay vexatious actions, ie reliant on the exercise of common law jurisdiction. It was therefore an error that the stay of the common law action had been granted by the Chief Judge in Equity in reliance on (Equity) lunacy jurisdiction. Since, however, the Full Court of the Supreme Court had power on appeal to disregard formal defects and irregularities in the proceedings, the High Court decided by majority to do the same. Accordingly the appeal was dismissed.

Griffith CJ (speaking for himself and Barton J) explained (at 568–9) that the Supreme Court of New South Wales was:

> one Court, having under its original constitution all the powers which the Courts of Chancery and the Common Law and Ecclesiastical Courts had in England. Every Judge of the Court has the powers and authority of a Judge of the Court, and his powers are not in fact or in law impaired if he erroneously attributes the source of any particular power to the wrong Statute. …

O'Connor J dissented strongly, stating (at 574–5):

> It is said there is only the one Supreme Court invested with both common law and Equity powers, and that it is always open to the Court to apply any of its powers to facts that come before it. It is true that there is only one Supreme Court invested with all these powers, but ever since the establishment of the Court under the Charter of Justice its powers in Equity and its powers at common law have been exercised by separate divisions of the Court – separate not only in name and form, but administering in many respects different systems of jurisprudence …

Statutory reforms were introduced to the Supreme Court of New South Wales in stages, culminating in the fusion of administration of law and equity and adoption of a common pleading system with the *Supreme Court Act 1970*. Section 57 of that Act commands the Court to 'administer concurrently all rules of law, including rules of equity'. There were other borrowings from the English provisions.

The early stirrings in the High Court nevertheless suggest that a bolder resort to existing judicial power might have broken the waters of separation for New South Wales, which had by 1900 become a legal Jurassic Park. They certainly affirm my proposition … that any distinction between law and equity is non-jurisdictional.

Substantive fusion achieved by the *Judicature Act*

Section 25 of the *Judicature Act 1873* (UK) also directly fused substantive law and equity. On the orthodox view, it did so only to a limited degree. It is, however, possible to see s 25(11) as the statutory capping of a process that had started in 1615. Parliament confirmed Equity's precedence as a matter of last resort (if Judges of a single Court could not sort out remedial and doctrinal differences between Law and Equity by their own devices).

The side-note to s 25 was 'Rules of law upon certain points'. Subsections (1) to (10) dealt with particular conflicts between law and equity in respect of the same subject matter. The 'conflicts or variances' thereby resolved related to assignments of choses in action, stipulations as to time in contract, the custody of infants, equitable waste, merger of estates, administration of insolvent estates and actions for trespass by mortgagors in possession. Resolution was generally in favour of Chancery's rule, but a statutory amalgam of law and equity was devised as regards assignments. The miscellany of topics is itself testimony to the extent to which the two systems were treading on each other's toes when administered separately. …

By the time that New South Wales took its great leap forward to the 19th century by enacting the *Supreme Court Act 1970* most of the matters covered by s 25(1)–(10) of the *Judicature Act 1873* (UK) had already been addressed by the New South Wales Parliament. It was only thought necessary to enact a modern variant of subs (11).

1.4 The maxims of equity

Students will come across references to the maxims of equity. The maxims are not rules, but they conveniently summarise some equitable principles. There is no authoritative list of equitable maxims, but the following are among those commonly cited and applied:

(a) A litigant who seeks equity must do equity.

(b) A litigant who comes to equity must come with clean hands.

(c) Equity looks to intent, rather than to form.

(d) Equity treats as done that which ought to be done.

(e) Equity acts in personam.

(f) Equity follows the law.

(g) Equity does not assist a volunteer.

(h) Equity will not perfect an imperfect gift.

(i) Delay defeats an equity.

1.4a *Corin v Patton* [1990] HCA 12; (1990) 169 CLR 540

Background

Mr and Mrs Patton were joint registered proprietors of land. Mrs Patton, who was terminally ill, wanted to sever the joint tenancy and give her share of the property to the plaintiff, her brother. She executed a memorandum of transfer of her interest in the property to the plaintiff, who was to hold it on trust for her until her death. She also executed a will leaving her estate to her children. If the transfer was successful, her share of the property would have formed part of her estate.

The certificate of title was held by a bank, as unregistered mortgagee of the property. Mrs Patton took no action to procure production of the certificate of title from the bank so as to enable the transfer to be registered. When she died, the plaintiff claimed her share of the land – a claim resisted partly because he was a volunteer and 'equity does not assist a volunteer'.

Decision

The High Court held that the transfer would have been complete in equity if Mrs Patton had done everything within her power to complete the transfer. It was, however, incomplete since she had not procured the certificate of title for registration before she died.

The following passage discusses the application of the principle that equity will not assist a volunteer.

Mason CJ and McHugh J

Of course it would be a mistake to set too much store by the maxim [that equity will not assist a volunteer]. Like other maxims of equity, it is not a specific rule or principle of law. It is a summary statement of a broad theme which underlies equitable concepts and principles. Its precise scope is necessarily ill-defined and somewhat uncertain. It is subject to certain clearly established exceptions such as the rule in *Strong v Bird* (1874) LR 18 Eq 315 and the doctrine of estoppel, where an equity arises in favour of an intended donee from the conduct of the donor after the making of the voluntary promise by the donor … These exceptions have no bearing on the present case except in so far as they demonstrate that the maxim does not enunciate an inflexible or universal rule. What is of importance is that this and the related maxim that equity will not perfect an imperfect gift are primarily associated with the rule that a voluntary covenant is not enforceable in equity, a rule which itself has become the subject of critical scrutiny in some of its applications: see Macnair, 'Equity and Volunteers', (1988) 8 Legal Studies 172. Thus, a volunteer who is the object of an intended trust will only succeed if the trust has been completely constituted.

Note

For other examples of use of equity's maxims, see *Smethurst v Commissioner of Police* ('equity will not suffer a wrong to be without a remedy') [3.3.2a]; *Black Uhlans* [6.4a]; *Giumelli v Giumelli* [6.6a] and [8.5a]; and *Milroy v Lord* [9.2a].

Questions

(1) How useful are the maxims? J Edelman in John McGhee (ed), *Snell's Equity* (Sweet and Maxwell, 2010) at 5–001 states that application of the maxims has 'led to decisions which obfuscate and which are difficult to justify or to understand. In few, if any, of the decisions in which the maxims have been exposited would the reasoning have been any worse, or the rule any less clear, without them. In most, the reasoning would have been improved'. Do you agree?

(2) How useful was the maxim that 'equity will not assist a volunteer' in deciding *Corin v Patton?*

(3) Why is the maxim 'equity acts in personam' relevant to determining whether an injunction can be awarded against a defendant located outside the court's jurisdiction?

Part B

Equitable remedies

2

An introduction to equitable remedies

2.1 Introduction

2.2 Examples of equitable remedies

2.1 Introduction

Equitable remedies grew out of the Chancellor's aim to put both parties in the positions that reflected the merits of the case, the parties' circumstances and circumstances of any other persons who might be affected by his orders.

The Chancellor's judgment was always discretionary, and might call for both the plaintiff and defendant to take remedial steps. The Chancellor's court was not shy about the need to unravel complex problems. There is a real sense in which the court did whatever was necessary to achieve an appropriate balance between the parties. That flexible attitude still informs modern equitable remedies.

Remedies are important in every case extracted in this book. This chapter merely attempts to provide the flavour of equity in action, to demonstrate equity unravelling complex interactions between parties, imposing obligations on the plaintiff as well as on the defendant, and taking into account the interests of third parties. The cases exhibit many of the objectives of equitable remedies, such as compensation, disgorgement, restitution, reformation, coercion and vindication.

2.2 Examples of equitable remedies

Questions for consideration

(1) Does the common law have the remedial armoury to properly resolve all problems that arise between parties?

(2) Compared with equity, what tools does it lack?

(3) What are the advantages and disadvantages of a flexible remedial system?

2.2a *Giumelli v Giumelli* [1999] HCA 10; (1999) 196 CLR 101

Background

Relying on various promises made by his parents to him, Robert Giumelli worked on the family orchard partially located at Dwellingup for little or no wages (although he was credited with earnings in the family partnership accounts). In 1974, the parents promised they would convey part of the Dwellingup land to him, to compensate him for working without wages, to recognise his efforts in improving the orchard, and for the fact that the costs of the improvements were being met from partnership funds.

In 1980, Robert informed his parents he intended to marry, and was told by his parents that he could build a house, which would be his, on the Dwellingup land. In reliance upon this promise, Robert built a three-bedroom home on the site. His parents promised Robert that the Dwellingup property would be subdivided to create a lot ('the Promised Lot'), which would include the house and the orchard, if he stayed on the property and did not accept an offer of work elsewhere. Robert's wife refused to live on the property and subsequently their marriage ended. Robert was reassured by his parents that, on his divorce, the Promised Lot would be transferred to him. In reliance on that promise, Robert stayed on the property and planted a new orchard.

Robert later became engaged to a woman of whom his parents disapproved. In 1985, his parents told him to choose between his proposed new wife and the family property. Robert chose to go ahead with his marriage and left.

After Robert's departure, his brother Steven and his family lived elsewhere on the Promised Lot and made substantial improvements to the land. In 1990, Robert sued his parents, seeking a declaration that they held the land on trust for him and an order they convey the Promised Lot to him. The Full Court of the Supreme Court of Western Australia held that the parents held the property upon a constructive trust to convey to Robert the Promised Lot. Robert's parents appealed to the High Court of Australia.

Decision

The High Court held that the parents were estopped from denying Robert an interest in the property. The Court, however, held that the appropriate remedy was an award of equitable compensation, and not a constructive trust, having regard among other factors to the improvements made to the property by Steven. The amount to be paid as equitable compensation was secured by an equitable charge over the whole of the Dwellingup property.

Gleeson CJ, McHugh, Gummow and Callinan JJ

The circumstances of the case

However, the appellants correctly challenge the Full Court order on other grounds. Before making an order designed to bring about a conveyance of the Promised Lot to the respondent, the Full Court was obliged to consider all the circumstances of the case. These circumstances included the still pending partnership action, the improvements to the Promised Lot by family members other than Robert, both before and after his residency there, the breakdown in family relationships and the continued residence on the Promised Lot of Steven and his family. It will be recalled that Steven is a party to the partnership action but not to the present action.

When these matters are taken into account, it is apparent that the order made by the Full Court reflected what in *Verwayen* was described as the prima facie entitlement of Robert. However, qualification was necessary both to avoid injustice to others, particularly Steven and his family, and to avoid relief which went beyond what was required for conscientious conduct by Mr and Mrs Giumelli. The result points inexorably to relief expressed not in terms of acquisition of title to land but in a money sum. This would reflect, with respect to the third promise, the approach taken by Nicholson J when giving relief in respect of the second promise.

Conclusion

Whilst the holding of the Full Court with respect to the third promise should be upheld, the Full Court erred in the measure of relief which it granted in respect of the Promised Lot. This is a case for the fixing of a money sum to represent the value of the equitable claim of the respondent to the Promised Lot. It will be necessary for the matter to be remitted to a judge of the Supreme Court to take that step. The amount so ascertained, with interest, should be charged upon the whole of the Dwellingup property. There will be no requirement of a subdivision of the Promised Lot as part of the remedy.

Fixing of the amount will require the making of valuations and allowances for a range of matters, some of which have been indicated above. It is neither possible nor appropriate now to fix any closed list of matters properly to be taken into account …

On one view, as to which we express no decision, for what is now some 12 years, the respondent has been deprived of a share of profits earned by the partnership from the Promised Lot and of rent from the house. Further, in fixing the sum to represent an ap-

propriate monetary order there may be a case for an allowance in his favour representing a share of anticipated profits from the partnership in relation to the Promised Lot for a specified period of future years, perhaps contingent upon the joint lives of Mr and Mrs Giumelli.

On the other hand, an allowance would have to be made for the improvement to the value of the land since 1986 brought about, in particular, by Steven's work. In addition to the planting of fruit trees and the construction of sheds and cool rooms, the appellants contend there has been significant expenditure on water supply and storage systems.

To enable the matter to be dealt with adequately, it would be appropriate for the partnership action to be brought on concurrently for trial of remaining issues. The moving party in that action is the present respondent and he should be required by the Supreme Court, by direction in the present action, to take the necessary steps to prosecute to trial all remaining issues in the partnership action.

Question

What factors did the members of the Court take into account when indicating how much compensation ultimately should be paid by the defendants?

Background

Mrs McKenzie wanted to sell her farm for a certain price. Her real estate agent knew it was worth that amount, but wrote to her exaggerating the farm's flaws, and suggesting she accept a lower price. Shortly after, he suggested an exchange: her farm (which he valued at £2,300) in exchange for his suburban shop (which he valued at £2,000) plus a payment of £300. The shop was really only worth £1,550; the farm was really worth £2,445. Mrs McKenzie accepted the deal. Less than eight months later, the real estate agent resold the land to a third party, for Mrs McKenzie's original asking price, on a ten-year contract.

The real estate agent was clearly Mrs McKenzie's fiduciary; his actions breached the equitable prohibition on fiduciaries making a profit at the expense of the beneficiary (see chapter 10). But Mrs McKenzie's land had now been sold to a good faith purchaser. What remedy should be awarded?

Decision

Dixon AJ

… I think, that he set out to make a bargain with her as advantageous to himself as possible, and to that end suppressed … (information about the true value of the land) …, took no steps to find a purchaser, and wrote a misleading and untruthful report which he intended to dishearten his client and make her eager to accept … (his proposal). … I think that he misstated his motives and intentions, under-estimated somewhat the value of the farm, grossly over-estimated the value of the shop, and adopted a form of expression … likely to mislead her.

In these circumstances, the plaintiff was entitled to have the agreement of exchange of the 25th September 1925 set aside. This agreement has, however, been fully carried into execution, … a new mortgage has been given over the farm, and … (a third party) … has apparently obtained an equitable interest therein.

[His Honour then discussed the remedy of rescission for a breach of fiduciary duty.]

But … the position of third parties concerned … make it peculiarly difficult to adopt that remedy.

Doubtless it is not necessary to restore the parties precisely to their former position if, by the exercise of the powers of the Court, a substantial restitution can be achieved. The views expressed by Holroyd J … seem to be fully borne out by the observations made by the members of the House of Lords in *Nocton v Lord Ashburton* – a case which shows that the jurisdiction to remedy breaches of fiduciary duty extends to decreeing compensation to the person whose confidence has been abused.

In this case, the defendant obtained, by his abuse of the plaintiff's confidence, a farm, in my opinion worth £2,445, for a shop, in my opinion worth £1,550, together with £300 and … the defendant was on this footing better off, and the plaintiff worse off, by £595. …

The sale … (of the farm) … was effected upon long terms … and it does not afford an absolute criterion for ascertaining the defendant's liability. I therefore treat the defendant as having obtained on the farm 5 shillings per acre more than the value assigned to the farm in the agreement of exchange, and as by his own dealings he has rendered it difficult to restore the farm to the plaintiff, he must recoup this difference to her. On the other hand, there is no difficulty in restoring to him the shop for which he obtained an allowance of £450 more … than its value. … [I]f the defendant decides to take the shop in specie there is no reason why he should not be permitted to do so. I therefore propose to decree him to pay £595 to the plaintiff by way of compensation, but to order further that if within 21 days he notifies the plaintiff of his election so to do he shall take over the shop at a value of £2,000, of which £450 is contained in the sum stated for compensation.

Note

Despite Dixon AJ's reference to *Nocton v Lord Ashburton,* it has never been entirely clear if the remedy granted in *McKenzie* was equitable compensation, or a monetary form of rescission (see textbook at [4.11]). The authors of *Meagher, Gummow and Lehane's Equity:*

Doctrines and Remedies (LexisNexis Butterworths, 5th ed, 2015) say at [23–135] that Dixon AJ 'awarded rescission in terms consonant with the restitutionary principles expressed in *Robinson v Abbott*'.

Questions

(1) Why was the defendant allowed to choose which remedy suited him best? Is justification to be found in equity's maxim that 'she who seeks equity must do equity'? Or is it to be found in equity's eschewal of punishment? See *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298.

(2) What factors did Dixon AJ take into account when deciding how much compensation should be paid by the defendant? What does this reveal about the *timing* of calculation of equitable remedies?

2.2c *Nelson v Nelson* [1995] HCA 25; (1995) 184 CLR 538

Background

Mrs Nelson provided purchase moneys for a house which was transferred into the names of her children, Elizabeth and Peter. This was done so that Mrs Nelson could later obtain a Defence Services Homes Act loan at preferential rates. She would have been ineligible to apply for such a loan if she already owned another house.

When Mrs Nelson later applied for the DSHA loan, she falsely declared she had no financial interest in another property. When the first house was sold, Mrs Nelson claimed to be entitled to the proceeds of sale by rebutting the equitable presumption, known as the presumption of advancement, that a parent who buys property in the name of a child is presumed to be making a gift of that property to the child (see textbook at [22.9]). If successful, the Court would have ordered the children to hold the proceeds on trust (termed a resulting trust) for Mrs Nelson. Elizabeth asserted her right to half the proceeds, claiming that the presumption of advancement in her favour could not be rebutted by her mother using her own illegal conduct as the basis of her claim that she did not intend to make a gift of the first house to her children.

Decision

The High Court held that Mrs Nelson was not debarred by her own illegal conduct from claiming the proceeds of the first house, based on her provision of the purchase money and absence of intention to make a gift of the first house to her children. A majority, Toohey and Dawson JJ dissenting on this issue, further declared that if Mrs Nelson did not repay the amount equal to the benefit to the Commonwealth, the proceeds should be held on trust for Elizabeth (as to the amount equal to the benefit) and for Mrs Nelson as to the balance, so that Mrs Nelson could not use equitable principles relating to resulting trusts to obtain the fruits of her illegal conduct.

Deane and Gummow JJ

The issues

There is an interplay of three doctrines or principles. They are that concerned with the imputation or presumption of a resulting trust in favour of Mrs Nelson as the source of the purchase moneys, the countervailing presumption of advancement which would leave the equitable title to Bent Street at home with the legal title, and the effect of what was classified as the illegal purpose in the later concealment by Mrs Nelson, to obtain the subsidy for the Kidman Lane property. … Do the circumstances of the case, as disclosed by the findings on the evidence, supply sufficient reason for concluding that the equitable title to Bent Street was not at home with the legal title when Bent Street was sold? …

Illegality and statute

Difficult questions may arise in relating the alleged illegality in the constitution or performance of the trust to what, upon its true construction, is the operation of the statute in question. Authorities … suggest the drawing of a distinction between (i) an express statutory provision against the making of a contract or creation or implication of a trust by fastening upon some act which is essential to its formation, whether or not the prohibition be absolute or subject to some qualification such as the issue of a licence; (ii) an express statutory prohibition, not of the formation of a contract or creation or implication of a trust, but of the doing of a particular act; an agreement that the act be done is treated as impliedly prohibited by the statute and illegal; and (iii) contracts and trusts not directly contrary to the provisions of the statute by reason of any express or implied prohibition in the statute but which are 'associated with or in furtherance of illegal purposes'. … In this last class of case, the courts act not in response to a direct legislative prohibition but, as it is said, from 'the policy of the law'. The finding of such policy involves consideration of the scope and purpose of the particular statute. The formulation of the appropriate public policy in this class of case may more readily accommodate equitable doctrines and remedies and restitutionary money claims than is possible where the making of the contract offends an express or implied statutory prohibition. … Two factors are of paramount importance. First, as the appellants submit and we would accept, the question of illegality is bound up with the view taken of the underlying policy of the Act. To quote a United States scholar, 'if illegality consists in the violation of a statute, courts will give or refuse relief depending upon the fundamental purpose of the statute'. Secondly, what is sought are equitable remedies in aid of an alleged trust and equity is equipped to attain a result which eschews harsh extremes.

The range and flexibility of equitable remedies assist in achieving an appropriate result in the particular case; this means, in the words of one commentator, '[t]he old common law idea of all or nothing will no longer have to apply'. Accordingly, unlike the common law, equity may impose terms upon a party seeking administration of equitable remedies. Further, equity has not subscribed to any absolute proposition that the consequence of illegality, particularly where what is involved is contravention of public policy manifested by statute, is that neither side may obtain any relief, so that the matter lies where it falls. Rather, in various instances equity has taken the view that it may intervene, albeit with the attachment of conditions, lest there be 'no redress at all against the fraud nor any body to ask it'. … [E]quity eschews any broad generalisations in favour of concentrating upon the specific situation which has arisen, in the light of the relevant statutory provisions. …

Resulting trusts and statutory illegality

The intersection between the institution of the resulting trust and the principles of illegality is identified by Scott as follows:

> Although a resulting trust ordinarily arises where A purchases property and takes title in the name of B, A may be precluded from enforcing the resulting trust because of the illegality of his purpose. If A cannot recover the property, B keeps it and is thereby enriched. The question in each case is whether the policy against the unjust enrichment of the grantee is outweighed by the policy against giving relief to the payor who has entered into an illegal transaction. … However, where the illegality flows from statute, the matter is not at large in the manner suggested above. Rather it is a question of the impact of the statute …

[W]e accept the submission for the appellants that the crucial step is to identify the relevant public policy, beginning with the provisions of the Act.

The scheme of the Act and the facts of the case

… [T]he relevant provisions of the legislation … show its purpose to be the provision of public moneys to facilitate the purchase of housing by eligible persons, but on the footing that the eligible person not own another dwelling … it has consistently been the scheme of the legislation that, if the public moneys are misapplied, they are made recoverable by the Corporation or the Commonwealth. However … the interest of the Corporation or the Commonwealth in the dwelling or proceeds of sale thereof is co-extensive with the funds provided by it; if they be restored then effect may be given to a trust in respect of the balance of the equitable interest in the dwelling or the proceeds of sale thereof.

A question in the present case thus arises as to whether the trust in respect of the proceeds of sale which Mrs Nelson asserts in her favour is tainted by illegality because of its association with or furtherance of a purpose which is contrary to the policy of the law as indicated by the scheme of the Act. If that be so, the question then is whether the consequence is that (i) no relief is available to Mrs Nelson, or (ii) relief may be granted but upon terms apt to make good the concern of the Commonwealth which was denied by the grant of the subsidy in respect of Kidman Lane whilst, as she always intended, Mrs Nelson was beneficial owner of the Bent Street property.

In our view, the answer to the first question is in the affirmative. The findings … show that the title to Bent Street was taken in the name of the children, with the intention that Mrs Nelson be the beneficial owner so as to put her in an advantageous position later to obtain, if she so wished, financial assistance under the Act by concealing the true state of affairs.

… The purpose was implemented with the obtaining of the subsidy for the Kidman Lane purchase. Mrs Nelson still holds this property. The litigation concerns ownership of the fund from the later sale of the Bent Street property. Given this state of affairs, the question remains as to what are the limitations upon the relief obtainable by Mrs Nelson.

In our view, as the price of obtaining the relief she seeks for the recognition and enforcement of a resulting trust in respect of the whole of the balance of the proceeds of sale of the Bent Street property, Mrs Nelson must be prepared to do equity according to the requirements of good conscience. That may involve consideration of more than the interests of the parties to the litigation. Here, good conscience calls for the taking by Mrs Nelson of steps sufficient to satisfy the demands of the underlying policy of the Act.

This requires denial to Mrs Nelson of the benefit in respect of the purchase of the Kidman Lane property which she has obtained by her unlawful conduct. … What is required is the formulation of, and acceptance by Mrs Nelson of, a term upon the relief to which she is otherwise entitled which denies to her the benefit she obtained by her unlawful conduct and provides for the payment to the Commonwealth of the benefit sum.

Conclusions

… There should be a declaration to the effect that, if on or before 9 January 1996 Mrs Nelson has paid to the Commonwealth an amount equal to the benefit sum received in respect of the purchase by her of the Kidman Lane property, the second respondents hold the whole of the balance of the proceeds of sale of the Bent Street property, together with any interest earned thereon, upon trust for [her]. …

McHugh J

Courts should not refuse to enforce legal or equitable rights simply because they arose out of or were associated with an unlawful purpose unless:

(a) the statute discloses an intention that those rights should be unenforceable in all circumstances; or

(b)

(i) the sanction of refusing to enforce those rights is not disproportionate to the seriousness of the unlawful conduct;

(ii) the imposition of the sanction is necessary, having regard to the terms of the statute, to protect its objects or policies; and

(c) the statute does not disclose an intention that the sanctions and remedies contained in the statute are to be the only legal consequences of a breach of the statute or the frustration of its policies.

Note

Dawson and Toohey JJ would have ordered a resulting trust in Mrs Nelson's favour, and left it up to the Commonwealth to recover the benefit amount from her, if it so wished.

Questions

(1) The Court made the order without seeking the Commonwealth's views as to repayment of the benefit amount. Similarly, in *Giumelli* above, Steven Giumelli was not a party to proceedings. How can we be certain courts take proper or relevant considerations into account when considering how remedies will impact third parties?

(2) If repayment of the Commonwealth was important, why was Mrs Nelson effectively given a choice as to whether to repay the benefit amount? Why should Elizabeth be entitled to any of the money if Mrs Nelson does not repay the Commonwealth?

3

Specific performance, injunctions and equitable damages

3.1 Introduction

3.2 Specific performance

3.3 Injunctions

3.4 Equitable damages

3.1 Introduction

The purpose of orders of specific performance of a contract and of injunctions is to compel the performance of legal obligations. Many, although not all, of the considerations relevant to an order granting specific performance of a contract are also germane to the award of an injunction. Matters such as inadequacy of damages, hardship and the ability of a court to supervise the execution of its own orders are relevant to both remedies (see textbook, chapter 3). Underlying the principles governing these orders are policy questions relating to the nature and limits of judicial coercion to which monetary remedies, such as damages, do not usually give rise. These questions include: to what extent can private law (as opposed to the criminal law) restrict individual freedom, including a person's freedom to select his or her employment? Can a court compel parties whose commercial relationship has broken down to co-operate with each other? And what are the limits of a court's power to prevent wrongdoing; for example, where the wrong is likely to occur outside a court's jurisdiction but will cause damage within its jurisdiction?

Equitable damages are awarded under successor legislation in every State and Territory to the *Chancery Amendment Act 1858* (Imp) (also known as *Lord Cairns' Act*, after the Chancellor who secured its enactment). The legislation enables a court to award damages in substitution for, or in addition to, the equitable remedies of specific performance or injunction. Prior to its enactment, a court of equity could not make a damages award in such circumstances. Equitable damages are considered in this chapter since the aims of an award under the legislation can only be understood in terms of the aims of specific performance or injunctions, for which damages are either a substitute or an adjunct.

3.2 Specific performance

Specific performance of a contract is awarded in equity's auxiliary jurisdiction when compensatory damages are inadequate to remedy the breach. It is therefore not the primary remedy for breach of contract. It is nonetheless a remedy for breaches of most types of contract, except contracts for the sale of generic goods and contracts of personal service. In view of the primacy placed by the High Court on contract performance (see *Zhu v Treasurer (NSW)* (2004) 218 CLR 530; *Tabcorp Holdings Pty Ltd v Bowen Investments Pty Ltd* (2009) 236 CLR 272, [13]), an important question is whether specific performance *should* be the primary remedy for breach.

Two criteria must be satisfied before an order of specific performance will be made. First, common law damages must be an inadequate

remedy. Secondly, there must be no bars (in the sense of equitable discretionary factors) preventing the award of specific performance. See chapter 6 for an analysis of the bars to equitable relief.

3.2.1 Inadequacy of damages

3.2.1.1 Contracts for the sale of land

3.2.1.1a *Loan Investment Corporation of Australasia v Bonner* [1970] NZLR 724

Background

The vendor of two properties agreed to sell them to the purchaser for £13,300. At the same time, the vendor agreed to lend the purchaser £11,000 for 10 years at 7.5 per cent interest without taking security. The land sale was part of a long-term loan agreement. When the vendor purported to rescind the agreement, the purchaser claimed specific performance.

Decision

The Privy Council, Sir Garfield Barwick dissenting, held that the purchaser was not entitled to specific performance. The following extracts summarise the arguments for and against ordering specific performance.

Lord Pearson

[T]heir Lordships can state their conclusions fairly shortly as follows.

(1) The contract was a composite contract. In seeking to ascertain what it was composed of, there is a need to recognise and notionally separate the two transactions which were combined in it. One was a transaction of sale and purchase of land at the price of £13,300. The other was a transaction of lending and borrowing £11,000 without security for a term of 10 years with interest in the meantime at 7 1/2 percent. Each was a principal transaction: neither was subsidiary or subordinate or ancillary to the other. On the other hand the contract was entire and indivisible according to the intention of the parties, as it may be inferred from the provisions of the contract and the relevant surrounding circumstances. Presumably the respondent would not have been willing to make the unsecured loan for 10 years unless he was going to receive the high price that he asked for his land. Presumably the appellant company would not have been willing to pay the high price for the land, unless they were going to receive the unsecured loan for 10 years. The consideration given by the appellant company was a twofold promise (i) expressly, to pay the price for the land and (ii) by necessary implication, to receive the loan and pay interest on it and repay the capital after the lapse of 10 years. The consideration given by the respondent was a twofold promise to convey the land and make the loan.

(2) The interpretation which the Chief Justice placed upon the contract was incorrect. The contract was neither in form nor in substance an ordinary contract for the sale of land with a usual ancillary provision for part of the price to remain on loan from the vendor to the purchaser. It is quite usual for part of the purchase price to remain on loan secured by a mortgage. That is a natural arrangement, as there is good security for the outstanding amount, the vendor in effect retains a partial interest in the property, and he has a solid and readily saleable asset. It is not usual, and indeed it is surprising, that a vendor should be willing to lend to the purchaser for a long period without security an amount equal to the greater part of the purchase price, five-sixths in this case. The form of the contract is a good prima facie guide to its nature and character, but ultimately the substance is more important. If a composite contract includes what is in substance and reality a long-term unsecured loan, the loan ought not to be treated, when specific performance is sought, as something different simply by being connected with a sale of land.

(3) An order for specific performance is a discretionary remedy. There are some very firmly established rules for the exercise of the discretion, but none of them covers this case. A mere contract for a loan of money will not be specifically enforced. An ordinary contract for sale and purchase of land will be specifically enforced. Such a contract will be specifically enforced, even if it includes an ancillary provision for part of the purchase price to remain on mortgage. This last rule might or might not be extended to cover contracts for sale and purchase of land with other ancillary provisions (in the nature of 'machinery provisions') as to the payment of the price, e.g. for payment of the price by instalments – perhaps covered by bills of exchange or promissory notes – or simply for deferred payment of part of the price. Such contracts, whether or not they would be suitable for specific performance, are distinguishable from the present composite contract, in which the long-term (or perhaps one should say medium-term) unsecured loan is not ancillary to the sale of land but is a principal transaction in itself.

(4) There is an obvious objection in principle to granting specific performance of an unsecured loan. It would have a one-sided operation, creating a position of inequality. The borrower obtains immediately the whole advantage of the contract to him, namely the loan itself – a sum of money placed completely at his disposal. The lender on the other hand has to wait and hope for the payment of interest from time-to-time and for the eventual repayment of the capital. The Court has means of compelling a party to pay a sum of money if he is able to do so. But no writ of attachment or sequestration or other equitable process can compel the borrower to repay the loan, if when the time comes at the end of the period he has not enough assets to enable him to do so. This objection in principle may not prevail in exceptional cases.

(5) This composite contract was predominantly in the nature of a commercial bargain. The appellant company wanted the property not for their own use but for selling, letting, mortgaging and perhaps developing, and they wanted the loan to help in financing their business generally. As has been stated, this is not a mere or ordinary contract for the sale of land, but a composite contract in which the other part, the provision for a loan, is not ancillary but a principal transaction. If the appellant company can show that they have been deprived of a good bargain by the respondent's wrongful refusal to carry it out, they are entitled to proper damages. On the whole, damages are a sufficient and suitable remedy, and the special remedy of specific performance should be refused.

Sir Garfield Barwick (dissenting)

As I have the misfortune to dissent in this case I have taken the opportunity to refresh my recollection over a very wide area of law relating to various aspects of the equitable doctrines as to specific performance. I feel able to say that there is no case in the books which lends the least colour to a suggestion that a plaintiff in specific performance can be defeated by a defendant demonstrating that the plaintiff has no interest in the purchase of the land but as a vehicle for the making or obtaining of money. Perhaps the cases as to hardship as a defence to a suit for specific performance to which I will later refer in another connection have a bearing on the point: for a plaintiff who has bought at an under value can easily be said only to be interested in profit making in buying the land. But the Courts of Equity have not yielded to mere inadequacy of price as a defence to a suit for specific performance. There has always been some other element to attract the equitable discretion to refuse the decree. Accordingly, in my opinion, the motives of the appellant in entering into this purchase are, in my opinion, irrelevant to the question whether, regarding the contract as one for the sale and purchase of land, an order for specific performance should be made. If the promise be to convey land, there is in my opinion, no further question of fact as to whether or not the promisee has some other interest in the subject-matter beyond the fact that it is the land he has selected for purchase.

Then it is said that there remains in a Court of Equity a general discretion to refuse specific performance although the contract be valid at law, though damages are not an adequate remedy and there is no equitable ground falling within any of the known categories or as it was said 'settled principles' of equity for refusing the decree. In my respectful opinion, there is no such general discretion in such circumstances. It is of course true that specific performance is never strictly as of right but always as of discretion: but from the earliest times that discretion has been said to be a judicial discretion and to be hedged round and to be governed by well settled rules for its exercise …

In the present case, as I have already remarked, the bargain as expressed was the bargain of the parties. There were no relevant facts then existing not known to the respondent. There were no facts upon which any of the known equitable defences to specific performance could be made out nor was there any attempt to make any of them out. As well as I can understand the argument for the respondent, and with great respect, the facts to which Turner J refers in his judgment [1968] NZLR 1025 at p. 1044, the case put

for the exercise of discretion against specific performance amounts to no more than this, that although the respondent knew the general nature of the purchasing company and of its business, though little of its financial standing, and was content to allow £11,000 of what would have otherwise been payable to him as purchase price to remain in the hands of the appellant for a long period of time at interest without security, the Court, unable as I think to conclude judicially anything as to the stability or the prospects of the purchaser company, ought to regard the agreement as unsatisfactory from the respondent's point of view in that it involved a hazard with respect to the repayment in due course of the £11,000: therefore the Court should withhold the remedy of specific performance. In my respectful opinion, there is no warrant whatever in the law for such a course. To refuse specific performance for such a suggested reason is not, in my respectful opinion, an exercise of judicial discretion. It falls again to my respectful opinion, into the class of case put outside such a discretion by the cases from which I have cited.

It is then said that this agreement is not a 'usual' agreement for the sale and purchase of land.

I suppose the form of such agreements which is most commonly seen is that of a single sale and purchase for cash. But whether usual or not, a contract for the sale and purchase of land will be specifically enforced, in my opinion, not because it is a 'usual' contract, but because damages are not an adequate remedy, justice thus requiring specific performance: and if damages are not an adequate remedy for the non-performance of the whole contract, specific performance will not be refused in my opinion simply because what the parties have themselves agreed upon is unusual in the experience of others.

Finally, I would like to deal with an argument which asserts that the circumstance that the Court could not at this time see that it would in due course be able effectively to enforce the repayment of the sum of £11,000 according to the terms agreed upon by the parties is a reason for refusing specific performance of the contract between the parties. But, in my opinion, there is no question of further supervising the performance of the contract than the making of an order that upon the tender of a sum in cash and a deposit receipt conformable to clause 9a of the contract the respondent will execute and hand over the appropriate transfer of the land and the certificate of title thereto along with possession of it. No question of the Court's supervision of the repayment of the loan involved in the transaction arises or, in my respectful opinion, can arise. To my mind the validity of the suggestion can be tested very simply. Suppose the contract had provided that the balance of purchase money would be payable in ten years with interest in the meantime with no vendor's lien. There could have been, in my respectful opinion, no doubt whatever that the Court would not refuse specific performance because it could not be assured that the vendor would necessarily recover the balance of his purchase price in ten years' time. Nor would it refuse such an order because of any supposed inequality of position in the vendor and purchaser in such a case. The proportion of the final payment would not, in my opinion, affect these conclusions. The respondent was satisfied with the agreed consideration and the manner of its satisfaction. I am unable to regard the resultant relationship as unequal in any relevant sense. But in any case, in my opinion, it is not for a Court, if the respondent is in an unequal position, not the result of inequitable conduct, to endeavour to protect him by denying the appellant the land which it has purchased. It cannot rest, in my opinion, with a Court to say that the parties' bargain, valid at law and not vitiated or tainted by any known defect or matter of equitable defence, is unsatisfactory or that in those circumstances where an unsecured promise to pay a sum of money is involved there is any relevant inequality between the parties arising out of that bargain consciously made.

Questions

(1) How do Lord Pearson and Sir Garfield Barwick characterise the transaction in question? Which characterisation do you prefer?

(2) Do Lord Pearson and Sir Garfield Barwick hold differing views as to how equitable discretion should be exercised?

(3) This is an exceptional case in which a contract for the sale of land was held not to be specifically enforceable even though no equitable bar, such as hardship, prevented enforcement. Why are contracts for the sale of land typically considered to be specifically enforceable?

3.2.1.2 Contracts for the sale of chattels

Background

The defendant contracted to sell a taxi, and its licence registration, to the plaintiffs for £1,850. The transfer of the licence required the consent of the Commissioner of Road Transport. The defendant failed to complete the transfer. Evidence showed that the number of licensed taxis was limited, and that few were for sale. The plaintiff sought specific performance of the contract. A few days before the hearing of the suit, the plaintiff bought a licensed taxi from a third party.

Decision

The High Court upheld the trial judge's order of specific performance, which was conditional on the Commissioner of Road Transport approving the transfer of registration.

Dixon J

The subject matter, it is said, is the sale of a chattel and, in general, a suit for the specific performance of an agreement to sell and deliver chattels will not be entertained. But, when the substance of the matter is considered, the agreement is not of this simple character. The legislation has resulted in a restriction upon the number of registered and licensed vehicles with which the calling of taxi-driving may be pursued. The contract is in fact for the transfer of a valuable privilege annexed to a chattel. Of the amount of the consideration, somewhat the greater part appears to represent the registration and licence and the lesser part the vehicle itself. The number of taxi-cabs licensed for the city and suburbs of Sydney which had not been already sold once since the commencement of Act No 22 of 1945 was shown to be only 880. Thirty-seven taxis had, according to the evidence, been sold since that date and the prices paid for the licences of the vehicles were said to have averaged £1,318. The subject of the sale is thus shown to be a special right attached to a chattel, transferable only with it, and numerically restricted …

But apart from land, a contract for which has always been considered a proper subject of specific performance, the question raised for the Court of Chancery was to say in what circumstances equity considered the purchaser entitled to the specific thing contracted to be sold or the vendor to divest himself of it and receive the price, rather than in either case being bound to accept damages as the price of the loss of the contract.

It was not difficult to say that a purchaser of 'articles of unusual beauty rarity and distinction' was entitled to obtain them in specie (*Falcke v Gray* (1859) 62 ER 250 at 252). Though a less obvious case, it was settled that 'a certain number of railway shares of a particular description, which railway shares are limited in number' and are not to be obtained by going on the share market, are a subject in respect of which a contract of sale will be enforced specifically (*Duncuft v Albrecht* (1841) 59 ER 1104 at 1108). But though it is within the power of a court of equity to decree specific performance of a contract for the sale and purchase of shares, yet when shares are dealt in largely on the market and anyone can go and buy them, there is no reason why they should not be in the same position as government stock is, in a contract for its sale and purchase (per Parker J, *Stern v Schwabacher; Re Schwabacher* (1907) 98 LT 127 at 128). Where chattels are sold or otherwise disposed of by contract as part of the particular equipment of a business, there is ground for equity granting specific relief. There appears to be no direct case of specific performance, but compare *North v Great Northern Railway Co* (1860) 66 ER 28 at 30; *Nutbrown v Thornton* (1804) 32 ER 805.

In the present case I think that we should have no difficulty in concluding that, because of the limited number of vehicles registered and licensed as taxi-cabs, because of the extent to which the price represents the value of the licence, and because of the essentiality to the purchaser's calling of the chattel and the licence annexed thereto, we should treat the contract as within the scope of the remedy of specific performance.

An answer was attempted on the part of the appellant to the effect that the respondents in fact succeeded in buying another taxi-cab. This, I think, is not material. It was not an election on their part to obtain a substitute at the expense, in damages, of the appellant. They were entitled to obtain an additional car, if they could, for their business without prejudicing their right to obtain *in specie* the taxi-cab registration and licence already contracted for.

Questions

(1) Are contracts for the sale of specific chattels specifically enforceable when the chattel is literally 'unique' – or does some other quality of the chattel attract the application of specific performance?

(2) Market volatility may result in some chattels or commodities being temporarily scarce. Can a contract which is not ordinarily specifically enforceable become specifically enforceable by reason of temporary scarcity? See *Sky Petroleum Ltd* v *VIP Petroleum Ltd* [1974] 1 WLR 576.

3.2.1.3 Contracts for the benefit of third parties

3.2.1.3a *Beswick v Beswick* [1968] AC 58

Background

An uncle agreed to transfer his coal merchant business to his nephew in return for the nephew's promise to pay an annuity to the uncle for the remainder of his life, and then to his widow after the uncle's death. The nephew paid the uncle's annuity but, after making one payment, refused to pay the annuity to the widow.

Decision

The House of Lords held that the widow was entitled, as administratrix of her late husband's estate, to sue the nephew for failure to pay the annuity. Since nominal damages payable to the widow as administratrix was an inadequate remedy on the facts of the case, specific performance in favour of the widow, in her capacity of third party to the contract, was ordered.

Lord Upjohn

As it is necessary to keep clear and distinct the rights of the widow as administratrix of her husband and personally, I think it will be convenient to use letters: letter A represents the deceased and A1 the widow, as personal representative, B the widow in her personal capacity and C the appellant. And in other examples I shall give, these letters will serve the same purpose.

Much is common ground between the parties: (1) B was not a party to the agreement; (2) A did not enter into the agreement as trustee for B in relation to the annuity to be paid to her; (3) A1 stands for all relevant purposes in the shoes of A and is entitled to sue C for breach of his admitted repudiation of the agreement … but the parties differ fundamentally as to the remedy to which A1 is entitled in such an action …

I incline to the view that on the facts of this case damages [at common law] are nominal … At all events let me assume that damages are nominal. So it is said nominal damages are adequate and the remedy of specific performance ought not to be granted. That is, with all respect, wholly to misunderstand that principle. Equity will grant specific performance when damages are inadequate to meet the justice of the case.

But in any event quantum of damages seldom affects the right to specific performance. If X contracts with Y to buy Blackacre or a rare chattel for a fancy price because the property or chattel has caught his fancy he is entitled to enforce his bargain and it matters not that he could not prove any damage.

In this case the court ought to grant a specific performance order all the more because damages *are* nominal. C has received all the property; justice demands that he pay the price and this can only be done in the circumstances by equitable relief. It is a fallacy to suppose that B is thereby obtaining additional rights; A1 is entitled to compel C to carry out the terms of the agreement.

Note

A similar conclusion had earlier been reached by the High Court in *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460, although the majority in that case construed the agreement in question as being one to pay royalties to the executor of the promisee's estate. Windeyer J, dissenting, stated at 503: 'It seems to me that contracts to pay money or transfer property to a third party are always, or at all events very often, contracts for breach of which damages would be an inadequate remedy – all the more so if it be right (I do not think it is) that damages recoverable by the promisee are only nominal. Nominal or substantial, the question seems to be the same, for when specific relief is given in lieu of damages it is because the remedy, damages, cannot satisfy the demands of justice.'

Damages may be adequate where legislation permits a third party to enforce a duty under a contract; for example, under the *Property Law Act 1974* (Qld) s 55 which provides for the direct enforcement by third parties of contracts supported by valuable consideration.

Questions

(1) Do *Beswick v Beswick* and Windeyer J's dicta in *Coulls* suggest that the true criterion for the award of specific performance is not whether damages are inadequate, but whether an award of damages is the most appropriate remedy on the facts of the case?

(2) When *Beswick* and *Coulls* were decided, the doctrine of privity of contract was strictly applied. Later cases, such as the High Court decision in *Trident General Insurance Co Ltd v McNiece Brothers Pty Ltd* (1988) 165 CLR 107, have relaxed the rigour of the doctrine, as has legislation such as s 55 of the *Property Law Act 1974* (Qld). Do cases such as *Trident* indicate that specific performance might be awarded in favour of a third party without the necessity of considering whether damages would be an adequate remedy for the promisee?

3.2.2 Bars to equitable relief

Equitable relief may be refused on various grounds, some of which overlap. Bars to relief are considered in chapter 6. The bars considered in that chapter apply to all equitable relief, although some have special relevance to applications for specific performance. See, in particular, how hardship can be a ground for refusing an order of specific performance, although it will not preclude an award of damages: *Patel v Ali* [6.5a]; *ANZ Executors and Trustees Ltd v Humes Ltd* [6.5b].

This section examines the circumstances in which relief will be refused on the ground that the court cannot adequately supervise the performance of the defendant's obligations under the court order (a bar relevant to applications for specific performance and injunctions) and lack of mutuality (which is a discretionary consideration relevant to an award of specific performance, as well as to an injunction to restrain a breach of contract).

3.2.2.1 Continuous supervision

3.2.2.1a *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1

Background

The plaintiff leased a supermarket to the defendant. The lease contained a covenant to keep the premises open for retail trade during usual trading hours. The supermarket was the anchor tenant in the shopping centre owned by the plaintiff and attracted custom to other stores in the centre. The supermarket was unprofitable and, without consulting or negotiating with the plaintiff, the defendant closed it when the lease still had 19 years to run. The plaintiff sought specific performance of the defendant's obligations under the lease, compelling them to keep the supermarket open for the remainder of the lease.

Decision

The House of Lords refused to order specific performance on the ground that a court of equity could not supervise performance of the defendant's obligations as tenant of the supermarket.

Lord Hoffmann

There has, I think, been some misunderstanding about what is meant by continued super-intendence. It may at first sight suggest that the judge (or some other officer of the court) would literally have to supervise the execution of the order. In *C H Giles & Co Ltd v Morris* [1972] 1 WLR 307, 318 Megarry J said that 'difficulties of constant superintendence were a 'narrow consideration' because:

> there is normally no question of the court having to send its officers to supervise the performance of the order … Performance … is normally secured by the realisation of the person enjoined that he is liable to be punished for contempt if evidence of his disobedience to the order is put before the court …

This is, of course, true but does not really meet the point. The judges who have said that the need for constant supervision was an objection to such orders were no doubt well aware that supervision would in practice take the form of rulings by the court, on applications made by the parties, as to whether there had been a breach of the order. It is the possibility of the court having to give an indefinite series of such rulings in order to ensure the execution of the order which has been regarded as undesirable.

Why should this be so? A principal reason is that, as Megarry J pointed out in the passage to which I have referred, the only means available to the court to enforce its order is the quasi-criminal procedure of punishment for contempt. This is a powerful weapon; so powerful, in fact, as often to be unsuitable as an instrument for adjudicating upon the disputes which may arise over whether a business is being run in accordance with the terms of the court's order. The heavy-handed nature of the enforcement mechanism is a consideration which may go to the exercise of the court's discretion in other cases as well, but its use to compel the running of a business is perhaps the paradigm case of its disadvantages and it is in this context that I shall discuss them.

The prospect of committal or even a fine, with the damage to commercial reputation which will be caused by a finding of contempt of court, is likely to have at least two undesirable consequences. First, the defendant, who ex hypothesi did not think that it was in his economic interest to run the business at all, now has to make decisions under a sword of Damocles which may descend if the way the business is run does not conform to the terms of the order. This is, as one might say, no way to run a business.

… Secondly, the seriousness of a finding of contempt for the defendant means that any application to enforce the order is likely to be a heavy and expensive piece of litigation. The possibility of repeated applications over a period of time means that, in comparison with a once- and-for-all inquiry as to damages, the enforcement of the remedy is likely to be expensive in terms of cost to the parties and the resources of the judicial system.

This is a convenient point at which to distinguish between orders which require a defendant to carry on an activity, such as running a business over a more or less extended period of time, and orders which require him to achieve a result. The possibility of repeated applications for rulings on compliance with the order which arises in the former case does not exist to anything like the same extent in the latter. Even if the achievement of the result is a complicated matter which will take some time, the court, if called upon to rule, only has to examine the finished work and say whether it complies with the order.

… It by no means follows, however, that even obligations to achieve a result will always be enforced by specific performance. There may be other objections, to some of which I now turn.

One such objection, which applies to orders to achieve a result and a fortiori to orders to carry on an activity, is imprecision in the terms of the order. If the terms of the court's order, reflecting the terms of the obligation, cannot be precisely drawn, the possibility of wasteful litigation over compliance is increased. So is the oppression caused by the defendant having to do things under threat of proceedings for contempt. The less precise the order, the fewer the signposts to the forensic minefield which he has to traverse. The fact that the terms of a contractual obligation are sufficiently definite to escape being void for uncertainty, or to found a claim for damages, or to permit compliance to be made a condition of relief against forfeiture, does not necessarily mean that they will be sufficiently precise to be capable of being specifically enforced. …

… There is a further objection to an order requiring the defendant to carry on a business, which was emphasised by Millett LJ in the Court of Appeal. This is that it may cause injustice by allowing the plaintiff to enrich himself at the defendant's expense. The loss which the defendant may suffer through having to comply with the order (for example, by running a business at a loss for an indefinite period) may be far greater than the plaintiff would suffer from the contract being broken. As Professor RJ Sharpe explains in 'Specific Relief for Contract Breach', ch 5 of *Studies in Contract Law* (1980), edited by Reiter and Swan, p 129:

> In such circumstances, a specific decree in favour of the plaintiff will put him in a bargaining position vis-á-vis the defendant whereby the measure of what he will receive will be the value to the defendant of being released from performance. If the plaintiff bargains effectively, the amount he will set will exceed the value to him of performance and will approach the cost to the defendant to complete.

This was the reason given by Lord Westbury LC in *Isenberg v East India House Estate Co Ltd* (1863) 3 De GJ & S 263, 273 for refusing a mandatory injunction to compel the defendant to pull down part of a new building which interfered with the plaintiff's light and exercising instead the Court of Chancery's recently-acquired jurisdiction under Lord Cairns' Act 1858 (21 & 22 Viet c 27) to order payment of damages:

> I hold it … to be the duty of the court in such a case as the present not, by granting a mandatory injunction, to deliver over the defendants to the plaintiff bound hand and foot, in order to be made subject to any extortionate demand that he may by possibility make, but to substitute for such mandatory injunction an inquiry before itself, in order to ascertain the measure of damage that has been actually sustained.

It is true that the defendant has, by his own breach of contract, put himself in such an unfortunate position. But the purpose of the law of contract is not to punish wrongdoing but to satisfy the expectations of the party entitled to performance. A remedy which enables him to secure, in money terms, more than the performance due to him is unjust. From a wider perspective, it cannot be in the public interest for the courts to require someone to carry on business at a loss if there is any plausible alternative by which the other party can be given compensation. It is not only a waste of resources but yokes the parties together in a continuing hostile relationship. The order for specific performance prolongs the battle. If the defendant is ordered to run a business, its conduct becomes the subject of a flow of complaints, solicitors' letters and affidavits. This is wasteful for both parties and the legal system. An award of damages, on the other hand, brings the litigation to an end. The defendant pays damages, the forensic link between them is severed, they go their separate ways and the wounds of conflict can heal.

Notes

(1) The principles enunciated by Lord Hoffmann in *Argyll Stores* have been applied by Australian courts: see, for example, *Chahal Group Pty Ltd v 7-Eleven Stores Pty Ltd* [2017] NSWSC 532, [272]–[275] where a franchise agreement had been validly terminated on the ground of the franchisee engaging in a 'cash back' arrangement, whereby employees were paid the relevant award rate but were required to repay an amount to the franchisee. Even if the ground of termination had not been established, it was held that the franchisee would not have obtained specific performance since a franchise agreement requires a high degree of trust and confidence between the parties: see [275].

The 'settled practice' of refusing specific performance of a contract to carry on a business does not mean that such an order will invariably be refused. For an example of an interlocutory order requiring the tenant of a supermarket with an adjacent petrol station to continue operating the petrol station, where *Argyll Stores* was held to be distinguishable on its facts, see *Diagnostic X-Ray Services Pty Ltd v Jewel Food Stores Pty Ltd* (2001) 4 VR 632.

(2) An exception to the principle that specific performance will not be ordered if constant supervision is necessary relates to building contracts. The English Court of Appeal stated in *Wolverhampton Corporation v Emmons* [1901] 1 KB 515, 524 that such contracts are specifically enforceable if: (a) the building work is defined by the contract; (b) the plaintiff has a substantial interest in performance so that damages will be inadequate compensation; and (c) the defendant is, under the contract, in possession of the land on which the work is to be done. It has been doubted whether the third requirement should be 'a requirement rather than an indication': *Hewett v Court* (1983) 149 CLR 639, 667 (Deane J).

Questions

(1) What does Lord Hoffmann identify as the principal objection to ordering specific performance of contracts which require constant supervision? Is the objection convincing?

(2) Does the building contracts exception suggest that the judicial objections to enforcing contracts requiring constant supervision are exaggerated?

3.2.2.1b *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30; (1998) 195 CLR 1

Background

During an industrial dispute, the union was granted interlocutory injunctions against the employer company, one of a group of stevedoring companies. One of the injunctions sought to prevent the employer company from doing anything that had the effect of terminating the employment of the company's employees. Two of the questions raised on the application were whether the order, if granted, would be in substance one of specific performance, and whether the order was objectionable on the ground that it required the Court to exercise continuous supervision of its order.

Decision

The High Court, Callinan J dissenting, held that the injunctions were not objectionable on the ground that they compelled the stevedores to work for the employer, or that they required the exercise of continuous supervision.

Brennan CJ, McHugh, Gummow, Kirby and Hayne JJ

We see in the orders no defect which sometimes is expressed as the involvement of the court in 'constant supervision' of continued conduct. Reservations of that nature have been expressed in decisions of this Court. However, questions of degree rather than absolute restrictions upon the scope of curial relief are involved. Reference was made in the Federal Court judgments and in submissions to this Court to the speech of Lord Hoffmann in *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1. His Lordship affirmed the refusal by the judge at first instance of an order for specific performance of a lease for a term of 35 years containing a covenant to keep premises open for retail trade during usual hours of business in the locality. His Lordship's statement that the usual practice was not to grant specific performance to carry on an activity over a period of time was made in response to a submission by the lessor to the effect that the equitable remedy was no longer to be understood as granted in the auxiliary jurisdiction where damages would be an inadequate remedy. The lessor submitted, without success, that in cases such as *Argyll Stores* the court 'should look at the whole panoply of available remedies and consider the appropriate one rather than the gloss of rules put on them restricting their use'.

The House of Lords discharged the order for specific performance which the Court of Appeal had made. The significance of Lord Hoffmann's speech for present purposes is not the rejection of the lessor's submissions. That rejection, with respect, was virtually inevitable. What is significant is the acceptance by the House of Lords that the concept of 'constant supervision by the court' by itself is no longer an effective or useful criterion for refusing a decree of specific performance. Rather, Lord Hoffmann placed stress on other propositions. First, a person who is subject to a mandatory order attended by contempt sanction (which 'must realistically be seen as criminal in nature') ought to know with precision what is required; and, second, the possibility of 'repeated applications for rulings on compliance' with orders requiring a party 'to carry on an activity, such as running a business over a more or less extended period of time' should be discouraged.

Reference to constant court applications should not be misunderstood. The courts are well accustomed to the exercise of supervisory jurisdiction upon applications by trustees, receivers, provisional liquidators and others with the responsibility for the conduct of administrations. The reservation of liberty to apply to the Federal Court in respect of certain of the orders to be made is in no way out of the ordinary in the exercise of equitable jurisdiction.

Note

The High Court also considered whether the injunction would compel employees to work for the employment company. Specific performance will not be ordered for a contract of employment, not only because the order might require constant supervision but also because the law will not compel one person to work for another. Equity will, however, in limited circumstances grant a negative injunction preventing an employee from working, in breach of contract, for a business rival of the plaintiff: see [3.3.4].

Questions

(1) Was the majority correct in treating *Argyll Stores* as authority for the proposition that 'constant supervision by the court' is no longer an effective or useful criterion for refusing a decree of specific performance?

(2) Does this extract suggest that an Australian court can order a defendant to perform a contractual obligation to carry on a business?

3.2.2.2 Lack of mutuality

The concept of mutuality captures the idea that a plaintiff should not be entitled to enforce the defendant's obligations under a contract unless the defendant can also compel performance of the plaintiff's obligations.

Affirmative mutuality means that, in principle (and subject to the discretionary considerations that govern all awards of equitable relief), specifically performable obligations are reciprocal. For example, just as a purchaser of land can, in principle, obtain specific performance of the vendor's promise to convey the land, so also the vendor can obtain specific performance of the purchaser's promise to pay the purchase price (*Turner v Bladin* (1951) 82 CLR 463).

Negative mutuality means that specific performance may be refused if, in the event of the defendant's breach of contract, the plaintiff has substantial unperformed obligations under the contract which a court cannot compel the plaintiff to perform. One of the reasons given by the majority of the Privy Council in *Loan Investment Corporation of Australasia v Bonner* [3.2.1.1a] for refusing specific performance was that, were the remedy to be granted to the purchaser of the land, the vendor could not easily obtain specific performance of the purchaser's promise to repay the loan made by the vendor which enabled the purchase price for the land to be paid.

Lack of mutuality was once considered an absolute bar to specific performance. But the trend of modern decisions, particularly since *Price v Strange* [1978] Ch 337, has been to treat the bar as discretionary. Few claims are barred exclusively on this ground, although a court may impose conditions on the grant of specific performance in order to protect the defendant's interest in ensuring the performance of the plaintiff's obligations.

3.3 Injunctions

The different types of injunctions are described at [3.13] of the textbook. While injunctions originated in equity, and the principles governing their award are equitable in character, the contemporary jurisdiction to award injunctions is statutory. Federal, State and Territory statutes provide that a court 'may by order, whether interlocutory or final, grant an injunction or appoint a receiver if it is just and convenient to do so'. The power to issue injunctions is not, however, at large; it can only be awarded in support of an established legal, equitable or statutory right. The statutory provision was considered in the following case.

3.3.1 General principles

3.3.1a *Australian Broadcasting Corporation v Lenah Game Meats Pty Ltd* [2001] HCA 63; (2001) 208 CLR 199

Background

Unidentified trespassers secretly filmed the stunning and killing of possums by the plaintiff's employees. The film was passed on to an animal liberation organisation, and then to the ABC for broadcasting. The plaintiff applied for an interlocutory injunction to restrain the ABC from broadcasting the film. It was conceded that the filming did not constitute a breach of confidence.

Decision

The High Court, Callinan J dissenting, held that the plaintiff was not entitled to an injunction because no legal or equitable right had been asserted which could be enforced by an injunction.

Kirby J held that it was not necessary for an injunction to support a legal or equitable right, but that the proper exercise of judicial discretion, which favoured freedom of discussion – in this case, of animal welfare – justified refusing the injunction.

Gummow and Hayne JJ

Lenah fixes upon the phrase in s 11(12) [of the *Supreme Court Civil Procedure Act 1932* (Tas)] 'in all cases in which it shall appear to the Court or judge to be just and convenient' as indicating all that has to be shown to enliven the power to award an interlocutory injunction. However, the terms which introduce that phrase, 'injunction' and 'receiver', are legal terms of art. The point was made by Lindley LJ, early in the operation of the Judicature system. In *Holmes v Millage* his Lordship said ([1893] 1 QB 551 at 557):

> Although injunctions are granted and receivers are appointed more readily than they were before the passing of the Judicature Acts, and some inconvenient rules formerly observed have been very properly relaxed, yet the principles on which the jurisdiction of the Court of Chancery rested have not been changed.

More recently, in *The Siskina,* Lord Diplock declared ([1979] AC 210 at 256):

> Since the transfer to the Supreme Court of Judicature of all the jurisdiction previously exercised by the court of chancery and the courts of common law, the power of the High Court to grant interlocutory injunctions has been regulated by statute. That the High Court has no power to grant an interlocutory injunction except in protection or assertion of some legal or equitable right which it has jurisdiction to enforce by final judgment, was first laid down in the classic judgment of Cotton LJ in *North London Railway Co* v *Great Northern Railway Co* (1883) 11 QBD 30 at 39–40, which has been consistently followed ever since.

Where interlocutory injunctive relief is sought in some special statutory jurisdiction which uses the term 'injunction' to identify a remedy for which it provides, that term takes its colour from the statutory regime in question. Nor should the references in the authorities to legal or equitable rights obscure the significant and traditional use of the injunction in the administration of public trusts, being trusts for charitable purposes, and in ensuring the observance of public law at the suit of the Attorney-General, with or without a relator, or at the suit of a person with a sufficient interest.

Further, as was pointed out in *Cardile v LED Builders Pty Ltd* (1999) 198 CLR 380 at 395 the injunctive remedy is still the subject of development in courts exercising equitable jurisdiction. This is true in public law, as *Enfield City Corporation v Development Assessment Commission* (2000) 199 CLR 135 illustrates. The treatment of the requirement for a legal right that is proprietary in nature, and of negative stipulations, referred to in *Cardile,* are other examples. In addition, as the general law develops in such fields as the economic torts and the protection of confidential information, there is an increase in the scope of the legal and equitable rights for which an injunctive remedy may be available. Similar development of equity is to be observed in England. Lord Millett has said that in England equity is not only 'now fully awake' and 'on the march again', but '[i]ndeed it is rampant' (Foreword, *Snell's Equity,* 30th ed, 2000). However, his Lordship also emphasised that 'the essential basis for principled advance' lies in 'analytical exposition of traditional doctrine'.

The basic proposition remains that where interlocutory injunctive relief is sought in a Judicature system court, it is necessary to identify the legal (which may be statutory) or equitable rights which are to be determined at trial and in respect of which there is sought final relief which may or may not be injunctive in nature. In *Muschinski v Dodds* (1985) 160 CLR 583 at 615 Deane J said that an equitable remedy:

> is available only when warranted by established equitable principles or by the legitimate processes of legal reasoning, by analogy, induction and deduction, from the starting point of a proper understanding of the conceptual foundation of such principles.

Note

Kirby J dissented on this issue, although agreeing with the majority that the plaintiff was not entitled to an injunction. One of the reasons he gave for not confining the award of an injunction to the protection of established legal, equitable and statutory rights was the discretionary, equitable character of the injunction. In particular, the 'beneficial remedy' of the interlocutory injunction must not be 'imprisoned in a cage of unyielding rules derived from ancient cases': (2001) 208 CLR 199, 266–7.

Questions

(1) The judicature legislation of all States and Territories permits courts exercising equity jurisdiction to grant an injunction, including an interlocutory injunction, 'if it is just and convenient to do so'. Why do these words not mean what they say?

(2) Must the right protected by an injunction be a property right? If not, how is the right defined?

3.3.2 The distinction between mandatory and prohibitory injunctions

3.3.2a *Smethurst v Commissioner of Police* [2020] HCA 14; (2020) 376 ALR 575

Background

The Australian Federal Police took a journalist's mobile phone pursuant to an illegal search warrant and copied data from the phone onto a USB stick. The phone was later returned. The journalist and the publisher of the newspaper employing her applied for a mandatory injunction requiring the destruction or delivery up of the information taken from the phone or, alternatively, an injunction restraining the police from making the information available to a prosecuting authority. The journalist was at risk of prosecution under the official secrets provisions of the *Crimes Act 1914* (Cth) although she denied she had committed an offence. The injunctions were sought on both public law and private law grounds. It was conceded that the unlawful taking of the phone amounted to the tort of trespass.

Decision

The High Court, Gageler, Gordon and Edelman JJ dissenting, held that the plaintiffs were not entitled to the award of an injunction.

Kiefel CJ, Bell and Keane JJ

The plaintiffs' argument for an injunction of this kind commences with a discussion of what would have occurred had they been able to apply for an injunction prior to the search being conducted and the trespass committed. They contend that the Court would have been in a position to grant a prohibitive injunction in its auxiliary equitable jurisdiction. It would not have been necessary for the plaintiffs to assert an entitlement to an injunction in the exclusive jurisdiction based on an equitable claim for breach of confidence. The threatened tort would have been sufficient to found an entitlement to the injunction. So much may be accepted. But it is also well settled that if a trespass is complete the courts will not interfere. They will only do so if the damage which has occurred is serious or the trespass is continuing in its effects

The argument then proceeds to the proposition that equity does not abandon persons such as the plaintiffs because they were unable to obtain an interlocutory order. An injunction may be granted to restore the status quo as it existed prior to the trespass by the court making orders with respect to the consequences of the tort, which is to say the copying of the information from the mobile

phone. Again, this is not said to depend upon the plaintiffs having proprietary rights or a claim to confidential information. Rather, it is said that equity will act in the auxiliary jurisdiction to restore the plaintiffs to the position in which they would have been had their legal rights not been infringed.

The plaintiffs' argument appears to be premised on the notion that 'equity will not suffer a wrong to be without a remedy', but the maxim has never meant that the courts of equity would invent a remedy solely because the plaintiff had suffered an injustice for which no remedy was available. A 'wrong' refers to conduct which is recognised as being contrary to law. The maxim means no more than that the court would afford a remedy for the invasion of a subsisting legal or equitable right.

To the extent that the plaintiffs may be understood to contend that a mandatory injunction may be granted where there is some ongoing effect from tortious conduct, the contention gains some support from *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30; (1998) 195 CLR 1. There Brennan CJ, McHugh, Gummow, Kirby and Hayne JJ said at [33] that, in a conspiracy case, where the acts referable to the conspiracy have occurred and the tort is complete, ordinarily the plaintiff is limited to the recovery of pecuniary damages. But, their Honours said, there is no rule which prevents a court from granting a mandatory injunction where the damage caused by tortious conduct is ongoing and is 'extreme, or at all events very serious' (at [33]). A mandatory injunction may issue to prevent the occurrence of further damage.

It may be accepted in the present case that the use of the information obtained from the first plaintiff's mobile phone may have serious consequences for the plaintiffs, but that is not to say that the plaintiffs have suffered damage by reason of the information being taken or that its use, in the investigation of an offence, constitutes damage recognised by the law. In *Patrick Stevedores*, had the conspiracy been carried through to its completion, employees who were members of the respondent union would have lost their employment and found it difficult to obtain other work. Those consequences were described as 'extremely serious' (at [32]) and it was said that damages would be 'very large' (at [32]) or 'enormous' and hence a factor relevant to the scope of relief available (at [34]).

In cases of trespass what may constitute injury is somewhat wider than in some other torts. Injury in the nature of an affront to a plaintiff's dignity or the apprehension of harm may qualify as damage for the purpose of an award of damages. Even so, it is not possible to regard the prospect that one may be investigated for an offence as injury. And needless to say, public policy would not permit such a course.

It may also be accepted that an award of damages will not redress the consequence that the information taken as a result of the trespass may be used in aid of the investigation of one or both of the plaintiffs. At a number of points in their submissions the plaintiffs placed some weight upon damages being an inadequate remedy as supporting the grant of an injunction.

The principle that a plaintiff does not obtain an injunction for actionable wrongs for which damages are the proper remedy is well established. If damages are adequate a party 'should be relegated to that remedy; only if damages are inadequate will an injunction lie' (Heydon, Leeming & Turner, *Meagher, Gummow and Lehane's Equity: Doctrine and Remedies* (5th ed, 2015) at [21-035]). The principle is given effect as a rule, in the nature of a negative condition, for a grant of an injunction. It is a necessary, but not sufficient, condition for a grant. It cannot be elevated to an independently sufficient basis for an injunction, as the plaintiffs suggest.

No doubt the plaintiffs' argument takes as its starting point the proposition that they would have been granted an interlocutory injunction prohibiting the trespass, had they been in a position to apply in time, because that has been said to be a requirement for a mandatory restorative injunction, one which reverses an act done by the defendant where damages are not an adequate remedy. Examples given in the text to which the plaintiffs refer (Young, Croft and Smith, *On Equity* (2009) at [16.110] footnote 57) of cases where such an order has been made include those involving damage to property and other rights and breach of contract, where the order is akin to specific performance. But nowhere is it suggested that such an order will be made where the plaintiff has no legal right. And here the plaintiffs can point to none.

It is well settled that for the grant of an injunction in equity's auxiliary jurisdiction, interlocutory or final, a plaintiff must have a legal right which the injunction will protect. It is so well settled that arguments concerning it tend to focus upon what may or may not constitute such a right. By way of example, recently, in *Glencore International AG v Federal Commissioner of Taxation* [2019] HCA 26 the plaintiffs accepted that they needed to show that they had an actionable right, but they did not succeed in establishing that legal professional privilege qualified as such a right…

…Nothing said in *Lenah Game Meats* detracts from the need for a plaintiff to identify a legal right as the subject of the court's protection by way of injunction in the auxiliary jurisdiction. Even accepting that the injunction remedy is still the subject of development by courts exercising equitable jurisdiction, as Gummow and Hayne JJ said, '[t]he basic proposition remains that where interlocutory injunctive relief is sought … it is necessary to identify the legal … or equitable rights which are to be determined at trial' (*Australian Broadcasting Corporation v Lenah Game Meats Pty Ltd* (2001) 208 CLR 199 at 241[9]). The plaintiffs can point to no authority which recognises their interest in not being investigated in relation to an offence as a right.

Nettle J

In a case like the present, questions as to the adequacy of damages and justifiable hardship require an assessment of the nature, gravity and contumacy of the trespass committed by the unlawful search and seizure and of the nature and extent of the damage that would be inflicted on the plaintiff if the Commissioner were not restrained. Thus, if this matter had involved a deliberate flouting of the law – as it would have if seizing officers had gone onto the first plaintiff's land and effected the seizure knowing, or recklessly indifferent as to whether, they had no lawful authority to do so – the public interest may have provided good reason to regard the official retention and use of the information as raising an equity for restorative injunction. And that would have been so whether the proceedings were brought in this Court, to ensure the rule of law against officers of the Commonwealth, or in a State Supreme Court having the powers of the courts at Westminster against officials of the State. But where, as here, it is not suggested that the unlawfulness of the search and seizure was the result of anything other than an honest error made in the course of a bona fide attempt to comply with the provisions of Pt IAA of the *Crimes Act* (by reason of the misdescription of the suspected offence in the warrant), it is difficult to see that the unlawfulness of the search and seizure, of itself, should be regarded as so obliquitous as to render continued detention and use of the information inequitable…

… As was made plain in the course of argument, the Commissioner does not seek to use the information for any purpose other than purposes that, but for the invalidity of the Second Warrant, would be expressly authorised by Pt IAA of the *Crimes Act*. Consequently, as was also made plain in argument, the only potential damage that the first plaintiff faces is the possibility that, if the Commissioner uses the information as intended, it may lead to the first plaintiff being prosecuted for a criminal offence (the commission of which she denies) of the kind that was infelicitously described in the warrant. The claim for injunction thus confronts the difficulty that, generally speaking, injunction will not go to restrain publication of information where the consequence of restraint would be to prevent disclosure of criminality which, in all the circumstances, it would be in the public interest to reveal.

Gageler J

It is important to be clear about what the common law would be attempting to compensate for in awarding compensatory damages. The gist of a common law cause of action for trespass, whether to land or to goods, is 'the wrong to the right to possession' (*Penfolds Wines Pty Ltd v Elliott* [1946] HCA 46; (1946) 74 CLR 204 at 227) At the heart of the common law right to possession is the common law right to control access by others and thereby to exclude others from access. In protecting the right to possession, the policy of the common law is to protect the right to exclude others which is bound up in possession.

The common law would accordingly be attempting to compensate Ms Smethurst for the AFP's infringement of her right to possession of her home and for the AFP's infringement of her right to possession of her mobile phone. Compensatory damages would seek to vindicate her interest in 'maintaining the right to exclusive possession … free from uninvited physical intrusion by strangers' (*New South Wales v Ibbett* [2006] HCA 57; (2006) 229 CLR 638 at 646 [29]). To those compensatory damages, aggravated damages might well be added to take account of the 'circumstances and manner of the wrongdoing' including the 'affront' to her dignity and quiet enjoyment (*New South Wales v Ibbett* [2006] HCA 57; (2006) 229 CLR 638 at 646–647 [31]).

In circumstances where the AFP continues to hold a copy of the data downloaded by the AFP from Ms Smethurst's mobile phone through the commission of the trespasses, however, how can damages possibly be an adequate remedy? The essential characteristic of the information embedded in the data as it existed on the mobile phone before the commission of the trespasses was that access to the information was within her exclusive power to control by virtue of her possession of the mobile phone and its location in her home. The information embedded in the data is information to which she alone would continue to control access but for the AFP having trespassed against her. For so long as the information remains in the hands of the AFP, the direct effects of the infringement of her rights to possession of her home and of her mobile phone are serious and ongoing. There being no suggestion that the value of the information embedded in the data to her is wholly commercial, money alone cannot restore her to the position she would have been in had the trespasses not been committed.

Had some technologically adept scoundrel forced his way into Ms Smethurst's home, hacked into her mobile phone, downloaded the same data and refused to give the data back, I cannot imagine that an application by her in the 'auxiliary jurisdiction' of equity to aid the common law for an injunction to compel the scoundrel to return the data would be refused on the basis that the trespasses did not have an ongoing effect that was legally cognisable or on the basis that damages were an adequate remedy. But even if such a response could be imagined in a matter between citizen and citizen, the constitutional dimension of the trespasses here and the constitutional nature of the jurisdiction invoked cannot be ignored. There is nothing 'auxiliary' about the jurisdiction conferred by s 75(v) of the Constitution, and there is every reason not to be reticent about its exercise.

It is now more than 250 years since the celebrated judgment of Lord Camden in *Entick v Carrington* ((1765) 19 St Tr 1029) cemented the position at common law that the holder of a public office cannot invade private property for the purpose of investigating criminal activity without the authority of positive law. Lord Camden referred to the private papers unlawfully seized in that case as their owner's 'dearest property'. He said that 'though the eye cannot by the laws of England be guilty of a trespass, yet where private papers are removed and carried away, the secret nature of those goods will be an aggravation of the trespass' ((1765) 19 St Tr 1029 at 1066). In so saying he recognised a link between protection of personal property and protection of freedom of thought and political expression …

The principles of constitutional liberty and security carried forward from *Entick v Carrington* are part of our common law inheritance. We ignore them – or, worse, devalue them – at our peril. For those principles to have appropriate contemporary operation in Australia, their practical application must be adapted to the contemporary reality that digital technology has provided new means by which personal property can be a repository of privately held information as well as new means by which such information can be extracted through the invasion of that private property and afterwards retained and disseminated.

More importantly, in an age in which invasions of common law rights can result in more than just common law remedies, talk of those principles must be backed up by a preparedness on the part of all courts 'within the limits of their jurisdiction and consistent with their obligation to act judicially … [to] provide whatever remedies are available and appropriate to ensure that those possessed of executive and administrative powers exercise them only in accordance with the laws which govern their exercise' (*Enfield City Corporation v Development Assessment Commission* [2000] HCA 5; (2000) 199 CLR 135 at 157 [56]). The remedy of an injunction being constitutionally available within the original jurisdiction of the High Court, the appropriate remedy for the unauthorised invasion by an officer of the Commonwealth of a common law right of a citizen of Australia cannot be presumptively confined to the common law remedy of damages: 'for if an owner of property is truly to have a 'strict' or 'fundamental' right not to be unlawfully invaded then this right must be supported by an effective sanction otherwise the term will be just meaningless rhetoric' [146]. In answer to an application by a citizen for a prohibitory injunction to restrain an unauthorised invasion of a common law right to property that is about to occur or is occurring, no officer of the Commonwealth should be heard to say 'you can have your damages later'. And in answer to an application by a citizen for a mandatory injunction to prevent the ongoing effect of an unauthorised invasion of such a common law right that has occurred, no officer of the Commonwealth should be heard to say 'your damages are enough'.

The juridical basis for the final mandatory injunction sought by Ms Smethurst does not lie in her having an interest in preventing the copied data from being used by the AFP. In the absence of statutory immunity validly conferred, no one has a legally cognisable interest in being protected from investigation for an offence.

The juridical basis for the injunction is also not dependent on the common law of Australia coming to recognise an independent cause of action for infringement of a distinct right of privacy. Unlike *Australian Broadcasting Corporation v Lenah Game Meats Pty Ltd* (2001) 208 CLR 199 at 248–258 [105]–[132], where that question was explored and left open, this is not a case in which a remedy is sought against someone other than a trespasser. Nor is it a case like *Coco v Shaw* ([1994] 1 Qd R 469, where the unauthorised use of a listening device to record a 'private' but not 'confidential' telephone conversation was not suggested to involve infringement of any right to possession. This is a case within the heartland of the tort of trespass.

The juridical basis for the final mandatory injunction sought by Ms Smethurst lies in its issue within the discretion of the Court being constitutionally appropriate to restore Ms Smethurst to the position she would have been in had her common law rights to control access to her real and personal property not been invaded by the tortious conduct of the AFP in circumstances in which money alone cannot restore her to that position (*Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* [1998] HCA 30; (1998) 195 CLR 1 at 31 [33]).

Edelman J

Whether the wrong is public or private, the injunction can be in a negative or prohibitory form or it can be in a positive or mandatory form. It has been held that a mandatory injunction cannot be obtained 'by merely saying 'Timeo' [I fear]' (*Attorney-General for the Dominion of Canada v Ritchie Contracting and Supply Co* [1919] AC 999 at 1005) and that there must be a 'likelihood of a future apprehended wrong' (*Redland Bricks Ltd v Morris* [1970] AC 652 at 666). What is far less usual, whether for private or public wrongs, is for a mandatory injunction to issue in order to ameliorate the consequences of a wrong rather than to prevent it occurring or continuing. As Story explained, an injunction 'seeks to prevent a meditated wrong more often, than to redress an injury already done' (*Commentaries on Equity Jurisprudence, As Administered in England and America* (1836), vol 2, §862 at 155).

A libertarian principle of the common law is that it is usually easier to justify ordering a wrongdoer to pay money to ameliorate the consequences of wrongdoing than to justify ordering a wrongdoer personally to act to ameliorate those consequences. The legal

rules concerned with the legal response to the consequences of wrongdoing for which the wrongdoer is liable are usually rules concerned with the measure of damages. Damages interfere with the defendant's liberty only by requiring payment of money. These money awards can respond to the consequences of wrongdoing in various ways beyond compensating for losses. In appropriate cases restitution of a gain or an account and disgorgement of profits or exemplary damages might be ordered. By contrast with orders for payment, orders requiring a defendant personally to perform other acts, when omitting to act would be lawful, were described by Lord Westbury LC as delivering the defendant to the plaintiff, 'bound hand and foot' (*Isenberg v The East India House Estate Company Ltd* [1863] EngR 1070; (1863) 3 De G J & S 263 at 273 [46 ER 637 at 641]). Hence, other things being equal, it is often the case that '[a] permanent injunction will only issue to prohibit acts which the law categorises as unlawful' (*Law Debenture Trust Corporation v Ural Caspian Oil Corporation Ltd* [1995] Ch 152 at 171).

However, other things are not always equal. As five members of this Court said in *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* ([1998] HCA 30; (1998) 195 CLR 1 at 31 [33], it has been established for more than a century that in exceptional cases a mandatory injunction can be granted despite the completion of the 'injury sought to be restrained'. The joint judgment in that case cited a line of authorities affirming the power to grant a mandatory injunction, after completion of the wrong, in order to restrain the continuation of damage caused by the wrongdoing where that damage is ongoing and very serious.

The central rationale for a mandatory injunction in cases where there is no anticipated or continuing unlawful action is that the interference with the liberty of the defendant by ordering the defendant to take action where inaction would be lawful is justified by the extent of the inadequacy of damages to ameliorate the consequences of the wrongdoing. However, the greater the intrusion into a defendant's liberty arising from the injunction the more that the decision to make the order must be 'attended with the greatest possible caution' (*Isenberg v The East India House Estate Company Ltd* [1863] EngR 1070; (1863) 3 De G J & S 263 at 272 [46 ER 637 at 641]).

A mandatory injunction is most easily justified where the consequences are ongoing and serious, the interference with the defendant's liberty is trivial and, compared with an injunction, damages are an inadequate means to 'undo the consequences of a wrong' (Smith, *Rights, Wrongs, and Injustices: The Structure of Remedial Law* (2019) at 271). For instance, in *McManus v Cooke* (1887) 35 Ch D 681, a mandatory injunction was granted to require the defendant to take action involving what was described as the insignificant inconvenience of removing a skylight from which 'it would be extremely difficult to estimate the damage' that the plaintiff would suffer ((1887) 35 Ch D 681 at 698).

The concerns of (i) inconvenience to, and interference with the liberty of, the defendant and (ii) adequacy of damages to the plaintiff are matters requiring caution before ordering a mandatory injunction which compels a defendant to act despite the lack of actual or anticipated unlawful conduct by the defendant. A simple, but powerful, example is where the police, without knowledge of the invalidity of a search warrant, take an ordinary saucer which contains the fingerprints of the perpetrator of a very serious offence. Could it really be suggested that it is just to compel the police to return the saucer to the perpetrator of the offence, so that the perpetrator can destroy the evidence of their crime, rather than to require the police to pay any damages, possibly nominal, if the saucer is wrongfully retained for a period in order to be used for the purpose of prosecution? No rhetorical resort to the fundamental nature of the sanctity of property could justify such a result.

In the above example, the mandatory injunction would be refused on the grounds that the plaintiff has no interest that could not be satisfied by damages but the intrusion into the liberty of the defendant would have significant adverse consequences. The injunction would be refused despite the continuing unlawfulness of the police retaining the saucer. The caution before interfering with the liberty of a defendant applies with even greater force where, as here, the injunction would compel a defendant to act when inaction would not otherwise be unlawful. However, there is nevertheless power in an appropriate case, where the interference with the liberty of the defendant is slight and the consequences of the wrongdoing to the plaintiff are significant, to order a mandatory injunction to reverse or ameliorate the consequences of a wrong even if the injunction would compel a defendant to act when inaction would not otherwise be unlawful. There is considerable authority that supports the existence of this power …

… The inadequacy of damages is to be assessed from the perspective of Ms Smethurst only, and not the perspective of the Australian Federal Police. From Ms Smethurst's perspective, the question is whether a damages award would be inadequate to ameliorate the consequences of the trespass by the Australian Federal Police. Contrary to Ms Smethurst's submission, the relevant consequence is not the possibility that she might be exposed to jeopardy due to any incriminating material on her mobile phone or the costs or distress associated with such exposure. Ms Smethurst pointed to no basis for any immunity from investigation by the Australian Federal Police and therefore no lawful interest in resisting investigation or exposure to jeopardy.

However, independently of any development of the law concerning private information, Ms Smethurst does have an interest in resisting the potential dissemination of private information contained on her mobile phone which has not been lawfully obtained. In an appropriate case, the strength of that interest will establish that damages are inadequate. The question is whether this case is such

an appropriate case. I have not found this question easy. The reasons of Nettle J concerning the limited use to which the Australian Federal Police are likely to put the information in the performance of their functions present a powerful case for a conclusion that damages would be adequate. Ultimately, however, I have concluded that Ms Smethurst's interest in privacy is sufficient to establish that damages would not be adequate …

… The inadequacy of damages is a consideration in favour of an injunction only from the plaintiff's perspective. The perspective of the defendant must also be considered when assessing whether the defendant should be compelled to take action to reverse or ameliorate the consequences of a wrong where the defendant is not under a duty otherwise to perform the act.

From the perspective of the Australian Federal Police, a mandatory injunction could involve a substantial interference with their liberty to act lawfully. Subject to the effect on the statutory powers of police of any development of common law or equitable principles concerning privacy, the Australian Federal Police are at liberty to disseminate private information about others in connection with their lawful investigation of Commonwealth offences …

[Edelman J would have awarded the plaintiffs an injunction balancing the interests of the parties: that upon 72 hours' notice from Ms Smethurst, and subject to the terms of any lawful warrant, the Commissioner of Police deliver up to Ms Smethurst a Universal Serial Bus (USB) storage device containing the information copied from Ms Smethurst's mobile phone in an accessible form, and delete all other copies of that information held by, or within the control of, the Australian Federal Police.]

Note

Gordon J dissented on the ground that the plaintiffs were entitled to the award of an injunction in the High Court's original jurisdiction under s 75(v) of the *Constitution*. Had it been necessary to consider the availability of an injunction for trespass, Gordon J would have granted the injunctions requested by the plaintiffs. Her Honour stated at [197] that '[i]n the current age, where information may be as valuable to individuals as property, the law cannot overlook the obtaining of data as a consequence of trespass that falls within the damage suffered as part of the trespass. It is not necessary to establish rights of property in the data itself to reach that conclusion.'

Questions

(1) Suppose that a mandatory injunction is sought by an employee of ABC Pty Ltd to compel XYZ Pty Ltd to destroy or hand over information which XYZ Pty Ltd obtained by stealing a mobile phone belonging to the employee. The phone was later returned. Will the employee be entitled to an injunction if:

(a) the information obtained from the phone is commercially sensitive, including information about new products ABC Pty Ltd intend to sell;

(b) the information concerns the breakdown of the employee's marriage; or

(c) the information relates to the employee's illegal drug dealing?

(2) Why, in the opinion of the plurality judgment, had the plaintiffs not established a legal right to an injunction even though the Australian Federal Police had committed trespass and common law damages for trespass were inadequate?

(3) Would the majority judges have awarded the plaintiffs a mandatory injunction if the Police had deliberately committed trespass?

(4) Do Gageler J and Edelman J dissent from the majority judgments for the same reasons? What are the principal differences between the judgments?

3.3.3 Social considerations

3.3.3a *Miller v Jackson* [1977] 1 QB 966

Background

A cricket club had played on the same ground for over 70 years. Property developers built houses on the edge of the ground, one of which was purchased by the plaintiffs. Cricket balls were frequently hit into the plaintiffs' property despite the construction of a high concrete boundary fence. Their house was damaged and the plaintiffs considered themselves at risk of personal injury.

They claimed damages from the cricket club for negligence and nuisance, as well as an injunction to restrain the club from playing cricket on the ground without first taking adequate steps to prevent balls from being hit onto their house or into their garden.

Decision

A majority of the Court of Appeal, Geoffrey Lane LJ dissenting, held that the plaintiffs were not entitled to an injunction. They were, however, awarded £400 damages 'to cover any past or future damage'.

Lord Denning MR

In this case it is our task to balance the right of the cricket club to continue playing cricket on their cricket ground as against the right of the householder not to be interfered with. On taking the balance, I would give priority to the right of the cricket club to continue playing cricket on the ground, as they have done for the last 70 years. It takes precedence over the right of the newcomer to sit in his garden undisturbed. After all, he bought the house four years ago in midsummer when the cricket season was at its height. He might have guessed that there was a risk that a hit for six might possibly land on his property. If he finds that he does not like it, he ought, when cricket is played, to sit on the other side of the house or in the front garden, or go out: or take advantage of the offers the club have made to him of fitting unbreakable glass, and so forth. Or, if he does not like that, he ought to sell his house and move elsewhere. I expect there are many who would gladly buy it in order to be near the cricket field and open space. At any rate he ought not to be allowed to stop cricket being played on this ground.

This case is new. It should be approached on principles applicable to modern conditions. There is a contest here between the interest of the public at large; and the interest of a private individual. The public interest lies in protecting the environment by preserving our playing fields in the face of mounting development, and by enabling our youth to enjoy all the benefits of outdoor games, such as cricket and football. The private interest lies in securing the privacy of his home and garden without intrusion or interference by anyone. In deciding between these two conflicting interests, it must be remembered that it is not a question of damages. If by a million to one chance a cricket ball does go out of the ground and cause damage, the cricket club will pay. There is no difficulty on that score. No, it is a question of an injunction. And in our law you will find it repeatedly affirmed that an injunction is a discretionary remedy.

In a new situation like this, we have to think afresh as to how discretion should be exercised. On the one hand, Mrs Miller is a very sensitive lady who has worked herself up into such a state that she exclaimed to the judge: 'I just want to be allowed to live in peace. … Have I got to wait until someone is killed before anything can be done?' If she feels like that about it, it is quite plain that, for peace in the future, one or other has to move. Either the cricket club has to move: but goodness knows where. I do not suppose for a moment there is any field in Lintz to which they could move. Or Mrs Miller must move elsewhere. As between their conflicting interests, I am of opinion that the public interest should prevail over the private interest. The cricket club should not be driven out. In my opinion the right exercise of discretion is to refuse an injunction; and, of course, to refuse damages in lieu of an injunction. Likewise as to the claim for past damages. The club were entitled to use this ground for cricket in the accustomed way. It was not a nuisance, nor was it negligent of them so to run it. Nor was the batsman negligent when he hit the ball for six. All were doing simply what they were entitled to do. So if the club had put it to the test, I would have dismissed the claim for damages also. But as the club very fairly say that they are willing to pay for any damage, I am content that there should be an award of £400 to cover any past or future damage. I would allow the appeal, accordingly.

Notes

(1) Geoffrey Lane LJ dissented on the ground that the real risk of injury to the plaintiffs justified the award of an injunction. However, he would have postponed its operation for 12 months in order to give the defendant time to find an alternative ground.

(2) An alternative to refusing the award of an injunction preventing the nuisance is to award an injunction on terms that permit the activity constituting the nuisance to be carried out on dates and conditions specified by the court. See *Kennaway v Thompson* [1981] QB 88, where the defendant's speedboat racing on a lake interfered with the plaintiff's enjoyment of her home on the edge of the lake. The injunction the plaintiff obtained for private nuisance limited the number of events the defendant could hold and the number of boats that could be raced simultaneously, as well as setting the maximum permissible noise level.

(3) In *Lawrence v Fen Tigers* [2014] AC 822, speedway racing and motocross activities, carried out pursuant to planning permissions, were held to constitute a nuisance. The Supreme Court of the United Kingdom restored the trial judge's injunction limiting the permitted noise levels of the activities and deferred the operation of the injunction to give the speedway operators time to reorganise their activities. The Supreme Court also held that, upon an application to vary the injunction, a damages award could be substituted for the injunction. In considering whether damages should be awarded in substitution for an injunction under *Lord Cairns' Act* (see [3.4]), Lord Neuberger stated at [124]:

> As for … public interest, I find it hard to see how there could be any circumstances in which it arose and could not, as a matter of law, be a relevant factor. Of course, it is very easy to think of circumstances in which it might arise but did not begin to justify the court refusing, or, as the case may be, deciding, to award an injunction if it was otherwise minded to do so. But that is not the point. The fact that a defendant's business may have to shut down if an injunction is granted should, it seems to me, obviously be a relevant fact, and it is hard to see why relevance should not extend to the fact that a number of the defendant's employees would lose their livelihood, although in many cases that may well not be sufficient to justify the refusal of an injunction. Equally, I do not see why the court should not be entitled to have regard to the fact that many other neighbours in addition to the claimant are badly affected by the nuisance as a factor in favour of granting an injunction.

Question

Do you think that courts should take into account community welfare in exercising discretion to award an injunction? How can courts identify and evaluate welfare interests?

3.3.4 Preventing breaches of contract by injunction

3.3.4a *Curro v Beyond Productions Pty Ltd* (1993) 30 NSWLR 337

Background

The defendant entered into a contract with the plaintiff, Beyond Productions, to present a television program. The contract provided that the defendant would not 'enter into any engagement or carry on any activity which might reasonably be expected to prevent her from rendering … her services' under the contract. Three months before the contract was due to expire, the defendant entered into a contract to work for a rival television company.

Decision

The New South Wales Court of Appeal upheld the award of an injunction restraining the defendant from taking up employment with the rival company until her contract with the plaintiff had expired.

The Court

[W]e shall endeavour to state in a concise form what we understand to be the law on this topic. Until recently, it could be summarised as reflecting three principles: first, that under the doctrine enunciated by Lord Cairns LC in *Doherty v Allman* (1878) 3 App Cas 709 at 720, a court of equity would always grant an injunction to enforce a negative contractual promise made for consideration; secondly, that, by way of exception a negative promise would not be enforced by injunction if that would have the practical effect of compelling specific performance of a contract of personal service or if it would force the defendant either to perform that contract or remain idle (with overtones of destitution); and thirdly, by way of exception to the exception, in the case of special services a promise not to take employment with a competitor, would, under the doctrine of *Lumley v Wagner,* be restrained.

It is no longer possible to state the law with such precision. The first rule enunciated in *Doherty v Allman* can no longer be maintained. Academic writers have long doubted the principle expressed in such wide terms and the High Court has now rejected it: *Dalgety Wine Estates Pty Ltd v Rizzon* (1979) 141 CLR 552. The second rule has been departed from in England in *Hill v C A Parsons & Co Ltd* [1972] Ch 305. … As to the third rule, which is in question here, *Lumley v Wagner* has been much discussed. It has, with varying degrees of enthusiasm, been followed by Australian courts. … The argument for the appellants that this Court should not follow *Lumley v Wagner* cannot be accepted. *Lumley v Wagner* concerned a contract by which Mme Wagner, a famous German opera singer promised to sing operatic roles for the plaintiff at Her Majesty's Theatre for a three months season. It contained a provision that she would sing nowhere else during the contract; she threatened to commit a breach of the contract by singing for a rival impresario at Covent Garden and the court restrained the breach.

The doctrine has always been said to apply to contracts for 'special services'. This includes contracts by opera singers *(Lumley v Wagner* (1852) 64 ER 1209), movie stars *(Warner Brothers v Nelson* [1937] 1 KB 209), actresses *(Warner Brothers v Ingolia* [1965] NSWR 988), rock singers *(Harrigan v Brown* [1967] 1 NSWR 342), football players *(Buckenara v Hawthorn Football Club, Hawthorn Football Club v Harding* [1988] VR 39) and newspaper production managers *(Evening Standard Co Ltd v Henderson* [1987] ICR 588). How many other occupations fit within this category can be left to the course of subsequent decisions. Learned counsel for the appellants argued that one reason why *Lumley v Wagner* should be rejected is that no satisfactory definition of 'special services' can be formulated. That is true but it is also true of many other terms of practical utility, both non-legal (for example, beauty, elegance) and legal (for example, reasonableness, unconscionability).

Lord St Leonards LC in *Lumley v Wagner* pointed out that the injunction would not compel Mme Wagner to perform her contract with Mr Lumley. Failure to sing for Mr Lumley would not be a breach of the injunction. On the other hand, on the facts in that case obedience to the injunction would not confront her with a choice between service with Mr Lumley and destitute idleness. She could employ her energies in some other occupation or perhaps return to Germany. The injunction was also of short duration. The contract was for three months from 1 April 1852. The Vice-Chancellor granted an injunction on 8 May, and the Chancellor dismissed Miss Wagner's appeal on 26 May. There was therefore no impediment to the court taking the attitude to defendants in Mme Wagner's position that 'it will not suffer them to depart from their contracts at their pleasure, leaving the party with whom they have contracted to the mere chance of any damages which a jury may give. The exercise of this jurisdiction has, I believe, had a wholesome tendency towards the maintenance of … good faith' (at 619; 693). This rationale for such injunctions should be emphasised as learned counsel for the appellants at times seemed aghast at the suggestion that a court of equity should hold parties to their contracts.

In some cases an attempt to obtain an injunction based on *Lumley v Wagner* has failed. One such decision is *Page One Records Ltd v Britton* [1968] 1 WLR 157; [1967] 3 All ER 822. A group of 'musicians' promised not to employ another manager during the four years of their contract with the plaintiff. The court refused to restrain the 'musicians' from continuing a clear breach of this promise. However, there were significant features which distinguish it from *Lumley v Wagner* and other cases in which an injunction has been granted. The injunction sought was for four years which is a long time in this context, and it would have compelled the defendants to re-employ the plaintiff or go out of business. In *Warren v Mendy* [1989] 1 WLR 853; [1989] 3 All ER 103, the Court of Appeal refused to restrain a boxer from employing a new manager, but again the decision is explicable on the facts: the injunction sought was for about two and a half years; the defendant acted in good faith, his relationship with the plaintiff broke down before he sought a new manager, a boxer has a very short career, and the trial judge had found that an injunction would compel the defendant to perform a contract for personal services. These decisions do not justify the conclusion urged on us by learned counsel for the appellants that some modern 'rule' has displaced *Lumley v Wagner.*

The appellant also relied on a lack of mutuality. This however is discretionary and not an absolute defence to proceedings such as these. As Nourse LJ said in *Warren v Mendy* (at 866; 113): '… We very much doubt whether a want of mutuality alone would now be decisive in a case of (this) kind'. We are of the view that the authorities establish that in a *Lumley v Wagner* case, an injunction will still be granted when the balance of discretionary factors is in the plaintiff's favour.

In the present case, to grant the injunction sought is not to order specific performance of the service and services contracts. Miss Curro could comply with the injunctions without resuming work for Beyond. She would not be forced to choose between service with

Beyond or idleness. Other employments would be open to her. There is no question of her being destitute. Damages would not be an adequate remedy. The final injunctions granted by Cole J only continue until 11 August, a relatively short period. Her breach of contract was flagrant and opportunistic. She sought to justify her behaviour by giving evidence which the judge found was untrue and in relation to the contents of her tape recording deliberately misleading. The injunctions do no more than oblige Miss Curro to comply with negative promises which are part of a fair and freely negotiated bargain made less than two years ago. We see no reason at all why she should not be ordered to keep her word. These considerations alone would require that any judicial discretion be exercised in its favour.

Note

As the Court explained, the injunction is named after *Lumley v Wagner* (1852) 42 ER 687, where the defendant, who was engaged to sing at Her Majesty's Theatre, Haymarket, was restrained from breaking her contract by singing at Covent Garden. Lord St Leonards stated: 'It is true that I have not the means of compelling [the defendant] to sing, but she has no cause of complaint if I compel her to abstain from the commission of an act which she has bound herself not to do, and thus possibly cause her to fulfil her engagement'. See S Waddams, 'Johanna Wagner and the Rival Opera Houses' (2001) 117(3) *Law Quarterly Review* 431.

Questions

(1) If specific performance cannot be granted of a contract of employment, why can an injunction be granted to restrain an employee from working for a rival employer? How convincing are the justifications for the *Lumley v Wagner* injunction given in *Curro?*

(2) What does the Court in *Curro* mean by contracts for 'special services'? Why are they special?

3.3.5 Interlocutory injunctions

See textbook at [3.19]–[3.20]; *Beecham Group v Bristol Laboratories* (1968) 118 CLR 618; and *Australian Broadcasting Commission v O'Neill* (2006) 227 CLR 57. Contrast the principles laid down by Lord Diplock in *American Cyanamid Co v Ethicon Ltd* [1975] AC 367.

3.4 Equitable damages

Prior to the enactment of the *Judicature Acts 1873–1876* (Imp), litigants who sought equitable relief in Chancery (for example, to compel performance of a contract or to prevent the commission of a tort), but who were refused equitable relief in spite of proving that a breach of contract or tort had occurred, would have to start a new action in a common law court in order to obtain damages. The *Chancery Amendment Act 1858* removed the necessity of bringing a new common law claim; damages could now be awarded in equity. The Judicature legislation removed the original rationale of the Act. The Act nonetheless enables damages to be awarded in some circumstances in which they would not otherwise be available.

3.4.1 The legislation

Two versions of the legislation are in force in Australian jurisdictions. New South Wales, Northern Territory, South Australia, Tasmania and Western Australia have enacted versions which, in updated language, are based on the original *Chancery Amendment Act 1858*. The distinguishing feature of this version is the emphasis placed on the commission of a wrongful act. An example is s 68 of the *Supreme Court Act 1970* (NSW) which provides:

> Where the Court has power:

> **(a)** to grant an injunction against the breach of any covenant, contract or agreement, or against the commission or continuance of any wrongful act, or
>
> **(b)** to order the specific performance of any covenant, contract or agreement,
>
> the Court may award damages to the party injured either in addition to or in substitution for the injunction or specific performance.

Queensland and Victoria have enacted versions, derived from s 50 of the *Senior Courts Act 1981* (UK), which omit the reference to wrongdoing. Section 38 of the *Supreme Court Act 1986* (Vic) provides:

> If the Court has jurisdiction to entertain an application for an injunction or specific performance it may award damages in addition to, or in substitution for, for an injunction or specific performance.

In the versions of the legislation which make explicit reference to 'a wrongful act', it has not been authoritatively settled whether the act is confined to torts and breaches of contract or extends to equitable wrongs, such as a breach of confidence. Equitable compensation is available to compensate for loss caused by breach of an equitable obligation, so there is no need to invoke the statutory jurisdiction to award damages. Moreover, the report of the Chancery Commissioners which preceded the enactment of the *Chancery Amendment Act 1858* stated that the purpose of the Act was to confer power on the Court of Chancery to award damages if a person was 'injured by a wrongful act which would entitle him to damages in a Court of Law'. Nevertheless, awards of statutory damages for breach of equitable obligation have been made, and in *Wentworth v Woollahra Municipal Council* (1982) 149 CLR 672, 676 the High Court stated: 'An incidental object of the Act was to enable the Court to award damages in lieu of an injunction or specific performance, even in the case of a purely equitable claim'.

The Queensland and Victorian versions of the *Chancery Amendment Act 1858* omit the expression 'wrongful act'. The Victorian Court of Appeal in *Giller v Procopets* (2008) 24 VR 1 held that the different wording of the Victorian provision justified an award of statutory damages for an equitable breach of confidence (see [3.4.3a] below).

3.4.2 Criteria for determining whether a damages award should be made

3.4.2a *Shelfer v City of London Electric Lighting Co* [1895] 1 Ch 287

Background

The defendant built a power station adjoining a public house leased by the plaintiff and his wife. The noise and vibrations caused by the operation of the defendant's machinery made the plaintiff's wife and daughter ill. The walls of the public house cracked and the upper floor was made uninhabitable. The plaintiff applied for an injunction to restrain the defendant causing a nuisance by reason of the operation of its machinery. The trial judge refused to award an injunction but awarded the plaintiff damages under the *Chancery Amendment Act 1858*.

Decision

The Court of Appeal allowed the plaintiff's appeal and substituted an injunction for the damages award.

AL Smith LJ

Many Judges have stated, and I emphatically agree with them, that a person by committing a wrongful act (whether it be a company for public purposes or a private individual) is not thereby entitled to ask the Court to sanction his doing so by purchasing his neighbour's rights, by assessing damages in that behalf leaving his neighbour with the nuisance, or his lights dimmed, as the case may be.

In such cases the well-known rule is not to accede to the application, but to grant the injunction sought, for the plaintiff's legal right has been invaded, and he is prima facie entitled to an injunction.

There are, however, cases in which this rule may be relaxed, and in which damages may be awarded in substitution for an injunction as authorized by this section.

In any instance in which a case for an injunction has been made out, if the plaintiff by his acts or laches has disentitled himself to an injunction the Court may award damages in its place. So again, whether the case be for a mandatory injunction or to restrain a continuing nuisance, the appropriate remedy may be damages in lieu of an injunction, assuming a case for an injunction to be made out.

In my opinion, it may be stated as a good working rule that –

(1) If the injury to the plaintiff's legal rights is small,

(2) And is one which is capable of being estimated in money,

(3) And is one which can be adequately compensated by a small money payment,

(4) And the case is one in which it would be oppressive to the defendant to grant an injunction:–

then damages in substitution for an injunction may be given.

There may also be cases in which, though the four above-mentioned requirements exist, the defendant by his conduct, as, for instance, hurrying up his buildings so as if possible to avoid an injunction, or otherwise acting with a reckless disregard to the plaintiff's rights, has disentitled himself from asking that damages may be assessed in substitution for an injunction.

It is impossible to lay down any rule as to what, under the differing circumstances of each case, constitutes either a small injury, or one that can be estimated in money, or what is a small money payment, or an adequate compensation, or what would be oppressive to the defendant. This must be left to the good sense of the tribunal which deals with each case as it comes up for adjudication. For instance, an injury to the plaintiff's legal right to light to a window in a cottage represented by £15 might well be held to be not small but considerable; whereas a similar injury to a warehouse or other large building represented by ten times that amount might be held to be inconsiderable. Each case must be decided upon its own facts; but to escape the rule it must be brought within the exception. In the present case it appears to me that the injury to the plaintiff is certainly not small, nor is it in my judgment capable of being estimated in money, or of being adequately compensated by a small money payment.

For nineteen years the plaintiff is saddled with his lease, and for that period, upon the hypothesis of the nuisance continuing, he is to suffer whatever annoyance, inconvenience, and personal discomfort other than by steam may be created by the user of the works of the defendants, and the cracks in the walls of the house already made by the defendants' works are to be increased, and it may be that his wife and daughter throughout that period are to continue to be made ill as heretofore. Can anyone truly say that that is a small injury to the plaintiff's legal rights?

Moreover, how are these injuries to be put into money, and upon what principle are these damages to be assessed so as to represent the continuing injury to the plaintiff? To guess at them is not assessing them at all.

Note

AL Smith LJ's 'good working rule' has been criticised both for imposing inelastic criteria in place of flexible equitable discretion, as well as on the ground of circularity: whether the plaintiff's injury can be adequately compensated in damages is not only a discrete element of the working rule but also the whole purpose of the inquiry. See ICF Spry, *The Principles of Equitable Remedies* (Lawbook Co, 9th ed, 2014) 664–5). The working rule has nonetheless been applied often by Australian courts. In *Break Fast Investments Pty Ltd v PCH Melbourne Pty Ltd* [2007] VSCA 311; (2007) 20 VR 311, Dodds-Streeton JA stated at [47]–[48] that the interests of the parties do not carry equal weight in applying the criteria:

> It will not suffice that the hardship entailed to the defendant by an injunction marginally outweighs the relief that the plaintiff will obtain thereby. Rather, the courts have typically required a significantly disproportionate damage to the defendant, reflected in the criterion of oppression in the Shelfer working rule.
> In that sense, the Shelfer working rule itself implicitly assumes that in order to justify the substitution of damages, it is ordinarily necessary that there be a relationship of significant disproportion between the relief afforded to the plaintiff's injury and hardship to the defendant entailed by the grant of an injunction.

Questions

(1) Does the 'good working rule' laid down by AL Smith LJ improperly fetter judicial discretion to award statutory damages?

(2) Does a damages award granted in lieu of an injunction result in compulsory expropriation of the plaintiff's rights? Should a wrong-doer be allowed to purchase the right to commit a nuisance by paying damages?

3.4.3 Quantifying damages

When statutory damages are awarded as an alternative to an injunction or order of specific performance, they will be assessed in accordance with the established principles for assessing damages in tort and for breach of contract: *Johnson v Agnew* [1980] 1 AC 367, 400. But damages can be awarded under the Act in cases where common law damages are not available; for example, when damages under *Lord Cairns' Act* are awarded instead of a *quia timet* injunction to prevent future harm (*Leeds Industrial Co-operative Society Ltd v Slack* [1924] AC 851). Common law principles will be irrelevant in such cases. In *Giller v Procopets*, the Victorian Court of Appeal considered that different principles of assessment were also applicable where an injunction was no longer available because the wrong complained of was not continuing and would not be repeated.

3.4.3a *Giller v Procopets* (2008) 24 VR 1

Background

The defendant, who had previously been in a de facto relationship with the plaintiff, took videos of their sexual activities. Some, but not all, of the videos had been made with the plaintiff's knowledge. The defendant attempted to show the videos to members of the plaintiff's family and to her employer. The police confiscated the videos and an order was granted preventing their future distribution. The plaintiff claimed damages for mental distress caused by the defendant's breach of confidence in attempting to show the videos.

Decision

The Victorian Court of Appeal held that the plaintiff was entitled to compensation for distress, either as equitable compensation or as statutory damages under the Victorian equivalent of the *Chancery Amendment Act 1858*. Ashley JA held that compensation for distress caused by a breach of confidence was only available under the *Chancery Amendment Act 1858* and also dissented on quantification of the compensation.

Neave JA

Typically, damages have been awarded under *Lord Cairns' Act* in lieu of an injunction where the defendant has infringed the plaintiff's property rights or has benefited by exploiting commercially valuable information. There is no Australian authority on the issue of whether damages under this head can be awarded to a plaintiff who has suffered distress or embarrassment as a result of the breach of confidence.

Under the law of negligence, damages are not recoverable for an injury to feelings which is unaccompanied by another recoverable loss (for example, physical injury). As Lord Wensleydale said in the old English case of *Lynch v Knight* (1861) 9 HLC 577, 598:

> Mental pain or anxiety the law cannot value, and does not pretend to redress, when the unlawful act complained of causes that alone; though where a material damage occurs, and is connected with it, it is impossible a jury, in estimating it, should altogether overlook the feelings of the party interested.

By contrast, damages for upset and distress can be awarded for torts such as defamation and deceit. In contract law, the general principle is that damages 'cannot ordinarily be awarded for distress or disappointment arising from breach' of the contract. Damages for loss of pleasure or enjoyment may, however, be payable if the contract expressly or impliedly promises to provide pleasure or enjoyment to the promisee.

Damages under *Lord Cairns' Act* are sui generis, and can be awarded in some circumstances where common law damages are not recoverable. In my view, such damages should be available where the essence of the plaintiff's case is that he or she has been embarrassed by the exposure of private information, rather than that the defendant has profited from the wrongful use of that information. In *Talbot v General Television Corporation Pty Ltd* [1980] VR 224, Young CJ treated damages under *Lord Cairns' Act* as compensating the plaintiff for what he or she had lost. It is consistent with that approach to compensate Ms Giller for the mental distress suffered as a result of the defendant's actions.

This conclusion is also consistent with the approach of the High Court in *Australian Broadcasting Corporation v Lenah Game Meats Pty Ltd* (2001) 208 CLR 199. The Full Court of the Supreme Court of Tasmania had granted an injunction to Lenah Game Meats to prevent the ABC from broadcasting a video of possum killing operations. The video was obtained by an unidentified person who had entered Lenah's abattoir as a trespasser. On appeal, the High Court (by majority) discharged the injunction.

Their Honours found it unnecessary to decide whether a tort of invasion of privacy should be recognised in Australian law, but Gummow and Hayne JJ said at 250:

> Lenah encountered … difficulty in formulating with acceptable specificity the ingredients of any general wrong of unjustified invasion of privacy. Rather than a search to identify the ingredients of a generally expressed wrong, the better course, as Deane J recognised [in *Moorgate Tobacco Co Ltd* v *Philip Morris Ltd (No 2)* (1984) 156 CLR 414, 444–445], is to look to the development and adaptation of recognised forms of action to meet new situations and circumstances.

Gleeson CJ agreed and said at 225:

> If the activities filmed were private, then the law of breach of confidence is adequate to cover the case … There would be an obligation of confidence upon the persons who obtained [images and sounds of private activities], and upon those into whose possession they came, if they knew, or ought to have known, the manner in which they were obtained … The law should be more astute than in the past to identify and protect interests of a kind which fall within the concept of privacy.

This approach – of strengthening the protection afforded to privacy interests by existing causes of action – supports my conclusion that damages should be available for breach of confidence occasioning distress, either as equitable compensation, or under *Lord Cairns' Act.*

Questions

(1) Does Neave JA's reasoning apply only to the special wording of the Victorian legislation, or does it apply more broadly to all State and Territory versions of *Lord Cairns' Act?*

(2) Reforms to tort law have restricted the availability of damages for mental harm (e.g. *Wrongs Act 1958* (Vic) pt XI). Can the restrictions be avoided by bringing the claim under *Lord Cairns' Act?* If there are sound public policy reasons for restricting the availability of damages for mental harm in tort, should the same restrictions apply in equity?

4

Monetary remedies in equity

4.1 Introduction

4.2 Accounts of profits

4.3 Equitable compensation

4.4 Common law principles and equitable compensation

4.5 Exemplary damages

4.1 Introduction

Equity's personal monetary remedies are the account of profits and equitable compensation: (see textbook, chapter 4). Additionally, statutory damages are available in some cases, under versions of *Lord Cairns' Act* discussed in chapter 3. The possibility of exemplary damages in equity will also be considered.

As the name suggests, an account of profits is a profit-stripping remedy. It can be contrasted with the proprietary remedy of a constructive trust (see textbook, chapter 23) which can also achieve profit-stripping by reallocating beneficial ownership of property held by the defendant. Accounts of profits are only intended to redirect gains made by the wrongdoer; they are not intended to punish. Therefore, allowances have to be made to the defendant for proven actual inputs and may also be made for 'value-adding' inputs such as skill and expertise. However, equity proceeds from the assumption that all profits are recoverable; it is up to the defendant to prove otherwise.

Accounts of profits are available for equitable wrongs such as breach of confidence, breach of trust, breach of fiduciary duty and third-party participation in a fiduciary breach. Legislation also makes them available in other causes of action such as intellectual property disputes. See, for example, *Patents Act 1990* (Cth) s 122(1) and *Copyright Act 1968* (Cth) s 115(2). It is usually said that accounts of profits are not available for common law wrongs, and that appears to be the case in Australia. It is sometimes suggested that accounts of profits should be available for breach of contract: *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 124–5 per Deane J (dissenting). This position has gained little traction, however: *Hospitality Group Pty Ltd v Australian Rugby Union Ltd* (2001) 110 FCR 157, [159]. See J Edelman, *Gain-Based Damages* (Hart Publishing, 2002) and K Barnett, *Accounting for Profit for Breach of Contract: Theory and Practice* (Hart Publishing, 2012) for detailed analyses of possible criteria for awarding an account of profits for breach of contract.

Equitable compensation (see textbook at [4.8]) is not aimed at profit-stripping. Instead, its goal is to compensate for loss made in breach of an equitable obligation. Equitable compensation differs from common law damages and is quantified according to discrete principles. Compensation in equity is assessed with the benefit of hindsight. Equity does not entirely follow the common law in quantifying loss. Although there must be a 'common sense' causative link between the defendant's wrong and the plaintiff's loss, considerations such as foreseeability and remoteness do not have the same force as is the case with common law damages. The same principles are said to apply to the remedy of account of profits: see *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd* [2018] HCA 43; (2018) 265 CLR 1, [89]–[90] (Gageler J).

Where a plaintiff has suffered a loss and the defendant made a profit, through the same breach, the plaintiff must elect between the two remedies, but is able to pursue the greater of the two.

As with all equitable remedies, personal monetary remedies in equity are discretionary, the discretion to be exercised in accordance with principles explained in chapter 6.

4.2a *Warman International Ltd v Dwyer* [1995] HCA 18; (1995) 182 CLR 544

Background

Warman International Ltd had an agency agreement with an Italian manufacturer of gearboxes, Bonfiglioli. Mr Dwyer was general manager of Warman's Queensland branch. Bonfiglioli unsuccessfully approached Warman in August 1986 to set up a joint venture with it. Shortly afterwards, Mr Dwyer informed Bonfiglioli that he planned to leave Warman and set up his own business. Mr Dwyer incorporated two companies, and early in 1988 began negotiating directly with Bonfiglioli. He poached Warman's staff to work in his new venture. In June 1988, Bonfiglioli terminated its agency agreement with Warman, and Mr Dwyer resigned from Warman. Later that year, one of his new companies entered into a 20-year agreement with Bonfiglioli to assemble and distribute its gearboxes in Australia.

At trial, it was held that Mr Dwyer had committed a breach of fiduciary duty, resulting in Warman losing the opportunity to retain the agency agreement. Both the loss to Warman and the profit made by Mr Dwyer's companies were assessed. The Court of Appeal denied Warman an account, holding that its remedy should be limited to equitable compensation.

Decision

The High Court held that Warman was entitled to elect between equitable compensation and account of profits. Their Honours noted that mathematical exactness was not required when assessing an account of profits; however, the aim was to obtain a true measure of the profits made by the fiduciary in breach of duty, as accurately as possible. Warman was entitled to two years' profits, taking into account the trial judge's finding that Warman's distributorship would have only continued for one year and the fact that Dwyer would have enjoyed some benefits from his fiduciary position for a further year. An allowance should be permitted to Dwyer and his associated companies to reflect the skill, expertise, effort and resources they contributed to their competing venture.

Mason CJ, Brennan, Deane, Dawson and Gaudron JJ

Ordinarily, a fiduciary will be ordered to render an account of the profits made within the scope and ambit of his duty. Of course, if the loss suffered by the plaintiff exceeds the profits made by the fiduciary, the fiduciary may elect to have a compensatory remedy against the fiduciary. That election will bind the plaintiff. Although an account of profits, like other equitable remedies, is said to be discretionary, it is granted or withheld according to settled principles. It will be defeated by equitable defences such as estoppel, laches, acquiescence and delay. … The conduct of the plaintiff may be such as to make it inequitable to order an account. Thus a plaintiff may not stand by and permit the defendant to make profits and then claim entitlement to those profits … [A] distinction should be drawn between cases in which a specific asset is acquired and cases in which a business is acquired and operated. … In the case of a business it may well be inappropriate and inequitable to compel the errant fiduciary to account for the whole of the profit of his conduct of the business or his exploitation of the principal's goodwill over an indefinite period of time. In such a case, it may be appropriate to allow a fiduciary a proportion of the profits, depending upon the particular circumstances. That may well be the case when it appears that a significant proportion of an increase in profits has been generated by the skill, efforts, property and resources of the fiduciary, the capital which he has introduced and the risks he has taken, so long as they are not risks to which the principal's property has been exposed. Then it may be said that the relevant proportion of the increase in profits is not the product or consequence of the plaintiff's property but the product of the fiduciary's skill, efforts, property and resources. … [I]n cases outside the realm of specific assets, the liability of the fiduciary should not be transformed into a vehicle for the unjust enrichment of the plaintiff. It is for the defendant to establish that it is inequitable to order an account of the entire profits. If the defendant does not establish that that would be so, then the defendant must bear the consequences of mingling the profits attributable to the defendant's breach of fiduciary duty and the profits attributable to those earned by the defendant's efforts and investments. … Whether it is appropriate to allow an errant fiduciary a proportion of profits or to make an allowance in respect of skill, expertise and other expenses

is a matter of judgment which will depend on the facts of the given case. However, as a general rule, in conformity with the principle that a fiduciary must not profit from a breach of fiduciary duty, a court will not apportion profits in the absence of an antecedent arrangement for profit-sharing, but will make allowance for skill, expertise and other expenses …

For calculation of an account of profits, taking into account overheads and opportunity costs, see *Dart Industries Inc v Décor Corporation Pty Ltd* (1993) 179 CLR 101.

Note

It is no answer to a claim for an account of profits that the profit would have been made by the defendant anyhow, even if no breach had occurred. But the defendant is only required to account for profits that are causally linked to the breach in question.

Questions

(1) Why was the account of profits in the above case limited to a period of time?

(2) What kind of evidence could a defendant lead to show an entitlement to an allowance?

(3) If the unjust enrichment of the principal must be avoided, is it ever appropriate to deny a fiduciary an allowance for its inputs?

4.2b *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd* [2018] HCA 43; (2018) 265 CLR 1

Background

The parties were competitors in marketing funeral insurance. In 2010, Lifeplan (through its subsidiary FPM) controlled approximately 70 per cent of the Australian market. Foresters' funeral insurance business was on a much smaller scale. Woff and Corby were employed by Lifeplan in senior positions. During 2010, with Foresters' knowledge and encouragement, they took steps to establish a new funeral insurance business with Foresters, and to divert Lifeplan's existing funeral insurance business to Foresters. Later in 2010, Woff and Corby resigned from Lifeplan and took up employment in Foresters' new venture. Foresters' new venture was highly successful, while

Lifeplan's business declined. Woff and Corby were held to be in breach of fiduciary obligations while Foresters was found to be a knowing assistant in a breach of fiduciary obligation. At issue was whether Foresters' assistance in the breach had caused the expansion of its business, and whether it should have to account for the whole value of the expanded business.

Decision

Foresters was required to account for the full value of the enhanced business.

Kiefel CJ, Keane and Edelman JJ

Causation

Foresters submitted that its liability to account and disgorge should be confined to those profits that are the direct result of each of the particular acts by which it committed the equitable wrong of knowingly assisting Woff and Corby in a dishonest and fraudulent design to breach their fiduciary obligations to Lifeplan … By focusing on each act of knowing assistance and its direct consequences, rather than the overall effect of Foresters' wrongful conduct, the submission ignores the obvious reality that Foresters'

particular interactions with Woff and Corby resulted … in the wholesale acquisition by Foresters of the business connections of Lifeplan … these connections being, as Foresters well knew, essential to Lifeplan['s] … funeral fund business.

Whether a benefit can be said to be obtained 'as a result of' knowing participation in a breach of fiduciary duty by another contrary to the principles of equity is a question of causation or contribution that depends on 'a precise examination of the particular facts' of the case, rather than upon attempts to refine the expression 'as a result of' … The equitable disgorgement principle with which we are concerned is a 'prophylactic rather than a restitutionary principle'. It is sufficient to show that the profit would not have been made but for the dishonest wrongdoing. Further, whatever may be the position of a wrongdoing that is not marked by dishonesty, a defendant cannot avoid liability to disgorge profits dishonestly made by showing that those profits might have been made honestly.

Quantification

Once it has been determined that a benefit or advantage has been caused by acts of knowing assistance, there remains the question of quantification of the benefit to be disgorged. While it is true that equity will not require an errant fiduciary or a participant in a breach of fiduciary to account for an advantage which the breach of fiduciary duty has not caused or to which it has not sufficiently contributed, where causation is sufficiently established the onus is on the errant fiduciary or participant to show that he or she should not account for the full value of the advantage. That onus is not discharged by mere conjecture or supposition giving the benefit of the doubt to a proven wrongdoer. …

There are two ways in which the wrongdoer might discharge that onus and reduce the extent of the liability to disgorge profits. The first way … is by proving his or her entitlement to an allowance for costs incurred, and labour and skill employed. …

The second way, which was the focus of this appeal, is by demonstrating that the benefit or advantage is beyond the scope of the liability for which the wrongdoer should account for profits. A wrongdoer might prove that some profit or benefit is beyond the scope of liability … if (it) has no reasonable connection to the wrongdoing. For example, in *Frank Music Corp v Metro-Goldwyn-Mayer Inc* the [Court] accepted that a copyright infringement by MGM Grand Hotel Inc in a performance at the MGM Grand Hotel entitled the plaintiffs to the profits directly from the performance. It also entitled the plaintiffs to a proportion of indirect profits, including from the consequential increase in hotel room bookings which were held to have a 'sufficient nexus' with the performance. But the direct profit from the performance to be disgorged was limited to nine per cent because the copyright infringement comprised only part of … a ten-act performance. Nor did it entitle the plaintiffs to any profits made by the liable parent company, Metro-Goldwyn-Mayer Inc, as a result of 'the advertising value of the hotel'.

No precise test has been prescribed for determining when it will be inequitable to account for a benefit on the basis that it has no reasonable connection with wrongdoing. Nor is there any need for such a test. All of the circumstances must be considered, including the nature of the conduct. It is pertinent here that the profits were from deliberate and dishonest conduct, and were those desired to be achieved.

It is important to bear steadily in mind that the onus was upon Foresters to show that it would be inequitable to require it to account for the whole of the advantage it acquired by its acquisition of the business connections of Lifeplan and FPM. Before the adoption and implementation of the Woff and Corby strategy for the despoliation of the funeral fund business of Lifeplan and FPM, Foresters' funeral fund business was not very profitable, if it was profitable at all. The evidence demonstrated that, after the implementation of that strategy, there was a compelling correlation between the increase in the profitability of Foresters' funeral fund business and the decrease in the profitability of the business of Lifeplan and FPM.

… Foresters adduced no evidence to show that what was, on any view, an extraordinary increase in the profitability of its business could be explained by any circumstance other than the success of the Woff and Corby strategy.

In all these respects, the present case is readily distinguishable from *Warman International Ltd v Dwyer,* where the profits awarded were limited to the first two years' exploitation of the business opportunity misappropriated by the defendants. In that case, the evidence showed that the advantage misappropriated was apt to endure only for a short period, and, even during that period, was of diminishing value. The present case can similarly be distinguished from *Kao Lee & Yi v Koo Hoi Yan,* where Ma J followed *Warman,* finding the relevant business would have been lost to the principal after a year so that after that time the profits were too remote from the breach of fiduciary duty.

The accounting

It is well established that a liability to account for profits will include the profits that have been made. However, Foresters submitted that this was the limit of the profits for which it could be called to account. In particular, Foresters submitted that the net present value of funeral bond contracts was an assessment of anticipated future profits rather than actual profits, and was therefore irrecoverable.

This submission is not consistent with principle or authority. As to principle, to confine the account in this way would sever the process of accounting for, and disgorgement of, profit from its rationale in the principle of ensuring that the wrongdoer should not be permitted to gain from the wrongdoing. As to authority, the liability to account for a profit was described in *Warman* as concerned with 'a profit or benefit' in language divorced from a confined conception of benefit as accrued profit in narrow accounting terms.

Conclusion

Given the facts of the present case, there was no principled basis for requiring Foresters to disgorge anything less than the value of the business connections appropriated by Foresters from its participation in the disloyalty of Woff and Corby.

Notes

(1) In *Boardman v Phipps* [1967] 2 AC 46 (see [10.5.2a]), the House of Lords confirmed the award of Wilberforce J that the defendants should be awarded a 'liberal allowance' for their work and skill. In the Court of Appeal ([1965] Ch 992), Lord Denning MR stated at 1021: 'If the agent has been guilty of any dishonesty or bad faith, or surreptitious dealing, he might not be allowed any remuneration or reward. But when, as in this case, the agent acted openly and above board, but mistakenly, then it would be only just that they should be allowed remuneration'. The authorities on the criteria for the award of an allowance to a fiduciary who has acted in breach of duty are not easy to reconcile. For an analysis of the justifications for awarding an allowance, see M Harding, 'Justifying Fiduciary Allowances' in A Robertson and TH Wu (eds), *The Goals of Private Law* (Hart Publishing, 2009) 341.

(2) In *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd* (above) at [88], Gageler J suggested that dishonesty also has a part to play in assessment of causation, commenting '[t]hat the fiduciary's breach of fiduciary obligation is dishonest and fraudulent is also good reason for treating a sufficient causal connection as existing if the dishonest and fraudulent breach can be concluded to have played a material part in contributing to the benefit or gain of the fiduciary or knowing participant even in circumstances where it cannot be concluded that the benefit or gain would not have been obtained but for the breach'.

Questions

(1) Is the difference in outcome between *Warman* and *Ancient Order of Foresters* largely attributable to fact, as suggested by the plurality?

(2) What information will a plaintiff need in order to make an informed election between equitable compensation and an account of profits?

(3) Suppose that Dwyer had successfully invested the profits he had made in breach of duty in shares which had doubled in value. Would Warman have been entitled to the increased value of the shares?

(4) According to the two case extracts above, when will a court make an allowance to a fiduciary? Was the award of an allowance in *Warman v Dwyer* consistent with the criteria laid down in *Boardman v Phipps?*

4.2c *Victoria University of Technology v Wilson* (2006) 68 IPR 597

Background

Two academics were approached by a former student with a business opportunity to develop computer software. Together with the student, they developed a highly successful product. They did not obtain the university's permission for the undertaking and developed the product on the university's property. When the university discovered the project, it sued the academics for breach of fiduciary duty, on the basis that the academics had misappropriated an opportunity that came to them in a fiduciary capacity. At trial, Nettle J held they had been in breach of fiduciary duty, and ordered that the academics' shares in companies set up to exploit the opportunity be held on constructive trust for the university. However, a generous allowance was to be made in the academics' favour for their expertise, skill, effort, risk and subscription moneys. A special referee (an accountant) was appointed to determine the amount of the allowance. The special referee dismissed expert evidence led concerning how the plaintiff and other universities usually approached the issue of money-making opportunities discovered by employees in the course of their employment, and fixed an extremely low figure for the allowance. This was overturned on appeal, and the matter remitted back to the special referee for further consideration.

Decision

Harper J

By his judgment, Nettle J restored (the profit-making opportunity) … to the University. But, in the next paragraph of his reasons for judgment, he added:

> In the result both logic and equity dictate that allowance be made for the efforts and outgoings devoted to the invention … *and that any interest in the invention which is to be accorded to the plaintiff should be limited to that extent* (emphasis added by Harper J).

Wilberforce J made much the same point at first instance in *Phipps v Boardman*. His Lordship there said that '[i]t … would be inequitable now for the beneficiaries [read "the University"] to step in and take the [benefit] without paying for the skill and labour which has produced it'. For if that were the course dictated by equity, the University would then obtain, for nothing, something which was of value. It would therefore be unjustly enriched, while on the other hand [the defendants] would be deprived not only of the profits they hoped to generate through their inventiveness and hard work, but also of any remuneration for all their labour and skill. Yet the labour was great, and the skill was of a high order. The benefits of this were to be transferred by order of Nettle J to the University. But, as his Honour indicated at paragraph [196] of his reasons for judgment, this must be done in a way which did not result in the University being unjustly enriched.

… If [the defendants] had not of their own initiative assumed the role of conceiving, designing and developing the invention … the University 'would have had to employ … an expert [such as the defendants] to do it for the University. … As a matter of commercial reality, the offer of such remuneration – if it were not to be an empty gesture – must have been attractive, but not over-generous, to a member of the University's academic staff of the seniority and background of [the defendants]. One might expect that such an offer, incorporating reasonable terms current in academia at the time, would – if followed by negotiation at arms' length, conducted with the assistance of appropriate legal advice – result in agreement with which all parties could happily live.

The special referee was, I think, mistaken in proceeding as if the defendants were supporting a purely hypothetical exercise while the plaintiff's submissions were wholly grounded in reality. Such a dichotomy was and is false. …

It is nevertheless my opinion that, in this case, the evidence of Professor Georgeff should not necessarily have been dismissed as irrelevant. It seems to me that the starting point of [the special referee's] inquiry should have been evidence of the terms that were most likely to have been agreed between the University on the one hand and [the defendants] on the other, assuming that both sides were at arm's length, properly advised, fully informed and willing to be reasonable. Each side was bound to accept that the setting against which their negotiations were taking place was academia, and that the setting in the wider world of commerce might not necessarily be the same. … The 'intellectual property' policies of academic institutions (including the embryonic intellectual property policy of the Victoria University of Technology itself) as these policies adjust the respective rights of the institutions and their academic staff to the property in inventions and the like made under the aegis of the academic institution, are – it seems to me – very much in point.

Once the appropriate terms of the hypothetical engagement of [the defendants] have been identified, the next step is to examine what actually happened. Account must be taken of any action or inaction by [the defendants] that … would have disadvantaged the University. … The question, when looking at what actually happened, is, therefore: Did [the defendants] fulfil [their] obligations to the

University as the notional agreement would have required and did [they] take advantage of or benefit from [their] academic role in ways that the agreement would not have allowed? …

The over-riding principle is that the fiduciary must not profit from his or her position as such. Put another way, by strict application of the rules of fiduciary accountability, the benefit for which the trustees must account is the benefit obtained by them as a result of the relevant breach of fiduciary duty. But neither [of the defendants] will profit from his position, or obtain a benefit as a result of a breach of fiduciary duty, if as a result of the special referee's fresh examination of the reference each receives an award that does no more than provide to each such remuneration as he would have received had he been as open with the University as he should …

Note

In most cases, the quantum of a 'liberal' or 'generous' allowance is settled by the parties outside of court. Harper J's solution to the dispute was to 'second-guess' the point that would have been reached by the parties' own sensible negotiations.

Questions

(1) Is it possible to 'second-guess' a sensible negotiated outcome where the fiduciary is not an employee of the principal?

(2) Harper J envisaged that the calculation of a 'generous' allowance could be reduced in some cases, according to the defendant's behaviour that might breach their employment contracts. Would such a reduction be consistent with the allowance awarded in *Warman* v *Dwyer?*

4.3 Equitable compensation

In understanding equitable compensation, we must first understand the notion of an accounting party, who is one that equity holds responsible for the administration of a fund. Accounting parties such as trustees and custodial fiduciaries are obliged to give an account, and may be required to return trust property or credit the account with value. It is this subsequent equitable obligation to pay which lays the foundation for the modern remedy of equitable compensation. An important development, however, has been to extend the availability of the remedy to non-custodial fiduciary relationships, as well as to other forms of equitable liability, such as liability for breach of confidence.

4.3.1 Account

4.3.1a *Libertarian Investments Ltd v Hall* (2013) 16 HKCFAR 681

Background

Woods was an investor who wanted to buy a 10 per cent share in The Sporting Exchange Ltd (TSE).

The defendant undertook to use his connections with TSE, and his knowledge of the company, to assist Woods to acquire the share. Woods' company, Libertarian, put the defendant in funds to buy the shares. The defendant did not use the money to buy shares and gave no explanation as to how he had used the funds.

Decision

The Hong Kong Court of Final Appeal upheld the finding at trial that the defendant had acted in breach of fiduciary duty in misapplying the funds Libertarian had provided and was liable to compensate Libertarian for the amount misapplied. The decision is extracted only on Lord Millett's analysis of the fiduciary's obligation to account.

Lord Millett

It is often said that the primary remedy for breach of trust or fiduciary duty is an order for an account, but this is an abbreviated and potentially misleading statement of the true position. In the first place an account is not a remedy for wrong. Trustees and most fiduciaries are accounting parties, and their beneficiaries or principals do not have to prove that there has been a breach of trust or fiduciary duty in order to obtain an order for account. Once the trust or fiduciary relationship is established or conceded the beneficiary or principal is entitled to an account as of right. Although like all equitable remedies an order for an account is discretionary, in making the order the court is not granting a remedy for wrong but enforcing performance of an obligation.

In the second place an order for an account does not in itself provide the plaintiff with a remedy; it is merely the first step in a process which enables him to identify and quantify any deficit in the trust fund and seek the appropriate means by which it may be made good. Once the plaintiff has been provided with an account he can falsify and surcharge it. If the account discloses an unauthorised disbursement the plaintiff may falsify it, that is to say ask for the disbursement to be disallowed. This will produce a deficit which the defendant must make good, either in specie or in money. Where the defendant is ordered to make good the deficit by the payment of money, the award is sometimes described as the payment of equitable compensation; but it is not compensation for loss but restitutionary or restorative. The amount of the award is measured by the objective value of the property lost determined at the date when the account is taken and with the full benefit of hindsight.

But the plaintiff is not bound to ask for the disbursement to be disallowed. He is entitled to ask for an inquiry to discover what the defendant did with the trust money which he misappropriated and whether he dissipated it or invested it, and if he invested it whether he did so at a profit or a loss. If he dissipated it or invested it at a loss, the plaintiff will naturally have the disbursement disallowed and disclaim any interest in the property in which it was invested by treating it as bought with the defendant's own money. If, however, the defendant invested the money at a profit, the plaintiff is not bound to ask for the disbursement to be disallowed. He can treat it as an authorised disbursement, treat the property in which it has been invested as acquired with trust money, and follow or trace the property and demand that it or its traceable proceeds be restored to the trust in specie.

If on the other hand the account is shown to be defective because it does not include property which the defendant in breach of his duty failed to obtain for the benefit of the trust, the plaintiff can surcharge the account by asking for it to be taken on the basis of 'wilful default', that is to say on the basis that the property should be treated as if the defendant had performed his duty and obtained it for the benefit of the trust. Since ex hypothesi the property has not been acquired, the defendant will be ordered to make good the deficiency by the payment of money, and in this case the payment of 'equitable compensation' is akin to the payment of damages as compensation for loss.

In an appropriate case the defendant will be charged, not merely with the value of the property at the date when it ought to have been acquired or at the date when the account is taken, but at its highest intermediate value. This is on the footing either that the defendant was a trustee with power to sell the property or that he was a fiduciary who ought to have kept his principal informed and sought his instructions.

At every stage the plaintiff can elect whether or not to seek a further account or inquiry. The amount of any unauthorised disbursement is often established by evidence at the trial, so that the plaintiff does not need an account but can ask for an award of the appropriate amount of compensation. Or he may be content with a monetary award rather than attempt to follow or trace the money, in which case he will not ask for an inquiry as to what has become of the trust property. In short, he may elect not to call for an account or further inquiry if it is unnecessary or unlikely to be fruitful, though the court will always have the last word.

Equitable compensation addresses losses and must be calculated in the context of the duty breached. … Its aim is to put the plaintiff in the position she would have occupied had the duty not been breached. The nature of the duty breached then becomes highly relevant. There is a distinction that can be drawn between a breach involving misappropriation of trust or fiduciary assets, requiring reinstatement or its monetary equivalent, and breaches involving other loss-causing behaviour, such as a solicitor's conflict of duties owed to two clients. The same quantification principles cannot be applied to each situation indiscriminately.

Equitable compensation is assessed with the full benefit of hindsight; for that reason quantum is usually assessed at date of judgment rather than date of breach. As with an account of profits, the remedy is not intended to be punitive in nature.

4.3.2 Substitutive and reparative compensation

4.3.2a *Agricultural Land Management Ltd v Jackson (No 2)* (2014) 48 WAR 1

Background

Agricultural Land Management (Agricultural) and Bunbury Centro (Bunbury) shared the same corporate parent and had interlocking directorships. Goff and Jackson were directors of both companies. In 2002, Bunbury entered a contract to sell land to Agricultural for $2.25 million. In addition, Agricultural agreed to pay Bunbury a licensing fee of up to $1.665 million to cover other information and know-how in its possession relating to the development of the land. The contract was executed on behalf of both companies by Goff and Jackson, and Agricultural paid both amounts to Bunbury. It was alleged that Goff and Jackson had placed themselves in a position where their fiduciary duties to Agricultural conflicted with their fiduciary duties to Bunbury.

Decision

Edelman J held that the directors had acted in breach of fiduciary duty, but no order for substitutive or reparative equitable compensation was made. Of relevance here is the discussion of the distinction between these two measures.

Edelman J

16 Equitable compensation: 'substitutive' and 'reparative' compensation

As I have explained above, Agricultural has failed to prove that either or both of the promised purchase price or the promised Licence fee under the Contract were at an undervalue in relation to the rights which Agricultural obtained in exchange. Perhaps in anticipation of this difficulty Agricultural framed its case for equitable compensation for breach of fiduciary duty in two different ways. One way focuses upon compensation for loss suffered. The other way permits compensation in the absence of any loss, to restore any unauthorised disposition of assets.

16.1 Two different types of 'compensation' for breach of trust

… As Dr Elliott and Professor Mitchell have observed, the historic difference between a claim based upon falsification of a common account and a claim based on surcharge of an account on the basis of wilful default has been concealed in modern cases which generally refer to both as 'equitable compensation': Mitchell C, 'Equitable compensation for breach of fiduciary duty' (2013) 66 CLP 307, 322. … Even in the leading decision of Street J in *Re Dawson* reference is made to equitable compensation claims which were concerned with loss and which would have historically been treated as based upon wilful default: *Caffrey v Darby*. … Those cases are of a fundamentally different character from cases of restoration on a common account. In wilful default claims, the claim is in the nature of a claim based on breach by a trustee. And the account taken on the basis of wilful default asks whether loss has been suffered: Mitchell C, [above] …

Dr Elliott, whose writing has shone light and brought much clarity to this area of law, has suggested the use of the labels 'substitutive compensation' and 'reparative compensation' to differentiate the two types of claim. The former, based on the common account, describes a claim for the substituted value of the asset dissipated without authority: it demands that the trustee perform his or her duty to maintain the assets or fund. The latter, based on the account on the basis of wilful default, describes a claim for reparation for the loss suffered by breach of duty. …

Since substitutive compensation is concerned with the duty to restore the value of an asset dissipated without authority it will not apply to every breach of duty by a company director. … '[T]he better approach … is to look to the policy behind compensation for breach of fiduciary duty and determine what remedies will best further that policy'. One 'policy' recognises the liability of a custodial fiduciary (including a company director) to restore an asset, or its value, where the asset has been dissipated without authority. This requires substitutive compensation. Another 'policy' is concerned with the reparation of losses suffered by a principal caused by the breaches of duty by the fiduciary. This requires reparative compensation.

Note

The dichotomy drawn here between substitutive and reparative equitable compensation is not universally accepted: see JD Heydon, MJ Leeming and PG Turner, *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (LexisNexis Butterworths, 5th ed, 2015) [23-610]–[23-615].

Question

A trustee sold a business to a purchaser, without ensuring payment for the business was received. The purchaser became bankrupt, and the trustee could not recover the purchase price. Is the trustee's liability for the loss to the trust estate an example of substitutive or reparative compensation?

4.3.3 Substitutive compensation

4.3.3a *Re Dawson (deceased)* [1966] 2 NSWR 211

Background

David Dawson died in 1932, leaving property in Australia and New Zealand. His son Percy acted as executor and trustee. In 1939, some of the New Zealand assets were sold for NZ£4,700. Percy wanted that sum transferred to Australia, and lent to companies in which he and other family members were interested. At the time, the currency transfer was prohibited, so Percy arranged for the entire sum to be withdrawn from the New Zealand account and handed to Raymond Nelson for transfer to Australia. Nelson, however, disappeared with the funds and was never seen again.

When Percy died his estate conceded that it was liable to repay the £4,700 to his father's estate, as his actions had been in breach of trust. However, in 1939 (the time of the breach) there had been parity between Australian and New Zealand currency. By the date of trial, NZ£4,700 was worth approximately A£5,829. Which sum had to be repaid?

Decision

Percy's estate was ordered to repay A£5,829 to his father's estate.

Street J

The present suit is brought … for the purposes of ascertaining whether:–

> **(a)** the sum of £4,700 now to be recouped … is to be in present-day Australian or present-day New Zealand currency; and
>
> **(b)** any and, if so, what rate of interest is to be charged against Percy … Dawson's estate on this £4,700.

I shall take each of these problems separately.

(A) Currency

It is clear that an obligation to repay £4,700 to the estate arose in 1939.

Reference to the earlier cases which have established the rule governing the conversion rate to be applied in actions for damages for breach of contract or for tortious acts disclose that the rule is founded upon common law principles governing remoteness of damage. …

[I]t may be that there is, to use the words of Lord Radcliffe 'sufficient peculiarity in the obligation' owed by a defaulting trustee to the trust estate to justify the adoption of a different rule. It becomes necessary then to examine the nature of the obligation owed by a defaulting trustee to recoup the trust estate in respect of moneys which he had wrongfully withdrawn from it. …

The obligation of a defaulting trustee is essentially one of effecting a restitution to the estate. The obligation is of a personal character and its extent is not to be limited by common law principles governing the remoteness of damage. …

Caffrey v Darby supra, is consistent with the proposition that if a breach has been committed then the trustee is liable to place the trust estate in the same position as it would have been in if no breach had been committed. Considerations of causation, foreseeability and remoteness do not readily enter into the matter. …

The principles embodied in this approach do not appear to involve any inquiry as to whether the loss was caused by or flowed from the breach. Rather the inquiry in each instance would appear to be whether the loss would have happened if there had been no breach.

The cases to which I have referred demonstrate that the obligation to make restitution, which courts of equity have from very early times imposed on defaulting trustees and other fiduciaries is of a more absolute nature than the common law obligation to pay damages for tort or breach of contract. … Moreover, the distinction between common law damages and relief against a defaulting trustee is strikingly demonstrated by reference to the actual form of relief granted in equity in respect of breaches of trust. The form of relief is couched in terms appropriate to require the defaulting trustee to restore to the trust estate the assets of which he has deprived it notwithstanding that market values may have increased in the meantime. The obligation to restore to the estate the assets of which he deprived it necessarily connotes that, where a monetary compensation is to be paid in lieu of restoring assets, that compensation is to be assessed by reference to the value of the assets at the date of restoration and not at the date of deprivation. In this sense the obligation is a continuing one and ordinarily, if the assets are for some reason not restored *in specie*, it will fall for quantification at the date when recoupment is to be effected, and not before.

… [I]n 1939 it was worth in Australian currency £4,700; at the present time in Australian currency it is worth £5,829 8s 3d. This latter sum represents what is in my view the correct measure …

(B) Rate of Interest

In circumstances such as the present this Court has jurisdiction to impose upon the party in default an obligation to pay interest upon the moneys lost to the estate through his breach. …

The general principle is that where a trustee has, through his breach of trust, occasioned loss to the trust estate then he is liable to make good that loss, together with interest. That is the principle which is to be applied in the present circumstances, and I pass to the next aspect of this question: namely, the determination of the rate of interest.

There does not appear to be any universal and inflexible principle which dictates the rate of interest to be applied in any given instance. … [His Honour then discussed cases where four per cent simple interest was ordered, and cases where five per cent was ordered, noting that the higher rate was used in cases of misconduct by the trustee, as distinguished from mere negligence].

The Court's jurisdiction in selecting the appropriate rate of interest is exercisable solely for compensatory purposes. Although orders for interest may in some cases appear to have the effect of penalizing defaulting trustees, the Court does not, in ordering interest and selecting a rate, attempt in any way to impose a punishment upon the defaulter. … The practice of imposing a higher rate in the second class of case is based on a requirement that the defaulter compensate the estate at the mercantile rate. The lesser rate of four per cent applied in the first class of case is a special rate which represents some concession in favour of the trustee: the assessment is made by reference to interest considered to be obtainable on authorized trustee investments rather than on the higher mercantile rate.

There can be little doubt but that the breach of trust committed by Percy Stewart Dawson belongs to the higher category and not to the lower, or four per cent category. It was a deliberate and wilful act the purpose of which was to deprive the estate of the moneys in question: and its intended manner of implementation involved illegalities according to the law of the country where this part of the estate was then situated.

It remains to determine whether or not five per cent is the mercantile rate which is to be applied at this time to cases falling within the second category. …

The position is that which might be said to be the ordinary rate applicable in the second category as the mercantile rate is five per cent: but at the same time the Court will still receive evidence and take into account particular circumstances (eg the *Interest Reduction Act 1931*, as amended) which may justify some variation of the ordinary five per cent rate.

The defendant has clearly asserted a right to have the £4,700 of New Zealand currency restored by reference to its present value. It may well be that if the misappropriated assets were income-earning (eg a parcel of consols) and the beneficiaries elected to demand restitution *in specie*, then, no matter what the character of the breach, the defaulter need only account in addition for the actual income derived in the interim, no matter how low that rate might be. Where, however, the asset taken is a sum of money which does not in itself generate any income whatever, then, on its restoration, the Court itself will presume an appropriate rate of interest to have been derived in the interim. It is upon this basis that I relate my adoption at five per cent …

Note

In 1966, Australian courts only entered judgment in Australian currency. Regardless of quantum, this would have prevented an order being made for repayment in New Zealand pounds, even though the trust was deprived of New Zealand pounds. Confusingly, in *Dawson*, judgment was made in Australian pounds, despite the adoption of decimal currency in February 1966.

Questions

(1) How does Street J describe the nature of the trustee's obligation?

(2) How does assessment of compensation where the trustee has failed to account for trust money received differ from assessment of common law damages? Are damages at common law necessarily determined differently today? See *Johnson v Perez* (1988) 166 CLR 351, 368 (Wilson, Toohey and Gaudron JJ).

(3) What is the justification for assessing compensation at date of judgment?

(4) Notice that Street J does not limit his comments to defaulting trustees, but includes 'other fiduciaries'. Should all other fiduciaries who cause loss be treated in the same manner?

(5) Why does Street J impose the higher rate of interest on the defaulting fiduciary in this case?

(6) Are there any circumstances in which the rate of interest fixed might be lesser (or indeed greater) than the mercantile rate?

4.3.3b *Youyang Pty Ltd v Minter Ellison Morris Fletcher* [2003] HCA 15; (2003) 212 CLR 484

Background

Youyang decided to invest in a product offered by EC Consolidated Capital Limited (ECCCL). Each investor in the scheme had to subscribe a minimum of $500,000. Subscription moneys were to be paid to the trust account of a firm of solicitors, Minter Ellison Morris Fletcher (Minters), who acted for ECCCL. A proportion of the subscription moneys was to be used to purchase a bearer deposit certificate, entitling the bearer to $500,000 10 years after its issue. The balance of the investment moneys was to be used by ECCCL investing in international money markets, with certain profits paid to the investors. The idea was that, at the very least, the investor would receive back their capital at the end of the 10 years, and the hope was that investors would also receive profits on their investment.

Under the terms of the agreement between the parties, Minters was authorised to release moneys held in their trust account for the purpose of purchasing the bearer deposit certificate. Once that was obtained, the balance could be released to ECCCL. However, Minters released $256,800 to a bank (DAL) on deposit without obtaining a bearer deposit certificate, and then released the balance to ECCCL.

A year later, ECCCL wanted to access the deposits at DAL. DAL required agreement from the individual investors before releasing the deposits. Youyang executed a Deed Poll allowing substitution of a deposit certificate from a prime bank, but otherwise confirming

the original agreement. A substituted certificate was obtained in favour of ECCCL. However, this provided no security for Youyang when ECCCL subsequently went into liquidation.

Decision

The High Court held that Minters had failed to carry out the obligations they owed to Youyang under the trust instrument. Minters was ordered to pay the plaintiff $500,000 with interest from the date when the money had been paid out in breach of trust.

Gleeson CJ, McHugh, Gummow, Kirby and Hayne JJ

Minters was obliged to hold the $500,000 proceeds of the bank cheque upon trust for … Youyang, with the power (and duty) to disburse it in accordance with the Subscription Agreement but not otherwise. Any disbursement by Minters other than as authorised by Youyang would be a dealing with Youyang's property which was in breach of trust.

Perhaps the most important duty of a trustee is to obey the terms of the trust. On 24 September 1993 there were several breaches by Minters of the trust obligations it had undertaken to Youyang. First, Minters released the trust moneys as to $256,800 for the purchase from DAL of what was not the requisite certificate of deposit. Secondly, the balance … was paid out of Minters' trust account to ECCCL in breach of the obligation not to do so unless the payment to DAL had procured the requisite certificate of deposit. … The result is that the whole of the $500,000 was dealt with by Minters in breach of its duties as trustee.

However, a little more should be said of the case by Youyang. It does not put a case of breach by the trustee of the proscriptive fiduciary obligations not to obtain an unauthorised benefit from the relationship and not to be in a position of conflict. These are identified and explained in *Breen v Williams* and *Pilmer v Duke Group Ltd (in liq).*

In particular, the present is not an instance, of which the decision of the House of Lords and Privy Council respectively in *Nocton v Lord Ashburton* and *Brickenden v London Loan and Savings Co* are the most celebrated examples, of a solicitor who has had financial transactions with a client, getting the client to prefer the personal interests of the solicitor. Thus, in *Nocton,* one transaction involved the solicitor getting the client to release from his mortgage property over which, by that release, the solicitor obtained further security for a mortgage of his own. In these cases, as Viscount Haldane put it, a court of equity may order the solicitor to replace the property improperly acquired from the client or make compensation if that property has been lost.

The essence of Youyang's complaint is shortly identified. It is the misapplication of moneys held on trust on terms that, in the events that happened, obliged Minters to hold the moneys absolutely for Youyang or at its direction. To adapt what was said by Fry LJ in *Webb v Stenton,* Minters has made itself 'personally liable to pay money to [Youyang] *by reason of* some breach of trust or default in the performance of [its] duties as trustee' (emphasis added).

This appeal turns upon the significance of the causal requirement expressed by Fry LJ in the phrase 'by reason of'. That serves to remind, as Mummery LJ recently put it, that '[t]here is no equitable by-pass of the need to establish causation' and that '[i]n questions of causation it is important to focus on the relevant equitable duty'.

Minters relies upon events subsequent to the completion date of 24 September 1993 as showing that Youyang seeks to render it accountable for a loss which is attributable to other circumstances. Youyang submits that it would not have suffered the loss of $500,000 but for the breaches of trust by Minters. Youyang's submissions should be accepted.

… [T]he moneys which ECCCL held on deposit with DAL never provided the security for the investment made by Youyang. The security was to be provided by a bearer certificate of deposit in the proper form lodged with the Registries. The subsequent release of the moneys held by ECCCL on investment with DAL had no effect upon the deficiency in Youyang's position. The 'non-bearer' instrument had been lodged with Registries, leaving Youyang's investment unsecured. After the events of 1994 and the execution of the Deed Poll, that position did not change. Youyang's investment was still unsecured. …

The execution of the Deed Poll and the implementation of these steps thereunder could be of significance on questions of causation if what had been brought about was the release of an existing bearer certificate of deposit and its replacement by a 'non-bearer' instrument. But that was not the order of events that transpired. Youyang was not provided at any stage with the security for which it had bargained. It is not to the point that, in addition to the breaches of trust by Minters, there may also have been dishonest and discreditable subsequent acts by third parties which led to the loss of the funds.

… The trust moneys were lost when paid out in breach of trust. That is the *injuria* with which equity is concerned, not the failure of the investment transaction.

Notes

(1) The extracts above address the test of causation, if any, required to demonstrate a claim for substitutive compensation. A related difficulty is the extent to which remoteness of loss will be a relevant consideration.

(2) In *AIB Group (UK) plc v Mark Redler & Co* [2015] AC 1503, the Supreme Court of the United Kingdom insisted that causation of loss was relevant to determining the measure of recovery for a seeking reconstitution of an express trust: (Lord Toulson) 'but absent fraud, which might give rise to other public policy considerations that are not present in this case, it would not in my opinion be right to impose or maintain a rule that gives redress to a beneficiary for loss which would have been suffered if the trustee had properly performed its duties'; and [135] (Lord Reed) '[t]he measure of compensation should therefore normally be assessed at the date of trial, with the benefit of hindsight. … [T]he loss must be caused by the breach of trust, in the sense that it must flow directly from it'.

Questions

(1) What was the breach of trust in *Youyang* v *Minter Ellison?*

(2) How was causation established?

(3) Are events occurring subsequent to a breach of trust ever relevant to quantifying compensation?

(4) Are the dicta of Lords Toulson and Reed in *AIB Group (UK) plc v Mark Redler & Co* consistent with the decisions discussed in this section?

4.3.4 Reparative compensation

4.3.4a *Nocton v Lord Ashburton* [1914] AC 932

Background

Nocton was Lord Ashburton's solicitor and thus owed him fiduciary duties. Nocton was also engaged in property development with Lord Ashburton's brother. He persuaded Lord Ashburton to lend money to developers who had purchased land from Nocton and Lord Ashburton's brother. As part of that purchase arrangement, the vendors were to provide some vendor finance, on the security of a second mortgage. Lord Ashburton agreed to make the loan, on the security of a first mortgage. Blocks of flats were to be erected on the land, but the builder became bankrupt after completing only one block. Nocton wrote to Lord Ashburton asking him to release the first block of flats from his mortgage, so that the development could be re-financed. This was done, and the effect was that the vendor's second mortgage (in which Nocton had an interest) became the first charge. Lord Ashburton was not repaid, and commenced action.

Decision

The House of Lords held that Nocton had acted in breach of fiduciary duty since his interest in promoting the development with Lord Ashburton's brother conflicted with his duty to give Lord Ashburton impartial and accurate advice on maintaining the value of his security. Compensation was payable to Lord Ashburton for the loss of his security caused by relying on Nocton's advice.

Viscount Haldane LC

The proper mode of giving relief might have been to order Mr Nocton to restore to the mortgage security what he had procured to be taken out of it, in addition to making good the amount of interest lost by what he did. The measure of damages may not always be the same as in an action of deceit or for negligence.

Lord Dunedin

Nocton was in a fiduciary position. He was Lord Ashburton's solicitor, advising him as to the very transaction which he was himself proposing, and his position was, so to speak, aggravated by the fact that he himself was interested in the transaction going through …

In such a state of facts, I think it is not doubtful that the plaintiff ought to have a remedy …

[T]here was a jurisdiction in equity [prior to the Judicature Act reforms] to keep persons in a fiduciary capacity up to their duty. … [I]t will be found that the word 'fraud' in the older cases in Chancery is often used where there the thing so characterized is a wrongful breach of duty, without consideration of whether there is such a mens rea as would found an action for deceit. … [A]ll the cases are based upon the existence of a fiduciary relationship, and subsequently the breach of duty arising.

I think that there was here a remedy in equity for breach of duty. I agree that the form the remedy would have taken would not have been damages, but, looking to the course the case has taken, I do not think it is incumbent on us to alter the remedy to another which would practically come to much the same.

Lord Shaw of Dunfermline

As, however, to the conduct of Mr Nocton, his cardinal error is intelligible. He allowed the idea of his relations to Lord Ashburton as co-speculator to obscure the view which he ought steadily to have kept before him of Lord Ashburton as his client.

Mr Nocton was a solicitor; Lord Ashburton was his client. … (He was also, as a matter of fact, personally interested and he profited as a co-speculator by the transaction of release; and I am of opinion that the duty of Mr Nocton was, in view of this fact, to decline to act professionally or as the adviser of his client and to insist that a separate solicitor should be retained …). In the whole circumstances mentioned every step taken by the solicitor which subsequent disclosures shew to have been out of accord with fact became for him a step of danger – a danger of liability if through the erroneous step the client is misled and loss accrues.

Note

See J Edelman, '*Nocton v Lord Ashburton*' in C Mitchell and P Mitchell (eds), *Landmark Cases in Equity* (Hart Publishing, 2012) 473 for a discussion of this decision which reaffirmed the significance of equitable compensation for breach of fiduciary duty.

Questions

(1) Do you think that *Nocton v Lord Ashburton* is an example of substitutive or reparative compensation? Why, if at all, does the distinction matter?

(2) How is loss to a beneficiary distinguishable from loss to a trust estate?

(3) Are tort principles for assessing compensation for loss relevant to assessing compensation for a beneficiary's loss caused by a breach of fiduciary duty? If so, what torts are relevant for this purpose?

4.3.4b *O'Halloran v RT Thomas & Family Pty Ltd* (1998) 45 NSWLR 262

Background

O'Halloran was the managing director of RT Thomas & Family Pty Ltd (RT Thomas), and was a director of Jeffries Industries Ltd (Jeffries). RT Thomas held shares in Jeffries. In 1994, RT Thomas agreed to sell its Jeffries shares to Bowes and Brown Pty Ltd (B&B) for $675,000. O'Halloran allowed the share transfer to B&B to be registered in the Jeffries share register without the purchase price being paid, for personal reasons. This was in breach of his fiduciary obligations to RT Thomas, as he allowed his duty to the company to be swayed by personal interests. By the time RT Thomas managed to have the share register rectified, the value of the Jeffries shares had fallen.

Decision

RT Thomas was entitled to be compensated for the loss of value of the purchase price.

Spigelman CJ

The case against O'Halloran is based on a breach of fiduciary duty. It has long been established that questions of causation of loss said to arise from breach of fiduciary obligation are to be determined in a different way from breach of common law obligations. Specifically, the remedy of equitable compensation differs from damages at common law. …

Causation and equitable compensation:

> The object of equitable compensation is to restore persons who have suffered loss to the position in which they would have been if there had been no breach of the equitable obligation …

In *Target Holdings Ltd v Redferns* [1996] 1 AC 421, Lord Browne-Wilkinson said (at 432E–H):

> At common law there are two principles fundamental to the award of damages. First, that the defendant's wrongful act must cause the damage complained of. Second, that the plaintiff is to be put 'in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation'. … Although, as will appear, in many ways equity approaches liability for making good a breach of trust from a different starting point, in my judgment those two principles are applicable as much in equity as at common law. Under both systems liability is fault-based: the defendant is only liable for consequences of the legal wrong he has done to the plaintiff and to make good the damage caused by such wrong. He is not responsible for damage not caused by his wrong or to pay by way of compensation more than the loss suffered from such wrong. The detailed rules of equity as to causation and the quantification of loss differ, at least ostensibly, from those applicable at common law. But the principles underlying both systems are the same.

His Lordship's ultimate conclusion was:

> Equitable compensation for breach of trust is designed to achieve exactly what the word compensation suggests. To make good a loss in fact suffered by the beneficiaries and which, using hindsight and common-sense, can be said to have been caused by the breach.

In *Canson Enterprises Ltd v Boughton* (1991) 85 DLR (4th) 129, her Ladyship Justice McLachlin, who was in the minority, said (at 163E–G):

> In summary, compensation is an equitable monetary remedy which is available when the equitable remedies of restitution and account are not appropriate. By analogy with restitution, it attempts to restore to the plaintiff what has been lost as a result of the breach, ie the plaintiff's lost opportunity. The plaintiff's actual loss as a consequence of the breach is to be assessed with the full benefit of hindsight. Foreseeability is not a concern in assessing compensation, but it is essential that the losses made good are only those which on a common sense view of causation, were caused by the breach.

In my opinion, this also represents the law in Australia. …

Not all duties owed by a director to a company are fiduciary duties … However, the exercise of the power to deal with assets of the company, by directors who conduct the affairs of the company, is a fiduciary power that must not be exercised for improper purposes.

As I have noted above, a claim for equitable compensation for breach of a fiduciary obligation requires a causal link between the breach and the loss. Causation in equity is not, however, susceptible to the formulation of a single test. It is necessary to identify the purpose of the particular rule to determine the appropriate approach to issues of causation. …

To adopt the words of the High Court in *Maguire v Makaronis* (at 473), the court must identify '… the criteria which supply an adequate or sufficient connection between the equitable compensation claimed and the breach of fiduciary duty'. In the case of a trustee dealing with trust property, the law has proceeded beyond the invocation of the formulaic 'common sense' approach to causation, by adopting a stringent test to the selection of those events preceding loss which are to be taken as causing the loss. There is a sufficient connection, irrespective of the identification of a separate and concurrent cause, when the loss would not have occurred if there had been no breach of duty. …

The issue is whether, in the circumstances of this case, an 'adequate or sufficient connection is established by applying the test appropriate in the case of breach by the trustee of a traditional trust or by some other, less stringent, test. …

The strict standard applicable to a trustee of a traditional trust with respect to improper application of trust property is based on the vulnerability of beneficiaries with respect to the disposition of property by a trustee who has control over such disposition. This policy applies equally to the case of a director of a company … who has … the power to dispose of company property and who does … dispose of such property for an improper purpose. The analogy of ensuring 'restitution' to the estate (in the sense of restoration) is, in my opinion, an appropriate one. … It is not necessary to consider the appropriate test for breach by a director of other fiduciary duties.

Causation and the facts of this case

Applying the test – would loss have occurred if there had been no breach – in this case, compels the conclusion that his Honour's judgment was correct. The act of registration meant that Thomas lost the capacity to deal with the property by way of sale to a third party. It is of no avail to O'Halloran to say that there is another cause of its failure to make such a sale – namely Thomas' attempt to enforce the contract with Bowes & Brown.

The affirmation of the contract with Bowes & Brown may, in a common law action, have been characterised as a *novus actus interveniens*. But this concept has no role to play in a case of a breach of fiduciary obligation involving disposition of property which disposition is fraudulent in equity. That is the present case.

Note

For a discussion of the overlap of causation principles and intervening acts, see K Barnett and S Harder, *Remedies in Australian Private Law* (Cambridge University Press, 2nd ed, 2018) [9.54]–[9.61].

Questions

(1) Do you think that *O'Halloran* is an example of reparative compensation? Or was the compensation ordered simply a substitute for the price that O'Halloran should have obtained for Thomas?

(2) Why did the principle of *novus actus interveniens* have no part to play in *O'Halloran* v *Thomas?*

4.3.4c *Stewart v Layton* (1992) 111 ALR 687; affirmed *Layton v Stewart* [1993] FCA 532; [1994] ANZ ConvR 283

Background

Layton was the longstanding solicitor for Stewart. Stewart entered into a contract to sell her property for $800,000. Layton also agreed to act as solicitor for the purchaser, Creighton. Stewart entered into a second contract to purchase another property. Settlement of both contracts was to be simultaneous; Stewart was relying on completion of her sale to enable her to complete her purchase. Creighton was unable to obtain finance, and the settlement was delayed. The vendors of the second property served a notice to complete on Layton as solicitor for Stewart. At that point he decided he was in a position of conflict of interest between his two clients, and he advised Creighton he could no longer act for him. Nevertheless, he remained Creighton's solicitor for a short period before a new solicitor could be appointed. During this time, Layton came into information concerning Creighton's precarious financial position. He did not pass that information on to Stewart and did not inform her that he no longer acted for Creighton.

Creighton's new solicitor requested vendor finance of $195,000. Faced with the option of providing vendor finance to Creighton or obtaining a bridging loan for her purchase, Stewart decided to provide the vendor finance. She accepted a second mortgage over the property as security. Some months later, Creighton became a bankrupt. The first mortgagee had exercised its power of sale and there were insufficient funds remaining to discharge Stewart's second mortgage. Stewart sued to recover her loss from Layton.

Decision

Layton had placed himself in a position of conflict between Stewart and Creighton. The extract discusses the principles applicable to the quantification of equitable compensation for Stewart's loss.

Foster J

It is convenient to refer in the first place to the applicant's case based upon alleged breach of fiduciary duty. Her claim, in this regard, is that the respondent allowed himself to get into a situation where he had conflicting duties to Creighton and to her, with the result that he could not and did not properly discharge his duty as a solicitor.

I am satisfied that in the period up to 29 September, when the respondent handed the relevant files to Creighton's new solicitor, Mr Tonkin, he continued to act for both parties in circumstances where, notice to complete having been served upon Creighton on behalf of the applicant, there was a clear conflict between the duty owed by him to each of them. Specifically, he had a duty to disclose to the applicant material relating to Creighton's ability to honour his financial obligations whilst at the same time he owed a duty to Creighton to keep such material confidential.

There can be no doubt that the applicant was entitled to be made aware of these matters by the respondent and to have the benefit of his advice in relation to them.

Although I have not found this matter at all easy to decide, I have ultimately come to the conclusion that the respondent was in breach of his fiduciary obligations to the applicant in failing to disclose to her his information as to Creighton's particular and general financial problems at a point in time sufficiently early to enable an informed discussion to take place between them as to what steps should be taken in the event that Creighton could not settle. Any such rational discussion would, in my view, have resulted in rejection out of hand of the option of providing second mortgage vendor finance.

I turn then to the question of remedies.

Counsel for the applicant based his case squarely upon the breach of fiduciary duty. He submitted that once this breach was established, then the relevant principle of equity required that the applicant be compensated by the return to her, with appropriate awards of interest, of the whole of the $195,000 sum advanced on second mortgage. It was not necessary, he submitted, to enter into any consideration as to what she might have done had the breach not been committed. This submission was based upon the often cited statement of Lord Thankerton in *London Loan and Savings Co of Canada v Brickenden* [1934] 3 DLR 465 at 469:

> When a party, holding a fiduciary relationship, commits a breach of his duty by non-disclosure of material facts, which his constituent is entitled to know in connection with the transaction, he cannot be heard to maintain that disclosure would not have altered the decision to proceed with the transaction, because the constituent's action would be solely determined by some other factor, such as the valuation by another party of the property proposed to be mortgaged. Once the court has determined that the non-disclosed facts were material, speculation as to what course the constituent, on disclosure, would have taken is not relevant. …

> [O]nce it is held that the principle is applicable to the facts of a case, a court administering the principles of equity is relieved of the task of unravelling and exposing strands of causation connecting breach with damage … I am confident, however, that the principle and its underlying policy does not extend so far as to encompass the result contended for by the applicant. At most, in my view, the application of the principle prevents the court, in the present case, from entering upon inquiry as to whether the applicant, having had the benefit of full disclosure to which she was entitled, would, nevertheless have opted to enter into the second mortgage arrangement. She is entitled to have her compensation assessed on the basis that she would not have advanced $195,000 to Creighton. This does not mean, however, that the court must be otherwise blind to the reality of the situation. … She would still have been faced with the necessity of settling her purchase of the Avalon property. The necessity was not thrust upon her as a result of any breach on the part of the respondent. She would still have to shoulder the misfortune of having contracted with a defaulting purchaser. In these circumstances, it is, in my view, as inevitable as it is just that her compensation must be assessed on the basis of placing her now in the position that she would have occupied had she taken the obviously less disadvantageous course of obtaining bridging finance and completing the purchase. [His Honour then calculated a figure representing that outcome, and ordered compensation in the sum of $165,000.]

Note

The status of Lord Thankerton's dicta in *Brickenden v London Loan & Savings Co* [1934] 3 DLR 465, 469 is unclear: see *Maguire v Makaronis* (1997) 188 CLR 449, 474 (Brennan CJ, Gaudron, McHugh and Gummow JJ).

Question

What is the justification for the principle set out by Lord Thankerton in *London Loan and Savings Co v Brickenden,* referred to above? Why was the principle not applied in *Stewart v Layton?*

4.4 Common law principles and equitable compensation

Awards of equitable compensation, in common with all equitable remedies, are subject to the application of equitable discretion (see chapter 6). There is, however, a discrete question as to whether the common law's limiting devices should be brought to bear on compensation in equity and the models for such devices; in particular, the extent to which equity is permitted to develop such principles by reference to those existing at law. The judgments of the New South Wales Court of Appeal in *Harris v Digital Pulse* [4.5a] expressed differing views on the suitability of developing equitable principles by analogy to the common law. The 'fusion by analogy' issue arises in several contexts.

Consider the following questions:

(1) Do the common law principles of *novus actus interveniens* apply in equity in determining whether the defendant's wrong caused the loss suffered by the plaintiff? On this question, consider this dictum of Brennan CJ, Gaudron, McHugh and Gummow JJ in *Maguire v Makaronis* [1997] HCA 23; (1997) 188 CLR 449 (see [5.4b]):

> [T]here is no translation into this field of discourse of the doctrine of *novus actus interveniens*. Until restitution is made, it is presumed that the default continues. In *Guerin v The Queen* [1984] 2 SCR 335, the Crown, in what was held to be breach of fiduciary duty to the plaintiffs, leased certain land for a term of 75 years and on other unsatisfactory terms. The Supreme Court of Canada evaluated the loss to the plaintiffs by presuming against the Crown that the plaintiffs would have made the most profitable use of the land by letting it for residential development not, as had the Crown, for use by a golf club. Thus, the presumption assisted in indicating the extent of the loss by relieving the plaintiffs from the need to prove that they would have let the land for such development. … [P]resumptions, some elevated to rules, operate in aid of the underlying policy of the law in holding trustees to their duties and thereby protecting the interests of the beneficiaries.

(2) To what extent will or should the plaintiff's acts or failure to act be taken into account when determining an award of equitable compensation? At law, such conduct will usually be viewed through the lens of contributory negligence, or a failure of the plaintiff to mitigate their own loss.

4.4a *Pilmer v Duke Group Ltd (in liq)* [2001] HCA 31; (2001) 207 CLR 165

Background

One company, Kia Ora, made a takeover bid for a second company, Western United. Since some of the directors sat on the boards of both companies, the Australian Stock Exchange Listing Rules required that a report on the valuation of the assets of Western United be provided by an independent qualified person. This report was to be provided to all the shareholders prior to a vote at an extraordinary general meeting. Without an independent report, the takeover could not go ahead. A firm of accountants was appointed to prepare the report. Members of the firm had had previous dealings with the directors of Kia Ora and Western United. Instead of preparing a competent report, the accountants 'did as they were told' by the directors involved, and delivered a report that dramatically overvalued Western United and stated that the price being offered for the company was 'fair and reasonable'. This proved not to be the case. Kia Ora was later wound up, and its liquidators sued the accountants, alleging breaches of contract, of common law duties of care in negligence, and of fiduciary obligations.

There was no doubt that the accountants were liable in respect of breach of contract and in negligence. At first instance, and on appeal to the South Australian Full Court, it was held that the accountants had acted in breach of fiduciary obligations. Further, the Full Court held that the equitable compensation recoverable in respect of the breach of fiduciary duty was liable to be reduced due to Kia Ora's contributory negligence.

Decision

The majority of the High Court, Kirby J dissenting, held that the accountants had not owed fiduciary obligations to Kia Ora. Nevertheless, in view of the decision in the lower court that equitable compensation could be reduced on the basis of contributory negligence, the High Court considered how equitable compensation should be assessed.

McHugh, Gummow, Hayne and Callinan JJ

With respect to question (c) concerning 'contributing fault', it is sufficient to say that the decision in *Astley v Austrust Ltd* indicates the severe conceptual difficulties in the path of acceptance of notions of contributory negligence as applicable to diminish awards of equitable compensation for breach of fiduciary duty. *Astley* affirms:

> At common law, contributory negligence consisted in the failure of a plaintiff to take reasonable care for the protection of his or her person or property. Proof of contributory negligence defeated the plaintiff's cause of action in negligence.

Contributory negligence focuses on the conduct of the plaintiff, fiduciary law upon the obligation by the defendant to act in the interests of the plaintiff. Moreover, any question of apportionment with respect to contributory negligence arises from legislation, not the common law. *Astley* indicates that the particular apportionment legislation of South Australia which was there in question did not touch contractual liability. The reasoning in *Astley* would suggest, *a fortiori*, that such legislation did not touch the fiduciary obligation.

Kirby J (dissenting as to outcome)

Added question (c) asked whether the Full Court erred in reducing the amount of equitable compensation awarded to Kia Ora on account of what the Full Court described as Kia Ora's 'contributing fault'. … The Full Court confronted, quite directly, a controversy

which has engaged judges and academic writers for some time, both in Australia and elsewhere. The issue was whether there can be grafted onto the principles governing equitable remedies a new equitable principle of reduction for responsibility in the case of 'contributing fault'. Can such a principle be adapted, by analogy, from the advances that have occurred in respect of common law claims and statutory provisions that apply where a defendant can show contributory negligence? … I do not consider that equitable remedies (any more than those of the common law) are chained forever to the rules and approaches of the past. Nor do I find that the notion of developing equitable rules (any more than those of the common law) by reference to statutory developments as uncongenial as, on occasion, this Court has done. The idea that the common law develops in 'imitation' of statutes is not a recent one. A similar notion was sometimes reflected in equitable remedies, particularly in relation to defences based on statutes of limitations. Furthermore, all equitable and legal principles must today operate in a universe dominated by the star of statute. It would be surprising if the gravitational pull of statute, felt everywhere else in the law, did not penetrate into the expression and re-expression of non-statutory rules.

Nevertheless, there are, as the joint reasons point out, severe 'conceptual difficulties' in the path of adopting a principle derived by analogy from contributory negligence to diminish awards of equitable compensation for the breach of fiduciary obligation. The foundation of the difficulty is explained by Gummow J, writing extracurially, in an essay to which I referred in *Maguire*:

> While negligence is concerned with the taking of reasonable care, a fiduciary traditionally has more expected of him. His duty is one of undivided and unremitting loyalty. The fiduciary acts in a 'representative' capacity in the exercise of his responsibility. One must fear that introduction of concepts of contributory negligence into that setting inevitably will work a subversion of fundamental principle.

To the same effect, Justice Handley has said:

> Equity has not hitherto considered that a beneficiary is bound to protect himself against his fiduciary. The relationship is not at arm's length and the beneficiary is entitled to place trust and confidence in the fiduciary. The basis for a finding of contributory negligence is therefore lacking.

Whatever might have been my inclination to explore the notion adopted by the Full Court prior to *Astley v Austrust Ltd,* I regard the holding in that case as a splash of cold water, discouraging any creative instinct in this connection. There, after all, the Court was considering the development of an apportionment principle within the four walls of the common law and the applicable statute. A majority of the Court concluded that no such development was available. Damages for breach of contract could therefore not be reduced under apportionment legislation expressed in terms of 'contributory negligence' whether or not the plaintiff had, or could also have, sued in tort. In the face of that decision and the repeated recognition by this Court that, in Australia, the substantive rules of equity have retained their identity as part of a separate and coherent body of principles, the attempt to push common law notions of contributory negligence, as now modified by statute, into equitable remedies collapses in the face of insurmountable obstacles.

Note

Consider the effect of proportionate liability legislation on principals seeking compensation from defaulting fiduciaries (see textbook at [20.36]).

Questions

(1) The High Court in this case was unanimous in holding that 'contributory negligence' could not be taken into account to reduce the quantum of equitable compensation. Might a different result have been reached if the Court had considered 'contributory responsibility' instead?

(2) Will establishing the plaintiff's contributory negligence be relevant to the application of other equitable bars? See chapter 6.

4.5 Exemplary damages

4.5a *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298

Background

Under their employment contracts with Digital Pulse Pty Ltd, Harris and Eden were prohibited from competing with their employer during the term of the employment. Nevertheless, they secretly set up their own business in competition with the employer, doing projects for existing or potential clients of Digital Pulse. Digital sued them for breach of contract and fiduciary duty, and various other breaches.

At trial, Palmer J held that they had breached their contractual and fiduciary obligations. He also found that the defendants had made a profit, while the plaintiff had suffered a loss through the defendants' breach. Digital was entitled therefore to equitable compensation or an account of profits at its election. Palmer J went on to order exemplary damages of $10,000 against each of the defendants due to their dishonesty. The defendants appealed against the award of exemplary damages.

Decision

The New South Wales Court of Appeal, Mason P dissenting, held that exemplary damages for breach of fiduciary duty were not available. The judgments expressed different views on the circumstances in which exemplary damages could be awarded in equity.

Spigelman CJ

The judgment and the submissions in this case adopt the terminology of 'exemplary damages'. I do not find that to be appropriate. 'Damages' are a remedy at common law. The issue before the Court is whether a punitive monetary award can be made in equity.

It is, in my opinion, unnecessary and undesirable to decide this case on the basis that a punitive monetary award can never be awarded in equity. Remedial flexibility is a characteristic of equitable jurisprudence.

The present proceedings should be determined on the basis of whether a power to make a punitive monetary award should be acknowledged with respect to the kind of fiduciary relationship in the case before the Court. That relationship can be identified at different levels of generality. The particular relationship is that of employer/employee. However, the appropriate level of generality is, in my opinion, to characterize the case as a relationship created by contract between the parties, in which one party has a fiduciary obligation to act in the interests of the other in relevant aspects. Should a power to make a punitive award be asserted in such a case?

Equitable remedies, including equitable compensation, have elements that may be seen to be more punitive or deterrent than common law remedies available in similar factual situations. This may occur, for example, by reason of the application of different rules of liability, principles of causation or tests for remoteness. The integrity of equity as a body of law is not well served by adopting a common law remedy developed over time in a different remedial context on a different conceptual foundation. The fact that exemplary damages are awarded in tort is, in my opinion, not a basis for asking 'Why not?' in equity.

Analogy with tort or contract?

The argument in this Court proceeded on the basis that in Australia, exemplary damages are not recoverable for breach of contract. … Whether the common law of Australia should be changed in this regard is a matter for the High Court.

In his judgment, Mason P poses the question whether the development of equitable jurisprudence should proceed by way of analogy with tort or by way of analogy with contract. It is not apparent to me that analogical reasoning at this level of generality is appropriate. Each is a distinct body of law with its own integrity. … To the extent that reasoning by analogy at this level of generality is appropriate, I believe that the contract analogy is more appropriate. Reasoning of the highest authority has described the imposition of fiduciary obligations in terms of 'undertaking' and 'agreement', albeit imputed by operation of law. …

The fiduciary duties in the present case are derived from the existence of the contract of employment. The 'undertaking or agreement' of the employees … is much closer to a contractual relationship than it is to circumstances creating obligations in tort. If argument by analogy of this kind is appropriate, I prefer the contract analogy.

Where, as here, the essential basis of the fiduciary duties is a contractual relationship, this Court should not develop for the first time a remedy which is not available in the law of contract. This analysis does carry with it the corollary that the refusal to develop the law should be confined to cases of the character now before the Court, as identified above. There may be other cases in equity in which a tort analogy is more appropriate.

Mason P

At issue is the Supreme Court's power to award exemplary damages for breach of an 'equitable' duty of fidelity. …

The appellants correctly submitted that this case is the first in Australia in which exemplary damages have been awarded in equity. No English case has made such an award. …

The appellants drew attention to some of the overseas cases, including *Aquaculture Corporation* in New Zealand and *Norberg v Wynrib* in Canada. We were invited to prefer the dissenting opinion of Somers J in *Aquaculture Corporation* where he said (at 302) that 'equity and penalty are strangers'. …

Turning from precedent to principle, the appellants submitted that: 'The jurisdiction to award exemplary damages must be found in equity's original jurisdiction' …

Exemplary damages are not only unprecedented, they are contrary to equitable principle, the appellants submitted. In particular:

- Equity does not punish (citing *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 109 per Mason J).
- Equity abhors penalties (citing Meagher, Gummow and Lehane: Equity Doctrines and Remedies, 3rd ed at [318] and *Campbell Discounts Co Ltd v Bridge* [1962] AC 600 at 632).
- Equity does not provide for vengeance.
- Equity looks to conscience to do justice as between the parties. Equity corrects (citing *Earl of Oxford's Case* (1615) 1 Ch Rep 1; 21 ER 485). …

It is common ground that there are no controlling precedents, in the sense of Australian appellate decisions, which either authorise or forbid the award in question. Nor does any English authority take a position on the matter.

Clearing away false issues

Before true issue can be joined it is necessary to clear away much dead wood. Some of the barriers raised by the appellants as floodgates against monstrous torrents are themselves infected with illogicality and naked prejudice against the very concept of exemplary damages. The debate must proceed from true premises.

We are dealing with a question of power, not jurisdiction. Judges of the Supreme Court of New South Wales have had jurisdiction to entertain the present claim since at least 1823. Since 1970 any judge of this Court could exercise that jurisdiction at any time regardless of the Division to which he or she was (temporarily) assigned. …

Suggestions, subliminal and otherwise, that the matter should be decided on the basis that exemplary damages are somehow improper should be resisted. Arguments can be marshalled for and against the remedy, but it is well and truly part of the common law of Australia. … To uphold this appeal due to a lack of sympathy with exemplary damages generally would be to engage in inappropriate judicial activism. …

At the forefront of the appellants' oral submissions was the proposition that the object of equitable compensation is to restore persons who have suffered loss to the position in which they would have been if there had been no breach of the equitable obligation …

In my view it is quite fallacious to seek to build an argument upon the premise that equitable compensation is compensatory. That blinding glimpse of the obvious tells you nothing about areas where equity goes further, for example, by granting an injunction, specific performance or account of profits. The authorities on equitable compensation cited do not address the present issue. … *Nocton* and its progeny never claimed to cover the field of equitable remedies directed at defaulting fiduciaries. The ample armoury of equity includes declaration, injunction, rescission coupled with ensuing money orders (see *Maguire v Makaronis* (1997) 188 CLR 449 at 472, where this remedy is contrasted with equitable compensation), account of profits, accounting (including accounting on the basis of wilful default), orders for indemnity etc … Proprietary remedies, such as remedial liens and constructive trusts, are also available in many situations.

The remedies go far beyond offering compensation to the plaintiff. In most circumstances, the plaintiff can elect to claim multiple or alternative remedies. These include remedies designed to strip improper gains. …

The appellants invoke authoritative dicta about the purpose of equity's relief against defaulting fiduciaries being restorative and compensatory, not punitive … But when these and earlier dicta cited in them are examined, it will be seen that they do not stand in the way of the power to award exemplary damages in a proper case. …

The appellants seek to draw a firm line between deterrence and punishment. The idea that equity might be involved with the latter is said to be unprecedented and unprincipled.

The respondent points to areas where equity has moulded its remedies in such a way as to punish or in circumstances where no distinction can be drawn between a deterrent and a punitive intent. …

These instances reveal that there is no general doctrine to the effect that equity never has regard to punishment in moulding relief. I recognise that the caselaw, taken as a whole, reveals that equity does not set out to punish as an end in itself; and that the situations where more stringent relief is awarded involve a more vigorous application of traditional equitable remedies designed to strip profits from defaulting fiduciaries (in order to deter repetition and to preclude unjust enrichment) or to compensate their victims. …

But it remains true, in my opinion, that equity reveals itself readier to select a more stringent remedy if the fiduciary's default is deserving of punishment, for example, because it was deliberate and/or motivated by greed.

The analogies of contract and the *Trade Practices Act* (Cth)

There are some similarities between fiduciary duties and contractual relationships, but the differences predominate. Most notably, fiduciary obligations are imposed by law (like torts) and they arise out of a relationship and/or conduct, as distinct from merely giving effect to a negotiated private arrangement that is a contract. And there is no principle of efficient breach underpinning remedies for breach of fiduciary relationship: indeed the deterrent function of remedies like account of profits shows that equity repudiates the type of efficiency encompassed in the contractual notion of efficient breach.

History aside, there is greater similarity between a breach of fiduciary relationship and a tort. Each exposes the miscreant to remedies imposed by law. There are interests wiser than those of the immediate parties in restraining the 'wrongdoing' involved. And, since exemplary damages will only be attracted in response to misconduct attracting moral opprobrium, there are good reasons for permitting a deterrent remedy in the hope that it will modify or restrain similar behaviour in the future. Most instances of breach of fiduciary relationship that would attract an award of exemplary damages would involve conduct that is also tortious if not criminal.

In my view, it is entirely consistent with equitable doctrine that 'Equity' should be prepared to strive for remedial adequacy. For the reasons given elsewhere, it is appropriate that the step taken by Palmer J should be endorsed. To do so, involves no inconsistency with fundamental policies of equity.

To refrain from doing so, involves an unjustified rejection of the policies acceptable throughout tort law. In my view, the tort analogy is forceful and should be followed in the interests of conceptual coherence. My reasons for preferring the tort analogy to the contractual analogy have already been stated.

Heydon JA

In my opinion, the present position in Australia can be summarised thus. There is no authority which decides that exemplary damages cannot, as a matter of principle, be given by a court of equity for breach of fiduciary duty. Accordingly, to hold that wrongful conduct which would attract an award of exemplary damages in an action in tort cannot attract exemplary damages if the cause of action is equitable creates an anomaly which, in this country, is not justifiable either by precedent or principle.

Consistency in the law requires that the availability of exemplary damages should be co-extensive with its rationale. Where wrongful and reprehensible conduct calls for the manifest disapprobation of the community, where a punishment is called for to deter the wrongdoer and others of like mind from similar conduct and where something more than compensation is felt necessary to ameliorate the plaintiff's sense of outrage, then it should make no difference in the availability of exemplary damages that the court to which a plaintiff comes is a court of equity rather than a court of common law.

There is no need to appeal to any perceived fusion between the principles of equity and those of the common law in order to invest the equity court with jurisdiction to award exemplary damages. Such jurisdiction is already inherent in the court. …

It has been seen that the plaintiff's arguments wavered between suggesting that the law already accommodated the possibility of exemplary damages in equity, and suggesting that while the law needed to be changed, the change called for involved only a slight extension. There are several matters which point against the possibility that the law presently accommodates the possibility of exemplary damages, and which also point against the desirability of this Court extending it.

Anomalies

The trial judge was concerned with the importance of avoiding anomalies. He saw it as anomalous that where identical conduct can constitute deceit and a breach of fiduciary duty, exemplary damages could be ordered in relation to the former cause of action but not the latter. It has already been pointed out that to grant exemplary damages on the present facts would create a new anomaly, since on the present facts there was a breach of contract, yet the High Court in *Gray v Motor Accident Commission* appear to have denied that exemplary damages can be awarded for a breach of contract. …

It is not irrational to maintain the existence of different remedies for different causes of action having different threshold requirements and different purposes. The resulting differences are not necessarily 'anomalous'.

Interaction with other fields of law

That exemplary damages should be recoverable in tort is not surprising for as Windeyer J point out in *Uren v John Fairfax & Sons Pty Ltd* (at 149) … 'the roots of tort and crime are greatly intermingled'. Common law crimes are usually crimes involving mens rea and in a practical sense issues of motivation, intention to injure and malign purposes such as dishonesty commonly arise. These mental states overlap with those relevant to the grant of exemplary damages. But equitable duties do not, in standard forms of their operation, turn on those mental states. There is no strong reason to import exemplary damages from one field into so different a field …

Conclusion on exemplary damages in equity

There is no power in the law of New South Wales to award exemplary damages for equitable wrongs. But a narrower proposition suffices for the purposes of deciding this case. There is no power in the law of New South Wales to award exemplary damages for equitable wrongs of the type involved in the circumstances of this case. No English or Australian authority supports it. There is no convincing reasoning in New Zealand, Canadian or United States authorities. This Court ought not to change the law of New South Wales so as to create power to do so. Nothing in the authorities or the commentaries suggest why it should or why this Court has power to.

Note

In *Giller v Procopets* [2008] VSCA 236; (2008) 24 VR 1 (see [3.4.3a]), the Victorian Court of Appeal rejected a claim for exemplary damages for breach of confidence. Neave JA noted the difference of opinion on the issue in *Harris v Digital Pulse* and concluded at [437]: 'I am not aware of any authority supporting a punitive monetary award for breach of confidence'.

Questions

(1) What is the ratio decidendi of *Harris v Digital Pulse?*

(2) What aims does an award of exemplary damages achieve? Do other equitable remedies, such as an account of profit, achieve the same aims?

5

Rescission and rectification

5.1 Introduction

5.2 Total and partial rescission

5.3 The election requirement

5.4 The restoration process

5.5 Rectification

5.1 Introduction

Rescission has several legal meanings. In this chapter, it refers to the setting aside of a contract or gift on the ground that the plaintiff's intention to contract or to make the gift was defective. Two types of defective intention can cause a transaction to be rescinded. First, the plaintiff's intent to transact may be vitiated by mistake, misrepresentation, duress or undue influence. Second, the defendant's blameworthy conduct may have caused the plaintiff to enter into a disadvantageous transaction. The second category includes transactions induced by unconscionable conduct, breach of fiduciary duty and failure to explain the nature and effect of a guarantee under the doctrine of *Yerkey v Jones* (1939) 63 CLR 649 (see [7.3.4]).

A transaction which is liable to be rescinded is voidable, not void. This means that it is valid until the plaintiff elects to set it aside. Failure to set aside a contract means that it remains valid and enforceable: see *Daly v Sydney Stock Exchange Ltd* (at [5.3a] below). It has been stated that because a plaintiff must elect to have a voidable contract rescinded, rescission is not a judicial remedy but is a form of self-help: see *Alati v Kruger* (at [5.4a] below). The intervention of the court is not needed if the contract is wholly executory. But if the plaintiff elects to set aside a contract under which money has been paid or property transferred, the court will make orders designed to restore both parties to their pre-contractual position.

Rescission can be ordered at common law as well as in equity. The differences between common law and equitable rescission are explained in the textbook at [5.6]–[5.8].

Questions for consideration

(1) Does common law rescission serve a useful purpose? Should rescission only be an equitable remedy?

(2) What is the function of the election requirement? What steps must a plaintiff take in order to exercise a valid election to rescind?

(3) How do courts restore contracting parties to their pre-contractual position? What should the court do when it is impossible to unwind a contract? See *McKenzie v McDonald* at [2.2b].

(4) In some cases, the plaintiff will have a choice between rescinding a contract and affirming it while seeking another remedy (eg damages for breach of contract or for the tort of deceit). In what circumstances will rescission be the preferred remedy?

5.2 Total and partial rescission

5.2a *Vadasz v Pioneer Concrete (SA) Pty Ltd* [1995] HCA 14; (1995) 184 CLR 102

Background

A director of a company (Vadipile) guaranteed payment of the company's debts to a supplier of goods to the company. The written guarantee stated that the director had promised to guarantee the company's past and future indebtedness. It was found that the director had only agreed to guarantee the company's future indebtedness to the supplier and that he would not have signed the guarantee if he had realised that he was guaranteeing payment of the company's past, as well as future, debts. It was also found that the supplier had induced the director to sign the guarantee in the belief that the guarantee only covered the company's future indebtedness.

Decision

The High Court upheld the decision of the trial judge who had found that the supplier's misrepresentation justified partial rescission of the guarantee. Since the director had agreed to guarantee the future indebtedness of the company, rescission should be confined to setting aside the obligation to guarantee the company's past indebtedness.

The Court

Consequences of rescission

As has been indicated, the respondent has not sought in this Court to overturn the trial judge's finding that the appellant's execution of the guarantee was induced by misrepresentation. Nor has the respondent sought to attack his conclusion, which was confirmed by the Full Court, that the guarantee should be rescinded at least as regards past indebtedness. The only question on the appeal to this Court is whether the trial judge was entitled to order rescission on a footing which left the appellant liable to the respondent for the debts incurred by Vadipile after the guarantee was signed.

In this context it should be remembered that the trial judge held that the appellant was 'entitled to equitable relief on the ground of the [respondent's] misrepresentation'. And his Honour held that the respondent was entitled in equity (as well as under the *Trade Practices Act)* to enforce the appellant's liability under the guarantee for future indebtedness. Had the appellant sought to rely on the common law, he would not have been entitled to rescission because the contract did not remain completely executory and 'because he was not then in a position to return to the [respondent] in specie that which he had received under the contract, in the same plight as that in which he had received it'. Complete restitution was not and is not possible in the circumstances of the

present case where the consideration which moved from the respondent to the appellant was, in the words of the guarantee, the respondent's 'having agreed or agreeing to sell goods … or giving credit' to a company owned by the appellant and his wife and where, in reliance upon the guarantee, the respondent in fact supplied on credit to that company, which was or became insolvent, large quantities of concrete which have been used and cannot be returned. That being so, the assumption of fraud does not avail the appellant at common law.

Thus we are very much in the realm of equity. Indeed, as we followed the argument, the appellant did not really seek to attack the conclusion of the trial judge and the Full Court that the appropriate relief in the circumstances of the present case is equitable in its nature in the sense that its origins can be traced to the old Court of Chancery. The appellant's case is that the appropriate equitable relief was the unconditional rescission or setting aside of the guarantee in its entirety. In that respect it is useful to have regard to what was said by Mason J in *Commercial Bank of Australia Ltd v Amadio* ((1983) 151 CLR 447 at 461):

> Historically, courts have exercised jurisdiction to set aside contracts and other dealings on a variety of equitable grounds. They include fraud, misrepresentation, breach of fiduciary duty, undue influence and unconscionable conduct. In one sense they all constitute species of unconscionable conduct on the part of a party who stands to receive a benefit under a transaction which, in the eye of equity, cannot be enforced because to do so would be inconsistent with equity and good conscience.

Where, as in this case, the court has granted equitable relief in the shape of rescission of a contract, the result is to set aside the contract ab initio. While equity followed the law in requiring restitution as a condition of rescission where the contract had been wholly or partly executed, it allowed greater flexibility in the basis upon which restitution and accounting between the parties may be ordered. Thus, equity did not require complete restitution of the position which existed before the contract but allowed its remedies, particularly an order for monetary accounts, to be utilised to achieve practical restitution and justice. That point was made by Dixon CJ, Webb, Kitto and Taylor JJ in *Alati v Kruger* ((1955) 94 CLR 216 at 223–224):

> If the case had to be decided according to the principles of the common law, it might have been argued that at the date when the respondent issued his writ he was not entitled to rescind the purchase, because he was not then in a position to return to the appellant in specie that which he had received under the contract, in the same plight as that in which he had received it: *Clarke* v *Dickson* (1858) 120 ER 463. But it is necessary here to apply the doctrines of equity, and equity has always regarded as valid the disaffirmance of a contract induced by fraud even though precise *restitutio in integrum* is not possible, if the situation is such that, by the exercise of its powers, including the power to take account of profits and to direct inquiries as to allowances proper to be made for deterioration, it can do what is practically just between the parties, and by so doing restore them substantially to the status quo.

In the present case, the appellant obtained the benefit which he sought as consideration for entering the contract of guarantee, namely, the subsequent supply on credit by the respondent of goods to Vadipile. In those circumstances, a practical restoration of the status quo which existed before the execution of the guarantee and the subsequent supply of goods on credit by the respondent would involve not only a cancellation of the appellant's obligations under the guarantee but either a return of the goods subsequently supplied by the respondent or the actual payment, either by Vadipile or the appellant, of an amount equivalent to the value of the goods which were subsequently supplied in reliance upon the appellant's guarantee of payment of their price.

However, the appellant does not offer to pay the respondent the amount which Vadipile has failed to pay for those subsequently supplied goods. Nor does he offer to submit to terms or conditions which would ensure that the purchase price of those goods, which has not been suggested to exceed their true value, is received by the respondent. As has been said, the appellant seeks to be relieved completely and unconditionally from all liability under the guarantee, leaving the respondent without either its subsequently supplied goods or any payment for them. If such complete and unconditional relief is to be granted, it must be on some basis other than mere entitlement to a practical restoration of the status quo upon rescission or 'disaffirmance' of a contract induced by fraud. The only such basis that comes to mind is equity's general jurisdiction, in setting aside contracts and other dealings on equitable grounds, to ensure the observance of the requirements of good conscience and practical justice. Thus in *O'Sullivan v Management Agency & Music Ltd* ([1985] QB 428) an exclusive management agreement made by a young composer was set aside by reason of undue influence because of a fiduciary relationship between the parties. The Court of Appeal upheld rescission even though the parties could not be restored to their original position. In their judgments the members of the Court of Appeal pointed

out that a contract may be set aside in equity so long as 'the court can achieve practical justice between the parties' and that 'the court will do what is practically just in the individual case' so long as 'it is possible to achieve what is practically just by granting rescission and restitution together with orders for accounts'.

In the present case, the consideration provided by the respondent involved the supply of goods upon credit to Vadipile. Any need for restitution arises by reason of Vadipile's insolvency. The respondent points to the fact that goods were supplied on credit in pursuance of its promise given as consideration for the appellant's guarantee and says in effect: 'I would not have made further deliveries of concrete to Vadipile and risked non-payment if the appellant had not guaranteed payment for those deliveries'. In the way in which the action between the parties was constituted, practical justice is achieved, so the respondent's argument runs, by holding the appellant liable on a money claim for that proportion of Vadipile's debt incurred after the appellant signed the guarantee. As Cussen J noted in *Bank of Victoria Ltd v Mueller* ([1925] VLR 642 at 659), in the context of insisting that equity shall be done as a condition of setting aside a guarantee: 'This is, of course, something quite different from rectification, although in some cases its effect may be much the same'.

The idea of a Court of Equity using its powers to do 'what is practically just' was referred to by Lord Blackburn in *Erlanger v New Sombrero Phosphate Co* ((1878) 3 App Cas 1218) well over 100 years ago. In contrasting the relief available in law and in equity on rescission of a contract, in particular the ability of equity to take account of profits and make allowance for deterioration of property, his Lordship said (at 1278–1279):

> And I think the practice has always been for a Court of Equity to give this relief whenever, by the exercise of its powers, it can do what is practically just, though it cannot restore the parties precisely to the state they were in before the contract.

In using the expression 'what is practically just', Lord Blackburn may well have adapted the language of *Lindsay Petroleum Co v Hurd* ((1874) LR 5 PC 221) referred to in his judgment. There the Privy Council considered the operation of laches where 'it would be practically unjust to give a remedy'. And in a contemporary edition of Story's *Commentaries on Equity Jurisprudence,* in the context of rescission and specific performance, it was said (at para [693]):

> [T]he interference of a court of equity is a matter of mere discretion … And in all cases of this sort … the court will, in granting relief, impose such terms upon the party as it deems the real justice of the case to require … The maxim here is emphatically applied – He who seeks equity must do equity.

Referring to Lord Blackburn's judgment, Lord Wright said in *Spence v Crawford* ([1939] 3 All ER 271 at 288):

> In that case, Lord Blackburn is careful not to seek to tie the hands of the court by attempting to form any rigid rules. The court must fix its eyes on the goal of doing 'what is practically just'. How that goal may be reached must depend on the circumstances of the case, but the court will be more drastic in exercising its discretionary powers in a case of fraud than in a case of innocent misrepresentation … The court will be less ready to pull a transaction to pieces where the defendant is innocent, whereas in the case of fraud the court will exercise its jurisdiction to the full in order, if possible, to prevent the defendant from enjoying the benefit of his fraud at the expense of the innocent plaintiff.

Underlying Lord Wright's judgment is the idea that restoration is essential to the idea of restitution and that the 'purpose of the relief is not punishment, but compensation'.

In *Amadio,* Deane J referred to what was said by Cussen J in *Mueller* in support of the proposition ((1983) 151 CLR at 481):

> Where appropriate, an order will be made which only partly nullifies a transaction liable to be set aside in equity pursuant to the principles of unconscionable dealing … [T]he order will, in an appropriate case, be made conditional upon the party obtaining relief doing equity.

Thus unconscionability works in two ways. In its strict sense, it provides the justification for setting aside a transaction. More loosely, it provides the justification for not setting aside the transaction in its entirety or in doing so subject to conditions, so as to prevent

one party obtaining an unwarranted benefit at the expense of the other.

In *Amadio* this Court upheld an order setting aside a mortgage in its entirety where the mortgagors believed they were committing themselves to securing their son's overdraft to a limit of $50,000 and for six months only. The reason for not setting aside the mortgage only to the extent that it involved a liability in excess of $50,000 was that the Amadios would not have entered into the transaction at all, had they known the true financial position of their son. In the present case it cannot be maintained that the appellant would not have entered into the guarantee had it been confined to the future indebtedness of Vadipile. Rather, the evidence is that he would have done so, if not happily, because it was the only way to secure future supplies of concrete for Vadipile. And, by reason of the guarantee of future debts, the respondent supplied concrete to the value of $170,929.32. In giving the guarantee, the appellant, who was one of two directors and one of two shareholders, was fully aware of the financial position of Vadipile. He stood to benefit personally from the operations of the company.

The appellant suggested that to set aside the guarantee in the present case only to the extent of past indebtedness was an invitation to others to misrepresent the terms of a contract because they would be no worse off than if they had revealed the true position. But that suggestion misconceives the ordinary function of civil remedies, including equitable relief. It may, depending upon whether the respondent would in fact have supplied its goods on the basis of the more limited guarantee which the appellant was prepared to give, be true to say that the orders made by the trial judge and upheld by the Full Court disadvantage the respondent only to the extent that it is unable to enjoy the benefit of its misrepresentation and is required to bear its own costs of the trial. Such a result would not, however, be either surprising or inappropriate. The concern of equity, in moulding relief between the parties is to prevent, nullify, or provide compensation for, wrongful injury. If it appears that the other party would not have entered into the contract at all if the true position were known, the contract may be set aside in its entirety as in *Amadio*.

The appellant is 'seeking the assistance of a court of equity and he who seeks equity must do equity'. The Court must look at what is practically just for both parties, not only the appellant. To enforce the guarantee to the extent of future indebtedness is to do no more than hold the appellant to what he was prepared to undertake independently of any misrepresentation.

Questions

(1) The ground of rescission in *Vadasz* was misrepresentation. Does it matter, in determining the relief to be awarded, whether the misrepresentation was fraudulent, negligent or innocent?

(2) Why was rescission not ordered at common law?

(3) Why did the High Court in *Vadasz* not order rescission of the entire contract, as it did in *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447 (see [7.3.3b])? Does rescission of only part of the contract effectively rewrite the terms of the contract the parties had originally agreed?

5.3 The election requirement

5.3a *Daly v Sydney Stock Exchange Ltd* [1986] HCA 25; (1986) 160 CLR 371

Background

An investor sought advice from a firm of stockbrokers about investing money in shares. An employee of the firm advised the investor that it was not a good time to buy shares and that the money should be placed on deposit with the firm. The deposit constituted a loan, with the firm required to pay interest to the investor. Unknown to the investor or the employee the stockbroking firm was in a parlous financial position. After the investor placed the money on deposit, the firm went into liquidation and the money was lost.

The investor claimed compensation from a statutory compensation fund. Compensation was only payable if the money had been held by the firm on trust for the investor. The investor argued that the firm, which owed him fiduciary duties, was constructive trustee of the money received and that the money invested was therefore trust money for the purpose of claiming compensation.

Decision

The High Court held that the stockbroking firm had acted in breach of fiduciary duty in failing to disclose its financial position to the investor. The money had, however, been loaned to the firm. Under a contract of loan the borrower obtains full beneficial title to the money lent while being under a duty to pay an equivalent sum (with interest, if specified in the contract) on the repayment date.

In this case the firm would have held the money on constructive trust for the investor if the investor had elected to rescind the contract of loan for breach of fiduciary duty. However, the investor had not elected to rescind before the firm went into liquidation and therefore was not the beneficiary of a trust for the purpose of obtaining compensation.

Brennan J

When a gift of property is made to a donee who has failed to discharge his fiduciary duty to the donor, the gift may be set aside so that the donee holds the gift on a constructive trust for the donor. The principle is well expressed in an American case:

> [I]f a party obtains the legal title to property by virtue of a confidential relation, under such circumstances that he ought not, according to the rules of equity and good conscience as administered in chancery, to hold and enjoy the benefits, out of such circumstances or relations a court of equity will raise a trust by construction, and fasten it upon the conscience of the offending party, and convert him into a trustee of the legal title. (*Pollard* v *McKenney* (1903) 96 NW 679 at 681, followed in *Maddox v Maddox* (1949) 38 NW 2d 547 at 550).

When property is not given but sold, the sale may be set aside. In *Tufton v Sperni* ([1952] 2 TLR 516 at 526) Jenkins LJ, referring to the passage earlier cited from *Tate v Williamson* ((1867) 2 Ch App 55 at 60–61):

> The transaction set aside in that case was a purchase by the defendant from a person to whom he stood in a fiduciary relationship, and although the principles enunciated in the passage I have quoted have been more commonly applied to cases of gift, there is, I think, no distinction for this purpose between a gift, a purchase at an undervalue, and a sale at an excessive price, where the donee or the person making the purchase or effecting the sale, as the case may be, stands in a fiduciary relationship to the person making the gift to him, selling to him or buying from him.

The usual case in which a court of equity is asked to intervene to set aside a conveyance or transfer on sale between a fiduciary and the person to whom he stands in a fiduciary relationship is a purchase at an undervalue or a sale at an excessive price, but unfairness in the terms of an impugned contract is not a condition of its avoidance. The fiduciary may have failed in his duty in some respect other than the obtaining of fair consideration. A conveyance or transfer on sale may be set aside though the terms of the contract are fair if it appears that the fiduciary has failed to give the advice which he was bound to give in respect of that contract. In *McPherson v Watt* ((1877) 3 App Cas 254 at 272) Lord Blackburn, speaking of a breach of the fiduciary obligation owed by an attorney to his client, said that the client:

> … is entitled to say, 'This may be a very fair and proper bargain, but I do not choose to let it stand.' I think the law, both in England and in Scotland, is that in such cases we do not inquire whether it was a good bargain or a bad bargain, before we set it aside. The mere fact that you, being in circumstances which made it your duty to give your client advice, have put yourself in such a position that, being the purchaser yourself, you cannot give disinterested advice, your own interests coming in conflict with his, that mere fact authorizes him to set aside the contract if he chooses so to do. (And see *Commercial Bank of Australia Ltd* v *Amadio* ((1983) 151 CLR 447 at 475, per Deane J).

Irrespective of the fairness of its terms, equity regards a contract made between a fiduciary and the person to whom he stands in a fiduciary relationship as voidable if the fiduciary has breached his fiduciary duty in respect of the contract. If property is transferred to the fiduciary pursuant to the contract, the transfer may be set aside in consequence of the avoidance of the contract: *Armstrong v Jackson* ([1917] 2 KB 822 at 825–826). The contract and the transfer are voidable, but not void. If the transfer is set aside, the fiduciary transferee (and, no doubt, a volunteer or a purchaser with notice of the circumstances) holds the property transferred on a constructive trust for the transferor which a court of equity will enforce subject to any accounts or inquiries that may be necessary to do equity to the transferee. The transferor may elect to avoid the contract and to assert his title to the land or other property transferred assuming it still exists in specie or, being money, can be traced. He may invoke the assistance of equity to recover the land or other property in specie or to trace the money.

The principles governing the setting aside of contracts of purchase or sale are applicable to contracts of loan. Since equity intervenes to prevent a fiduciary from retaining property acquired under a contract entered into in breach of his fiduciary obligation, equity will intervene to prevent him from retaining money acquired in like circumstances. Of course, the occasions for invoking the assistance of equity to recover money lent may be infrequent, and the remedy of tracing the money lent into hands other than the borrower's – a remedy which the common law does not afford – may frequently be frustrated by dissipation of the money or its payment to another creditor: cf *In re Diplock, Diplock v Wintle* ([1948] 1 Ch 465 at 521). Nevertheless, a person lending money to a fiduciary who obtains the loan without discharging his fiduciary duty is entitled in equity to avoid the contract of loan and to recover, by tracing if need be, the money lent.

It may be said that a party who elects to avoid a contract and set aside a transfer of property made pursuant to the contract had an equitable interest in the property from the beginning, that the equitable remedies available to him are incidental to that interest and that his equitable interest arose before, and does not depend upon the court's decree: see *Scott on Trusts,* 3rd ed (1967), Vol 5, §462.4, p 3421. Thus, in *Stump v Gaby* ((1852) 42 ER 1015), where the plaintiff had conveyed an estate in land to his attorney pursuant to a contract of sale for an undervalue, Lord St Leonards LC held the contract to be voidable, saying (at 1018):

> In the view of this Court he remains the owner, subject to the repayment of the money which has been advanced by the attorney, and the consequence is that he may devise the estate, not as a legal estate, but as an equitable estate, wholly irrespective of all question as to any rights of entry or action, leaving the conveyance to have its full operation at law, but looking at the equitable right to have it set aside in this Court.

If a decree setting aside the conveyance is made, the plaintiff's equitable title is treated 'as having been, from the first, a trustee for the grantor, who, therefore, has an equitable estate, not a mere right of suit'. That was the effect, according to Menzies J in *Latec Investments Ltd v Hotel Terrigal Pty Ltd (in liq)* ((1965) 113 CLR 265 at 290), of the decision of Knight Bruce LJ in *Gresley v Mousley* ((1859) 45 ER 31). Menzies J in *Latec Investments* referred to the view that a plaintiff who was entitled to avoid a contract of sale and to have the conveyance set aside had a mere equity and the competing view that he had an equitable interest in the property from the beginning. He said (at 290–291):

> If there is a difference between the two lines of authority, that difference seems to me to arise from concentration upon different aspects of what follows from a voidable conveyance. Thus, *Phillips* v *Phillips* ((1861) 45 ER 1164), in so far as it says that a person with the right to have a voidable conveyance set aside has but a mere equity, directs attention to the right to have the conveyance set aside as a right to sue which must be successfully exercised as a necessary condition of there being any relation back of the equitable interest established by the suit. *Stump* v *Gaby* directs attention to the result of the eventual avoidance of the conveyance upon the position ab initio and throughout of the persons by whom and to whom the conveyance of property was made and says that, in the event of a successful suit (which may be maintained by a devisee), the conveyor had an equitable estate capable of devise and that the conveyee holds, and has always held, as trustee.

But where property has been sold and conveyed, the purchaser's beneficial title must be ascertained by reference to the sale so long as it stands; the vendor cannot insist on an equitable interest in the property if he does not choose to enforce his equity to avoid the sale: see per Kitto J in *Latec Investments* ((1965) 113 CLR at 277–278); and *In re Sherman dec'd* ([1954] 1 Ch 653 at 658). Similarly, until the lender elects to avoid the contract of loan, he cannot assert an equitable title to the money lent. He cannot at once leave the contract on foot and deny the borrowers the title to the money which the contract confers. When, as in the present case, a borrower acquires title to money paid to him under and pursuant to a contract of loan, the borrower cannot be made a trustee of the

money without his consent so long as the contract stands. There is no analogy between the present case and one in which a constructive trust is imposed on money or other property which is acquired by a fiduciary in breach of his duty but not pursuant to a voidable contract. In such a case there is no question of avoiding the contract before the constructive trust is imposed. A fortiori, there is no analogy between the present case and one where a constructive trust is imposed on money or other property which is acquired by a non-fiduciary otherwise than by contract: as, e.g., in *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* ([1981] 1 Ch 105 at 118–120).

Although Dr Daly or Mrs Daly was entitled to avoid the contracts of loan for breach of the fiduciary obligation resting on Patrick Partners, there is no evidence that the contracts of loan were avoided. In equity, Patrick Partners' title to the money lent was imperfect from the beginning by reason of their failure to discharge their duty as a fiduciary (cf *Allcard v Skinner* ((1887) 36 Ch D 145 at 184, per Lindley LJ) and, had the contract of loan been avoided, Mrs Daly's rights as against Patrick Partners might have been determined as though the firm had from the beginning held the money lent on a constructive trust for Dr Daly and then for Mrs Daly. But even if that be the true basis on which to measure Mrs Daly's rights as against Patrick Partners and any person into whose hands the borrowed moneys can be traced (a question which ought not be determined in the absence of the parties directly interested in the answer), it does not satisfy the statutory criterion of a liability enforceable against the fidelity fund.

As I construe that criterion, it is incumbent on a claimant to show that, at the time when the stockbroker received the moneys in question, he received them on behalf of another or as a trustee. The criterion is not satisfied if he received the moneys under a contract which gave him a beneficial title recognized by equity, albeit a beneficial title that is imperfect and liable to be divested by relation back in the event of avoidance of the contract of loan. In the absence of evidence of avoidance of the contracts of loan, there is nothing to show that Dr Daly or Mrs Daly has the equitable interest in the moneys lent by Dr Daly to Patrick Partners which might have arisen by relation back. The relationship between Dr Daly and Mrs Daly on the one hand and Patrick Partners on the other was in the beginning and has remained that of creditor and debtor.

Questions

(1) Why must a beneficiary elect to rescind a contract with a fiduciary when the fiduciary has committed a breach of duty? Should the breach automatically entitle the beneficiary to the benefit of a constructive trust? Fiduciary obligations, and liability for breach of fiduciary duty, are discussed in chapter 10.

(2) How does a plaintiff elect to rescind a contract? Does initiating legal proceedings to rescind constitute an election? Suppose that the plaintiff is the victim of fraud and the fraudster has disappeared. How can the plaintiff elect to rescind? See *Car & Universal Finance* v *Caldwell* [1965] 1 QB 525. The answers to these questions are relevant to contracts for the sale of goods where goods have been sold to a fraudster who fails to pay for them but who later resells them to a good faith purchaser. Section 27 of the *Sale of Goods Act 1923* (NSW) (and equivalent legislation in other States and Territories) provides that:

> Where the seller of goods has a voidable title thereto but the seller's title has not been avoided at the time of sale, the buyer acquires a good title to the goods, provided the buyer buys them in good faith and without notice of the seller's defect of title.

(3) What interest does the plaintiff have in the subject matter of a voidable contract prior to rescission? What interest does she have after electing to rescind? See *Latec Investments Ltd v Hotel Terrigal Pty Ltd (in liq)* (1965) 113 CLR 265 (at [8.3a]).

5.4 The restoration process

5.4a *Alati v Kruger* [1955] HCA 64; (1955) 94 CLR 216

Background

The plaintiff bought a fruit business from the defendant. The trial judge found that the plaintiff had been induced to buy the business as a result of the defendant's fraudulent misrepresentations as to the takings. After two weeks of running the business, when the plaintiff became aware of the misrepresentation, he elected to rescind the contract of sale and obtained from the landlord of the business premises an agreement to reassign the lease to the defendant, in the event that his rescission claim was successful. The trial judge held that the plaintiff was entitled to rescind the contract and directed a separate hearing to determine the terms on which remedy was to be granted. Before the hearing date the plaintiff abandoned the business and the landlord took possession of the premises.

Decision

The High Court confirmed the trial judge's finding that the plaintiff had validly rescinded the contract of sale of the business for fraudulent misrepresentation. The terms on which rescission was granted were, however, varied.

Dixon CJ, Webb, Kitto and Taylor JJ

If the case had to be decided according to the principles of the common law, it might have been argued that at the date when the respondent issued his writ he was not entitled to rescind the purchase, because he was not then in a position to return to the appellant *in specie* that which he had received under the contract, in the same plight as that in which he had received it: *Clarke v Dickson* ((1858) 120 ER 463). But it is necessary here to apply the doctrines of equity, and equity has always regarded as valid the disaffirmance of a contract induced by fraud even though precise *restitutio in integrum* is not possible, if the situation is such that, by the exercise of its powers, including the power to take accounts of profits and to direct inquiries as to allowances proper to be made for deterioration, it can do what is practically just between the parties, and by so doing restore them substantially to the *status quo: Erlanger v New Sombrero Phosphate Co* ((1878) 3 App Cas 1218 at 1278, 1279); *Brown v Smitt* ((1924) 34 CLR 160 at 165, 169); *Spence v Crawford* ([1939] 3 All ER 271 at 279, 280). It is not that equity asserts a power by its decree to avoid a contract which the defrauded party himself has no right to disaffirm, and to revest property the title to which the party cannot affect. Rescission for misrepresentation is always the act of the party himself: *Reese River Silver Mining Co v Smith* ((1869) LR 4 HL 64 at 73). The function of a court in which proceedings for rescission are taken is to adjudicate upon the validity of a purported disaffirmance as an act avoiding the transaction *ab initio*, and, if it is valid, to give effect to it and make appropriate consequential orders: see *Abram Steamship Co Ltd v Westville Shipping Co Ltd* ([1923] AC 773). The difference between the legal and the equitable rules on the subject simply was that equity, having means which the common law lacked to ascertain and provide for the adjustments necessary to be made between the parties in cases where a simple handing back of property or repayment of money would not put them in as good a position as before they entered into their transaction, was able to see the possibility of *restitutio in integrum,* and therefore to concede the right of a defrauded party to rescind, in a much wider variety of cases than those which the common law could recognize as admitting of rescission. Of course, a rescission which the common law courts would not accept as valid cannot of its own force revest the legal title to property which had passed, but if a court of equity would treat it as effectual the equitable title to such property revests upon the rescission.

In the present case, what changes affecting the possibility of restitution had occurred in the short period between 16th June when the respondent took possession of the business and 29th June when he issued the writ? He had had possession of the premises, and although that might have sufficed at common law to preclude rescission: *Blackburn v Smith* ((1848) 154 ER 707 at 711), it could hardly do so in equity, since a money payment could compensate for any difference there might be between the rental value of the premises and the rent paid by the respondent to the landlords. The title to the term created by the lease had been vested in the respondent by assignment, but that was subject to any right which he had to disaffirm the transaction. The title would revest in equity when he elected to rescind, and he was in a position to make a legal re-assignment with the landlord's consent. He had taken over (as he said in evidence) about twenty pounds worth of stock, but while of course he could not restore that to the appellant *in specie* he could pay or allow for its value, and nothing more could in justice be required. The business itself had deteriorated but this would not matter, for, as the trial judge has found, it was not due to any fault on the respondent's part, and even at common law the necessity to return property in its original condition was qualified so as to allow for incidents for which the buyer was not responsible, such as those to which the property was liable either from its inherent nature (cf *Newbigging v Adam* (1886) 34 Ch D 582 at 588; *Adam v*

Newbigging (1888) 13 App Cas 308 at 330) or in the course of the exercise by the buyer of those rights over it which the contract gave: *Head v Tattersall* ((1871) LR 7 Exch 7 at 12). No other change had occurred. The case was therefore typical of the class of cases in which a defrauded purchaser is regarded by a court exercising equitable jurisdiction as entitled to rescind the purchase and obtain a decree, on proper terms, declaring and giving effect to the rescission as an avoidance of the transaction from the beginning.

There remains, however, the question whether the respondent lost his right to such a decree by his conduct in discontinuing the business and leaving the premises before judgment was given in the action. The remedy is discretionary *(Story on Equity,* 3rd English ed (1920), pp 293, 294, 295), and if the respondent had acted unconscientiously during the pendency of the action, as by causing the loss of a valuable leasehold and goodwill by discontinuing the business and abandoning the premises without giving the appellant a reasonable opportunity to take them back, no doubt the court might refuse relief. But nothing of that kind happened. The term was, of course, still vested at law in the respondent, and it is not impossible that, despite low takings and actual losses, the business had some residual goodwill. But it is impossible to convict the respondent of any unfairness in the circumstances. The service of the writ had given the appellant clear notice that if the case alleged against him were made out at the trial the business and the lease would be held to have been his all along. He knew from the judge's announcement of his findings that in fact the issues of fact in the case had gone against him. He could have applied for the appointment by the court of a receiver and manager to preserve the property pending the determination of the case, but he made no such application. He did not even make any offer to the respondent to take the property back or suggest any *modus vivendi.* He took his chance, contenting himself with such maintenance of the business as the respondent's continuing conduct of it might afford. But the respondent was under no duty to go on indefinitely, working for nothing and incurring losses, especially after the judge had announced findings of fact in his favour. It does not appear from the material before us whether he gave the appellant any specific warning of his intention to give up the business and leave the premises, but, even if he did not, the appellant had ample opportunity to protect his interests, and his inaction is far more likely to have been due to an opinion that neither the lease nor the business was worth worrying about, particularly in view of the competition which the 'super-market' had created, than to any expectation that the respondent would obligingly continue to act as an unpaid manager.

For these reasons the appeal must fail. It is desirable, however, to make one or two variations in the judgment of the Supreme Court, because, as framed, it makes the respondent's right to be repaid his purchase money conditional upon his re-assigning the lease to the appellant and delivering to the appellant all other property the subject of the contract. The lease cannot now be re-assigned, and the other property referred to would include the stock-in-trade which obviously cannot now be returned, and the chattels referred to in the schedule to the contract which now may or may not be available for re-delivery. The judgment should therefore be varied so as to order the plaintiff to return to the defendant Alati such of the chattels mentioned in the schedule to the contract as he is able to return, and to order the defendant to repay to the plaintiff the balance of the purchase money (£700) and interest thereon which shall remain after deducting the value as at the date of the contract of such of the scheduled chattels as the plaintiff cannot return, the value as at that date of the stock-in-trade which the plaintiff received from the defendant under the contract, the damages awarded in the judgment of the Supreme Court, and any amount which ought to be allowed in the defendant's favour in respect of the plaintiff's use of any of the property comprised in the contract.

Note

One obstacle to rescission is that the defendant has sold the subject-matter of the contract to a good faith purchaser for value without notice of the plaintiff's power to rescind. The power, being equitable, is not binding on the purchaser. Can the plaintiff claim the consideration paid by the good faith purchaser to the defendant? What can a court do if the defendant has spent the consideration received from the good faith purchaser? See *Hartigan v International Society for Krishna Consciousness Inc* [2002] NSWSC 810 for the availability of what is sometimes termed 'pecuniary rescission'.

Questions

(1) The judgment refers to rescission at common law. How does rescission at common law differ from rescission in equity?

(2) What was the High Court's objective in fashioning relief?

(3) 'Rescission for misrepresentation is always the act of the party himself' (Dixon CJ, Webb, Kitto and Taylor JJ). Do you agree? What are the roles of the plaintiff and the court in effecting rescission of a contract?

(4) If a contract for the sale of a business is rescinded for the vendor's misrepresentation, how relevant are the following factors in determining the terms on which rescission will be granted:

(a) the vendor was fraudulent

(b) the buyer made no serious attempt to prevent losses accruing in running the business

(c) perishable goods deteriorated and had to be destroyed

(d) chattels transferred as part of the business stock were sold off by the buyer

(e) a significant period of time elapsed before the buyer elected to rescind, although the delay was not long enough to bar the buyer from obtaining rescission?

(5) If the plaintiff is entitled to the money equivalent of property transferred to the defendant under the voidable contract and later sold to a good faith purchaser, should the award be assessed as: (a) the value of the property at the time of sale to the third-party purchaser; (b) the consideration received by the defendant (possibly including any increase in value if the defendant has invested the consideration successfully); (c) the value of the property at the date of the plaintiff's election to rescind; (d) the value of the property at the date of the judgment; or (e) such amount as the court considers appropriate in the exercise of its discretion?

5.4b *Maguire v Makaronis* [1997] HCA 23; (1997) 188 CLR 449

Background

The defendants, Mr and Mrs Makaronis, agreed to buy a chicken farm. They consulted the plaintiffs, who were solicitors, about financing the purchase. The defendants assumed that the plaintiffs would act for them in obtaining a loan of $250,000 from the Commonwealth Bank. The loan would enable them to buy the chicken farm, repayment being secured over their Melbourne home. The plaintiffs in fact themselves obtained the loan of $250,000 from the bank at an interest rate of 22 per cent (which, although high, was found to be in line with prevailing interest rates for short-term finance at that time). The plaintiffs then lent the $250,000 to the defendants at an interest rate of 24 per cent on the security of the defendants' Melbourne home. The defendants, who had a poor command of English, were unaware that the plaintiffs, and not the bank, were their mortgagees.

The defendants purchased the chicken farm but only repaid one instalment of the loan. The plaintiffs claimed possession of the Melbourne home. The defendants counter-claimed for rescission of the mortgage on the ground of the plaintiffs' breach of fiduciary duty.

Decision

The High Court upheld the trial judge's finding that the defendants were entitled to rescind the contract of loan on the ground of the plaintiffs' breach of fiduciary duty. The duties the plaintiffs owed to the defendants as their solicitors conflicted with their interest as

lenders and mortgagees of the defendants' home.

Rescission was conditional on the defendants repaying the plaintiffs the outstanding amount of the loan, together with interest at the commercial rates applicable to the loan (which was 22 per cent at the time the loan was made, though commercial lending rates later fell).

Brennan CJ, Gaudron, McHugh and Gummow JJ

Doing equity

There remains for consideration the submission by the appellants that the majority of the Appeal Division erred in upholding the granting of the remedy of rescission so as to set aside the mortgage and amend accordingly the registered title of the Radford property, but without calling upon the respondents first to do equity by honouring their contractual obligations to pay the money and interest secured by the mortgage.

To an extent, the majority appears to have proceeded on the footing, supported before this Court by the respondents, that the respondents had not taken their advance from the appellants and had not created a relationship of debtor and creditor between them. We have indicated earlier in these reasons that so to conclude would be to depart from the admission on the pleadings and from the documentary and certain of the oral evidence. Moreover, the mortgage itself, in its terms, both contained covenants by the respondents to pay to the appellants principal and interest, and created the security for that indebtedness. The order made at first instance and upheld by the Full Court that the mortgage 'be set aside' and the registration thereof be removed from the title carries with it the destruction not only of the security but of the covenants therein. As Brooking J pointed out in his dissenting judgment, that result would go beyond the result in such cases as *Barron v Willis* ([1900] 2 Ch 121). There the plaintiff sought and obtained relief which had the effect of declaring void certain deeds only in so far as they deprived her of a power of appointment, this being the matter concerning which she had not properly been advised. That case may be compared with *Vadasz v Pioneer Concrete (SA) Pty Ltd* ((1995) 184 CLR 102), a misrepresentation case, to which we have referred.

Here, given the undisclosed role of the appellants as mortgagee, the breach of duty went to the identity of the parties having the benefit under the mortgage both of the security and of the covenants to pay money. To set aside the mortgage purely in its operation as a security, without conditioning that upon repayment, would be to reform the transaction in an impermissible fashion. It would be to strike down the security interest without ensuring repayment of that which was paid in return for it. The respondents would be left with the fruits of the transaction of which they complain, whereas their equity was to have the whole transaction rescinded and, so far as possible, the parties remitted to their original position.

Interest

As we have indicated earlier in these reasons, this is not a case where the effecting of restitution *in integrum* is made more difficult by intervening changes in the subject matter of the transaction, for example, business as in *Alati v Kruger* ((1955) 94 CLR 216). Nor is it a case where the subject matter of the rescission is reconveyance of land at the instance of the vendor who must repay not only the purchase price but, as a condition of relief, pay to the purchaser reasonable interest upon the moneys of which the vendor has had the use.

Brooking J, with whose reasons we are respectfully in general agreement, would have made the grant of relief to the respondents conditional upon payment by them to the appellants of the amount of the advance, together with interest thereon at the rate of 9 per cent per annum from the settlement date of 8 June 1990 to the date of repayment, calculated with half-yearly rests. As we have indicated, the mortgage stipulated a rate of 24 per cent reducible to 22 per cent for prompt payment and the trial judge held that the terms of the loan 'were not disadvantageous in the market-place of the day'. Brooking J determined upon the lower rate of 9 per cent as a rate which reflected that obtainable on authorised trustee investments. The trustee rate was taken as that which also is usually allowed upon the setting aside of a conveyance at the suit of the vendor. His Honour indicated that he was adopting this as an appropriate analogy.

However, in our view, there was no occasion for application of any analogy. When a contract of sale is set aside at the suit of a vendor, the vendor is obliged, as we have indicated, to repay to the purchaser that which has been received on or on account of the price and, the purchaser having been kept out of his or her money, relief is conditioned upon the payment of interest. There is no legal right otherwise existing in favour of the purchaser to recover interest. Here, the mortgage conferred such a right. The ques-

tion then becomes whether the transaction should be reformed, as a condition of relief, adversely to the parties suffering rescission by reduction in the rate of interest otherwise due and secured to them.

There was a well-developed body of principle in suits in which borrowers sought equitable relief in respect of contracts rendered void by the old usury laws. Equity intervened, but on terms that the plaintiff pay the defendant what was 'bona fide due' after disallowing the interest above the permitted statutory rate.

In *Langman v Handover* ((1929) 43 CLR 334 at 356), Rich and Dixon JJ cited a passage in the judgment of Lord Selborne LC in *Jervis v Berridge* ((1873) 8 Ch App 351 at 358). There, in the course of dealing with a bill in Chancery for delivery up and cancellation of an agreement, the Lord Chancellor said:

> There are, indeed, certain cases where a defendant has incurred forfeitures or penalties, or where the controversy relates to usurious or other unlawful transactions, in which the whole locus standi in curia of the plaintiff is dependent on an election, which must be declared by the bill, to forego legal rights for the sake of equitable remedies.

Rich and Dixon JJ went on to consider the decision to the same effect of Chancellor Kent in *Fanning v Dunham* ((1821) 9 Am Dec 283). There the Chancellor held that, where a borrower seeks relief in equity (such as delivery up and cancellation) in respect of a security on the ground of illegal usury, the plaintiff must, before being entitled to relief, pay or offer to pay the principal and so much of the interest as is lawfully due. There also are authorities which indicate that unconscientious transactions, particularly mortgages of reversionary interests, stipulating an exorbitant, albeit not illegal, rate of interest may be set aside on terms that the plaintiff pay interest at a reduced and reasonable rate.

In the present case there is no suggestion that the rate exceeded any legal maximum, or that the terms of the loan were disadvantageous in the market-place of the day. Indeed, there were findings by the trial judge that, whilst the rate appears high, it was not out of line with those then charged by banks on short term loans of this nature. That being so, there is no footing for the imposition of a condition as to payment by the respondents which is disadvantageous to the appellants. To impose such a qualification would be to distort the equity of the respondents on their counter-claim.

It would, however, be contrary to principle for the appellants to profit by being allowed a higher rate of interest than that payable by them to the Commonwealth Bank for the money ultimately advanced to the respondents. The evidence as to the arrangement which existed between the appellants and the Commonwealth Bank is far from satisfactory. And there is no evidence as to the interest actually paid by them with respect to the money which was advanced to the respondents. However, there is evidence that the rate payable by the appellants at the time the mortgage was executed was 22 per cent, i.e. 2 per cent less than the penalty rate stipulated in the mortgage. And it is a matter of common knowledge that interest rates have fallen since. It would, thus, seem likely that to impose a condition on the grant of relief requiring payment of interest at the rate stipulated in the mortgage would result in a profit to the appellants.

Notes

(1) The plaintiff solicitors argued that the contract of loan should not have been rescinded because, assuming that they had committed a breach of fiduciary duty, the defendants would have purchased the chicken farm even if they had been aware of the facts constituting the breach of duty. The High Court rejected this argument, holding that causation was of no further relevance once it had been shown that the breach of duty had caused the defendants to enter into the voidable contract.

(2) The causation argument required the High Court to consider the so-called 'rule' in *Brickenden v London Loan & Savings Co* [1934] 3 DLR 465 (PC). Lord Thankerton in *Brickenden* stated that where a fiduciary commits a breach of duty by failing to disclose material facts to the beneficiary, the fiduciary will not be permitted to argue that the beneficiary would nonetheless have entered into the transaction even if full disclosure had been made. The majority of the High Court in *Maguire v Makaronis* held that, while the principle laid down by Lord Thankerton might be relevant to some cases where equitable compensation was claimed for breach of fiduciary duty, it was not relevant to an application for rescission. In a separate judgment, Kirby J held that the *Brickenden* principle applied to rescission claims as well as to claims for equitable compensation, and that it applied in *Maguire v Makaronis* to defeat the solicitor's causation argument. See [4.3.4c] on the *Brickenden* principle, and S Harder, 'Equitable Compensation for a Fiduciary's Non-disclosure and Hypothetical Courses of Events' (2011) 5(1) *Journal of Equity* 22.

(3) The High Court noted at 467–8 that in cases of fraudulent misrepresentation the plaintiff will, in addition to rescission, be entitled to an indemnity for losses 'directly caused' by the defendant's misrepresentation: see *Whittington v Seale-Hayne* (1900) 82 LT 49; *Munchies Management Pty Ltd v Belperio* (1988) 58 FCR 274, 282–6.

Questions

(1) What happens if the plaintiff does not comply with the terms imposed on her as the condition of being allowed to rescind a contract?

(2) If an important aim of equitable relief is to deter fiduciary wrongdoing, does an award of rescission on terms (some of which may be onerous to the plaintiff and advantageous to the fiduciary) undermine the attainment of the objective?

(3) M, a moneylender, lends $250,000 to I, an investor, to enable I to invest in the share market. M registers a charge over I's home as security for repayment. The interest rate is stated to be 5%, which is 3% over bank loan interest rates at that time. As M knows, I's only source of income is a disability pension, although I's house provides full security for M's loan. I, whose investments are all unsuccessful, has not made any loan repayments. Is I entitled to rescind the loan contract? If so, what terms is a court likely to impose? In answering these questions see, in addition to *Maguire v Makaronis*, *Perpetual Trustees Victoria Ltd v Burns* [2015] WASC 234 and Stubbings v Jams 2 Pty Ltd [2022] HCA 6.

5.5 Rectification

5.5a *Simic v New South Wales Land and Housing Corporation* [2016] HCA 47; (2016) 260 CLR 85

Background

A construction company, Nebax, entered into a contract with the Housing Corporation to demolish buildings and replace them with unit blocks. The contract required Nebax to obtain a performance bond from a financial institution in favour of the Housing Corporation, as security for performance of Nebax's obligations under the contract. Nebax obtained a bond from ANZ Banking Group Ltd, stated to be in favour of the non-existent 'New South Wales Land & Housing Department trading as Housing NSW ABN 45754121940' as principal. The Housing Corporation claimed $146,965 from the bank pursuant to the bond. The bank refused to pay on the ground that the Corporation was not named as the principal of the bond. In the subsequent litigation the Corporation argued that, as a matter of construction, it was the principal and therefore entitled to payment. Alternatively, it applied for rectification of the instrument creating the bond on the ground that by reason of a common mistake the bond did not accurately reflect the intentions of the parties.

Decision

The High Court rejected the construction argument but held that the Housing Corporation was entitled to rectification of the performance bond on the ground that the parties had made a common mistake as to the identity of the principal. Upon rectification the Corporation was entitled to payment from the bank of the sum claimed.

French CJ

In my opinion, the relevant intention is correctly characterised as that of Nebax and ANZ. It was their common intention to bring the Undertakings into existence conditioned upon Nebax entering into indemnity arrangements with ANZ. So far as equity is concerned,

it must have been their common intention that the amounts specified in the Undertakings be payable on demand to the Principal of the underlying construction contract, such as to render it unconscionable for ANZ to contend otherwise.

At a conceptual level, construction and rectification of a contract are different processes. The first involves determination of the meaning of the words of the contract defined by reference to its text, context and purpose. Resort to extrinsic circumstances and things external to the contract may be necessary to identify its purpose and in determining the proper construction where there is a constructional choice. The question for constructional purposes is not about the real intentions of the parties, not what the parties meant to say, but what they actually said.

There has been debate in the United Kingdom about reliance upon the 'real' as distinct from objectively attributed intentions of the parties in relation to the rectification of contracts. One line of reasoning in the debate is that reliance upon an objectively ascertained common intention for the purpose of rectification serves to bring about coherence with the common law of contract. In *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL38; [2009] AC 1101, Lord Hoffmann's obiter remarks supporting a requirement for an objectively attributed common intention for the purposes of rectification commanded the assent of his colleagues. However, that objective test was not argued in this case and does not represent the common law of Australia as it presently stands. A change in the law would require full argument in a case in which the question was relevant to the outcome.

There is a conceptual distinction between construction and rectification but that does not mean that there is not a close connection in their practical operation. Professor Carter has pointed to the close relationship between construction and rectification and the pragmatic view that the fundamental difference between them lies in the ability to use the prior negotiations of the parties (JW Carter, *The Construction of Commercial Contracts* (2013) at 306 [9-44]). However, he has properly acknowledged the difference of principle between mistakes which can be corrected by construction and those for which a formal order is required, commenting that:

The fact that rectification is a remedy informed by matters such as the prevention of unconscionable conduct must still have some relevance. (footnote omitted)

As to that, it may be added that the relevance is considerable given the historical and doctrinal bases upon which rectification is granted.

Kiefel J

It has for some time been settled law that the existence of an antecedent agreement is not essential to the grant of relief by way of rectification and that rectification may be granted in cases where the instrument sought to be rectified is the only agreement between the parties *(Maralinga Pty Ltd v Major Enterprises Pty Ltd* [1973] HCA 20; (1973) 128 CLR 336 at 350). The focus of the courts turned to the common intention of the parties up to the time the relevant instrument was made. That intention must be proved by admissible evidence and proved to a high standard. In a passage from *Fowler v Fowler* ((1859) 4 De G & J 250 at 265; 45 ER 97 at 103), which has been cited with approval by this Court, Lord Chelmsford said that:

> a person who seeks to rectify a deed upon the ground of mistake must be required to establish, in the clearest and most satisfactory manner, that the alleged intention to which he desires it to be made conformable continued concurrently in the minds of all parties down to the time of its execution.

What is necessary to be shown is the actual intention of each of the parties. This has often been referred to by intermediate appellate courts as the subjective intention of the parties. A court, in determining whether the burden of proof is discharged, may be said to view the evidence of intention objectively, in the sense that it does not merely accept what a party says was in his or her mind, but instead considers and weighs admissible evidence probative of intention. It is in this sense that statements such as that of Hodgson J in *Bush v National Australia Bank Ltd* ((1992) 35 NSWLR 390 at 406), that common continuing intention 'must be objectively apparent from the words or actions' of each party, may be understood.

It is not to be expected that parties to contractual negotiations will express themselves in terms of their intentions. It is therefore to be expected that proof to the necessary standard will usually require some manifestation of the intention of each party by their words or conduct and that the requisite common intention will be a matter of inference for the court from that evidence. As Yeldham J pointed out in *Bishopsgate Insurance Australia Ltd v Commonwealth Engineering (NSW) Pty Ltd* ([1981] 1 NSWLR 429 at 431), it would not be sufficient for proof of intention to refer to a party's state of mind which remained undisclosed in the course of negotiations …

… [I]t may be said that the traditional approach of the courts, following cases such as *Fowler v Fowler,* is to grant rectification only if the instrument in question did not reflect the actual common intention of the parties. That intention is proved in the usual way, by admissible evidence to the requisite standard. The assessment undertaken by the court may, in the sense referred to above, be described as an objective one. But the term 'objective' is apt to be misunderstood because it can be applied with respect to a quite different process, as the decision in *Chartbrook Ltd v Persimmon Homes Ltd* ([2009] UKHL 38; [2009] AC 1101) shows.

In *Chartbrook,* Lord Hoffmann suggested ([2009] UKHL 38; [2009] AC 1101 at 1126 [59]–[60]) that, in cases of rectification, 'the terms of the contract to which the subsequent instrument must conform must be objectively determined in the same way as any other contract'. The approach to which his Lordship referred was that applied under the common law to the interpretation of contracts, namely, 'what an objective observer would have thought the intentions of the parties to be'. His Lordship clearly considered a consistency of approach – to rectification and to interpretation – to be both warranted and necessary.

Lord Hoffmann's view involves a departure from the traditional approach of the courts to rectification. Its utility has been questioned. It has been observed (McGhee, *Snell's Equity* (33rd ed, 2015) at 426) that it is difficult to see why a prior agreement, objectively determined, should override the later instrument, unless it reflects the parties' actual intentions. The need for consistency which his Lordship thought desirable may also be questioned. Rectification is an equitable remedy which is concerned with a mistake as to an aspect of what an instrument records and with the conscience of the parties. The common law, on the other hand, deals with the interpretation of the words chosen by the parties to reflect their agreement and it does so pragmatically, by reference to considerations such as business efficacy.

It is not necessary to express a concluded opinion on these and other matters to which Lord Hoffmann's view gives rise. Although that aspect of Lord Hoffmann's reasons commanded the assent of other members of the House of Lords, it was not necessary to the decision in *Chartbrook.* Moreover, whilst other aspects of the reasons in that case have been referred to in some recent decisions of this Court, his Lordship's view in this regard has not been the subject of any consideration. It was not the subject of argument in this appeal, which should be approached by reference to settled principle.

Gageler, Nettle and Gordon JJ

Rectification is an equitable remedy, the purpose of which is to make a written instrument 'conform to the true agreement of the parties where the writing by common mistake fails to express that agreement accurately' *(Maralinga Pty Ltd v Major Enterprises Pty Ltd* [1973] HCA 23; (1973) 128 CLR 336 at 350). For relief by rectification, it must be demonstrated that, at the time of the execution of the written instrument sought to be rectified, there was an 'agreement' between the parties in the sense that the parties had a 'common intention', and that the written instrument was to conform to that agreement *(Slee v Warke* [1949] HCA 57; (1949) 86 CLR 271 at 281). Critically, it must also be demonstrated that the written instrument does not reflect the 'agreement' because of a common mistake *(Maralinga Pty Ltd v Major Enterprises Pty Ltd* [1973] HCA 23; (1973) 128 CLR 336 at 350–351). Unless those elements are established, the 'hypothesis arising from execution of the written instrument, namely, that it is the true agreement of the parties' cannot be displaced (*Maralinga* at 350–351).

The issue may be approached by asking – what was the actual or true common intention of the parties *Ryledar Pty Ltd v Euphoric Pty Ltd* [2007] NNSWCA 65; (2007) 69 NSWLR 603 at 642 [182], [185]). There is no requirement for communication of that common intention by express statement (*Bishopsgate Insurance Australia Ltd v Commonwealth Engineering (NSW) Pty Ltd* [1981] 1 NSWLR 429 at 431), but it must at least be the parties' actual intentions, viewed objectively from their words or actions, and must be correspondingly held by each party (*Bush v National Australia Bank Ltd* (1992) 35 NSWLR 390 at 405–406).

However, here there was such communication, and as is apparent from the primary judge's findings, all parties to the transaction intended that the Undertakings should enure to the benefit of the party with which Nebax entered into the Construction Contract. It was Mr Simic's intention, and, therefore, Nebax's intention, that the Undertakings should operate in favour of Nebax's counterparty to the Construction Contract. Similarly, it was Ms Hanna's understanding, and, therefore, ANZ's understanding, that the Undertakings were to be entered into in relation to the Construction Contract. …

… Rectification of the applications and the Undertakings to refer to the Corporation gives effect to what Nebax required, as well as the stated intention of ANZ to provide the security to the entity with which Nebax had contracted to provide the building and construction services. That intention (to provide security to the entity with which Nebax had contracted) was the actual or true common intention of Nebax and ANZ. And that was the actual intention of each party, viewed objectively. The fact that the 'Principal' was wrongly identified in the applications and the Undertakings was, in the particular circumstances of this case, a matter that could be and should be rectified.

Notes

(1) In *Simic v New South Wales Land and Housing Corporation*, rectification was granted on the ground of the parties' common mistake. Unilateral mistake is also a basis for rectification of a contract where one party knows that an instrument contains a mistake in his favour but does nothing to correct it: *Leibler v Air New Zealand (No 2) Ltd* [1999] 1 VR 1; *Re Premier Bay Pty Ltd* [2018] VSC 168, [705]–[714].

(2) Rectification is not confined to contracts; a trust instrument can be rectified: *Day v Day* [2014] Ch 114. Identifying the intention of the settlor of the trust may not be straightforward if, as often occurs for tax reasons, the trust has a nominal settlor, such as the solicitor who drafts the trust instrument or some other individual not otherwise connected with the trust who agrees to constitute the trust by settling a small amount of money on the terms of the trust: *Public Trustee v Smith* (2008) 1 ASTLR 488, [71]–[74]; *Re Kirkham* [2010] WASC 106.

(3) It is important to keep in mind that it is not the contract or trust that is rectified but the instrument that embodies the terms of the arrangement.

Questions

(1) What is the relationship between construing a contract in accordance with the intentions of the parties and rectifying a contract so as to reflect the intentions of the parties? Is the evidence admissible to construe a contract the same as the evidence admissible to rectify a contract?

(2) How does rectification differ from partial rescission, as ordered in *Vadasz* v *Pioneer Concrete (SA) Pty Ltd* ([5.2a] above)?

(3) Does rectification depend on ascertaining the subjective or objective intentions of the parties?

(4) How is the conscience of the parties relevant to an application to rectify a written contract?

(5) Ada, intending to create a trust for her only nephew, Larry, and her only niece, Marina, leaves her property in her will to the State Trustee Company to be held on trust 'for Larry and Matilda in equal shares'. No one in Ada's family is named Matilda. The State Trustee Company refuses to recognise Marina as a beneficiary. Marina claims that the reference in the will to Matilda is obviously intended to refer to her. Discuss.

6

Bars to relief

6.1 Introduction

6.2 Laches

6.3 Acquiescence

6.4 Unclean hands

6.5 Hardship

6.6 Effect of order on third parties

6.1 Introduction

Plaintiffs may have an 'equity for relief' but this does not mean that the plaintiff holds a right to relief. All equitable relief is discretionary, and judicial discretion is exercised in a principled manner. The court considers the surrounding circumstances of the case, weighing factors from both the plaintiff's and defendant's perspectives in fashioning an appropriate remedy. Principles informing the exercise of equitable discretion include the doctrines of laches and acquiescence, unclean hands and hardship to the defendant. Additionally, a court exercising equitable jurisdiction will not make an order that is futile or impossible to supervise. The impact of the court's order on third parties will also be considered. These factors apply generally to all equitable remedies. The availability of specific performance is additionally controlled by particular discretionary grounds: want of mutuality and the plaintiff's willingness and readiness to perform her own obligations (see chapter 3 and textbook at [3.3]–[3.5], [3.12]).

Bars to relief are sometimes referred to as equitable defences but properly understood they are not true defences. Since there is no right to relief, any equity held by the plaintiff is merely coextensive with the extent to which equitable discretion will bend in her favour. However, there are true equitable defences which are considered elsewhere in this book: for example, estoppel may operate as a defence (see chapter 7) and the fully informed consent of the principal may be a defence to a breach of fiduciary duty (see chapter 10).

Questions for consideration

(1) When an application is made for an equitable remedy, what factors 'tend towards the justice or injustice of granting the remedy that is sought' (*Bridgewater* v *Leahy* (1998) 194 CLR 457, 494)?

(2) Is the court's discretion a rule-based discretion or is it an unbounded discretion?

(3) Are the conduct and conscience of both the plaintiff and defendant relevant to the court's deliberations?

6.2 Laches

Equity denies relief for stale demands. Where there is delay in claiming an equity or prosecuting a commenced action, it may be open to the defendant to raise the delay, and the impact of this delay, in resisting a remedy.

6.2a *Lindsay Petroleum Co v Hurd* (1874) LR 5 PC 221

Background

Land owned by Kemp was thought to contain oil. When Lindsay Petroleum Co was being formed to search for oil on Kemp's land, the company promotor (Hurd) and Kemp entered into a contract giving a high purchase price for the land to Kemp and a secret profit to Hurd. To conceal the arrangement from Lindsay Petroleum's shareholders, Kemp and Hurd entered into a 'dummy agreement' recording the sale and purchase of Kemp's land. On discovering the fraud, Lindsay Petroleum sought rescission of the contract for the sale of land. Kemp and others submitted that Lindsay Petroleum by 'delays and laches' was precluded from any relief in the cause.

Decision

Lord Selborne

Now the doctrine of laches in Courts of Equity is not an arbitrary or a technical doctrine. Where it would be practically unjust to give a remedy, either because the party has, by his conduct, done that which might fairly be regarded as equivalent to a waiver of it, or where by his conduct and neglect he has, though perhaps not waiving that remedy, yet put the other party in a situation in which it would not be reasonable to place him if the remedy were afterwards to be asserted, in either of these cases, lapse of time and delay are most material. But in every case, if an argument against relief, which otherwise would be just, is founded upon mere delay, that delay of course not amounting to a bar by any statute of limitations, the validity of that defence must be tried upon principles substantially equitable. Two circumstances, always important in such cases, are, the length of the delay and the nature of the acts done during the interval, which might affect either party and cause a balance of justice or injustice in taking the one course or the other, so far as relates to the remedy. In this case the delay was at all events not of very long duration, because the conveyance to the company was dated about fifteen months before the filing of the bill; the whole purchase-money was not paid before that time; and there is nothing which would justify us in reckoning the currency of time from an earlier period than that conveyance. Neither were any acts done in the interval, as it appears to us, at all material to the equity between the parties. There was possession taken, no doubt, but it would be a very novel proposition that mere possession is to be a bar, so as to raise a counter equity in cases of this description. Nothing appears to have been done beyond the sinking of a single well … that well, if the land is restored, can in no substantial way operate to the prejudice of the Respondents; and, if any profit had been derived from it, the Court of first instance offered an account of that profit; but it manifestly was known that there was none, for that account was not accepted. The situation of the parties having, therefore, in no substantial way been altered, either by the delay or by anything done during the interval, there is in these circumstances nothing to give special importance to the defence founded on time. …

Notes

(1) Mere delay is not sufficient to establish laches. The delay must cause disadvantage or prejudice to the defendant or a third party which is so substantial as to render it unjust to allow equitable relief. The court asks whether the defendant will be in a substantially worse position if proceedings are brought against them now rather than previously. A mere risk of disadvantage or prejudice will not suffice.

(2) The defendant bears the burden of proving both the delay and its impact.

Background

On 24 September 1956, Alfred Lamshed (the appellant) entered into a binding contract to sell a grazing property to Lamshed & Co (a family firm whose members included his brother). By the end of November 1956, Alfred had purported to repudiate the contract. The members of Lamshed & Co waited until 5 April 1957 to 'issue their writ' seeking specific performance of the contract. Thereafter, the action in specific performance lay dormant until 26 March 1962 when Lamshed & Co set the matter down for trial. In the interim, land values increased, and Alfred purported to sell the property on 11 January 1962 to the Hallos. When the Hallos placed a caveat upon the title, members of Lamshed & Co were motivated to pursue their equity for relief.

Decision

The High Court, McTiernan J dissenting, held that laches was established. Lamshed & Co was disentitled to the remedy of specific performance.

Kitto J

The bare fact of delay is not enough. Where there is nothing at all in the circumstances to justify either a conclusion that the delay has been to the prejudice of the defendant or of any third party, or a conclusion that the plaintiff ought to be regarded as having abandoned any rights he ever had, specific performance is not ordinarily refused: *Fitzgerald v Masters* (1956) 95 CLR, at p 433. ...

Plainly it would have been inequitable for the respondents in the present case, if they wanted specific performance, to lie by until 26th March 1962, continuing to assert the existence of a contract but taking no proceedings and leaving the appellant in the position of not knowing whether any money he might spend on the property would benefit him or the respondents, or whether he was free to sell the property to a third party, or whether his estate, if he should die, would include the property or the purchase money for which the respondents said that he had agreed to sell it. With this view [the trial judge] agreed. But his Honour considered that the reasoning had no application to the circumstances of a case in which the parties who were alleging the existence of a contract had commenced an action for specific performance with reasonable promptitude and had carried it without undue delay to a point at which the other party might either have applied for it to be dismissed for want of prosecution or have set it down for trial himself. In such a case, his Honour thought, the plaintiff's delay in setting the action down is no bar to their ultimate success, where they have had a sufficient reason for not proceeding and the defendant is not shown to be likely to suffer prejudice as a result of the delay. In the present case he thought that those conditions were fulfilled.

With respect, I do not think that this view is sound. The fact that the appellant might either have got rid of the action without a trial or have forced it to trial is a circumstance to be considered, no doubt, but the conclusion does not necessarily follow that during the four years and eight months in question the appellant was not prejudiced by reason of uncertainty as to whether or not he would be required to perform the contract which the respondents said he had made. He was faced with the most emphatic form of assertion that the contract existed. Yet he found that for some reasons not disclosed to him his opponents seemed unwilling to proceed to a hearing. He might let a sleeping dog lie or take the risk of waking it. There were advantages and disadvantages in either course. The respondents had shown no intention of abandoning the rights they asserted, but their apparent lack of enthusiasm for a trial might well have encouraged him to hope, and as time went on even to believe, that they lacked faith in their cause and would let it die in the manner least likely to cause loss of face. To let this happen was certainly for him the cheapest and easiest course. True, relevant evidence might be lost as time went on; the memories of witnesses might become impaired; and if the appellant honestly thought he was in the right these possibilities would seem to him important. Moreover he had constantly to face serious uncertainty as to how he stood in regard to ownership of the property, and what difficulties he might cause for himself if he were to make improvements, enter into share-farming agreements or the like, or contract to sell the property. But, while by taking the offensive he might put an end to the uncertainty, he might lose the case. Perhaps better to let the litigation die of inanition. Such was the quandary in which the appellant was placed by the respondents' inaction. The decision under appeal means that there is nothing inequitable in a plaintiff's leaving a defendant in such a state of uncertainty for months and years, and then, when it pleases him, asking the court to decide the issue he has allowed to become stale and grant the remedy of specific performance.

But it means even more than that. The respondents did not seek any injunction against sale of the property, and did not even take the simple step of entering a caveat. Ultimately, in 1962, the appellant, having waited for more than four years, sold the land to the Hallos. The case is therefore not one of bare delay; it is not even one in which all that can be said against the granting of relief is that the plaintiff's delay has unfairly placed the appellant in a position of uncertainty over a substantial period; it is a case in which a defendant, not precipitately but at length, in circumstances which made it not altogether unreasonable to do so, has prejudiced his position; and it is a case in which third parties, not shown to be in any way at fault and not being warned by any caveat on the title, have acquired interests which will be defeated if a decree for specific performance should now be made. It seems to me a clear case for refusing relief on the ground of delay unless the law be that delay after action brought cannot afford a defence to a suit for specific performance. ...

The conclusion to which I have come, therefore, is that by the time the respondents set the action down for trial they had lost their right to specific performance and accordingly that remedy should have been refused.

Note

Laches may arise via a lack of urgency in commencing proceedings. However, as shown by *Lamshed,* the plaintiff's delay in prosecuting a commenced action may similarly support laches.

Question

In *Lamshed*, what was the prejudice to the defendant vendor caused by the delay?

Background

In 1968, Stone acquired a leasehold interest in land known as 'Cockatoo' for $156,000. Orr contributed $30,000 to the purchase price on the basis that Stone would hold one half of the land on trust for him. Stone was elderly and suffering from mental deterioration to the extent that by 1982 a protection order had been made in favour of the Public Trustee of Queensland. With the deterioration of his mental faculties, Stone came to regard the land as his. Stone granted a sublease of it to his manager and by a will made in 1978 he purported to devise 'Cockatoo' to his manager and his housekeeper. Orr had no knowledge of this will. Stone died in October 1982 and probate was granted in November 1985. Although Orr had visited Stone at frequent intervals, Orr had done nothing in his dealings with Stone to assert his rights to the land. Once the declaration in favour of the Public Trustee was made, Orr via his solicitors wrote to the Public Trustee asserting a resulting trust founded on his contribution to the purchase price. After the grant of probate, Orr commenced proceedings asserting his rights in the land. Stone's executors pleaded laches, arguing that the estate would suffer prejudice in defending the claim by reason that evidence, which might earlier have been available, was lost.

Decision

The High Court, Mason CJ and Deane J dissenting, held that laches could not be established, as no crucial evidence had been lost, and there was no prejudice to other parties.

Wilson, Toohey and Gaudron JJ

The question of prejudice resulting from unavailability of evidence necessarily involves some degree of speculation, but it is not a question of pure speculation. The issue is not whether evidence may have been lost but whether evidence which may have cast a different complexion on the matter has been lost.

Deane J (dissenting)

The ultimate test effectively remains that enunciated by Lord Selborne LC … in *Lindsay Petroleum Co v Hurd* … whether the plaintiff has, by his inaction and standing by, placed the defendant or a third party in a situation in which it would be inequitable and unreasonable 'to place him if the remedy were afterwards to be asserted'.

Whether, at the end of the day, the defence of laches should prevail in the present case 'is necessarily a matter of degree and must depend on the circumstances of the given case' … As has been seen, those circumstances include: the nature of the claim as a claim to the fruits of what was (to the extent it exceeded a proportionate share) in substance an alleged gift made by Dr Stone; the long period of standing by in the face of an unequivocal and undisputed assertion by Dr Stone, who was by then an old man, that he remained sole owner of the leasehold selection; the deliberate and calculated character of the standing by until Dr Stone was dead; and, the grave unfairness and injustice of the consequences if Mr Orr is permitted to enforce his claim at this late stage. On balance, and notwithstanding any hardship to Mr Orr, the circumstances of the case compel the conclusion that Mr Orr's conduct in standing by for some eight years constituted 'gross laches' which precludes the grant of the equitable relief which he seeks. That does not, however, mean that the order of the learned trial judge that the action should be dismissed should be allowed to stand. As has been said, it is conceded that the effect of the conclusion that the Act did not preclude or render unenforceable any trust of a share of 'Cockatoo' is that Mr Orr was beneficially entitled to a 30/156 share of 'Cockatoo' and it has not been argued that laches precludes the grant of declaratory relief in relation to that beneficial interest.

Notes

(1) Laches was argued only in relation to Orr's claim to a 50 per cent share of the property under an express trust. It was conceded by Stone's executors that, if their other arguments (not extracted) that the trust was illegal or unenforceable by ss 91 and 296 of the *Land*

Act 1962 (Qld) failed, Orr was beneficially entitled to 30/156 of 'Cockatoo' under a resulting trust arising from his payment of $30,000 towards the original purchase. Thus, in Deane J's judgment, the reference to the '30/156 share' is to Orr's (lesser) resulting trust interest.

(2) The disadvantage or prejudice establishing laches may often be financial, but any kind of disadvantage or prejudice will qualify. The point in time from which delay and its impact are assessed is when the plaintiff came to know of the facts giving rise to their equity.

(3) The court considers the reasons for the plaintiff's delay. Thus, the court may consider both the plaintiff's state of mind and whether it was reasonable in all of the circumstances to delay either bringing or prosecuting proceedings.

(4) Unlike Chancery, common law courts historically had no means of controlling relief in circumstances of delay. It was not until the passing of limitations statutes that common law actions required alacrity. However, limitation statutes may within their own terms apply to equitable claims. Whether or not they do so will be a question of construction. In *Williams v Central Bank of Nigeria* [2014] AC 1189, the victim of a banking fraud alleged the defendant bank had knowingly received funds in breach of trust, or knowingly assisted in the breach, so as to give rise to an obligation to account to the defendant as a constructive trustee (see chapter 11). Section 21 of the *Limitation Act 1980* (UK) provided that no limitation period should apply to a trust beneficiary for an action in respect of any fraudulent breach of trust which was an exception to the six-year limitation period that would otherwise apply. Section 38(1) defined 'trust' and 'trustee' as having the same meanings as in the *Trustee Act 1925* (UK). Section 68(17) of the *Trustee Act 1925* provided that these definitions included implied or constructive trusts. Did this definition of trustee include a '[51] … stranger to a trust who is a knowing recipient or a dishonest assister – i.e. a person, not otherwise the trustee, who is liable to account on the grounds of knowing receipt of trust assets and/or on the grounds of dishonest assistance in a breach of trust'? Lord Sumption and Lord Neuberger (Lord Hughes concurring) held that the claim *was* time barred – see [90] (Lord Neuberger): 'Accordingly, I conclude that a "trustee" in section 21(1)(a) does not include a party who is liable to account in equity simply because he was a dishonest assister and/or a knowing recipient. This is because such a party, while liable to account in the same way as a trustee, is not, according to the law laid down by the courts, a trustee, not even a constructive trustee; and "trust" and "trustee" in the 1925 Act were meant to have orthodox meanings'.

(5) Equity also acts by analogy in applying limitations statutes to claims occurring both in its exclusive and auxiliary jurisdictions. Various limitations statutes specifically recognise the phenomenon of acting by analogy: *Limitation Act 1969* (NSW) s 23; *Limitation of Actions Act 1958* (Vic) s 5(8); *Limitation of Actions Act 1974* (Qld) s 10(6)(b). The relationship between laches and equity applying limitations acts by analogy was explored in *Gerace v Auzhair Supplies Pty Ltd (in liq)* (2014) 87 NSWLR 435. Auzhair brought proceedings against three of its directors for breach of equitable duties in transferring assets of the business. This conduct also constituted a breach of directors' duties under *Corporations Act 2001* (Cth) ss 181–3. The proceedings in equity were brought more than six years after the breaches of duty. The appellants (directors) asserted that since the equitable duties were essentially the same as the statutory duties, the statutory limitation period under the *Corporations Act* applied by analogy to bar the proceedings. In his judgment, Meagher JA said:

> [70] … in purely equitable proceedings, where there is a corresponding remedy at law in respect of the same matter and that remedy is the subject of a statutory bar, equity will apply the bar by analogy unless there exists a ground which justifies its not doing so because reliance by the defendant on the statute would in the circumstances be unconscionable. They do not support the proposition that equity retains any broader discretion whether to apply the bar. The description of such a ground, or the conduct giving rise to or constituting it, as unconscionable or unconscientious leaves to be identified the principles according to which equity justifies that conclusion: *Australian Broadcasting Corporation v Lenah Game Meats Pty Ltd* [2001] HCA 63; 208 CLR 199 at [45] (Gleeson CJ) and *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* [2003] HCA 18; 214 CLR 51 at [41]–[42] (Gummow and Hayne JJ).
> [71] In applying the statute by analogy, equity gives effect to the maxim that it follows the law and acts on the basis that 'laches is presumable in cases where it is positively declared at law' … In doing so, it must be taken also to be giving effect to the legislature's judgment in fixing the relevant limitation period and in allowing for any exceptions to its application. …
> [72] The distinction, referred to by Isaacs J in *McNeil,* between equity applying its own doctrine of laches and adopting, in analogous cases, the measure of time fixed by statute unless there is a 'greater equity', is one of substance. The circumstances in which such an equity arises include where fraudulent conduct of the defendant has denied the plaintiff the opportunity to sue within the statutory period. That equity is satisfied by preventing the defendant from taking advantage of the plaintiff's omission to do so.
> [73] The doctrine of laches is directed to a broader and different question. That question is whether, as between the parties, it would be practically unjust to give relief which otherwise would be just. In answering that question, account is taken of the length of any delay, the nature of acts done during the period of that delay, whether the plaintiff had sufficient knowledge to justify the commencement of proceedings, whether there has been prejudice to the defendant or others and the nature of the relief claimed: see *Lindsay Petroleum* … That doctrine does not focus on circumstances that would justify not permitting the statute to be relied on because there has been fraud or mistake or misrepresentation or other conduct or circumstances against the consequences of which equity relieves.

[74] If equity retains a residual discretion not to apply a limitation statute by analogy in circumstances where there would not be a defence of laches, it would not truly be acting by analogy and following the law. Equity would only apply the relevant statute where there had been mere delay during the limitation period. In all other cases it would be necessary to undertake the exercise described by Lord Selborne in *Lindsay Petroleum*. Doing so would leave little scope or need for the operation of the doctrine of fraudulent concealment in this context because … the statute would not be applied if the plaintiff was ignorant of his rights. The argument that equity does not apply limitation statutes by analogy to claims brought in its exclusive jurisdiction was rejected by the English Court of Appeal in *Cia de Seguros Imperio v Heath (REBX) Ltd* [1999] 1 All ER (Comm) 750 at 121, 122 relying, in part, on the judgment of Millett LJ in *Paragon Finance PLC*.
[75] The grounds on which equity declines to permit a defendant to rely upon a statutory bar by analogy include where there has been fraudulent concealment, which requires either fraudulent conduct as an element of the right of action or conduct consisting of active concealment of a right of action that does not include fraud as an element: *Meagher Gummow & Lehane's Equity Doctrines and Remedies* at [34-085]. The more recent cases which discuss this doctrine do so when applying the modern statutory equivalents of s 26 of the *Real Property Limitation Act* 1833 (UK). The references to 'fraud', 'concealment' and 'fraudulent concealment' in those statutes have been understood in the same sense as they are in the equitable doctrine on which those provisions were based. The equitable doctrine is not confined to common law fraud or deceit and requires a consciousness on the part of the defendant that what is being done is wrong or that to take advantage of a particular situation involves wrongdoing …

Question

Why was prejudice not established in *Orr v Ford*?

6.3 Acquiescence

Acquiescence centres on the plaintiff's acceptance of the state of affairs or the conduct of which she later complains. Equity declines to intervene or limits intervention since, the plaintiff having by her words or conduct expressly or impliedly indicated that she is content with the state of affairs, it would be unconscionable now to require the defendant to make amends.

6.3a *Orr v Ford* [1989] HCA 4; (1989) 167 CLR 316

Background

See above at [6.2c].

Decision

Deane J

[A]cquiescence is used … to refer to conduct by a person, with knowledge of the acts of another person, which encourages that other person reasonably to believe that his acts are accepted (if past) or not opposed (if contemporaneous) …

Notes

(1) Although in an evidentiary sense, delay is relevant to both laches and acquiescence, the two doctrines are separate. In laches, the delay must cause prejudice whereas in acquiescence the delay may be evidence of some kind of agreement or acceptance of the other's conduct. However, other facts may also establish acquiescence.

(2) In order for the plaintiff to accept and acquiesce in the defendant's wrong, she must have full knowledge of her rights, and the facts on which they are based. See *Gafford v Graham* [1998] EWCA Civ 666.

(3) The condition of full knowledge of the consenting party as a foundation for acquiescence is emphasised in *Byrnes v Kendle* [2011] HCA 26; (2011) 243 CLR 253 (extracted at [14.2a]), [79] (Gummow and Hayne JJ) who said that acquiescence 'is best understood as requiring calculated (that is, deliberate and informed) inaction by [the plaintiff] or standing by, which encouraged [the defendant] reasonably to believe that [the defendant's] omissions were accepted or not opposed by [the plaintiff].' See also [25], [30] (French CJ) and [136] (Heydon and Crennan JJ).

Question

Can acquiescence be shown not merely by the plaintiff's words, but also by her conduct, which leads the defendant reasonably to believe that his acts are accepted or not opposed?

6.4 Unclean hands

6.4a *Black Uhlans Inc v New South Wales Crime Commission* [2002] NSWSC 1060; (2002) 12 BPR 22,421

Background

The Black Uhlans motorcycle club leased premises as its clubhouse. In 1991, a club member (Wilson) purchased these premises, *in part* funding the purchase via a loan from Citibank as mortgagee. It was subsequently proven that the club, via its members, had also provided funds to Wilson towards the purchase price.

Wilson was later convicted of various criminal offences and his assets were forfeited to the Crown under confiscation of proceeds of crime legislation. That forfeiture order resulted in his interest in the club premises becoming vested in the NSW Public Trustee. The club contended that a proportionate share of the property was held by the Public Trustee on trust for it (ie the club) under a resulting trust, and hence that that share of the *beneficial ownership* of property was *not* forfeited to the Crown. In support of this argument, the club alleged it had supplied part of the purchase moneys to the club member. Campbell J held that the resulting trust in favour of the club was established.

Against this proposition, it was argued that the club could not assert a resulting trust since the club did not come before the Court with 'clean hands'. Relevantly, Wilson had made false statements on his loan application to Citibank. The Crown argued that the club had been privy to this deception and therefore that the club had unclean hands such as should deprive it equitable relief.

Decision

Campbell J held that the misleading of Citibank/the mortgagee did not relate to the contribution of funds by the plaintiff club to the purchase price and thus did not impeach the club's equity. The Court held that the interest of the club member Wilson in the property was from the time of purchase held on trust for the club, in proportion to the funds contributed by the club towards the purchase price.

Campbell J

That someone who comes to equity must have clean hands is an equitable maxim. Such a maxim provides an explanation for the circumstances in which equity recognises rights, and confers remedies, across a broad range of equity's jurisdiction. … [T]he maxim

remains of ongoing importance, as a guide to how cases not governed by specific rules of substantive law ought be decided, or as a guide to how specific rules of substantive law ought be extrapolated.

The unclean hands maxim requires the Court to look at the conduct of the litigant who seeks the assistance of equity, rather than the conduct of the defendant. Further, it is conduct which the litigant who seeks the assistance of equity has engaged in in the past which is required to be looked at. In this way it differs from the maxim that he who seeks equity must do equity, which looks at the conduct which a litigant who seeks the assistance of equity undertakes to engage in in the future.

Some examples of the circumstances in which the maxim has been the basis on which a case has been decided illustrate the breadth of application of the maxim. Thus, specific performance of a contract will not be granted at the suit of a plaintiff who has made a relevant misrepresentation to the defendant: *Cadman v Horner* (1810) 18 Ves Jun 10; 34 ER 221; *Wall v Stubbs* (1815) 1 Madd 80; 56 ER 31. Unclean hands can be a ground for refusing relief against forfeiture of a lease: *Litvinoff v Kent* (1918) TLR 298; *Gill v Lewis* [1956] 2 QB 1; [1956] 1 All ER 844. It can be a ground on which a court declines to enforce a trust: *Gascoigne v Gascoigne* [1918] 1 KB 223; *Re Emery's Investment Trusts; Emery v Emery* [1959] Ch 410; [1959] 1 All ER 577; *Tinker v Tinker* [1970] 1 All ER 540; [1970] P 136. It can be a basis upon which the beneficiary of a trust, who has led the trustee to commit a breach of trust, can be denied a remedy for that breach: *Cory v Gertcken* (1816) 2 Madd 40; 56 ER 250. It can provide a ground for refusing an injunction to enforce a negative contractual stipulation, if that contract has been procured by a misrepresentation of the plaintiff: *Hewson v Sydney Stock Exchange Ltd* [1968] 2 NSWR 224. It can provide a basis for refusing an injunction to enforce a restrictive covenant, if a person entitled to the benefit of the covenant has represented it will not be enforced, and that representation is acted upon by the person bound by the covenant: *Greater Sydney Development Association Ltd v Rivett* (1929) 29 SR (NSW) 356, at 360–361. Where the plaintiff and the defendant are both bound by restrictive covenants arising under a common building scheme, and the plaintiff is in serious breach of the covenant, unclean hands provides a basis on which the plaintiff cannot obtain an injunction to require the defendant to observe the restrictive covenant: *Goddard v Midland Railway Company* (1891) 8 TLR 126. It can provide a basis for refusing an injunction to prevent passing off, where the reputation which the plaintiff seeks to have protected has itself been built up by deceptive means: *Kettles and Gas Appliances Ltd v Anthony Hordern & Sons Ltd* (1934) 35 SR (NSW) 108. It can provide a basis for refusing equitable relief to prevent a breach of copyright where the work contained false statements calculated to deceive the public: *Slingsby v Bradford Patent Truck and Trolley Co* [1905] WN 122; [1906] WN 51. Further, some cases have held that it can provide a basis for refusing equitable relief in circumstances where a plaintiff has engaged in, or advocated, immorality of some kind: *Bodly v* – (1679) 2 Chan Cas 15; 22 ER 824; *Glyn v Weston Feature Film Company* [1916] 1 Ch 261 …

However, the operation of the maxim is not triggered by any act of wrongful conduct by a defendant, regardless of its nature or connection to the subject matter of the suit. …

Similarly, Brandeis J has referred to there being a limitation on the types of bad conduct which trigger the operation of the maxim by saying: 'Equity does not demand that its suitors shall have led blameless lives': *Loughrin v Loughrin* 292 US 216 (1934) at 229. Young J has expressed the limitations on the operation of the maxim by saying:' … unless there is established one of the equitable defences, then general naughtiness or the desire of the court to censor the plaintiff's conduct, does not enter into the equation when one is considering whether the plaintiff should get relief': *FAI Insurances Ltd v Pioneer Concrete Services Ltd* (1987) 15 NSWLR 552, 554.

A test for the circumstances in which the maxim operates was provided in *Dering v Earl of Winchelsea* (1787) 1 Cox 318; 29 ER 1184. That case arose from the appointment of a Mr Dering as a collector of customs duties. In connection with the appointment, bonds for his proper performance were given to the Crown by his elder brother (Sir Edward Dering) and two others. When Mr Dering fell into arrears in making payments to the Crown, the Crown sued Sir Edward Dering on his bond, and recovered the full amount of the arrears. In this action, Sir Edward Dering sought contribution from the other two sureties. Those sureties resisted the action on the ground that Sir Edward Dering had unclean hands. This argument was dealt with by Lord Chief Baron Eyre at 319–320 Cox; ER 1184–85 as follows:

> The misconduct imputed to Sir Edward is that he encourages his brother in gaming and other irregularities; that he knew his brother had no fortune of his own, and must necessarily be making use of the public money, and that Sir Edward was privy to his brother's breaking the orders of the Lords of the Treasury, to keep the money in a particular box, and in a particular manner, etc this may all be true, and such a representation of Sir Edward's conduct certainly places him in a bad point of view; and perhaps it is not a very decorous proceeding in Sir Edward to come into this Court under these circumstances: he might possibly have involved his brother in some measure, but yet it is not made out to the satisfaction of the Court, that these facts will constitute a defence. It is argued that the author of the loss shall not have the benefit of a contribution; but no cases have been cited to this point, nor any principle which applies to this case. It is not laying down any principle to say that his ill conduct disables him from having any relief in this court. If this can be founded on any principle, it must be, that a man must

> come into a Court of Equity with clean hands; but when this is said, it does not mean a general depravity; it must have an immediate and necessary relation to the equity sued for; it must be a depravity in a legal as well as in a moral sense. In a moral sense, the companion, and perhaps the conductor, of Mr Dering, may be said to be the author of the loss, but to legal purposes, Mr Dering himself is the author of it, and if the evil example of Sir Edward led him on, this is not what the Court can take cognisance of.

What is meant by the expression 'an immediate and necessary relation to the equity sued for' is best explained by reference, first, to cases where an allegation of unclean hands was made, but did not result in the plaintiff failing to be granted relief. …

Argyle v Argyle [1967] 1 Ch 302 involved an application by the Duchess to restrain her former husband, the Duke, from publishing newspaper articles which revealed various confidential communications which had passed between them while the marriage was on foot. The Duke claimed that she was disentitled to an injunction because she herself had published newspaper articles which revealed some other confidential information which had passed between them, and because her conduct (which the judge hearing their divorce case had described as 'wholly immoral') showed that she had no regard for the sanctity of marriage. Those submissions failed. The disclosures which the plaintiff had made in her article included that the Duke had been taking drugs called 'purple hearts', and that he had had certain financial embarrassments. Ungoed-Thomas J said, at 329–330:

> … none of the matters complained of in the plaintiff's articles disclosed anything complained of in the Duke's articles. The Duke does not say that he can disclose matters because the plaintiff has already disclosed those same matters; but what he says is that the plaintiff has betrayed the marriage relationship in some ways and so he should be free to betray it in others. … but even after allowing for the disclosure about the purple hearts the accumulation of the Duke's breaches of most intimate confidences in his articles are, to my mind, of an altogether different order of perfidy. … A person coming to Equity for relief – and this is equitable relief which the plaintiff seeks – must come with clean hands; but the cleanliness required is to be judged in relation to the relief that is sought. First, with regard to the plaintiff's articles, for the reason is already indicated I do not consider that the plaintiff's own articles justify the objectionable passages in the Duke's articles, or, of themselves, should disentitle the plaintiff to the court's protection.

Notwithstanding that Ungoed-Thomas J accepted that the plaintiff's immorality was the basis for the divorce and the termination of the marriage, he held, at 332–333 that confidentiality still attached to communications which had initially been made in circumstances of confidence. …

With these cases are to be contrasted cases where the plaintiff's unclean hands have resulted in relief being denied. That an injunction to restrain passing off is refused when the public has been misled by the conduct of the plaintiff *(Kettles and Gas Appliances Ltd v Anthony Hordern & Sons Ltd* (1934) 35 SR (NSW) 108), shows that the statements in Francis' *Maxims* … and *Jones v Lenthal*… to the effect that it is only iniquity practiced on the defendant which matters, is too narrow. (That unclean hands can exist when a plaintiff misleads the Court (*Armstrong v Sheppard & Short Ltd* [1959] 2 QB 384 at 397) would also show that the statements in Francis' *Maxims* and *Jones v Lenthal* were too narrow.) However, *Kettles* still illustrates the principle that unclean hands is a reason for denying equitable relief only when it has an immediate relation to the equity sued for – an injunction to restrain passing off requires that the plaintiff prove that it has a reputation with the public, and seeks to protect that reputation, so if the plaintiff's reputation has been built up through its own deception the granting of an injunction would enable the plaintiff to benefit from its own wrongful conduct.

Gascoigne v Gascoigne [1918] 1 KB 223 was a case where a husband put a lease of land in his wife's name and built a house upon the land with his own money. He used his wife's name in the transaction, with her knowledge and connivance, for the purpose of misleading, defeating and delaying present or future creditors. After the parties separated, the husband sought a declaration that the wife was trustee for him of the property. He succeeded at first instance, but on appeal he failed. The Divisional Court (Lawrence and Lush JJ) said, at 226:

> … What the learned judge has done is this: he has permitted the plaintiff to rebut the presumption [of advancement] which the law raises by setting up his own illegality and fraud, and to obtain relief in equity because he has succeeded in proving it. The plaintiff cannot do this; and, whether the point was taken or not in the County Court this court cannot allow a judgment to stand which has given relief under such circumstances as that.

Gascoigne was a case where it was necessary for the plaintiff to prove his own bad conduct to rebut the presumption of advancement and thus to establish the trust he sued to enforce. … If a plaintiff needs to prove his own bad conduct to be able to prove the circumstances which he says entitles him to an equitable remedy, that bad conduct has an immediate and necessary relation to the equity sued for. …

The two tests emerging from the portion quoted … above, from *Dering v Earl of Winchelsea* ('immediate and necessary relation to the equity sued for' and 'a depravity in a legal as well as in a moral sense') do not provide a complete guide to the circumstances in which the 'unclean hands' maxim will be applied to deprive the litigant with the unclean hands of a remedy. Those two tests are a necessary condition for the application of the 'unclean hands' maxim, but not a sufficient condition. Equitable relief is always discretionary, and other factors can influence the exercise of the discretion. For example, a restrictive covenant arising under a common building scheme, which binds both plaintiff and defendant, might be enforced at the suit of the plaintiff even if the plaintiff has committed some slight breaches of the covenant: *Goddard v Midland Railway Company* (1891) 8 TLR 126. …

Further, the weight which is accorded to bad conduct on the part of the plaintiff can differ depending upon the relief which is sought, and the alternatives for relief which the plaintiff has open to him. In *Vigers v Pike* (1842) 8 Clark & Finnelly 562; 8 ER 220, Lord Cottenham (at 645 of C & F, 251–252 of ER) noted that there is a:

> … marked distinction made by the Court of Equity between what is necessary to resist a suit for the specific performance of a contract, and what is necessary to support a suit to set aside a deed executed and an arrangement completed, and consequently to resist a suit founded upon such deed and growing out of such arrangement. When the Court simply refuses to enforce the specific performance of the contract it leaves the party to his remedy at Law; but if it were to refuse to administer equities founded upon a deed executed, it would leave the party applying without remedy, and his opponent in possession of that for which what was sought to be obtained was reserved as an equivalent.

If refusal of relief might occasion injustice to people who are not parties, the court might decide to grant relief notwithstanding bad conduct on the part of the plaintiff, if the transaction is objectionable on the grounds of public policy, 'the relief not being given for their sake but for the sake of the public.'

Notes

(1) There must be a nexus between the unclean hands and the particular dispute between the parties. See *Black Uhlans* (Campbell JA) [163] (referring to *FAI Insurances Ltd v Pioneer Concrete Services Ltd* (1987) 15 NSWLR 552, 554 (Young JA)): 'unless there is established one of the equitable defences, then general naughtiness or the desire of the court to censor the plaintiff's conduct, does not enter into the equation when one is considering whether the plaintiff should get relief'.

(2) Unclean hands may not act as a permanent bar to relief. If the plaintiff's misconduct has ceased sufficiently prior to proceedings, a court may overlook the conduct. See *Cadwaller v Bajco Pty Ltd* [2002] NSWCA 328, [180] (Heydon JA with whom Santow JA and Gzell J agreed): 'the Court declines to take the view that because the plaintiff's hands were once dirty they can never be washed: *Kettles & Gas Appliances Ltd v Anthony Hordern & Sons Ltd* (1934) 35 SR (NSW) 108, 129. That is, unclean hands can cease to be material if the conduct constituting them has ceased. It must equally be the case that unclean hands are immaterial even if, though there was once an intention to engage in conduct which would amount to unclean hands, that conduct was never carried out'.

(3) In exercising its discretion, the court also considers the consequences of refusing relief. This will include injustices which may thereby be caused to a third party, and public interest concerns. For example, an order for delivery up and the destruction of documents may be granted despite unclean hands to avoid the risk that others would be misled by those documents *(Money v Money (No 2)* [1966] 1 NSWR 348). Compare *Kettles & Gas Appliances Ltd v Anthony Hordern & Sons Ltd* (1934) 35 SR (NSW) 108, referred to above.

Question

Might the reasoning of the court and the result in *Black Uhlans* have been different if the club's entitlement had rest on Citibank's role in the purchase of the clubhouse? Why/why not?

6.5 Hardship

Equity may deny relief where the remedy itself would cause such hardship to the defendant such that it would be unjust and unreasonable to grant relief. In some instances, this discretion extends to the situation where hardship is caused to third parties.

Background

In 1979, Mr and Mrs Ali and Mr and Mrs Ahmed were living in a house jointly registered in the names of the defendants, Mr Ahmed and Mrs Ali. On 31 July 1979, a contract was entered into between both defendants as vendors and the plaintiffs, Mr and Mrs Patel, as purchasers. The contractual completion date was 28 August 1979. Settlement was delayed by factors beyond the control of the vendors and purchasers. The writ in these proceedings was issued on 11 August 1980, but the application for summary judgment was not until 4 July 1983 and the plaintiffs obtained an order from Master Barratt in September 1983 that the contract be specifically performed and carried into execution.

In the intervening period, Mrs Ali was diagnosed with bone cancer and her right leg was amputated at the hip, while she was pregnant with her second child born in August 1980. A third child was born in August 1983. Mrs Ali was greatly dependent on the assistance of friends and relatives to maintain the house and look after the children, and moving house would have greatly diminished the assistance her friends and relatives could provide. The defendant asked the Court to refuse specific performance and to leave the plaintiffs to their remedy in damages, which sympathetic persons in Mrs Ali's community were willing to help her pay.

Decision

Goulding J refused to order specific performance by reason of the hardship that the granting of the order would cause the defendant. His Honour directed an inquiry as to the damage suffered by reason of the breach of contract by Mr Ahmed and the defendant. Subject to that amount being paid into court, Master Barratt's order was discharged.

Goulding J

That the hardship to the defendant of enforced removal from the property would be great is, on the evidence, beyond doubt. Any accommodation which the local authority could immediately provide for the defendant is likely to deprive her of the daily assistance on which she relies, or at least greatly to diminish it. The move would necessarily cause much more severe disturbance to the lives of the children, now aged five years, three years and four or five months, than a family removal does in ordinary cases, and might even make it impossible for the defendant to keep them with her, handicapped as she is by her physical disability.

The hardship which would be caused to the plaintiffs if specific performance were refused and adequate pecuniary compensation were available is not, so far as the evidence reveals, greater than what is necessarily involved in being disappointed of the purchase after so long a delay. Since the contractual date for completion in 1979 the plaintiffs have lived in accommodation rented from their local authority, Brent London Borough Council. …

I am satisfied that the court's discretion is wide enough, in an otherwise proper case, to refuse specific performance on the ground of hardship subsequent to the contract and not caused by the plaintiff. …

In the end, I am satisfied that it is within the court's discretion to accede to the defendant's prayer if satisfied that it is just to do so. And, on the whole, looking at the position of both sides after the long unpredictable delay for which neither seeks to make the other responsible, I am of opinion that it *is* just to leave the plaintiffs to their remedy in damages if that can indeed be effective.

I have come to this conclusion without taking into account the welfare of the defendant's children except as involved in her own personal hardship. I much doubt whether, even in the present atmosphere of opinion on which Mr Briggs dwelt in his address, the interests of the children are material in their own right, though he did derive some support from the obiter observations of Isaacs J in the High Court of Australia in *Gall v Mitchell* (1924) 35 CLR 222, 230:

> Hardships of third persons entirely unconnected with the property are immaterial. But I do not think that rule excludes the case of third persons so connected with the defendant that, by reason of some legal or moral duty which he owes them, it would be 'highly unreasonable' for the court actively to prevent the defendant from discharging his duty. The circumstances of such a case might, in my opinion, be properly weighed for the purpose of determining the discretion of the court.

Notes

(1) Note that any hardship falling on the defendant is balanced in the Court's reasoning against the hardship which the plaintiff would suffer from the refusal of that remedy.

(2) Hardship has particular resonance in applications for specific performance and injunctive relief. The hardship in question is that caused by awarding the equitable remedy sought as opposed to common law damages. Thus, where a plea of hardship succeeds, it will be open to the party whose legal rights have been affected to claim damages at law.

(3) Hardship may include both financial and non-financial hardship.

Question

If a court elects to exercise its discretion to deny the equitable remedy sought on the ground of hardship, what might be the overall remedial outcome? Consider *Patel v Ali*, in which an order for specific performance of the contract for the sale of land was discharged on the grounds of hardship. What remedy was in the end obtained by the plaintiff? Was the plaintiff denied a remedy altogether?

6.5b *ANZ Executors and Trustees Ltd v Humes Ltd* [1990] VR 615

Background

The Smorgon family had won a takeover battle for control of Humes Ltd. By 1988, Smorgon held all 223 million issued shares in Humes. Shares in Humes were therefore not freely available in the market. However, as part of its earlier dealings with ANZ Bank, Humes had issued a large number of convertible notes. Convertible notes are debt instruments which acknowledge indebtedness between the issuer of the note (Humes) and the noteholder. Once issued, convertible notes may be traded in the market. By the terms of the Humes convertible notes, noteholders were entitled to convert the notes into ordinary shares in Humes at any time between 1 November 1988 and 30 June 1994. Humes did not have the right to repay the notes until after 30 June 1994. The presence of the convertible notes thus presented a risk for Smorgon which wished, for tax reasons, to retain control of Humes. Two noteholders, Elontat and PS Enterprises, sought conversion of their notes into shares. Humes resisted and the noteholders sought specific performance of their notes. The Humes and Smorgon interests alleged that they would suffer hardship if specific performance was granted and the notes converted.

Decision

Brooking J rejected the hardship plea and ordered that the contracts should be specifically performed.

Brooking J

The defendant must show that hardship amounting to an injustice would be inflicted on him by holding him to his bargain and that it would not be reasonable to do so: *Suttor v Gundowda Pty Ltd* (1950) 81 CLR 418, at p 439. …

I should say that Mr Myers relies on hardship not only to Humes but also to its shareholders. Mr Archibald submits that any hardship that may be suffered by the shareholders is irrelevant. No authorities were cited but I have looked at quite a number of decisions that bear on this question.

I am not going to decide the point. For I am going to assume, in favour of Humes, that I may have regard to hardship that will be suffered by the shareholders. …

It should have been obvious to Humes and the Smorgon interests, at the time the trust deed was executed, that in the event that the Smorgon interests or any other party made a successful takeover bid for Humes, the Smorgon group or other party would not have available to it any power of compulsory acquisition in relation to the Humes convertible notes. …

A takeover offer for Humes by the Smorgon interests or some other party was or ought reasonably to have been always in contemplation as a possibility and the difficulty that is said to afford a reason for refusing specific performance should also reasonably have been in contemplation. A company like Humes, and a group like the Smorgon group, must be aware, or should be aware, of the problems that minority shareholdings can create, including the particular problem of the transfer of losses for tax purposes. … Really it should have been obvious to the presumably experienced and astute men at Smorgons and Humes that a huge number of convertible notes was being created and that there was no power of compulsory acquisition in the event of a takeover of Humes, so that minority interests might well exist, with all that this entails, including … [loss of the taxation advantage]. This does not remove the hardship from consideration, but it does considerably affect the weight to be given to it.

Hardship set up by a defendant to a claim for specific performance must be balanced against any hardship which the plaintiff would suffer from the refusal of that remedy: *Tamplin v James* (1880) 15 Ch D 215, at 221, per James LJ; *Eastes v Russ* [1914] 1 Ch 468, at 480, per Swinfen Eady LJ; *Keats v Wallis* [1953] NZLR 563, at 566 and *Nicholas v Ingram* [1958] NZLR 972, at 974. In all the circumstances of this case I am not satisfied that the hardship that will be caused to Humes and the Smorgon interests by enforcing the contract specifically should in all the circumstances, including the detriment that the plaintiff will suffer if it is confined to its remedy in damages, lead to a refusal of specific relief. … I think it is legitimate to put one's self in the position of the plaintiff and consider what view it might reasonably form – and I emphasise 'reasonably' – with regard to its own interests. If I were the plaintiff, I should regard myself as much disadvantaged if I were forced to take in substitution for the shares a claim for damages which presents very great difficulties so far as assessment is concerned and in relation to which I would carry the burden of proof. I should much prefer to get what the contract says I am to get – the 1000 shares – and then be able to bargain with the Smorgon interests for the sale of those shares and the sale of the convertible notes. I would then, if I were the plaintiff, hope that that well known entity 'market forces', the clash of self-interest with self-interest against the background of the highly unusual situation that has developed, would lead to a resolution of the problem by arriving at a figure which a judge or master assessing damages would have the greatest difficulty in determining.

Bear in mind that specific performance does not necessarily lead to the loss of the [taxation advantage]. It is still open to the Smorgons to buy the shares before 1 July. … And so far as pressure and risk are concerned, the Smorgons will not be the only ones affected. The plaintiff must realise that it runs the risk that its shares will lose their special value to the Smorgons. It is at hazard too. The shrewdness and judgment of all those who have an interest in this affair and their advisers will, I hope, by the interplay of forces, lead to a resolution of the problem.

Notes

(1) Hardship is *not* that caused as a result of the underlying bargain or arrangement between the parties. The risks run by Smorgon and Humes were inherent in their bargain, rather than being a particular function of the specific performance of the bargain.

(2) The hardship of third parties is raised in this case. Notice that Brooking J 'assumed' that he 'may have regard to hardship that will be suffered by the shareholders'. To what extent is this consistent with *Gall v Mitchell* (1924) 35 CLR 222, 230 (Isaacs J), referred to above in *Patel v Ali*? Note that, despite acknowledging that counsel for Mrs Ali 'derived some support from the obiter observations of Isaacs J in … *Gall v Mitchell*', in *Patel* Goulding J reasoned his decision without taking into account the welfare of Mrs Ali's children, who were third parties to the action.

6.6 Effect of order on third parties

Hardship to third parties may be relevant in the balance of justice. However, equity has a broader jurisdiction to consider the interests of third parties when fashioning relief. The effect of an order on a third party may itself be a reason to modify or deny the plaintiff's remedy.

6.6a *Giumelli v Giumelli* [1999] HCA 10; (1999) 196 CLR 101

Background

For a statement of the facts, see [2.2a].

Decision

The High Court held that the parents were estopped from denying Robert an interest in the property. The Court, however, held that the appropriate remedy was an award of equitable compensation, and not a constructive trust, having regard among other factors to the improvements made to the property by Steven. The amount to be paid as equitable compensation was secured by an equitable charge over the whole of the Dwellingup property.

Gleeson CJ, McHugh, Gummow and Callinan JJ

The circumstances of the case

However, the appellants correctly challenge the Full Court order on other grounds. Before making an order designed to bring about a conveyance of the Promised Lot to the respondent, the Full Court was obliged to consider all the circumstances of the case. These circumstances included the still pending partnership action, the improvements to the Promised Lot by family members other than Robert, both before and after his residency there, the breakdown in family relationships and the continued residence on the Promised Lot of Steven and his family. It will be recalled that Steven is a party to the partnership action but not to the present action.

When these matters are taken into account, it is apparent that the order made by the Full Court reflected what in *Verwayen* was described as the prima facie entitlement of Robert. However, qualification was necessary both to avoid injustice to others, particularly Steven and his family, and to avoid relief which went beyond what was required for conscientious conduct by Mr and Mrs Giumelli. The result points inexorably to relief expressed not in terms of acquisition of title to land but in a money sum. This would reflect, with respect to the third promise, the approach taken by Nicholson J when giving relief in respect of the second promise.

Conclusion

Whilst the holding of the Full Court with respect to the third promise should be upheld, the Full Court erred in the measure of relief which it granted in respect of the Promised Lot. This is a case for the fixing of a money sum to represent the value of the equitable claim of the respondent to the Promised Lot. It will be necessary for the matter to be remitted to a judge of the Supreme Court to take that step. The amount so ascertained, with interest, should be charged upon the whole of the Dwellingup property. There will be no requirement of a subdivision of the Promised Lot as part of the remedy.

Fixing of the amount will require the making of valuations and allowances for a range of matters, some of which have been indicated above. It is neither possible nor appropriate now to fix any closed list of matters properly to be taken into account …

On one view, as to which we express no decision, for what is now some 12 years, the respondent has been deprived of a share of profits earned by the partnership from the Promised Lot and of rent from the house. Further, in fixing the sum to represent an appropriate monetary order there may be a case for an allowance in his favour representing a share of anticipated profits from the partnership in relation to the Promised Lot for a specified period of future years, perhaps contingent upon the joint lives of Mr and Mrs Giumelli.

On the other hand, an allowance would have to be made for the improvement to the value of the land since 1986 brought about, in particular, by Steven's work. In addition to the planting of fruit trees and the construction of sheds and cool rooms, the appellants contend there has been significant expenditure on water supply and storage systems.

To enable the matter to be dealt with adequately, it would be appropriate for the partnership action to be brought on concurrently for trial of remaining issues. The moving party in that action is the present respondent and he should be required by the Supreme Court, by direction in the present action, to take the necessary steps to prosecute to trial all remaining issues in the partnership action.

Notes

(1) See also *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1, 45–6 (French CJ, Gummow, Hayne, Heydon and Kiefel JJ): 'A constructive trust ought not to be imposed if there are other orders capable of doing justice. … One point made in the *Giumelli v Giumelli* line of cases is that care must be taken to avoid granting equitable relief which goes beyond the necessities of the case. Another point in those cases is that third party interests must be borne in mind in deciding whether a constructive trust should be granted. That line of cases does not permit a constructive trust to be declared in a manner injurious to third parties merely because the plaintiff has no other useful remedy against a defendant'.

(2) For discussion of constructive trusts and the availability of proprietary relief, see chapter 23 and textbook chapter 23.

Question

How does a court determine whether third parties may be affected by a remedy, if the third parties are not litigants in the matter in question?

Part C

Equity, contract and property

7

Equity in contract law

7.1 Introduction

7.2 Equitable estoppel

7.3 Equity and voidable transactions

7.4 Equitable relief against penalties and forfeiture

7.1 Introduction

Equitable intervention into contract law defies easy summary. Apart from equitable remedies to enforce contracts, such as specific performance and injunctions (see chapter 3), or to rescind voidable contracts (see chapter 5), equitable doctrines perform a number of distinct roles in the formation, modification and enforcement of contracts. Equity recognises more extensive grounds than the common law to set aside agreements based on defective consent. So, while contracts can be rescinded at common law for duress or fraudulent misrepresentation, in equity they can be avoided on the additional grounds of undue influence, unconscionability, non-fraudulent misrepresentation, mistake and under the rule in *Yerkey v Jones* (1939) 63 CLR 649.

Equity can also occasionally modify or prevent contract enforcement even though the bargaining process was not defective. Terms constituting penalties (as opposed to liquidated damages clauses), forfeiture clauses and contractual restrictions on a mortgagor's equity of redemption belong to this category and can be set aside. The category is controversial because the focus of inquiry is on the substantive unfairness of a bargain rather than on defects in the process of contract formation. There is always room for disagreement as to whether a term of a contract is substantively 'fair'.

Finally, equitable estoppel doctrines (promissory and proprietary) enable some promises to be enforced even though they are not enforceable as contracts because they are not supported by consideration. They also enable some contracts to be modified even if the modification is not supported by fresh consideration. The role of 'detrimental reliance' is critical to determining which promises and modifications are enforceable as estoppels.

Equitable intervention into contract law is sometimes rationalised on the ground that equity prevents, or relieves against, unconscionable conduct. The proposition is true at a high level of generality, unconscionability is not, without more, an adequate criterion for deciding cases. While the procurement of a contract by unconscientious conduct is a discrete ground on which a contract may be rescinded (*Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447), and while some equitable relief can be justified in terms of the prevention of the unconscionable enforcement of legal rights (*Garcia v National Australia Bank Ltd* (1998) 194 CLR 395), in many other cases references to unconscionability add nothing to the specific criteria for relief. Estoppel is an arguable case in point.

7.2 Equitable estoppel

7.2.1 Promissory estoppel

Background

Waltons Stores negotiated for a lease from the Mahers. It was agreed that the Mahers would demolish the existing building on their property and construct a new building to be operated by Waltons as a supermarket. When all the essential terms of the lease had been agreed, the Mahers' solicitor forwarded to Waltons' solicitor an executed lease 'by way of exchange'. At the same time, he urged Waltons to sign the lease promptly so that work could begin on demolishing the existing building. Waltons raised no objection to the terms but changed its mind about taking the lease, instructing its solicitor to 'go slow'. Meanwhile, to Waltons' knowledge, the Mahers began demolishing the existing building. After the Mahers had demolished the building and constructed 40 per cent of the new building, Waltons informed them that they did not intend to take the lease.

The Mahers claimed specific performance of the lease or, alternatively, damages under the *Supreme Court Act 1970* (NSW) s 68, in lieu of specific performance.

Decision

The High Court held that Waltons was estopped from denying the existence of the lease. According to Mason CJ, Wilson and Brennan JJ, Waltons had represented that it *would* sign the lease. Deane and Gaudron JJ, however, were of the view that Waltons had represented that it *had* signed the lease. On either analysis, Waltons was bound by an enforceable estoppel.

Mason CJ and Wilson J

Our conclusion that the respondents assumed that exchange of contracts would take place as a matter of course, not that exchange had in fact taken place, undermines the factual foundation for the common law estoppel by representation found by Kearney J and the common law estoppel based on omission to correct a mistake favoured by the Court of Appeal. There is, as Mason and Deane JJ pointed out in *Legione v Hateley* (1983) 152 CLR 406 at 432, a long line of authority to support the proposition that, to make out a case of common law estoppel by representation, the representation must be as to an existing fact, a promise or representation as to future conduct being insufficient: *Jorden v Money* (1854) 10 ER 868 … It was pointed out in *Legione* that, although in *Thompson v Palmer* (1933) 49 CLR 507 Dixon J did not distinguish between an assumption founded upon a representation of existing fact and an assumption founded upon a representation as to future conduct, at the time the doctrine of consideration was thought to be a significant obstacle to the acceptance of an assumption founded upon a representation (or promise) as to future conduct as a basis for common law estoppel by representation. …

Because estoppel by representation is often treated as a separate category, it might be possible to confine the distinction between a representation as to existing fact and one as to future conduct to that category. The adoption of such a course would leave an estoppel based on an omission to correct a mistaken assumption free from that troublesome distinction. However, the result would be to fragment the unity of the common law conception of estoppel and to confine the troublesome distinction at the price of introducing another which is equally artificial. And the result would be even more difficult to justify in a case where, as here, the mistaken assumption as to future conduct arises as a direct consequence of a representation.

If there is any basis at all for holding that common law estoppel arises where there is a mistaken assumption as to future events, that basis must lie in reversing *Jorden v Money* and in accepting the powerful dissent of Lord St Leonards in that case. The repeated acceptance of *Jorden* v *Money* over the years by courts of the highest authority makes this a formidable exercise …

This brings us to the doctrine of promissory estoppel on which the respondents relied in this Court to sustain the judgment in their favour. Promissory estoppel certainly extends to representations (or promises) as to future conduct: *Legione*. So far the doctrine has been mainly confined to precluding departure from a representation by a person in a pre-existing contractual relationship that he will not enforce his contractual rights, whether they be pre-existing or rights to be acquired as a result of the representation … But Denning J in *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130 at 134–135 treated it as a wide-ranging doctrine operating outside the pre-existing contractual relationship: see the discussion in *Legione*. In principle there is certainly no reason why the doctrine should not apply so as to preclude departure by a person from a representation that he will not enforce a non-contractual right. …

There has been for many years a reluctance to allow promissory estoppel to become the vehicle for the positive enforcement of a representation by a party that he would do something in the future. Promissory estoppel, it has been said, is a defensive equity: *Hughes v Metropolitan Railway Co* (1877) 2 App Cas 439 at 448; *Combe v Combe* [1951] 2 KB 215 at 219–220 and the traditional notion has been that estoppel could only be relied upon defensively as a shield and not as a sword: *Perpetual Trustee Co Ltd v Pacific Coal Co Pty Ltd* (1953) 55 SR (NSW) 495 at 508, 518–519 (reversed on appeal on other grounds, (1954) 91 CLR 486; (1955) 93 CLR 479) … *High Trees* itself was an instance of the defensive use of promissory estoppel. But this does not mean that a plaintiff cannot rely on an estoppel. Even according to traditional orthodoxy, a plaintiff may rely on an estoppel if he has an independent cause of action, where in the words of Denning LJ in *Combe v Combe* the estoppel 'may be part of a cause of action, but not a cause of action in itself'.

But the respondents ask us to drive promissory estoppel one step further by enforcing directly in the absence of a pre-existing relationship of any kind a non-contractual promise on which the representee has relied to his detriment. For the purposes of discussion, we shall assume that there was such a promise in the present case. The principal objection to the enforcement of such a promise is that it would outflank the principles of the law of contract. Holmes J expressed his objection to the operation of promissory estoppel in this situation when he said 'It would cut up the doctrine of consideration by the roots, if a promisee could make a gratuitous promise binding by subsequently acting in reliance on it': *Commonwealth v Scituate Savings Bank* (1884) 137 Mass 301 at 302. Likewise, Sir Owen Dixon considered that estoppel cut across the principles of the law of contract, notably offer and acceptance and consideration: 'Concerning Judicial Method' (1956) 29 *Australian Law Journal* 468, at p 475. And Denning LJ in *Combe v Combe,* after noting that 'The doctrine of consideration is too firmly fixed to be overthrown by a side-wind', said that such a promise could only be enforced if it was supported by sufficient consideration. Moreover, it has been suggested that the enforcement of a promise given without consideration is by no means consistent with *Hoyt's Pty Ltd v Spencer* (1919) 27 CLR 133 and *Maybury v Atlantic Union Oil Co Ltd* (1953) 89 CLR 507. …

There is force in these objections and it may not be a sufficient answer to repeat the words of Lord Denning MR in *Crabb v Arun District Council* [1976] Ch 179 at 187: 'Equity comes in, true to form, to mitigate the rigours of strict law'. True it is that in the orthodox case of promissory estoppel, where the promisor promises that he will not exercise or enforce an existing right, the elements of reliance and detriment attract equitable intervention on the basis that it is unconscionable for the promisor to depart from his promise, if to do so will result in detriment to the promisee. And it can be argued (see, e.g., Greig and Davis, *Law of Contract,* p 184) that there is no justification for applying the doctrine of promissory estoppel in this situation, yet denying it in the case of a non-contractual promise in the absence of a pre-existing relationship. The promise, if enforced, works a change in the relationship of the parties, by altering an existing legal relationship in the first situation and by creating a new legal relationship in the second. The point has been made that it would be more logical to say that when the parties have agreed to pursue a course of action, an alteration of the relationship by non-contractual promise will not be countenanced, whereas the creation of a new relationship by a simple promise will be recognized: see D Jackson, 'Estoppel as a Sword' (1965) 81 *Law Quarterly Review* 223, at p 242. … One may therefore discern in the cases a common thread which links them together, namely, the principle that equity will come to the relief of a plaintiff who has acted to his detriment on the basis of a basic assumption in relation to which the other party to the transaction has 'played such a part in the adoption of the assumption that it would be unfair or unjust if he were left free to ignore it': per Dixon J in *Grundt v Great Boulder Pty Gold Mines Ltd* (1937) 59 CLR 641; see also *Thompson v Palmer.* Equity comes to the relief of such a plaintiff on the footing that it would be unconscionable conduct on the part of the other party to ignore the assumption …

… [T]he crucial question remains: was the appellant entitled to stand by in silence when it must have known that the respondents were proceeding on the assumption that they had an agreement and that completion of the exchange was a formality? The mere exercise of its legal right not to exchange contracts could not be said to amount to unconscionable conduct on the part of the appellant. But there were two other factors present in the situation which require to be taken into consideration. The first was the element of urgency that pervaded the negotiation of the terms of the proposed lease. As we have noted, the appellant was bound to give up possession of its existing commercial premises in Nowra in January 1984; the new building was to be available for fitting out by 15 January and completed by 5 February 1984. The respondents' solicitor had said to the appellant's solicitor on 7 November that it would be impossible for Maher to complete the building within the agreed time unless the agreement were concluded 'within the next day or two'. The outstanding details were agreed within a day or two thereafter, and the work of preparing the site commenced almost immediately.

The second factor of importance is that the respondents executed the counterpart deed and it was forwarded to the appellant's solicitor on 11 November. The assumption on which the respondents acted thereafter was that completion of the necessary exchange was a formality. The next their solicitor heard from the appellant was a letter from its solicitors dated 19 January, informing

him that the appellant did not intend to proceed with the matter. It had known, at least since 10 December, that costly work was proceeding on the site.

It seems to us, in the light of these considerations, that the appellant was under an obligation to communicate with the respondents within a reasonable time after receiving the executed counterpart deed and certainly when it learnt on 10 December that demolition was proceeding. It had to choose whether to complete the contract or to warn the respondents that it had not yet decided upon the course it would take. It was not entitled simply to retain the counterpart deed executed by the respondents and do nothing: cf *Thompson,* at p 547; *Olsson v Dyson* (1969) 120 CLR 365 at 376. The appellant's inaction, in all the circumstances, constituted clear encouragement or inducement to the respondents to continue to act on the basis of the assumption which they had made. It was unconscionable for it, knowing that the respondents were exposing themselves to detriment by acting on the basis of a false assumption, to adopt a course of inaction which encouraged them in the course they had adopted. To express the point in the language of promissory estoppel the appellant is estopped in all the circumstances from retreating from its implied promise to complete the contract.

Brennan J

In my opinion, to establish an equitable estoppel, it is necessary for a plaintiff to prove that

> **(1)** the plaintiff assumed that a particular legal relationship then existed between the plaintiff and the defendant or expected that a particular legal relationship would exist between them and, in the latter case, that the defendant would not be free to withdraw from the expected legal relationship;
>
> **(2)** the defendant has induced the plaintiff to adopt that assumption or expectation;
>
> **(3)** the plaintiff acts or abstains from acting in reliance on the assumption or expectation;
>
> **(4)** the defendant knew or intended him to do so;
>
> **(5)** the plaintiff's action or inaction will occasion detriment if the assumption or expectation is not fulfilled; and
>
> **(6)** the defendant has failed to act to avoid that detriment whether by fulfilling the assumption or expectation or otherwise.

For the purposes of the second element, a defendant who has not actively induced the plaintiff to adopt an assumption or expectation will nevertheless be held to have done so if the assumption or expectation can be fulfilled only by a transfer of the defendant's property, a diminution of his rights or an increase in his obligations and he, knowing that the plaintiff's reliance on the assumption or expectation may cause detriment to the plaintiff if it is not fulfilled, fails to deny to the plaintiff the correctness of the assumption or expectation on which the plaintiff is conducting his affairs.

Deane J

It has often been said that estoppel can be used only as a shield and not as a sword. In so far as estoppel by conduct is concerned, that statement is generally true only in the very limited sense that such an estoppel operates negatively to preclude the denial of, or a departure from, the assumed or promised state of affairs and does not of itself constitute an independent cause of action. The authoritative expositions of the doctrine of estoppel by conduct (or, in more obscure language, in pais) to be found in judgments in this Court have been consistently framed in general terms and lend no support for a constriction of the doctrine in a way which would preclude a plaintiff from relying upon the assumed or represented mistaken state of affairs (which a defendant is estopped from denying) as the factual foundation of a cause of action arising under ordinary principles of the law … There is no basis in principle for such a constriction of the doctrine. In so far as decisions or statements in judgments in cases in other courts would support a contrary view, they should not be accepted in this country. It follows that a plaintiff in the position of the Mahers in the present case is entitled to plead and rely upon the facts giving rise to an operative estoppel by conduct which precludes the defendant from denying the existence of a binding contract for the purpose of affirmatively establishing the foundation for the case to be dealt with on the basis of the assumed fact that there was such a contract. That being so, such an estoppel provides the factual foundation of an ordi-

nary action for enforcement of that 'contract' notwithstanding that those facts demonstrate that no binding contract was actually made.

Notes

(1) Some of the issues discussed in the extracts were further considered in the later High Court decisions of *Foran v Wight* (1989) 168 CLR 385 and *Commonwealth v Verwayen* (1990) 170 CLR 394. The judgments of Mason CJ and Deane J in both cases explored, albeit along different lines, the potential for fusing common law and equitable doctrines of estoppel. Later High Court decisions, including *Giumelli v Giumelli* ([8.5a]), have declined to consider further the arguments for fusing or amalgamating estoppel doctrines.

(2) In *Commonwealth v Verwayen,* different views were expressed as to whether equitable relief in estoppel should enforce the representee's reasonable expectations or be confined to the 'minimum equity' required to satisfy the estoppel. In practice the 'minimum equity' is usually equated with the representee's reliance expenditure incurred on the faith of the representation. The differences were resolved by the High Court in *Giumelli v Giumelli* (see [8.5a]).

(3) For further discussion of estoppel, see DSK Ong, *Ong on Estoppel* (Federation Press, 2020); KR Handley, *Estoppel by Conduct and Election* (Sweet and Maxwell, 2006); JC Campbell, '*Waltons v Maher*: History, Unconscientiousness and Remedy – The "Minimum Equity"' (2013) 7(3) *Journal of Equity* 171; A Robertson, 'Three Models of Promissory Estoppel' (2013) 7(3) *Journal of Equity* 226; J Hudson, 'The True Purpose of Estoppel by Representation' (2015) 32(3) *Journal of Contract Law* 275.

(4) Proprietary estoppel is discussed in chapter 8. The development of promissory estoppel was, and continues to be, influenced by developments in the law of proprietary estoppel. Indeed, it has been argued that *Waltons Stores* is an application of proprietary estoppel principles (see KR Handley, *Estoppel by Conduct and Election,* above and question 1 below)).

Questions

(1) Was *Waltons Stores* a decision on: (a) common law estoppel; (b) equitable promissory estoppel; or (c) equitable proprietary estoppel? See *DHJPM Pty Ltd v Blackthorn Resources Ltd* (2011) 83 NSWLR 728 at [122] (Handley AJA); and KR Handley, 'Three High Court Decisions on Estoppel 1988–1990' (2006) 80 *Australian Law Journal* 724, 725–9 for the argument that *Waltons Stores* is a decision on proprietary estoppel.

(2) Why are representations as to a present state of affairs, relied upon by the representee to her detriment, distinguished from representations as to the representor's future intention, also relied upon by the representee to her detriment? Did Waltons induce the Mahers to believe that a contract to take a lease of the Mahers' property had been signed, or that it would be signed? Why should it matter which representation had been made?

(3) What role, if any, does unconscionability play in the application of equitable estoppel? Why was it unconscionable for Waltons to rely on the absence of a legally enforceable lease, given that both parties were advised by lawyers who were aware of the legal requirements for executing a lease?

(4) In *Waltons Stores*, the parties had agreed all the material terms of the proposed lease. Suppose that the parties had agreed the essential terms of their proposed contract – for example, relating to the rent payable and the duration of the lease – but had not agreed comparatively minor terms. Can a party be estopped in these circumstances from denying that a lease will be executed? See *Austotel Pty Ltd v Franklins Selfservice Pty Ltd* (1989) 16 NSWLR 582.

(5) Raoul promises to give his niece, Amelia, $3,000 on her birthday. Relying on Raoul's promise, Amelia spends $2,000 on buying a new laptop computer, leaving her with only $500 in her bank account. When he made the promise, Raoul knew that Amelia wanted to buy a new laptop and was waiting for the right opportunity to make the purchase. Is Raoul bound to pay Amelia $3,000?

7.3 Equity and voidable transactions

At common law, contracts can be rescinded for fraudulent misrepresentation and duress inducing a party to enter into the contract, provided that both parties can be restored precisely to their pre-contractual position. The grounds of rescission in equity are broader: unilateral mistake, misrepresentation (even if innocent), duress, undue influence, unconscionability, breach of fiduciary duty, and the failure to explain the nature and effect of a guarantee under *Yerkey v Jones* (1939) 63 CLR 649 are all flaws in the bargaining process which may result in the contract being set aside. Moreover, the objective of rescission in equity is not to restore the parties *precisely* to their pre-contractual position but to achieve practical justice by restoring them *substantially* to this position. Terms can be imposed on both parties as a condition of granting rescission. Although the fashioning of the terms and conditions on which rescission will be granted is a discretionary exercise, the overriding objective is the same in all cases: namely, to compel both parties to return benefits they have received under the contract (or the money value of the benefits) on the ground that the continued retention of these benefits is unjust.

This section of the chapter focuses on rescission in equity for undue influence, unconscionability and under the rule in *Yerkey v Jones*. It should be read in conjunction with chapter 5.

7.3.1 Undue influence

7.3.1a *Thorne v Kennedy* [2017] HCA 49; (2017) 263 CLR 85

Background

The plaintiff, Ms Thorne, became engaged to the defendant, a wealthy 60-year-old property developer. She possessed no substantial assets and, had the relationship ended, would not have enjoyed secure migration status in Australia. The defendant made clear from the outset that his substantial fortune would pass on his death to his children from a previous marriage. Less than a fortnight before the wedding, he arranged for the plaintiff to consult an independent solicitor to enable her to see, for the first time, and discuss his proposed pre-nuptial agreement. He told her that, unless she signed, the marriage would not go ahead. The plaintiff was told by the experienced solicitor that the agreement (and a substantially identical agreement signed after the wedding) was 'entirely inappropriate', being the worst that the solicitor had seen. The financial provision made for her, in the event of their separation after three years without children, was described as 'piteously small'. In spite of this advice, Ms Thorne, who wanted to have children and was under stress caused by the imminence of the wedding, signed the agreement.

The couple separated, without children, after slightly less than four years of marriage. The agreements the plaintiff had signed entitled her to some $50,000. She applied for their rescission, and for orders under the *Family Law Act 1975* (Cth) in excess of $1 million to be substituted. The *Family Law Act* contains provisions promoting the enforcement of pre-nuptial contracts entered into with the benefit of legal advice. But an agreement is liable to be set aside under s 90K(1)(b) where 'the agreement is void, voidable or unenforceable'. Section 90KA provides that validity 'is to be determined by the court according to the principles of law and equity' appropriate to the case. The primary judge set aside the agreements on the ground of duress, finding that Ms Thorne's circumstances led her to believe that she had no choice, and that she was powerless to act in any way other than to sign the pre-nuptial agreement. If she did not sign the first agreement, the wedding would not take place and 'she would have nothing. No job, no visa, no home, no place, no community'. The second agreement was simply a continuation of the first and accordingly was equally vitiated.

The Full Family Court, allowing an appeal by the defendant's executors (the defendant having meanwhile died), concluded that the agreements had not been vitiated by duress, undue influence or unconscionable conduct. The Court found the agreement to be fair and reasonable because the plaintiff accepted that the bulk of the defendant's wealth was intended for his children. Moreover, the plaintiff's only concern in discussions about the pre-nuptial agreement was to ensure that she was provided for in the event of the defendant's death, and not in the event of separation.

Decision

The High Court restored the order made by the primary judge. However, the plurality set aside the agreements not for duress but on the grounds of undue influence and unconscionability. The extracts below focus on the availability of undue influence as grounds of relief. Unconscionability is considered below at [7.3.3c].

Kiefel CJ, Bell, Gageler, Keane and Edelman JJ

Undue influence

In *Allcard v Skinner* (1887) 36 Ch D 145 at 183, Lindley LJ said that 'no Court has ever attempted to define undue influence'. One reason for the difficulty of defining undue influence is that the label 'undue influence' has been used to mean different things. It has been used to include abuse of confidence, misrepresentation, and the pressure which amounts to common law duress. Each of those concepts is better seen as distinct. Nevertheless, the boundaries, particularly between undue influence and duress, are blurred. One reason why there is no clear distinction is that undue influence can arise from widely different sources, one of which is excessive pressure. Importantly, however, since pressure is only one of the many sources for the influence that one person can have over another, it is not necessary that the pressure which contributes to a conclusion of undue influence be characterised as illegitimate or improper.

In 1836, in a passage which was copied verbatim by Snell thirty years later (Snell, *The Principles of Equity* (1868) at 370), Story said that a person can be subjected to undue influence where the effect of factors such as pressure is that the person 'has no free will, but stands *in vinculis* [in chains]' (Story, *Commentaries on Equity Jurisprudence* (1836), vol 1 at 243). He explained that 'the constant rule in Equity is, that, where a party is not a free agent, and is not equal to protecting himself, the Court will protect him'. In 1866, this approach was applied in equity by the House of Lords, recognising undue influence in a case of pressure that deprived the plaintiff of 'free agency' *(Williams v Bayley* (1866) LR 1 HL 200 at 215–216 per Lord Chelmsford). In 1868, in probate, Sir James Wilde also described undue influence as arising where a person is not a 'free agent' (*Hall v Hall* (1868) LR 1 P & D 481 at 482). In *Johnson v Buttress* ([1936] HCA 41; (1936) 56 CLR 113 at 134), Dixon J described how undue influence could arise from the 'deliberate contrivance' of another (which naturally includes pressure) giving rise to such influence over the mind of the other that the act of the other is not a 'free act'. And, in *Bank of New South Wales v Rogers* ([1941] HCA 9; (1941) 65 CLR 42 at 61), McTiernan J characterised the absence of undue influence as a 'free and well-understood act' and Williams J referred to 'the free exercise of the respondent's will' (ibid at 85).

The question whether a person's act is 'free' requires consideration of the extent to which the person was constrained in assessing alternatives and deciding between them. Pressure can deprive a person of free choice in this sense where it causes the person substantially to subordinate his or her will to that of the other party. It is not necessary for a conclusion that a person's free will has been substantially subordinated to find that the party seeking relief was reduced entirely to an automaton or that the person became a 'mere channel through which the will of the defendant operated' *(Tufton v Sperni* [1952] 2 TLR 516 at 530, per Jenkins LJ). Questions of degree are involved. But, at the very least, the judgmental capacity of the party seeking relief must be 'markedly substandard' (Birks & Chin, 'On the Nature of Undue Influence', in Beatson and Friedmann (eds), *Good Faith and Fault in Contract Law,* (1995) 57 at 67) as a result of the effect upon the person's mind of the will of another.

An example which illustrates the characterisation by a court of a lack of free will sufficient to amount to undue influence is the decision of this Court in *Johnson v Buttress* ([1936] HCA 41; (1936) 56 CLR 113). In that case, Mr Buttress was a 67 year old man, who was 'wholly illiterate, not very intelligent, and of little or no experience or capacity in business' (ibid at 124). He made a voluntary transfer of land to a relative of his wife. The land was his only property and his only means of livelihood. When he made the transfer he did not understand that he had parted with the land irrevocably. After Mr Buttress died, the administrator of his estate brought an application to set aside the transfer. The trial judge set aside the transfer on the basis of undue influence. This decision was upheld in this Court. Although other members of the Court relied upon a presumption of undue influence, which is considered below, one member of the Court, Starke J, concluded that it was open to the trial judge to find that undue influence arose without any presumption. His Honour upheld the conclusion of the trial judge that the circumstances of the transfer invited the inference that it was 'not the result of the free and deliberate judgment of the deceased' (ibid at 126).

There are different ways to prove the existence of undue influence. One method of proof is by direct evidence of the circumstances of the particular transaction. That was the approach relied upon by the primary judge in this case. Another way in which undue influence can be proved is by presumption. This presumption was relied upon by Ms Thorne in this Court as an alternative. A presumption, in the sense used here, arises where common experience is that the existence of one fact means that another fact also exists. Common experience gives rise to a presumption that a transaction was not the exercise of a person's free will if (i) the person is proved to be in a particular relationship, and (ii) the transaction is one, commonly involving a 'substantial benefit' to an-

other, which cannot be explained by 'ordinary motives' *(Allcard v Skinner* (1887) 36 Ch D 145 at 185 per Lindley LJ), or 'is not readily explicable by the relationship of the parties' (*Royal Bank of Scotland v Etridge (No 2)* [2001] UKHL 44; [2002] 2 AC 773 at 798 [21] per Lord Nicholls of Birkenhead). Although the classes are not closed, in *Johnson v Buttress* ([1936] HCA 41; (1936) 56 CLR 113 at 119) Latham CJ described the relationships that could give rise to the presumption as including parent and child, guardian and ward, trustee and beneficiary, solicitor and client, physician and patient, and cases of religious influence. Outside recognised categories, the presumption can also be raised by proof that the history of the particular relationship involved one party occupying a similar position of ascendency or influence, and the other a corresponding position of dependency or trust. In either case, the presumption is rebuttable by the other party proving that the particular transaction or transfer, in its particular circumstances, was nevertheless the result of the weaker party's free will.

Ms Thorne submitted that she was entitled to the benefit of a presumption of undue influence because the relationship of fiancé and fiancée should be recognised as one to which the presumption attaches. This submission was concerned with a presumption of undue influence (that a transaction was the result of a lack of free will) and not with the different doctrine concerning the possibility of an abuse of confidence in any relationship of intimacy. The submission should not be accepted.

Although the relationship of fiancé and fiancée was first seen as falling within the recognised categories by Lord Langdale MR in 1848 *(Page v Horne* (1848) 11 Beav 227 at 235; 50 ER 804 at 807), and although it was also recognised in this Court by Dixon J in 1936 *(Johnson v Buttress* [1936] HCA 41; (1936) 56 CLR 113 at 134) and 1939 *(Yerkey v Jones* [1939] HCA 3; (1939) 63 CLR 649 at 675), in 1961 in England Lord Evershed MR refused to apply the established presumption, saying that 'this is 1961 and what might have been said of the position, independence, and the like, of women in 1848 would have to be seriously qualified today' *(Zamet v Hyman* [1961] 1 WLR 1442 at 1446). In 1992 in *Louth v Diprose* ((1992) 175 CLR 621, 630) Brennan J observed that it 'may no longer be right to presume that a substantial gift made by a woman to her fiancé has been procured by undue influence'. Common experience today of the wide variety of circumstances in which two people can become engaged to marry negates any conclusion that a relationship of fiancé and fiancée should give rise to a presumption that either person substantially subordinates his or her free will to the other …

The primary judge was correct to consider the unfair and unreasonable terms of the prenuptial agreement and the post-nuptial agreement as matters relevant to her consideration of whether the agreements were vitiated. Of course, the nature of agreements of this type means that their terms will usually be more favourable, and sometimes much more favourable, for one party.

However, despite the usual financial imbalance in agreements of that nature, it can be an indicium of undue influence if a prenuptial or post-nuptial agreement is signed despite being known to be grossly unreasonable even for agreements of this nature. In other words, what the Full Court rightly recognised as the significant gap between Ms Thorne's understanding of Ms Harrison's strong advice not to sign the 'entirely inappropriate' agreement and Ms Thorne's actions in signing the agreement was capable of being a circumstance relevant to whether an inference should be drawn of undue influence.

The Full Court also mischaracterised the effect of the primary judge's reasons. As explained above, the primary judge found that Ms Thorne was 'powerless' and that Ms Thorne believed that she had 'no choice' to do anything other than sign the agreements as presented. The primary judge's finding was, in effect, that Ms Thorne was deprived of the ability to bring a free choice to the decision as to whether to sign the agreements. Ms Thorne's choices about entering the agreements on Mr Kennedy's terms were subordinated to the will of Mr Kennedy. Despite the strong advice from Ms Harrison, Ms Thorne accepted the terms of the agreements in part due to her 'reliance on Mr Kennedy for all things'. Although the primary judge described her conclusion as one of 'duress', for the reasons explained above her conclusion is more aptly described as one of undue influence. It was, therefore, unnecessary for the primary judge to assess the extent to which the pressure upon Ms Thorne came from Mr Kennedy as might be required for the doctrine of duress. It was also unnecessary for the primary judge to consider whether, for the purposes of the doctrine of duress, the pressure that Mr Kennedy exerted upon Ms Thorne was improper or illegitimate. These are matters within the domain of duress rather than undue influence. Contrary to the reasoning of the Full Court, the failure of the primary judge to reach these conclusions was not an error …

In the particular context of pre-nuptial and post-nuptial agreements, some of the factors which may have prominence include the following: (i) whether the agreement was offered on a basis that it was not subject to negotiation; (ii) the emotional circumstances in which the agreement was entered including any explicit or implicit threat to end a marriage or to end an engagement; (iii) whether there was any time for careful reflection; (iv) the nature of the parties' relationship; (v) the relative financial positions of the parties; and (vi) the independent advice that was received and whether there was time to reflect on that advice.

Nettle J

Nettle J, concurring with the plurality judgment, stated at [71], with respect to rescission on the ground of duress, that 'there appears to be much to be said for the view that, rather than persist with a blanket restriction of illegitimate pressure to pressure exerted by unlawful means, it would better accord with equitable principle, and better align with English and American authority, if the test of illegitimate pressure were whether the pressure goes beyond what is reasonably necessary for the protection of legitimate interests'.

Gordon J (dissenting on whether the pre-nuptial agreements should be set aside for undue influence)

Underlying the difference in approach is an important point of principle. The point of principle concerns the relationship between undue influence and the judgment of the person whose will is said to have been affected. In this particular case, Ms Thorne's capacity to make an independent judgment was not affected. The primary judge found that Ms Thorne was able to comprehend what she was doing when she signed the agreements, and that she knew and recognised the effect and importance of the advice she was given. Moreover, Ms Thorne wanted the marriage to Mr Kennedy to proceed and to prosper. She knew and understood that it would proceed only if she accepted the terms proffered. Once she decided to go ahead with the marriage, it was right to say, as the primary judge said, that she had 'no choice' except to enter into the agreements. No other terms were available. But her capacity to make an independent, informed and voluntary judgment about whether to marry on those terms was unaffected and she chose to proceed. Her will was not overborne …

The critical element for relief on the ground of undue influence is the impairment of the will of Ms Thorne. Undue influence does not protect against bad deals. Here, the equitable jurisdiction will be engaged if entry into the agreements was 'the outcome of such an *actual influence* over the mind of [Ms Thorne] that it cannot be considered [her] free act' (emphasis added). Put another way, when Ms Thorne signed the agreements, was her capacity to make independent judgments impaired so that she was not acting in the free exercise of her independent and voluntary will?

The primary judge found that Ms Thorne knew and understood that the first agreement was 'terrible'. Yet, despite that knowledge and understanding, she signed it. The question posed by the primary judge was: why? There was an explanatory gap between the fact that Ms Thorne, an intelligent person, knew and understood how disadvantageous it was and the fact that she nevertheless signed it (and the second agreement). So what filled that gap? Her knowledge about the contents of each agreement and Mr Kennedy's financial position was not incomplete, although that information was provided late by Mr Kennedy.

Was her will impaired, or did she simply have a strong desire to marry him because, as the primary judge found, she was in love with Mr Kennedy, she wanted to marry him and she wanted to have a child with him? Was her 'enthusiasm', or willingness, to sign the financial agreements the result of undue influence?

Whatever metaphors and descriptors are used to describe the relevant principles, the focus of the doctrine is on identifying whether and how a person's will is impaired. A belief on Ms Thorne's part that she had no choice but to sign the agreements if she wanted the relationship to continue does not speak to a lack of will or capacity to exercise independent judgment. Indeed, in light of the primary judge's findings, such a belief demonstrates that she did enter into each agreement in the free exercise of her independent will. As the primary judge explained, Mr Kennedy held '[e]very bargaining chip and every power' and did not create any opportunities to negotiate. Ms Thorne's choices were limited to (1) signing each agreement, including agreeing to the clauses which substantially displaced her entitlements in the event of separation, or (2) ending the relationship, which would have disastrous consequences. Those findings were amply supported by the evidence. Accordingly, if Ms Thorne did believe that she had 'no choice' but to sign each agreement if she wanted to fulfil her desire to marry and continue her relationship with Mr Kennedy, then her assessment of the options was plainly correct. The evident correctness of her assessment militates against the conclusion that her will was impaired.

And the fact that Ms Thorne's options were narrow, even eliminated, is not to the point. The paucity of options is relevant to whether, for the purposes of the doctrine of unconscionable conduct, Ms Thorne was suffering from a special disability or disadvantage of which Mr Kennedy unconscientiously took advantage. But it says nothing about her will. It cannot be said that her entry into each agreement was the outcome of 'such an actual influence over the mind' of Ms Thorne that it cannot be considered her free act. The only sense in which it can be said that Ms Thorne was not 'free' was that circumstances (including Mr Kennedy's conduct) had conspired to limit the outcomes that she could realistically obtain by exercising her decision-making capacity. As to that, equity does not aspire to resolve philosophical questions about whether it is meaningful to speak of 'free will' when one's zone of autonomy has been bounded.

For those reasons, Ms Thorne's will was not overborne in the sense explained and there should not be a finding of undue influence.

Note

The pre-nuptial agreements were also set aside on the ground that Ms Thorne had been subject to unconscionable conduct in entering into the agreements. The unconscionability issue is discussed at [7.3.3c].

Questions

(1) The plurality refused to apply earlier authorities holding that the relationship of fiancée and fiancé was one of presumed undue influence. Why were the authorities rejected? What are relationships of presumed undue influence? What is the purpose of the presumption?

(2) Why did Gordon J dissent from the plurality's conclusion that Ms Thorne had signed the agreements under undue influence? Which judgment on this question do you find the more convincing?

(3) Ms Thorne received advice from an accredited family law solicitor that the pre-nuptial agreements were 'the worst that [the solicitor] had seen' and were 'entirely inappropriate'. Should a contracting party be relieved from her obligations on the ground of undue influence or unconscionability if she chooses to ignore the good advice of an experienced solicitor that she should not sign the contract?

(4) Is undue influence an equitable 'wrong', in the same sense that a tort or breach of contract are common law wrongs? Or is it a ground of unjust enrichment in respect of which a court will order restitution? Or both? On these questions, see *Anderson v McPherson (No 2)* [2012] WASC 19; (2012) ASTLR 321, [245] (Edelman J). Did Ms Thorne want either restitution for unjust enrichment or compensation for loss?

(5) Is relief for undue influence based on public policy? If so, what is the public policy?

7.3.2 Undue influence and third parties

A third party who receives property transferred as a result of undue influence must return the property or its traceable proceeds unless the third party is a good faith purchaser for value without notice of the circumstances giving rise to the undue influence (*Bank of New South Wales v Rogers* (1941) 65 CLR 42).

Where undue influence induces a spouse, de facto partner or elderly parent to guarantee repayment of a loan made by a bank to the other spouse, partner or child, a critical question will be whether the bank has notice of the undue influence. In practical terms the answer to the question depends on whether the bank comes under a duty to apply procedures aimed at identifying any improper pressure imposed on the guarantor. In Australian equity, relief has been given to the guarantor in cases where undue pressure has been exerted, or insufficient information supplied, by applying unconscionability principles or the principles laid down by the High Court of *Yerkey v Jones* (1939) 63 CLR 649. These principles are discussed in the next sections of this chapter. While the principles enunciated in *Yerkey v Jones* apply to spousal guarantees, and possibly to guarantees provided to de facto partners, the doctrines of undue influence and unconscionability apply more generally.

7.3.3 Unconscionability in equity

7.3.3a *Blomley v Ryan* [1956] HCA 81; (1956) 99 CLR 362

Background

The defendant sold 'Worrah', a large grazing property in New South Wales, to the plaintiff for £25,000.

Valuation evidence showed that the property was worth £33,450 at the date of sale. A deposit of only £5 was payable by the purchaser, with the balance being payable over four years at an interest rate below current interest rates. The defendant was an alcoholic and during the negotiations for the sale of the farm was plied with rum by the plaintiff's father and by an estate agent who was supposedly acting for the defendant but who in fact wanted the plaintiff to buy the property. When the defendant refused to complete the sale, the plaintiff applied for specific performance. The defendant counterclaimed for rescission of the sale contract on the ground that it had been procured by the plaintiff's unconscionable conduct.

Decision

The High Court, Kitto J dissenting, affirmed the trial judge's decision to refuse specific performance and order rescission of the sale contract. The plaintiff, through his agents, was aware of the defendant's alcoholism and had exploited it to obtain very favourable terms of sale. Kitto J dissented on the ground that the case was not one based on the defendant's poverty or ignorance, against which equity relieved, and that the defendant had agreed to a price for the property which adequately met his retirement needs.

Fullagar J

The case is not one of that comparatively rare class where a man's faculties, whether from age or natural infirmity or drink or any other cause, are so defective that he does not really know what he is doing – that his mind does not go with his deed. In such a case his instrument is void even at law – *non est factum* … It is a case, I think, in which relief could be obtained by the defendant, if at all, only in equity. And, when we look for the principle on which equity did grant relief in such cases, we find as so often in equity, only very wide general expressions to guide us. There was, I think, a typical difference in approach between equity and the common law. To the common law the transaction in question might be void or voidable, but the primary question was as to the reality of the assent of the person resisting enforcement of the contract. Equity traditionally looked at the matter rather from the point of view of the party seeking to enforce the contract and was minded to inquire whether, having regard to all the circumstances, it was consistent with equity and good conscience that he should be allowed to enforce it …

… [The authorities] show also that cases in which an allegation of intoxication is a main feature are approached with great caution by courts of equity. This is, I think, not so much because intoxication is a self-induced state and a reprehensible thing, but rather because it would be dangerous to lend any countenance to the view that a man could escape the obligation of a contract by simply proving that he was 'in liquor' when it was made. So we find it said again and again that *mere* drunkenness affords no ground for resisting a suit to enforce a contract. Where, however, there is real ground for thinking that the judgment of one party was, to the knowledge of the other, seriously affected by drink, equity will generally refuse specific performance at the suit of that other, leaving him to pursue a remedy at law if he so desires. And, where the court is satisfied that a contract disadvantageous to the party affected has been obtained by 'drawing him in to drink', or that there has been real unfairness in taking advantage of his condition, the contract may be set aside.

One other general observation may be made before proceeding to the facts of the present case. The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or to set a transaction aside, are of great variety and can hardly be satisfactorily classified. Among them are poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary. The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage *vis-á-vis* the other. It does not appear to be essential in all cases that the party at a disadvantage should suffer loss or detriment by the bargain.

Questions

(1) In what circumstances will addiction to drink or drugs entitle the addicted party to set aside a contract entered into under the influence of the addiction: (a) at common law and (b) in equity?

(2) The purchaser in *Blomley* v *Ryan* claimed specific performance of the contract of sale of the grazing property, but the result was that the vendor was awarded rescission. Will the court's refusal of specific performance, say on the ground of hardship, automatically entitle the defendant to rescind the contract? See chapters 5 and 6.

(3) How useful is Fullagar J's list of circumstances potentially entitling a plaintiff to rescission in equity? Is it as relevant today as it was in 1956? What would you include in an updated list?

7.3.3b *Commercial Bank of Australia Ltd v Amadio* [1983] HCA 14; (1983) 151 CLR 447

Background

The plaintiffs' son was a builder who had a large unauthorised overdraft with the defendant bank. The bank selectively dishonoured cheques drawn on the overdrawn account, paying out on some of the cheques in order to assist the son to maintain an appearance of solvency to his creditors. The bank had an interest in maintaining the son's solvency, as its subsidiary was involved in a property joint venture with the son.

The bank informed the son that it would increase his permitted overdraft on condition that the plaintiffs signed a guarantee and a mortgage over their home to secure the present and future indebtedness of his company. The plaintiffs agreed to act as guarantors, and Mr Virgo, the bank's branch manager, visited their home to obtain their signatures to the guarantee documents. The plaintiffs were elderly and had a poor command of written English. They were under the impression that the guarantee was limited to $50,000 when, in fact, it was unlimited. They also thought that the duration of the guarantee was six months when it was unlimited in duration. The bank knew that the plaintiffs had been misinformed. The son's business failed and the bank sought to enforce the guarantee. The plaintiffs applied to have the guarantee and mortgage rescinded.

Decision

The High Court, Dawson J dissenting, ordered the guarantee and mortgage to be set aside. Mason CJ, Wilson and Deane JJ held that the plaintiffs were under a special disability, when they entered into the guarantee, which was sufficiently evident to the bank, so that enforcement would be unconscientious.

Gibbs CJ held that the bank was under a duty to disclose to the plaintiffs the unusual features of the guarantee. Breach of the duty entitled the plaintiffs to rescind the guarantee.

Dawson J dissented on the ground that the trial judge had found no evidence of unconscionable conduct or material non-disclosure, and there was no reason to disturb these findings.

Mason CJ

Historically, courts have exercised jurisdiction to set aside contracts and other dealings on a variety of equitable grounds. They include fraud, misrepresentation, breach of fiduciary duty, undue influence and unconscionable conduct. In one sense they all constitute species of unconscionable conduct on the part of a party who stands to receive a benefit under a transaction which, in the eye of equity, cannot be enforced because to do so would be inconsistent with equity and good conscience. But relief on the ground of 'unconscionable conduct' is usually taken to refer to the class of case in which a party makes unconscientious use of his superior position or bargaining power to the detriment of a party who suffers from some special disability or is placed in some special situation of disadvantage, e.g., a catching bargain with an expectant heir or an unfair contract made by taking advantage of a person who is seriously affected by intoxicating drink. Although unconscionable conduct in this narrow sense bears some resemblance to

the doctrine of undue influence, there is a difference between the two. In the latter the will of the innocent party is not independent and voluntary because it is overborne. In the former the will of the innocent party, even if independent and voluntary, is the result of the disadvantageous position in which he is placed and of the other party unconscientiously taking advantage of that position.

There is no reason for thinking that the two remedies are mutually exclusive in the sense that only one of them is available in a particular situation to the exclusion of the other. Relief on the ground of unconscionable conduct will be granted when unconscientious advantage is taken of an innocent party whose will is overborne so that it is not independent and voluntary, just as it will be granted when such advantage is taken of an innocent party who, though not deprived of an independent and voluntary will, is unable to make a worthwhile judgment as to what is in his best interest.

It is not to be thought that relief will be granted only in the particular situations mentioned by their Honours. It is made plain enough, especially by Fullagar J [in *Blomley v Ryan*] that the situations mentioned are no more than particular exemplifications of an underlying general principle which may be invoked whenever one party by reason of some condition or circumstance is placed at a special disadvantage vis-á-vis another and unfair or unconscientious advantage is then taken of the opportunity thereby created. I qualify the word 'disadvantage' by the adjective 'special' in order to disavow any suggestion that the principle applies whenever there is some difference in the bargaining power of the parties and in order to emphasize that the disabling condition or circumstance is one which seriously affects the ability of the innocent party to make a judgment as to his own best interests, when the other party knows or ought to know of the existence of that condition or circumstance and of its effect on the innocent party.

Because times have changed new situations have arisen in which it may be appropriate to invoke the underlying principle. Take, for example, entry into a standard form of contract dictated by a party whose bargaining power is greatly superior, a relationship which was discussed by Lord Reid and Lord Diplock in *A Schroeder Music Publishing Co Ltd v Macaulay* [1974] 1 WLR 1308 at 1314–1315, 1316 … In situations of this kind it is necessary for the plaintiff who seeks relief to establish unconscionable conduct, namely that unconscientious advantage has been taken of his disabling condition or circumstances. …

It is to be hoped that the respondents' amended statement of claim does not find its way into the precedent books. It leaves much to be desired. It alleges unconscionable conduct and alternatively undue influence on the part of the bank. It does not, as it might have done, allege undue influence on the part of the respondents' son Vincenzo, with notice on the part of the bank. The findings, and indeed the evidence, contradict or fail to support the alleged case of undue influence on the part of the bank. The critical issue then is whether, in accordance with the principle already explained, the respondents are entitled to relief on the ground of unconscionable conduct.

There are a number of factors which go to establish that there was a gross inequality of bargaining power between the bank and the respondents, so much so that the respondents stood in a position of special disadvantage vis-á-vis the bank in relation to the proposed mortgage guarantee. By way of contrast to the bank, the respondents' ability to judge whether entry into the transaction was in their own best interests, having due regard to their desire to assist their son, was sadly lacking. The situation of special disadvantage in which the respondents were placed was the outcome of their reliance on and their confidence in their son who, in order to serve his own interests, urged them to provide the mortgage guarantee which the bank required as a condition of increasing the approved overdraft limit of his company, V Amadio Builders Pty Ltd ('the company'), from $80,000 to $270,000 and misled them as to the financial position of the company. Their reliance on their son was due in no small degree to their infirmities – they were Italians of advanced years, aged 76 and 71 respectively, having a limited command of written English and no experience of business in the field or at the level in which their son and the company engaged. They believed that the company's business was a flourishing and prosperous enterprise, though temporarily in need of funds. In reality, as the bank well knew, the company was in a perilous financial condition.

No doubt the respondents' age and lack of business experience played a part in their reliance on their son's judgment and in their failure to make any inquiries as to the financial position of the company and their failure to seek advice as to the probable or possible consequences of the transaction into which they entered. Their lack of command of English, especially written English, apart from contributing to their reliance on their son, had an additional importance. Vincenzo had informed them that the bank would present for signature a guarantee and very probably a security of some sort, though the precise nature of that security, i.e., mortgage or charge, was not specified. He had incorrectly said that the liability would be limited to a period of six months and to an amount of $50,000. Mr Virgo, the bank manager, in the conversation which took place immediately before execution, informed them that their liability under the instrument was unlimited in time, the question having been raised by Mr Amadio senior. Mr Virgo said nothing on the topic of unlimited liability because the respondents did not mention it. …

In deciding whether the bank took unconscientious advantage of the position of disadvantage in which the respondents were placed, we must ask, first, what knowledge did the bank have of the respondents' situation?

Mr Virgo was aware that the respondents were Italians, that they were of advanced years and that they did not have a good command of English. He knew that Vincenzo had procured their agreement to sign the mortgage guarantee. He had no reason to think that they had received advice and guidance from anyone but their son. In cross-examination he conceded that he believed that Vincenzo had acted in the 'role of adviser/explainer' in relation to the transaction and referred to him as acting 'in his capacity as dominant member of the family'. Mr Virgo also knew that, in the light of the then financial condition of the company, it was vital to Vincenzo to secure his parents' signature to the mortgage guarantee so that the company could continue in business. It must have been obvious to Mr Virgo, as to anyone else having knowledge of the facts, that the transaction was improvident from the viewpoint of the respondents. In these circumstances it is inconceivable that the possibility did not occur to Mr Virgo that the respondents' entry into the transaction was due to their inability to make a judgment as to what was in their best interests, owing to their reliance on their son, whose interests would inevitably incline him to urge them to sign the instrument put forward by the bank.

Indeed, the inquiry by Mr Amadio senior as to the duration of the arrangement should have alerted Mr Virgo to the likelihood that Vincenzo had not adequately or accurately explained the intended transaction to them, let alone the possible or probable consequences which attended it.

Whether it be correct or incorrect to attribute to Mr Virgo knowledge of this possibility, the facts as known to him were such as to raise in the mind of any reasonable person a very real question as to the respondents' ability to make a judgment as to what was in their own best interests. In *Owen and Gutch v Homan* (1853) 10 ER 752 at 1035, Lord Cranworth LC said:

> … [I]t may safely be stated that if the dealings are such as fairly to lead a reasonable man to believe that fraud must have been used in order to obtain [the concurrence of the surety], he is bound to make inquiry, and cannot shelter himself under the plea that he was not called on to ask, and did not ask, any questions on the subject. In some cases wilful ignorance is not to be distinguished in its equitable consequences from knowledge.

The principle there stated applies with equal force to this case. The concept of fraud in equity is not limited to common law deceit; it extends to conduct of the kind engaged in by the respondents' son when he took advantage of the confidence and reliance reposed in him to induce his parents to enter into a transaction in order to serve his ends, thereby depriving them of the ability to make a judgment as to what is in their interests.

As we have seen, if A having actual knowledge that B occupies a situation of special disadvantage in relation to an intended transaction, so that B cannot make a judgement as to what is in his own interests, takes unfair advantage of his (A's) superior bargaining power or position by entering into that transaction, his conduct in so doing is unconscionable. And if, instead of having actual knowledge of that situation, A is aware of the possibility that that situation may exist or is aware of facts that would raise that possibility in the mind of any reasonable person, the result will be the same.

The knowledge of Mr Virgo was the knowledge of the bank. Whether we treat Mr Virgo as having knowledge of the possibility already discussed or as having knowledge of facts which would raise that possibility in the mind of any reasonable person the inevitable conclusion is that the bank was guilty of unconscionable conduct by entering into the transaction without disclosing such facts as may have enabled the respondents to form a judgment for themselves and without ensuring that they obtained independent advice.

Deane J

The jurisdiction of courts of equity to relieve against unconscionable dealing developed from the jurisdiction which the Court of Chancery assumed, at a very early period, to set aside transactions in which expectant heirs had dealt with their expectations without being adequately protected against the pressure put upon them by their poverty (see *O'Rorke v Bolingbroke* (1877) 2 App Cas 814 at 822). The jurisdiction is long established as extending generally to circumstances in which (i) a party to a transaction was under a special disability in dealing with the other party with the consequence that there was an absence of any reasonable degree of equality between them and (ii) that disability was sufficiently evident to the stronger party to make it prima facie unfair or 'unconscientious' that he procure, or accept, the weaker party's assent to the impugned transaction in the circumstances in which he procured or accepted it. Where such circumstances are shown to have existed, an onus is cast upon the stronger party to show that the transaction was fair, just and reasonable: 'the burthen of shewing the fairness of the transaction is thrown on the person who seeks to obtain the benefit of the contract' (see per Lord Hatherley, *O'Rorke* v *Bolingbroke* (1877) 2 App Cas 814 at 823; *Fry v Lane* (1888) 40 Ch D 312 at 322; *Blomley v Ryan* (1956) 99 CLR 362 at 428–429).

The equitable principles relating to relief against unconscionable dealing and the principles relating to undue influence are closely related. The two doctrines are, however, distinct. Undue influence, like common law duress, looks to the quality of the consent or assent of the weaker party (see *Union Bank of Australia Ltd v Whitelaw* [1906] VLR 711 at 720; *Watkins v Combes* (1922) 30 CLR 180 at 193–194; *Morrison v Coast Finance Ltd* (1965) 55 DLR (2d) 710 at 713). Unconscionable dealing looks to the conduct of the stronger party in attempting to enforce, or retain the benefit of, a dealing with a person under a special disability in circumstances where it is not consistent with equity or good conscience that he should do so. …

In most cases where equity courts have granted relief against unconscionable dealing, there has been an inadequacy of consideration moving from the stronger party. It is not, however, essential that that should be so (see *Blomley v Ryan* (1956) 99 CLR 362 at 405; *Harrison v National Bank of Australasia Ltd* (1928) 23 Tas LR 1; but cf *Lloyds Bank v Bundy* [1975] 1 QB 326 at 337 and *Cresswell v Potter* [1978] 1 WLR 255 at 257). Notwithstanding that adequate consideration may have moved from the stronger party, a transaction may be unfair, unreasonable and unjust from the view point of the party under the disability. An obvious instance of circumstances in which that may be so is the case where the benefit of the consideration does not move to the party under the disability but moves to some third party involved in the transaction.

Notes

(1) In *Blomley v Ryan* and *Commercial Bank of Australia v Amadio*, old authorities on relieving against the exploitation of 'poverty' and 'ignorance' were generalised into the modern formulation of relieving against the exploitation of a special disadvantage where that disadvantage is known to the counterparty. Consider whether the following conditions constitute a special disadvantage either on their own or in conjunction with other factors:

(a) Emotional dependence: *Louth v Diprose* (1992) 175 CLR 621.

(b) A 'situational disadvantage', such as possessing inferior bargaining power in commercial negotiations; for example, where a tenant negotiating renewal of a lease is compelled to abandon legal claims against the landlord as the price of obtaining renewal: *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51.

(c) Addiction to gambling: *Kakavas v Crown Melbourne Ltd* (2013) 250 CLR 392.

(2) It is sometimes suggested that the defendant must have exploited the plaintiff's special disadvantage. The exploitation need not be active. The passive acceptance of a benefit in unconscionable circumstances constitutes exploitation: *Bridgewater v Leahy* (1998) 194 CLR 457.

(3) In *Kakavas v Crown Melbourne* (2013) 250 CLR 392, the High Court rejected the proposition that knowledge of a special disadvantage includes constructive knowledge. The Court stated at [161]: 'Equitable intervention to deprive a party of the benefit of its bargain on the basis that it was procured by unfair exploitation of the weakness of the other party requires proof of a predatory state of mind. Heedlessness of, or indifference to, the best interests of the other party is not sufficient for this purpose. The principle is not engaged by mere inadvertence, or even indifference, to the circumstances of the other party to an arm's length commercial transaction. Inadvertence, or indifference, falls short of the victimisation or exploitation with which the principle is concerned'.

(4) A commercially significant lending practice is asset-based lending, whereby a loan is made on a valuation of the borrower's assets available as security without regard to, and possibly in ignorance of, whether the borrower has an income from which loan repayments can be made. The practice is controversial when loans are made on this basis to enable individuals, rather than substantial corporations, to buy properties. Asset-based lending was found on the facts to be unconscionable in *Elkofairi v Permanent Trustee Co Ltd* (2002) 11 BPR 20,841 and *Stubbings v Jams 2* (2022) 399 ALR 409. Potentially relevant to cases where a lending system is implemented with the express aim of ensuring that a lender has no knowledge of the borrower's circumstances is the dictum of Edelman J in *Commonwealth Bank v Kojic* (2016) 249 FCR 421, [153], that 'it might be difficult for a corporation to avoid a finding that it has acted unconscionably if it puts into place procedures intended to ensure that no particular individual could have the requisite knowledge'.

(5) Guarantors can obtain relief against banks not only in equity but also under statute, in particular under ss 12CA and 12CB of the *Australian Securities and Investments Commission Act 2001* (Cth), which proscribes unconscionable conduct in the supply of financial services. A bank may also, in special cases, owe a common law duty of care to a guarantor. In establishing unconscionability or a breach of the duty of care, it may be relevant to determine whether the bank has complied with procedures laid down in the *Code of Banking Practice,* promulgated by the Australian Bankers' Association, which include urging the prospective guarantor to obtain legal

advice. A relevant issue in some cases is whether the *Code* has been incorporated into the contract of guarantee: see *Commonwealth Bank of Australia v Doggett* (2015) 47 VR 302, [109]–[139].

(6) In addition to equitable relief against unconscionability, legislation proscribes unconscionable conduct: see, in particular, s 20 of the *Australian Consumer Law* (formerly s 51AA of the *Trade Practices Act 1974* (Cth)) which provides that 'A person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law from time to time'. Liability under the Act can include the knowing exploitation of a special disadvantage, within the *Amadio* doctrine: see, for example, *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2003) 214 CLR 51. However, it also covers other 'conscience-based' grounds of equitable liability, such as undue influence, equitable mistake and estoppel: *Body Bronze International Pty Ltd v Fehcorp Pty Ltd* (2011) 34 VR 536, [87]. Contrast s 20 with liability for unconscionable conduct under ss 21 and 22, which is not confined to the equitable conception of unconscionability: *Australian Securities and Investments Commission v Kobelt* (2019) 267 CLR 1. All three statutory provisions require proof of 'conduct' that can be identified as unconscionable; a condition in a contract is not, without more, 'conduct' for the purpose of granting relief on the ground of unconscionability: *Paciocco v Australia & New Zealand Banking Group Ltd* [2016] HCA 28; (2016) 258 CLR 525, [185] (Gageler J).

7.3.3c *Thorne v Kennedy* [2017] HCA 49; (2017) 263 CLR 85

Background

See [7.3.1a].

Decision

The agreements entered into by Ms Thorne were set aside for unconscionability, as well as for undue influence.

Kiefel CJ, Bell, Gageler, Keane and Edelman JJ

In *Commercial Bank of Australia Ltd v Amadio* ([1983] HCA 14; (1983) 151 CLR 447 at 474), Deane J said that the equitable principles concerning relief against unconscionable conduct are closely related to those concerned with undue influence. The same circumstances can result in the conclusion that the person seeking relief (i) has been subject to undue influence, and (ii) is in a position of special disadvantage for the purposes of the doctrine concerned with unconscionable conduct. For instance, in *Diprose v Louth (No 1)* ((1990) 54 SASR 438 at 448–449), the trial judge, King CJ, observed that both doctrines were satisfied where the defendant 'was in a position of emotional dominance which gave her an influence over the [plaintiff] which she exercised unconscientiously to procure the gift of the house'. Before the High Court in that case, Mr Diprose relied only upon the ground of unconscionable conduct.

Although undue influence and unconscionable conduct will overlap, they have distinct spheres of operation. One difference is that although one way in which the element of special disadvantage for a finding of unconscionable conduct can be established is by a finding of undue influence, there are many other circumstances that can amount to a special disadvantage which would not establish undue influence. A further difference between the doctrines is that although undue influence cases will often arise from the assertion of pressure by the other party which might amount to victimisation or exploitation, this is not always required …

… The Full Court recognised that Ms Thorne was labouring under a disadvantage, although the Court did not add the adjective 'special', which, as Mason J in *Commercial Bank of Australia Ltd v Amadio* ([1983] HCA 14; (1983) 151 CLR 447 at 462) explained, is used to emphasise that the disadvantage is not a mere difference in the bargaining power but requires an inability for a person to make a judgment as to his or her own best interests. The findings by the primary judge that Ms Thorne was subject to undue influence – powerless, with what she saw as no choice but to enter the agreements – point inevitably to the conclusion that she was subject to a special disadvantage in her entry into the agreements.

Ms Thorne's special disadvantage was known to Mr Kennedy. Her special disadvantage had been, in part, created by him. He created the urgency with which the pre-nuptial agreement was required to be signed and the haste surrounding the post-nuptial agreement and the advice upon it. While Ms Thorne knew Mr Kennedy required her acknowledgement that his death would not result in her receiving a windfall inheritance at the expense of his children, she had no reason to anticipate an intention on his part to insist upon terms of marriage that were as unreasonable as those contained in the agreements. Further, Ms Thorne and her family

members had been brought to Australia for the wedding by Mr Kennedy and his ultimatum was not accompanied by any offer to assist them to return home. These matters increased the pressure which contributed to the substantial subordination of Ms Thorne's free will in relation to the agreements. Mr Kennedy took advantage of Ms Thorne's vulnerability to obtain agreements which, on Ms Harrison's uncontested assessment, were entirely inappropriate and wholly inadequate. Even within that class of agreement, the agreements which Ms Thorne signed involved 'gross inequality' *(Gartside v Isherwood* (1778) 1 Bro CC 558 at 560–561 per Lord Thurlow LC [28 ER 1297 at 1298]).

Gordon J

Plainly, Mr Kennedy, as the other party to the relationship, not only was aware of, but played a central role in creating, the various factors constituting the special disadvantage. And having regard to the circumstances in which they were entered into and their content, the financial agreements were 'neither fair nor just and reasonable' *(Bridgewater v Leahy* (1998) 194 CLR 457, 492) and the entry into them involved an unconscientious taking of advantage by Mr Kennedy.

First, the agreements were 'grossly improvident' *(Bridgewater v Leahy* (1998) 194 CLR 457, 493). Although it is not essential or necessarily decisive that there is 'an inadequacy of consideration' *(Commercial Bank of Australia Ltd v Amadio* [1983] HCA 14; (1983) 151 CLR 447 at 475), it is relevant to observe that the entitlements for which they provided in the event of separation were extraordinarily and disproportionately small in comparison to what Ms Thorne would have been entitled to if she had not entered into the agreements.

Second, the circumstances in which the agreements were entered into support the conclusion that Mr Kennedy's procurement or acceptance of Ms Thorne's assent to each agreement was unconscientious. True it is that some kind of agreement or 'paper' relating to Mr Kennedy's wealth had long been in the contemplation of the parties, and that Ms Thorne was not under any relevant misapprehension as to the effect of each agreement. However, having brought Ms Thorne to Australia promising to look after her like 'a queen', it was not until two weeks before the wedding that Mr Kennedy arranged for Ms Thorne to receive legal advice; and it was not until ten days before the wedding that she received detailed information about his finances and became aware of the specific contents of the first agreement.

It is not a sufficient response to the conclusion of unconscionable conduct to point to the fact that Ms Thorne received independent legal advice about the two agreements and chose to reject her solicitor's recommendation on each occasion. The fact that Ms Thorne was willing to sign both agreements *despite* being advised that they were 'terrible' serves to underscore the extent of the special disadvantage under which Ms Thorne laboured, and to reinforce the conclusion that in these circumstances, which Mr Kennedy had substantially created, it was unconscientious for Mr Kennedy to procure or accept her assent.

Questions

(1) How would you define the 'special disability or disadvantage' of the plaintiffs in (a) *Amadio,* and (b) *Thorne v Kennedy?* Do age, insecure migrant status or a poor command of written English constitute, without more, a special disadvantage?

(2) Unlike Mr Amadio, Ms Thorne understood the terms of the agreements she had signed and received accurate and informed legal advice on their effect. Why were these factors insufficient to negative her 'special disadvantage'?

(3) If an economically strong party compels a weaker party to enter into a standard form contract on terms disadvantageous to the weaker party, can the contract be set aside on the ground that the stronger party has exploited the special disadvantage of the weaker party?

(4) What knowledge must the defendant have of the plaintiff's special disadvantage? Will relief be given if the defendant has constructive notice of its existence?

(5) Distinguish undue influence from unconscionable conduct. Give an example of (a) a contract voidable for undue influence that is not unconscionable, and (b) a contract voidable for unconscionability that is not liable to be set aside for undue influence?

(6) In *Amadio,* Deane J considered whether the guarantee should be partially rescinded, permitting the bank to enforce the guarantee up to $50,000, being the amount the parents were willing to guarantee. He concluded that, in the circumstances, the guarantee should be totally rescinded. Why did the High Court order total rescission in *Amadio* but only partial rescission in *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995) 184 CLR 102 (see [5.2a])?

(7) Can compensation be obtained in equity where a victim of unconscionable conduct has incurred (a) financial, or (b) non-financial loss?

7.3.4 *Yerkey v Jones* liability

7.3.4a *Garcia v National Australia Bank Ltd* [1998] HCA 48; (1998) 194 CLR 395

Background

The plaintiff executed a mortgage over her share of the matrimonial home as security for repayment of all debts owed by her and her husband as guarantors of a loan made by the bank to her husband's company, Citizens' Gold Bullion Exchange Pty Ltd. The plaintiff was a director of the company. She later obtained a divorce from her husband and applied for a declaration that the guarantee and mortgage were void on the ground that the terms of the guarantee had not been sufficiently explained to her.

Decision

The High Court ordered the guarantees and mortgages to be set aside. Gaudron, McHugh, Gummow and Hayne JJ applied the principle of *Yerkey v Jones* (1939) 63 CLR 649, holding that the bank had not explained the nature and effect of the guarantees to the plaintiff. Kirby J rejected the application of the principle of *Yerkey v Jones*, but held the bank liable on the ground that it had constructive notice of undue influence and misrepresentation practised by the husband on the plaintiff since it had failed to ensure that she properly understood the guarantee.

Gaudron, McHugh, Gummow and Hayne JJ

Yerkey v Jones (1939) 63 CLR 649 was said, in argument, to reflect outdated views of society generally and the role of women in society in particular. It was submitted that changes in Australian society since 1939, when *Yerkey v Jones* was decided, require that equitable rules move on to meet these changed circumstances.

That Australian society, and particularly the role of women in that society, has changed in the last six decades is undoubted. But some things are unchanged. There is still a significant number of women in Australia in relationships which are, for many and varied reasons, marked by disparities of economic and other power between the parties. However, the rationale of *Yerkey v Jones* is not to be found in notions based on the subservience or inferior economic position of women. Nor is it based on their vulnerability to exploitation because of their emotional involvement, save to the extent that the case was concerned with actual undue influence.

So far as *Yerkey v Jones* proceeded on the basis of the earlier decision of Cussen J in *Bank of Victoria Ltd v Mueller* [1925] VLR 642, it is based on trust and confidence, in the ordinary sense of those words, between marriage partners. The marriage relationship is such that one, often the woman, may well leave many, perhaps all, business judgements to the other spouse. In that kind of relationship, business decisions may be made with little consultation between the parties and with only the most abbreviated explanation of their purport or effect. Sometimes, with not the slightest hint of bad faith, the explanation of a particular transaction given by one to the other will be imperfect and incomplete, if not simply wrong. That that is so is not always attributable to intended deception, to any imbalance of power between the parties, or, even, the vulnerability of one to exploitation because of emotional involvement. It is, at its core, often a reflection of no more or less than the trust and confidence each has in the other.

It may be that the principles applied in *Yerkey v Jones* will find application to other relationships more common now than was the case in 1939 – to long term and publicly declared relationships short of marriage between members of the same or of opposite sex – but that is not a question that falls for decision in this case. It may be that those principles will find application where the husband acts as surety for the wife but again that is not a problem that falls for decision here. This case concerns a husband and wife and it is to that relationship that the present decision relates, just as it is concerned only with the circumstance of the wife acting as surety for her husband. The resolution of questions arising in the context of other relationships may well require consideration of other issues. Thus to take one example, if cohabitation is taken as a criterion, what should a lender know or seek to find out about the nature of the relationship between the parties? But those issues did not arise and were not debated on the hearing of this appeal.

In his reasons for decision in *Yerkey v Jones,* Dixon J dealt with at least two kinds of circumstances: the first in which there is actual undue influence by a husband over a wife and the second, that dealt with in *Mueller*, in which there is no undue influence but there is a failure to explain adequately and accurately the suretyship transaction which the husband seeks to have the wife enter for the immediate economic benefit not of the wife but of the husband, or the circumstances in which her liability may arise. The former kind of case is one concerning what today is seen as an imbalance of power. In point of legal principle, however, it is actual undue influence in that the wife, lacking economic or other power, is overborne by her husband and goes surety for her husband's debts when she does not bring a free mind and will to that decision. The latter case is not so much concerned with imbalances of power as with lack of proper information about the purport and effect of the transaction. The present appeal concerns circumstances of the latter kind rather than the former.

[After setting out passages from the judgment of Dixon J in *Yerkey v Jones,* the plurality judgment continued.]

Thus, Dixon J was dealing with two kinds of case. In the former, the case of actual undue influence, as Dixon J says, explaining the effect of the document to the surety will not protect the creditor and '[n]othing but independent advice or relief from the ascendancy of her husband over her judgment and will would suffice'. In the latter, '[i]f the creditor takes adequate steps to inform [the wife] and reasonably supposes that she has an adequate comprehension of the obligations she is undertaking and an understanding of the effect of the transaction, the fact that she has failed to grasp some material part of the document, or, indeed, the significance of what she is doing' cannot give her an equity to set the instrument aside. ....

It was submitted that *Yerkey v Jones* has been overruled by *Amadio* or that the principles applied in *Yerkey v Jones* had been subsumed in principles applied in *Amadio.*

There are several answers to this contention. First, there is nothing in *Amadio* that suggests that it was intended to overrule *Yerkey v Jones* or to subsume the rules applied there in some broader principle enunciated in *Amadio.*

Secondly, far from anything said in *Amadio* suggesting that it was intended to mark out the boundaries of the whole field of unconscionable conduct, as Mason J said ((1983) 151 CLR 447 at 461):

> It goes almost without saying that it is impossible to describe definitively all the situations in which relief will be granted on the ground of unconscionable conduct.

Thirdly, *Amadio* was a case of unconscionable conduct very different from the cases considered in *Yerkey v Jones*. In *Amadio* there was actual misconduct on the part of the son of the respondents which affected their entry into the mortgage and guarantee and the bank was on notice of that misconduct. There was no allegation of undue influence by the son with notice on the part of the bank (a situation corresponding to that in *Bank of New South Wales v Rogers* (1941) 65 CLR 42), nor was the alleged case of undue influence on the part of the bank made out. What Mason J identified as '[t]he critical issue' ((1983) 151 CLR 447 at 464) was whether the plaintiffs were entitled to relief on the ground of unconscionable conduct. The transaction was not enforced against the respondents because it would have been unconscionable for the bank to do so. And it was unconscionable for the bank to enforce it because the bank's employee had shut his eyes to the vulnerability of the respondents and the misconduct of their son.

The principles applied in *Yerkey v Jones* do not depend upon the creditor having, at the time the guarantee is taken, notice of some unconscionable dealing between the husband as borrower and the wife as surety. *Yerkey v Jones* begins with the recognition that the surety is a volunteer: a person who obtained no financial benefit from the transaction, performance of the obligations of which she agreed to guarantee. It holds, in what we have called the first kind of case, that to enforce that voluntary transaction against her when in fact she did not bring a free will to its execution would be unconscionable. It holds further, in the second kind of case, that to enforce it against her if it later emerges that she did not understand the purport and effect of the transaction of suretyship would be unconscionable (even though she is a willing party to it) if the lender took no steps itself to explain its purport and effect to her or did not reasonably believe that its purport and effect had been explained to her by a competent, independent and disinterested stranger. And what makes it unconscionable to enforce it in the second kind of case is the combination of circumstances that: (a) in fact the surety did not understand the purport and effect of the transaction; (b) the transaction was voluntary (in the sense that the surety obtained no gain from the contract the performance of which was guaranteed); (c) the lender is to be taken to have understood that, as a wife, the surety may repose trust and confidence in her husband in matters of business and therefore to have understood that the husband may not fully and accurately explain the purport and effect of the transaction to his wife; and yet (d) the lender did not itself take steps to explain the transaction to the wife or find out that a stranger had explained it to her.

It will be seen that the analysis of the second kind of case identified in *Yerkey v Jones* is not one which depends upon any presumption of undue influence by the husband over the wife. As we have said, undue influence is dealt with separately and differently. Nor does the analysis depend upon identifying the husband as acting as agent for the creditor in procuring the wife's agreement to the transaction. Rather, it depends upon the surety being a volunteer and mistaken about the purport and effect of the transaction, and the creditor being taken to have appreciated that because of the trust and confidence between surety and debtor the surety may well receive from the debtor no sufficient explanation of the transaction's purport and effect. To enforce the transaction against a mistaken volunteer when the creditor, the party that seeks to take the benefit of the transaction, has not itself explained the transaction, and does not know that a third party has done so, would be unconscionable. …

We consider that the only question of notice that arises is whether the creditor knew at the time of the taking of the guarantee that the surety was then married to the creditor. Other questions of notice do not intrude.

As is apparent from what was said in *Yerkey v Jones* the creditor may readily avoid the possibility that the surety will later claim not to have understood the purport and effect of the transaction that is proposed. If the creditor itself explains the transaction sufficiently, or knows that the surety has received 'competent, independent and disinterested' advice from a third party *(Yerkey v Jones* at 686, Dixon J), it would not be unconscionable for the creditor to enforce it against the surety even though the surety is a volunteer and it later emerges that the surety claims to have been mistaken.

What then of the present case? The trial judge found that the appellant did not understand the purport or effect of the transaction. She knew it was a guarantee but she thought it was a guarantee of limited overdraft accommodation to be applied only in the purchase of gold. Nor did she understand that her obligations under the guarantee were secured by the mortgage which she had given over her home. It being found that the bank took no step to explain the transaction to her and knew of no independent advice to her about it (there having been no such independent advice) the conclusion that the appellant was entitled to succeed in her claim to set the transaction aside was inevitable if she was a volunteer.

The trial judge found that the appellant was not 'directly involved' in Citizens Gold *(Murphy v Wright* (1993) 5 BPR 11,996 at 12,006). And he made this finding notwithstanding that the surety was shown in records held by the Australian Securities Commission to be both a director of, and a shareholder in, the company. The records of Citizens Gold held at the Australian Securities Commission presented, however, a confusing picture of movements in shareholdings over the years: so confusing that the trial judge said that it could be 'seen from the records that the exact beneficial holding in the various companies [including Citizens Gold] is quite obscure' *(Murphy v Wright* at 12,005). Although the trial judge found that from time to time some benefit flowed to the family from the companies, he found that they were companies that were in the 'complete control' of the appellant's husband. Taken as a whole, those findings demonstrate that the appellant in fact obtained no real benefit from her entering the transaction; she was a

volunteer. The fact that she was a director of the company is nothing to the point if, as the trial judge's findings show, she had no financial interest in the fortunes of the company.

Questions

(1) What are the two types of case to which the principle of *Yerkey v Jones* applies? Why is the first type of case not covered by the law of undue influence? Which type of case was *Garcia*?

(2) Do you agree with this observation of Margaret McMurdo P in *Agripay Pty Ltd v Byrne* [2011] QCA 85; [2011] 2 Qd R 501, 507 [4]: 'There seems to be no sound reason why these principles should be limited to wives entering into guarantees of their husbands' liabilities. Human weakness and unconscionable conduct are not limited to heterosexual relationships. These legal principles should apply equally to all vulnerable partners in personal relationships'. See also *Kranz v National Australia Bank Ltd* [2003] VSCA 92; (2003) 8 VR 310, 319–22 [24]–[31]; and J Edelman and E Bant, 'Setting aside contracts of suretyship: The theory and practice of both limbs of *Yerkey v Jones*' (2004) 15 *Journal of Banking and Finance Law and Practice* 5.

(3) What is meant by a 'volunteer' in this context? Why was Mrs Garcia a volunteer even though she was a director of Citizens Gold Bullion Exchange?

7.4 Equitable relief against penalties and forfeiture

Equitable relief from penalties and forfeiture of property interests differs from other equitable interventions into contract law, being directed towards promoting the *substantive* fairness of a contract (focusing on the outcome of the bargaining process), rather than questions of *procedural* fairness (focusing on how the bargain was reached). Classical contract theory holds that the parties, and not the court, are the best judges of the substantive merits of a contract. From this perspective, equitable relief on these grounds is problematic. Moreover, there is a danger in this area that ingenious drafting can subvert the application of equitable principles. One aim of the High Court decision of *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30; (2012) 247 CLR 205 was to prevent the undermining of equitable principles and to re-emphasise the importance of substance over form. But the aim was arguably achieved at the expense of commercial certainty. It has been suggested that equitable intervention should be limited to cases of procedural unfairness (S Worthington, *Equity* (Oxford University Press, 2nd ed, 2006) 227). See also the decision of the United Kingdom Supreme Court in *Cavendish Square Holding BV v Talal El Makdessi* [2016] AC 1172.

7.4.1 Relief against penalties

The application of the penalties doctrine requires two distinct questions to be answered. The questions were considered at different stages of *Andrews v Australia and New Zealand Banking Group Ltd* and *Paciocco v Australia & New Zealand Banking Group Ltd*, where the legitimacy of charges levied by banks on their personal and business customers were tested in a class action. The first question is to determine whether the penalties doctrine is engaged. Before *Andrews v Australia and New Zealand Banking Group Ltd*, it had generally, but not universally, been assumed that the doctrine applied to sums of money payable (or property transferable) on breach of contract. The High Court in *Andrews* held that it was not only breaches of contract, but also non-compliance with some other conditions in contracts giving rise to payment obligations, that attract the operation of the penalties doctrine.

If the doctrine is engaged, the second question is whether the sum payable, or property transferable, under the contract in fact constitutes a penalty and not a liquidated damages provision. The latter is a genuine pre-estimate of the loss likely to be incurred by the innocent party as a result of a breach of contract or non-compliance with a condition. Such a provision is judicially enforceable. Whether a payment provision constitutes a penalty will be assessed as at the date of entry into the contract and not at the date of breach. The High Court in *Paciocco v Australia & New Zealand Banking Group Ltd* reviewed the criteria for determining whether a contractual payment constitutes a

penalty. A payment provision found to be a penalty will be unenforceable although the innocent party will still be entitled to damages for actual loss flowing from a breach of contract.

7.4.1a *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30; (2012) 247 CLR 205

Background

Over 30,000 customers commenced representative proceedings in the Federal Court against the defendant bank seeking declarations that fees payable by customers under their contracts with the bank for honouring or dishonouring cheques, late payment fees and over-limit fees (the 'exception fees') were void and unenforceable as penalties. The fees were not payable upon breach of contract but on failure of the customer to satisfy contractual conditions. The bank argued that the penalties doctrine only applied to sums payable under the terms of a contract upon breach of contract. Since the exception fees were not payable upon breach, they fell outside the scope of the doctrine.

Decision

The High Court held that the penalties doctrine applied even though the sums were not payable upon breach of contract. The case was remitted to the Federal Court to determine whether the exception fee provisions were in fact void on the ground that they were penalties against which equity grants relief.

The Court

In general terms, a stipulation prima facie imposes a penalty on a party (the first party) if, as a matter of substance, it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party an additional detriment, the penalty, to the benefit of the second party. In that sense, the collateral or accessory stipulation is described as being in the nature of a security for and in terrorem of the satisfaction of the primary stipulation. If compensation can be made to the second party for the prejudice suffered by failure of the primary stipulation, the collateral stipulation and the penalty are enforced only to the extent of that compensation. The first party is relieved to that degree from liability to satisfy the collateral stipulation.

It has been established at least since the decision of Lord Macclesfield in *Peachy v Duke of Somerset* ((1720) 93 ER 626) that the penalty doctrine is not engaged if the prejudice or damage to the interests of the second party by the failure of the primary stipulation is insusceptible of evaluation and assessment in money terms. It is the availability of compensation which generates the 'equity' upon which the court intervenes; without it, the parties are left to their legal rights and obligations. The point is illustrated by *Waterside Workers' Federation of Australia v Stewart* ((1919) 27 CLR 119). A bond was given by the appellant in the sum of £500 on condition that it pay £50 if and so often as its members in combination should go on strike. Isaacs and Rich JJ emphasised that, whilst refusal to work almost inevitably would cause loss to employers, 'no one can ever tell how much loss is sustained by not doing business' and on the principle stated by Lord Macclesfield no relief was to be given against payment of the £50.

It should be noted that the primary stipulation may be the occurrence or non-occurrence of an event which need not be the payment of money. Further, the penalty imposed upon the first party upon failure of the primary stipulation need not be a requirement to pay to the second party a sum of money. …

… The primary judge erred in concluding, in effect, that in the absence of contractual breach or an obligation or responsibility on the customer to avoid the occurrence of an event upon which the relevant fees were charged, no question arose as to whether the fees were capable of characterisation as penalties.

Indeed, a further issue appears to have been presented by her Honour's findings set out above. This may be stated as being whether the requirement to pay the fees in question was not enjoyed by the ANZ as security for performance by the customer of its other obligations to the ANZ, or whether the fees were charged by the ANZ, as specified in pre-existing arrangements with the customer, and ANZ, respectively, for the further accommodation provided to the customer by its authorising payments upon instructions by the customer upon which the ANZ otherwise was not obliged to act, or upon refusal of that accommodation.

The operative distinction would be that upon which the majority of the New South Wales Court of Appeal (Jacobs JA and Holmes JA) decided *Metro-Goldwyn-Mayer Pty Ltd v Greenham* ([1966] 2 NSWR 717 at 723–724, 727). Their Honours contrasted a stipulation attracting the penalty doctrine and one giving rise consensually to an additional obligation. This distinction had been identified long before, by Lord St Leonards in *French v Macale* ((1842) 2 D & W 269, 275–276), as follows:

> [I]t appears, that the question for the Court to ascertain is, whether the party is restricted by covenant from doing the particular act, although if he do it a payment is reserved; or *whether according to the true construction of the contract, its meaning is, that the one party shall have a right to do the act, on payment of what is agreed upon as an equivalent.* If a man let meadow land for two guineas an acre, and the contract is, that if the tenant choose to employ it in tillage, he may do so, paying an additional rent of two guineas an acre, no doubt this is a perfectly good and unobjectionable contract; the breaking up the land is not inconsistent with the contract, which provides, that in case the act is done the landlord is to receive an increased rent. (Emphasis added.)

… In *Metro-Goldwyn-Mayer,* the contract for the hiring of films to exhibitors for public showing conferred the right to one screening only. The exhibitor was obliged to pay for each additional screening a sum equivalent to four times the original fee. The questions of construction of the contract were resolved by Jacobs JA and Holmes JA in such a fashion that the penalty doctrine had no application. Jacobs JA concluded ([1966] 2 NSWR 717, 723):

> There is no right in the exhibitor to use the film otherwise than on an authorised occasion. If he does so then he must be taken to have exercised an option so to do under the agreement, if the agreement so provides. The agreement provides that he may exercise such an option in one event only, namely, that he pay a hiring fee of four times the usual hiring fee.

But it should be emphasised that the determination, with respect to the relevant exception fees, of live issues of this nature is entirely a matter upon further trial, along with the grounds upon which the applicants submit the penalty doctrine does apply to those fees.

Note

For the response of the United Kingdom Supreme Court to this decision, see *Cavendish Square Holding BV v Talal El Makdessi* [2016] AC 1172, [40]–[43] (Lord Neuberger, rejecting the extension of the doctrine beyond breach of contract). Lord Neuberger noted that the 'breach' requirement had resulted in the avoidance of the penalties doctrine by 'ingenious drafting', rendering a contracting party liable to make a payment upon failure to comply with a condition not constituting a breach of contract. However, he stated at [15] that 'the capricious consequences of this state of affairs are mitigated by the fact that, as the equitable jurisdiction shows, the classification of terms for the purpose of the penalty rule depends on the substance of the term and not on its form or on the label which the parties have chosen to attach to it'.

Questions

(1) After *Andrews*, in what circumstances will the penalties doctrine apply in equity?

(2) How does the equitable doctrine of penalties differ from the common law doctrine? Do you think that the doctrines should be fused?

(3) Does the High Court decision undermine commercial certainty by bringing within the scope of the penalties doctrine conditional payment clauses which are routinely inserted into contracts entered into between commercial parties? See JW Carter, W Courtney, E Peden, A Stewart and GJ Tolhurst, 'Contractual penalties: Resurrecting the equitable jurisdiction' (2013) 30 *Journal of Contract Law* 99, 112–13.

(4) Suppose that a contract of loan provides that the annual interest payable by the borrower will be 10 per cent but that, if the borrower makes timely payment of the monthly repayment instalments for six months, the annual interest rate shall be reduced to five per cent. Does the provision come within the penalties doctrine? See *Kellas-Sharpe v PSAL Ltd* [2013] QCA 371; [2013] 2 Qd R 233.

(5) In *Cavendish Square Holding BV v Talal El Makdessi* (see note above), Lord Neuberger stated that determining whether a breach of contract had been committed was a matter of substance, and did not depend on the formal drafting of the contract. Is this a preferable approach to solving problems caused by 'ingenious drafting' of the kind revealed by the bank charges litigation? Is it open to the same criticisms that have been made of the *Andrews* decision?

7.4.1b *Paciocco v Australia & New Zealand Banking Group Ltd* [2016] HCA 28; (2016) 258 CLR 525

Background

After the High Court in *Andrews* had remitted the bank charges litigation to the Federal Court, the only charges found to be penalties were late payment fees payable on a customer's personal and business credit card for failure to make minimum monthly amounts payable by a specified date. The failure to pay the amounts by the due date constituted a breach of contract, so that the test laid down in *Andrews* for determining the applicability of the penalties doctrine was not engaged.

The bank conceded that the amount of the late payment fee bore no relation to the costs incurred by a customer's late payment. It argued, however, that it was entitled to take into account other costs in fixing the amount of the fee. These other costs were provisioning costs (being the provision made in the bank's accounts for the risk of customer default), regulatory capital costs (being the amount regulators required the bank to set aside as a buffer against unexpected losses) and operational costs (being part of the bank's costs in collecting debts it was owed). The primary judge held that no account could be taken of these costs in determining whether the late payment was a penalty. The Federal Court, reversing the decision, held that these costs were relevant to setting the amount of the fee.

Decision

The High Court, Nettle J dissenting, held that the bank had a legitimate interest in imposing the late payment fee and that the amount was not out of proportion to the bank's interest in enforcing the obligation to which the payment provision applied. The judgments reassessed the House of Lords decision in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79, where Lords Dunedin and Atkinson had laid down criteria for distinguishing a penalty from a liquidated damages clause.

Keane J

The preceding discussion of the rationale of the penalty rule affords a contemporary framework for a discussion of Lord Dunedin's statements in *Dunlop* ([1914] UKHL 1; [1915] AC 79 at 86–87) upon which the appellants' case was based. Lord Dunedin was concerned to offer guidance in drawing the distinction between an agreed payment and a penalty. His Lordship said:

> **(2)** The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage.
>
> **(3)** The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach.
>
> **(4)** To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:
>
> > **(a)** It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.
> >
> > **(b)** It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid.
> >
> > **(c)** There is a presumption (but no more) that it is penalty when 'a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage'.
> >
> > On the other hand:
> >
> > **(d)** It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties.' (citations omitted)

Four points may be made here in relation to his Lordship's propositions. First, it is to be noted that proposition 4(b) harks back to the classic case of a bond upon condition to secure the payment of a lesser sum by a covenant to pay a greater sum. The more general run of cases, where breach engages an obligation to pay a specified sum, is addressed by Lord Dunedin's proposition 4(a).

...

The late payment fee is not within … Lord Dunedin's proposition 4(b). As Allsop CJ noted *(Paciocco* [2015] FCAFC 50 at [137]), '[t]he fee may or may not, in fact, be greater than the sum due; [but] that does not appear on the face of the provision, or from an understanding of the facts.' Thus, the late payment fee was not necessarily a demand for payment of a larger sum upon failure to pay a smaller sum. The appellants' attempt to rely upon Lord Dunedin's proposition 4(b) is out of step, not only with the rationale of the penalty rule applicable in cases of breach of contract, but with authority. It is proposition 4(a), not proposition 4(b), on which the appellants' case must depend.

Secondly, as Mason CJ and Wilson J observed in *Hungerfords v Walker* ([1989] HCA 8; (1989) 171 CLR 125 at 146), 'legal and economic thinking about the remoteness of financial and economic loss have developed markedly in recent times.' This observation has much force. It was only in that case, decided in 1989, that Australian jurisprudence finally accepted the (now obvious) economic reality that to be kept out of money due is to suffer real economic loss so that damages should be recoverable in tort for loss of the use of money. More recent decisions have recognised the nature of the consequences for a lender of a default by a borrower in a payment obligation, and that these consequences extend beyond the mere fact of non-payment of the sum due on the due date … In *Lordsvale Finance Plc v Bank of Zambia* ([1996] QB 752 at 763), Colman J observed that:

> the borrower in default is not the same credit risk as the prospective borrower with whom the loan agreement was first negotiated. … [M]oney is more expensive for a less good credit risk than for a good credit risk.

The common law's relatively recent acceptance of the economic reality that risky credit is more expensive credit has been accompanied by an appreciation of the nature of the relationship between the greater financial risk assumed by a bank by reason of late

payments by customers and the costs to the bank's revenue stream associated with that increased risk. In short, if the adverse effects of late payment upon the bank's revenue stream are not covered by a late payment fee, those expenses can be expected to be covered by other charges, or by way of higher interest rates, imposed across the class of bank customers who use the same lending facility as the contract breaker. In this regard, in the United States, the Court of Appeals for the Second Circuit in *Citibank NA v Nyland (CF8) Ltd* ([1989] USCA 2 609; 878 F 2d 620 at 625 (2nd Cir 1989)), referring to earlier authority in that Court which rejected the assertion that an uplift in interest rates upon default was a penalty, said:

> [D]ebtors might fare worse … if creditors were not allowed to impose variable rates, because creditors would then impose higher rates for the full life of the loan in order to reallocate the risk.

Thirdly, á propos of Lord Dunedin's proposition 4(c), which states a 'presumption' (albeit a weak one) that a single lump sum payable on the occurrence of one of several breaches of differing levels of seriousness is a penalty, it may be said that Mr Paciocco's choice to run his affairs by risking the fees affords a practical demonstration that the fixed quantum of the fee was sufficiently modest in amount that it was not apt, in the circumstances of its contemplated operation, to have an effect in terrorem of Mr Paciocco ….

… In the present case, as noted above, Mr Paciocco freely risked incurring the late payment fee as a matter of his own convenience. It can be inferred that having to pay the fee was, in the commercial context in which the fee was to operate, an acceptable cost of avoiding the expense and inconvenience of meeting his obligations as to timely payment of his account. That such an inference is available as to the operation of the provision in its commercial context is inconsistent with a purpose of punishment for breach.

Fourthly, Lord Dunedin's summary was meant as a guide to the application of the rule. His Lordship's propositions were not intended to be applied as if they were the provisions of a statute. The terms 'extravagant' and 'unconscionable' in Lord Dunedin's proposition 4(a) are not used in contradistinction to 'reasonable', much less as free-standing criteria of invalidity. In proposition 4(a), the terms 'extravagant' and 'unconscionable' function as pointers towards the punitive purpose which imbues the challenged provision with the character of a punishment.

In *Cavendish Square Holding BV v Makdessi* ([2015] UKSC 67 at [36]–[38]), Lord Neuberger and Lord Sumption accepted that, although there was 'a case' for judicial abrogation of the penalty rule on the ground that it is 'antiquated, anomalous and unnecessary, especially in the light of the growing importance of statutory regulation', the penalty rule should be retained because it serves the useful purpose of preventing a party from exercising a remedy where 'the adverse impact of [the remedy] on the defaulter significantly exceeds any legitimate interest of the innocent party.' (ibid at [29]) Lord Neuberger and Lord Sumption considered that the courts can avoid inappropriate application of the penalty rule (ibid at [39]):

> (i) by [proceeding upon] a realistic appraisal of the substance of contractual provisions operating on breach, and (ii) by taking a more principled approach to the interests that may properly be protected by the terms of the parties' agreement.

In *Andrews*, this Court summarised ([2012] HCA 30; (2012) 247 CLR 205 at 236) the 'critical issue' as being 'whether the sum agreed was commensurate with the interest protected by the bargain.' This Court's discussion in *Andrews* of the decision in *Dunlop* focused upon the reasons of Lord Atkinson ([1914] UKHL 1; [2015] AC 79 at 91–93), who accepted that an agreed payment upon breach should not be unenforceable where, though it 'appeared imprecise as a pre-estimate of damage, it protected the [seller's] interest in preventing undercutting, which would disorganise its trading system'. Accordingly, the question to be addressed in order to distinguish a penalty from a provision protective of a legitimate interest is *(Cavendish Square Holding BV v Makdessi* [2015] UKSC 67 at [255]):

> whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract.

ANZ'S LEGITIMATE INTEREST

It may be accepted immediately that a bank, like any other party to a contract, has no legitimate interest in punishing its customers for their defaults or in threatening them with punishment in order to discipline their behaviour. But a bank has a multi-faceted interest in the timely performance of its customers' obligations as to payment.

The legitimate interest of ANZ protected by the late payment fee cannot be apprehended without an understanding of the commercial context in which that interest requires protection. It is an awkward irony of the appellant's case that, in a class action representing many claimants unified in their assertion that this aspect of the contract of adhesion made by each of them with the bank is unenforceable as a penalty, the appellant's focus was upon the individual contract between Mr Paciocco and ANZ.

Lord Dunedin in *Dunlop* ([1914] UKHL 1; [1915] AC 79 at 87–88) recognised that the supposedly penal character of the operation of a contractual term must be understood by reference to the 'inherent circumstances' in which it is to operate. In the present case, those circumstances include the fact that ANZ is a bank engaged in providing financial accommodation by way of bank card facilities to many customers on standard terms. The agreement, common to each customer, to pay the late payment fee required by ANZ was an aspect of ANZ's business which enabled the bank to provide accommodation to each customer. The fixing of risk and reward on each side of each transaction reflected the circumstance that it was one of many transactions and that the very multiplicity of these transactions was a factor bearing upon the pricing of each facility to each of many customers. The circumstance that the value of an increase in credit risk may be difficult to assess is a consideration which tends against an affirmative conclusion that the stipulation is to be characterised as a punishment. That consideration gains added force where the creditor is a bank which, as such, is exposed to the risk that many borrowers may default at one time in circumstances unforeseen at the time of the original arrangements.

One aspect of ANZ's interest is obvious as an ordinary aspect of the business of a bank. Because of the relationship between the financial risks assumed by a lender and the cost of the facility to customers, the economic effect of provisions calculated to secure the protection of the bank by a late payment clause cannot be viewed in isolation from other elements of the cost of the facility to borrowers, such as interest …

Another legitimate interest which is an ordinary aspect of the business of a bank is the freedom the bank obtains, by timely repayment by its customers, to pursue more profitably its business of lending to its customers than would be the case if it is constrained to take into account the effect of defaulting customers upon its revenues. This interest is not limited to the loss of the opportunity to profit by re-investing funds paid late. If a bank's customers comprised only borrowers who paid on time in accordance with their contractual arrangements, the bank's freedom from the risks associated with late payment would enable it to maximise its revenues by reducing the cost of its facilities to all its customers in order to secure more customers and hence higher revenues. Some lenders may seek to improve their profits by deliberately soliciting the business of chronic defaulters, but it would be distinctly naïve to think that those borrowers would not be required to pay for a less attractive credit rating by higher interest rates.

Pre-estimate of damage or recoverable damages

The appellants argued that the Full Court misapplied Lord Dunedin's proposition 4(a). They noted that the expression used in *Dunlop* – 'the greatest loss that could conceivably be proved to have followed from the breach' – speaks only of damages recoverable by action in consequence of a breach of contract and not of loss which is too remote to be compensated by an award of damages. The appellants' submission was that it is not the case that any set of circumstances resulting in loss that might be hypothesised can be taken into account in assessing whether a clause is penal.

The appellants submitted that the primary judge was correct to reject ANZ's submission that 'increase in loss provisions' and 'increase in the cost of regulatory capital' were losses incurred as a result of late payment and to conclude that these matters were too remote to form part of compensable damage. The appellants also argued that, to the extent that the Full Court held that collection costs exceeding the amount of the late payment fee could be taken into account, that finding should be set aside.

It is not the case that authoritative formulations of the test of punitive extravagance are invariably stated in terms of a comparison between the impugned payment and what might be recovered by litigation. This Court said in *Ringrow Pty Ltd v BP Australia Ltd* ([2005] HCA 71; (2005) 224 CLR 656 at 662):

> The law of penalties, in its standard application, is attracted where a contract stipulates that on breach the contract-breaker will pay an agreed sum which exceeds what can be regarded as a genuine pre-estimate of the damage likely to be caused by the breach.

It will be noted that this formulation of the rule does not depend upon a demonstration of the quantum of damages which would be recovered in an action. To speak of damage, as opposed to damages, is to speak of the loss caused by the breach, not the remedy which might be awarded by a court. To speak of a 'genuine pre-estimate of the damage' is to speak of the damage liable to be suffered by those parts of the bank's legitimate business interest that it is trying to protect. A genuine pre-estimate of that damage may encompass items of loss actually suffered, albeit too remote to be compensable by way of damages by virtue of the rules in *Hadley v Baxendale* ((1854) 9 Ex 341; 156 ER 145). An agreement for the recovery of such loss is consistent with the absence of a punitive purpose. For a party to stipulate for a more ample remedy than is available at law is not to visit a punishment on the other party.

An agreed provision avoids the uncertainty and expense of litigation. The benefit of such a provision to both parties and to the legal system is obvious. Even in medieval times, the authority we know as Bracton considered that a clause providing for the payment of an agreed sum upon a breach of contract served the legitimate purpose of removing the uncertainty and expense of litigation involved in establishing the quantum of damages recoverable for a breach of contract.

Nettle J (dissenting)

Prima facie, where a bargain is for the provision of a credit card facility made available at an agreed rate of interest, the lender's only legitimate interest in the enforcement of the primary obligation is repayment of the facility with interest at the agreed rate plus adequate recoupment of any costs imposed on the lender as a result of the customer's failure to adhere to the terms of the facility. Other things being equal, the lender's interest to be protected by the bargain does not extend to the payment of a liquidated sum that is disproportionate to any amount of additional costs imposed on the lender by reason of the breach or which could have been conceived of at the time of entry into the contract as a cost which would be incurred as a result of the breach.

Of course, there are exceptions. In some cases, there may be evidence or other indications of some broader interest to be protected … But, for reasons which will be explained, in this case, there is no evidence or other indication of any interest to be protected by the timeous performance of the Monthly Payments obligation apart from the avoidance of costs.

In *Dunlop,* the evidence given by the appellant's manager established that the payment in question was calculated to protect Dunlop's pricing structure, and thus goodwill, albeit that it was impossible to quantify the damage to its pricing structure or goodwill other than to say that it was potentially very substantial. …

In contrast here, as has been seen, the only evidence offered in support of the late payment fee was Mr Inglis' projections as to what he termed the greatest amount of costs which could conceivably have been, but which were not in fact, incurred. On the available evidence, including any inferences which might legitimately be drawn from the fact that the late payment fee was imposed by a bank, and that there were a very large number of customers of the Bank with similar credit card facilities, the only interest which it might reasonably be supposed the Bank had in the timeous performance of the Monthly Payments obligation was the avoidance of the costs in fact incurred or the costs which the parties could reasonably have conceived at the time of entry into the contract would flow from late payment.

Counsel for the Bank contended that it could be assumed that the Bank had an interest in keeping its cost of funds to a minimum and therefore that the late payment fee was calculated to ensure a degree of compliance with the Monthly Payments obligation resulting in a risk profile of the Bank's credit card account assets which optimised the Bank's cost of funds. In short, it was contended that riskier credit self-evidently is more costly credit.

That contention is not persuasive. There was no evidence of how much greater the cost of funds might be and, in the absence of evidence, as Mr Regan observed, it is equally probable that the likelihood of default in performance of the obligation to make Monthly Payments was already priced into the relatively high rates of interest charged on credit card facilities. There is, moreover, no apparent correlation between the amount of the late payment fee and the amount and duration of lateness of the Monthly Payments; and, in that critical respect, the late payment fee is the antithesis of the kind of interest rate increase which Colman J concluded in *Lordsvale Finance Plc v Bank of Zambia* ([1996] QB 752 at 763) could be justified on the basis that riskier credit is more costly credit.

Counsel for the Bank also submitted that the late payment fee could be viewed as a 'non- punitive' financial incentive, set by the Bank in the context of a competitive banking market, of which the objective purpose was to encourage customers to comply with the terms of their facilities as opposed to punishing them for failing to comply with those terms.

That submission is equally unpersuasive. Whether the late payment fee is called an incentive or a punishment is beside the point. In effect, every penalty (or punishment) is an incentive even though not every incentive is a penalty. As the law of penalties has evolved, however, it is not concerned with whether an obligation is properly to be conceived of as a punishment as such. It is concerned with whether an obligation to make a payment on breach of a contractual or other principal obligation is of an amount which

is grossly disproportionate to the foreseeable consequences of the breach. In effect, the gross disproportion is in itself sufficient to render the obligation 'unconscionable' and therefore unenforceable. Accordingly, in England, and hitherto in this country, the main purpose of the law of penalties has been as a rule of law to prevent a party recovering a sum of money in respect of a breach of contract which bears little or no relationship to the loss actually suffered by that party. And, similarly, in equity, as Mason and Wilson JJ observed in *AMEV-UDC Finance Ltd v Austin* ([1986] HCA 63; (1986) 162 CLR 170 at 190) (and as was later re-affirmed in *Andrews* [2012] HCA 30; (2012) 247 CLR 205 at 233), 'there seems to have been no instance of equity awarding compensation over and above the amount awarded as common law damages, other than cases in which equity would not relieve against the penalty'.

For the same reason, the fact that the late payment fee may have been set by reference to what other banks were charging in the context of a competitive banking market is essentially irrelevant. As Lords Neuberger and Sumption observed in *Cavendish* ([2015] UKSC 67 at [34]) although the penalty rule originated out of equity's concern to prevent exploitation at a time when credit was scarce and borrowers were particularly vulnerable, the modern rule is substantive, not procedural. It does not normally depend for its operation on establishing that advantage was taken of one party. An obligation to pay a fee does not cease to be penal just because the obligee's competitors impose similar penalties on their customers. Where there is an incentive constituted of an obligation to pay a sum of money conditioned on a breach of contract of which the amount is wholly disproportionate to the greatest costs which would have been conceived of at the time of entry into the contract, the obligation will be regarded as penal unless there be some aspect of the contract which makes it possible to say that the amount of the obligation is not wholly disproportionate to the interest protected by the bargain.

Nor does the fact that the late payment fee may have been set by reference to fees being charged by the Bank's competitors establish that the Bank had an interest in the timeous performance of the Monthly Payments obligation other than its performance or adequate compensation for its breach. Of itself, it suggests no more than that the extent of competition, or more likely lack of it, led the Bank to conclude that the level at which it set the fee was unlikely to result in an unacceptable loss of custom to other banks. That says nothing about whether this fee or those fees were penal in the relevant sense.

In the result, although in some circumstances the test of whether a fee is a penalty may go beyond the quantitative assessment of disproportion between the fee and the greatest loss that could conceivably be proved, and if so may require a qualitative assessment of disproportion between the fee and a more imprecise conception of the interest protected by the bargain, in this case it is not possible to identify any interest to be protected by the bargain other than payment of the amount which was due together with compensation for such costs incurred as a result of late payment as would be recoverable as damages for breach of contract.

Note

For a critique of *Paciocco* see JW Carter, W Courtney and GJ Tolhurst, 'Assessment of Contractual Penalties: Dunlop Deflated' (2017) 34(1) *Journal of Contract Law* 4.

Questions

(1) What is the policy justification for the penalties doctrine? Would statute promote that policy more effectively than equity? (Note that, in *Paciocco*, the High Court also held that the statutory unconscionability provisions did not invalidate the bank's late payment fee provisions).

(2) How did Australian courts decide whether a contractual payment provision was a penalty before *Paciocco* was decided? How will a court decide this question after *Paciocco?*

(3) Can a contractual payment provision be justified by reference to (a) a corporation's interest in profitability, or (b) a corporation's interest in maintaining market share for the sale of its products?

7.4.2 Relief against forfeiture

Background

A purchaser of land failed to pay the price on the due date. After negotiations, a new contract was signed with a revised settlement date and which stipulated that time was of the essence of the contract. The purchaser failed to settle on the revised settlement date when Singapore authorities delayed transmission of settlement funds in order to make certain security checks. The purchaser received the funds on the following day and was willing to settle but the vendor issued a notice to terminate the contract. The purchaser claimed specific performance and relief against forfeiture of his interest under the contract of sale.

Decision

The High Court held that the purchaser was not entitled to specific performance or to relief against forfeiture.

Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ held that relief against forfeiture would only be granted in cases of fraud, mistake to which the vendor had contributed, accident or surprise, and that none of these elements were present in this case.

Kirby J held that it was not unconscionable or inequitable for the vendor to rely on its legal right to terminate the contract.

Callinan J held that there were no exceptional circumstances justifying relief from forfeiture since the vendor was not responsible for the late tender of the purchase price and that the purchaser had already been given additional time to pay.

Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ

What Lord Wilberforce in *Shiloh Spinners* called 'the special heads of fraud, accident, mistake or surprise' ([1973] AC 691 at 723) identify in a broad sense the circumstances making it inequitable for the vendors to rely upon their termination of Tanwar's contracts as an answer to its claim for specific performance. No doubt the decided cases in which the operation of these 'special heads' is considered do not disclose exhaustively the circumstances which merit this equitable intervention. But, at least where accident and mistake are not involved, it will be necessary to point to the conduct of the vendor as having in some significant respect caused or contributed to the breach of the essential time stipulation. Tanwar's situation falls beyond that pale. The statement by Mason CJ in *Stern* ((1988) 165 CLR 489 at 502–503) respecting the insignificance of subsequent events for which the vendors were in no way responsible is fatal to the main thrust of Tanwar's case.

It should be made clear that what is said above does not support any proposition that the circumstances must be 'exceptional' before equity intervenes. In their joint judgment in *Stern* ((1988) 165 CLR 489 at 526), Deane and Dawson JJ, with reference to what had been said by Mason and Deane JJ in *Legione* ((1983) 152 CLR 406 at 449), said, in a passage which puts the point of present significance:

> Mason and Deane JJ were not saying that there must be unconscionable conduct of an exceptional kind before a case for relief can be made out. Rather, what was being said was that a court will be reluctant to interfere with the contractual rights of parties who have chosen to make time of the essence of the contract. The circumstances must be such as to make it plain that it is necessary to intervene to avoid injustice or, what is the same thing, to relieve against unconscionable – or, more accurately, unconscientious – conduct.

Thus, it remains for Tanwar to show that it is against conscience for the vendors to set up the termination of the contracts. In the present appeal, as already has been indicated, there was no representation by the vendors which could found any estoppel. Nor has Tanwar asserted that there was any mistake in any relevant sense.

In *Ciavarella* ((1983) 153 CLR 438 at 453), the order for remittal made in *Legione* was seen to have been made on the footing that there were already in the evidence indications that the vendors in *Legione* had helped to lull the purchasers into the belief that they would accept completion provided it occurred within a few days. To relieve in those circumstances would be an exercise of the jurisdiction with respect to 'surprise'. That, as remarked earlier in these reasons, cannot be asserted in the present case.

The second matter which Mason and Deane JJ emphasised in *Legione* was the possibility that a case might be made out in the Supreme Court that the vendors were seeking to reap the benefits of the very valuable improvements to the property which the pur-

chasers had effected whilst in possession under the contract. It is not clear from their Honours' remarks whether the reaping of the benefit of the improvements as a consequence of termination of itself would be sufficient to deny insistence by the vendors upon their rescission. It is not readily apparent how that circumstance alone could be sufficient. The contract in *Legione* had permitted the purchasers to enter into possession and any improvements they then made were at risk of the operation of the contractual provisions for termination.

Accident

In its extremity, Tanwar then founds upon the jurisdiction to relieve against the consequences of 'accident'.

In *Legione* ((1983) 152 CLR 406 at 444), Mason and Deane JJ referred to authorities disputing the treatment of cases of relief against penalties and forfeitures as instances of relief against accident. The jurisdiction with respect to accident was recognised at a time before the development of any settled body of equitable principles. The point is well made by Professors Keeton and Sheridan (*Equity*, 3rd ed (1987) at 38):

> 'Accident' was a vague term which covered many situations, in their nature unforeseen, and it could, in particular situations, shade off into fraud. The law of mistake, particularly in relation to contracts and conveyances, is included under this head, and it led in turn to the development of the equitable rules governing the rectification of contracts and other instruments, and the rescission of documents of all kinds.

What then remains as the subject-matter of accident in modern equity? In *Baird v BCE Holdings Pty Ltd* ((1996) 40 NSWLR 374 at 385–386), Young J referred to various writings on the subject which distinguish mistake as supposing an operation of the will of the agent in producing the event, albeit by reason of erroneous impressions on the mind. Spence, writing in 1846, said that the kinds of accidents or cases of extremity which might be relieved against were only to be ascertained from an examination of the cases *(The Equitable Jurisdiction of the Court of Chancery* (1846) vol 1 at 628). He instanced forfeiture and penalties. Other instances include the accidental diminution of assets in the hands of an executor, lost evidence and the defective execution of powers of appointment, all far from the present case.

However, the learned writers on the subject emphasise and put to one side those situations where the event which has come to pass is one for which an express exculpatory provision might have been made, but was not sought or was not agreed to, and where to relieve against its consequences after it has occurred would deprive the other party to the contract of an essential right. In particular, equity will not relieve where 'the possibility of the accident may fairly be considered to have been within the contemplation of the contracting parties' (Smith, *Principles of Equity,* 4th ed (1908) at 240–244). …

It is here that the circumstances leading up to, and the terms of, the 2001 Deeds are of critical importance. The vendors withdrew the earlier notices of termination in return for the assumption by Tanwar of obligations to complete couched in unqualified terms. The obligation in the 2001 Deeds to settle by the stipulated time was not made subject to the availability of Tanwar's finance on that day. That there might be a failure by a third party to provide the finance was reasonably within the contemplation of Tanwar. The failure by Tanwar to avail itself of the advantages it obtained by negotiating the 2001 Deeds and by keeping the contracts on foot had the effect of exposing Tanwar again to the exercise by the vendors of their rights to terminate the contracts. Equity does not intervene to prevent the effective exercise of those rights.

Notes

(1) The High Court decided *Tanwar v Cauchi* along with another appeal, *Romanos v Pentagold Investments Pty Ltd* (2003) 217 CLR 367, which also involved the late tender of the price by a purchaser of land. A majority of the New South Wales Court of Appeal granted relief from forfeiture on the ground that termination of the contract would entitle the vendor to the 'windfall benefit' of the increased development value of the land. The High Court allowed the vendor's appeal, holding that the fact that a party would obtain a windfall from the termination of a contract was not by itself a reason for granting the other party equitable relief.

(2) Prior to *Tanwar v Cauchi*, the leading High Court decision on relief against forfeiture was *Stern v McArthur* (1988) 165 CLR 489. In *Stern v McArthur*, a majority of the High Court granted relief to purchasers under an instalment contract for the purchase of land. The purchasers fell behind in their instalment payments but later tendered the arrears, together with interest and costs. They had erected a building on the land. Deane and Dawson JJ granted relief on the basis that the purchasers were in substance mortgagors, and equity

allows a mortgagor to retain her equity of redemption in the mortgaged property provided that she pays the outstanding arrears of principal, interest and costs. In *Tanwar v Cauchi*, the High Court accepted, at [34], that equitable relief could be given on this basis. However, the contract of sale in *Tanwar v Cauchi* was not analogous to a mortgage and the principle applied by Deane and Dawson JJ in *Stern* was therefore inapplicable.

(3) Equity's intervention to prevent the forfeiture of a property interest evolved from equity's protection of the mortgagor's equity of redemption, encapsulated in the maxim 'once a mortgage, always a mortgage'. Equity invalidates any fetter (or clog) on the equity of redemption, and the mortgagee is not allowed to obtain any advantage, such as an option to buy the mortgaged property, from the mortgage agreement beyond his right to enforce his security, on the ground that the advantage will in substance destroy the mortgagor's equity of redemption. The advantage can, however, be secured by entering into an independent agreement with the mortgagor. The principle of 'once a mortgage, always a mortgage' has been criticised as an impermissible restriction on freedom of contract where the mortgage agreement has been entered into between commercial parties. Like the other doctrines considered in this section, it is directed to relieving against substantive, not procedural, unfairness. It has been argued that, in the absence of unconscionable conduct, the parties should be allowed to agree any terms they wish. See *Westfield Holdings Ltd v Australian Capital Television Pty Ltd* (1992) 32 NSWLR 194, 202–3; *Lift Capital Partners Pty Ltd v Merrill Lynch International* (2009) 73 NSWLR 404, 430–31. For a justification of the principle on the ground that it prevents a lender from exercising rights equivalent to a penalty, see *Sun North Investments Pty Ltd v Dale* [2014] 1 Qd R 369, [109]–[125].

Questions

(1) What is the forfeited interest in respect of which equity gives relief?

(2) What in this context is meant by 'accident' and 'surprise'? Do you think that a more coherent basis for relief against forfeiture than the principles laid down in *Tanwar v Cauchi* would be to allow equity to grant relief whenever it would be unconscionable for the defendant to forfeit the plaintiff 's interest?

(3) Do the cases in this section demonstrate the folly of allowing equity judges to adjudicate upon the substantive fairness of a contract?

8

Equitable proprietary interests

8.1 Introduction

8.2 The nature of equitable ownership

8.3 Equitable interests and equities

8.4 The doctrine of notice

8.5 Proprietary estoppel

8.1 Introduction

Equitable rights are either personal or proprietary. This chapter examines equitable proprietary rights. Equitable proprietary rights evolved from the regular enforcement of personal equitable remedies, principally specific performance and injunctions, initially against the legal owner of property and later against a recipient of the property from the legal owner.

The best known equitable proprietary interest – namely, the interest of a beneficiary in the trust property – is explained in chapter 13. For the purposes of this chapter, it is enough to note that a beneficiary under an express trust will not always have a proprietary interest in the trust property. A beneficiary under a fixed trust has a proprietary interest in the subject-matter of the trust. A beneficiary under a discretionary trust, however, (known as an 'object' of the trust) only has a personal right to enforce the trustee's obligations. Nevertheless, events such as termination of the trust may entitle the beneficiary to a share of the trust property.

Other equitable proprietary interests are either equitable equivalents of recognised common law interests, such as the equitable lease, equitable mortgage and equitable easement, or they have no counterpart at common law, such as a partner's interest in partnership property and a restrictive covenant imposed over land. Whereas common law interests in land had to be created by deed (with exceptions, for example, for short leases), and today are, in some cases, only effective at law if registered (as in the case of land subject to Torrens title registration), equitable interests require no such formality. In equity, payment of valuable consideration for the interest in the property affects the conscience of the legal interest-holder if the property has special value. The unconscientious conduct of the legal interest-holder can, in some cases, also entitle a party harmed by the conduct to an equitable interest, enforceable by way of a constructive trust or equitable lien, over the property. A subsequent legal owner will be bound by a subsisting equitable interest in the property except where the subsequent owner is a good faith purchaser for valuable consideration without notice of the facts entitling the claimant to the equitable interest.

The doctrine of proprietary estoppel enables the creation of proprietary interests where a party has relied to her detriment on an assumption that she will be granted an interest in or over property to which the party inducing the assumption holds title. Proprietary estoppel is discussed at [8.5].

Equitable interests in property are protected and enforced by equitable remedies discussed in Part B. Special attention should be paid to the role of equitable discretion (chapter 2) and bars to relief (chapter 6).

8.2 The nature of equitable ownership

Background

29 Macquarie (No 14) Pty Ltd owned land. A meeting of its directors and of the directors of DKLR Holding Co (No 2) Pty Ltd passed various resolutions, one being that the land was to be conveyed to DKLR to be held on trust for 29 Macquarie. The resolution provided that DKLR was only to hold the legal estate in the land, 'there being no intention on the part of [29 Macquarie] to part with beneficial ownership of land'. A question later arose as to whether stamp duty was payable in respect of the instrument creating the trust.

Decision

A majority of the High Court held that stamp duty was payable on the instrument declaring the trust. The extracts below consider the creation of equitable interests in property.

Aickin J

A preliminary argument advanced on behalf of DKLR was that the transfer of the land to it by 29 Macquarie was effective to transfer only the 'bare legal estate' and to leave remaining in 29 Macquarie the entire beneficial interest. It was said that immediately prior to the transfer 29 Macquarie held both the unencumbered legal estate and the entire equitable interest in that property and that all that it had done was to transfer the legal estate. In my opinion this argument is based upon a fundamental misconception as to the nature of legal and equitable interests in land or other property. If one person has both the legal estate and the entire beneficial interest in the land he holds an entire and unqualified legal interest and not two separate interests, one legal and the other equitable. If he first holds the legal estate upon trust for some other person and thereafter that other person transfers to him the entire equitable interest, then again the first-named person does not hold two separate interests, one the legal and the other the equitable estate; he holds a single entire interest – he is the absolute owner of an estate in fee simple in the land. The equitable interest merges into the legal estate to comprise a single absolute interest in the land. It is a fundamental principle of both the common law and of equity that the holder of an estate in fee simple cannot be a trustee of that fee simple for himself for what he holds is a single estate, being the largest estate in land known to the law.

Brennan J

29 Macquarie could not except or reserve an equitable estate from the property transferred by it to DKLR, nor could DKLR become a trustee of an interest excepted or reserved from the transfer. A transferee does not become a trustee by failing to acquire an interest in the property transferred; a trustee holds on trust only such interest as he acquires. An equitable interest is not carved out of a legal estate but impressed upon it. It may be convenient to say that DKLR took only the bare legal estate, but that is merely to say elliptically that 29 Macquarie transferred to DKLR the property in respect of which DKLR had declared that it would be trustee. The charter of 29 Macquarie's interest was DKLR's declaration, not the memorandum of transfer; and DKLR's declaration was moved by the transfer to it of the property to be held on the trust declared.

Note

Whether an equitable interest will be impressed on a legal estate depends on whether the criteria for the recognition and enforcement of an equitable interest have been satisfied. In the case of trust obligations, these criteria are discussed in chapters 14 and 15

It should not be assumed that the equitable obligations imposed on the holder of the legal estate will necessarily be trust obligations, or even be proprietary. In some cases, only equitable personal obligations will be imposed. For example, a beneficiary under a will has no proprietary interest in any asset of the estate while it is in the course of administration. The executor holds the beneficial title to the assets until administration is complete. The beneficiary is, however, entitled to personal remedies to compel the due administration of

the estate. See *Commissioner of Stamp Duties (Qld) v Livingston* [1965] AC 694. Lord Radcliffe stated in *Livingston* that '[e]quity in fact calls into existence and protects equitable rights and interests in property only where their recognition has been found to be required in order to give effect to its doctrines'.

The personal right to compel due administration of a deceased's estate is, however, a chose in action – in other words, a species of intangible property – which can be disposed of under the beneficiary's will or vest in his trustee in bankruptcy if he becomes bankrupt: *Official Receiver in Bankruptcy v Schultz* (1990) 170 CLR 306.

Question

How do the principles explained by Aickin J and Brennan J apply to equitable leases and equitable mortgages?

8.3 Equitable interests and equities

8.3a *Latec Investments Ltd v Hotel Terrigal Pty Ltd (in liq)* [1965] HCA 17; (1965) 113 CLR 265

Background

Hotel Terrigal was the registered proprietor of land. Latec had taken a mortgage over the property to secure a loan. Hotel Terrigal fell into arrears in repaying the loan and Latec, purporting to exercise its mortgagee's power of sale, sold the property to a subsidiary company, Southern. Subsequently, Southern gave MLC Nominees an equitable charge over its assets, including the property in question. MLC Nominees was therefore entitled to an equitable interest in the property. Nearly five years later, Hotel Terrigal successfully claimed that the sale by Latec was voidable because the power of sale had not been exercised in good faith: no attempt had been made to sell the hotel in an open market at a fair price, and the sale itself had not been properly advertised. MLC Nominees had, however, acquired its equitable interest as a good faith purchaser without notice of the mortgagee's fraudulent sale. Hotel Terrigal argued that its power to have the mortgagee's sale set aside for fraud was binding on MLC Nominees.

Decision

The High Court held that MLC Nominees' equitable interest under the charge prevailed over Hotel Terrigal's power (or 'equity') to have the sale rescinded.

Kitto J

[I]n my opinion the equitable charge of the trustee for the debenture holders stands in the way of the mortgagor's success because it was acquired for value and without any notice either of the existence of the mortgagor's right to set aside the sale or of any facts from which such a right might be inferred. The trustee, of course, has not the legal estate; its rights are purely equitable; but the case falls within one of the categories described in the judgment of Lord Westbury in *Phillips v Phillips* (1861) 4 De GF & J 208, at p 218 (45 ER 1164, at p 1167) in which the legal estate is not required in order that a defence of purchase for value without notice may succeed. It is the case of a suit 'where there are circumstances that give rise to an equity as distinguished from an equitable estate – as, for example, an equity to set aside a deed for fraud, or to correct it for mistake' (1861) 4 De GF & J, at p 218 (45 ER at p 1167). In such a case, his Lordship said, if the purchaser under the instrument maintains the plea of purchase for value without notice 'the Court will not interfere' (1861) 4 De GF & J, at p 218 (45 ER, at p 1167). It is true that if the mortgagor in the present case was entitled to have the mortgagee's sale set aside it had more than a mere equity: it had, as I have pointed out, an equity of redemption, and such an interest, being in respect of an estate in fee simple, has been considered an equitable estate ever since Lord Hardwicke decided *Casborne v Scarfe* (1737) 1 Atk 603 (26 ER 377) see also (1738) 2 J & W 194 App (37 ER 600). But each of the illustrations

Lord Westbury chose was also a case where the equity was accompanied by an equitable interest which might constitute an equitable estate. So much had been shown by decisions of most eminent judges, at least twice in the ten years before his Lordship spoke: see *Stump v Gaby* (1852) 2 De GM & G 623 (42 ER 1015); *Gresley v Mousley* (1859) 4 De G & J 78 (45 ER 31), and Lord Westbury's judgment gives every indication of an intention to state systematically the effect of previous decisions, and not to depart from them in any degree. The illustrations therefore make it clear, it seems to me, that the cases to which his Lordship was referring were not only those in which there is an assertion of an equity unaccompanied by an equitable interest (as was held to be the case in *Westminster Bank Ltd v Lee* (1956) Ch 7 and *National Provincial Bank Ltd v Hastings Car Mart Ltd* (1964) Ch 9 – indeed he may not have had them in mind at all – but those in which an equity is asserted which must be made good before an equitable interest can be held to exist. In the latter class of cases the equity is distinct from, because logically antecedent to, the equitable interest, and it is against the equity and not the consequential equitable interest that the defence must be set up. That the defence of purchase for value without notice (in the absence of the legal estate) is a good defence against the assertion of the equity in such a case had been established long before Lord Westbury's time. In *Malden v Menill* (1737) 2 Atk 8, at p 13; (26 ER 402, at p 405), for example, Lord Hardwicke had refused rectification of an instrument for mistake, as against a purchaser of an equitable interest without notice, on the ground that the mistake should not 'turn to the prejudice of a fair purchaser'. Such cases as *Garrard v Frankel* (1862) 30 Beav 445 (54 ER 961) and *Bainbrigge v Browne* (1881) 18 Ch D 188 were soon to be decided on the same principle. See generally *Halsbury's Laws of England,* 3rd ed vol 14, p 537, par 1008. The reason of the matter, as I understand it, is that the purchaser who has relied upon the instrument as taking effect according to its terms and the party whose rights depend upon the instrument being denied that effect have equal merits, and the court, finding no reason for binding the conscience of either in favour of the other, declines to interfere between them. Consequently the party complaining of the fraud or mistake finds himself unable to set up as against the other the equitable interest he asserts; but the fact remains that it is against the preliminary equity, and not against the equitable interest itself, that the defence of purchase for value without notice has succeeded. The maxim qui prior est tempore is not applicable, for it applies only as between equitable interests, the logical basis of it being that in a competition between equitable interests the conveyance in virtue of which the later interest is claimed is considered, as Lord Westbury pointed out, to be innocent, in the sense of being intended to pass that which the conveyor is justly entitled to and no more: (1861) 4 De G F & J 208, at p 215; (45 ER 1164, at p 1166). Where a claim to an earlier equitable interest is dependent for its success upon the setting aside or rectification of an instrument, and the court, notwithstanding that the fraud or mistake (or other cause) is established, leaves the instrument to take effect according to its terms in favour of a third party whose rights have intervened, the alleged earlier equitable interest is unprovable against the third party, and consequently, so far as the case against him discloses, there is no prior equitable interest to which his conveyance can be held to be subject.

On the principle to which Lord Westbury referred it seems to me inevitable that the mortgagor's claim in the present case to have the mortgagee's sale and the transfer to the purchaser 'set aside', i.e. treated as if they were only a sale and transfer of the mortgage, should fail as against the trustee for the debenture holders, though it should succeed as against the mortgagee and the purchaser. It appears that the mortgage was a second mortgage and that after the sale the purchaser paid off the first mortgage. The purchaser is entitled therefore to stand in the shoes of the first mortgagee. The result is that the mortgaged property is subject, first, to the purchaser's rights in respect of the discharge of the first mortgage; secondly, to the trustee's charge; and thirdly, to the purchaser's rights as notional transferee of the second mortgage under the (otherwise invalid) sale. The mortgagor is entitled to anything that may remain of the property or its proceeds after these encumbrances have been satisfied. The indications seem to be that after the rights of the trustee have been satisfied there will be nothing left, and for that reason it seems unnecessary to make an order for working out the rights of all parties in detail.

Taylor J

… In the present case it is contended on behalf of The MLC Nominees that after the sale and transfer to Southern Hotels, Hotel Terrigal had on the view of the facts most favourable to it nothing more than a mere equity to set aside the transaction and, as I understand the argument, this proposition is put upon the authority of the examples given by Lord Westbury of cases where the right which is being asserted is 'an equity as distinguished from an equitable estate – for example, an equity to set aside a deed for fraud, or to correct it for mistake'. But to my mind the argument misconceives the significance of Lord Westbury's observation and the assertion that Hotel Terrigal had nothing more than a mere equity is made in the face of abundant authority to the contrary to which I shall presently refer. Before doing so, however, it should be observed that this is not a case of a common law mortgage; it is a case where the registered mortgage created a statutory charge over the mortgagor's land leaving the whole of the legal and beneficial ownership thereof in the mortgagor. No doubt the registration of the transfer operated to transfer the legal title in the land to South-

ern Hotels but I find it difficult to see why it should be thought that a sale and transfer made and given by a mortgagee not bona fide 'within the limits of the power' *(Pendlebury v Colonial Mutual Life Assurance Society Ltd* (1912) 13 CLR 676) can operate to strip the mortgagor of the whole of his equitable interest in the land: cf *Cloutte v Storey* (1911) 1 Ch 18. However this may be, there is, as I have said, abundant authority for the proposition that the owner of land a transfer of which has been obtained by fraud retains an equitable interest therein. *Uppington v Bullen* (1842) 2 Dr & War 184 was such a case as also were *Stump v Gaby* (1852) 2 De GM & G 623 (42 ER 1015) and *Gresley v Mousley* (1859) 4 De G & J 78 (45 ER 31). In *Stump v Gaby* (1852) 2 De GM & G 623 (42 ER 1015) Lord St Leonards said:

> I will assume that the conveyance might have been set aside in equity for fraud: what then is the interest of a party in an estate which he has conveyed to his attorney under circumstances which would give a right in this Court to have the conveyance set aside? In the view of this Court he remains the owner, subject to the repayment of the money which has been advanced by the attorney, and the consequence is that he may devise the estate, not as a legal estate, but as an equitable estate, wholly irrespective of all question as to any rights of entry or action, leaving the conveyance to have its full operation at law, but looking at the equitable right to have it set aside in this Court. The testator therefore had a devisable interest. My strong impression is that this very point is concluded upon authority, but if not I am ready to make an authority on the present occasion, and to decide that, assuming the conveyance to have been voidable, the grantor had an equitable estate which he might have devised … (1852) 2 De GM & G, at p 630 (42 ER, at p 1018) …

However these cases were, as was pointed out to us, decided before *Phillips v Phillips* (1861) 4 De GF & J 208 (45 ER 1164) and it was urged upon us that we should in this case treat Lord Westbury's observation as conclusive on the point. But the point has received attention since then … *In re Garnett; Robinson v Gandy* (1886) 33 Ch D 300 is another case which illustrates the proposition that the execution of a release voidable in equity for fraud does not deprive the releasor of his equitable title to the subject fund. The contention raised in this case was that upon the setting aside of a release given by a wife before marriage she and her husband then acquired a new title so that it could be said, in accordance with the provisions of a marriage settlement made after the release was executed, that they had become entitled to the subject fund during coverture. The contention was rejected, Cotton LJ observing: 'The setting aside of the release did not give them any new right, but merely had the effect of removing that which, if it had stood, would have been a bar, and have prevented their previously existing right to assert their title to the residuary personal estate of their uncle … a right which they had at the time the settlements were executed, and a right which was not obtained by them in consequence of the release having been set aside' (1886) 33 Ch D, at p 303 …

… These cases, however, have nothing to say concerning the principles upon which the priority of competing equitable interests is to be determined. But they do serve to indicate that where a grantor is entitled to set aside a conveyance for fraud he has, in every sense of the term, an equitable interest in the subject land and that if he is to be postponed to an equitable interest acquired without notice at some later time it is not because it can be said, in the sense in which the appellants use that expression, that he has a mere equity as distinguished from an equitable estate; if he is to be postponed then there must be some other reason …

Menzies J

… The second question – that is, the question of priority between Terrigal's and MLC Nominees' equitable rights – I find one of substantial difficulty. If the maxim 'Qui prior est tempore potior est jure' applies, Terrigal's right to have the conveyance set aside and to be restored to the register, without regard to MLC Nominees' equitable interest, prevails, but the appellants' contention is that this right is a mere equity and the maxim has no application when the contest is between such an equity and an equitable interest of the character held by MLC Nominees. This contention rests upon the line of authority based upon *Phillips v Phillips* (1861) 4 De GF & J 208 (45 ER 1164). Lord Westbury there said:

> Hence grantees and incumbrancers claiming in equity take and are ranked according to the dates of their securities; and the maxim applies, 'Qui prior est tempore potior est jure'. The first grantee is potior – that is, potentior. He has a better and superior – because a prior – equity. The first grantee has a right to be paid first, and it is quite immaterial whether the subsequent incumbrancers at the time when they took their securities and paid their money had notice of the first incumbrance or not … Now, the defence of a purchaser for valuable consideration is the creature of a Court of Equity, and it can never be used in a manner at variance with the elementary rules which have already been stated … But there appear to be three cases in which the use of this defence is most familiar: – … Thirdly, where there are circumstances that give rise to

> an equity as distinguished from an equitable estate – as for example, an equity to set aside a deed for fraud, or to correct it for mistake – and the purchaser under the instrument maintains the plea of purchase for valuable consideration without notice, the Court will not interfere (1861) 4 De G F & J, at pp 215–218 (45 ER, at pp 1166, 1167).

In *Cave v Cave* (1880) 15 Ch D 639, Fry J, referring to the defence of purchaser for value without notice, said: 'That defence, as we all know, has been the subject of a great deal of decision, and it is by no means easy to harmonize the authorities and the opinions expressed upon the subject. Criticisms upon old cases lie many strata deep, and eminent Lord Chancellors have expressed diametrically opposite conclusions upon the same question. The case of *Phillips v Phillips* (1861) 4 De G F & J 208; 45 ER 1164 is the one which has been principally urged before me, and that, as being the decision of a Lord Chancellor, is binding upon me, notwithstanding the subsequent comments upon it of Lord St Leonards in his writing' (1880) 15 Ch D at p 646. His Lordship went on to cite the passage I have already quoted from Lord Westbury's judgment in *Phillips v Phillips* (1861) 4 De G F & J 208 (45 ER 1164) and, having come to the conclusion that he was dealing with a contest between equitable estates and not between an equitable estate and a mere equity, concluded: 'Therefore I shall conclude that, within the case of *Phillips v Phillips* (1861) 4 De G F & J 208 (45 ER 1164), the interest of the plaintiff in this case is an equitable interest, and not merely an equity like the equity to set aside a deed, and therefore it must take its priority according to the priority of date' (1880) 15 Ch D 639, at p 649.

There is, however, as Fry J said, another line of cases, the authority of which is beyond question, establishing that where there is an equity to have the voidable conveyance of an estate set aside, there remains in the conveyor, notwithstanding the conveyance, an equitable estate which may be devised or transferred. Thus, in *Stump v Gaby* (1852) 2 De GM & G 623 (42 ER 1015), Lord St Leonards, speaking of a conveyance by an heir at law to his solicitor, said:

> I do not deny that a deed may be so fraudulent as to be set aside at law; this, however, is not such a case; but I will assume that the conveyance might have been set aside in equity for fraud: what then is the interest of a party in an estate which he has conveyed to his attorney under circumstances which would give a right in this Court to have the conveyance set aside? In the view of this Court he remains the owner, subject to the repayment of the money which has been advanced by the attorney, and the consequence is that he may devise the estate, not as a legal estate, but as an equitable estate, wholly irrespective of all question as to any rights of entry or action, leaving the conveyance to have its full operation at law, but looking at the equitable right to have it set aside in this Court. The testator therefore had a devisable interest. My strong impression is that this very point is concluded upon authority, but if not I am ready to make an authority on the present occasion, and to decide that, assuming the conveyance to have been voidable, the grantor had an equitable estate which he might have devised (1852) 2 De G M & G, at p 630 (42 ER 1015, at p 1018) …

… There is no doubt that the two lines of authority are well established. See, for instance, *Halsbury's Laws of England,* 3rd ed, vol 14, pars 1009 and 1030. Furthermore, there is room for the application of each in appropriate circumstances. Thus, if Terrigal were a person instead of a company and the question were whether, in the circumstances here, that person had a devisable interest in the hotel property by virtue of his equity to have the conveyance to Southern set aside, *Stump v Gaby* (1852) 2 De G M & G 623 (42 ER 1015) would require an affirmative answer on the footing that, in the circumstances, Terrigal had an equitable interest in the hotel property. Where, however, the question arises in a contest between Terrigal and MLC Nominees, the holders of an equitable interest in the hotel property acquired without notice of Terrigal's rights, the authority of *Phillips v Phillips* (1861) 4 De G F & J 208 (45 ER 1164) is (i) that the contest is between Terrigal's equity to have the conveyance set aside and the equitable interest of MLC Nominees and (ii) that in that contest, Terrigal's equity is not entitled to priority merely because it came into existence at an earlier time than the equitable interest of MLC Nominees. In the circumstances here, therefore, the maxim 'Qui prior est tempore potior est jure' has no application.

Questions

(1) How did each judge classify Hotel Terrigal's power to have the mortgagee's sale set aside for fraud? Did it matter whether the power was classified as an equity, equitable interest or something else?

(2) Which, if any, of the following constitute an 'equity'?

(a) a power to rescind a transfer of land procured by the purchaser's unconscionable conduct

(b) a right to a transfer of land arising out of a successful estoppel claim

(c) a mortgagor's equity of redemption (contrast *Latec* with *Forsyth v Blundell* (1973) 129 CLR 477; *Swanston Mortgage Pty Ltd v Trepan Investments Pty Ltd* [1994] 1 VR 672; *Patmore v Upton* (2004) 13 Tas R 95, [61]).

8.3b *Walsh v Lonsdale* (1882) 21 Ch D 9

Background

The plaintiff orally agreed to take a lease of Providence Mill from the defendant for a term of seven years with the rent to be payable in advance. At common law, a lease of this duration must be executed by deed but none had been executed. Nevertheless, the plaintiff went into possession and paid rent quarterly in arrears. The defendant demanded arrears of rent payable in advance. When the plaintiff failed to pay, he distrained some of the plaintiff's personal property on the premises. The plaintiff claimed damages for illegal distress, as well as orders of specific performance of the lease and an injunction to prevent the defendant from selling off the distrained chattels. The relief claimed by the plaintiff depended on whether a valid equitable lease had been created.

Decision

The Court of Appeal held that the agreement created an equitable lease for seven years, on the application of the maxim that equity considers as done that which ought to be done. The agreement was specifically enforceable in equity and entitled the defendant to distrain the plaintiff's chattels since, under the equitable lease, rent was payable in advance.

Jessel MR

There is an agreement for a lease under which possession has been given. Now since the *Judicature Act* the possession is held under the agreement. There are not two estates as there were formerly, one estate at common law by reason of the payment of the rent from year to year, and an estate in equity under the agreement. There is only one Court, and the equity rules prevail in it. The tenant holds under an agreement for a lease. He holds, therefore, under the same terms in equity as if a lease had been granted, it being a case in which both parties admit that relief is capable of being given by specific performance. That being so, he cannot complain of the exercise by the landlord of the same rights as the landlord would have had if a lease had been granted. On the other hand, he is protected in the same way as if a lease had been granted; he cannot be turned out by six months' notice as a tenant from year to year. He has a right to say, 'I have a lease in equity, and you can only re-enter if I have committed such a breach of covenant as would if a lease had been granted have entitled you to re-enter according to the terms of a proper proviso for re-entry.' That being so, it appears to me that being a lessee in equity he cannot complain of the exercise of the right of distress merely because the actual parchment has not been signed and sealed.

Note

The principle of *Walsh v Lonsdale* was applied by the High Court in *Chan v Cresdon* (1989) 168 CLR 242. Mason CJ, Brennan, Deane and McHugh JJ stated at [20] that the Court's willingness to treat the agreement as an equitable lease 'rests on the specific enforceability of the agreement'. In this context, a broad meaning of 'specific performance' was adopted, meaning the protection in equity, by injunction or otherwise, of rights acquired under, and defined by, a contract.

Questions

(1) Is an equitable lease as good as a legal lease? How does an equitable lease differ from a legal lease in respect of (a) mode of creation, and (b) its enforceability?

(2) Was it important to the outcome of the case that both parties accepted that the agreement was specifically enforceable? On what grounds might an agreement for a lease not be specifically enforceable?

(3) Jessel MR has been criticised for misstating the effect of the judicature legislation (see chapter 1) in the passage above. Do you agree with the criticism?

8.4 The doctrine of notice

8.4a *Conveyancing Act 1919* (NSW)

Section 164: Restriction on constructive notice

(1) A purchaser shall not be prejudicially affected by notice of any instrument, fact, or thing, unless:

(a) it is within the purchaser's own knowledge, or would have come to the purchaser's knowledge, if such searches as to instruments registered or deposited under any Act of Parliament, inquiries, and inspections had been made as ought reasonably to have been made by the purchaser, or

(b) in the same transaction with respect to which a question of notice to the purchaser arises, it has come to the knowledge of the purchaser's counsel as such, or of the purchaser's solicitor or other agent as such, or would have to come to the knowledge of the purchaser's solicitor or other agent as such, if such searches, inquiries, and inspections had been made as ought reasonably to have been made by the solicitor or other agent.

...

Note

Section 164(1)(a) defines actual and constructive notice for the purposes of the Act. Section 164(1)(b) defines imputed notice. The provision is derived from the English *Conveyancing Act 1882* s 3. Equivalent provisions are *Property Law Act 1974* (Qld) s 346; *Law of Property Act 1936* (SA) s 117; *Conveyancing and Law of Property Act 1884* (Tas) s 5; *Property Law Act 1958* (Vic) s 199.

Background

The plaintiffs were trustees of the will of Michael McMahon who had settled his sheep stations and sheep on trust for his children for their lives, with remainders to his grandchildren. Some of the sheep had been sold through the agency of Pitt to the second defendant, McLaughlin, who later resold them, paying some of the proceeds to Pitt but retaining the balance. The plaintiffs claimed that the sheep had been sold in breach of trust, and that the trust estate was entitled to the proceeds of sale received by McLaughlin.

Decision

The Court held that the claim failed, since McLaughlin was a good faith purchaser of the sheep without actual or constructive notice of the trust.

Owen J

If a person in possession of goods, and purporting to sell as owner, sells to a purchaser for value without notice, and there are no circumstances creating suspicion and putting the purchaser on enquiry, such purchaser will obtain a good title in equity although it be shown that the vendor had no title or a defective title, or a title affected by trusts or equities. The principle on which the Court proceeds is that although the plaintiff has a good title to the assistance of the Court, the defendant has an equal right to the protection of the Court, and therefore the Court refuses to interfere in favour of either party. The tendency of the Courts nowadays is not to extend the doctrine of constructive notice: *Wyllie v Pollen.* And in this community, considering the nature of the transactions in buying and selling stock on stations, the necessity which frequently arises for prompt sale, and the impossibility in outlying districts of enquiry or search, I think the Court ought to be very careful in applying the doctrine to such transactions.

Notes

(1) Owen J stated at 297 that it was for the trustees to establish that the defendant had constructive notice of the trust 'by clear and convincing evidence'. Although not authoritatively settled, the general view is that it is for the holder of the legal title to prove that he is a purchaser for value without notice of the claimant's equitable interest: see *Mills v Renwick* (1901) 1 SR (NSW) Eq 173; *Barclays Bank plc v Boulter* [1999] 4 All ER 513, 518.

(2) *Hermann v Pitt* was decided before the codification of the law of sale of goods. State and Territory sales legislation contains provisions dealing with a sale by a person not the owner of goods: see *Sale of Goods Act 1923* (NSW) ss 26–28; *Goods Act 1958* (Vic) ss 27–31. These provisions are not applicable to an unauthorised sale by a trustee of goods constituting trust property. The validity of the title obtained by the purchaser in such cases remains governed by the doctrine of notice.

(3) The significance of the doctrine of notice has been greatly reduced with respect to land transactions by the Torrens legislation of every State and Territory, and with respect to security interests taken over personal property by the *Personal Property Securities Act 2009* (Cth).

Questions

(1) Distinguish between express, constructive and imputed notice.

(2) Does constructive notice, as defined by s 164(1)(a) of the *Conveyancing* Act *1919* (NSW), mean the same as the doctrine of constructive notice discussed by Owen J in *Hermann v Pitt?* Does the former require 'circumstances creating suspicion'? Does the doctrine of constructive notice applicable to conveyancing transactions differ from the doctrine as it applies to commercial transactions involving personal property?

(3) In *Manchester Trust v Furness, Withy & Co* [1895] 2 QB 539, Lindley LJ stated, at 545, that courts have 'always set their face resolutely' against the application of the doctrine of constructive notice to commercial transactions. Note also the reluctance of Owen J in *Hermann v Pitt* to apply the doctrine to sheep sales. What are the objections to applying the doctrine to commercial transactions? Are they convincing?

8.5 Proprietary estoppel

8.5a *Giumelli v Giumelli* [1999] HCA 10; (1999) 196 CLR 101

Background and decision

For a statement of the facts, see [2.2a].

Gleeson CJ, McHugh, Gummow and Callinan JJ

Detriment

In their submissions, the appellants stress the need to limit the measure of equitable relief lest the requirement for consideration to support a contractual promise be outflanked and direct enforcement be given to promises which did not give rise to legal rights. However, in *Verwayen* (1990) 170 CLR 394 at 454, Dawson J, after pointing out that at common law the role of estoppel was largely as a rule of evidence, stated that in equity its role has been vastly expanded to raise questions of substance. His Honour continued:

> At the same time, the discretionary nature of the relief in equity marks a further reason why the fear of the common law that promissory estoppel would undermine the doctrine of consideration is unwarranted.

It is necessary now to say something as to the circumstances which gave rise to the litigation in *Verwayen,* upon which decision the appellants place much reliance. By its defence to an action in tort brought against it by a former naval serviceman, the Commonwealth admitted liability and did not plead that the action was statute-barred or that it had owed no duty of care to the plaintiff because he was injured whilst acting as a serviceman in the course of combat exercises. The failure to plead such defences was in accordance with the then stated policy of the Commonwealth. The question of damages remained in issue. Following a change in that policy, the Commonwealth applied to a Master for leave to amend its defence so as to raise both defences. Leave was opposed but was granted …

… [L]eave was granted to amend so as to raise both defences. By his reply the plaintiff pleaded that the Commonwealth had waived the two defences and that it was estopped from relying on either …

… In this Court, the majority (Deane, Dawson, Toohey and Gaudron JJ; Mason CJ, Brennan and McHugh JJ dissenting) upheld the reply to the amended defence and decided that the Commonwealth was not free to dispute its liability to the plaintiff. Deane J and Dawson J decided the appeal on the footing of estoppel, the equity being raised by the Commonwealth's conduct being such as could only be accounted for by holding it to the assumed state of affairs before the amended defence. Toohey J and Gaudron J decided that the Commonwealth had waived its right to rely on either defence.

In this Court, the Commonwealth had submitted that the only reliance by the plaintiff had been his apparent decision to continue with the action where, had there been no representation, the action may have been discontinued. It further submitted that the only detriment flowing from the reliance was legal costs so that to uphold the reply would be to confer a remedy disproportionate to that detriment.

Deane J emphasised at 443:

> Prima facie, the operation of an estoppel by conduct is to preclude departure from the assumed state of affairs. It is only where relief framed on the basis of that assumed state of affairs would be inequitably harsh, that some lesser form of relief should be awarded.

His Honour added at 445 that ultimately:

> the question whether departure from the assumption would be unconscionable must be resolved not by reference to some preconceived formula framed to serve as a universal yardstick but by reference to all the circumstances of the case, including the reasonableness of the conduct of the other party in acting upon the assumption and the nature and extent of the detriment which he would sustain by acting upon the assumption if departure from the assumed state of affairs were permitted.

The prima facie entitlement to which his Honour had referred would be qualified if that relief would 'exceed what could be justified by the requirements of conscientious conduct and would be unjust to the estopped party'; an appropriate qualification might be a requirement that the party relying upon the estoppel do equity.

[Their Honours considered the other judgments in *Verwayen* and concluded:]

The upshot is that the respondent is correct in his submissions that the reasoning in the judgments in *Verwayen* does not foreclose, as a matter of doctrine, the making in the present case of an order of the nature made by the Full Court.

The circumstances of the case

However, the appellants correctly challenge the Full Court order on other grounds. Before making an order designed to bring about a conveyance of the promised lot to the respondent, the Full Court was obliged to consider all the circumstances of the case. These circumstances included the still pending partnership action, the improvements to the promised lot by family members other than Robert, both before and after his residency there, the breakdown in family relationships and the continued residence on the promised lot of Steven and his family. It will be recalled that Steven is a party to the partnership action but not to the present action.

When these matters are taken into account, it is apparent that the order made by the Full Court reflected what in *Verwayen* was described as the prima facie entitlement of Robert. However, qualification was necessary both to avoid injustice to others, particularly Steven and his family, and to avoid relief which went beyond what was required for conscientious conduct by Mr and Mrs Giumelli. The result points inexorably to relief expressed not in terms of acquisition of title to land but in a money sum. This would reflect, with respect to the third promise, the approach taken by Nicholson J when giving relief in respect of the second promise.

Notes

(1) The cases in this section should be considered in conjunction with the criteria for estoppel recognised by the High Court in *Waltons Stores (Interstate) Ltd v Maher* [7.2.1a]. See also Ying Khai Liew, 'The "*Prima Facie* Expectation Relief" Approach in the Australian Law of Proprietary Estoppel' (2019) 39(1) *Oxford Journal of Legal Studies* 183.

(2) As a practical matter, it can be difficult to determine exactly when a plaintiff has established a claim to relief on the basis of proprietary estoppel, particularly if the plaintiff has improved the defendant's property over a number of years. In cases where the plaintiff becomes entitled to a proprietary interest by reason of her acts of detrimental reliance, the interest takes effect from the date on which the criteria of a proprietary estoppel claim have been met, and not from the date of the court's judgment awarding a proprietary remedy. See *Varma v Varma* (2010) 6 ASTLR 152; *McNab v Graham* (2017) VR 311.

(3) In *McNab v Graham* (2017) 53 VR 311, the Victorian Court of Appeal held that proprietary constructive trust relief granted to enforce a successful estoppel claim was not defeated by limitations legislation. Section 21(1)(b) of the *Limitation of Actions Act 1958* (Vic) provides that no limitation period applies 'to recover from the trustee trust property or the proceeds thereof in the possession of the trustee'. Apart from limitations legislation, how might lapse of time defeat a proprietary estoppel claim?

Questions

(1) What reasons did the High Court give in *Giumelli* for not awarding the plaintiff a proprietary interest in the land he had improved?

(2) Why was the money order awarded based on the improved value of the land and not on the contributions made by the plaintiff, in money and labour, to the improvement of the property?

(3) Can a court take into account any fact in determining equitable relief for proprietary estoppel? Are considerations such as the financial needs of the parties or the fact that one of the parties has provided financial support for the other relevant to determining equitable relief?

(4) In order to establish a claim of proprietary estoppel, the plaintiff must prove that she incurred some detriment or prejudice in relying on the defendant's conduct. Will a court also take into account benefits received by the plaintiff in relying on that conduct? See *Q v E Co* [2020] NSWCA 220, [154]–[163].

(5) Is a plaintiff who establishes a proprietary estoppel claim entitled to an equity or an equitable interest? Why does the distinction matter?

8.5b *Sidhu v Van Dyke* [2014] HCA 19; (2014) 251 CLR 505

Background

The defendant and his wife were joint tenants of a rural property in New South Wales. The defendant's brother-in-law and his wife, the plaintiff, occupied a cottage on the property, paying rent to the defendant's wife below market rates. The plaintiff and defendant began an affair which led to the defendant's divorce. The defendant promised, both orally and in writing, to the plaintiff, who stayed on at the property after her husband left her, that he would have the property subdivided and give the cottage to her. Subdivision required the consent of the council, as well as of the defendant's former wife who remained joint tenant. The plaintiff repaired and improved the property. Relying on the defendant's promise, she did not negotiate a property settlement when she divorced her husband and did not look for employment.

The plaintiff claimed the benefit of an estoppel based on the defendant's promise. The trial judge dismissed her claim on the basis that she had not detrimentally relied upon the defendant's promise, save to a limited degree. The New South Wales Court of Appeal found that the plaintiff had relied on the defendant's promise to her detriment, with the burden of proof resting on the defendant to show that there had been no detrimental reliance.

Decision

The High Court held:

(1) The burden of proof rested on the plaintiff to establish detrimental reliance. The burden had been satisfied on the facts of the case. It was not necessary for the conduct of the party estopped to be the sole inducement on the plaintiff to act to her detriment.

(2) It was no answer to the estoppel claim that the performance of the promise depended on council approval of the subdivision and on the consent of the defendant's ex-wife. The categorical nature of the defendant's promise meant that the plaintiff was entitled to expect that the necessary consents would be forthcoming.

(3) Where the unconscionable conduct takes the form of failing to carry out a promise, the usual relief in estoppel will be to award the plaintiff the value of the promise. The relief awarded by the Court of Appeal – namely, an order of equitable compensation assessed as the value of the cottage at the date of judgment – was appropriate. The case was remitted to the trial judge to determine that amount.

The extract focuses on the High Court's discussion of the measure of relief.

French CJ, Kiefel, Bell and Keane JJ

In *Grundt v Great Boulder Pty Gold Mines Ltd* (1937) 59 CLR 641 at 674–675, Dixon J, speaking of estoppel in pais, said:

> [I]t is often said simply that the party asserting the estoppel must have been induced to act to his detriment. Although substantially such a statement is correct and leads to no misunderstanding, it does not bring out clearly the basal purpose of the doctrine. That purpose is to avoid or prevent a detriment to the party asserting the estoppel by compelling the opposite party to adhere to the assumption upon which the former acted or abstained from acting. This means that the real detriment or harm from which the law seeks to give protection is that which would flow from the change of position if the assumption were deserted that led to it. So long as the assumption is adhered to, the party who altered his situation upon the faith of it cannot complain. His complaint is that when afterwards the other party makes a different state of affairs the basis of an assertion of right against him then, if it is allowed, his own original change of position will operate as a detriment. His action or inaction must be such that, if the assumption upon which he proceeded were shown to be wrong and an inconsistent state of affairs were accepted as the foundation of the rights and duties of himself and the opposite party, the consequence would be to make his original act or failure to act a source of prejudice.

… If the [plaintiff] had been induced to make a relatively small, readily quantifiable monetary outlay on the faith of the [defendant's] assurances, then it might not be unconscionable for the [defendant] to resile from his promises to the [plaintiff] on condition that he reimburse her for her outlay. But this case is one to which the observations of Nettle JA in *Donis v Donis* (2007) 19 VR 577 at 588–589 [34] are apposite:

> [H]ere, the detriment suffered is of a kind and extent that involves life-changing decisions with irreversible consequences of a profoundly personal nature … beyond the measure of money and such that the equity raised by the promisor's conduct can only be accounted for by substantial fulfilment of the assumption upon which the respondent's actions were based.

The [defendant's] argument, rightly, sought no support from the discussion in cases decided before *Giumelli v Giumelli* of the need to mould the remedy to reflect the 'minimum relief necessary to "do justice" between the parties'. There may be cases where '[i]t would be wholly inequitable and unjust to insist upon a disproportionate making good of the relevant assumption'; but in the circumstances of the present case, as in *Giumelli v Giumelli,* justice between the parties will not be done by a remedy the value of which falls short of holding the appellant to his promises. While it is true to say that 'the court, as a court of conscience, goes no further than is necessary to prevent unconscionable conduct', where the unconscionable conduct consists of resiling from a promise or assurance which has induced conduct to the other party's detriment, the relief which is necessary in this sense is usually that which reflects the value of the promise.

In the circumstances of the present case, no reason has been identified by the [defendant] to conclude that good conscience does not require that the [defendant] be held to his promises. In particular, it is no answer for the [defendant] to say that the perfor-

mance of his promises was conditional on the completion of the subdivision and the consent of his wife to the transfer to the [plaintiff]. His assurances to the [plaintiff] were expressed categorically so as to leave no room for doubt that he would ensure that the subdivision would proceed and that the consent of the [defendant's] wife would be forthcoming.

Questions

(1) Why was the plaintiff awarded equitable compensation and not the cottage she was promised?

(2) Following *Giumelli v Giumelli* and *Sidhu v Van Dyke,* will a court always enforce the reasonable expectations of a plaintiff who establishes the elements of a proprietary estoppel claim? In what kind of case will a plaintiff not have her reasonable expectations enforced?

(3) 'One does not test reliance by asking what the plaintiff would have done if [the promise] had not been made. One asks what he would have done if, the promise having been made, he had been told that it would not be kept' (Hoffmann LJ, *Walton v Walton* (CA, 14 April 1994). What would the plaintiffs in *Guimelli v Giumelli* and *Sidhu v Van Dyke* have done if they had been told that the promises made to them would not be kept? For a discussion of this issue, see *Q v E Co* [2020] NSWCA 220, [87]–[120].

9

Equitable assignments

9.1 Introduction

9.2 Equitable recognition of ineffective gifts of legal property

9.3 Assignments of future property

9.4 Gifts of equitable property

9.5 Assignment of choses in action at common law

9.6 Statutory assignment of choses in action

9.7 Statutory writing requirements for the assignment of equitable property

9.1 Introduction

9.1.1 Legal property and equitable property

Assignments are transfers of property from one party to another. The dualist nature of our legal system is exhibited here. The common law originally only recognised two kinds of property (land and chattels), and developed mechanisms for their legal transfer. Over time, new varieties of property interests (such as shares in companies) were recognised by the common law, and transfer methods adopted for them. Different methods of assignment (most now sourced in statute) apply to different forms of legal property (see textbook at [9.5]).

Equity enforced rights that were unrecognised at common law, such as the partnership interest and the beneficiary's interest in trust property. The Court of Chancery developed its own methodology for assignment of property or rights it recognised. All equity required was that the assignor manifest an immediate intention to assign the equitable property interest. It was even possible to manifest an immediate intention to assign without any writing. A statutory requirement of writing was, however, later introduced (see textbook at [9.36]–[9.42]). As different transfer rules apply to each, a crucial initial question when dealing with assignments is deciding whether the property in question is legal or equitable in nature.

9.1.2 Equity's intervention in assignments of legal property

In addition to recognising transfers of equitable interests, equity treats assignments of legal property as being sufficiently complete in some situations where the common law would regard the assignment as ineffective (see textbook at [9.7]–[9.13]). In such cases, equity will enforce the assignment against the assignor, and insist that whatever steps necessary to complete the assignment at law are taken. The guiding principle here is that equity intervenes when the assignor's conscience can be regarded as bound by the transaction. Practically, equitable intervention in legal assignments happens in two scenarios:

(1) where the property being assigned is legal in nature, but the legal assignment has not been effective

(2) where the property being assigned is legal in nature, but cannot be assigned at law (the assignment of partial choses in action) (see textbook at [9.4], [9.35]).

9.1.3 Equity and consideration

A second crucial question concerns the nature of the transaction, no matter what kind of property is involved. Assignments of property can be for valuable consideration or by way of gift. If valuable consideration has passed, equity regards the assignor's conscience as engaged by its receipt, and will enforce the transaction in most cases. However, if the transaction is a gift, equity will only enforce the transaction if it can be shown that the assignor's conscience is nevertheless bound. This chapter largely deals with the situation where no consideration for the transfer has been received.

In the case of ineffective *gifts* of legal property, the principle has developed in Australia that equity regards the assignor's conscience as bound when the assignor has done all that he alone has to do in order to render the transaction binding on him. The cases extracted below track that development.

9.1.4 Presently existing or future property?

'Future property' (property that is not yet held by the assignor) cannot be assigned at common law, and can only be assigned in equity for valuable consideration. Only receipt of consideration for future property will bind the assignor's conscience (see textbook at [9.19]–[9.25]). Equity will insist that, if and when the future property is received by an assignor, it is transferred to the assignee who has provided consideration. As presently existing property can be assigned in equity without consideration, it then becomes important to decide whether the property which the assignor is attempting to transfer should be characterised as presently existing property or future property. This characterisation can be problematic, as the cases extracted show.

9.1.5 Transfers of choses in action

Neither legal nor equitable choses in action could originally be assigned at common law, due to fears of champerty and maintenance. But this could result in tying up assets represented by the chose in action for potentially long periods. Equity thought this was unjustifiable, and allowed the transfer of most rights of action. Eventually, as fears of champerty and maintenance faded, a statutory method of assignment of legal choses in action was introduced (see textbook at [9.30]–[9.34]). However, it is limited in its application to assignments of the entire legal chose. Assignments of partial legal choses in action cannot occur under the statute (except in Western Australia) and therefore rely upon equitable transfer principles for their efficacy.

9.1.6 The requirement for writing in equitable assignments

Despite Chancery only requiring manifestation of an immediate intention to assign equitable property, the statutory provisions in most Australian States that are derived from the *Statute of Frauds 1677* (Imp) require that dispositions of equitable interests be made in writing (see *Civil Law (Property) Act 2006* (ACT) s 201; *Conveyancing Act 1919* (NSW) s 23C; *Conveyancing and Law of Property Act 1884* (Tas) s 60; *Property Law Act 1969* (WA) s 34; *Property Law Act 1958* (Vic) s 53). The provisions in force in the Northern Territory and Queensland require only that the disposition be manifested and proved in writing: see *Law of Property Act* (NT) s 10; *Property Law Act 1974* (Qld) s 11. Cases concerning the meaning of the term 'disposition' and the application of the writing requirements to transactions are also extracted below.

Questions for consideration

(1) When will equity enforce an assignment of legal property that is incomplete at law? Is the justification for that intervention convincing?

(2) Why should an assignor's conscience be bound by anything less than the receipt of consideration for attempted assignments? Why is equity frequently satisfied with less?

(3) How does the holder of an equitable chose in action assign that interest? Should the statutory assignment method for legal choses in action also apply to an equitable chose in action? (See textbook at [9.33]–[9.34].)

(4) Should it be easier or harder to assign equitable property rights? For example, consider Victorian Law Reform Commission, *Review of the Property Law Act* (Final Report No 20, October 2010).

9.2 Equitable recognition of ineffective gifts of legal property

The foundation case concerning ineffective gifts of legal property is *Milroy v Lord*. While the attempted assignment in this case failed, the test proposed by Lord Justice Turner proved to be hard to apply in more marginal cases.

9.2a *Milroy v Lord* (1862) 4 De GF & J 264; 45 ER 1185

Background

Prior to the *Married Women's Property Act 1882* (UK), a married woman's property became that of her husband. Trusts were often used as a way of providing income for married women, without ownership of the capital passing to the husband. In 1852, Mr Medley tried to create a trust in favour of his niece, Eleanor (later Mrs Milroy). He attempted to transfer shares in a Bank to Mr Lord, who was to act as trustee. Mr Medley delivered the share certificates to Mr Lord. Under the Bank's constitution, shares were transferable in the Bank's books. This never occurred, although Mr Lord paid the dividends received to the niece. Mr Medley died in 1855. After his death, Mr Lord delivered the share certificates to Mr Medley's executor. The question for the Court was whether the shares had been validly settled on trust, or whether they remained the property of Mr Medley's estate.

Decision

Turner LJ

Under the circumstances of this case it would be difficult not to feel a strong disposition to give effect to this settlement to the fullest extent … but, after full and anxious consideration, I find myself unable to do so. I take the law of this Court to be well settled, that, in order to render a voluntary settlement valid and effectual, the settlor must have done everything which, according to the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property and render the settlement binding upon him. He may of course do this by actually transferring the property to the persons for whom he intends to provide, and the provision will then be effectual, and it will be equally effectual if he transfers the property to a trustee for the purposes of the settlement, or declares that he himself holds it in trust for those purposes. but, in order to render the settlement binding, one or other of these modes must … be resorted to, for there is no equity in this Court to perfect an imperfect gift. The cases I think go further to this extent, that if the settlement is intended to be effectuated by one of the modes to which I have referred, the Court will not give effect to it by applying another of those modes. If it is intended to take effect by transfer, the Court will not hold the intended transfer to operate as a declaration of trust …

Applying then, these principles to the case, there is not here any transfer … [to Eleanor] … and the question therefore must be, whether a valid and effectual trust in favour of … [Eleanor] was created in the Defendant Samuel Lord or in the settlor himself as to all or any of those shares. Now it is plain that it was not the purpose of this settlement, or the intention of the settler to constitute himself a trustee of the bank shares. The intention was that the trust should be vested in the Defendant Samuel Lord, and I think therefore that we should not be justified in holding that by the settlement, or by any parol declaration made by the settlor, he himself became a trustee of the shares for the purposes of the settlement.

Note

Although the niece was unsuccessful, she was not left completely empty-handed. Mr Medley's will left her a legacy of £4,000. Mr Lord's position is somewhat questionable. His own daughter married Mr Medley. The report does not make clear who the residuary beneficiary of the Medley estate was, but it can be surmised that it was Mr Lord's daughter or perhaps grandchildren.

Questions

(1) What are the three methods of making voluntary provision for someone else as discussed by Turner LJ?

(2) The phrase 'everything, which according to the nature of the property … was necessary to be done in order to transfer the property and render the settlement binding on him' is opaque. Did Turner LJ mean that all necessary *legal* steps to transfer the property had to be taken, and at that point, the settlement would be binding? Or was it possible that the settlement could be regarded as binding at an earlier point in the transaction? See *Corin v Patton* (below).

9.2b *Corin v Patton* [1990] HCA 12; (1990) 169 CLR 540

Background

Mr and Mrs Patton were joint registered proprietors of land. Mrs Patton, who was terminally ill, wanted to sever the joint tenancy and give her share of the land to the plaintiff, her brother. She executed a memorandum of transfer in favour of the plaintiff, who was to hold the share on trust for her until her death. She also executed a will leaving her estate to her children. If the transfer was successful, her share of the land would have formed part of her estate.

The certificate of title was held by a bank as unregistered mortgagee of the property. Mrs Patton took no action to arrange production of the certificate of title before her death, and the transfer remained unregistered.

The question for the Court was whether Mrs Patton had successfully made a gift of her interest in land in equity, transfer of the title at law having failed.

Decision

Mason CJ and McHugh J

The rationale for refusing to complete an incomplete gift is that the donor should not be compelled to make a gift, the decision to give being a personal one for the donor to make. However, that rationale cannot justify continued refusal to recognise any interest in the donee after the point when the donor has done all that is necessary to be done on his part to complete the gift, especially when the instrument of transfer has been delivered to the donee. Just as a manifestation of intention plus sufficient acts of delivery are enough to complete a gift of chattels at common law, so should the doing of all necessary acts by the donor be sufficient to complete a gift in equity. The need for compliance with subsequent procedures such as registration, procedures which the donee is able to satisfy, should not permit the donor to resile from the gift. … [This] approach has the advantage that it gives effect to the clear intention and actions of the donor rather than insisting upon strict compliance with the legal forms. …

… [T]he principle is that, if an intending donor of property has done everything which it is necessary for him to have done to effect a transfer of legal title, then equity will recognize the gift. So long as the donee has been equipped to achieve the transfer of legal ownership, the gift is complete in equity. 'Necessary' used in this sense means necessary to effect a transfer. From the viewpoint of the intending donor, the question is whether what he has done is sufficient to enable the legal transfer to be effected without further action on his part.

Although Griffith CJ [in *Anning v Anning* (1907) 4 CLR 1049] did not explicitly say so, his proposition implicitly recognizes that the donee acquires an equitable estate or interest in the subject matter of the gift once the transaction is complete so far as the donor is concerned. …

The question is then whether Mrs Patton did all that was necessary for her to do in order to effect a transfer. Two obstacles are suggested to completion of the gift. First, the certificate of title remained throughout with the mortgagee and Mrs Patton took no steps to arrange for its production for the purposes of registration. Secondly, it is not clear whether or not (the solicitor) held the executed transfer on Mrs Patton's instructions or those of Mr Corin.

Whether or not it is correct to say that the production of a certificate of title is 'necessary' to achieve registration of a transfer of Torrens system land, it is apparent that a gift of such land cannot be regarded as complete in equity while the donor retains possession or control of the certificate of title … That is because it can scarcely be said that the donor has done everything necessary to be done by him if he has retained the certificate of title, by virtue of possession of which the gift might well be thwarted. …

Accordingly, the transactions failed to pass the equitable property in the land to Mr Corin … Further, because the gift was incomplete, Mrs Patton could have recalled the transfer at any time. But it is not strictly relevant to ask whether or not Mrs Patton could have recalled the gift; that is not a criterion but rather a result of the efficacy or otherwise of the gift.

Deane J

The transfer in the present case, being unregistered, did not of itself operate as an assignment of either the legal or the equitable estate … That being so, the question arises whether, notwithstanding the ineffectiveness of the unregistered transfer as an actual assignment, there was such an alienation of Mrs Patton's interest by reason of the fact that the circumstances of the case were such as to give rise to a trust in Mr Corin's favour of that interest. Ultimately, that is the critical question in the case. Two distinct, albeit related, lines of reasoning lead me to conclude that it must be answered in the negative. … [The second line], based on the perception of Mr Corin as a mere volunteer, accords with the general approach of Mason CJ and McHugh J, as supplemented by the adoption of part of the reasoning of Hope JA (with whom Priestley and Clarke JJA agreed) in the Court of Appeal.

… Where property is capable of being assigned at common law, a purported legal assignment of the property which is ineffective at law is of itself inoperative in equity in the absence of valuable consideration. … Such an ineffective assignment will not be construed as itself constituting a declaration of trust in order to make it operative in equity … That being so, an intended gift under such a voluntary assignment will be effective in equity only if the overall circumstances of the case are such that the stage is reached where equity regards the gift as complete …

… In my view, Dixon J's judgment in *Brunker [Brunker v Perpetual Trustee Co Ltd* (1937) 57 CLR 555] should be accepted not as establishing a new kind of statutory right but as identifying the test for determining whether the stage has been reached when a gift of [Torrens] land under an unregistered memorandum of transfer is complete and effective in equity. That test is a twofold one. It is whether the donor has done all that is necessary to place the vesting of the legal title within the control of the donee and beyond the recall and intervention of the donor. Once that stage is reached and the gift is complete and effective in equity, the equitable interest in the land vests in the donee, and that being so, the donor is bound in conscience to hold the property as trustee for the donee pending the vesting of legal title. …

In the present case, the fact that Mrs Patton had taken no step to enable Mr Corin to procure the production of the duplicate certificate of title which was held by the bank meant that she had not done all that was necessary to place the vesting of common law title within Mr Corin's control. … In any event, it is apparent that it remained in Mrs Patton's power to intervene to prevent the vesting of any legal interest in him. In circumstances where Mr Corin's only involvement was as a bare trustee for Mrs Patton, she was entitled to terminate the trust at any time and demand the return of the unregistered transfer.

Notes

(1) At what point has all that is necessary to be done to transfer the property been done? (See textbook at [9.10]–[9.11].) When no transfer of Torrens title land has been registered, this point could have been fixed at numerous places, as was demonstrated in *Anning v Anning* (1907) 4 CLR 1049. Isaacs J would have required full compliance with statutory registration requirements. Higgins J took the view that equity could regard the transaction as complete when all that remained to be done was in the control of a third party, such as the Registrar of Titles. Griffith CJ thought that 'all that was necessary' should be judged from the position of the donor – had the donor taken all steps necessary to be taken by him *alone?* As *Corin v Patton* shows, Griffith CJ's views have been preferred.

(2) In *Corin v Patton,* Deane J adopted a slightly different test for judging the point of completion in equity. In addition to the donor having taken all steps necessary for her alone to take, Deane J would require that the transaction be beyond the recall of the donor (see textbook at [9.10]). For Deane J, the trust structure adopted by Mrs Patton had the effect of leaving Mrs Patton in a position where she could have recalled the gift – a second ground for saying the gift was ineffective in equity. The difference in approach may be largely semantic. For Mason CJ and McHugh J, a donor cannot recall a gift when she has taken all the steps she alone must to complete the

gift. Deane J's view of 'recall' is more functional. If the donor will be able to regain the property even after the gift is complete, his Honour would not have viewed the gift as 'beyond recall'.

(3) According to Mason CJ and McHugh J in *Corin v Patton,* it is only upon completion of the gift that it is beyond the power of the assignor to recall it. Thus, if the assignee (or a third party acting for it) does not have the assignor's authority to use documents it is holding to complete the transaction, there is still an opportunity for the assignor to change their mind: *Marchesi v Apostolou* [2009] FCA 259 (see textbook at [9.11]); *Isin v Ozen* (2017) 19 BPR 38,123. Indeed, this is one explanation of the outcome in *Milroy v Lord.* Although Mr Lord held Mr Medley's power of attorney, its terms did not allow him to complete the transfer of shares in the Bank without further reference to Mr Medley.

(4) *Corin v Patton* and most of the other cases mentioned in these notes concern gifts of Torrens title land where registration of a paper transfer has not occurred. Australian jurisdictions have either adopted, or are in the process of adopting, electronic transfer and registration schemes. These differ from traditional transfer registration methods, and it is unclear whether title to gifted Torrens land may have passed in equity at a point prior to electronic registration: see S Barkehall Thomas, 'Electronic Conveyancing and Incomplete Gifts of Torrens Land' (2019) 27(1) *Australian Property Law Journal* 87.

Questions

(1) What steps could the parties have taken to satisfy Deane J's secondary test of 'beyond recall'?

(2) Despite Mr Medley's clear intention to create a trust for his niece in *Milroy v Lord,* and Mrs Patton's clear intention to transfer property to her brother in *Corin v Patton,* neither was successful. Should equity regard the settlor's *intention* as paramount in such cases? See *Pennington* v *Waine* [2002] 1 WLR 2075.

9.3 Assignments of future property

Assignments of future property are ineffective at common law. Equity will recognise an assignment of future property only if it is for valuable consideration. If the 'future property' comes into the hands of the assignor, equity regards the assignor as holding it on constructive trust for the assignee. Therefore, in cases where no consideration has passed, the success of the assignment depends upon the property being classified as presently existing, rather than future, property.

9.3a *Norman v Federal Commissioner of Taxation* [1963] HCA 21; (1963) 109 CLR 9

Background

In an attempt to reduce his taxable income, Mr Norman tried to gift some income to his wife. In December 1956, the parties executed an assignment purporting to assign all dividends on specified shares, and some of the interest derived from a loan to a firm, which Mr Norman was to receive between 1 January 1957 and 30 June 1958. Under the terms of the loan, interest was payable in arrears. The borrower had the right to repay the loan wholly or in part at any time. The question for the Court was whether Mr Norman had effectually assigned his right to receive the dividends or interest.

Decision

The High Court held unanimously that undeclared dividends could not be effectually assigned by way of gift. The Court split 3:2 in deciding that the interest was also future property, and unable to be assigned by way of gift. Although in dissent as to outcome,

Windeyer J's statement of the law is generally accepted as authoritative. It is compendious on the topics of future property, assignments in equity, and assignments in accordance with the statutory provisions for assignments of choses in action.

Dixon CJ

… [A]t the date of the indenture and at the opening of the year of income …, no interest had accrued and no dividend existed, that is to say, had been declared. In each case, the subject matter of the assignment … was a sum of money which did not exist but which was expected to arise with more or less confidence. In the case of the dividend, that depended upon the affairs of the companies and the course that might have taken. In the case of the interest, that depended upon the subsistence of the loan. The loan, however, might have been repaid and of course anything may have happened to affect the accrual of interest. So far as the dividend is concerned, I think the structure of s 44 of the *Income Tax and Social Services Contribution Assessment Act 1936–1958* makes it impossible that future undeclared dividends should be assigned by the shareholder so as to exclude him from liability to include the dividends when declared in his assessable income. …

As to the question of the alleged assignment of the interest, I have had the advantage of reading the discussion contained in the judgment of Windeyer J of the whole subject of voluntary equitable assignments and I do not know that there is anything contained in it with which I am disposed to disagree. In the conclusion, however, that there was an effectual equitable assignment of the future interest, I cannot agree. … It appears to me that the future interest was the merest expectancy or possibility, having no existence in contemplation of law. After all, it must be remembered that to escape the obligation of including the interest in his assessable income the taxpayer must show that by 1st July 1957 he had denuded himself of all right to the interest. That, I think, could not be correct. After all, there was no more than an expected right with respect to the sums and I do not think the necessary divestment of future accrual could be made by way of gift.

Windeyer J

The ultimate question in this case is whether before 1st July 1957 the taxpayer had effectually assigned his right to receive certain moneys that would otherwise have been receivable by him and been part of his income. … The transaction relied upon as an assignment is a deed dated 21st December 1956. By it the taxpayer purported to assign to his wife, by way of gift, certain items of his income. These included part of the interest that would become due during the year in question upon money lent by him to two private companies trading in partnership, and the dividends that might come to him from shares he held in certain public companies. Before considering the transaction in detail, it is as well to consider the legal doctrines around which the argument revolved.

(i) As to the attempted assignment of things not in existence:

As it is impossible for anyone to own something that does not exist, it is impossible for anyone to make a present gift of such a thing to another person, however sure he may be that it will come into existence and will then be his to give. He can, of course, promise that when the thing is his he will make it over to the intended donee. But in the meantime he may change his mind and when the time comes refuse to carry out his promise, even though it were by deed. A court of law could not compel him to perform it. A court of equity would not. Courts of equity never had the objections to all agreements about future interests that, until the seventeenth century, were deeply rooted in the common law. Equity did not share the view that such agreements were void on the ground of maintenance. But things not yet in existence could only be the subject of agreement, not of present disposition. And in relation to promises and agreements, equity has been faithful to its maxim that it does not come to the aid of volunteers. For equity a deed does not make good a want of consideration.

If we turn from attempted gifts of future property to purported dispositions of it for value, the picture changes completely. The common law objection remains. But in equity a would-be present assignment of something to be acquired in the future is, when made for value, construed as an agreement to assign the thing when it is acquired. A court of equity will ensure that the would-be assignor performs this agreement, his conscience being bound by the consideration. The purported assignee thus gets an equitable interest in the property immediately the legal ownership of it is acquired by the assignor, assuming it to have been sufficiently described to be then identifiable. …

(ii) As to assignments of choses in action:

… Assignment means the immediate transfer of an existing proprietary right, vested or contingent, from the assignor to the assignee. Anything that in the eye of the law can be regarded as an existing subject of ownership, whether it be a chose in possession or a chose in action, can today be assigned, unless it be excepted from the general rule on some ground of public policy or by statute. But a mere expectancy or possibility of becoming entitled in the future to a proprietary right is not an existing chose in action. It is not assignable, except in the inexact sense into which, again to use Maitland's words, lawyers slipped when it is said to be assignable in equity for value.

The distinction between a chose in action, which is an existing legal right, and a mere expectancy or possibility of a future right is of cardinal importance in this case, as will appear. It does not, in my view, depend on whether or not there is a debt presently recoverable by action because presently due and payable. A legal right to be paid money at a future date is, I consider, a present chose in action. …

… [T]he law now provides a means whereby the legal owner of a chose in action may make a complete and perfect gift of it. That being so, and as equity does not perfect an imperfect gift, can there now ever be an effective voluntary assignment unless all the statutory requirements are met? The question is not an easy one if a purely logical answer be sought. Equity intervened to assist the assignment of choses in action because they were not assignable at law. Now that they are, why, it may be asked, should equity aid imperfect attempts at voluntary assignments of them. On the other hand, it can be urged that the statute provides a method or machinery whereby assignment may be effected, but that it does not detract from the validity of any transaction that would have been effective in equity if it had occurred before the statute came into operation. … If an attempt is made to assign, by way of gift, a chose in action assignable under the statute, then, as I see the matter, the requirements of the statute cannot be ignored; for the general rule of equity is that an effective assignment only occurs if the donor does all, according to the nature of the property, he must do to transfer the property to the donee. But the weight of authority is, I think in favour of the view that in equity there is a valid gift of property transferable at law if the donor, intending to make, then and there, a complete disposition and transfer to the donee, does all that on his part is necessary to give effect to his intention and arms the donee with the means of completing the gift according to the requirements of the law. … I think therefore that, if a man, meaning to make an immediate gift of a chose in action that is his, executes an instrument that meets the requirements of the statute and delivers it to the donee, actively or constructively, he has put it out of his power to recall his gift. It is true that until notice is given to the debtor or person against whom the chose is enforceable at law, all the requirements of the statute have not been complied with. But the notice can be given by the donee; and, if the donee has express or implied authority to give it, I think that equity would not allow the donor to deny the right of the donee to do so and intercept his gift. …

(iii) As to assignments of part of a debt:

It has been held that the statutory method of assignment is not available for the assignment of parts of debts or choses in action. … [His Honour then explained that, prior to the statute, proceedings to enforce the assignment of part chose in action had to be brought in a court of equity, and that such an assignment still had to take effect as an equitable assignment.] …

There are several senses in which the phrase 'equitable assignment' may be used; and the question, 'Is consideration necessary for an equitable assignment?' does not admit of a single short answer covering all of them.

If the interest to be assigned is a creature of equity, such as the beneficial interest of a cestui que trust, then, apart from any statutory provisions, an assignment of it can, of course, only be effected in equity; for the common law does not know it. Any present assignment of such an interest, that is to say of a chose in equity, is therefore necessarily an equitable assignment. Such an assignment can be by way of gift; and, except that writing is required by s 9 of the *Statute of Frauds,* no formality is necessary beyond a clear expression of an intention to make an immediate disposition. … It is, of course, necessary that the transaction should take the form of, and be intended as, an immediate transfer of the beneficial interest of the assignor, as distinct from an agreement to assign it. …

Turning, from assignments that are equitable because the property assigned is a chose in equity, to assignments that are equitable because the property assigned is a legal chose in action not assignable except by the aid of equity …

It seems to me that, in principle, so far as a deed has any efficacy in connexion with equitable assignments, it is not that a deed takes the place of valuable consideration where that is needed to attract the aid of equity. Rather it is that, in cases where value is not so required but a clear expression of intention is, the delivery of a deed couched in terms of present gift manifests, in the best possible way, the intention of the assignor to make an immediate and irrevocable transfer.

An agreement to assign will be effective as an equitable assignment if it be for value; for then equity looks on that as done which ought to be done. But this does not mean that there cannot be in equity an actual assignment of a chose in action as distinct from

an agreement to assign. I think there can, and that it can be by way of gift. In such a case, equity enforces the assignment, not by compelling the assignor to do something, but by refusing to allow him to act in a way inconsistent with what he has done, that is by restraining him from derogating from his gift. His conscience becomes bound, not by value received, but because, as between him and the assignee, his gift was complete.

Note

The loan in the above case was not commercial in nature. Its special features were important to the outcome in the case.

Questions

(1) Why is the assignor's conscience not bound where no consideration is received for an assignment of future property?

(2) What is the difference between 'a mere expectancy' and an existing right of action? See *Kennon v Spry* (2008) 238 CLR 366, 417 (Heydon J).

(3) Consider the following case:

> X assigns in writing his rights as a potential object of a discretionary trust to Y for $1,000. The following week, the trustee of the discretionary trust appoints trust property to X. Y claims the property.

What difference would it make if X executed a deed assigning his rights to Y?

9.3b *Shepherd v Commissioner of Taxation (Cth)* [1965] HCA 70; (1965) 113 CLR 385

Background

Mr Shepherd invented a furniture castor, and held a patent for it. He granted a licence to a manufacturer (Cowen) to produce and sell the castors. The manufacturer was to pay a monthly royalty of five per cent of the gross sale price of castors sold during the previous month. Shepherd then executed a deed poll, assigning 'absolutely and unconditionally' all his right title and interest in and to an amount equal to 90 per cent of the income which might accrue under the licence for a period of three years, to several members of his family.

The Commissioner of Taxation assessed Mr Shepherd's income for the following tax year as including all royalties payable under the licence agreement.

The Commissioner argued that what Mr Shepherd had gifted was the income from royalties which was therefore taxable in his hands. Mr Shepherd argued that he had made a binding gift of part of his *right to the royalties.*

Decision

The High Court, Owen J dissenting, held that Mr Shepherd had made a valid gift of his right to the royalties.

Barwick CJ

In my opinion, the situation of the deed poll is that it is ineffective at law to confer on any of the named persons any legal right whether to any part of the promise to pay royalties or of the royalties themselves when received.

However, a part or parts of a chose in action can be assigned in equity. In my opinion, if the assignment of a part of the chose in action consisting of the promise to pay royalties is complete, it is effective to vest the appropriate part of the right equitably in the assignee, whether or not the assignment is for consideration or by way of gift. It is only if the donee needs the assistance of equity to complete the gift, as distinct from enforcing the right given, that he can be met with the defence that equity will not assist a volunteer. Here, if there was an immediate gift of a proportion of the right to the royalties, the donees need seek no assistance. If the deed upon its true construction evidences an intention presently to assign part of the right, the assignment would be complete within the doctrines of equity. If, on the other hand, the deed purports to assign the stated proportion of the royalties as after-acquired property the assignment would be ineffective in equity for want of consideration. … The task in construing the deed is to find the meaning intended by the taxpayer as expressed. No form of words is required for an equitable assignment but it is necessary to find the expression of an intention to assign. …

No doubt to speak of the subject matter of the gift as an amount of income to accrue from royalties would seem to support the conclusion that what is to be given is the property in the form of money produced by the promise to pay royalties. But the full description of the subject matter of the assignment is of 'the right' to such amounts – an unlikely expression to describe the money itself. In my opinion, it indicates that the taxpayer was not intending to promise that he would pay money measured by the amount of royalties accrued or that he was intending to assign the royalties themselves. Its use rather suggests, to my mind, that he was intending to place the persons he wished to benefit in the position of being able to assert a right to receive the appropriate amounts from the licencee. … I have come to the conclusion that upon the true construction of the deed poll the taxpayer did thereby equitably assign to the named donees the stated proportions of his right during the ensuing three years to royalties from the licensee under the licence to manufacture the patented article.

It was also submitted by the Commissioner that the subject matter of the intended assignment was a mere spes or possibility which could not be voluntarily assigned. …

The basis of this submission is that in the event there may not be any amount payable for royalties because no sales of castors may be made. But this misconceives the matter. That a promise may not be fruitful does not make it incapable of assignment. Reference was made … to *Norman v Federal Commissioner of Taxation* [1963] HCA 21; (1963) 109 CLR 9. But that case did not decide anything to the contrary of what I have just said. So far as that case dealt with the attempted assignment of the promise to pay interest, it must, in my respectful opinion, depend upon the view that the promise to pay interest in that case inhered in the existence of a principal sum upon which the interest was to be calculated and payable. Consequently, there was no promise to pay interest, if no principal remained due.

Kitto J

… There existed at that time (of the assignment) a contractual relationship between the appellant and Cowen (the licensee) which by its terms must continue throughout the ensuing three years, whether Cowen should wish it to continue or not. The appellant, therefore, had a vested right in respect of those three years. It might indeed become divested, for the licence agreement provided for cesser of Cowen's liability to pay royalties if the letters patent could not be maintained … but the right existed, though it was thus subject to defeasance by events not within the control of Cowen. It is true also that what the appellant's right under the licence agreement would yield in royalties in those years – indeed, whether it would yield any royalties at all in those years – no doubt depended upon contingencies within the control of Cowen. It was for him to decide how many castors, if any, he would manufacture … and try to sell. … But whatever he might do or desire to do, the existence of the appellant's contractual right would be unaffected, though the quantum of its product might be. The tree, though not the fruit, existed at the date of the assignment as a proprietary right of the appellant of which he was competent to dispose; and he assigned ninety per centum of the tree.

Notes

(1) The *Shepherd* decision follows the *Norman* case and is usually distinguished from *Norman* on its facts (see textbook at [9.24]). In *Shepherd,* the majority (Barwick CJ and Kitto J) were able to interpret the assignment as a transfer of a proportion of a contractual right to receive income (presently existing property) as distinct from the income itself, not yet received (future property).

(2) The case is well known for Kitto J's metaphor in explaining the difference between presently existing property and future property as the 'tree' and the 'fruit'. It is not possible in equity to assign the yet-to-be produced 'fruit' alone, as the tree may never bear fruit. It

is possible in equity to assign the 'tree', or a proportion of it. That right will carry with it any fruit ultimately produced.

Questions

(1) What kind of property was Mr Shepherd assigning? What assignment method was appropriate?

(2) Is the distinction drawn between *Norman* and *Shepherd* convincing? Is there any practical difference between a right to terminate a contract early (*Norman*) and a right to perform a contract in such a way that no income is produced (*Shepherd*)?

9.3c *Holroyd v Marshall* (1862) 10 HLC 191; 11 ER 999

Background

Mr Taylor, a mill owner, was in financial difficulties. He sold the machinery and equipment in his mill to the appellants for £5,000 upon terms which specified that the machinery and equipment were to be held on trust for Mr Taylor and restored to him upon repayment of the £5,000; otherwise, they were to be sold and the proceeds applied in discharging the debt owed to the appellants. The deed also specified that the machinery and equipment could continue to be used by Mr Taylor. Any replacement for the machinery or equipment was to be held on the terms of the same trust.

Mr Taylor acquired additional machinery but did not transfer it to the trustee. Subsequently, two judgment creditors, who had notice of the trust, claimed the additional machinery. The issue was whether the trustee, on behalf of the appellants, or the judgment creditors were entitled to the additional machinery.

Decision

The House of Lords held the appellants were entitled to the additional machinery, which constituted part of the security for repayment of the £5,000.

Lord Westbury LC

The question may be easily decided by the application of a few elementary principles long settled in Courts of Equity. In equity it is not necessary for the alienation of property that there should be a formal deed of conveyance. A contract for valuable consideration, by which it is agreed to make a present transfer of property, passes at once the beneficial interest, provided the contract is one of which a Court of Equity will decree specific performance. In the language of Lord Hardwicke, the vendor becomes a trustee for the vendee; subject, of course, to the contract being one to be specifically performed. And this is true, not only of contracts relating to real estate, but also of contracts relating to personal property, provided that the latter are such as a Court of Equity would direct to be specifically performed.

A contract for the sale of goods, as, for example, of five hundred chests of tea, is not a contract which would be specifically performed, because it does not relate to any chests of tea in particular; but a contract to sell five hundred chests of the particular kind of tea which is now in my warehouse in Gloucester, is a contract relating to specific property, and which would be specifically performed. ...

... But it is alleged that this is not the effect of the contract, because it relates to machinery not existing at the time, but to be acquired and fixed and placed in the mill at a future time. It is quite true that a deed which professes to convey property which is not in existence at the time is as a conveyance void at law, simply because there is nothing to convey. So in equity a contract which engages to transfer property, which is not in existence, cannot operate as an immediate alienation merely because there is nothing to transfer.

But if a vendor or mortgagor agrees to sell or mortgage property, real or personal, of which he is not possessed at the time, and he receives the consideration for the contract, and afterwards becomes possessed of property answering the description in the contract, there is no doubt that a Court of Equity would compel him to perform the contract, and that the contract would, in equity, transfer the beneficial interest to the mortgagee or purchaser immediately on the property being acquired. This, of course, assumes that the supposed contract is one of that class of which a Court of Equity would decree specific performance. If it be so, then immediately on the acquisition of the property described the vendor or mortgagor would hold it in trust for the purchaser or mortgagee, according to the terms of the contract. For if a contract be in other respects good and fit to be performed, and the consideration has been received, incapacity to perform it at the time of its execution will be no answer when the means of doing so are afterwards obtained.

Apply these familiar principles to the present case; it follows that immediately on the new machinery and effects being fixed or placed in the mill, they became subject to the operation of the contract, and passed in equity to the mortgagees, to whom Taylor was bound to make a legal conveyance, and for whom he, in the meantime, was a trustee of the property in question.

Notes

(1) The principle of *Holroyd v Marshall* – that an assignment of future property is valid in equity if supported by valuable consideration – was recognised by Windeyer J in *Norman* (above). Its basis in equitable doctrine is, however, less clear. Lord Westbury considered the specific enforceability of the contract to be essential. But, in *Tailby v Official Receiver* (1888) 13 App Cas 523, Lords Watson and Macnaghten stated that the assignment was valid once the consideration had been executed, applying the principle that equity regards as done that which ought to be done. This was also assumed by the High Court to be the explanation in *Palette Shoes Pty Ltd v Krohn* (1937) 58 CLR 1.

(2) *Holroyd v Marshall* provides the legal basis of debt factoring, whereby a trader assigns to a financier ('factor') present and future debts owed to the trader in return for cash, or gives them as security for a loan. Section 12 of the *Personal Property Securities Act 2009* (Cth) (PPSA) provides that the Act applies to 'an interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation (without regard to the form of the transaction or the identity of the person who has title to the property)'. Section 12(2)(j) includes assignments which secure payment or performance of an obligation within this definition. Security agreements may provide for security interests in after-acquired property (s 18(2)) and are enforceable, not by virtue of equitable doctrine, but by virtue of the statutory rules of attachment (s 19(2)). The principal significance of the Act is that it replaces equitable priority rules with statutory priority rules, principally but not exclusively depending on registration of the security interest. The assignment in *Holroyd v Marshall* would, in Australia today, be governed by the PPSA. See A Duggan and D Brown, *Australian Personal Property Securities Law* (LexisNexis Butterworths, 2012) 1.31–1.32 and chapter 7.

9.4 Gifts of equitable property

Windeyer J's judgment in *Norman* above [9.3a] discusses the principles for the assignment of equitable property.

9.4a *Norman v Federal Commissioner of Taxation* [1963] HCA 21; (1963) 109 CLR 9

Background

For a statement of the facts, see [9.3a].

Decision

Windeyer J

If the interest to be assigned is a creature of equity, such as the beneficial interest of a cestui que trust, then, apart from any statutory provisions, an assignment of it can, of course, only be effected in equity; for the common law does not know it. Any present assignment of such an interest, that is to say of a chose in equity, is therefore necessarily an equitable assignment. Such an assignment can be by way of gift; and, except that writing is required by s 9 of the *Statute of Frauds*, no formality is necessary beyond a clear expression of an intention to make an immediate disposition. … It is, of course, necessary that the transaction should take the form of, and be intended as, an immediate transfer of the beneficial interest of the assignor, as distinct from an agreement to assign it.

Note

These observations were echoed in *Halloran v Minister Administering National Parks and Wildlife Act 1974* (2006) 229 CLR 545, [70] where a unanimous High Court said: 'Where an interest to be transferred is, as here, a creature of equity, equity requires a clear expression of intention to make an immediate disposition; that, in the absence of an applicable statutory requirement, suffices.'

Question

The interest Windeyer J was referring to in the above extract was a beneficiary's interest in a trust. What other kinds of interests are 'creatures of equity'?

9.5 Assignment of choses in action at common law

Choses in action (see textbook at [9.4]) can be either legal or equitable in nature. The labels 'legal' or 'equitable' merely reflect that, prior to the judicature legislation, litigants had to commence their actions in the appropriate court; legal actions were commenced in King's Bench courts, and equitable actions were commenced in Chancery. The common law disapproved of assignment of choses in action. As Windeyer J mentioned in *Norman's* case (above), this was due to a fear of champerty and maintenance. Snell describes maintenance and champerty in the following extract.

9.5a John McGhee QC (ed), *Snell's Equity* (Thomson Reuters, 2010) 55

Maintenance or champerty

(a) *The principle.* An assignment or a chose in action is void if it involves unlawful maintenance or champerty. The meaning of those terms has evolved over time as the courts have gradually liberalised the rules allowing the assignment of choses in action. Unlawful maintenance is now regarded as the wanton and officious intermeddling with the disputes of others, in which the maintainer has no interest. The maintainer's assistance to the party's litigation must be without any justification or excuse. Champerty is maintenance where it is also agreed that the person lending his assistance will take a share of the proceeds of the litigation.

In all cases, the test depends on whether the person lending his assistance has a substantial interest in the outcome of the litigation or whether he has a genuine commercial interest in taking the assignment and enforcing it for his own benefit. If he has such an interest, then his involvement in the litigation, although amounting to maintenance in a strict sense, will not be unlawful. …

The rule prohibiting maintenance is sometimes expressed by saying that a person may not make an assignment of a bare right to litigation or a bare cause of action. …

(b) *Background.* The effect of the prohibition on unlawful maintenance can best be understood in the light of its history. The modern test for unlawful maintenance reflects a concern for the proper administration of justice. The same concern was especially acute in medieval times. Powerful or unscrupulous people might seek to stir up worthless claims or meddle in another person's litigation in order to harass the defendant. Champerty posed special risks to the administration of justice. A person who bought a share in litigation might be tempted to suborn judges or witnesses to secure a return on his share.

The simple assignment of claims is now not thought to involve those risks. The courts have other ways to deal robustly with people who abuse their proceedings. …

Note

For an extended discussion of the history of champerty and maintenance, see *Gladstone Ports Corporation Ltd v Murphy Operator Pty Ltd* (2020) 6 QR 497.

Background

Investors in a blueberry farm project entered into loan agreements with a finance company to fund their participation. In 1997, Equuscorp acquired the finance company's interests in the loans. When Equuscorp tried to recover principal and interest from the investors, the primary judge held that most of the agreements were illegal for failure to comply with provisions of the *Companies Code,* and unenforceable against the investors. However, in some cases, it was held the investors were liable to restore the money borrowed. Both sides appealed. Was an action for money had and received available? If so, was such a chose in action able to be assigned? And if so, had it been effectively assigned?

Decision

The majority of the High Court (French CJ, Gummow, Crennan, Kiefel and Bell JJ; Heydon J dissenting) held that the finance company could not recover under the illegal contracts or for money had and received, and that therefore there was no assignable right. In a joint judgment, French CJ, Crennan and Kiefel JJ discussed the assignment of choses in action.

French CJ, Crennan and Kiefel JJ

The respondents submitted that a claim for money had and received is not a 'chose in action' but a 'bare right of action' and therefore not assignable. The concept of the chose in action has a tangled historical background, linked closely to questions of assignability which, in turn, reflected logical concerns about the personal nature of contractual and delictual rights and policy concerns about maintenance. OR Marshall, writing in 1950, observed that historically the question whether something was a chose in action was independent of the question whether it was assignable *(The Assignment of Choses in Action* at 24). Then confusion arose:

> A thing in action is not assignable; that which is not assignable is a thing in action. This is a vicious circle. There is no test for determining a chose in action or assignability apart from their interrelation.

Marshall argued that the assignability of choses in action depended upon a positive common law prohibition which has gradually been relaxed. That the relaxation did not extend to tortious actions was, he suggested, a survival of the objection that the subject matter of a grant must be certain.

In *Campbells Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386, Gummow, Hayne and Crennan JJ observed (at [74]) that:

> The distinction between the assignment of an item of property and the assignment of a bare right to litigate was regarded as fundamental to the application of the law of maintenance and champerty. But drawing the distinction was not always easy. And it was a distinction whose policy roots were not readily discernible, the undesirability of maintenance and champerty being treated as self-evident.

In *Ellis v Torrington* [1920] 1 KB 399, Scrutton LJ referred to the common position of Courts of Law and Equity in opposition to the assignment of 'a bare right of action, a bare power to bring an action'. Such an assignment was seen as 'offending against the law of maintenance or champerty or both'. That opposition was qualified however (at 411):

> [E]arly in the development of the law the Courts of equity and perhaps the Courts of common law also took the view that where the right of action was not a bare right, but was incident or subsidiary to a right in property, an assignment of the right of action was permissible, and did not savour of champerty or maintenance.

The attenuated role of maintenance and champerty in relation to assignabilty was acknowledged by Lord Mustill in *Giles v Thompson* [1994] 1 AC 142 who spoke of them as maintaining a living presence in only two respects, first as the source of the rule against contingency fees and secondly, as the ground for denying recognition to the assignment of a 'bare right of action'. Of the latter, Lord Mustill said it was, in his opinion, 'best treated as having achieved an independent life of its own'.

The criteria for assignability of causes of action was widened by the House of Lords in *Trendtex Trading Corporation v Credit Suisse* [1982] AC 679. The non-assignability of a bare right to litigate was still treated as a fundamental principle. Nevertheless, Lord Roskill said (at 703):

> But it is today true to say that in English law an assignee who can show that he has a genuine commercial interest in the enforcement of the claim of another and to that extent takes an assignment of that claim to himself is entitled to enforce that assignment unless by the terms of that assignment he falls foul of our law of champerty, which, as has often been said, is a branch of our law of maintenance.

The application of criteria of assignability to restitutionary claims has remained uncertain. However, as is pointed out in M Smith, *The Law of Assignment* (at 335):

> [a]s with tortious causes of action, restitutionary claims can arise independently of any prior relationship between the parties. That said, a restitutionary claim can be so intertwined with a contract that a legitimate interest may be easy to establish.

The author points out that the question has received very little consideration either in the case law or in text books.

Australian authority on the assignability of restitutionary rights is sparse. …

A restitutionary claim for money had and received under an unenforceable loan agreement is inescapably linked to the performance of that agreement. If assigned along with contractual rights, albeit their existence is contestable, it is not assigned as a bare right of action. Neither policy nor logic stands against its assignability in such a case. The assignment of the purported contractual rights for value indicated a legitimate commercial interest on the part of the assignee in acquiring the restitutionary rights should the contract be found to be unenforceable. Equuscorp fell into the category of a party with a genuine commercial interest in the restitutionary rights. Notwithstanding the difficulties that may attend the claims having regard to particular circumstances which might affect their vindication, the better view is that adopted by the Court of Appeal, namely, that the restitutionary rights were assignable. The question that next arises is whether they were assigned.

[The plurality went on to hold that the deed executed by the parties was not effective to assign restitutionary rights to Equuscorp, had any such rights existed.]

Note

Recent cases have discussed whether the prohibition against assignment of bare rights of action is open to question. In *Bakewell v Anchorage Capital Master Offshore Ltd* (2019) 372 ALR 349, 360, Bell P (Macfarlan and White JJA agreeing) commented that 'the principle … could not be regarded … as completely set in stone and impervious to development, modification or even ultimate elimination'. See also *Gladstone Ports Corporation Limited v Murphy Operator Pty Ltd* (2020) 6 QR 497.

Question

On the basis of the above extract, do you think it is easy or difficult for an assignee to establish a 'legitimate commercial interest'?

9.6 Statutory assignment of choses in action

One of the *Judicature Act* reforms was to provide a statutory system of assignment of debts and other choses in action that were previously unassignable at common law (see textbook at [9.30]–[9.34]). The basic principle is that the statute allows the assignment of the entire chose in action. The assignment must be in writing, and notice of the assignment must be given to the person liable to the action. Windeyer J discussed both complete statutory assignments of legal choses in action, and equity's recognition of incomplete assignments in *Norman's* case, extracted above at [9.3a].

9.6a *Conveyancing Act 1919* (NSW)

Section 12: Assignments of debts and choses in action

Any absolute assignment by writing under the hand of the assignor (not purporting to be by way of charge only) of any debt or other legal chose in action, of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to receive or claim such debt or chose in action, shall be, and be deemed to have been effectual in law (subject to all equities which would have been entitled to priority over the right of the assignee if this Act had not been passed) to pass and transfer the legal right to such debt or chose in action from the date of such notice, and all legal and other remedies for the same, and the power to give a good discharge for the same without the concurrence of the assignor: Provided always that if the debtor, trustee or other person liable in respect of such debt or chose in action has had notice that such assignment is disputed by the assignor or anyone claiming under the assignor, or of any other opposing or conflicting claims to such debt or chose in action, the debtor, trustee or other person liable shall be entitled, if he or she thinks fit, to call upon the several persons making claim thereto to interplead concerning the same, or he or she may, if he or she thinks fit, pay the same into court under and in conformity with the provisions of the Act for the relief of trustees.

Note

Equivalent provisions in other jurisdictions are: *Civil Law (Property) Act 2006* (ACT) s 205; *Law of Property Act* s (NT) s 182; *Property Law Act 1974* (Qld) s 199; *Law of Property Act 1936* (SA) s 15; *Conveyancing and Law of Property Act 1884* (Tas) s 86; *Property Law Act 1958* (Vic) s 134; *Property Law Act 1969* (WA) s 20.

9.6.1 Equitable choses in action

Equitable choses in action were always assignable according to the methodology discussed above at [9.4]. However, the question arose whether the statutory assignment method for legal choses in action might also apply to the assignment of equitable choses.

9.6.1a *Federal Commissioner of Taxation v Everett* [1980] HCA 6; (1980) 143 CLR 440

Background

Mr Everett was a partner in a Sydney firm of solicitors with three other partners. In 1969, he purported to assign to his wife for value 6/13ths of his partnership share 'together with all those rights including the right to receive an appropriate share of the profits' that he was entitled to as a partner. Mr Everett's partners consented to the assignment, and Mr Everett gave notice to his partners when the assignment was executed. Thereafter, the wife received the income herself or gave directions for its payment.

In the 1973 tax year, the assignment reduced Mr Everett's declared income from $35,418 to $24,233. The Commissioner argued that $35,418 should have been included in Mr Everett's assessable income.

Decision

The High Court, Murphy J dissenting, held that Mr Everett had assigned a share of his presently existing partnership interest.

Barwick CJ, Stephen, Mason and Wilson JJ

Of paramount importance to the success of the appellant's argument is the proposition that the right of the respondent as a partner to receive his proportion of partnership profits was a right separate and severable from his share in the partnership and that this right did not flow from, nor was it 'the fruit of' that share. An examination of this proposition calls in the first instance for an explanation of the nature of a partner's interest in the partnership and of the incidents and consequences of an assignment of such an interest.

Although a partner has no title to specific property owned by the partnership, he has a beneficial interest in the partnership assets, indeed in each and every asset of the partnership. His share in the partnership consists of a right to a proportion of the surplus after the realization of the assets and payment of the debts and liabilities of the partnership. … Historically the interest of a partner in a partnership has been considered to be an equitable interest because it is a right or interest enforceable in equity and not in law (*Bolton v Federal Commissioner of Taxation* (1965) ALR 481).

A partner's interest in the partnership is a chose in action assignable in whole or in part. … The better opinion seems to be that, though the interest of a partner is an equitable interest, it may be assigned under s 12 of the *Conveyancing Act 1919* (NSW). … The interest, being a chose in action, falls within the expression 'debt or other legal chose in action' because the section, in providing that notice shall be given to a trustee 'as a person liable in respect of such debt or other legal chose in action', appears to contemplate the assignment by a beneficiary of an equitable chose in action against a trustee. There would be no point in referring to a trustee if the section made provision only for the assignment by strangers to the trust of debts owing by, and choses against, persons who happen to be trustees. The expression 'legal chose in action' may be read as 'lawfully assignable chose in action'. …

However, the weight of authority is against the view that part of a debt or a chose in action can be assigned under that section. Consequently, the assignment in the present case had effect as an equitable assignment.

… [A] share in a partnership carries with it the right to receive the proportion of the partnership profits to which the partner is entitled by virtue of the partnership agreement. Consequently, when the share is assigned, it carries with it the right to receive the assigning partner's proportion of those profits. In the same fashion, when a portion of a share is assigned, the portion carries with it the right to receive the proportion of profits attributable to that portion. As the right to receive profits is inherent in the partner's interest in the partnership … it is carried on assignment of the shares, even though no mention of it be made in the assignment. … The distinction between present property and future property or mere expectancy gives rise to some borderline cases. For the present purposes the point to be made is that an equitable assignment of present property for value, carrying with it a right to income in the future, takes effect at once whereas a like assignment of mere future income, dissociated from the proprietary interest with which it is ordinarily associated, takes effect when the entitlement to that income crystallizes or when it is received, and not before.

… The consequence in the present case is that because the respondent assigned present property, a chose in action, being a share of his interest in the partnership which carried with it the right to a proportionate share of future income attributable to his interest, the assignment became effective at once and conferred on his wife an immediate equitable entitlement as against the respondent and the other partners to such income referable to the share assigned as might subsequently be derived. This case is to be distinguished from Kelly's Case and other cases in which there have been assignments of future income dissociated from the property or proprietary right to which that income is attributable.

Murphy J

The real question is whether the federal Parliament intended to allow the income-splitting device adopted by the taxpayer to divert (for tax avoidance) some of his income derived from personal exertion (as a solicitor in a partnership).

The *Income Tax Assessment Act* should not be construed to impute an intention to Parliament to have its main purpose defeated by an income-splitting device which tends to defeat its policy of graduated tax rates, is available only to the professional and commercial classes, and allows the burden of taxation to be shifted increasingly from those taxpayers most able to afford it to those less able.

Notes

(1) 'Everett assignments' were a popular method of tax minimisation in the 1980s. Their efficacy relied on a partner's ability to alienate a proportion of the partnership interest. That proportion would carry with it income earned in the future. The partner's taxable income would then be reduced, even though it could be argued that the income was really earned through the partner's personal efforts. Murphy J's objection to Everett assignments was that this form of tax avoidance was only available to those in businesses or partnerships. It could never have been utilised by wage earners, who had no 'asset' that could be assigned in part. Parliament ultimately agreed with Murphy J's views. While Everett assignments are no longer effective as a tax avoidance method, the law relating to the nature of the partnership interest, its assignability, and the rights to income carried with the right to partnership share remains good.

(2) Mr Everett's chose in action was equitable in nature. As Mr Everett was only assigning part of his interest, the statutory assignment method could never have applied to the case (see textbook at [9.30]–[9.31]). The majority in *Everett* suggest that the statutory method of assignment of legal choses in action applies to equitable choses also: (1980) 143 CLR 440, 447. Arguably, the passage suggests that the statutory method could be *required* for assignments of entire equitable choses. Some academic writers treat the statutory assignment method in this way, which would mean that the equitable assignment method referred to in *Norman's* case ([9.3a] above) would only be needed for the partial assignment of legal and equitable choses: see GE Dal Pont, *Equity and Trusts in Australia* (Lawbook, 5th ed, 2011) [3.40]. The alternative interpretation is that the statutory method is one method of assigning equitable choses in action, but not the only method. This conclusion is arguably supported by dicta in the more recent High Court decision, *Halloran v Minister Administering National Parks and Wildlife Act 1974* (2006) 229 CLR 545, where the Court discusses assignment of equitable interests without suggesting that compliance with the statutory method would be required.

Questions

(1) Is it preferable that the statutory method of assignment be required for all equitable assignments?

(2) Who is protected by the requirement that notice be given in the statutory method of assignment?

9.7 Statutory writing requirements for the assignment of equitable property

9.7a *Property Law Act 1958* (Vic)

Section 53(1): Instruments required to be in writing

...

(c) a disposition of an equitable interest or trust subsisting at the time of the disposition must be in writing signed by the person disposing of the same, or by his agent thereunto lawfully authorized in writing or by will.

Notes

(1) Equivalent provisions in other jurisdictions are: *Civil Law (Property) Act 2006* (ACT) s 201(3); *Conveyancing Act 1919* (NSW) s 23C(1)(c); *Law of Property Act* (NT) s 10(1)(c); *Property Law Act 1974* (Qld) s 11(1)(c); *Law of Property Act 1936* (SA) s 29(1)(c); *Conveyancing and Law of Property Act 1884* (Tas) s 60(2)(c); *Property Law Act 1969* (WA) s 34(1)(c).

(2) The Northern Territory's and Queensland's provisions differ from the others (all of which are derived from the *Statute of Frauds 1677* (Imp) s 3) in that the disposition in these jurisdictions must be 'manifested and proved' by writing, but need not be in writing.

(3) It has been argued that s 23C(1)(c) of the *Conveyancing Act 1919* (NSW) is confined to dispositions of equitable interests in land (and not in personal property) because it is located in Part 2, Division 3 (Assurances of Land) of the Act. In *PT Ltd v Maradona Pty Ltd (No 2)* (1992) 27 NSWLR 241, 251, Giles J stated that the heading of the division in which a section appears was but one factor to be taken into account in the event of uncertainty, and s 23C encompasses interests in personalty. This understanding is consistent with the decision in *Grey v Inland Revenue Commissioners* [1960] AC 1 (see [9.7c]) and with the views of three members of the majority in *Adamson v Hayes* (1973) 130 CLR 276.

(4) Where the subsisting equitable interest is an interest in land, *Property Law Act 1969* (WA) s 34(1)(a) is also relevant: *Adamson v Hayes* (1973) 130 CLR 276.

Question

How does the writing requirement for the disposition of equitable interests interact with the statutory method of assignment discussed at [9.6]?

9.7b *Comptroller of Stamps (Vic) v Howard-Smith* [1936] HCA 12; (1936) 54 CLR 614

Background

Mr Howard-Smith was the residuary beneficiary of his late wife's estate. Before the grant of probate, he wrote to the executor and trustee of his wife's estate (who also held Mr Howard-Smith's power of attorney) requesting that, upon the issue of probate, the trustee pay his share of the estate to several others. In due course, the payments were made. The Comptroller of Stamps assessed stamp duty as payable on the letter. Stamp duty would have been payable had the letter assigned the property mentioned in the letter. Mr Howard-Smith argued that the letter merely gave permission to the trustee to dispose of the property in accordance with the terms of the letter, rather than having a dispositive effect.

Decision

The High Court held that the request did not constitute an assignment of his equitable interest.

Dixon J

The question which this appeal raises for decision is whether [the letter] amounts to an equitable assignment. The appellant claims that it is an instrument liable to stamp duty. … His claim cannot succeed unless by the [letter] itself, equitable interests were made over to the various persons and bodies intended to benefit.

As a residuary legatee, the husband was not entitled to specific items of property, but to equitable interest in the entire mass. There is thus no question of an assignment of a legal chose in action. The property dealt with was simply an equitable interest. Further, there is no question of consideration. The distribution directed by the letter was by way of gift.

A voluntary disposition of an equitable interest may take one of at least three forms. It may consist of an expression or indication of intention on the part of the donor that he shall hold the equitable interest vested in him upon trust for the persons intended to benefit. In that case he retains title to the equitable interest, but constitutes himself trustee thereof, and, by his declaration, imposes upon himself an obligation to hold it for the benefit of others, namely, the donees.

In the second place, the disposition may consist of a sufficient expression of an immediate intention to make over to the persons intended to benefit the equitable interest vested in the donor or some less interest carved out of it. In that case communication to the trustee or the person in whom legal title is vested is not required in order effectually to assign the equitable property. Notice to the trustee may be important to bind him to respect the assignment and in order to preserve priorities. But it is not a condition precedent to the operation of the expression of intention as an assignment. Nor does it appear to be necessary that the intention to pass the equitable property shall be communicated to the assignee. What is necessary is that there shall be an expression of intention then and there to set over the equitable interest, and, perhaps, it should be communicated to someone who does not receive the communication under confidence or in the capacity only of an agent for the donor.

In the third place, the intending donor for whom the property is held on trust may give to his trustee a direction requiring him thenceforth to hold the property on trust for the intended done. …

Accordingly, a voluntary disposition of an equitable interest may be effected by the communication to the trustee of a direction, intended to be binding upon him, thenceforward to hold the trust property on trust for the donee. But it must be a direction, and not a mere authority revocable until acted upon. Such an authority is not in itself an assignment. It may, it is true, result in a transfer of an equitable interest. For the trustee acting upon it may make an effectual appropriation of the trust property to the new beneficiary, or may acknowledge to him that he holds the trust property thenceforward on his behalf. If the authority contemplates or allows such a method of imparting an equitable interest to the donee, the action of the trustee may be effectual to bring about the result. But, in such a case, it is not the donor's expression of intention which per se constitutes the assignment. It is the dealing with the trust property under his authorization. The distinction is, of course, of great importance in considering whether a document is itself an assignment, and, as such, liable to stamp duty. …

[Dixon J went on to hold that the particular document was only an authorisation allowing the trustee to act in the stated manner, and was not dispositive of Howard-Smith's equitable interest.]

Note

Mr Howard-Smith's letter would have satisfied the statutory requirement of writing for the disposition of an equitable interest. The discussion above illustrates how easily an equitable interest could have been transferred at equity, and the resultant lack of transparency which perhaps necessitated the statutory insistence on writing.

Questions

(1) Why could Mr Howard-Smith's letter not be characterised as a declaration of sub-trust? What factors would have prevented the Court from interpreting Mr Howard-Smith's letter as a manifestation of an immediate intention to assign the interest?

(2) Up until such time as the trustee gives the property to Mr Howard-Smith's intended donees, who is entitled to it?

9.7c *Grey v Inland Revenue Commissioners* [1960] AC 1

Background

Mr Hunter wished to settle property on trust for his grandchildren, and was attempting to avoid stamp duty taxation on the transaction by making the operative elements of the transaction oral (and therefore not liable to stamp duty under the existing legislation). On 1 February 1955, Mr Hunter transferred 18,000 shares to the appellants, to be held by the appellants as nominees for and to the order of Mr Hunter. On 15 February 1955, Mr Hunter met with the appellants and *orally* and irrevocably directed them to divide the shareholding into six parcels and to hold each parcel on trusts previously established for his grandchildren. On 25 March 1955, the appellants and Mr Hunter executed six declarations of trust, reciting the events mentioned above, and acknowledging and declaring that the appellants had been holding the shares on the six trusts since the time of Mr Hunter's oral declaration.

Decision

The House of Lords held that direction to the trustees constituted a disposition which was invalid for failure to satisfy the writing requirements of the *Statute of Frauds.*

Viscount Simonds

These facts give rise to the plain question whether the oral directions given by Mr Hunter were effective, or were, having regard to s 53(1)(c) of the *Law of Property Act 1925,* wholly ineffective. In the former event the instruments would not, and in the latter would, be chargeable with *ad valorem* duty.

… Briefly, then, were the several oral directions given by Mr Hunter dispositions by him of the equitable interest in the shares held by the Appellants as nominees for him?

If the word 'disposition' is given its natural meaning, it cannot, I think, be denied that a direction given by Mr Hunter whereby the beneficial interest in the shares theretofore vested in him became vested in another or others is a disposition. But it is contended by the Appellants that the word 'disposition' is to be given a narrower meaning and (so far as relates to *inter vivos* transactions) be read as if it were synonymous with 'grants and assignments' and that, given this meaning, it does not cover such a direction as was given in this case. As I am clearly of the opinion … that there is no justification for giving the word 'disposition' a narrower meaning than it ordinarily bears, it will be unnecessary to discuss the interesting problem that would otherwise arise. …

Lord Radcliffe

If there is nothing more in this appeal than the short question whether the oral direction that Mr Hunter gave to his trustees on the 18th February, 1955 amounted in any ordinary sense of the words to a 'disposition of an equitable interest or trust subsisting at the time of disposition', I do not feel any doubt as to my answer. I think that it did. Whether we describe what happened in technical or more general terms the full equitable interest in the 18,000 shares concerned, which at that time was his, was (subject to any statutory invalidity) diverted by his direction from his ownership into the beneficial ownership of the various equitable owners … entitled under his six existing settlements.

But that is not the question which has led to difference of opinion in the Courts below. Where opinions have differed is on the point whether his direction was a 'disposition' within the meaning of section 53(1)(c) of the *Law of Property Act 1925*. …

In my opinion it is a very nice question whether a parol declaration of trust of this kind was or was not within the mischief of section 9 of the *Statute of Frauds*. The point has never, I believe, been decided and perhaps it never will be. Certainly it was long established as law that while a declaration of trust respecting land or any interest therein required writing to be effective, a declaration of trust respecting personalty did not. Moreover, there is warrant for saying that a direction to his trustee by the equitable owner of trust property prescribing new trusts of that property was a declaration of trust. But it does not necessarily follow from that that such a direction, if the effect of it was to determine completely or *pro tanto* the subsisting equitable interest of the maker of the direction, was not also a grant or assignment for the purposes of section 9 and therefore required writing for its validity. Something had to happen to that equitable interest in order to displace it in favour of the new interest created by the direction: and it would be at any rate logical to treat the direction as being as an assignment of the subsisting interest to the new beneficiary or beneficiaries or, in other cases, a release or surrender of it to the trustee.

Notes

(1) The oral final and irrevocable direction given to the trustees in this case was wholly ineffective, due to a failure to comply with the statutory formality requiring writing. Notice how Viscount Simonds and Lord Radcliffe give the term 'disposition' its natural meaning. The effect of the transaction was to move beneficial ownership from one person (Mr Hunter) to others. This movement in ownership indicated that there had been a disposition of the interest. As Lord Radcliffe put it, 'something must have happened' to result in such a movement.

(2) Statutes may also provide definitions of the term 'disposition'. See, eg, *Income Tax Assessment Act 1997* (Cth) ss 104–110; *Ellison v Sandini Pty Ltd* (2018) 263 FCR 460.

(3) The application of ss 53(1)(a) and (b) of the *Law of Property Act 1925* (UK) is limited to interests in land. *Grey* shows that s 53(1)(c) is not so limited. It is concerned with the disposition of subsisting equitable interests, whether those interests be in land or personalty.

Questions

(1) The stamp duty avoidance scheme in *Grey* failed, as *ad valorem* duty was payable on the written declarations of trust executed after the oral directions given to the trustees. What would have happened if the declarations of trust had not been signed by Mr Hunter?

(2) Does Lord Radcliffe's judgment suggest that a single transaction could be both a 'declaration of trust' and a 'disposition of a subsisting equitable interest'?

Part D

Equitable obligations

10

Fiduciary relationships and obligations

10.1 Introduction

10.2 Identifying fiduciary relationships: recognised or status based fiduciary relationship

10.3 Identifying fiduciary relationships: criteria

10.4 Scope of the fiduciary relationship

10.5 Fiduciary obligations

10.6 Contracting out of fiduciary obligations

10.1 Introduction

Fiduciary relationships arise in equity's exclusive jurisdiction and are relationships to which equity grants particular protection. Fiduciary obligations are owed by the fiduciary to identified others or a group of people, often described as the *principal* of the obligation or, somewhat confusingly, the *beneficiary* to whom the obligation is owed. In broad terms, the core obligation of a fiduciary is undivided loyalty. The fiduciary must act exclusively in the interests of the beneficiary. This obligation is not unbounded; for example, fiduciary obligations may be limited by time or the nature of the activities giving rise to the obligation in question. Fiduciary obligations thus exist within a defined scope. Additionally, as discussed in chapters 17 and 18, not all of the obligations owed by the fiduciary to the beneficiary will be fiduciary obligations. For example, a trustee may be required to exercise a degree of care when making investment decisions, but this obligation is not fiduciary in nature.

Questions for consideration

(1) What criteria are applied by the court in determining the existence of a fiduciary relationship?

(2) What is the scope of the relationship and to what extent does that scope inform the determination of breach of duty?

(3) Is the breach an actual or *potential* conflict, and is the conflict or potential conflict one of duty and interest or duty and duty, or both?

(4) To what extent is the fully informed consent of the beneficiary possible?

10.2 Identifying fiduciary relationships: recognised or status-based fiduciary relationships

Equity recognises some relationships as fiduciary, although this list of so-called 'status based' relationships is not closed.

10.2a *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; (1984) 156 CLR 41

Background

United States Surgical Corporation (USSC) was a United States company which manufactured surgical stapling products. USSC entered into an oral contract with Mr Blackman, who later became the distributor of USSC's products in Australia. USSC's products were not patented in Australia. Mr Blackman's Australian company was Hospital Products Limited (later renamed Hospital Products International Pty Ltd (HPI)). In competition with USSC, HPI repackaged USSC's products and sold them under the HPI brand. In addition, HPI and Mr Blackman reverse engineered USSC's surgical stapling devices, thus enabling competing products to be developed and sold into other markets, including the United States. HPI thus competed with USSC in the United States and Australian markets. USSC terminated its distributorship contract with Mr Blackman and sued him and HPI for breach of contract and breach of fiduciary duty.

Decision

The High Court held unanimously that HPI had broken its contractual obligations to USSC and, Mason J dissenting, that HPI had not owed any fiduciary obligations to USSC. Mason and Deane JJ held that USSC was entitled to limited constructive trust relief against HPI. This question did not arise for the other judges.

Gibbs CJ

The archetype of a fiduciary is of course the trustee, but it is recognized by the decisions of the courts that there are other classes of persons who normally stand in a fiduciary relationship to one another e.g., partners, principal and agent, director and company, master and servant, solicitor and client, tenant-for-life and remainderman. There is no reason to suppose that these categories are closed.

Note

Mason J left off this list (at 96) tenant-for-life and remainderman, and included (at 101) bailor and bailee. The relationship of guardian and ward is sometimes included in the list of status based fiduciary relationships. See *Hospital Products Ltd v United States Surgical Corporation* (1994) 156 CLR 41, 141 (Dawson J) and *Clay v Clay* (2001) 202 CLR 410, 430 (the Court), in which it was recognised that the guardian is a fiduciary concerning property that the guardian administers for the ward. Beyond guardian and ward, the Canadian Supreme Court in *M(K) v M(H)* (1992) 96 DLR (4th) 289, 232 (La Forest J) held that the parent–child relationship is 'intuitively fiduciary'. However, no Australian court recognises parents as fiduciaries, and Canadian fiduciary law must be treated with caution in the Australian context, given the differing structure of Canadian fiduciary principles in which obligations are proscriptive rather than prescriptive.

One category which has been described as an emerging status based category is that of financial adviser and client.

Background

For a statement of the facts, see [5.3a]. Of interest here is the High Court's consideration of the existence of a fiduciary relationship between client and financial adviser.

Decision

Gibbs CJ

It was right to say that Patrick Partners owed a fiduciary duty to Dr Daly and acted in breach of that duty. The firm, which held itself out as an adviser on matters of investment, undertook to advise Dr Daly, and Dr Daly relied on the advice which the firm gave him. In those circumstances the firm had a duty to disclose to Dr Daly the information in its possession which would have revealed that the transaction was likely to be a most disadvantageous one from his point of view. Normally, the relation between a stockbroker and his client will be one of a fiduciary nature and such as to place on the broker an obligation to make to the client a full and accurate disclosure of the broker's own interest in the transaction.

Brennan J

A stockbroker who is engaged to buy or sell shares on behalf of his client has been held to be an agent subject to a fiduciary's obligations in buying and selling … But Patrick Partners did not buy or sell shares on behalf of Dr Daly. Dr Daly sought advice from Patrick Partners on the investment of his money and they advised him. The question is whether, in advising Dr Daly, Patrick Partners were in the position of a fiduciary. …

… Whenever a stockbroker or other person who holds himself out as having expertise in advising on investments is approached for advice on investments and undertakes to give it, in giving that advice the adviser stands in a fiduciary relationship to the person whom he advises. The adviser cannot assume a position where his self-interest might conflict with the honest and impartial giving of advice …

The duty of an investment adviser who is approached by a client for advice and undertakes to give it, and who proposes to offer the client an investment in which the adviser has a financial interest, is a heavy one. His duty is to furnish the client with all the relevant knowledge which the adviser possesses, concealing nothing that might reasonably be regarded as relevant to the making of the investment decision including the identity of the buyer or seller of the investment when that identity is relevant, to give the best advice which the adviser could give if he did not have but a third party did have a financial interest in the investment to be offered, to reveal fully the adviser's financial interest, and to obtain for the client the best terms which the client would obtain from a third party if the adviser were to exercise due diligence on behalf of his client in such a transaction. Such a duty has been established by authority: see *Haywood v Roadknight* and the cases therein referred to … especially *Gibson v Jeyes* and *McPherson v Watt.*

Notes

(1) There are some indications that the approach in *Daly,* which finds a fiduciary relationship *inherent in the giving of advice,* based on the factors identified by Gibbs CJ and Brennan J, continues to command support. See *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165, 197 [72] (McHugh, Gummow, Hayne and Callinan JJ) in which it was confirmed: '[t]he trial judge correctly recognised that in some instances contractual and fiduciary relationships co-exist and he referred to *Daly* as indicating that, in certain circumstances, a financial adviser may owe fiduciary obligations to a client'. However, on the facts of *Pilmer*, no fiduciary relationship was found because no advice was given. An accountant had been engaged by Kia-Ora to provide a report to its shareholders, as required by the Stock Exchange Listing Rules, as to whether the proposed takeover price offered by Kia-Ora for shares in Western United was fair and reasonable. The report was in the event incompetently prepared and stated the accountant's opinion that the price was in the circumstances

fair and reasonable. Whilst the accountant acted in breach of contractual and tortious duties, this did not mean it gave advice as a fiduciary. See also *Breen v Williams* (1996) 186 CLR 71, 108 (Gaudron and McHugh JJ) and 134 (Gummow J).

(2) Notice that 'Patrick Partners did not buy or sell shares on behalf of Dr Daly' (Brennan J), thus presenting a factual obstacle to any argument that Patrick Partners acted as Dr Daly's agent, owing fiduciary obligations in this capacity. However, the course of dealing may nonetheless support the conclusion that a financial adviser is the agent of the client/principal, thus engaging fiduciary obligations within the relevant scope of dealing. Depending on the facts, this scope may or may not include advice provided by the financial adviser.

(3) Other cases involving financial advisers establish a fiduciary relationship not on the basis of status, or *Daly,* but rather according to the 'essence' of a fiduciary relationship set out in Mason J's judgment in *Hospital Products Ltd v United States Surgical Corporation* at [10.3.1a] below. See, for example, *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* (2012) 301 ALR 1, [743] (Rares J) which found the financial adviser (Grange) owed fiduciary obligations to its client (Swan Council). See also *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35, [282]–[286] (Jacobson J) where, although a fiduciary duty was found to have been validly contractually excluded, the underlying duty was established according to *Daly*, which was itself expressed to be 'consistent with the principle stated by Mason J in *Hospital Products'* ([284]).

(4) In *ABN AMRO Bank NV v Bathurst Regional Council* (2014) 24 FCR 1, [1070], the Court emphasised: 'the question is *not* whether [the alleged financial adviser] "fits" into the facts of a decided case and, in particular, *Daly v Sydney Stock Exchange* … The question was and remains whether the facts disclose the existence of a fiduciary relationship'.

Questions

(1) Would any of Gibbs CJ's status fiduciaries in *Hospital Products* apply to the facts in *Daly?* Could the decision in any case be explained without creating a separate category for (financial or investment) advisers?

(2) Would the reasoning in the case have been different if, instead of placing funds on deposit with Patrick Partners, the stockbrokers had purchased shares for Daly?

(3) To what extent does an adviser hold 'a power or discretion which will affect the interests of … [the advisee] in a legal or practical sense'? (*Hospital Products*, 97 (Mason J)).

10.3 Identifying fiduciary relationships: criteria

Outside of these recognised relationships, there are criteria of general application which inform when a fiduciary relationship arises. There are a variety of formulations capable of explaining some or all of the instances in which a fiduciary relationship has been held on particular facts to exist. The following section outlines these various accounts.

10.3.1 'Distil the essence' or the characteristics of the relationship approach

This method of identifying a fiduciary relationship follows the important and influential dicta of Mason J in *Hospital Products*. Note that Mason J was the only judge in the High Court to find a fiduciary relationship, albeit limited in scope, established between the Australian distributor (HPI) and the American manufacturer (USSC) of the products in question.

10.3.1a *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; (1984) 156 CLR 41

Background

For a statement of the facts, see [10.2a] above.

Decision

Mason J

Was HPI a fiduciary?

Because distributor-manufacturer is not an established fiduciary relationship, it is important in the first instance to ascertain the characteristics which, according to tradition, identify a fiduciary relationship. As the courts have declined to define the concept, preferring instead to develop the law in a case by case approach, we have to distil the essence or the characteristics of the relationship from the illustrations which the judicial decisions provide. In so doing we must recognize that the categories of fiduciary relationships are not closed: *Tufton v Sperni; English v Dedham Vale Properties Ltd.*

The accepted fiduciary relationships are sometimes referred to as relationships of trust and confidence or confidential relations (cf *Phipps v Boardman),* viz., trustee and beneficiary, agent and principal, solicitor and client, employee and employer, director and company, and partners. The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position. The expressions 'for', 'on behalf of', and 'in the interests of' signify that the fiduciary acts in a 'representative' character in the exercise of his responsibility, to adopt an expression used by the Court of Appeal.

It is partly because the fiduciary's exercise of the power or discretion can adversely affect the interests of the person to whom the duty is owed and because the latter is at the mercy of the former that the fiduciary comes under a duty to exercise his power or discretion in the interests of the person to whom it is owed: see generally Weinrib, 'The Fiduciary Obligation', (1975) *25 University of Toronto Law Journal,* at pp 4–8. Thus a mere subcontractor is not a fiduciary. Although his work may be described loosely as work which is to be carried out in the interests of the head contractor, the sub-contractor cannot in any meaningful sense be said to exercise a power or discretion which places the head contractor in a position of vulnerability.

That contractual and fiduciary relationships may co-exist between the same parties has never been doubted. Indeed, the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction.

My conclusion that HPI was at liberty to make some business decisions by reference to its own interests, subject to the obligations arising under the best efforts promise and the other terms of the contract express and implied, presents an overwhelming obstacle to the existence of the comprehensive fiduciary relationship found by the Court of Appeal. This is because HPI's capacity to make decisions and take action in some matters by reference to its own interests is inconsistent with the existence of a general fiduciary relationship. However, it does not exclude the existence of a more limited fiduciary relationship for it is well settled that a person may be a fiduciary in some activities but not in others: *Kuys; Birtchnell v Equity Trustees, Executors and Agency Co Ltd; Phipps.*

The appellant submits, mistakenly in my view, that the very existence of the best efforts promise is inconsistent with the coexistence of a fiduciary duty. True it is that a promise or a contractual term may be so precise in its regulation of what a party can do that there is no relevant area of discretion remaining and therefore no scope for the creation of a fiduciary duty: *R H Deacon & Co Ltd v Varga.* Here, however, HPI enjoyed a substantial area of discretion in the exercise of its responsibility to promote the market in Australia for USSC surgical stapling products. The giving of a best efforts promise to promote that market did not relevantly limit the ambit of HPI's discretion in discharging that responsibility.

In considering whether a fiduciary duty, and if so, what fiduciary duty, was generated by that responsibility we have to take account of the following factors: (1) there was a valuable market for USSC's products in Australia; (2) USSC, by appointing HPI, entrusted HPI with the exclusive responsibility of promoting that market during the term of the distributorship which was determinable by either party on reasonable notice; (3) the manner in which the market was to be promoted was left to HPI's general discretion,

subject to the express and implied terms of the contract; (4) the exercise of that discretion provided HPI with a special opportunity of acting to the detriment of the market for USSC's products, rendering USSC vulnerable to abuse by HPI of its position, USSC having no representation at all in Australia; (5) in selling USSC's products to Australian customers HPI was not acting as agent for USSC; (6) although HPI's actions would not alter or affect USSC's legal rights vis-á-vis others, its actions could and did affect adversely in a practical sense the market in Australia for USSC's products and consequently its product goodwill in this country; (7) in the circumstances mentioned in (1)–(6) above USSC relied on HPI to protect and promote USSC's product goodwill in Australia; and (8) HPI's responsibility to protect and promote USSC's product goodwill was necessarily subject to the qualification of reasonableness attached to the best efforts promise.

Point (8) above presents an unusual problem. The classical illustrations of the fiduciary relationship are those in which the fiduciary is under a duty to act not in his own interests or solely in his own interests but in the interests of another or jointly in the interests of another and himself, e.g., a trustee and a partner. In the present case the nature of the distributorship relationship and the best efforts promise with its attendant standard of reasonableness necessarily entailed that HPI could make some business decisions by reference to its financial interests, without subordinating them to the promotion of the market for USSC's products, so long at any rate as HPI did not deliberately do something, or omit to do something, for the purpose of destroying or injuring that market. And, as we know, HPI when it entered into a contract to sell USSC's products to an Australian customer was not acting as trustee or agent for USSC. The contractual rights which arose against the customer were held by HPI in its own right and were not the subject of any trust in favour of USSC. HPI was entitled to recover and retain the purchase price for its own benefit, being under no duty to account to USSC.

But entitlement to act in one's own interests is not an answer to the existence of a fiduciary relationship, if there be an obligation to act in the interests of another. It is that obligation which is the foundation of the fiduciary relationship, even if it be subject to qualifications including the qualification that in some respects the fiduciary is entitled to act by reference to his own interests. The fiduciary duty must then accommodate itself to the relationship between the parties created by their contractual arrangements. And entitlement under the contract to act in a relevant matter solely by reference to one's own interests will constitute an answer to an alleged breach of the fiduciary duty. The difficulty of deciding under the contract when the fiduciary is entitled to act in his own interests is not in itself a reason for rejecting the existence of a fiduciary relationship, though it may be an element in arriving at the conclusion that the person asserting the relationship has not established that there is any obligation to act in the interests of another.

There is a strong case for saying that because USSC entrusted HPI with the responsibility of protecting and promoting the market for USSC's products in Australia HPI was a fiduciary in protecting and promoting USSC's Australian product goodwill. In procuring orders for, making sales of and supplying USSC's products to Australian consumers HPI was acting in USSC's interests as well as its own. And by engaging in these activities HPI enhanced both USSC's local product goodwill and the goodwill of its own distributing business. By the sale of its products to its distributor here and by its sale of those products to Australian consumers under the name of 'Auto Suture' in circumstances in which the products were associated by consumers with USSC as manufacturer, USSC created a local product goodwill: *Estex Clothing Manufacturers Pty Ltd v Ellis and Goldstein Ltd; Imperial Tobacco Company of India Ltd v Bonnan*. The remarks of Latham CJ and Rich J in *Commissioner of Taxes (Qld) v Ford Motor Co of Australia Pty Ltd* indicate that goodwill cannot be assigned independently of the business with which it is associated, but they do not deny the existence of local product goodwill in a case such as the present. The difficulty of determining how much of the goodwill in Australia was local product goodwill of USSC and how much was goodwill of HPI's distributing business does not deny the separate existence in USSC of local product goodwill.

USSC, by entrusting HPI with a responsibility for protecting and promoting the market for USSC's products in Australia, effectively constituted HPI the custodian of its product goodwill in this country. Its responsibility in procuring orders, making sales and effecting deliveries of USSC's products in Australia armed HPI with a power and discretion to affect USSC's product goodwill. And in exercising this responsibility HPI had a special opportunity of acting to the detriment of USSC which was, accordingly, vulnerable to the abuse by HPI of its position.

HPI's position as custodian of USSC's product goodwill in Australia may be likened in a general way to that of a bailee whose duty it is to protect and preserve a chattel bailed to him. It has been well recognized, at least since the judgment of Jessel MR in *In re Hallett's Estate,* that a bailee stands in a fiduciary relationship with his bailor when the bailor entrusts to the bailee goods to be held or dealt with by him for the benefit of the bailor or for certain limited purposes stipulated by the bailor.

In engaging in the activities which I have mentioned, activities related to the production and promotion of USSC's product goodwill, HPI was acting in its own interests as well as in the separate interests of USSC. Although, as we have seen, it was entitled to prefer its own interests to the interests of USSC in some situations where those interests might come into conflict, this entitlement was necessarily subject to the requirement that HPI act bona fide and reasonably with due regard to the interests of USSC. In no

circumstance could it act solely in its own interests without reference to the interests of USSC. This, as it seems to me, fixed HPI with the character of a fiduciary in relation to those activities mentioned, notwithstanding that in pursuing them HPI was also acting in its own interests and that it was carrying on the distributorship business generally for its own benefit and in no sense as a trustee for USSC.

This conclusion is largely founded on the general nature of the responsibility which, according to the contract, HPI undertook to discharge in pursuing the relevant activities, though the obligation not to compete and the obligation not to deliberately injure USSC's market were significant elements in that responsibility. And it is the general nature of that responsibility which distinguishes HPI from the mortgagee who is bound to exercise his power of sale in good faith. In exercising that power the mortgagee is acting in his own interests, subject to the requirement of good faith (see *Kennedy v De Trafford)* and possibly that of reasonable care: see *Australia and New Zealand Banking Group Ltd v Bangadilly Pastoral Co Pty Ltd.* Even so, the mortgagee's duty in exercising the power is sometimes described as analogous to a fiduciary duty: Sir Frederick Jordan, *Chapters on Equity,* 6th ed (1947), p 113.

Notes

(1) Despite stating (at 141) that there is 'no satisfactory single test … which will serve to identify a relationship which is fiduciary', Dawson J (at 142) opined: '[t]here is, however, the notion underlying all the cases of fiduciary obligation that inherent in the nature of the relationship itself is a position of disadvantage or vulnerability on the part of one of the parties which causes him to place reliance upon the other and requires the protection of equity acting upon the conscience of that other'; it is from this requirement that fiduciary obligations arise. On the facts, Dawson J concluded that no fiduciary relationship arose between USSC and Blackman/HPI. In his judgment, no obligation beyond a contractual 'best efforts' obligation required Blackman to have any regard to USSC's interests to the exclusion of his own or that of HPI's.

Gibbs CJ (at 69) stated: 'I doubt if it is fruitful to attempt to make a general statement of the circumstances in which a fiduciary relationship will be found to exist. Fiduciary relations are of different types, carrying different obligations (see *In re Coomber; Coomber v Coomber, Jenyns v Public Curator (Qld)* and *Phipps v Boardman*) and a test which might seem appropriate to determine whether a fiduciary relationship existed for one purpose might be quite inappropriate for another purpose'. Although he pointed to various status based categories and factors such as confidence and entrustment, the commercial context and fact that HPI was by an arms' length contract entitled to make a profit from the arrangement presented an 'insuperable obstacle' to the finding of a fiduciary relationship.

Despite their differing positions as to the practicality of a general test, Wilson J (at 116) stated himself to be 'substantially in accord' with both Gibbs CJ and Dawson J. Deane J (at 123) held that, subject to 'one possible qualification', the arrangement was not fiduciary. Noting that the distributorship did not establish a partnership or joint venture, Deane J pointed out that '[t]he conclusion that the overall relationship between USSC and the distributor was not fiduciary does not preclude the possibility that, within or arising from that relationship, a more restricted fiduciary relationship might exist. Indeed, the continuing relationship of manufacturer and distributor might well provide a context in which it would be easier to imply an undertaking by one party to act as a fiduciary in relation to a particular matter than would be the case if that relationship did not exist'. On the facts, this more limited fiduciary relationship was not established. HPI was given by contract the exclusive opportunity of exploiting and developing the local goodwill of USSC's products, subject only to the contractual best efforts obligation to do so for the common benefit of USSC and itself (HPI).

(2) Although Mason J was in the minority in *Hospital Products*, his distillation of the essence of a fiduciary relationship has been referred to by the High Court and other appellate courts. See *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1, 34 [86] (the Court), where the *parties* accept that the 'relevant principles are those stated by Mason J in that case [referring to *Hospital Products*]'; and *Breen v Williams* (1996) 186 CLR 71, 92–3 (Dawson and Toohey JJ), who extract Mason J's statement but then go on to explain that in their view Mason J 'did not intend to suggest that this description of a fiduciary relationship isolated those features from other relationships of trust and confidence which *do not* impose fiduciary obligations' (emphasis added).

Questions

(1) Did Mason J purport to identify the elements describing a fiduciary relationship rather than criteria for the purposes of identifying a fiduciary relationship *de novo?* Was his Honour's intention to look at those categories in which equity is relatively certain that a fiduciary relationship exists and *distil the essence* of those relationships rather than identifying the criteria of the existence of a fiduciary relationship?

(2) What is the interrelationship between the 'critical features' identified by Mason J? Are all of these features necessary ingredients, or do some describe the relationship once it is established?

(3) What was the role of the contractual relationship between USSC and HPI in the finding of a fiduciary relationship? Note that presence of a contract in the factual matrix is considered separately below.

(4) Consider whether Mason J's dicta in *Hospital Products* have particular resonance when applied to vertical relationships.

10.3.2 The 'multifactorial' approach

In *Breen v Williams* (1996) 186 CLR 71, Gaudron and McHugh JJ identified several circumstances that point towards, but do not determine, the existence of a fiduciary relationship.

Background

Ms Breen had a bilateral breast augmentation in 1977 in which silicone breast implants were inserted.

Complications developed and Ms Breen consulted a plastic surgeon, Dr Williams, who performed surgery but did not remove the breast implants. Ms Breen suffered further complications and in 1993 she wished to participate in a United States class action against Dow Corning, the manufacturers of the breast implants. In order to participate in the United States class action, Ms Breen had to 'opt in' to the proceedings, requiring her to file with the United States District Court in Alabama copies of her medical records. Ms Breen sought access to the records kept by Dr Williams. She could have chosen to use discovery in the Supreme Court of New South Wales, but instead asserted an independent right of access to her medical records to the extent that these were created for her benefit. Dr Williams denied that Ms Breen had such a right. However, he offered to allow Ms Breen access to her records on condition that she release him from any claim which might arise in relation to the treatment that he had performed. She declined this offer. Ms Breen brought proceedings in the Equity Division of the Supreme Court of New South Wales seeking a declaration that she had a proprietary interest in the information in the medical records which had been compiled and held by Dr Williams. Pursuant to this claim, Ms Breen unsuccessfully sought a declaration that their doctor–patient relationship was fiduciary.

Decision

The High Court held that Dr Williams did not owe Ms Breen a fiduciary duty carrying with it a right of access to her medical records.

Gaudron and McHugh JJ

Australian courts have consciously refrained from attempting to provide a general test for determining when persons or classes of persons stand in a fiduciary relationship with one another. This is because, as counsel for Dr Williams pointed out, the term 'fiduciary relationship' defies definition. In *Hospital Products Ltd v United States Surgical Corporation* Gibbs CJ said:

> I doubt if it is fruitful to attempt to make a general statement of the circumstances in which a fiduciary relationship will be found to exist. Fiduciary relations are of different types, carrying different obligations … and a test which might seem appropriate to determine whether a fiduciary relationship existed for one purpose might be quite inappropriate for another purpose. For example, the relation of physician and patient, and priest and penitent, may be described as fiduciary when the question is whether there is a presumption of undue influence, but may be less likely to be relevant when an alleged conflict between duty and interest is in question.

As the law stands, the doctor–patient relationship is not an accepted fiduciary relationship in the sense that the relationships of trustee and beneficiary, agent and principal, solicitor and client, employee and employer, director and company and partners are recognised as fiduciary relationships. In *Hospital Products,* Mason J pointed out that in all those relationships 'the fiduciary acts in a "representative" character in the exercise of his responsibility'. But a doctor is not generally or even primarily a representative of his patient.

However, the categories of fiduciary relationship are not closed, and the courts have identified various circumstances that, if present, point towards, but do not determine, the existence of a fiduciary relationship. These circumstances, which are not exhaustive and may overlap, have included: the existence of a relation of confidence; inequality of bargaining power; an undertaking by one party to perform a task or fulfil a duty in the interests of another party; the scope for one party to unilaterally exercise a discretion or power which may affect the rights or interests of another; and a dependency or vulnerability on the part of one party that causes that party to rely on another.

Notes

(1) Brennan CJ held (at 83) that the doctor–patient relationship was not generally an agency as would give rise to a fiduciary relationship and nor was it, on the facts, a relationship of 'ascendancy or influence by one party over another, or dependence or trust on the part of that other' (at 82).

(2) Dawson and Toohey JJ declined to find a fiduciary relationship, emphasising the role of the law of negligence and contract in governing the relationship between a doctor and a patient. Their Honours stated (at 92) that 'the law has not … been able to formulate any precise or comprehensive definition of the circumstances in which a person is constituted a fiduciary in his or her relations with another' and referred to Mason J's 'essence' account in *Hospital Products*. Their Honours (at 93) relied on the representative character of the fiduciary, such that 'it is of significance that a fiduciary acts in a representative character in the exercise of his responsibility'. Whilst agreeing that the patient might place trust and confidence in the doctor, their Honours pointed out that the doctor received this trust and confidence not because the doctor in any sense acts as a representative of the patient 'but simply in the exercise of his or her professional responsibilities'.

(3) Gaudron and McHugh JJ held (at 110) that there was 'no basis upon which [it could be held] that Dr Williams owed Ms Breen a fiduciary duty to give her access to the medical records'. Their Honours stated (at 107–8) that '[i]n some circumstances, the dependency of the patient or the provision of confidential information may make the relationship between a doctor and patient fiduciary in nature. But that does not mean that their relationship would be fiduciary for all purposes'.

(4) Gummow J stated (at 138) that the engagement of Dr Williams was to 'advise and treat' Ms Breen and held (at 134) that '[c]onformably with the reasoning of Gibbs CJ and Brennan J in *Daly v Sydney Stock Exchange Ltd*, the relationship between medical practitioner and patient who seeks skilled and confidential advice and treatment is a fiduciary one'. However, as discussed below at [10.4a], the scope of any fiduciary obligation owed by Dr Williams did not intersect with his conduct in refusing Ms Breen access to her medical records.

Questions

(1) To what extent does the multifactorial approach predict instances in which one party will be constituted as a fiduciary for another?

(2) Within its own terms, is this multifactorial approach intended to operate as a predictor of the existence of a fiduciary relationship?

10.3.3 The 'entitlement to expect' approach

This approach looks to the circumstances of the relationship and asks whether, given these circumstances, the principal is entitled to expect that the putative fiduciary will act in the principal's interests in and for the purposes of the relationship.

10.3.3a *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; (2012) 200 FCR 296

Background

Directors of a mining company had improperly applied company funds towards the acquisition of valuable mining tenements in Western Australia. The directors had acted in breach of fiduciary duty and of duties they owed under the *Corporations Act 2001* (Cth). The directors, and companies they controlled, were also held liable for knowingly receiving money and shares in breach of fiduciary duty and for knowingly assisting breaches of duty. The judgment is extracted here for its statement of principle in relation to the identification of a fiduciary relationship.

Decision

Finn, Stone and Perram JJ

There is no issue in this matter as to when a person will be found to be a fiduciary and as to what are the duties imposed upon him or her if found to be such.

As to who is a 'fiduciary', while there is no generally agreed and unexceptionable definition, the following description suffices for present purposes: a person will be in a fiduciary relationship with another when and insofar as that person has undertaken to perform such a function for, or has assumed such a responsibility to, another as would thereby reasonably entitle that other to expect that he or she will act in that other's interest to the exclusion of his or her own or a third party's interest: on who is a fiduciary, see *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 96–97 …; *News Limited v Australian Rugby Football League Ltd* (1996) 64 FCR 410 at 538–541; and see generally Conaglen, *Fiduciary Loyalty,* Ch 9 (2010).

Note

The 'entitlement to expect' approach is associated with the work of Professor Paul Finn (as he then was) who wrote:

> [w]hat must be shown … is that the actual circumstances of a relationship are such that one party is entitled to expect that the other will act in his interests in and for the purposes of the relationship. Ascendancy, influence, vulnerability, trust, confidence or dependence doubtless will be of importance in making this out, but they will be important only to the extent that they evidence a relationship suggesting that entitlement.
> The critical matter in the end is the role that the alleged fiduciary has, or should be taken to have, in the relationship. It must so implicate that party in the other's affairs or so align him with the protection or advancement of that other's interests that foundation exists for the 'fiduciary expectation'. (P Finn, 'The Fiduciary Principle' in TG Youdan (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1989), 46–7)

Questions

(1) How might a court determine what a putative principal is *reasonably entitled* to expect from the putative fiduciary?

(2) To what extent is this account different from that given by Mason J in *Hospital Products*?

10.3.4 Horizontal relationships

A distinction may be drawn between horizontal and vertical relationships. In *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410, 539–40, the Court distinguished between a vertical relationship, such as principal and agent or employer and employee, and a

collaborative or horizontal relationship, such as a partnership or joint venture. Although noting that the criteria to be applied in determining whether the relationship is fiduciary will not necessarily vary between these two categories of case, the Court emphasised that the significance of a particular criterion may vary depending upon whether the relationship is vertical or horizontal. Thus, where one party undertakes or agrees to act *solely* for or in the interests of someone else, this will be easier to apply when the relationship between them is vertical. By contrast, an undertaking to act for mutual advantage will more likely exist in a horizontal relationship.

A commercial relationship may be horizontal in that both parties may bring resources, skill and information in the pursuit of a common goal. Archetypes include joint ventures and partnerships.

10.3.4a *United Dominions Corporation Ltd v Brian Pty Ltd* [1985] HCA 49; (1985) 157 CLR 1

Background

United Dominions Corporation (UDC) entered into an agreement described as a 'joint venture' with Brian Pty Ltd (Brian) and Security Projects Ltd (SPL) in order to build a shopping centre which was financed by borrowings from UDC. SPL owned the land on which the shopping centre was constructed. The terms of the agreement provided that the shares of the relevant participants in the project were SPL (58.4%), UDC (10%), Brian (9.2%) and others (22.4%), and that on construction and ultimate sale of the shopping centre, participants were to be repaid their financial contributions and their share of the profit. The shopping centre was successfully developed and realised a substantial profit, but Brian was neither repaid its financial contribution nor paid its share of the profit.

Without Brian's knowledge or consent, SPL had previously mortgaged the land to UDC as security for 'all moneys' borrowed from UDC, including amounts advanced by UDC to SPL for both joint venture purposes and purposes other than developing the shopping centre. UDC claimed to retain all of the surplus proceeds of sale of the shopping centre and to apply them in reduction of amounts owing to it by reason of borrowings made by SPL and others in relation to two other projects with which Brian had no connection. SPL defaulted under this mortgage, went into liquidation and was wound up. Brian commenced proceedings against UDC seeking recovery of the amounts withheld by UDC under the all moneys security. Brian successfully argued that a fiduciary relationship existed between it and UDC, breach of which meant that UDC could not rely on the mortgage or the all moneys security to deny Brian's entitlement under the joint venture agreement.

Decision

The High Court held that a fiduciary relationship existed between Brian and UDC, breach of which meant that UDC could not rely on the mortgage to deny Brian's entitlement under the joint venture agreement.

Mason, Brennan and Deane JJ

The term 'joint venture' is not a technical one with a settled common law meaning. As a matter of ordinary language, it connotes an association of persons for the purposes of a particular trading, commercial, mining or other financial undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing money, property or skill. The term is, however, apposite to refer to a joint undertaking or activity carried out through a medium other than a partnership: such as a company, a trust, an agency or joint ownership. The borderline between what can properly be described as a 'joint venture' and what should more properly be seen as no more than a simple contractual relationship may on occasion be blurred. Thus, where one party contributes only money or other property, it may sometimes be difficult to determine whether a relationship is a joint venture in which both parties are entitled to a share of profits or a simple contract of loan or a lease under which the interest or rent payable to the party providing the money or property is determined by reference to the profits made by the other. One would need a more confined and precise notion of what constitutes a 'joint venture' than that which the term bears as a matter of ordinary language before it could be said by way of general proposition that the relationship between joint venturers is necessarily a fiduciary one (but cf per Cardozo CJ, *Meinhard v Salmon)*. The most that can be said is that whether or not the relationship between joint venturers is fiduciary will depend upon the form which the particular joint venture takes and upon the content of the obligations which the parties to it have undertaken. If the joint venture takes the form of a partnership, the fact that it is confined to one joint undertaking as distinct from being a continuing relationship will not prevent the relationship between the joint venturers from being a fiduciary one. In such a case, the

joint venturers will be under fiduciary duties to one another, including fiduciary duties in relation to property the subject of the joint venture, which are the ordinary incidents of the partnership relationship, though those fiduciary duties will be moulded to the character of the particular relationship (see, generally, *Birtchnell v Equity Trustees, Executors and Agency Co Ltd*).

In the present case, it is apparent that the relationship between the participants in the shopping centre venture was a fiduciary one at least from the time when the formal agreement was executed. Under the agreement, the participants were joint venturers in a commercial enterprise with a view to profit. Profits were to be shared. The joint venture property was held upon trust. The participants indemnified the managing participant (SPL) against losses. The policy of the joint enterprise was ultimately a matter for joint decision. Apart from the absence of any reference in the agreement to 'partnership' or 'partners', the relationship between the participants under the agreement exhibited all the indicia of, and plainly was, a partnership (cf *Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd)*. It is true that UDC came to the joint venture in the role of prospective financier and, in so far as borrowings from it by the SPL group on behalf of the partnership were concerned, occupied the role of lender as well as that of partner. In so far as the property which was the subject of the joint venture was concerned however, the fact that UDC was a lender to SPL on behalf of the partnership did not absolve it from the ordinary fiduciary obligations of a partner.

It was submitted on behalf of UDC that no fiduciary relationship existed and no fiduciary duties arose between the prospective participants in the joint venture until the joint venture agreement was actually executed in July 1974. To the extent that that submission involves a general legal proposition that the relationship between prospective partners or joint venturers cannot be a fiduciary one until a formal agreement is executed, it is clearly wrong. A fiduciary relationship can arise and fiduciary duties can exist between parties who have not reached, and who may never reach, agreement upon the consensual terms which are to govern the arrangement between them. In particular, a fiduciary relationship with attendant fiduciary obligations may, and ordinarily will, exist between prospective partners who have embarked upon the conduct of the partnership business or venture before the precise terms of any partnership agreement have been settled. Indeed, in such circumstances, the mutual confidence and trust which underlie most consensual fiduciary relationships are likely to be more readily apparent than in the case where mutual rights and obligations have been expressly defined in some formal agreement. Likewise, the relationship between prospective partners or participants in a proposed partnership to carry out a single joint undertaking or endeavour will ordinarily be fiduciary if the prospective partners have reached an informal arrangement to assume such a relationship and have proceeded to take steps involved in its establishment or implementation.

In the present case, the relationship between UDC, Brian and SPL had plainly assumed a fiduciary character prior to 24 October 1973 when SPL gave the first of the mortgages to UDC. By that time, the arrangements between the prospective joint venturers had passed far beyond the stage of mere negotiation. Each had, by then, agreed to be, and been accepted as, a participant in each of the proposed joint ventures, if both or either of them went ahead. Each had made or agreed to make financial contributions towards the costs of the project or projects in which it or he had agreed to participate. SPL was acting as agent for the proposed joint venturers in relation to the establishment of each of the joint ventures and as trustee of those funds with which it had already been entrusted. In so far as Brian was concerned, it was a fundamental element of the substratum of the fiduciary relationship that then existed that the subject land, which was being purchased with joint venture funds for joint venture purposes, would be held available to be devoted to any ensuing joint venture or joint ventures and that Brian, as an accepted joint venture who had already made financial contribution towards the proposed hotel joint venture, was and would remain able to participate in the net profits in accordance with its share in the relevant joint venture. To transpose the words of Dixon J in *Birtchnell* (at pp 407–408), the participants in each of the then proposed joint ventures were 'associated for … a common end' and the relationship between them was 'based … upon a mutual confidence' that they would 'engage in (the) particular … activity or transaction for the joint advantage only. It matters not, for present purposes, whether that relationship is seen as that which may exist between prospective partners or joint venturers before the terms of any partnership or joint venture agreement have been settled or whether it is seen as a limited preliminary partnership or joint venture to investigate and explore the possibilities of an ultimate joint venture or ventures. On either approach, it was a fiduciary one.

That being so, the proposed participants in each joint venture were under fiduciary obligations to one another in relation to the proposed project at the time when the first of the mortgages was given and accepted. In particular, each participant was under a fiduciary duty to refrain from pursuing, obtaining or retaining for itself or himself any collateral advantage in relation to the proposed project without the knowledge and informed assent of the other participants. 'The subject matter over which the fiduciary obligations' extended must be 'determined by the character of the venture or undertaking for which' the relationship between the prospective joint venturers existed (per Dixon J, *Birtchnell*, at p 408 in a partnership context but equally applicable here). It included the land which was the subject of the proposed joint ventures and whose purchase had been funded by moneys contributed by the prospective participants or borrowed by SPL for the purposes of the proposed ventures. By that mortgage, SPL and UDC combined

to apply the property the subject of the proposed joint venture to their own collateral purposes in a manner which involved the obtaining of a collateral advantage for themselves and which was, both potentially and in the event, destructive of the whole interest of the other joint venturers including Brian. In combining to apply the property to their own collateral purposes and in giving and obtaining those collateral advantages without the knowledge or consent of Brian, SPL and UDC each acted in breach of its fiduciary duty to Brian.

Questions

(1) Partnership is a status based category of fiduciary relationship. To what extent did members of the High Court rely on this characterisation of the arrangement between the parties in their reasoning?

(2) Notice that equity is concerned with the whole course of dealings between the parties in determining the existence of a fiduciary relationship, not simply the terms of a formal agreement. Consider the relevance of equity's reach to pre-contractual negotiations.

10.3.5 Equity and contract

Care must be taken when considering the existence and scope (considered below) of a fiduciary relationship in a contractual context. As demonstrated by *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; (1984) 156 CLR 41 and *United Dominions Corporation Ltd v Brian Pty Ltd* [1985] HCA 49; (1985) 157 CLR 1, the contract might be part of the course of dealing which brings together the parties, and may also serve to narrow or limit the existence and scope of any fiduciary relationship. The presence of a contract thus has the potential both to create a fiduciary relationship and also to limit that relationship. Analysis is highly fact-dependent, and the entirety of the parties' course of dealing, including that which existed prior to entering into any contract, will be relevant. See also the discussion below on contracting out (at [10.6]).

10.3.5a *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; (1984) 156 CLR 41

Background

For a statement of the facts, see [10.2a] above.

Decision

Mason J

See extract from judgment at [10.3.1a] above.

10.3.5b *United Dominions Corporation Ltd v Brian Pty Ltd* [1985] HCA 49; (1985) 157 CLR 1

Background

For a statement of the facts, see [10.3.4a] above.

Decision

Mason, Brennan and Deane JJ

See extract from judgment at [10.3.4a] above.

Note

A key element in the reasoning of Mason, Brennan and Deane JJ in *United Dominions Corporation Ltd v Brian Pty Ltd* [1985] HCA 49; (1985) 157 CLR 1 was that, depending on the facts, a fiduciary relationship can arise in the pre-contractual dealing of parties, or 'between parties who have not reached, and who may never reach, agreement upon the consensual terms which are to govern the arrangement between them' (at p 12). As in *UDC*, where such pre-contractual dealing gives rise to a fiduciary relationship, any subsequent transaction entered into between the parties, and the terms of that transaction, may well fall into the scope of that fiduciary relationship (see the discussion below on scope of the fiduciary relationship at [10.4]) and will therefore be subject to the prohibitions against conflict of duty and interest or conflict of duty and duty, and misuse of fiduciary position (see the discussion below on fiduciary obligations at [10.5]).

10.3.5c *Breen v Williams* [1996] HCA 57; (1996) 186 CLR 71

Background

For a statement of the facts, see [10.3.2a] above.

Decision

The High Court held that Williams did not owe Breen a fiduciary duty carrying with it a right of access to her medical records.

Gummow J

I have dealt with the reliance by the appellant upon contract. The appellant, as I have indicated, also relies upon incidents of the relationship between medical practitioner and patient which may attract equitable intervention. In my opinion, there is no substance in these submissions.

However, in what follows I am not to be understood as supporting the existence of any necessary antipathy between concurrent contractual and fiduciary obligations. The law of partnership is an obvious example of such a concurrence. The mere presence of a contract does not exclude the co-existence of concurrent fiduciary duties and the contract may, in particular circumstances, provide the occasion for their existence. That is not to deny that a contractual term may be so precise in its regulation of what a party may do that there is no scope for the creation of a fiduciary duty.

Note

What is the position in relation to contract and so-called status based fiduciaries? In *Rahme v Benjamin and Khoury Pty Ltd* (2019) 100 NSWLR 550, a solicitor was found to owe fiduciary obligations to its client prior to the execution of a costs agreement by the client. Macfarlan JA (with whom Bathurst CJ and McCallum JA agreed) stated at [86]:

> As [the claimant/client] contended both at first instance and on appeal, fiduciary duties may, and ordinarily will, be owed in the course of negotiations for and steps taken to establish a fiduciary relationship. Thus, such duties will be owed in respect of the entry into a solicitor/client relationship, that being undoubtedly fiduciary in character. … [90] The salutary effect of fiduciary duties would be considerably diminished if soon-to-be fiduciaries could ignore conflicts of interest, or fail to disclose material facts, in the creation of their fiduciary relationships. Authority does not countenance this.

Questions

(1) Agency may arise out of a contract. Will an agent *always* be a fiduciary for the principal? Why/why not?

(2) Consider the terms of an agency contract which permit the 'agent' to act in their own interests and to accept conflicted engagements. To what extent might we consider the agent stands in a fiduciary position vis-a-vis the principal?

10.3.5.1 Termination of contract

Given that the course of dealing which raises a fiduciary relationship may include a contract between the parties, will any fiduciary obligations survive the termination of that contract?

10.3.5.1a *Prince Jefri Bolkiah v KPMG* [1999] 2 AC 222 (HL)

Background

KPMG was a firm of chartered accountants which had been retained by Prince Jefri Bolkiah, the youngest brother of the Sultan of Brunei, to provide forensic accounting services and litigation support in major litigation involving his personal financial affairs. That litigation settled in March 1998 and KPMG undertook no further work for Prince Jefri. During the same period, Prince Jefri was also the chairperson of the Brunei Investment Agency (BIA). Since 1983, KPMG had been engaged to audit the records of the BIA and in July 1998 the Government of Brunei retained KPMG to investigate the whereabouts of particular BIA assets which were suggested to have been used by Prince Jefri for his own benefit (codenamed 'Project Gemma'). By then, Prince Jefri was no longer the chairperson of the BIA. KPMG put in place an information barrier, and other measures to protect the confidentiality of information it held about Prince Jefri, but the Prince strenuously objected to KPMG taking on the engagement. Prince Jefri sought an injunction against KPMG, restraining them from acting for the BIA, and brought an action for breach of confidence.

Decision

Lord Millett (Lord Browne-Wilkinson, Lord Clyde and Lord Hutton agreeing) and Lord Hope, injunction granted

KPMG did not discharge the heavy burden of showing there is no risk that the information in their possession, which is confidential to Prince Jefri and which they obtained in the course of a former client relationship, may unwittingly or inadvertently come to the notice of those working on Project Gemma.

Lord Millett

My Lords, the question in this appeal is whether, and if so in what circumstances, a firm of accountants which has provided litigation support services to a former client and in consequence has in its possession information which is confidential to him can undertake work for another client with an adverse interest.

THE LAW

The issues raised in these proceedings have not previously been considered by your Lordships' House. The controlling authority in England hitherto has been the decision of the Court of Appeal in *Rakusen v Ellis, Munday and Clarke* [1912] 1 Ch 831. The facts of that case were unusual. It concerned a small firm of solicitors with only two partners who carried on what amounted to separate practices, each with his own clients, without any knowledge of the other's clients and with the exclusive services of some of the clerks. The plaintiff consulted one of the partners in relation to a contentious matter. After he had terminated his retainer, the other partner, who had never met the plaintiff and was not aware that he had consulted his partner, was retained by the party opposite in the same matter. The judge granted an injunction to restrain the solicitor from acting. The Court of Appeal found that there was no risk of disclosure of confidential information and discharged the injunction.

The case is authority for two propositions: (i) that there is no absolute rule of law in England that a solicitor may not act in litigation against a former client; and (ii) that the solicitor may be restrained from acting if such a restriction is necessary to avoid a significant risk of the disclosure or misuse of confidential information belonging to the former client. Like most of the later authorities, the case was concerned with the duties of a solicitor. The duties of an accountant cannot be greater than those of a solicitor, and may be less, for information relating to his client's affairs which is in the possession of a solicitor is usually privileged as well as confidential. In the present case, however, some of the information obtained by K.P.M.G. is likely to have attracted litigation privilege, though not solicitor-client privilege, and it is conceded by K.P.M.G. that an accountant who provides litigation support services of the kind which they provided to Prince Jefri must be treated for present purposes in the same way as a solicitor.

THE BASIS OF THE JURISDICTION

In *Rakusen's* case the Court of Appeal founded the jurisdiction on the right of the former client to the protection of his confidential information. This was challenged by counsel for Prince Jefri, who contended for an absolute rule, such as that adopted in the United States, which precludes a solicitor or his firm altogether from acting for a client with an interest adverse to that of the former client in the same or a connected matter. In the course of argument, however, he modified his position, accepting that there was no ground on which the court could properly intervene unless two conditions were satisfied: (i) that the solicitor was in possession of information which was confidential to the former client and (ii) that such information was or might be relevant to the matter on which he was instructed by the second client. This makes the possession of relevant confidential information the test of what is comprehended within the expression 'the same or a connected matter'. On this footing the Court's intervention is founded not on the avoidance of any perception of possible impropriety but on the protection of confidential information.

My Lords, I would affirm this as the basis of the court's jurisdiction to intervene on behalf of a former client. It is otherwise where the court's intervention is sought by an existing client, for a fiduciary cannot act at the same time both for and against the same client, and his firm is in no better position. A man cannot without the consent of both clients act for one client while his partner is acting for another in the opposite interest. His disqualification has nothing to do with the confidentiality of client information. It is based on the inescapable conflict of interest which is inherent in the situation.

This is not to say that such consent is not sometimes forthcoming, or that in some situations it may not be inferred. There is a clear distinction between the position of a solicitor and an auditor. The large accountancy firms commonly carry out the audit of clients who are in competition with one another. The identity of their audit clients is publicly acknowledged. Their clients are taken to consent to their auditors acting for competing clients, though they must of course keep confidential the information obtained from their respective clients. This was the basis on which the Privy Council decided *Kelly v Cooper* [1992] A.C. 205 in relation to estate agents.

Where the court's intervention is sought by a former client, however, the position is entirely different. The court's jurisdiction cannot be based on any conflict of interest, real or perceived, for there is none. The fiduciary relationship which subsists between solicitor and client comes to an end with the termination of the retainer. Thereafter the solicitor has no obligation to defend and advance

the interests of his former client. The only duty to the former client which survives the termination of the client relationship is a continuing duty to preserve the confidentiality of information imparted during its subsistence.

Accordingly, it is incumbent on a plaintiff who seeks to restrain his former solicitor from acting in a matter for another client to establish (i) that the solicitor is in possession of information which is confidential to him and to the disclosure of which he has not consented and (ii) that the information is or may be relevant to the new matter in which the interest of the other client is or may be adverse to his own. Although the burden of proof is on the plaintiff, it is not a heavy one. The former may readily be inferred; the latter will often be obvious. I do not think that it is necessary to introduce any presumptions, rebuttable or otherwise, in relation to these two matters. But given the basis on which the jurisdiction is exercised, there is no cause to impute or attribute the knowledge of one partner to his fellow partners. Whether a particular individual is in possession of confidential information is a question of fact which must be proved or inferred from the circumstances of the case. In this respect also we ought not in my opinion to follow the jurisprudence of the United States.

THE EXTENT OF THE SOLICITOR'S DUTY

Whether founded on contract or equity, the duty to preserve confidentiality is unqualified. It is a duty to keep the information confidential, not merely to take all reasonable steps to do so. Moreover, it is not merely a duty not to communicate the information to a third party. It is a duty not to misuse it, that is to say, without the consent of the former client to make any use of it or to cause any use to be made of it by others otherwise than for his benefit. The former client cannot be protected completely from accidental or inadvertent disclosure. But he is entitled to prevent his former solicitor from exposing him to any avoidable risk; and this includes the increased risk of the use of the information to his prejudice arising from the acceptance of instructions to act for another client with an adverse interest in a matter to which the information is or may be relevant.

DEGREE OF RISK

It follows that in the case of a former client there is no basis for granting relief if there is no risk of the disclosure or misuse of confidential information. This was the ground on which the Court of Appeal discharged the injunction in *Rakusen's* case [1912] 1 Ch 831. The test for disqualification was expressed in different terms by each of the three members of the court, but the case has been taken to indicate that the Court will not intervene unless it is satisfied that there is a 'reasonable probability of real mischief'. This test has been the subject of criticism both in this country and overseas, particularly in relation to solicitors, and a more stringent test has frequently been advocated: … The clear trend of the authorities is towards a stricter approach.

My Lords, I regard the criticisms which have been made of the test supposed to have been laid down by in *Rakusen's* case as well founded. It imposes an unfair burden on the former client, exposes him to a potential and avoidable risk to which he has not consented, and fails to give him a sufficient assurance that his confidence will be respected. It also exposes the solicitor to a degree of uncertainty which could inhibit him in his dealings with the second client when he cannot be sure that he has correctly identified the source of his information.

It is in any case difficult to discern any justification in principle for a rule which exposes a former client without his consent to any avoidable risk, however slight, that information which he has imparted in confidence in the course of a fiduciary relationship may come into the possession of a third party and be used to his disadvantage. Where in addition the information in question is not only confidential but also privileged, the case for a strict approach is unanswerable. Anything less fails to give effect to the policy on which legal professional privilege is based. It is of overriding importance for the proper administration of justice that a client should be able to have complete confidence that what he tells his lawyer will remain secret. This is a matter of perception as well as substance. It is of the highest importance to the administration of justice that a solicitor or other person in possession of confidential and privileged information should not act in any way that might appear to put that information at risk of coming into the hands of someone with an adverse interest.

Many different tests have been proposed in the authorities. These include the avoidance of 'an appreciable risk' or 'an acceptable risk'. I regard such expressions as unhelpful: the former because it is ambiguous, the latter because it is uninformative. I prefer simply to say that the court should intervene unless it is satisfied that there is no risk of disclosure. It goes without saying that the risk must be a real one, and not merely fanciful or theoretical. But it need not be substantial. …

I would also reject the approach taken by the New Zealand Court of Appeal in *Russell McVeagh McKenzie Bartleet v Tower Corporation* and adopted by the Court of Appeal in the present case. In my opinion the balancing exercise which was undertaken was inappropriate. This is not because the considerations which were thought to militate against the granting of injunctive relief were

irrelevant: far from it. It is clearly relevant that Prince Jefri retained K.P.M.G. in the knowledge that they were the BIA's auditors, and that the BIA would be put to inconvenience and expense if his retainer were to prevent it from employing K.P.M.G.'s services in future. But such considerations are relevant to a different question: whether in the circumstances Prince Jefri must be taken to have consented to K.P.M.G.'s undertaking the further assignment for the B.I.A. For the reasons I have given, he must be taken to have consented to the acceptance by K.P.M.G. of the instructions given to Mr. Harrison in June, for these were a natural extension of the audit. But Project Gemma was a very different matter. Absent such consent, the considerations which the Court of Appeal took into account cannot in my opinion affect the nature and extent of K.P.M.G.'s duty to protect confidentiality or convert it into a duty do no more than take reasonable steps to protect it. This would run counter to the fundamental principle of equity that a fiduciary may not put his own interest or those of another client before those of his principal. In my view no solicitor should, without the consent of his former client, accept instructions unless, viewed objectively, his doing so will not increase the risk that information which is confidential to the former client may come into the possession of a party with an adverse interest.

THE ADEQUACY OF THE PROTECTIVE MEASURES TAKEN BY K.P.M.G.

Once the former client has established that the defendant firm is in possession of information which was imparted in confidence and that the firm is proposing to act for another party with an interest adverse to his in a matter to which the information is or may be relevant, the evidential burden shifts to the defendant firm to show that even so there is no risk that the information will come into the possession of those now acting for the other party. There is no rule of law that Chinese Walls or other arrangements of a similar kind are insufficient to eliminate the risk. But the starting point must be that, unless special measures are taken, information moves within a firm. In *MacDonald Estates v. Martin* 77 D.L.R. (4th) 249, Sopinka J. said at p. 269 that the court should restrain the firm from acting for the second client 'unless satisfied on the basis of clear and convincing evidence that all reasonable measures have been taken to ensure that no disclosure will occur.' With the substitution of the word 'effective' for the words 'all reasonable' I would respectfully adopt that formulation.

APPLICATION TO THE FACTS OF THE PRESENT CASE

In the present case K.P.M.G. engaged different people, different servers, and ensured that the work was done in a secure office in a different building. K.P.M.G. maintain that these arrangements satisfy the most stringent test, and that there is no risk that information obtained by K.P.M.G. in the course of [work done for Prince Jefri] has or will become available to anyone engaged on Project Gemma.

I am not persuaded that this is so. Even in the financial services industry, good practice requires there to be established institutional arrangements designed to prevent the flow of information between separate departments. Where effective arrangements are in place, they produce a modern equivalent of the circumstances which prevailed in *Rakusen's* case [1912] 1 Ch 831. The Chinese Walls which feature in the present case, however, were established *ad hoc* and were erected within a single department. When the number of personnel involved is taken into account, together with the fact that the teams engaged on Project Lucy and Project Gemma each had a rotating membership, involving far more personnel than were working on the project at any one time, so that individuals may have joined from and returned to other projects, the difficulty of enforcing confidentiality or preventing the unwitting disclosure of information is very great. It is one thing, for example, to separate the insolvency, audit, taxation and forensic departments from one another and erect Chinese Walls between them. Such departments often work from different offices and there may be relatively little movement of personnel between them. But it is quite another to attempt to place an information barrier between members all of whom are drawn from the same department and have been accustomed to work with each other. I would expect this to be particularly difficult where the department concerned is engaged in the provision of litigation support services, and there is evidence to confirm this. Forensic accountancy is said to be an area in which new and unusual problems frequently arise and partners and managers are accustomed to share information and expertise. Furthermore, there is evidence that physical segregation is not necessarily adequate, especially where it is erected within a single department.

In my opinion an effective Chinese Wall needs to be an established part of the organisational structure of the firm, not created *ad hoc* and dependent on the acceptance of evidence sworn for the purpose by members of staff engaged on the relevant work.

Note

Prince Jefri Bolkiah v KPMG [1999] 2 AC 222 (HL) therefore holds that, whilst a solicitor's equitable duty of confidence will survive the termination of the retainer, the fiduciary duties owed by the solicitor do not survive. *Prince Jefri* has yet to be considered by the High Court but has been followed in most State and Territory jurisdictions. See textbook at [10.21]–[10.22]. These cases rest any duty of confidence owed by a solicitor to former clients on either an equitable obligation of confidence or the inherent jurisdiction of the court to supervise officers of the court. See, eg, *Beach Petroleum NL v Abbott Tout Russell Kennedy* (1999) 48 NSWLR 1, [205]; *Técnicas Reunidas SA v Andrew* [2018] NSWCA 192; *PDP Group Pty Ltd v Bennett & Philp* [2013] QSC 231; *Lyons v Legalese Pty Ltd* (2016) 126 SASR 232; *A v Law Society of Tasmania* [2001] 10 Tas R 152; *Ismail-Zai v The State of Western Australia* (2007) 34 WAR 379; *Birkett Investments Pty Ltd v Streatfield Investments Pty Ltd* [2016] ACTSC 323; *Dealer Support Services Pty Ltd v Motor Trades Association of Australia Ltd* (2014) 228 FCR 252.

However, the Supreme Court of Victoria appears to have declined to follow *Prince Jefri*. In *Spincode Pty Ltd v Look Software Pty Ltd* (2001) 4 VR 501, Brooking JA held in obiter that the duty of loyalty, which survived termination of a retainer, was an independent ground for a former client restraining a solicitor from acting for a client with an interest adverse to that of the former client. Brooking JA at [53] relied on an equitable obligation of loyalty which 'imposes an abiding negative obligation not to act against the former client in the same [or closely related] matter'. The other members of the Court (Ormiston JA and Chernov JA) did not unequivocally endorse Brooking JA's view.

Ormiston JA stated at [61]: 'I would like to have been able to reach a conclusion also on the other aspects raised in his judgment, especially the principle of fiduciary "loyalty" and the precise obligation owed by solicitors to former clients. Those aspects do raise, however, issues only touched upon in argument and authorities and papers, especially those by Paul Finn, given when a professor and before his appointment to the Federal Court, which were not discussed in argument. If I had had the luxury of further time to consider them, I may have reached agreement with Brooking, J.A. on each of those aspects, but the case came on urgently and was given an expedited hearing, so that the litigation proper, involving potentially the winding up of the subject company on the ground of oppression, could proceed with reasonable expedition.'

Chernov JA at [63] stated that Brooking JA had 'made a compelling case' and that it was not necessary to decide for the 'purposes of this appeal whether there is an absolute obligation on solicitors not to act against their former clients in the same or substantially the same proceeding'.

However, in *Schmidt v AHRKalimpa Pty Ltd* [2020] VSCA 193, [142], the Victorian Court of Appeal held in relation to whether fiduciary duties are owed by joint venturers:

> [w]e acknowledge that there is authority in jurisdictions outside Victoria to the effect that a fiduciary duty does not survive the termination of the relationship that gave rise to it. However, in our view, in the absence of a contrary decision by the High Court, the law in Victoria is as stated by this Court in [*Edmonds v Donovan* [2005] VSCA 27, (2005) 12 VR 513]. That is, depending on the circumstances of a particular case, fiduciary duties may survive the termination of the relationship that first called those duties into being.

10.4 Scope of the fiduciary relationship

All fiduciary relationships sit in a particular context and have a particular scope of operation. To assert that one party is a fiduciary is merely a gateway to analysis. Frankfurter J in *Securities and Exchange Commission v Chenery Corporation,* 318 US 80 (1943) said (in words repeated in *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165, 198–9 (McHugh, Gummow, Hayne and Callinan JJ)): 'to say that a man is a fiduciary only begins analysis; it gives direction to further enquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?' Not all of the aspects of the relationship or course of dealing between the parties may be caught by the fiduciary relationship. Usually, one party will owe fiduciary obligations to another in some areas but not others. For example, there may be divisions according to the passage of time or the subject-matter of their interactions such that parts of their relationship are fiduciary and parts are not. The determination of the scope of the fiduciary relationship will be closely connected to the question of breach of fiduciary duty. Conduct which falls under suspicion as being potentially in breach may be exonerated if the duty owed by the putative fiduciary is narrow in scope. Conversely, if the fiduciary duty is defined broadly, then there is a greater field of interaction between the activities of the fiduciary and their fiduciary duty.

Background

For a statement of the facts, see [10.3.2a] above.

Decision

Brennan CJ

Whichever be the source of the duty, it is necessary to identify 'the subject matter over which the fiduciary obligations extend' (*Birtchnell* (1929) 42 CLR 384 at 409, per Dixon J). It is erroneous to regard the duty owed by a fiduciary to his beneficiary as attaching to every aspect of the fiduciary's conduct, however irrelevant that conduct may be to the agency or relationship that is the source of fiduciary duty. As Fletcher Moulton LJ pointed out in *In re Coomber; Coomber v Coomber,* fiduciary relations are of many different types and where there is a fiduciary relation the court may interfere and set aside acts which, between persons in a wholly independent position, would have been perfectly valid. His Lordship then added:

> Thereupon in some minds there arises the idea that if there is any fiduciary relation whatever any of these types of interference is warranted by it. They conclude that every kind of fiduciary relation justifies every kind of interference. Of course that is absurd. The nature of the fiduciary relation must be such that it justifies the interference. There is no class of case in which one ought more carefully to bear in mind the facts of the case, when one reads the judgment of the Court on those facts, than cases which relate to fiduciary and confidential relations and the action of the Court with regard to them.

As Mason J said in *Hospital Products Ltd v United States Surgical Corporation*:

> it is now acknowledged generally that the scope of the fiduciary duty must be moulded according to the nature of the relationship and the facts of the case.

In the same case, Gibbs CJ said:

> Fiduciary relations are of different types, carrying different obligations … and a test which might seem appropriate to determine whether a fiduciary relationship existed for one purpose might be quite inappropriate for another purpose.

Gaudron and McHugh JJ

In the present case, if Dr Williams owed a fiduciary duty to Ms Breen, the duties and obligations which arose from their fiduciary relationship could only come from those aspects of the relationship which exhibited the characteristics of trust, confidence and vulnerability that typify the fiduciary relationship. They could only attach in respect of matters that relate to diagnosis, advice and treatment.

A consideration of the fundamental obligations of a fiduciary shows that Dr Williams owed no fiduciary duty to Ms Breen to give her access to the records that he had created.

Gummow J

Conformably with the reasoning of Gibbs CJ and Brennan J in *Daly v Sydney Stock Exchange Ltd,* the relationship between medical practitioner and patient who seeks skilled and confidential advice and treatment is a fiduciary one. That will be so regardless of

whether it is because the relationship between the parties is one which gives the medical practitioner a special opportunity to affect the interests of the patient who is vulnerable to abuse by the fiduciary of his position, or because the medical practitioner undertakes to exercise professional skill for the benefit of the patient, and particular reliance is placed upon the medical practitioner by the patient.

Advice given by the physician to the patient involves specialised knowledge and matters of skill and judgment, which render the advice difficult, if not impossible, of objective and unassisted assessment by the patient. Hence the particular reliance placed upon the physician. In a real sense, especially if invasive procedures upon the person of the patient are involved, the patient has delegated control to the person providing health care. Further, for the patient to obtain the benefit sought from the relationship the patient often must reveal confidential and intimate information of a personal nature to the medical practitioner. Finally, the efforts of the medical practitioner may have a significant impact not merely on the economic but upon the fundamental personal interests of the patient. These considerations, as Professor De Mott has pointed out, serve to emphasise why there is a fiduciary element in the relationship between medical practitioner and patient.

However, to reach that stage of reasoning is not to attain the destination desired by the appellant. First, it is necessary to consider not only whether the relationship between the parties is such as to give rise to fiduciary obligations but also the extent of those obligations in the particular case, 'the subject matter over which the fiduciary obligations extend', so that there may be identified the breach or apprehended breach for which the plaintiff seeks relief from a court of equity. The subject-matter here is the provision of medical treatment after, or in the course of, consultation with the patient.

Questions

(1) In *Breen v Williams,* did the Court exclude the possibility of a fiduciary relationship for all purposes?

(2) Within what scope might a fiduciary relationship have been found?

(3) To what extent might a doctor be constituted a fiduciary for their patient in relation to *advice*?

10.4b *Howard v Commissioner of Taxation (Cth)* [2014] HCA 21; (2014) 253 CLR 83

Background

Mr Howard was a member of a joint venture. In related Victorian Supreme Court proceedings, other joint venturers were found to have breached their fiduciary duties owed to Mr Howard by diverting a business opportunity away from the joint venture. He was awarded equitable compensation for this lost opportunity. Disctronics Pty Ltd (an investment vehicle) was also a plaintiff in these proceedings, and its claim that the defaulting venturers owed it fiduciary duties was rejected. In addition to having personally been a participant in the joint venture, Mr Howard was a director of Disctronics. Mr Howard did not include his awarded equitable compensation in his assessable income on the ground that he received the amount as 'trustee for Disctronics' since he was a director of that company. The Commissioner of Taxation claimed that the equitable compensation Mr Howard received was part of his assessable income. In finding against Mr Howard, the Court was obliged to consider the scope of his fiduciary obligation to Disctronics in his capacity as a director. Howard received and held the sum of equitable compensation awarded to him by the Supreme Court on his own account, which was therefore taxable in his hands.

Decision

The High Court held that Mr Howard had received the award of equitable compensation on his own account and did not owe fiduciary obligations to Disctronics to account for the award.

French CJ and Keane J

Despite their broad judicial formulations, fiduciary duties are not infinitely extensible. That point was made in *Chan v Zacharia,* which concerned the content of the fiduciary duties of members of a partnership inter se. The limits of those duties were to be determined by the character of the venture for which the partnership existed, the express agreement of the parties and the course of dealings actually pursued by the firm. The scope of the fiduciary duty generally in relation to conflicts of interest must accommodate itself to the particulars of the underlying relationship which give rise to the duty so that it is consistent with and conforms to the scope and limits of that relationship. It is to be 'moulded according to the nature of the relationship and the facts of the case'. By way of example, company directors are frequently shareholders. The decisions they take as directors may therefore affect their personal interests. They do not breach their fiduciary obligations merely because in promoting the interests of the company they are also promoting their own. On the other hand, a decision taken by directors to advantage themselves other than as members of the general body of shareholders would constitute an abuse of fiduciary powers.

Overbroad assertions of fiduciary duties, uninformed by a close consideration of the facts and circumstances of the particular case, are sometimes made for reasons which have nothing to do with the protective rationale of those duties. The plurality in *Maguire v Makaronis* referred to:

> attempts to throw a fiduciary mantle over commercial and personal relationships and dealings which might not have been thought previously to contain a fiduciary element.

The forensic purposes of such attempts may include the availability of advantageous equitable remedies and the avoidance of stringent time limits. The appellant attempted to stretch the fiduciary mantle attaching to his position as director to his membership of the joint venture. He did so in order to defeat a claim that he was liable to pay income tax on the amount of equitable compensation awarded to him in the Supreme Court of Victoria. His purpose had nothing to do with the vindication or protection of Disctronics' interests.

Hayne and Crennan JJ

It follows that the working out of the application of the rule to company directors is not achieved by the bare repetition of its terms. Much closer attention must be given to the duties, interests and alleged manner of conflict than is given by simply observing that directors owe fiduciary duties. It is necessary to identify the duties or interests which are said to conflict or present a real possibility of conflict.

Obtaining an unauthorised benefit

It is equally well established that a fiduciary cannot profit from the relationship. A fiduciary must account for a profit or benefit obtained or received by reason or by use of the fiduciary position or by reason or by use of any opportunity or knowledge resulting from the position.

This obligation is engaged when a company director diverts a business opportunity of the company to his or her personal advantage. It may be engaged by other circumstances. A director's diversion of the company's business opportunity will also commonly (perhaps inevitably) engage the director's obligation not to be in a position of conflict. But regardless of whether the obligation to avoid conflicts is engaged, a critical question presented for consideration in relation to the obligation not to obtain unauthorised benefits will be whether the director has obtained a benefit *by reason or by use of* the relationship between that director and the company.

That question requires careful attention to how and why it is said that the director obtained a benefit *by reason or by use of* the relationship. And as *Regal (Hastings) Ltd v Gulliver* demonstrates, if the opportunity came to the director in the course or as a result of holding office as a director, it is not to the point to establish that the company could not or would not have exploited the opportunity. In *Regal (Hastings),* the directors of the company were held bound to account to the company for their profit despite the company's inability to raise the capital necessary to undertake the venture from which the directors made their profit.

Obtaining an unauthorised benefit in this case? ...

Asserting that Disctronics 'sought' or 'desired' to invest in 'the project' (whether by becoming purchaser of the tenanted golf course or in some other role) does not demonstrate that the appellant's gain or profit was an unauthorised gain or profit which he held on trust for Disctronics. Instead, it is necessary to ask whether the identified gain or profit was obtained or received *by reason or by use of* the appellant's position as a director of Disctronics or *by reason or by use of* any opportunity or knowledge resulting from that position. It was not.

Unlike *Regal (Hastings),* the appellant made no transaction in the course of his management of Disctronics. He did not obtain or receive the gain or profit by using in any way 'the position and knowledge possessed by [him] in virtue of' his office as director. And he did not obtain or receive the gain or profit *by reason or by use of* any opportunity or knowledge resulting from his office as a director of Disctronics. So much may be taken to have been rightly recognised by the appellant's concession in oral argument that 'the opportunity did not come to [him] by reason of his office'.

By suing for and recovering equitable compensation from the defaulting venturers, the appellant did not obtain a gain or profit by reason or by use of his position as a director of Disctronics. The award of compensation was for the diversion by the defaulting venturers of the *joint venturers'* opportunity to pursue a profitable venture by buying and leasing the golf course. As is explained below, the opportunity thus diverted was the joint venturers', not Disctronics'. The compensation awarded was for the defaulting venturers' diversion of the joint venturers' opportunity, not of Disctronics'. The appellant did not obtain that (or any other) gain or profit by use of any opportunity or knowledge resulting from his position as a director of Disctronics.

Conflict of duties or conflict of duty and interest in this case?

[After quoting *Furs Ltd v Tomkies* (1936) 54 CLR 583, 592 [94] (Rich, Dixon and Evatt JJ)] … [I]t is necessary to identify with care the subject matter over which the fiduciary obligations extend. The duty which a fiduciary owes may not (and usually will not) attach to every aspect of the fiduciary's conduct.

The venture which the defaulting venturers were found to have wrongly turned to their account was a venture between the six individuals. It was not a venture to which Disctronics was a party. Disctronics had asserted in the Supreme Court that it, too, had been one of the joint venturers and that the defaulting venturers should compensate it as well, but its claim was rejected. The appellant did not contend to the contrary in his proceedings against the Commissioner. And it followed from what was held in the Supreme Court litigation (to which Disctronics was a party) that if the appellant had diverted to Disctronics the business opportunity which the joint venturers sought to pursue, he would have been as much in breach of his fiduciary obligations to his co-venturers as the defaulting venturers were when they diverted the opportunity to their own advantage.

Having agreed upon a venture with his co-venturers, the appellant *attempted* to have the others agree to Disctronics playing a part in that venture, not as one of the venturers, but as purchaser of the golf course land. If it was his duty to seek to introduce Disctronics to the venture, he performed that duty. But he was not able to have Disctronics play a part in any venture concerning the golf course before the defaulting venturers diverted the opportunity to pursue the venture to their own use by themselves procuring the purchase of the golf course.

It may be assumed that, before the defaulting venturers diverted the venture to their own use, the appellant's duty as a director of Disctronics was to seek to have the company acquire the golf course at least cost to it. And his interest as a joint venturer was to use the land (whether by sale subject to tenancy, or holding the land as landlord) in whatever way would provide greatest profit at least cost. It may also be assumed that his duty to his co-venturers was to do his part in bringing about that result. *If* the venture had not been diverted by the defaulting venturers, there may have been some conflict between his duty and his interests. *If* Disctronics had bought the tenanted golf course, there may have been some conflict between his duty and his interests. But the venture was diverted. Disctronics did not buy the golf course. The appellant made no gain or profit before the joint venturers' opportunity for profit (and any hope which Disctronics may have had for profit) was foreclosed by the defaulting venturers' conduct. Once the defaulting venturers had diverted the opportunity, there was no conflict thereafter between the appellant's duties or between his duty and his interests and there was no real possibility of conflict.

10.5 Fiduciary obligations

The core obligation owed by the fiduciary is one of loyalty. The fiduciary must not obtain any unauthorised profit from the relationship and must not put herself in a position of conflict or serious possibility of conflict with that of the principal. Not every obligation owed by a fiduciary will be a fiduciary obligation: it is important to remember that fiduciaries also owe non-fiduciary obligations.

10.5a *Breen v Williams* [1996] HCA 57; (1996) 186 CLR 71

Background

For a statement of the facts, see [10.3.2a] above.

Decision

Gaudron and McHugh JJ

Thirdly, the Canadian law on fiduciary duties is very different from the law of this country with respect to that subject. One commentator has recently pointed to the 'vast differences between Australia and Canada in understanding of the nature of fiduciary obligations'. One significant difference is the tendency of Canadian courts to apply fiduciary principles in an expansive manner so as to supplement tort law and provide a basis for the creation of new forms of civil wrongs. The Canadian cases also reveal a tendency to view fiduciary obligations as both proscriptive and prescriptive. However, Australian courts only recognise proscriptive fiduciary duties. This is not the place to explore the differences between the law of Canada and the law of Australia on this topic. With great respect to the Canadian courts, however, many cases in that jurisdiction pay insufficient regard to the effect that the imposition of fiduciary duties on particular relationships has on the law of negligence, contract, agency, trusts and companies in their application to those relationships. Further, many of the Canadian cases pay insufficient, if any, regard to the fact that the imposition of fiduciary duties often gives rise to proprietary remedies that affect the distribution of assets in bankruptcies and insolvencies.

In this country, fiduciary obligations arise because a person has come under an obligation to act in another's interests. As a result, equity imposes on the fiduciary proscriptive obligations – not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict. If these obligations are breached, the fiduciary must account for any profits and make good any losses arising from the breach. But the law of this country does not otherwise impose positive legal duties on the fiduciary to act in the interests of the person to whom the duty is owed.

Questions

(1) Distinguish between proscriptive and prescriptive fiduciary duties.

(2) Why does the distinction matter?

10.5.1 Obligation not to obtain any unauthorised profit from the relationship

10.5.1a *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378; [1967] 2 AC 134

Background

Regal Hastings Ltd (Regal) owned a cinema and wanted to acquire a lease over two further cinemas. In order to do this, Regal formed a subsidiary company, Hastings Amalgamated Cinemas Ltd (Amalgamated). The capital of Amalgamated was 5,000 £1 shares. In the event, Regal could not raise sufficient finance to subscribe for all of the shares in Amalgamated. The company directors and secretary purchased the remaining shares, and a lease of the two cinemas was executed in favour of Amalgamated. A purchaser offered to buy Regal's cinema and the lease of the other cinemas; but for taxation reasons, the nature of the deal changed, and instead, all of the shares in Regal and Amalgamated were purchased. The new board of directors of Regal then sued the former directors, claiming the former directors had used their position to obtain a personal profit.

Decision

The House of Lords unanimously held the directors accountable to Regal for their profit.

Lord Russell

The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well intentioned, cannot escape the risk of being called upon to account.

Lord Macmillan

The issue, as it was formulated before your Lordships, was not whether directors of Regal (Hastings) Ltd, had acted in bad faith. Their bona fides was not questioned. Nor was it whether they had acted in breach of their duty. They were not said to have done anything wrong. The sole ground on which it was sought to render them accountable was that, being directors of the plaintiff company and therefore in a fiduciary relation to it, they entered in the course of their management into a transaction in which they utilised the position and knowledge possessed by them in virtue of their office as directors, and that the transaction resulted in a profit to themselves. The point was not whether the directors had a duty to acquire the shares in question for the company and failed in that duty. They had no such duty. We must take it that they entered into the transaction lawfully, in good faith and indeed avowedly in the interests of the company. However, that does not absolve them from accountability for any profit which they made, if it was by reason and in virtue of their fiduciary office as directors that they entered into the transaction.

The equitable doctrine invoked is one of the most deeply rooted in our law. It is amply illustrated in the authoritative decisions which my noble and learned friend Lord Russell of Killowen has cited.

I should like only to add a passage from *Principles of Equity* by Lord Kames … which puts the whole matter in a sentence: 'Equity,' he says, 'prohibits a trustee from making any profit by his management, directly or indirectly.'

The issue thus becomes one of fact. The plaintiff company has to establish two things: (i) that what the directors did was so related to the affairs of the company that it can properly be said to have been done in the course of their management and in utilisation of their opportunities and special knowledge as directors; and (ii) that what they did resulted in a profit to themselves. The first of these propositions is clearly established by the analysis of the whole complicated circumstances for which the House is indebted to my noble and learned friend who has preceded me. The second proposition is admitted, except in the case of Gulliver, in whose case I agree that … he is not proved to have made any profit personally. The conditions are therefore in my opinion present which preclude the four directors who made a personal profit by the transaction from retaining such profit.

The position of … [the solicitor] is quite different. He was … in no sense a trustee for it. True, he made a profit, as did the four directors, but he subscribed for his shares not only with the knowledge, but at the express request, of his clients, and I know of no principle on which he could be held accountable to them for any resultant profit to himself.

Questions

(1) Does liability depend on conflict of duty and interest, or is infringement of the 'no profit' rule sufficient explanation of the result in *Regal (Hastings)*?

(2) In *Regal (Hastings)*, the directors were found by the Court to have acted honestly, but consider the following questions: Who was it that decided that the only way to finance the venture was by creating the subsidiary (Amalgamated)? Who was it that determined that it was an appropriate business strategy for Regal in the first place?

Note: See also the extracts from *Howard v Commissioner of Taxation (Cth)* above at [10.4b].

10.5.2 Obligation not to be in a position of conflict

The fiduciary must avoid conflicts of duty and self-interest and conflicts in fiduciary duties owed to other parties. Thus, the fiduciary may be in conflict of duty and self-interest (duty–interest conflict) or in a position where she owes conflicting obligations to more than one party (duty–duty conflict).

10.5.2a *Boardman v Phipps* [1967] 2 AC 46

Background

John Phipps (the plaintiff/respondent, 'John') was a beneficiary under the Phipps trust, entitled to a 5/18th share. Trust property comprised shares in a private company, Lester & Harris Ltd, which carried on a textile business. The defendants/appellants were Thomas Boardman (solicitor to the trustees, 'Boardman'), Thomas Phipps (another beneficiary, 'Tom Phipps'), Wilfred Fox (accountant and trustee) and Marquita Noble (trustee). Fox and Noble took no part in the legal proceedings; the only active trustee was Fox.

Boardman and Tom Phipps attempted to improve the value of the shares held by the trust in Lester & Harris, after one of the trustees formed the opinion that the company was being poorly run. Boardman and Tom Phipps attended the annual general meeting of the company representing the trust holding, expressed their dissatisfaction with the position of the company and sought without success to get Tom elected a director. Following that meeting, Boardman and Tom Phipps decided that the only real hope of the trust getting true value out of the shares was by acquiring a controlling interest in the company and then by liquidating company assets in order to make a repayment of capital to shareholders, including the Phipps trust. Using information acquired while acting as agents for trustees (both at the annual general meeting when holding trust proxy forms and in subsequent negotiations for the purchase of the shares), Boardman and Tom Phipps acquired on their own behalf a majority shareholding in Lester & Harris. The trial judge, Wilberforce J, found that John had not been kept fully informed of Boardman's plans.

Following this takeover, the share price rose sharply so that all shareholders benefited, including the Phipps trust. The company was able to make capital distribution to shareholders after which the shares were still worth a considerable amount. John nonetheless brought an action seeking a declaration that the defendants held 5/18ths of their shares on constructive trust for him and that they should account to him for that proportion of the profit they had made on their own account. Wilberforce J and the Court of Appeal held that the declaration sought should be granted.

Decision

A majority of the House of Lords, Viscount Dilhorne and Lord Upjohn dissenting, upheld Wilberforce J's finding that the defendants had acted in breach of fiduciary duty and that the order, in terms of the declaration sought, should be confirmed.

Lord Hodson

So far as … Tom Phipps … is concerned, he was not placed in a fiduciary position by reason of his being a beneficiary under his father's will. He was acting as agent for the trustees with … Boardman before any question of acting with him for his own benefit arose. He has not, however, sought to be treated in a different way from … Boardman upon whom the conduct of the whole matter depended and with whom he has acted throughout as a co-adventurer; he does not claim that he should succeed in this appeal if … Boardman fails.

… Boardman's fiduciary position arose from the fact that he was at all material times solicitor to the trustees of the will of Mr Phipps senior. This is admitted … It was as solicitor to the trustees that he obtained the information which is so clearly summarised in the judgment of Wilberforce J and repeated in the speech of my noble and learned friend Lord Upjohn. This information enabled him to acquire knowledge of a most extensive and valuable character, as the learned judge pointed out, which was the foundation upon which a decision could and was taken to buy the shares in Lester & Harris Ltd.

This information was obtained on behalf of the trustees, most of it at a time during the history of the negotiations when the proposition was to divide the assets of the company between two groups of shareholders. This object could not have been effected without a reconstruction of the company and … Boardman used the strong minority shareholding which the trustees held, that is to say, 8,000 shares in the company, wielding this holding as a weapon to enable him to obtain the information of which he subsequently made use.

As to this it is said on behalf of the appellants that information as such is not necessarily property and it is only trust property which is relevant. I agree, but it is nothing to the point, to say that in these times corporate trustees, e.g., the Public Trustee and others, necessarily acquire a mass of information in their capacity of trustees for a particular trust and cannot be held liable to account if knowledge so acquired enables them to operate to their own advantage, or to that of other trusts. Each case must depend on its own facts and I dissent from the view that information is of its nature something which is not properly to be described as property. We are aware that what is called 'know-how' in the commercial sense is property which may be very valuable as an asset. I agree with the learned judge and with the Court of Appeal that the confidential information acquired in this case which was capable of being and was turned to account can be properly regarded as the property of the trust. It was obtained by … Boardman by reason of the opportunity which he was given as solicitor acting for the trustees in the negotiations with the chairman of the company, as the correspondence demonstrates. The end result was that out of the special position in which they were standing in the course of the negotiations the appellants got the opportunity to make a profit and the knowledge that it was there to be made.

The appellants argue that this is not enough, and in support of the contention rely on the authority of *Aas v Benham*. … *Aas v Benham* was a case depending on the alleged relationship of principal and agent as it exists between one partner and another. There was no such relationship here but the position of an agent is relevant and the expression 'self-appointed agent' used by the learned judge is a convenient way to describe someone who, assuming to act as agent for another, receives property belonging to that other so that the property is held by the self-constituted agent as trustee for such other. Such a case was *Lyell v Kennedy.* Thus the learned judge found that the appellants were in the same position as if they had been agents for the trustees in the technical sense for the purpose of using the trust shareholding to extract knowledge of the affairs of the company and ultimately to improve the company's profit-earning capacity.

Keech v Sandford was a case in which it was impossible for the cestui que trust to obtain the renewal of a lease, nevertheless the trustee was held accountable for renewal obtained by him. Similarly in *Regal (Hastings) Ltd v Gulliver,* from which some of your Lordships have cited passages, the directors of Regal were held accountable to the company for the profit they made in acquiring shares when the opportunity fell to them as directors of the company, notwithstanding the fact that it was impossible for Regal to take the shares owing to lack of funds.

Regal (Hastings) Ltd v Gulliver differs from this case mainly in that the directors took up shares and made a profit thereby, it having been originally intended that the company should buy these shares. Here there was no such intention on the part of the trustees. There is no indication that they either had the money or would have been ready to apply to the court for sanction enabling them to do so. On the contrary, Mr Fox, the active trustee and an accountant who concerned himself with the details of the trust property, was not prepared to agree to the trustees buying the shares and encouraged the appellants to make the purchase. This does not affect the position. As *Keech v Sandford* shows, the inability of the trust to purchase makes no difference to the liability of the appellants, if liability otherwise exists. The distinction on the facts as to intention to purchase shares between this case and *Regal (Hastings) Ltd v Gulliver* is not relevant. The company (Regal) had not the money to apply for the shares upon which the profit was made. The directors took the opportunity which they had presented to them to buy the shares with their own money and were held accountable. Mr Fox's refusal as one of the trustees to take any part in the matter on behalf of the trust, so far as he was concerned, can make no difference. Nothing short of fully informed consent which the learned judge found not to have been obtained could en-

able the appellants in the position which they occupied having taken the opportunity provided by that position to make a profit for themselves.

Likewise it is no answer to the respondent's claim that there was no contract of agency and that the appellants were at all times acting for themselves without concealment and indeed with the encouragement of one of the trustees, namely, Mr Fox.

If they received confidential information from Lester & Harris in their capacity as representing the trustees it matters not whether or no there was a true agency. I refer again to the passage from Lord Wright's judgment in *Regal (Hastings) Ltd v Gulliver* when he speaks of 'an agent, a director, a trustee or other person in an analogous fiduciary position' and, as an illustration, says that the most usual and typical case of this nature is that of principal and agent.

The relevant information is not any information but special information which I think must include that confidential information given to the appellants which is so fully detailed in the judgment of Wilberforce J. There is a passage in *Aas v Benham* in the judgment of Bowen LJ which I think is of assistance, although the learned Lord Justice was dealing with partnership, not trusteeship: he was explaining some observations of Cotton LJ in *Dean v MacDowell.* These were:

> Again, if he (that is, a partner) makes any profit by Boardman the use of any property of the partnership, including, I may say, information which the partnership is entitled to, there the profit is made out of the partnership property.

Bowen LJ commented:

> He is speaking of information which a partnership is entitled to in such a sense that it is information which is the property, or is to be included in the property of the partnership – that is to say, information the use of which is valuable to them as a partnership, and to the use of which they have a vested interest. But you cannot bring the information obtained in this case within that definition.

Aas v Benham is an important case as showing that a partner may make a profit from information obtained in the course of the partnership business where he does so in another firm which is outside the scope of the partnership business. In that case the partnership business was ship-broking and the profit made was in a business which had no connection with that of the partnership. This shows the limitation which must be kept in mind in considering the sense in which each partner is the agent of the partnership, but does not assist the appellants. … Boardman continued to be in a fiduciary position up to and including the time when the shares were purchased (March,1959), and the scope of the trust concerning which his fiduciary relationship existed was not limited in the same way as a partnership carrying on a particular business.

It cannot, in my opinion, be said that the purchase of shares in Lester & Harris was outside the scope of the fiduciary relationship in which … Boardman stood to the trust. The confidential information which the appellants obtained at a time when … Boardman was admittedly holding himself out as solicitor for the trustees was obtained by him as representing the trustees, the holders of 8,000 shares of Lester & Harris. As Russell LJ put it:

> The substantial trust shareholding was an asset of which one aspect was its potential use as a means of acquiring knowledge of the company's affairs, or of negotiating allocations of the company's assets, or of inducing other shareholders to part with their shares.

Whether this aspect is properly to be regarded as part of the trust assets is, in my judgment, immaterial. The appellants obtained knowledge by reason of their fiduciary position and they cannot escape liability by saying that they were acting for themselves and not as agents of the trustees. Whether or not the trust or the beneficiaries in their stead could have taken advantage of the information is immaterial, as the authorities clearly show. No doubt it was but a remote possibility that … Boardman would ever be asked by the trustees to advise on the desirability of an application to the court in order that the trustees might avail themselves of the information obtained. Nevertheless, even if the possibility of conflict is present between personal interest and the fiduciary position the rule of equity must be applied. This appears from the observations of Lord Cranworth LC in *Aberdeen Railway Co v Blaikie.*

In the later case of *Bray v Ford* Lord Herschell stated the rule in a way which has peculiar application to the facts of this case, when he said:

> It is an inflexible rule of a Court of Equity that a person in a fiduciary position, such as the respondent's is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule. But I am satisfied that it might be departed from in many cases, without any breach of morality, without any wrong being inflicted, and without any consciousness of wrong-doing. Indeed, it is obvious that it might sometimes be to the advantage of the beneficiaries that their trustee should act for them professionally rather than a stranger, even though the trustee were paid for his services.

Lord Upjohn (dissenting)

In these circumstances the respondent rather surprisingly seeks to hold the appellants accountable to him for his 5/18ths share of the 21,986 shares so purchased, on the footing that the appellants are constructive trustees of these shares for and on behalf of the trust. So I turn to the relevant law upon which this claim is based, but start by stating what is not in dispute, that the conduct of the appellants and each of them has never been anything except utterly honest and above board in every way. If they or either of them are accountable it is because of the operation of some harsh doctrine of equity upon consciences completely innocent in every way.

Rules of equity have to be applied to such a great diversity of circumstances that they can be stated only in the most general terms and applied with particular attention to the exact circumstances of each case. The relevant rule for the decision of this case is the fundamental rule of equity that a person in a fiduciary capacity must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict.

It is perhaps stated most highly against trustees or directors in the celebrated speech of Lord Cranworth LC in *Aberdeen Railway v Blaikie* where he said:

> And it is a rule of universal application, that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect.

The phrase 'possibly may conflict' requires consideration. In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict. …

My Lords, it would, in my opinion, be most unjust to the appellants to draw any inference against them in such circumstances without giving them any opportunity of explaining the situation as it really occurred in 1958. We do not know what would have been said on this point in the witness box, but it is not unlikely Mr Fox would have said: 'I knew all about it but I was still inflexibly opposed to a purchase of more shares. All along I hoped the appellants would buy them.' Had he said that, it would seem to me perfectly clear that there would be no possible conflict between the appellants' duty and interest …

… Apart from that, what was the position? The appellants were able to offer a greatly increased price in phase 3 by reason of the knowledge they had acquired but they were not acquiring trust property or, so far as the evidence goes, any property which the trustees had any idea of purchasing. The inference I draw is that the trustees were still giving their blessing to the idea that the appellants should purchase the majority holding so that it should be in friendly hands.

Questions

(1) Consider whether Tom Phipps and Boardman acted in self-interest or for the benefit of the trust.

(2) Did Tom Phipps and Boardman benefit from the acquisition of shares in a personal capacity?

(3) What test(s) were applied in the House of Lords to determine a breach of fiduciary duty?

(4) Is this a case about a breach of the no conflict rule or the no profit rule, or both?

(5) What is the difference in the reasoning of Lord Hodson and Lord Upjohn?

10.5.2b *Hospital Products Ltd v United States Surgical Corporation* [1984] HCA 64; (1984) 156 CLR 41

Background

For a statement of the facts, see [10.2a] above.

Decision

Mason J

> … [T]he fiduciary's duty may be more accurately expressed by saying that he is under an obligation not to promote his personal interest by making or pursuing a gain in circumstances in which there is a conflict or a real or substantial possibility of a conflict between his personal interests and those of the persons whom he is bound to protect.

Note

Mason J's statement of principle was adopted by *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165, [78] (McHugh, Gummow, Hayne and Callinan JJ). See also *Howard v Commissioner of Taxation (Cth)* (2014) 253 CLR 83, [59] (Hayne and Crennan JJ).

10.5.2c *Commonwealth Bank of Australia v Smith* (1991) 42 FCR 390

Background

At a branch of the Commonwealth Bank (CBA) located in Kadina, a small country town, Smith (respondent) had been accustomed to seeking financial advice from the branch manager (Dungan). Smith approached Dungan in order to discuss the possibility of buying a hotel or a hotel licence in the area. The Smiths intended to sell their house to provide part of the funding for this venture and to obtain a bank loan for the balance. Owning a hotel was a new business venture for the Smiths whose experience in business and financial matters was limited.

On 16 February 1988, Mr and Mrs Smith met with Dungan at his invitation to discuss the Weeroona Hotel. Dungan said that it would be a good hotel for them, that it would be a better purchase than the Kadina Hotel they had also been considering, and that it would be within their financial reach. At the end of that meeting, Mr and Mrs Smith understood that they would inspect the Weeroona Hotel the following weekend and did not thereafter discuss with Dungan the Kadina Hotel or any other prospective ventures. The

vendor company selling the lease and business of the Weeroona Hotel and its directors and shareholders were customers of the Kadina CBA. The vendor company's bank account was in overdraft and the CBA held a mortgage over the hotel business, the business having been purchased by the vendor with the assistance of a mortgage loan from the CBA in 1986. Dungan disclosed his position of conflict to Mr and Mrs Smith, explaining that the vendor was a CBA customer. However, he provided little further information and specifically said that he could not disclose the amount of the hotel's takings deposited with the CBA as that was confidential information. In evidence, he reported he had said words to the effect: 'I am a banker for both people. I am going to have difficulty helping you with anything that might prejudice the other party.'

On 3 March 1988, all parties met in Dungan's office and signed the contract for the sale of the hotel business for $160,000. The CBA required a valuation of the hotel lease as a condition of its loan to the Smiths. The valuation of a commercial lease is in part a function of the number of years left to run and the possibility of renewal. The CBA's valuation was made on the false assumption that the lease had six years rather than four years to run. Finance was approved and the transaction went ahead. Mr and Mrs Smith had sought the assistance of a solicitor and an accountant prior to completion but not for the purpose of being advised on the purchase price or the further extension of the lease. The Smiths lost money in operating the Weeroona Hotel and, not being able to obtain an extension of the lease as had been promised by Dungan, commenced proceedings including, *inter alia,* for breach of fiduciary duty.

Decision

The Full Federal Court held that the bank owed fiduciary obligations to the Smiths and had placed itself in a position of conflict between its interest in selling the hotel and the duty it owed to the Smiths to provide them with disinterested advice. The bank was ordered to compensate the Smiths for the losses they had incurred in running the hotel.

Davies, Sheppard and Gummow JJ

His Honour referred to evidence given by Mr Dungan that, although loan repayments and forecasts were predicated on the respondents not being entitled to any extension of the lease beyond July 1992, Mr Dungan thought that there was only a one in 100 chance that the lease would not be renewed. His Honour said that it was on the assumption that the lease would be renewed for a further two years that he wrote that the value of the leasehold estate, for security purposes, was $150,000. His Honour thought that it was probable that Mr Dungan had been shown the lessor's letter of 11 March 1988 before completion and added, that, whether this was so or not, Mr Dungan did not check before completion whether the lessors had in fact agreed to extend the lease.

A matter which needs to be mentioned concerns the amount of Mr Mudge's valuation of the leasehold. It is to be borne in mind that the valuation would be likely to have been a conservative one because it was made for security purposes. Nevertheless Mr Mudge's figure was substantially below the $160,000 which Mr Dungan had led the respondents to believe was a good price. Putting aside the fact that it was made on an erroneous assumption, the situation is one in which Mr Dungan, having given the respondents advice about the appropriateness of the purchase, let them proceed without informing them of Mr Mudge's conclusions notwithstanding the fact that Mr Smith had subsequently raised with him the question of the price during the cooling off period when the contract might have been rescinded. The situation was one in which Mr Dungan had told the respondents that the purchase was a good one, had told them that it was not appropriate to seek to negotiate with the vendor for a lower price, had proceeded himself upon a false assumption as to the length of the lease and did not disclose the outcome of the valuation which might have suggested to the respondents that the price they were paying was excessive.

The statement which Mr Dungan made was a serious one. He must have known that it was of critical importance to the respondents. He knew that they would rely upon his advice. When he made the statement, that is what he intended them to do. There does not appear in the entirety of the evidence any basis whatever for the statement which was made. At the time it was made, he had no valuation, not even a bank valuation, which was current. He did not have Mr Mudge's valuation and, if he had had it, it would have been no use to him because it was made on the assumption that the lease had six years, rather than four years, to run. The respondents were entitled to think that the statement was made by a bank manager who had close knowledge of the hotel and what it was appropriate for them to pay for it. They knew, because Mr Dungan told them, that the vendor was a customer of the bank and they knew that Mr Dungan was advising it also because that is what he said when he purported to discuss his conflict of interest. They were not to know that his statement was made in the absence of any credible information of what the value of the hotel was. It seems to us, although we do not need to go so far, that there was a substantial degree of recklessness in Mr Dungan's conduct. We are satisfied that it was amply demonstrated in this case, to pick up the words of the Court in *Global Sportsman*, that there was no basis for the state of mind which Mr Dungan needed to have if his conduct were not to be regarded as misleading and deceptive.

In our view, the primary Judge was correct in concluding on the facts that the bank became the investment adviser of the respondents in the matter of the purchase of the Weeroona Hotel and that a fiduciary relationship arose. The question then was one of (i) identifying the relevant incidents of that relationship and duties arising from it, and (ii) determining whether there had been a breach of duty leading to loss for which there was an obligation upon the bank to compensate the respondents.

The crucial incident of the fiduciary relationship in this case arose from the conflicting interests between the two sets of customers of the bank. As Von Doussa J put it, and we agree, Mr Dungan had become the representative of one customer of the bank, No Justice Pty Limited, that is to say, in substance, of two other customers, Messrs Gwynne and Hart, in helping to bring about the sale of their business to two other customers of the bank. Not only must the fiduciary avoid, without informed consent, placing himself in a position of conflict between duty and personal interest, but he must eschew conflicting engagements. The reason is that by reason of the multiple engagements, the fiduciary may be unable to discharge adequately the one without conflicting with his obligation in the other. Thus, it has been said, after ample citation of authority, that where an adviser in a sale is also the undisclosed adviser of the purchaser, an actual conflict of duties arises: Finn, 'Fiduciary Obligations', pages 253–254.

In such a case, it is not to the point that the fiduciary himself may not stand to profit from the transaction he brings about between the parties. The prohibition is not against the making of a profit (though many cases of breach of fiduciary duty involve the wrongful acquisition of a profit, rather than the infliction of a loss) but of the avoidance of conflict of duties, something described in forceful terms by Lord Cozens-Hardy MR in *Moody v Cox and Hatt* (1971) 2 Ch 71 at 81–82. It is true that the evidence did not show that the bank was pressing Messrs Gwynne and Hart to sell, or that their company was having trouble in meeting its commitments. But, as we have indicated, it would not be necessary for such facts to exist in order for the fiduciary obligations that we have described to arise. Nor, of course, is it to the point that the appellants did not act with fraudulent intent: *Nocton v Lord Ashburton* (1914) AC 932 at 957.

10.5.2d *Breen v Williams* [1996] HCA 57; (1996) 186 CLR 71

Background

For a statement of the facts, see [10.3.2a] above.

Decision

Gummow J

Likewise, the fiduciary is obliged not to enter upon conflicting engagements to several parties. This is because the fiduciary (for example, a solicitor acting for vendor and purchaser) may be unable to discharge adequately the one obligation without conflicting with the requirement for observance of the other obligation.

As indicated earlier in these reasons, one answer to what otherwise would be breach of duty is the presence of informed consent. Further, a court of equity has inherent jurisdiction or power to authorise, at least in some cases, entry into transactions which otherwise would be in breach of duty. The fiduciary will be brought to account for any benefit or gain which (1) has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between the fiduciary duty and personal interest in the pursuit or possible receipt of the benefit or gain or (2) was obtained or received by use or by reason of the fiduciary position or opportunity or knowledge resulting from it.

Notes

(1) Breach of duty arises not only where there is an *actual* conflict of duty and interest or duty and duty, but also in circumstances of *potential* conflict satisfying the tests outlined above. Potential conflicts in breach of fiduciary law exist not only in relation to *duty–interest conflicts* but also *duty–duty conflicts*. As emphasised in *Agricultural Land Management Ltd v Jackson (No 2)* (2014) 48 WAR 1, [268] (Edelman J), 'when focus is directed to the prohibition against a fiduciary placing himself or herself in a position of conflicting duties

there are many authorities which emphasise that the underlying duty upon the fiduciary is not circumscribed by whether *actual* advantage has been taken or whether the fiduciary has actually pursued the conflict'.

(2) A situation in which conflicting fiduciary duties potentially arise is the solicitor–client relationship. Leaving to one side professional conduct rules which vary between jurisdictions, it may be possible for multiple clients to have the same solicitor to the extent that there is an identity of interest or separate and unrelated interests. The following formulation in *Farrington v Rowe McBride & Partners* [1985] 1 NZLR 83, 90 (Richardson J) was referred to with approval in *Maguire v Makaronis* (1997) 188 CLR 449, 461 (Brennan CJ, Gaudron, McHugh and Gummow JJ): 'A solicitor's loyalty to his client must be undivided. He cannot properly discharge his duties to one whose interests are in opposition to those of another client. If there is a conflict in his responsibilities to one or both he must ensure that he fully discloses the material facts to both clients and obtains their informed consent to his so acting: … And there will be some circumstances in which it is impossible, notwithstanding such disclosure, for any solicitor to act fairly and adequately for both. But the acceptance of multiple engagements is not necessarily fatal. There may be an identity of interests or the separate clients may have unrelated interests.'

10.5.3 Informed consent

The principal's fully informed consent to what would otherwise be a breach of fiduciary duty operates as a defence. The existence of this fully informed consent is a question of fact to be determined on all the circumstances of the case as part of the course of dealing between the fiduciary and the principal.

10.5.3a *Maguire v Makaronis* [1997] HCA 23; (1997) 188 CLR 449

Background

For a statement of the facts, see [5.4b].

Decision

Brennan CJ, Gaudron, McHugh and Gummow JJ

Thirdly, in the circumstances disclosed above, if the appellants were to escape the stigma of an adverse finding of breach of fiduciary duty, with consequent remedies, it was for them to show, by way of defence, informed consent by the respondents to the appellants' acting, in relation to the Mortgage, with a divided loyalty. What is required for a fully informed consent is a question of fact in all the circumstances of each case and there is no precise formula which will determine in all cases if fully informed consent has been given. The circumstances of the case may include (as they would have here) the importance of obtaining independent and skilled advice from a third party. On no footing could it be maintained that the appellants had taken the necessary steps of this nature to answer the charge of breach of fiduciary duty. However, it should be noted that, contrary to what appeared to be suggested by the respondents in argument, there was no duty as such on the appellants to obtain an informed consent from the respondents. Rather, the existence of an informed consent would have gone to negate what otherwise was a breach of duty.

Notes

(1) It is important to distinguish between a principle which operates as a defence and a matter going to the elements of the claim for breach of fiduciary duty. See, for example, *Hasler v Singtel Optus Pty Ltd* (2014) 87 NSWLR 609, [3] (Barrett JA): 'Proof of the absence of the principal's informed consent is not an element of the equitable claim against … the fiduciary … Rather, proof of the existence of such consent operates by way of defence if the elements of the equitable claim are established.'

(2) Black J in *Barescape Pty Ltd v Bacchus Holdings Trust (No 9)* [2012] NSWSC 984, [154] said:

> Informed consent generally requires that a fiduciary disclose to the beneficiary all information in his or her possession in relation to the proposed transaction which was relevant to the beneficiary's consideration of whether or not to consent to it, and at least the material facts: *Boardman v Phipps* [1967] 2 AC 46 at 93, 98, 112; *New Zealand Netherlands Society 'Oranje' Inc v Kuys* [1973] 2 NZLR 163; 1 WLR 1126; 2 All ER 1222, 1227; *Spellson v George* [1992] NSWCA 254; (1992) 26 NSWLR 666, 670 (per Handley JA), 685 (per Young AJA). It is not sufficient for a fiduciary to disclose information which is sufficient only to 'put the principal on inquiry': *New Zealand Netherlands Society 'Oranje' Inc v Kuys* [1973] 2 All ER 1222, 1227. The nature of existing legal rights between the parties may be material circumstances in respect of such consent: *Short v Crawley* (No 30) [2007] NSWSC 1322 at [619]. In *Re McGrath (in their capacity as liquidators of HIH Insurance Ltd)* [2010] NSWSC 404; (2010) 78 ACSR 405, Barrett J referred to that decision in noting that 'the task of explanation inherent in a request to be excused from a fiduciary requirement is an onerous and exacting one'.

(3) In examining the facts of the case to determine sufficiency of disclosure, the High Court has said that this disclosure must be calibrated to the defendant. See *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, [107] (the Court): '[T]he sufficiency of disclosure can depend on the sophistication and intelligence of the persons to whom disclosure must be made.'

(4) In *Maguire v Makaronis* (1997) 188 CLR 449, 466–67, Brennan CJ, Gaudron, McHugh and Gummow JJ stated that whether the plaintiff has obtained 'independent and skilled advice from a third party' may be an important circumstance in determining whether informed consent has been given. In *Rahme v Benjamin and Khoury Pty Ltd* (2019) 100 NSWLR 550, Macfarlan JA (Bathurst CJ and McCallum JA agreeing) explained at [106]: '[t]o ensure that consent is fully informed, independent advice must be "meaningful" advice enabling the person advised to make an independent, intelligent choice concerning the transaction (*Bester v Perpetual Trustee Co Ltd* [1970] 3 NSWR 30, 36 (Street J); Paul Finn, *Fiduciary Obligations* (Republication, 2016)). In *Bester,* Street J held that the advice of a solicitor was inadequate in circumstances where the solicitor "read the document through" and "invite[d] questions of the plaintiff" but did not give the plaintiff "advice as to whether or not she should sign the document" (at 33–5).'

(5) Where the principal is a company, owed equitable fiduciary obligations by its directors, the defaulting directors' knowledge of their own breaches of fiduciary duty is not able to be imputed to the company so as to amount to consent. As explained in *Lewis Securities Ltd (in liq) v Carter* (2018) 355 ALR 703 (citing *Grimaldi v Chameleon Mining NL (No 2)* (2002) 200 FCR 296, [282]–[284]) '[t]he knowledge of the fraudulent acts of those controlling a company is not imputed to the company' ([85] (Leeming JA). See also [182] Emmett AJA.

Questions

(1) What is meant by the statement that informed consent is a *defence* to a claim?

(2) Who bears the onus of establishing that informed consent is given?

(3) What is meant by the requirement that there be *informed* consent?

10.5.4 Two principles or one?

Are the conflict and profit principles two principles or one? In *Howard v Commissioner of Taxation (Cth)* (2014) 253 CLR 83, [57], Hayne and Crennan JJ noted the controversy but did not need to decide the issue:

> Whether there are two distinct obligations, or they are properly to be seen as 'one "fundamental rule" [which] embodies two themes', need not be explored. It is convenient, for the purposes of this case, to treat the obligations as if they are distinct, while recognising that both may, and often will, be engaged by the one set of facts.

10.5.4a *Chan v Zacharia* [1984] HCA 36; (1984) 154 CLR 178

Background

The parties were doctors who were partners in a medical practice. They held a three-year lease of the premises where they conducted their practice, with an option of renewal for a further two years. To renew, notice had to be given to the lessor not later than three months before the expiration of the three-year term. The parties quarrelled and a receiver was appointed to wind up the partnership. The parties could not agree, via the receiver, to jointly exercising the option to renew the lease. Chan sought a renewal of the lease on his own account within the option period. The lessor later granted Chan a lease, albeit at a premium. Chan agreed to indemnify the lessor against 'all actions, suits and demands' which Zacharia might bring against it in respect of a lease to Chan.

Decision

The High Court held that Chan was, in the winding up of the partnership, a constructive trustee for Zacharia of any interest he acquired under the agreement for a new lease.

Of relevance below is Deane J's discussion about the relationship between the conflict and profit principles.

Deane J

There is a wide variety of formulations, of the general principle of equity requiring a person in a fiduciary relationship to account for personal benefit or gain. The doctrine is often expressed in the form that a person 'is not allowed to put himself in a position where his interest and duty conflict' *(Bray v Ford)* or 'may conflict' *(Phipps v Boardman)* or that a person is 'not to allow a conflict to arise between duty and interest' *(New Zealand Netherlands Society 'Oranje' Inc v Kuys).* As Sir Frederick Jordan pointed out however (see *Chapters on Equity* ...), this, read literally, represents 'rather a counsel of prudence than a rule of equity': indeed, even as an unqualified counsel of prudence, it may, in some circumstances, be inappropriate (see, e.g., *Hordern v Hordern; Smith v Cock*). The equitable principle governing the liability to account is concerned not so much with the mere existence of a conflict between personal interest and fiduciary duty as with the pursuit of personal interest by, for example, actually entering into a transaction or engagement 'in which he has, or can have, a personal interest conflicting ... with the interests of those whom he is bound to protect' (per Lord Cranworth LC, *Aberdeen Railway Co v Blaikie Brothers)* or the actual receipt of personal benefit or gain in circumstances where such conflict exists or has existed.

The variations between more precise formulations of the principle governing the liability to account are largely the result of the fact that what is conveniently regarded as the one 'fundamental rule' embodies two themes. The first is that which appropriates for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest. The second is that which requires the fiduciary to account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it: the objective is to preclude the fiduciary from actually misusing his position for his personal advantage. Notwithstanding authoritative statements to the effect that the 'use of fiduciary position' doctrine is but an illustration or part of a wider 'conflict of interest and duty' doctrine (see, e.g., *Phipps v Boardman, New Zealand Netherlands Society 'Oranje' Inc v Kuys),* the two themes, while overlapping, are distinct. Neither theme fully comprehends the other and a formulation of the principle by reference to one only of them will be incomplete. Stated comprehensively in terms of the liability to account, the principle of equity is that a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it.

... It may still be arguable in this Court that, notwithstanding general statements and perhaps even decisions to the contrary in cases such as *Regal (Hastings) Ltd v Gulliver* and *Phipps* v *Boardman*, the liability to account for a personal benefit or gain obtained or received by use or by reason of fiduciary position, opportunity or knowledge will not arise in circumstances where it would be unconscientious to assert it or in which, for example, there is no possible conflict between personal interest and fiduciary duty and it is plainly in the interests of the person to whom the fiduciary duty is owed that the fiduciary obtain for himself rights or benefits which he is absolutely precluded from seeking or obtaining for the person to whom the fiduciary duty is owed: cf *Peso Silver Mines Ltd (NPL) v Cropper.* In that regard, one cannot but be conscious of the danger that the over-enthusiastic and unnecessary statement of

broad general principles of equity in terms of inflexibility may destroy the vigour which it is intended to promote in that it will exclude the ordinary interplay of the doctrines of equity and the adjustment of general principles to particular facts and changing circumstances and convert equity into an instrument of hardship and injustice in individual cases: see *Canadian Aero Service Ltd v O'Malley;* Cretney …; Oakley, … There is 'no better mode of undermining the sound doctrines of equity than to make unreasonable and inequitable applications of them': per Lord Selborne LC, *Barnes* v *Addy*.

10.5.4b *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; (2012) 200 FCR 296

Background

See [10.3.3a] above for the facts.

Decision

Finn, Stone and Perram JJ

As Australian law presently stands, the obligation of loyalty imposed upon a fiduciary is expressed in two overlapping proscriptive 'themes' which govern the fiduciary's liability to account to his or her own beneficiary. The best known formulation of these is that of Deane J in *Chan v Zacharia* (1984) 154 CLR 178 at 198–199:

> The first is that which appropriates for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest. The second is that which requires the fiduciary to account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it: the objective is to preclude the fiduciary from actually misusing his position for his personal advantage.

See also *Breen v Williams* (1996) 186 CLR 71 at 113.

The concept of 'duty' in the 'conflict of duty and interest' formula of the first of these is convenient shorthand. It refers simply to the function, the responsibility, the fiduciary has assumed or undertaken to perform for, or on behalf of, his or her beneficiary. What that function or responsibility is, is a question of fact. It may be narrow and circumscribed, as is often the case with specific agencies; it may be broad and general, as is characteristically the case with the functions of company directors; its scope may have been antecedently defined or determined; it may have been ordained by past practice; it may be left to the fiduciary's discretion to determine; and it may evolve over time as is commonly the case with partnerships. Put shortly the actual function or responsibility assumed determines '[t]he subject matter over which the fiduciary obligations extend' for conflict of duty and interest and conflict of duty and duty purposes: *Birtchnell v Equity Trustees, Executors and Agency Co Ltd* at 408. As Lord Upjohn noted in *Phipps v Boardman* [1967] 2 AC 46 at 127:

> Having defined the scope of those duties [undertaken or assumed by the fiduciary] one must see whether he has committed some breach thereof by placing himself within the scope and ambit of those duties in a position where his duty and interest may possibly conflict. It is only at this stage that any question of accountability arises.

One comment should be made about the term 'interest' as used in the conflict formula. Put compendiously, the term signifies the presence of some personal concern of possible pecuniary value in a decision taken, or a transaction effected, within the scope of a fiduciary's duties. Importantly for present purposes, it may be a contingent or expectant one, as where a trustee uses a trust's shareholding in a company to vote himself onto the company's board from which position he will be likely to derive directors' fees:

see e.g. *In re Macadam; Dallow v Codd* [1946] Ch 73 at 81; or where a dealing with an agent proceeds on the assumption that a success fee is to be paid if a transaction is effected: *McCann v Switzerland Insurance Australia Ltd* (2000) 203 CLR 579.

The second 'theme' – that of misuse of a fiduciary position – overlaps with the first to a considerable degree. The agent who successfully solicits (or 'extorts') a secret commission will characteristically transgress both the conflict of duty and interest and the misuse of position proscriptions. Importantly, though, misuse of position has an area of independent operation – an area which does not require it to be shown that the fiduciary has assumed some responsibility to his or her beneficiary in relation to the matter in issue. Its concern, as Deane J indicated, is to preclude the *misuse* of the position the fiduciary has, or of knowledge or opportunity derived from it. A longstanding exemplification of this is to be found in the Partnership Act which renders a partner liable to the firm for any benefit derived from any use made of the partnership property, name, or business connection: see e.g. *Russell v Austwick* (1826) 1 Sim 52; 57 ER 498; *Partnership Act 1892* (NSW), s 29.

Notes

(1) In *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250, [5], the Court held that 'an agent must not make a profit out of his trust' and 'must not place himself in a position in which his duty and his interest may conflict' – and that, as Lord Upjohn pointed out in *Boardman v Phipps*, the former proposition is 'part of the [latter] wider rule'. Lord Upjohn in *Boardman* [1967] 2 AC 46, 123 had said: 'a person in a fiduciary capacity must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict'.

(2) *Chan v Zacbaria* [1984] HCA 36; (1984) 154 CLR 178, [30] (Deane J) appears to contemplate a separate profit principle and has been quoted with approval in *Warman International Ltd v Dwyer* (1995) 182 CLR 544, 559 [28] (the Court).

Question

If we were to regard the conflict principle *as encompassing* the profit principle, might the following example given by Lord Upjohn in *Boardman v Phipps* [1967] AC 46, 130, be decided differently? (In this example, substitute fiduciary for trustee.)

> Blackacre is trust property and next to it is Whiteacre; but there is no question of the trustees being interested in a possible purchase of Whiteacre as being convenient to be held with Blackacre. Is a trustee to be precluded from purchasing Whiteacre for himself because he may have learnt something about Whiteacre while acting as a trustee of Blackacre? I can understand the owner of Whiteacre being annoyed but surely not the beneficial owners of Blackacre, they have no interest in Whiteacre and their trustees have no duties to perform in respect thereof.

10.6 Contracting out of fiduciary obligations

A fiduciary or putative fiduciary may attempt by contract to remove or limit the existence of a fiduciary obligation. Particularly in commercial relationships, this will be a desirable strategy. Given that the core obligation of a fiduciary is loyalty, it is not difficult to understand why parties who have opposing commercial interests may not wish to be obliged via fiduciary law to act in the interests of one another. The question of whether or not these contractual devices are successful depends in part upon the course of dealing between the alleged fiduciary and the principal. Put simply, if there is a pre-existing fiduciary relationship between the parties, an attempt subsequently by the fiduciary to nullify or limit fiduciary obligations may itself be caught by the fiduciary relationship.

Recall *United Dominions Corporation Ltd v Brian Pty Ltd* (1985) 157 CLR 1, 12 (Mason, Brennan and Deane JJ) (extracted above at [10.3.4a]):

> A fiduciary relationship can arise and fiduciary duties can exist between parties who have not reached, and who may never reach, agreement upon the consensual terms which are to govern the arrangement between them. In particular, a fiduciary relationship with

> attendant fiduciary obligations may, and ordinarily will, exist between prospective partners who have embarked upon the conduct of the partnership business or venture before the precise terms of any partnership agreement have been settled. Indeed, in such circumstances, the mutual confidence and trust which underlie most consensual fiduciary relationships are likely to be more readily apparent than in the case where mutual rights and obligations have been expressly defined in some formal agreement. Likewise, the relationship between prospective partners or participants in a proposed partnership to carry out a single joint undertaking or endeavour will ordinarily be fiduciary if the prospective partners have reached an informal arrangement to assume such a relationship and have proceeded to take steps involved in its establishment or implementation.

Thus, the operation of fiduciary law may itself govern or limit any attempt to contract out. See also chapter 7.

10.6a *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4)* (2007) 160 FCR 35

Background

Toll Holdings (Toll) in 2004 planned a hostile takeover of Patrick Corporation Ltd (Patrick), a highly secret operation which would fail if the Patrick share price rose prior to an official takeover announcement by Toll. Toll engaged the Investment Banking division of Citigroup as financial adviser for the takeover. The Equities Division of Citigroup (an information barrier divided the divisions) traded shares on Citigroup's own account, including shares in Patrick. The mandate letter under which Citigroup advised Toll in the Patrick takeover included a term stating:

> [Toll] acknowledges that Citigroup has been retained … solely as an adviser to [Toll] and not as an adviser to or agent of any other person, and that [Toll's] engagement of Citigroup is as an independent contractor and not in any other capacity including as a fiduciary. … [Toll] should be aware that Citigroup and/or its related bodies corporate may be providing or may in the future provide financial or other services to other parties with conflicting interests. However, consistent with our long-standing policy to hold in confidence the affairs of our customers, we will not use confidential information obtained from [Toll] except in connection with our services to, and our relationship with, [Toll], nor will we use on [Toll's] behalf any confidential information obtained from any other customer.

The mandate letter was signed on 8 August 2005. However, Citigroup had known of Toll's plan to take over Patrick earlier, and had been seeking to obtain the engagement to advise Toll since at least January 2005. The clause purporting to exclude the fiduciary relationship had appeared on all drafts of the mandate letter since June 2005 and had never been objected to by Toll. The mandate letter also failed to disclose that Citigroup was trading securities on its own account and the proprietary trading or Equities Division of Citibank was never explained to Toll. After the mandate letter was signed but before the takeover was announced, a Citigroup Equities Division trader purchased on behalf of Citigroup over 1 million Patrick shares worth $6 million. The Patrick share price rose as other investors observed the trading activity and began chasing Patrick stock. Citigroup's advisers to Toll became nervous and in breach of the information barrier that supposedly existed between the two divisions at Citigroup, took aside the proprietary trader on a cigarette break, telling him: 'Don't buy any more shares in Patrick.' In response, he immediately divested Citigroup's holding of one-quarter of the shares he had acquired which further reinforced the market tendency to put pressure on the Patrick share price as it was taken as further confirmation that Citigroup was preparing a bid on Toll's behalf to take over Patrick. The Patrick share price continued to rise. After a lengthy takeover battle, Toll eventually succeeded in the takeover on Patrick at a price of $5.8 billion rather than the predicted $4 billion.

Toll executives believed that the market would likely have detected information about the takeover preparations in any case and absorbed the share price increase. It was conceded that they might have preferred that Citigroup had not engaged in the buying and selling of shares in Patrick given that Patrick was Toll's intended target, but no further action against Citigroup was taken. ASIC brought proceedings against Citigroup on the ground that Citigroup had breached s 912A(1) of the *Corporations Act 2001* (Cth). A necessary precondition of ASIC's case was the finding that Citigroup and Toll were in a fiduciary relationship.

Decision

It was held on the construction of the mandate letter that Citigroup owed no fiduciary obligations to Toll.

Jacobson J

… [T]he question of whether any fiduciary relationship existed between Citigroup and Toll is to be determined by the proper construction of the mandate letter.

In *Chan v Zacharia,* Deane J said in plain terms at 196 that the parties to a partnership agreement could provide 'that any fiduciary relationship between the partners was excluded'. The observations of Mahoney JA in *Woolworths v Kelly* at [225] were to the same effect. His Honour said that fiduciary duties could be 'varied or released' by contract. Also, in *News Limited,* a Full Court of this Court (Lockhart, von Doussa and Sackville JJ) said at 539 that whether there are any fiduciary obligations at all may depend on the terms of the contract.

It is difficult to see that the words of the mandate letter have anything other than their plain meaning. Citigroup was retained solely as an adviser to Toll, as an independent contractor and not as a fiduciary. The engagement of Citigroup as an 'independent contractor and not in any other capacity' suggested that the parties had in mind the distinction between independent contractors and employees or agents; see for example *Stevens v Brodribb Sawmilling Company Pty Limited* (1986) 160 CLR 16 per Mason, Wilson, Brennan, Deane and Dawson JJ. Thus, these words also point against the assumption of any fiduciary capacity.

It is true, as is shown by *Daly, Hadid* and *Aequitas,* that an adviser may have fiduciary obligations to the client. But for the express terms of the mandate letter, the pre-contract dealings between Citigroup and Toll would have pointed strongly toward the existence of a fiduciary relationship in Citigroup's role as an adviser.

I have set out the pre-contract dealings … because … they contain all of the indicia of a fiduciary relationship of adviser and client.

In summary, Citigroup gave Toll advice as to the wisdom and merits of making a bid for Patrick. Citigroup gave strategic advice which involved the use of its financial acumen, judgment and expertise to further Toll's interests. Citigroup worked closely with Toll as is evidenced by the presentations made before the execution of the mandate, as well as the large number of communications between them, both oral and by email.

Moreover, Citigroup actively 'pitched' to obtain the mandate and it sought a primary role, comparing itself favourably with Carnegie Wylie from an advisory perspective. It emphasised its 'access to global players' and its abilities, not just as a funder but also as an adviser. It promised to back the transaction 'to the hilt even if it gets a little hairy'.

In addition, Citigroup gave advice to Toll about many aspects of the transaction, including, in particular, extensive advice, prior to the execution of the mandate letter, as to the pricing of the offer and the calculation of the premium. Citigroup's advice was that the premium should be calculated so as 'to convey the most optically appealing bid'.

There were substantial negotiations as to the fees payable to Citigroup, and Citigroup ultimately secured success fees in the range of AUD$10 million to AUD$18 million. Fees of that order are testimony in themselves to a finding that Citigroup held itself out as an expert adviser on mergers and acquisitions, which points to the existence of a fiduciary relationship: see *Daly* at 377 per Gibbs CJ, 385 per Brennan J; *Aequitas* at [307], [310] per Austin J.

The mandate letter does not spell out the advisory services to be supplied by Citigroup, other than to describe them as financial advisory and investment banking services in connection with the proposed transaction as are customary and appropriate.

Customary financial advisory services would include those described by Mr Tuch, such as advising on the merits of entering into the transaction, strategic advice and advising on timing, structure and pricing: see [263] above. The services which would be considered to be appropriate would also be determined by reference to those supplied by Citigroup before the execution of the mandate letter, as part of the relevant factual matrix.

However, ASIC did not suggest that the factual matrix, or the object or purpose of the mandate letter, could bear upon the proper construction of the acknowledgment that the relationship between the parties was not fiduciary.

Nor did ASIC argue that the words 'including as a fiduciary' should be limited or read down by anything else in the terms of the lengthy acknowledgment.

It is true, as Frankfurter J said in *Securities and Exchange Commission v Chenery Corporation* [1943] USSC 32; 318 US 80 (1943) at 85, that 'to say a man is a fiduciary only begins the analysis': see the citation in *Beach Petroleum* at [185] per Spigelman CJ, Sheller JA and Stein JA. But it is otherwise where the parties acknowledge that they are not in a fiduciary relationship. In my view, those words mean what they say and should be enforced accordingly, unless the mandate letter was vitiated as a matter of law.

ASIC did not contend that the mandate letter was unenforceable in accordance with its terms. There was of course no allegation of mistake or misrepresentation. Nor did ASIC argue that the exclusion of a fiduciary relationship was contrary to the regulatory

obligations imposed on Citigroup by s 912A(1)(aa) of the *Corporations Act* to have in place adequate arrangements for the management of conflicts of interest.

It seems to me to follow that the exclusion of the fiduciary relationship was effective, notwithstanding the fact that Citigroup undertook to provide financial advisory services to Toll and that both parties' interests were 'well aligned' in the fee structure set out in the mandate letter.

The exclusion of the fiduciary relationship in the mandate letter is to be contrasted with the more extensive acknowledgments contained in the Custodian & Nominee Appointment. There, the form of appointment authorised Citigroup to have a variety of specified conflicts and to carry on business through the operation of Chinese walls … See also the form of mandate letter entered into between Toll and Citigroup in an earlier transaction: see [77] above.

However, those documents cannot bear upon the proper construction of the mandate letter itself. At most, they may point to Toll's informed consent to proprietary trading by Citigroup …

Note

ASIC did not rely on the High Court decision in *United Dominions Corporation Ltd v Brian Pty Ltd* (1985) 157 CLR 1, 12 (Mason, Brennan and Deane JJ) (see [10.3.4a] above). J Getzler, *'ASIC v Citigroup:* Bankers' conflict of interest and the contractual exclusion of fiduciary duties' (2007) 2 *Journal of Equity* 62–70, 66 notes that the intensity of the parties' commercial relationship prior to Toll executing the mandate letter could perhaps have engaged this theory of creation of a fiduciary relationship.

Questions

(1) Was there a pre-existing fiduciary relationship in this case?

(2) If so, what was the scope of this relationship?

(3) Did the fiduciary relationship encompass the attempt to contract out of a fiduciary obligation?

11

Participants in a breach of fiduciary obligation

11.1 Introduction

11.2 Knowing receipt

11.3 Knowing assistance

11.1 Introduction

The previous chapter examined the liability of the fiduciary for breach of obligation. A successful claim against the fiduciary may result in an award of compensation for loss, disgorgement of gain or restitution of property misappropriated by the fiduciary. But it will sometimes be impossible for the plaintiff to obtain complete relief, particularly if the fiduciary is insolvent or beyond the jurisdiction of the court. In such cases, the plaintiff may be able to pursue third parties who participated in the breach of duty. The principles governing the imposition of liability on participants are discussed in this chapter.

This chapter principally examines the liability of third parties under the so-called 'two limbs' of *Barnes v Addy* (1874) LR 9 Ch App 244. Liability under the first limb arises when the defendant has knowingly received property in breach of fiduciary duty. Liability is imposed under the second limb on a defendant who knowingly assists the commission of a breach of fiduciary duty. But, as the cases (particularly *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89) make clear, third parties can be held accountable on other equitable grounds; for example, for knowingly inducing or procuring a breach of fiduciary duty. Deliberate involvement in the management of a trust by a non-trustee may result in the non-trustee being held accountable in equity as a trustee de son tort (trustee by reason of his own wrongdoing). Finally, a common law claim can sometimes be brought in unjust enrichment against the third party which does not require proof of a breach of fiduciary duty (see *Fistar v Riverwood Legion and Community Club Ltd* [2016] NSWCA 81; (2016) 91 NSWLR 732 at [11.2.5a] and *Great Investments Ltd v Warner* (2016) 243 FCR 516). Various policies inform these heads of liability although no single policy objective wholly explains their imposition: relevant considerations include the prevention of equitable wrongdoing, the vindication of property rights, and the reversal of unjust enrichment.

Two points need to be kept in mind when reading the cases. The first is that the third party can be held liable even if no claim for breach of fiduciary duty has been brought against the fiduciary. If a trustee has committed a breach of trust with the assistance of his solicitor, the beneficiaries may decide to seek compensation for loss to the trust from the insured solicitor rather than from the uninsured trustee. The solicitor may have an equitable or statutory claim to contribution from the trustee (see A Gurr, 'Accessory Liability and Contribution, Release and Apportionment' (2010) 34(2) *Melbourne University Law Review* 481).

The second point is that some breaches of fiduciary duty are not committed directly by the fiduciary but by a corporation formed and controlled by the fiduciary. For example, a trustee may establish a corporation solely for the purpose of receiving property he has misappropriated. In this type of case, the corporation is regarded as the 'alter ego' of the trustee. In other words, the corporation's liability is that of the trustee and not that of a third party participant in the breach of duty (*Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89, [110], [128]).

The starting point for considering the liability of third parties for breach of fiduciary duty is *Barnes v Addy.*

11.1a *Barnes v Addy* (1874) LR 9 Ch App 244

Background

Addy, who was a co-trustee of a family trust, appointed Barnes sole trustee of half of the trust fund. Barnes improperly diverted trust money into his own business and later became bankrupt. The plaintiffs, who were beneficiaries of the trust, brought proceedings for breach of trust against Addy, and against two solicitors for having assisted the breach of trust. Due to the general risk to the security of the trust fund in appointing a sole trustee, one solicitor had advised Addy not to appoint Barnes as sole trustee but had nevertheless drawn up the deed of appointment. The other solicitor had also drafted some of the documentation required to make the appointment.

Decision

The Court of Appeal in Chancery held that the solicitors were not liable for having assisted in any breach of trust committed by Barnes.

Lord Selborne LC

It is equally important to maintain the doctrine of trusts which is established in this Court, and not to strain it by unreasonable construction beyond its due and proper limits. There would be no better mode of undermining the sound doctrines of equity than to make unreasonable and inequitable applications of them.

Now in this case we have to deal with certain persons who are trustees, and with certain other persons who are not trustees. That is a distinction to be borne in mind throughout the case. Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees *de son tort,* or actually participating in any fraudulent conduct of the trustee to the injury of the *cestui que trust.* But, on the other hand, strangers are not to be made constructive trustees merely because they act as agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a fraudulent and dishonest design on the part of the trustees. Those are the principles, as it seems to me, which we must bear in mind in dealing with the facts of this case. If those principles were disregarded, I know not how anyone could, in transactions admitting of doubt as to the view that a Court of Equity might take of them, safely discharge the office of solicitor, of banker, or of agent of any sort to trustees. But, on the other hand, if persons dealing honestly as agents are at liberty to rely on the legal power of the trustees, and are not to have the character of trustees constructively imposed upon them, then the transactions of mankind can safely be carried through; and I apprehend those who create trusts do expressly intend, in the absence of fraud and dishonesty, to exonerate such agents of all classes from the responsibilities which are expressly incumbent, by reason of the fiduciary relation, upon the trustees.

Notes

(1) Lord Selborne distinguished between agents who 'receive and become chargeable' with trust property and agents who 'assist with knowledge in a fraudulent and dishonest design on the part of the trustees'. Later authority has recognised a distinction between those (not only agents) who knowingly receive property in breach of fiduciary duty (not only a breach of trust) and those who knowingly assist the commission of a breach of fiduciary duty – again, the assistants need not be agents, and the fiduciaries are not confined to trustees. Liability for 'knowing receipt' is sometimes described as liability under the 'first limb' of *Barnes v Addy* and liability for 'knowing assistance' as liability under the 'second limb' of *Barnes v Addy.*

(2) See textbook at [11.25] for discussion of liability as 'trustee de son tort'.

Questions

(1) What purpose, if any, is served by distinguishing between cases of 'knowing receipt' and 'knowing assistance'? Should both heads of liability be replaced by a unified liability for knowingly participating in a breach of fiduciary duty? See P Finn, 'The liability of third parties for knowing receipt or assistance' in DWM Waters (ed), *Equity, Fiduciaries and Trusts* (Carswell, 1993) ch 10; P Ridge, 'Equitable Accessorial Liability: Moving Beyond *Barnes v Addy*' (2014) 8(1) *Journal of Equity* 28.

(2) What policy reasons did Lord Selborne give for limiting the equitable liability of agents, such as solicitors, who assist trustees? Is the policy reasoning still valid today?

(3) What did Lord Selborne mean when he said that agents were 'not to have the character of trustees imposed upon them'?

11.2 Knowing receipt

Three conditions must be satisfied before liability will be imposed for knowingly receiving property in breach of fiduciary duty: breach of fiduciary duty, receipt of property by a third party, and knowledge.

11.2.1 Breach of fiduciary duty

In *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89, the High Court stated at [113]:

> In recent times it has been assumed, but rarely if at all decided, that the first limb applies not only to persons dealing with trustees, but also to persons dealing with some other types of fiduciary. Since the appellants did not contend that the first limb was incapable of applying … the correctness of this assumption need not be examined.

Later cases have confirmed that liability under the first limb applies to recipients of property from any fiduciary who has acted in breach of duty in transferring the property. See *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557, [152]–[159] (Giles JA); *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1.

Suppose that a director of a company transfers corporate property to a third party in breach of the obligations he owes to the company. Title to the property is vested in the company, not the director. Nevertheless, for the purposes of imposing liability for 'knowing receipt', the property is treated as having been received by the third party from the director. The position was explained by Buckley LJ in *Belmont Finance Corporation Ltd v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393, 405:

> A limited company is of course not the trustee of its own funds: it is their beneficial owner; but in consequence of the fiduciary character of their duties the directors of a limited company are treated as if they were the trustees of those funds of the company which are in their hands or under their control, and if they misapply them they commit a breach of trust … So, if the directors of a company in breach of their fiduciary duties misapply the funds of their company so that they come into the hands of some stranger to the trust who receives them with knowledge (actual or constructive) of the breach, he cannot conscientiously retain those funds against the company unless he has some better equity.

See also *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557, [152]–[159]. On the question of whether a failure by a company director to exercise powers and discharge duties with due care and skill is a breach of fiduciary duty for the purpose of a 'knowing receipt' claim, see *GFIN Pty Ltd v Gooden, Re GFIN Pty Ltd (No3)* [2021] FCA 227, [225].

11.2.2 Receipt of property by a third party

Two questions have to be considered under this heading. The first relates to what is received. A third party is only liable under the first limb

of *Barnes v Addy* if what is received constitutes, in law, property. Failure to prove that the third party received legally recognised property was one of the reasons the claim for 'knowing receipt' failed in the High Court decision of *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (below).

11.2.2a *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89

Background

The plaintiff and defendant entered into a joint venture agreement to develop a property. Mr Elias, who controlled the defendant company (Farah Constructions) applied to the council for planning permission for the development. Planning permission was refused. The reason for the refusal, communicated to Mr Elias by a Notice of Determination, was because the site was too narrow for the proposed development. The council also informed Mr Elias that permission might be granted if adjoining houses were purchased and incorporated into the development. Mr Elias received information that two adjoining houses were for sale. Without informing the plaintiff, Mr Elias arranged for the defendant company to purchase the houses and completed the development. Title to the houses the company had bought was taken in the name of Mr Elias' wife and daughters.

The plaintiff claimed that the defendant company had committed a breach of fiduciary duty in exploiting the opportunity to purchase the houses and completing the development. In addition, it argued that Mr Elias' wife and daughters were accountable in equity for having knowingly received property transferred in breach of the defendant company's fiduciary obligations.

Decision

The High Court held that, on the facts, the defendant company was not liable for breach of fiduciary obligation. The plaintiff had also been notified of the council's decision and had received information that the properties were available for purchase. Being aware of the defendant's actions, it had therefore consented to what would otherwise have amounted to a breach of obligation.

The Court went on to hold that, even if the defendant had committed a breach of fiduciary obligation to which the plaintiff had not consented, Mr Elias' wife and daughters were not liable for having knowingly received property in breach of fiduciary duty or for having knowingly assisted a breach. One of the reasons given for rejecting the 'knowing receipt' claim against the wife and daughters was that they had received information, which in law does not constitute property.

The Court

For the following reasons there was no receipt of property within the meaning of the first limb of *Barnes v Addy*. The information which the Court of Appeal thought that Mr Elias ought to have disclosed was not confidential. So far as that information was in the Notice of Determination, that document was available for public inspection. The Notice of Determination was a document which had to be notified to the applicant and various other persons pursuant to s 81(1) of the *Environmental Planning and Assessment Act 1979* (NSW). Clause 266 of the *Environmental Planning and Assessment Regulation 2000* (NSW) created an obligation on the Council to retain the Notice of Determination. Clause 268(1)(b) imposed an obligation on the Council to make the Notice of Determination available for inspection by the public. So far as the relevant information was in the report of 3 April 2001 by the Council's Group Manager, Environmental and Community Services, to the Building and Development Committee, which, inter alia, summarised the letter of 8 March 2001 from the Department of Urban Affairs and Planning, it was reported and discussed at the meeting of that Committee on 3 April 2001. That meeting was open to the public, and the minutes were available for inspection at the Council's Public Library. The same applies to the Group Manager's report of 20 June 2000 and the Building and Development Committee meeting on 26 June 2000. An inquirer at the Council about the development potential of No 11 would be informed of the planning instruments affecting the development potential of No 11. A persistent inquirer, particularly one with a genuine commercial interest, would no doubt be able to obtain an interview with an informed Council officer. In *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, Stephen J denied that knowledge of property development applications, 'the essence of which was wholly in the public domain', was property capable of being owned by anyone.

Further, the evidence does not show that any attempt was made to transfer the relevant information to Mrs Elias and her daughters. It shows only that what they got was property the availability of which was ascertained by Mr Elias. It is erroneous to speak of

the acquisition of the three units in No 15 by Mr Elias's family as receipt of trust property, because the three units cannot be described as trust property. Nor are they the traceable proceeds of trust property, because the information cannot be traced into the units.

The second question relates to the nature of the receipt. A recipient will only be liable for 'knowing receipt' if he has beneficially received the property in question. An agent who receives property on behalf of the principal receives the property ministerially, not beneficially. Issues relating to beneficial receipt most commonly arise with respect to banks. Banks are the legal owners of money they receive, but a payment received by a bank to be credited to a customer's account is usually received by the bank as the customer's agent. The bank will therefore not be liable for knowing receipt unless it applies the money for its own benefit. The principles were explained by Millett J in *Agip (Africa) Ltd v Jackson* [1990] Ch 265 (affirmed on this point [1991] Ch 547).

11.2.2b *Agip (Africa) Ltd v Jackson* [1990] Ch 265

Background

The chief accountant of the plaintiff fraudulently diverted payment orders to companies registered in England and controlled by some of the defendants. Two of the defendants, Jackson and Bowers, were ignorant of the fraud but had allowed some of the proceeds to be paid into their bank accounts before being released to the fraudsters.

Decision

It was held that Jackson and Bowers were not liable for having knowingly received the proceeds of a breach of fiduciary duty since they had not received the money beneficially but as innocent agents for other parties involved in the fraud.

Millett J

Without attempting an exhaustive classification, it is necessary to distinguish between two main classes of case under this heading. The first is concerned with the person who receives for his own benefit trust property transferred to him in breach of trust. He is liable as a constructive trustee if he received it with notice, actual or constructive, that it was trust property and that the transfer to him was a breach of trust; or if he received it without such notice but subsequently discovered the facts. In either case he is liable to account for the property, in the first case as from the time he received the property, and in the second as from the time he acquired notice.

The second and, in my judgment, distinct class of case is that of the person, usually the agent of the trustees, who receives the trust property lawfully and not for his own benefit but who then misappropriates it or otherwise deals with it in a manner which is inconsistent with the trust. He is liable to account as a constructive trustee if he received the property knowing it to be such, though he will not necessarily be required in all circumstances to have known the exact terms of the trust.

… The essential feature of the first class is that the recipient must have received the property for his own use and benefit. This is why neither the paying nor the collecting bank can normally be brought within it. In paying or collecting money for a customer the bank acts only as his agent. It is otherwise, however, if the collecting bank uses the money to reduce or discharge the customer's overdraft. In doing so, it receives the money for its own benefit.

Notes

(1) On the question of the knowledge required of the recipient, this passage should be read subject to the dicta of the High Court in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89 (extracted at [11.2.3a] below).

(2) For an application of the concept of beneficial receipt so as to hold a bank liable for 'knowing receipt', see *Stephens Travel Service International Pty Ltd v Qantas Airways Ltd* (1988) 13 NSWLR 331.

11.2.3 Knowledge

A recipient will only be liable in equity under the first limb of *Barnes v Addy* if she knows of the facts constituting the breach of fiduciary duty. In *Farah Constructions Pty Ltd v Say-Dee Pty Ltd,* the High Court reviewed the authorities on the meaning of 'knowledge' in this context.

11.2.3a *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89

Background

See [11.2.2a] above for the facts.

Decision

In holding Mr Elias' wife and daughters liable for receiving property transferred in breach of the fiduciary duties the defendant company, controlled by Mr Elias, owed to the plaintiff, the New South Wales Court of Appeal analysed 'knowing receipt' liability as an application of the law of unjust enrichment. The wife and daughters had been unjustly enriched at the expense of the plaintiff (or, more accurately, at the expense of the plaintiff's share of the joint venture) and must make restitution of the properties so that they could be incorporated into the property development pursued by the co-venturers. Liability in unjust enrichment is strict, so on this analysis it was unnecessary for the plaintiff to show that the wife and daughters knew of Mr Elias' (assumed) breach of fiduciary duty.

The High Court rejected the application of unjust enrichment principles to the law of 'knowing receipt' and confirmed that a recipient is not liable under this head unless he has knowledge of the breach of fiduciary duty.

The Court

… The second reason why the Court of Appeal's treatment of this subject was a grave error is the confusion it is causing. Either the Court of Appeal is to be treated as abandoning the notice test for the first limb of *Barnes v Addy,* or it is to be treated rather as recognising a new avenue of recovery, which exists alongside the first limb. Although Say-Dee submitted that the law should develop by recognising a new but additional avenue of recovery, the Court of Appeal's approach was to abandon the notice test for the first limb. In doing so, it was flying in the face not only of the received view of the first limb of *Barnes v Addy,* but also of statements by members of this Court in *Consul Development Pty Ltd v DPC Estates Pty Ltd* [1975] HCA 8; (1975) 132 CLR 373. It is true that those statements were dicta in the sense that the case was decided on the second limb of *Barnes v Addy.* But, contrary to the Court of Appeal's perception, the statements did not bear only 'indirectly' on the matter: they were seriously considered. And, also contrary to the Court of Appeal's perception, they were not uttered only by two members of the Court, that is Stephen J, with whom Barwick CJ concurred. Gibbs J took the same view, so that it was shared by the entire majority. Gibbs J cited with approval *Soar v Ashwell* [1893] 2 QB 390 which approved the extension of *Barnes v Addy* to the case 'where a person received trust property and dealt with it in a manner inconsistent with trusts of which he was cognizant'. That language is also employed in another case Gibbs J cited, *Lee v Sankey* (1872) LR 15 Eq 204. In a third case cited by Gibbs J, *In re Blundell; Blundell v Blundell* (1888) 40 Ch D 370 at 381, Stirling J said a stranger who received trust property was not liable unless 'to his knowledge the money is being applied in a manner which is inconsistent with the trust'. Leaving aside any technical question about whether the doctrine of *stare decisis* strictly applied, abandonment of the rule that the plaintiff must prove notice on the part of the defendant is not an appropriate step for an intermediate court of appeal to take in relation to so long-established an equitable rule – for other illustrations of it both before and after *Barnes v Addy* can be found, its existence had been acknowledged in the Court of Appeal itself the previous year, and its correctness has been assumed in this Court. If, on the other hand, the Court of Appeal is to be treated not as abandoning the notice test for the first limb of *Barnes v* Addy, but rather as recognising a new and additional avenue of relief, it is an avenue which tends to render the first limb otiose. That too is not a step which an intermediate court of appeal should take in the face of long-established authority and seriously considered dicta of a majority of this Court.

Note

In addition to rejecting unjust enrichment reasoning, the High Court approved its earlier decision in *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 in which the knowledge requirement was considered. The following extract summarises the present consensus of judicial opinion on the meaning of 'knowledge'.

11.2.3b *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; (2012) 200 FCR 296

Background

Directors of a mining company had improperly applied company funds towards the acquisition of valuable mining tenements in Western Australia. The directors had acted in breach of fiduciary duty and of duties they owed under the *Corporations Act 2001 (Cth)*. (See [10.3.3a] for discussion of the fiduciary aspects of the case.) The directors, and companies they controlled, were also held liable for knowingly receiving money and shares in breach of fiduciary duty and for knowingly assisting breaches of duty. The judgment is extracted here for its discussion of the knowledge required to establish recipient liability.

Decision

Finn, Stone and Perram JJ

Put compendiously liability both for knowing receipt and knowing assistance turns on what the third party knew, or had reason to know, of the circumstances constituting the breach of 'trust' (recipient liability) or the 'dishonest and fraudulent design' (assistance liability). It is here, as justly observed in *Jacobs'* (at [1335]), that the whole topic has 'become bedevilled by an obsessive refinement of distinctions between degrees of knowledge and notice'. What the authors have described as the 'zenith of complexity' was attained by Peter Gibson J in *Baden v Société Générale pour Favouriser le Développment du Commerce et de l'Industrie en France SA* [1993] 1 WLR 509 at [250] where five categories of knowledge and notice were postulated. They were:

(i) 'actual' knowledge;

(ii) the wilful shutting of eyes to the obvious ('Nelsonian' knowledge);

(iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make;

(iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; and

(v) knowledge of circumstances which would put an honest reasonable man on inquiry (that is, constructive notice as traditionally understood).

The comment that should be made at the outset about this five-fold classification is that it tends to invite the use of formulae to solve problems. Unsurprisingly judges have cautioned against treating each category as an exclusive and rigid one. That caution is justified and is illustrated in his Honour's reasons as will be seen.

The first two categories of 'knowledge' require no comment. The third involves such a calculated abstention from inquiry as would disentitle the third party to rely upon lack of actual knowledge of the trustee's or fiduciary's wrongdoing. The fourth reflects what seems to have been accepted provisionally by three judges of the High Court in *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 at 398 and 412–413. It is, in essence, an understandable, objective, default rule designed to prevent a third party setting up his or her own 'moral obtuseness' as the reason for not recognising an impropriety that would have been apparent to an ordinary person: *Consul,* 398. It is the surrogate of actual knowledge. The form of constructive notice used in category (v) derives from the bona fide purchaser for value without notice doctrine. …

When one turns to 'knowing receipt' a more complex picture emerges. It is necessary to refer initially to English law. Prior to the abandonment of the *Baden* categories in England, first in relation to 'knowing assistance' in *Royal Brunei Airlines,* and then in rela-

tion to 'knowing receipt' in *BCCI (Operations),* there were two distinct lines of cases on recipient liability. One expressed the view that cases typically falling within categories (iv) and (v) would not suffice for liability: see e.g. *Re Montagu's Settlement Trusts* [1987] 1 Ch 264 at 285; *Eagle Trust plc v SBC Securities Ltd* [1992] 4 All ER 488 at 509; *Cowan de Groot Properties Ltd v Eagle Trust plc* [1992] 4 All ER 700 at 758–761. What has been called the third party's 'want of probity' needed to be shown.

The other line, which Millett J's observations in *Agip (Africa) Ltd v Jackson* at 292–293 typify, founded the knowing receipt liability on protection of 'rights of priority in relation to property'. Hence would accommodate constructive notice, i.e. categories (iv) and (v), as a basis for liability: see also *Westpac Banking Corporation v Savin* [1985] 2 NZLR 41.

We do not seek to express a view on which line carried the weight of authority, though Underhill and Hayton (at 98.29) suggest the latter did. All that needs emphasis is that English case law revealed two rationales for recipient liability – fault and property protection – and depending on which was accentuated would contrive the extent to which, if at all, constructive notice sufficed for liability to ensue: see generally the discussion in Dietrich and Ridge, at 57–62. We should add that Winterfall [a defendant], as will be seen, relies upon cases in the 'want of probity' line to challenge his Honour's reliance upon category (iv) notice in a recipient liability case.

The orthodox view in this country has been that there was a difference for knowledge/ notice purposes between knowing receipt and knowing assistance, with constructive notice (encompassing both categories (iv) and (v)) sufficing for the former: see e.g. *Ninety Five Pty Ltd (in liq) v Banque Nationale de Paris* [1988] WAR 132 at 175–176.

In *Consul* Stephen J was prepared to countenance category (iv), but not category (v), notice in a knowing assistance claim: at 412. However, his Honour had earlier observed that the distinction between the two liabilities had been said to be based on the acceptance of constructive notice (a reference, seemingly, to traditional or category (v) constructive notice) for receipt but not for assistance. Of this he commented that:

> It is not clear to me why there should exist this distinction between the case where trust property is received and dealt with by the defendant and where it is not; perhaps its origin lies in equitable doctrines of tracing, perhaps in equity's concern for the protection of equitable estates and interests in property which comes into the hands of purchasers for value.

We share the doubt expressed here. We do not consider that a property protection rationale for recipient liability (beyond a proprietary claim to a subsisting equitable interest in property, or its proceeds, in the third party's hands) of itself provides a sufficient justification for imposing a personal liability to account. That liability arises as a matter of conscience not of property. As with assistance liability, recipient liability should be seen as fault based and as making the same knowledge/notice demands as in assistance cases. We need not pursue this particular matter further because the weight of authority in this country appears now to draw no distinction between the two types of liability in this respect …

The High Court in *Farah* did not settle the knowledge/notice requirement in relation to recipient liability. Nonetheless, from at least the 1990's and in the wake of the *Baden* classification, judges had begun in recipient liability cases to generalise from what had been said both by Gibbs J (at 398) and by Stephen J (at 412) with whom Barwick CJ agreed, about the insufficiency of traditional, or category (v), constructive notice – though not of category (iv) notice – as a basis for personal liability. To allow that, as Stephen J commented, would be 'to disregard equity's concern for the state of conscience of the defendant': at 412 … In *Kalls Enterprise Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557 – a decision which post-dates *Farah* – the New South Wales Court of appeal applied *Baden's* categories (i)–(iv), but not category (v) to a knowing receipt claim. *Kalls Enterprise* in turn has been applied subsequently: see e.g. *Horsman v M G Kailis Pty Ltd* [2009] WASC 166; *Fodare Pty Ltd v Shearn* [2011] NSWSC 479.

Note

For different views on recipient liability and unjust enrichment, see Lord Nicholls, 'Knowing receipt: The need for a new landmark' in WR Cornish et al (eds), *Restitution: Past Present and Future* (Hart Publishing, 1998) ch 15; L Smith, 'Unjust Enrichment, Property and the Structure of Trusts' (2000) 116(3) *Law Quarterly Review* 412; William Swadling, 'The Nature of "Knowing Receipt'" in Paul S Davies and James Penner (eds), *Equity, Trusts and Commerce* (Hart Publishing, 2017) 303.

Questions

(1) What knowledge must a recipient possess for the purpose of the first limb of *Barnes v Addy?*

(2) What is the distinction between the doctrine of notice, which determines the enforceability of equitable proprietary interests, and knowledge, as applied to knowing receipt claims?

(3) Do you agree with the Full Federal Court that the five categories of knowledge identified in the *Baden* case overcomplicates what ought to be a simple factual inquiry? Why do judges distinguish between different types of knowledge?

(4) The High Court in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* rejected the analysis of recipient liability in terms of restitution for unjust enrichment. Do you think that a recipient of property transferred by a fiduciary in breach of duty has been unjustly enriched at the expense of the principal? If a trustee, in breach of trust, pays trust money to a third party, is the third party enriched at the expense of the beneficiaries?

11.2.4 Remedy

The remedy most commonly awarded in a 'knowing receipt' case is personal. Equitable compensation, assessed as the value of the property received, may be awarded, in some cases with compound interest: *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1. Alternatively, an account of profits may be ordered against a recipient who has profited from the receipt of the property; for example, by investing trust money successfully: *Michael Wilson & Partners Ltd v Nicholls* (2011) 244 CLR 427, [106]; *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; (2012) 200 FCR 296, [557], [725]–[749].

In *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89, the High Court stated that proprietary relief is available. Where the subject matter of the constructive trust is land, a question will arise as to the trust's enforceability under the Torrens system of title registration. See *Farah Constructions* at [190]–[198]. Extensive academic writing on this question includes L Bennett Moses, 'Recipient Liability and Torrens Title' (2006) 1(1) *Journal of Equity* 135; M Harding, '*Barnes v Addy* Claims and the Indefeasibility of Torrens Title' (2007) 31(2) *Melbourne University Law Review* 343; Rohan Havelock, 'Reconciling Equitable Claims with Torrens Title' (2019) 41(4) *Sydney Law Review* 455.

Questions

(1) T holds a Sidney Nolan painting on trust for B. T, in breach of trust, gives the painting to X. X is unaware that the painting is trust property. When informed of the breach of trust, X claims that he is entitled to keep the painting because he had no previous knowledge of T's breach. Is X entitled to keep the painting?

(2) The facts are as in (1) except that before he becomes aware of the breach of the trust, X sells the painting and buys a country property with the proceeds. The property is now worth more than the painting. Is B entitled to the property?

(3) The facts are as in (1) except that before he becomes aware of the breach of trust, X sells the painting and applies the proceeds to paying off his bank overdraft. Is B entitled to any equitable relief against X?

11.2.5 Alternative grounds of personal recipient liability

Liability under the first limb of *Barnes v Addy* is not the only basis on which a recipient can be made to pay the value of property received in breach of fiduciary duty. For example, a recipient of property to which he is not entitled from an executor of a deceased estate can be ordered to make personal restitution of the value of the property received if the property, or its traceable proceeds, cannot be returned to

those entitled under the will or intestacy: *Re Diplock* [1948] 1 Ch 465 (affirmed on this point as *Ministry of Health v Simpson* [1951] AC 251). See [21.6a].

A personal claim can also be brought against a recipient of property in an action for money had and received (in substance a claim for unjust enrichment) in some circumstances. Liability is strict, subject to the availability of defences such as change of position and good faith purchase. In *Fistar v Riverwood Legion and Community Club Ltd* [2016] NSWCA 81; (2016) 91 NSWLR 732, the New South Wales Court of Appeal rejected the argument that the personal claim should be disallowed because it would outflank the principles governing equitable 'knowing receipt' liability laid down by the High Court in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89.

11.2.5a *Fistar v Riverwood Legion and Community Club Ltd* [2016] NSWCA 81; (2016) 91 NSWLR 732

Background

Ms Fistar made out a cheque for $598,853.53 to a company controlled by Ms Rapaja, who held herself out to be a financial adviser. Ms Rapaja undertook to invest the money so as to enable Ms Fistar to complete the purchase of a property ('the Dolls Point property'). Most of the money was dissipated without being invested. Later, a dishonest officer of the Riverwood Legion and Community Club (the club) arranged for $800,000 in the club's accounts to be electronically transferred to Ms Rapaja's company account. Ms Rapaja then withdrew $481,189 from the account, using funds transferred by the club and, together with the unspent proceeds of Ms Fistar's cheque, paid Ms Fistar's solicitors the amount required to complete the purchase of the Dolls Point property. The club brought a personal claim in unjust enrichment against Ms Fistar to recover the club's money used to purchase the Dolls Point property.

Decision

The New South Wales Court of Appeal held that, while the strict liability claim in unjust enrichment was, in principle, permissible because it did not outflank recipient liability under the first limb of *Barnes v Addy,* Ms Fistar was not liable to make restitution of the club's money since she did not receive the payment as a volunteer but in discharge of a debt. In other words, she was a good faith purchaser. In the following extract, Leeming JA considers whether the unjust enrichment claim outflanks equitable liability for 'knowing receipt'.

Leeming JA

Ms Fistar's first submission was that where property was received by a third party following a breach of fiduciary duty, the third party could *only* be liable under the first limb of *Barnes v Addy.* There was no dispute about the principles governing that form of liability. Where the recipient of trust property has sufficient knowledge of the breach of trust, then the recipient will be accountable as a constructive trustee under the first limb of *Barnes v Addy.* That is so irrespective of whether the recipient retains the trust property: *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; 200 FCR 296 at [253]. It is sufficient if the recipient had knowledge of circumstances that would indicate the facts to an honest and reasonable person, but it is insufficient if the recipient merely had knowledge of circumstances which would put an honest and reasonable person on inquiry: *Grimaldi* at [268]–[269]. …

… Ms Fistar's submission … is, with respect, unsound. There are at least three reasons why that is so.

First, there are many overlapping claims against recipients of stolen property

The first and most fundamental way in which that may be seen arises from considering the nature of stolen property in the hands of a third party. In Australia it is settled law that '[w]here money has been stolen, it is trust money in the hands of the thief, and he cannot divest it of that character': *Black v S Freedman & Co* [1910] HCA 58; (1910) 12 CLR 105 at 110 (O'Connor J).

[After discussing *Black v S Freedman & Co* (see [23.6a]), Leeming JA continued:]

It follows therefore that the victim of theft may have a variety of claims when a third party receives trust property. In practice, there may be claims based on the victim's legal title to the property, and, because any dealing with trust property by the thief to a

third party will be in breach of the trust, there may be equitable claims consequent upon that breach.

However, if the recipient is a bona fide purchaser for value without notice, he or she is under no liability to a claimant whose title is equitable. Plainly enough, that is the position of the executrix of the deceased estate of Leslie Phillip Gleeson, who delivered title to the Dolls Point property in exchange for a bank cheque purchased in large measure with money taken from the Club. …

An unstated premise of Ms Fistar's submission that personal liability for money had and received could not co-exist with liability under the first limb of *Barnes v Addy* was that that was the *only* way in which recipients of trust property could be liable. The premise is not established. It is not established once one bears in mind claims at law for the recovery of chattels (see *McKeown v Cavalier Yachts Pty Ltd* (1988) 13 NSWLR 303 at 307–8). It is not established once one bears in mind proprietary claims in equity based on a better equitable title. And it is not established even if one confines attention to equitable claims based on the conscience of the recipient, as opposed to the property rights of the victim, because inconsistent dealing is different from knowing receipt.

Given all those well-established forms of liability, there is nothing antithetical or incoherent about there being a further species of liability on the part of a volunteer who receives trust property, or the traceable proceeds of trust property, and who subsequently learns the true position, such that he or she is obliged in equity to account for the identifiable property remaining …

More generally, there is nothing foreign to the Australian legal system in a plaintiff having alternative claims arising out of the same facts, a point noted by D Jackson, 'The first limb of *Barnes v Addy:* a taxonomy in tatters' in J McKenna and A Boylan (eds), *Queensland Legal Yearbook 2014* (2015, Supreme Court Library Queensland) 285 at 299–300. One example is that a plaintiff suing an adviser may and commonly will have claims in contract, tort and in equity – each of which may have different elements, different tests for breach and causation and different ways of calculating a pecuniary remedy (see the claims summarised in *Pilmer v Duke Group Ltd* [2001] HCA 31207 CLR 165 at [9]–[12] for negligence, breach of contract and in equity). Another example is the 'overlay' of the equitable relationship of trustee and beneficiary with the legal relationship of debtor and creditor to which Gageler J referred in *Fischer v Nemeske Pty Ltd* at [105]. A third is the overlap between trespass to the person and negligence considered in *Williams v Milotin* [1957] HCA 83; (1957) 97 CLR 465 at 473–474. Examples could readily be multiplied.

What in truth is foreign to the Australian legal system is the notion that causes of action are structured in such a way that there can be no such overlap. Submissions to that effect are advanced from time to time, such as the unsuccessful submission in *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567 that a loan transaction, giving rise to a legal action for debt, necessarily excluded the implication of any trust. It was said that 'a transaction may attract one action or the other, it could not admit of both'. Lord Wilberforce writing for the House rejected the submission, saying at 581 that he should be 'surprised if an argument of this kind – so conceptualist in character – had ever been accepted' and that '[t]here is surely no difficulty in recognising the co-existence in one transaction of legal and equitable rights and remedies'.

The same applies more generally throughout the Australian legal system. In large measure, that is a consequence of history. The Australian legal system is ultimately derived from a multiplicity of courts, all of limited jurisdiction, in competition with each other for litigation, each developing and favouring particular causes of action. Professor Simpson once emphasised, pointedly but aptly, the way in which the common law is the opposite of the regularly ordered taxonomy of causes of action which underlies Ms Fistar's primary submission:

> We must start by recognizing what common sense suggests, which is that the common law is more like a muddle than a system, and that it would be difficult to conceive of a less systematic body of law: AWB Simpson, *Legal Theory and Legal History: Essays on the Common Law* (1987, Hambledon Press) 359 at 381.

One may question whether the complexity, which is also a product of overlapping and sometimes competing principles, is desirable or otherwise. But there is no denying that it is antithetical to the concept underlying Ms Fistar's submission.

Second reason: a misreading of [134] of *Farah Constructions*

Secondly, Ms Fistar's submission misapprehends the force of [134] of *Farah Constructions*. That passage was critical of the decision of this Court in reformulating the liability of a recipient of property taken in breach of fiduciary obligations such that it was (speaking generally) strict subject to defences. It is not necessary to summarise the reasoning of the Court of Appeal, which was held to be erroneous. What matters is what the High Court said of that reasoning, which was as follows:

> Either the Court of Appeal is to be treated as abandoning the notice test for the first limb of *Barnes v Addy*, or it is to be treated rather as recognising a new avenue of recovery, which exists alongside the first limb. Although Say-Dee submitted that the law should develop by recognising a new but additional avenue of recovery, the Court of Appeal's approach was to abandon the notice test for the first limb. [After dealing with the decisions standing against that course, the joint judgment continued] Leaving aside any technical question about whether the doctrine of stare decisis strictly applied, abandonment of the rule that the plaintiff must prove notice on the part of the defendant is not an appropriate step for an intermediate court of appeal to take in relation to so long-established an equitable rule – for other illustrations of it both before and after *Barnes* v *Addy* can be found, its existence had been acknowledged in the Court of Appeal itself the previous year, and its correctness has been assumed in this Court. If, on the other hand, the Court of Appeal is to be treated not as abandoning the notice test for the first limb of *Barnes v Addy*, but rather as recognising a new and additional avenue of relief, it is an avenue which tends to render the first limb otiose. That too is not a step which an intermediate court of appeal should take in the face of long-established authority and seriously considered dicta of a majority of this Court (citations omitted).

The point which was made by the High Court was that neither the abandonment of the existing liability under *Barnes v Addy*, nor the creation of a new and more readily satisfied liability, was an appropriate course for an intermediate court of appeal to take, given the state of Australian authority. The High Court was saying nothing about the existence of a common law right to recover damages. As much is confirmed, as Sackville AJA has observed, by the reference subsequently to *NIML Ltd v Man Financial Australia Ltd* [2004] VSC 449; 1 BFRA 204. I agree with what his Honour has said in that regard. Nor was the High Court denying the essential disorderliness of the Australian legal system, in which overlapping causes of action are a familiar feature, as has already been noticed. That much is readily seen from the citation with evident approval at [151] of *Farah Constructions* of what Gummow J had earlier written in *Roxborough v Rothmans of Pall Mall Australia Ltd* [2001] HCA 68; 208 CLR 516 at [74]:

> There is support in Australasian legal scholarship for considerable scepticism respecting any all-embracing theory in this field, with the treatment of the disparate as no more than species of the one newly discovered genus.

Third reason: inconsistency with authority and principle

A third way in which Ms Fistar's submission may be seen to be unsound emerges from a consideration of the decisions which, if it were to be accepted, would have been wrongly decided. [Counsel for Ms Fistar] came close to accepting in argument that he had to contend that *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548 was wrongly decided. It is difficult to see how, if Ms Fistar be correct, the innocent recipient Ms Belle could have been found liable in *Heperu* itself, although I did not understand Ms Fistar to seek to overrule *Heperu* in terms, and certainly no application was made for this Court to be constituted by five judges for that purpose.

More generally, acceptance of Ms Fistar's submission would mean that the only civil redress for the victims of theft and fraud against third party recipients was in a court with an equitable jurisdiction. But it is to turn basal notions of the role of equitable principles and remedies on their head to use them to supplant and deny the availability of common law actions and relief. Equity supplements but does not contradict the common law, as Lord Templeman observed in *Rhone v Stephens* [1994] UKHL 3; [1994] 2 AC 310 at 317; see also *Forestview v Perpetual Trustees WA Ltd* [1998] HCA 15; 193 CLR 154 at [15].

Note

Fistar was approved by the Full Federal Court (Jagot, Edelman and Moshinsky JJ) in *Great Investments Ltd v Warner* (2016) 243 FCR 516, where bonds transferred by a director of a company were recovered from the recipients in unjust enrichment on the ground that the director had no authority to transfer the bonds. The Court held that the liability of the recipients was strict and that equitable 'knowing receipt' principles were inapplicable. The Full Court stated at [53]:

> The position would be different if the company sought to recover consequential losses as equitable compensation or, in the alternative, to obtain an account and disgorgement of a recipient's profits. An action for knowing receipt would be needed for those remedies.

See also *Sino Iron Pty Ltd v Worldwide Wagering Pty Ltd* (2017) 52 VR 664, [274]–[294] and *Smith v Leveraged Equities* [2020] WASCA 122 for applications of the *Fistar* principle.

Questions

(1) Why did the club in *Fistar* not claim the house Ms Fistar had bought with its money?

(2) If it was a 'grave error' for the New South Wales Court of Appeal to apply unjust enrichment principles in *Farah Constructions*, why was it acceptable for the New South Wales Court of Appeal to permit recovery in unjust enrichment in *Fistar?* Restitution for unjust enrichment requires proof of a legally recognised 'unjust factor', such as mistake, duress or failure of consideration. What was the 'unjust factor' in *Fistar* and *Great Investments Ltd v Warner*?

(3) Does the dictum of the Full Federal Court in *Great Investments v Warner* (see note above) mean that equitable 'knowing receipt' claims are only relevant where the victim of a breach of fiduciary duty claims consequential losses for breach of duty or disgorgement of the fiduciary's profits from a third party?

11.3 Knowing assistance

Liability will be imposed for knowingly assisting the commission of a breach of fiduciary duty if the following criteria are met.

11.3.1 A dishonest and fraudulent breach of trust

In *Barnes v Addy,* Lord Selborne stated that strangers are accountable if they 'assist with knowledge in a dishonest and fraudulent design on the part of the trustees'. Australian and English authority has diverged on the question of whether the breach of fiduciary duty must be dishonest and fraudulent.

11.3.1a *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378

Background

The plaintiff airline appointed a company, of which the defendant was managing director, as its agent to sell tickets to passengers. The agency agreement provided that the company was to hold the proceeds of sale of airline tickets on trust for the airline until they were paid over to the airline. The defendant arranged for the company to pay the proceeds of sale of airline tickets into its current bank account instead of into a trust account. The arrangement constituted a breach of trust by the company. The money was later applied for the company's own business purposes. The company went into liquidation. The plaintiff claimed that the defendant was accountable as constructive trustee to compensate the plaintiff for the loss of the misapplied proceeds of airline tickets on the basis of having knowingly assisted the company commit a breach of trust.

Decision

The Privy Council held:

(1) For the purpose of imposing liability for 'knowing assistance', the plaintiff was not required to prove that the breach of trust was dishonest and fraudulent.

(2) The defendant was liable because he had dishonestly assisted the company he controlled to commit the breach of trust.

Lord Nicholls

Take the simple example of an honest trustee and a dishonest third party. Take a case where a dishonest solicitor persuades a trustee to apply trust property in a way the trustee honestly believes is permissible but which the solicitor knows full well is a clear breach of trust. The solicitor deliberately conceals this from the trustee. In consequence, the beneficiaries suffer a substantial loss. It cannot be right that in such a case the accessory liability principle would be inapplicable because of the innocence of the trustee. In ordinary parlance, the beneficiaries have been defrauded by the solicitor. If there is to be an accessory principle at all, whereby in appropriate circumstances beneficiaries may have direct recourse against a third party, the principle must surely be applicable in such a case, just as much as in a case where both the trustee and the third party have been dishonest. Indeed, if anything, the case for liability of the dishonest third party seems stronger where the trustee is innocent, because in such a case the third party alone was dishonest and that was the cause of the subsequent misapplication of the trust property.

The position would be the same if, instead of *procuring* the breach, the third party dishonestly *assisted* in the breach. Change the facts slightly. A trustee is proposing to make a payment out of the trust fund to a particular person. He honestly believes he is authorised to do so by the terms of the trust deed. He asks a solicitor to carry through the transaction. The solicitor well knows that the proposed payment would be a plain breach of trust. He also well knows that the trustee mistakenly believes otherwise. Dishonestly he leaves the trustee under his misapprehension and prepares the necessary documentation. Again, if the accessory principle is not to be artificially constricted, it ought to be applicable in such a case.

These examples suggest that what matters is the state of mind of the third party sought to be made liable, not the state of mind of the trustee. The trustee will be liable in any event for the breach of trust, even if he acted innocently, unless excused by an exemption clause in the trust instrument or relieved by the court. But *his* state of mind is essentially irrelevant to the question whether the *third party* should be made liable to the beneficiaries for the breach of trust. If the liability of the third party is fault-based, what matters is the nature of his fault, not that of the trustee. In this regard dishonesty on the part of the third party would seem to be a sufficient basis for his liability, irrespective of the state of mind of the trustee who is in breach of trust. It is difficult to see why, if the third party dishonestly assisted in a breach, there should be a further prerequisite to his liability, namely that the trustee also must have been acting dishonestly. The alternative view would mean that a dishonest third party is liable if the trustee is dishonest, but if the trustee did not act dishonestly that of itself would excuse a dishonest third party from liability. That would make no sense.

This analysis was not, however, accepted by the High Court in *Farah Constructions.*

11.3.1b *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89

Background

See [11.2.2a] for the facts.

Decision

In addition to finding the wife and daughter of the controller of the defendant company not liable for having knowingly received property in breach of fiduciary duty, the High Court held that they were not liable for having knowingly assisted the commission of a breach of fiduciary duty. In reaching this conclusion, the High Court restated the requirement that the breach of fiduciary duty must be dishonest and fraudulent.

The Court

What then of the phrase 'dishonest and fraudulent design'? Since the widening of the second limb of *Barnes v Addy* beyond breaches of express trust, attempts commonly are made in corporate insolvencies to render liable on this footing directors, advisers and bankers of the insolvent company. This makes a proper understanding of the second limb important, lest its application prove unjust. As Lord Selborne said in *Barnes v Addy* (1874) LR 9 Ch App 244, 251:

> There would be no better mode of undermining the sound doctrines of equity than to make unreasonable and inequitable applications of them.

The relevant passages in *Consul* establish for Australia that 'dishonest and fraudulent designs' can include not only breaches of trust but also breaches of fiduciary duty; but any breach of trust or breach of fiduciary relied on must be dishonest and fraudulent.

The reformulation proposed by the respondent, with its abandonment of the 'fraudulent and dishonest design' integer and its stiffening of the notice requirements in a way adverse to the plaintiffs, should not be adopted. No sufficient difficulty in the current rules has been demonstrated to justify the taking of any such step. In any event, Mrs Elias and her daughters would not be liable even under the reformulated test. They did not participate 'in a significant way' in Farah's breach and they had no 'actual knowledge of the essential facts which constituted the breach'.

Say-Dee relied upon the statement of Gibbs J in *Consul* (1975) 132 CLR 373, 397:

> [A] person who knowingly participates in a breach of fiduciary duty is liable to account to the person to whom the duty was owed for any benefit he has received as a result of such participation.

His Honour also said that the words 'dishonest and fraudulent' included 'a breach of trust or of fiduciary duty' (at 398). However, Gibbs J did not categorise all breaches of trust or fiduciary duty as 'dishonest and fraudulent' because he said that the expression was to be understood by reference to equitable principles (at 398).

Say-Dee relied on the former passage and on passages in the judgment of Stephen J (at 408, 412) to support the submission that in Australian law the 'dishonest and fraudulent design' requirement had been superseded and that it was sufficient to plead and prove any knowing participation in a breach of trust or fiduciary duty, save for 'a *de minimis* breach'. However, Say-Dee accepted that this qualification had not been stated in *Consul.*

In its final form, the submission put by Say-Dee was that a defendant who had not received a direct financial benefit 'but who has participated in a significant way in a significant breach of duty/ trust with actual knowledge of the essential facts which constituted

the breach should be liable to the beneficiary of the duty/trust for the consequence of the breach'. This submission should be rejected.

Breaches of trust and breaches of fiduciary duty vary greatly in their seriousness. Some breaches are well intentioned, some are trivial. In *Maguire v Makaronis* (1997) 188 CLR 449 this Court observed at 473–474:

> The stringency apparent in some of the nineteenth century breach of trust cases displayed what Lord Lindley MR called 'a very hard state of the law, and one which shocked one's sense of humanity and of fairness'. The result was what his Lordship called the deliberate relaxation of the law by s 3 of the *Judicial Trustees Act 1896* (UK). This conferred a power of curial relief in respect of breach of trust where the trustee had acted 'honestly and reasonably' and 'ought fairly to be excused'. There is no such general power of dispensation in respect of loss caused by breach of duty owed by other fiduciaries.

However, some breaches of fiduciary duty by company officers, employees, auditors, experts, receivers, and receivers and managers and liquidators may be excused on similar grounds (*Corporations Act 2001* (Cth) s 1318).

Note

In *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*, the High Court did not define 'dishonest and fraudulent' breach of fiduciary duty and there has been some disagreement on the meaning of the term. In *Hasler v Singtel Optus Pty Ltd* (2014) 87 NSWLR 609, Leeming JA stated at [124], with the concurrence of the other members of the Court of Appeal, that '[d]ishonesty amounts to a transgression of ordinary standards of honest behaviour'. This definition was accepted and applied by Gageler J in *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd* [2018] HCA 43; (2018) 265 CLR 1, [71].

Questions

(1) What reasons does Lord Nicholls give in *Royal Brunei Airlines v Tan* for rejecting the 'dishonest and fraudulent design' requirement? What reasons does the High Court give in *Farah Constructions v Say-Dee* for retaining it? Which judgment, in your opinion, is the more convincing?

(2) Why does the 'dishonest and fraudulent design' requirement not apply to liability for 'knowing receipt'?

11.3.2 Assistance in the breach

In the extract from *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* set out at [11.3.1b], the High Court states that the accessory must participate 'in a significant way' in the commission of a breach of fiduciary duty. Mr Elias' wife and daughters in that case had not participated significantly in Mr Elias' assumed breach of fiduciary duty. In *Re-Engine Pty Ltd (in liq) v Fergusson* (2007) 209 FLR 1, Dodds-Streeton J stated at [120] that the assistance should 'forward or advance the primary breach or misconduct in some way. Mere passive acquiescence in the breach would not, in the ordinary case, suffice to establish liability on the ground of assistance'. Omissions, if not amounting to passive acquiescence, can nonetheless constitute assistance. See also *Harstedt v Tomanek* (2018) 55 VR 158, [116]–[118] for a discussion of different types of assistance.

Question for consideration

Can a third party be held liable if the breach of fiduciary duty would have occurred even if he had not assisted the breach?

11.3.3 Knowledge

11.3.3a *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378

Background

See [11.3.1a] for the facts.

Decision

The Privy Council held that liability for assisting the breach of a fiduciary duty requires proof that the assister acted dishonestly. The meaning of dishonesty in this context was explained by Lord Nicholls in the following extract.

Lord Nicholls

Given, then, that in some circumstances a third party may be liable directly to a beneficiary, but given also that the liability is not so strict that there would be liability even when the third party was wholly unaware of the existence of the trust, the next step is to seek to identify the touchstone of liability. By common accord dishonesty fulfils this role. Whether, in addition, negligence will suffice is an issue on which there has been a well-known difference of judicial opinion. The *Selangor* decision [1968] 1 WLR 1555 in 1968 was the first modern decision on this point. Ungoed-Thomas J, at p 1590, held that the touchstone was whether the third party had knowledge of circumstances which would indicate to 'an honest, reasonable man' that the breach in question was being committed or would put him on inquiry. Brightman J reached the same conclusion in *Karak Rubber Co Ltd v Burden (No 2)* [1972] 1 WLR 602. So did Peter Gibson J in 1983 in *Baden v Société Générale pour Favouriser le Développment du Commerce et de l'Industrie en France SA* [1993] 1 WLR 509. In that case the judge accepted a five-point scale of knowledge which had been formulated by counsel. …

Dishonesty

Before considering this issue further it will be helpful to define the terms being used by looking more closely at what dishonesty means in this context. Whatever may be the position in some criminal or other contexts (see, for instance, *R v Ghosh* [1982] QB 1053), in the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard. At first sight this may seem surprising. Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonesty are mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour.

In most situations there is little difficulty in identifying how an honest person would behave. Honest people do not intentionally deceive others to their detriment. Honest people do not knowingly take others' property. Unless there is a very good and compelling reason, an honest person does not participate in a transaction if he knows it involves a misapplication of trust assets to the detriment of the beneficiaries. Nor does an honest person in such a case deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless.

Note

Since the Privy Council decision in *Royal Brunei Airlines v Tan,* English decisions have renamed the second limb 'dishonest assistance'. Lord Nicholls' judgment substituted a dishonesty requirement for the knowledge test applied in *Barnes v Addy.* The High Court in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* confirmed, however, that, at least for the time being, liability depends on proof of knowledge.

11.3.3b *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89

Background

See [11.2.2a] for the facts.

Decision

The High Court held, assuming that Elias had committed a breach of fiduciary duty, that his wife and daughters, who had taken title to properties in consequence of the assumed breach, had not knowingly assisted the breach.

The Court

In this Court, Say-Dee proposed various paths to relief other than those discussed by the Court of Appeal. The first of these was what has become known as the second limb of *Barnes v Addy.*

As conventionally understood in Australia, the second limb makes a defendant liable if that defendant assists a trustee or fiduciary with knowledge of a dishonest and fraudulent design on the part of the trustee or fiduciary.

Several points of a general nature should be made here. The first concerns the scope of the second limb. This was not expressed by Lord Selborne LC as an exhaustive statement of the circumstances in which a third party who has not received trust property and who has not acted as a trustee *de son tort* nevertheless may be accountable as a constructive trustee. Before *Barnes v Addy,* there was a line of cases in which it was accepted that a third party might be treated as a participant in a breach of trust where the third party had knowingly induced or immediately procured breaches of duty by a trustee where the trustee had acted with no improper purpose; these were not cases of a third party assisting the trustee in any dishonest and fraudulent design on the part of the trustee.

Secondly, the distinction has been recognised in the Australian case law but, on one reading of *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, may have been displaced by the Privy Council in favour of a general principle of 'accessory liability' expressed as follows:

> A liability in equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation. It is not necessary that, in addition, the trustee or fiduciary was acting dishonestly, although this will usually be so where the third party who is assisting him is acting dishonestly. 'Knowingly' is better avoided as a defining ingredient of the principle.

Thirdly, whilst the different formulations of principle may lead to the same result in particular circumstances, there is a difference between rendering liable a defendant participating with knowledge in a dishonest and fraudulent design, and rendering liable a defendant who dishonestly procures or assists in a breach of trust or fiduciary obligation where the trustee or fiduciary need not have engaged in a dishonest or fraudulent design. The decision in *Royal Brunei* has been referred to in this Court several times but not in terms foreclosing further consideration of the subject in this Court, in particular, further consideration of the apparent necessity to displace the acceptance in *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373 of the formulation of the second limb of *Barnes v Addy* were *Royal Brunei* to be adopted in this country. Until such an occasion arises in this Court, Australian courts should continue to observe the distinction mentioned above and, in particular, apply the formulation in the second limb of *Barnes v Addy.*

On the present appeal, specific reliance was not placed by Say-Dee upon *Royal Brunei,* although there was a suggestion, not soundly based, discounting any difference between what might be called the traditional approach and that adopted in *Royal Brunei.*

The changes to the law in Australia which were sought by Say-Dee did not include any adoption of a cause of action of the kind expressed in the passage in *Royal Brunei* set out above. Accordingly, it is unnecessary to decide now how far *Royal Brunei,* and subsequent decisions in the House of Lords and Privy Council, have modified the second limb of *Barnes v Addy* or, rather, restated the form of liability operating antecedently to and independently of *Barnes v Addy,* and if so, whether these changes should be adopted in Australia. ...

What is required by the requirement of 'knowledge' expressed in the second limb? In the passage in which Lord Selborne formulated the second limb in terms of assisting with knowledge in a dishonest and fraudulent design on the part of the trustees, he contrasted those 'actually participating in any fraudulent conduct of the trustee' and those 'dealing honestly as agents'.

As a matter of ordinary understanding, and as reflected in the criminal law in Australia, a person may have acted dishonestly, judged by the standards of ordinary, decent people, without appreciating that the act in question was dishonest by those standards. Further, as early as 1801, Sir William Grant MR stigmatised those who 'shut their eyes' against the receipt of unwelcome information.

Against this background, it has been customary to analyse the requirement of knowledge in the second limb of *Barnes v Addy* by reference to the five categories agreed between counsel in *Baden v Société Générale pour Favoriser le Dévelopment du Commerce et de l'Industrie en France SA* [1993] 1 WLR 509 at 575–576, 582:

> (i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which would put an honest and reasonable man on inquiry.

In *Bank of Credit and Commerce International (Overseas) Ltd v Akindele (BCCI)* [2001] Ch 437 at 454, Nourse LJ observed that the first three categories have generally been taken to involve 'actual knowledge', as understood both at common law and in equity, and the last two as instances of 'constructive knowledge' as developed in equity, particularly in disputes respecting old system conveyancing. After noting that in *Royal Brunei* the Privy Council had discounted the utility of the *Baden* categorisation, Nourse LJ in *BCCI* went on to express his own view that the categorisation was often helpful in identifying the different states of knowledge for the purposes of a knowing assistance case.

Although *Baden* post-dated the decision in *Consul*, the five categories found in *Baden* assist in an analysis of that for which *Consul* provides authoritative guidance on the question of knowledge for the second limb of *Barnes v Addy.*

Note

The dishonesty test approved in *Royal Brunei Airlines v Tan* has not proved easy to apply. See *Twinsectra Ltd v Yardley* [2002] 2 AC 164; *Barlow Clowes International Ltd v Eurotrust International Ltd* [2006] 1 All ER 333. A majority of the House of Lords in *Twinsectra* held that the test, although objective, has a subjective component insofar as the defendant will only be dishonest if he realised that his conduct would be regarded as dishonest by the standards of reasonable and honest people. But in *Barlow Clowes,* Lord Hoffmann restated the test in wholly objective terms, although he considered that the objective test was not inconsistent with the hybrid test applied in *Twinsectra.*

Questions

(1) Is the dishonesty test laid down by Lord Nicholls in *Royal Brunei Airlines v Tan* in substance the same as the knowledge test laid down by the High Court in *Farah Constructions?*

(2) Did the High Court in *Farah Constructions* reject the dishonesty test, or did it decline to consider whether to replace the previously accepted definition of knowledge?

(3) Why should someone who has assisted the commission of a breach of fiduciary duty escape liability if she knew facts which would put an honest and reasonable person on inquiry into whether the breach had occurred?

(4) S has settled $2 million on T, to be held on trust for S's children. The money is held in a trust account at XYZ Bank. The terms of the trust instrument provide that the money must not be released without the written consent of L, S's lawyer, and B, S's brother, who has never been shown the trust instrument and does not know its terms. T decides to apply some of the trust money to assist D, S's cousin, who is not one of the beneficiaries. T knows that assisting D out of the trust fund is a breach of trust, but he wants to do a favour for D, who has worked as an unpaid intern in T's office. L and B give the written consent required to release the trust money to D from the XYZ Bank. Consider the liability of L, B and the XYZ Bank for dishonestly or knowingly assisting T to commit a breach of trust.

11.3.4 Remedies for knowing assistance

Constructive trusteeship imposed for 'knowing assistance' is personal. It is possibly the only application of constructive trusteeship recognised by Australian law which never entitles a successful claimant to an interest in property (but see P Ridge, 'Constructive Trusts, Accessorial Liability and Judicial Discretion' in E Bant and M Bryan (eds), *Principles of Proprietary Remedies* (Thomson Reuters, 2013) 73, 88–94, arguing that proprietary relief may occasionally be relevant).

The assistant will be liable to pay equitable compensation for loss caused to the trust or to the principal by the breach which he has assisted. Compound interest may be payable: *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1. Where the assistant has, independently of the fiduciary, made a profit from his participation from the breach, an account of profits will be ordered: *Michael Wilson & Partners Ltd v Nicholls* (2011) 244 CLR 427, 457 [106]; *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296, 404 [510]. The following extract discusses both when an assistant will be liable to account for a profit and how the profit will be quantified.

11.3.4a *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society Ltd* [2018] HCA 43; (2018) 265 CLR 1

Background

See [4.2b].

Decision

The High Court, Nettle J dissenting, ordered Foresters to account for the full value of the business connections obtained when it knowingly assisted former employees of Lifeplan and Funeral Plan Management Pty Ltd (FPM) to break their fiduciary obligations to Lifeplan.

Kiefel CJ, Keane and Edelman JJ

Foresters submitted that its liability to account and disgorge should be confined to those profits that are the direct result of each of the particular acts by which it committed the equitable wrong of knowingly assisting [the fiduciaries] Woff and Corby in a dishonest and fraudulent design to breach their fiduciary obligations to Lifeplan and FPM. By focusing on each act of knowing assistance and its direct consequences, rather than the overall effect of Foresters' wrongful conduct, the submission ignores the obvious reality that Foresters' particular interactions with Woff and Corby resulted, as they were always apt to do, in the wholesale acquisition by Foresters of the business connections that Lifeplan and FPM had with funeral directors, these connections being, as Foresters well knew, essential to Lifeplan and FPM's funeral fund business.

Another way of putting this point is to say that Foresters could not limit its liability to disgorge profits by claiming that only limited profits were caused by particular acts of knowing assistance when the consequences of those acts were inseparable from the consequences of Woff and Corby's general scheme of breach of fiduciary duty.

In *Consul Development Pty Ltd v DPC Estates Pty Ltd* [1975] HCA 8; (1975) 132 CLR 113 at 118–119, in a passage accepted as authoritative by both sides in the present case, Gibbs J said that:

> a person who knowingly participates in a breach of fiduciary duty is liable to account to the person to whom the duty was owed for any benefit he has received as a result of such participation.

So described, the liability to account and to disgorge benefits encompasses 'any benefit' received by the knowing participant in a breach of fiduciary duty 'as a result of' that participation. The benefit of a business connection is such a benefit. Foresters' submission fails to come to grips at all with the fact that the benefit that Foresters stood to gain, and in fact acquired, from its participation in the various acts of disloyalty by Woff and Corby was not sporadic deposits from retail customers; it was the business connections of Lifeplan and FPM.

In addition, Foresters' submission, by framing the issue as involving an enquiry as to whether there was a causal connection between each of the particular acts of Foresters, whereby it participated in the strategy formulated by Woff and Corby, and particular deposits associated with its new business, diverts attention away from the significance of the circumstance that Foresters' acts of participation in the disloyalty of Woff and Corby were not only informed by, but were also an integral part of, the strategy for despoiling the business of Lifeplan and FPM.

Whether a benefit can be said to be obtained 'as a result of' knowing participation in a breach of fiduciary duty by another contrary to the principles of equity is a question of causation or contribution that depends on 'a precise examination of the particular facts' of the case, rather than upon attempts to refine the expression 'as a result of', as if that phrase has some determinate operation of its own that may be discerned and applied independently of the equitable principle of which it is part. The equitable disgorgement principle with which we are concerned is a 'prophylactic rather than a restitutionary principle'. It is sufficient to show that the profit would not have been made but for dishonest wrongdoing. Further, whatever may be the position for wrongdoing that is not marked by dishonesty, a defendant cannot avoid liability to disgorge profits dishonestly made by showing that those profits might have been made honestly. This is not an approach to causation that is unique to dishonesty in equity. A defendant who is liable to compensate for deceit cannot avoid that liability by showing that the loss would have been suffered even without the deceit; and it is sufficient that the deceit was an inducement to engage in the conduct that occasioned the loss even if there were other inducements. And in taking an account of profits for dishonest infringement of intellectual property rights, courts do not reduce the profit by reference to opportunity cost, that is, the revenue that would have been received by a lawful alternative. As Lord Radcliffe said in the context of disgorgement of profits for a breach of fiduciary duty involving non-disclosure, 'it is neither here nor there to speculate whether, if he had done his duty, he would not have been left in possession of the same amount of profit' *(Gray v New Augarita Porcupine Mines Ltd* [1952] 3 DLR 1 at 15).

Foresters' submission also ignores the obvious reality that Foresters' participation was not merely that of a passive recipient of the benefits of the success of the Woff and Corby strategy. Foresters provided the commercial vehicle which would acquire and exploit the business connections to be appropriated from Lifeplan and FPM. That vehicle was necessary to enable Woff and Corby to implement the strategy of despoliation that they had devised. There was no suggestion in the evidence that the strategy could have been implemented by Woff and Corby acting alone or, indeed, with any other competitor in the market.

That Foresters' role was crucial to the implementation by Woff and Corby of the strategy devised by them is confirmed by the urgency and diligence with which Woff and Corby pursued Foresters' participation, and the absence of any suggestion in the evidence that they ever had it in mind to pursue their strategy either by themselves or with some other participant. Given the knowledge and experience of Woff and Corby of this particular market, there is no reason to suppose that their appreciation of the central impor-

tance of the participation of Foresters to the success of their strategy was not soundly based. And there is no reason apparent from the evidence to decline to attribute the same level of understanding to Foresters.

As a matter of fact, the strategy proposed by Woff and Corby to acquire the valuable business connections of Lifeplan and FPM with funeral directors succeeded, and could only have succeeded, by reason of the knowing participation of Foresters. Accordingly, the quantification of the benefit to be disgorged by Foresters requires an assessment of the attributable value of the business connections acquired by Foresters as a result of its participation in the disloyalty of Woff and Corby.

Gageler J

A causal connection between a fiduciary's breach of fiduciary obligation and a benefit or gain sufficient for the fiduciary or knowing participant to be liable to the equitable remedy of account will exist if the benefit or gain to the fiduciary or knowing participant would not have been obtained 'but for' the breach, in the same way as a causal connection sufficient for the fiduciary to be liable to the equitable remedy of compensation will exist if a loss to the person to whom the fiduciary obligation is owed would not have been sustained but for the breach *(Re Dawson (dec'd)* [1966] NSWR 211 at 214–216). Because the concern of equity is to vindicate the equitable obligation that has been breached, the 'but for' connection will be sufficient even though other contributing causes might be in play. That the fiduciary's breach of fiduciary obligation is dishonest and fraudulent is also good reason for treating a sufficient causal connection as existing if the dishonest and fraudulent breach can be concluded to have played a material part in contributing to the benefit or gain of the fiduciary or knowing participant even in circumstances where it cannot be concluded that the benefit or gain would not have been obtained but for the breach.

Obviously enough, as with any other question of causation in equity, the causal connection between a fiduciary's breach of fiduciary obligation and a benefit or gain must be judged using common sense and 'with the full benefit of hindsight' (cf *Canson Enterprises Ltd v Boughton & Co* [1991] 3 SCR 534 at 556). And as with other questions of causation in equity, the inquiry into causation is not to be constrained by normative limitations imported from the common law. To introduce those limitations would risk confusing distinct legal policies underlying distinct bases of legal liability and limiting equity's capacity to mould equitable relief to the circumstances of the individual case. …

… [W]hat Foresters obtained by reason of the breaches of fiduciary duty by Mr Woff and Mr Corby in which Foresters knowingly participated was a business. Foresters obtained that business to the cost of the business which Lifeplan operated through FPM. Foresters' business can be, and has been, appropriately valued in a manner which duly allows for all of Foresters' expenses and for all of Foresters' ongoing business risks. Foresters has failed to establish any reason for considering that an order that it account for the entirety of the business as so valued is inequitable.

[Nettle J dissented on the ground that the Full Federal Court had not erred in holding that the account of profits should be limited to the profits made during a five-year period covered by a business plan prepared by the fiduciaries and adopted by Foresters.]

Questions

(1) In what respects, if any, does the reasoning of Kiefel CJ, Keane and Edelman JJ differ from Gageler J's reasoning?

(2) Why are participants in a breach of fiduciary duty, such as Foresters, held liable as 'constructive trustees'? Does the terminology of constructive trusteeship serve any purpose?

11.3.5 Other forms of participatory liability

See textbook at [11.23]–[11.25] for a discussion of other claims against third parties arising out of breaches of fiduciary duty. In *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89, the High Court noted at [161] that other forms of participatory liability were recognised in equity before *Barnes v Addy*, including liability for knowingly inducing or procuring a breach of trust: see extract at [11.3.3b] above. These forms do not require proof that the breach was dishonest and fraudulent. They have been discussed in later deci-

sions: *Marriner v Australian Super Developments Pty Ltd* (2012) 46 VR 213; *Metropolitan Petar v Mitreski* [2012] NSWSC 1610 (Brereton J), reversed on the facts: [2013] NSWCA 223; *Pittmore Pty Ltd v Chan* (2020) 104 NSWLR 62.

12

Breach of confidence

12.1 Introduction

12.2 The elements of the cause of action

12.3 Defences

12.4 Remedies

12.1 Introduction

Equity has always protected certain information from unauthorised misuse. In *Coco v AN Clark (Engineers) Ltd* (1968) 1A IPR 587, Megarry J dated this jurisdiction to before 1535, saying: 'The equitable jurisdiction in cases of breach of confidence is ancient; confidence is the cousin of trust'. However, equity's protection is not unlimited.

Four elements must be satisfied in order for an equitable obligation of confidence to arise:

(1) The information must be specifically identified.

(2) It must have the necessary quality of confidence.

(3) It must have been received by the defendant in circumstances that import an obligation of confidence.

(4) There must be an actual or threatened misuse of the information, contrary to the plaintiff's wishes.

Any kind of information may be protected by the equitable obligation of confidence, such as trade secrets or commercially valuable information that cannot otherwise be protected by patent, trademark or copyright law. It can also be used to protect personal information. Confidential information can take virtually any form, such as oral confidences, drawings, written documents, photographs, works of art, electronic documents and recordings, and physical items such as prototype inventions.

Questions for consideration

(1) Must the information claimed to be confidential be secret?

(2) What interests is equity seeking to protect by imposing obligations of confidence?

12.2 The elements of the cause of action

Background

Coco designed a moped engine, and negotiated with the defendants for its manufacture. Designs were disclosed during negotiations. After negotiations broke down, the defendants started production of a moped that Coco claimed was based on his design. He sought an injunction preventing manufacture.

Decision

While Coco was able to establish that the circumstances under which the defendant received the information imposed an obligation of confidence, he was unable to show that the information imparted was confidential in nature, or that unauthorised use was made of his information, as opposed to information readily available from public sources.

Megarry J

In the case before me, it is common ground that there is no question of any breach of contract, for no contract ever came into existence. Accordingly, what I have to consider is the pure equitable obligation of confidence, unaffected by contract. Furthermore, I am here in the realms of commerce, and there is no question of any marital relationship such as arose in *Duchess of Argyll v Duke of Argyll* [1967] Ch 302. Thus limited, what are the essentials of the doctrine?

… I think it is quite plain … that the obligation of confidence may exist where … there is no contractual relationship between the parties. In cases of contract, the primary question is no doubt that of construing the contract and any terms implied in it. Where there is no contract, however, the question must be one of what it is that suffices to bring the obligation into being; and there is the further question of what amounts to a breach of that obligation.

In my judgment, three elements are normally required if, apart from contract, a case of breach of confidence is to succeed. First, the information itself … must 'have the necessary quality of confidence about it'. Secondly, that information must have been imparted in circumstances importing an obligation of confidence. Thirdly, there must be an unauthorised use of that information to the detriment of the party communicating it. I must briefly examine each of these requirements in turn.

First, the information must be of a confidential nature. As Lord Greene said in the *Saltman* case, 'something which is public property and public knowledge' cannot per se provide any foundation for proceedings for breach of confidence. However confidential the circumstances of communication, there can be no breach of confidence in revealing to others something which is already common knowledge. But this must not be taken too far. Something that has been constructed solely from materials in the public domain may possess the necessary quality of confidentiality: for something new and confidential may have been brought into being by the application of skill and ingenuity of the human brain. Novelty depends on the thing itself, and not upon the quality of its constituent parts. …

The difficulty comes, as Lord Denning MR pointed out in the *Seager* case, when the information used is partly public and partly private; for then the recipient must somehow segregate the two and, although free to use the former, must take no advantage of the communication of the latter. …

The second requirement is that the information must have been communicated in circumstances importing an obligation of confidence. However secret and confidential the information, there can be no binding obligation of confidence if that information is blurted out in public or is communicated in other circumstances which negative any duty of holding it confidential. … It seems to me that if the circumstances are such that any reasonable man standing in the shoes of the recipient of the information would have realised that upon reasonable grounds the information was being given to him in confidence, then this should suffice to impose upon him the equitable obligation of confidence. In particular, where information of commercial or industrial value is given on a business-like basis and with some avowed common object in mind, such as a joint venture or the manufacture of articles by one party for another, I would regard the recipient as carrying a heavy burden if he seeks to repel a contention that he was bound by an obligation of confidence: … On that footing, for reasons that will appear, I do not think I need explore this head further. I merely add that I doubt whether equity would intervene unless the circumstances are of sufficient gravity; equity ought not to be invoked merely to protect trivial tittle-tattle, however confidential.

Thirdly, there must be an unauthorised use of the information to the detriment of the person communicating it. Some of the statements of principle in the cases omit any mention of detriment; others include it. At first sight, it seems that detriment ought to be present if equity is to be induced to intervene; but I can conceive of cases where a plaintiff might have substantial motives for seeking the aid of equity and yet suffer nothing which could fairly be called detriment to him, as when the confidential information shows him in a favourable light but gravely injures some relation or friend of his whom he wishes to protect. The point does not arise for decision in this case, for detriment to [Coco] plainly exists.

Notes

(1) For a modern statement of the elements of breach of confidence, see *Optus Networks Pty Ltd v Telstra Corporation Ltd* (2010) 265 ALR 281, [39].

(2) Obligations of confidence can arise other than in equity. Confidentiality may be imposed by other regimes, such as contract law and statute.

Questions

(1) Does Megarry J suggest that the equitable obligation of confidence is of most assistance to claimants where there is no other source of obligation?

(2) How do courts deal with cases where contractual and equitable obligations of confidence arise? See *Mid-City Skin Cancer & Laser Centre v Zahedi-Anarak* (2006) 67 NSWLR 569; *Crown Resorts Ltd v Zantran Pty* (2020) 276 FCR 477.

(3) What are the similarities and differences between the obligation of confidence and fiduciary obligations? See D Klinck, 'Things of Confidence: Loyalty, Secrecy and Fiduciary Obligation' (1990) 54(1) *Saskatchewan Law Review* 73.

12.2.1 Specifying the confidential material

The plaintiff must specify the information it claims is confidential in pleadings, so that the defendant can defend the action by demonstrating its lack of confidentiality, and so that the court can make appropriate remedial orders.

12.2.1a *O'Brien v Komesaroff* [1982] HCA 33; (1982) 150 CLR 310

Background

Mr Komesaroff was a solicitor whose practice included creating and implementing tax minimisation schemes. Mr O'Brien was an accountant. He believed Mr Komesaroff's schemes could be useful to his own clients. He obtained a set of the necessary documents from Mr Komesaroff, and prepared unit trust deeds for his clients based on the Mr Komesaroff documents. Mr Komesaroff alleged breach of copyright and breach of confidence.

Decision

The High Court held that Mr Komesaroff's claim of breach of confidence failed because he was unable to specify information that was confidential in nature in his pleadings.

Mason J

The case for breach of confidence … has two aspects. The first aspect relates to the use by the appellants … of the concepts expressed in the unit trust deeds … in relation to which, the respondent claimed, an obligation of confidence arose. The second aspect of the claim concerns the 'overseas trust concept'. … A theoretical scheme only was outlined to the appellant by the respondent. Approximately nine months later, after consultations with and advice from counsel and overseas journeys … a viable scheme was devised. As with the first aspect of the claim, the respondent claimed that the appellants breached a duty of confidence which arose in relation to the information.

In relation to the unit trust deeds, the primary judge was not satisfied that any information of a confidential nature was imparted to the appellant by the respondent. His Honour held that there was much that was public property and common knowledge in the deeds and that, although the respondent's skill and ingenuity went into producing them, the deeds ought not to be regarded as containing confidential information capable of founding an action for breach of confidence. …

… The Full Court dismissed an appeal by the respondent, holding that 'a vital question at the root of the case, namely, what was the information which was the subject of the alleged wrongful use or communication' was answered neither by the respondent's pleadings nor by his submissions.

The Full Court stated further that: 'Mr Komesaroff was repeatedly asked by all members of the Bench, what was the intelligence that was "entrusted and communicated to the defendants and each of them in confidence", and we obtained no answer less vague than that provided by the pleadings themselves.'

The Full Court held that [the unit trust deed], when read on its own, without the proof of further material facts, none of which were pleaded, was not a sufficiently precise definition of what was the confidential information which was to be the foundation of an action for breach of confidence.

The respondent … was given every opportunity to define more specifically the information upon which he relied. The respondent could do no more than rely on [the unit trust deed]. And, as the Full Court said, there is nothing in [the unit trust deed] per se which gives any indication that it is information of a confidential nature. It is merely a unit trust deed. In effect, there was no information of sufficient particularity to enable the Court to embody it in an order.

In this Court the respondent agreed to submit written submissions on the matter, after several requests to carefully define the confidential information upon which he relied. The respondent in his written submissions contends that he communicated to the appellant the effect and practical operation of his unit trust scheme. But this still begs the vital question. What did he communicate?

According to the written submissions now presented to us the confidential information relates to (1) discretionary trusts and private unit trusts; and (2) private unit trusts having an overseas trust in a 'tax haven' country as a beneficiary, being information which was valuable for tax avoidance or tax minimization purposes. The confidential information is then described as comprising information which is embodied: (1) in the unit trust deeds drafted by the respondent …; (2) in the respondent's draft memorandum and articles of association for a proprietary company; (3) in oral communications by the respondent to the appellant in 1973 and 1974 as to the effect and practical operation of discretionary trusts and of the unit trust scheme devised by the respondent; (4) in oral communications by the respondent to the appellant in November 1975 and 1976 … (concerning income distribution); and (5) in oral communications by the respondent to the appellant as to the legal and practical defects and legal inadequacies of a discretionary trust which had been adopted by lawyers and accountants in Australia and the United Kingdom as a means of reducing income tax and estate duty and the manner in which the 'unit trust' overcame these defects and inadequacies.

Plainly enough, in the light of the findings of the primary judge and the evidence, there is very little, if anything, in documents mentioned … above that can constitute confidential information. Generally speaking the contents of the unit trust deed and the articles of association were matters of common knowledge … Only those improvements evolved by the respondent could give rise to a claim for breach of confidence. … It is at this point that the respondent has consistently failed to identify the particular contents of the documents which he asserts constitute information the confidentiality of which he is entitled to protect. The consequence is that he has failed to formulate a basis on which the court could grant him relief on the assumption that some part or parts of the documents constitute confidential information.

12.2.1.1 Quality of confidence

Information must have 'the necessary quality of confidence about it': *Coco v AN Clark (Engineers) Ltd* (1968) 1A IPR 587, 590 (Megarry J). Sometimes, confidentiality is inherent in the relationship between the parties. In *Duchess of Argyll v Duke of Argyll* [1967] Ch 302, it was

held that confidences of a married couple passed within an equitable relationship of confidence. The solicitor and client relationship is also inherently confidential: *Lord Ashburton v Pape* [1913] 2 Ch 469. In other cases, the quality of confidence can be shown by the steps taken by the plaintiff to ensure the information is not used by others: *Attorney-General (UK) v Heinemann Publishers Australia Pty Ltd* (1987) 10 NSWLR 86, 189–90 (McHugh J).

However, information can only be protected while it remains confidential. Information loses its confidentiality when it enters the public domain. This is always a question of degree of publication, as is demonstrated by *Australian Football League v The Age*.

12.2.1.1a *Australian Football League v The Age Co Ltd* (2006) 15 VR 419

Background

Contracts between professional football players and the AFL required players to submit to random drug testing for use of 'recreational' drugs. The main purpose of drug testing was stated to be focused on the education and rehabilitation of drug-using players. The contracts stated that the first two positive drug tests a player returned were to remain confidential between the AFL and the player. A third positive drug test resulted in publication and penalty. Three AFL players returned second positive tests. That information came into the hands of *The Age* newspaper in March 2006. *The Age* and another newspaper proposed publishing the names of the three footballers. The AFL and the AFL Players' Association sought a permanent injunction to prevent publication.

The newspapers conceded that the information was confidential in nature. However, they argued that the information had lost any equitable confidentiality protection it had once held through entering the public domain.

The information had clearly spread past its original holders, through instances of limited publication. Was this publication sufficient to destroy the confidentiality of the information?

Decision

It was held that the information remained confidential, notwithstanding that limited disclosure of the names of the footballers had occurred.

Kellam J

The issue before me is whether the information the subject of confidentiality has received sufficient publicity to effectively destroy the purpose of confidentiality, and thus make it pointless on the part of the court to restrain the further publication of confidential information.

THE SUBMISSION OF THE [NEWSPAPERS] AS TO THE PUBLIC DOMAIN

… [T]he media defendants contend that there is ample evidence of widespread public dissemination of the names of the three AFL players. … It is submitted that the court in such circumstances cannot sensibly restrain the media defendants from publishing what is, it is submitted, known publicly. The defendants submit that even when confidentiality has been destroyed wrongfully, if the information is in the public domain, then the confidentiality does not continue to exist. …

The media defendants submit that if the confidential information has entered the public domain then the information in question has lost any confidential quality it may have had previously. That is plainly so. It would be entirely pointless and indeed, would bring the administration of justice into disrepute, for the court to endeavour to restrain the publication of matters which are well known by a large number of members of the public. I do not understand the [AFL] to argue to the contrary. The real issue between the parties is whether the confidential information had entered the public domain. It is obvious from what I have set out above that the names of three players who have allegedly tested positive to illicit substances are known by a number of people in the community. However, the question of whether or not the information can be said to have passed into the public domain is a question of fact. …

In the *Spycatcher* case *(Attorney-General v Guardian Newspapers Ltd (No 2)* [1990] 1 AC 109 at 282), Lord Goff described the expression 'public domain' as meaning:

> … no more than that the information in question is so generally accessible that, in all the circumstances, it cannot be regarded as confidential.

A number of considerations have been regarded by the courts as being relevant to the question of whether information has entered the public domain. In determining whether the information should be regarded as being confidential, the degree of accessibility has been seen to be an important factor. In *Franchi v Franchi* [1967] RPC 149 at 152–153, Cross J said:

> Clearly a claim that the disclosure of some information would be a breach of confidence is not to be defeated simply by proving that there are other people in the world who know the facts in question besides the man as to whom it is said that his disclosure would be a breach of confidence and those to whom he has disclosed them.

In that case, Cross J was dealing with a trade secret, but he used the following phrase which appears to me to be of general application:

> It must be a question of degree depending on the particular case, but if relative secrecy remains, the plaintiff can still succeed. …

Accordingly, it would appear that, as a general rule, the publication of confidential information in widely-circulating print media would place information in the public domain. However, there are few authorities dealing with the effect of publication of confidential material on the internet. …

THE SUBMISSION OF THE [AFL AND PLAYERS] AS TO THE PUBLIC DOMAIN

However, the plaintiffs submit that there has been no more than limited speculation in the internet exchanges. In some parts they refer to many different players. Other parts acknowledge expressly the rumour-like nature of the postings. The plaintiffs contend that the internet exchanges do not amount to the information being in the 'public domain'. They submit further that the information, even if published in some internet postings, is not common knowledge. It is argued that even if the names are known by some persons, there is nevertheless much to protect, as is clear by the desire of the media to publish the information. The plaintiffs submit that even if any of the published speculation has named one or more players who may have tested positive, whether coincidental or not, such publication has been limited.

They contend, first, that the publication of three names as part of the speculation that occurred when the *Sydney Morning Herald* was distributed electronically to a small number of organisations and then recalled is of no consequence. By itself, I accept that this publication would not be sufficient to say that the confidential information has entered the public domain.

The plaintiffs contend further that the mention of a name on Fox Footy by a caller was momentary, speculative, and heard by a limited audience only. There is no evidence before me as to the size of the audience but by itself, I accept that this incident would not be of such moment that it could be said the information came into the public domain by reason thereof.

As to the dissemination of any confidential material within the AFL, the evidence before me is of limited oral discussion … I do not consider that the evidence in this regard is such as to say the confidential information of the identity of any player who has tested positive … is in the public domain.

CONCLUSION AS TO WHETHER OR NOT THE CONFIDENTIAL INFORMATION IS IN THE PUBLIC DOMAIN ---

In my view, the strongest argument [that the information is in the public domain] relates to the information referred to in the various internet postings, or alternatively, that in conjunction with the above three possible sources of release of confidential information.

The nature of the information appearing on the various internet sites … bears some consideration. An analysis of the exhibits … does show that the websites in question over the period of March and April of 2006 contain a large number of references to the issue of drug-testing by the AFL. However, much of what is placed upon the websites … is speculation. … Other of the exhibits … reveal similar sentiments to the effect that the information is gossip and speculation. On the other hand, there are several positive

assertions as to the identity of the players who tested positive, but by an unnamed person or persons using a pseudonym. The question is whether such internet postings have put the confidential information into the public domain. …

Can it be said … that a 'discussion forum' which enables opinions, gossip, trivia, rumour and speculation to be published as an assertion of fact by anonymous contributors places the information the subject of such discussion into the public domain? There can be little doubt that, as the High Court in *Dow Jones & Co Inc v Gutnick* (2002) 210 CLR 515 at 617–619 observed, the internet throws up many challenges for established principles of common law, but that does not mean it can be a 'law free zone'. The fact is that anyone, be it a disgruntled employee, a journalist, or anyone else interested in propagating what might otherwise be confidential information can put information upon a discussion forum under an assumed name. Indeed the lack of accountability is such that one person can place such information upon a discussion forum, or for that matter on numerous discussion for a, in many different names. If speculation, gossip or even assertion from an anonymous source, thus being incapable of being verified or in any way held accountable, is to be regarded as putting of information in the public domain, then the opportunity for the unethical, and the malicious, to breach confidentiality and then claim there is no confidentiality is unrestrained. For example, an unethical intending publisher could, without having access to confidential information, speculate by use of an assumed name, as to what might be confidential. This speculation could be placed on a number of discussion fora under a number of pseudonyms and asserted to be fact. Could it then be asserted, as here, that the fact that the material has been the subject of assertion in 'chat rooms' means that confidentiality is lost?

In my view, the fact that such speculative gossip, innuendo and assertion by unknown persons has been placed on the websites of various discussion fora does not make confidential information lose its confidential nature. … [I]t is still in the realm of speculation. That is a vastly different proposition from the circumstances of publication of material by a newspaper, television station or other source of dissemination of news and other material such as radio and authorised websites conducted by such sources. Those sources are accountable for the information they publish and are, to an extent at least, trusted by the public to report material to that public accurately. On the evidence before me the public, and particularly that part of the public who use internet chat rooms have no such expectation of authenticity, veracity or otherwise of the information posted on such websites.

Note

The digital age poses problems concerning information entering the public domain. The *availability* of information on the internet may not necessarily indicate its public status, as the above extract shows. The fact that a newspaper wants to publish a 'scoop' may indicate that the digital information has not yet reached a wide audience.

Questions

(1) Kellam J thought that unattributed internet gossip did not destroy the confidentiality of information. Should a plaintiff be able to restrain unattributed gossip where that gossip discloses confidential information? See *AMI Australia Holdings Pty Ltd v Fairfax Media Publications Pty Ltd* [2010] NSWSC 1395.

(2) Is a defendant who releases confidential information able to rely on that disclosure to show that information has lost its confidentiality? See *Speed Seal Productions Ltd v Paddington* [1985] 1 WLR 1327, 1332–3; *British American Tobacco Australia Ltd v Gordon* [2007] NSWSC 292, [11].

12.2.2 Circumstances imposing an obligation of confidence

According to Megarry J in *Coco v AN Clark* ([12.2a] above) at 591, 'if the circumstances are such that any reasonable man standing in the shoes of the recipient of the information would have realised … that the information was being given to him in confidence, this should suffice to impose upon him the equitable obligation of confidence'. In some cases, what a reasonable person would have realised can be a nuanced matter.

Background

Smith Kline and & French Laboratories (SK & F) held the patent for a class of drug, called 'Cimetidine', used to treat stomach ulcers. Prior to distribution in Australia, customs regulations required evaluation of the drug and marketing approval from the Department of Community Services and Health (the Department). In order for this to occur, SK & F delivered to the Department, over an 11-year period, extensive data (the B1 data) concerning the drug, including information concerning its chemistry and quality control. Marketing approval was obtained.

Later, Alphapharm, a marketer of 'generic' pharmaceutical products, applied for marketing approval in respect of a brand of Cimetidine, to be manufactured overseas and assembled in Australia. While the SK & F and Alphapharm products would have been similar, they would not have shared all the same physical characteristics; for example, different production methods could have led to different impurity levels.

The Department's usual action where a 'generic' application had been lodged was to consult any recently completed evaluations on the same drug. SK & F opposed the use of its application and data on the basis that the data had been provided to the Department in confidence.

Decision

It was held that the Department neither knew or ought to have known of the limited purpose of the disclosure.

Gummow J

I have indicated, the position of the applicants in the SK and F proceedings is that the Department should not use or apply their … data … in evaluating the Alphapharm application. They allege that to do so would be in breach of obligations of confidence owed to them in equity by the Department. The applicants seek injunctive and declaratory relief together with an order for delivery up of documents prepared by or for the Department which contain any comparison between [the two products]. …

… Having heard and read all that was said on the subject, I accept the propositions … that it would be bad scientific practice, and could be dangerous, to ignore innovator B1 data when evaluating a generic product which appeared to be identical to or closely related to the innovator product. …

In *Commonwealth v John Fairfax & Sons Ltd* [1980] HCA 44; (1980) 147 CLR 39 at 50, Mason J adopted the statement of principle by Swinfen Eady LJ in *Lord Ashburton v Pape* [1913] 2 Ch 469 at 475, that a court of equity will 'restrain the publication of confidential information improperly or surreptitiously obtained or of information imparted in confidence which ought not to be divulged'. It will be observed that in that formulation, confidential information improperly or surreptitiously obtained, on the one hand, and information imparted in confidence, on the other, are treated as two species of the same genus. This accommodates within the general rubric of the equitable jurisdiction, cases of eavesdropping or theft, for example, *Franklin v Giddins* [1978] Qd R 72. The present case is put as one of the second species, namely information 'imparted in confidence'. …

A general formulation apt for the present case of an equitable obligation of confidence has four elements: (i) the plaintiff must be able to identify with specificity, and not merely in global terms, that which is said to be the information in question, and must be able to show that (ii) the information has the necessary quality of confidence (and is not, for example, common or public knowledge), (iii) the information was received by the defendant in such circumstances as to import an obligation of confidence, and (iv) there is an actual or threatened misuse of that information, without the consent of the plaintiff. … In addition, it has been suggested that the breach must inflict or be likely to inflict 'detriment', a matter to which I will return later in these reasons. As I have indicated, I am satisfied that the applicants … have made out their case as to elements (i) and (ii). The central issue concerns element (iii). If the applicants succeed also as to element (iii), then what the Secretary on his own case wishes to be at liberty to do would amount to a sufficient threat for element (iv).

The central issue is whether the Secretary and those involved in evaluating the Alphapharm application … are bound by an obligation of confidence owed to the applicants … not to use for the purposes of the evaluation of the Alphapharm application … the B1 data disclosed on various occasions since 17 June 1975 …

… The applicants plead … that the B1 data was provided to the Department for the sole purpose of enabling consideration and decision upon applications made by SK and F for permission … to market [its] products. The content of the alleged obligation of confidence is said to be not to use the information other than for that sole purpose. It is alleged that the Department 'well knew' of that limited purpose. Alternatively, it is submitted that the Department 'ought to have known' of it.

… The conclusion I have reached is that the Department did not know that the B1 data was furnished for a purpose which excluded the use to which the Secretary now seeks to have it put in evaluating the Alphapharm application. After dealing with further factual maters … it will be necessary to determine whether the Department nevertheless ought to have had that knowledge. …

The position is if officers of SK and F had turned their minds to the question over this period from 1975, they would have said that they regarded the … information as 'confidential' in the sense that it was not to be disclosed to competitors or potential competitors without the prior permission of SK and F. But no one … focused attention on the question of use by the Department of B1 data in the manner which is the subject of this case. …

The Secretary submits, in my view correctly, that the circumstance that the person who imparted the information in question intended to do so for a limited purpose, will not necessarily of itself be sufficient to bind the conscience of the party to whom the information was imparted. The Secretary submits that the conscience of the other party will be bound if, by the combined effect of the confidential nature of the relevant information and the circumstances in which it was communicated, there appears an equity which answers the description of an obligation of confidence …

No doubt it is not necessary that the defendant have known of the limited purpose of the disclosure to him. However, where the defendant neither knew nor ought to have known of the alleged limited purpose of the disclosure, it is difficult to see on what footing equity should intervene to bind his conscience. …

The conclusion I have reached makes it unnecessary to decide whether the applicants … would have failed in any event because they had not established that they would suffer detriment from the apprehended breach of confidence. But if it had been necessary to rely upon them, my conclusion would have been as follows …

… I share the view of this learned author, and of Professor Birks in his note 'A Lifelong Obligation of Confidence' (1989) 105 LQR 501, that equity intervenes to uphold an obligation and not necessarily to prevent or to recover loss; see also Gurry, *Breach of Confidence,* 1984, pp 407–408 … The basis of the equitable jurisdiction to protect obligations of confidence lies, as the present case illustrates, in an obligation of conscience arising from the circumstances in or through which the information, the subject of the obligation, was communicated or obtained: *Moorgate Tobacco Co Limited v Philip Morris Limited (No 2)* [(1984) 156 CLR 414] at 438. The obligation of confidence is to respect the confidence, not merely to refrain from causing detriment to the plaintiff. …

In any event, I would have accepted as sufficient 'detriment' the apprehended prejudice to SK and F from the presence on the market of a rival (and cheaper) cimetidene product …

Note

The 'reasonable man' (as referred to by Megarry J in *Coco v AN Clark (Engineers) Ltd* (1968) 1A IPR 587, 591, above at 12.2.2) is more frequently seen in tort than in equity. One commentator has noted that while there is no difficulty imposing an obligation of confidence on complete strangers, it then becomes impossible to use trust-based rhetoric and reasoning. See J Morgan, 'Privacy, Confidence and Horizontal Effect: "Hello" Trouble' [2003] 62(2) *Cambridge Law Journal* 444, 456.

Questions

(1) How relevant was the fact that evaluation of the rival product in the above case was a matter that would impact on public health? Would an explicit claim of disclosure for the limited purpose claimed have made a difference?

(2) Does Gummow J suggest that obtaining information surreptitiously always results in the defendant being subject to an obligation to keep the information confidential?

12.2.3 Unauthorised use

Use or threatened use of confidential information against the plaintiff's wishes must also be shown. Any unauthorised use is potentially a breach. This element is not usually controversial. 'Use' is a wide concept. It may be as simple as threatened publication, as in *Australian Football League v The Age Co Ltd* (2006) 15 VR 419, or a commercial exploitation of the information, as in *Coco v AN Clark (Engineers) Ltd* (1968) 1A IPR 587. Alternatively, the misuse can be more complex, as in the use proposed in *Smith Kline & French Laboratories (Australia) Ltd v Secretary, Department of Community Services and Health* [1990] FCA 206; (1990) 22 FCR 73 which involved use of the information for comparative purposes.

It is not necessary for the plaintiff to show that she will suffer detriment from misuse of the confidential information because the equitable obligation of confidence protects against unauthorised use of information, rather than against loss, as discussed by Gummow J in *Smith Kline & French.* The exception is where the plaintiff is the government, attempting to protect governmental secrets from exposure. In such cases, the government is required to demonstrate that there will be some detriment to the public interest if information is released. This is discussed below in *Commonwealth v John Fairfax & Sons Ltd.*

12.2.3a *Commonwealth v John Fairfax & Sons Ltd* [1980] HCA 44; (1980) 147 CLR 39 (the '*Defence Papers Case*')

Background

Book extracts were to be published in two newspapers – the *Sydney Morning Herald* and *The Age* – commencing on 8 November 1980. The extracts were advertised as containing unpublished government documents, relating to defence and international security but containing 'no material of value to a hostile power' (Mason J, 46 [10]). On 7 November 1980, the Commonwealth applied ex parte for injunctions to restrain publication. The injunctions were granted in the early hours of the morning of 8 November, but by then over 60,000 early editions of the newspapers had been distributed. Injunctions were also obtained to prevent the book's publishers from distributing it. Again, some copies had been distributed before the injunction was served on the publisher.

After the interlocutory injunctions were obtained, the Commonwealth sought their continuance.

Decision

Mason J granted an interim injunction restraining the newspapers from infringing the Commonwealth's copyright in the documents but held that the degree of embarrassment to Australia's foreign relations was insufficient to justify the award of an injunction.

Mason J

The plaintiff's case is that it is the owner of the copyright in most of the documents in the book, that they are classified documents which contain confidential information the disclosure of which will in a number of instances prejudice Australia's relations with other countries, especially Indonesia, and that it has not authorized or consented to publication. … The defendants do not dispute that the plaintiff has copyright in most of the documents; nor do they allege that the plaintiff has consented to publication. They do, however, contest the view that the documents contain confidential information and that disclosure will be prejudicial to the national interest. …

However, the plaintiff must show, not only that the information is confidential in quality and that it was imparted so as to import an obligation of confidence, but also that there will be 'an unauthorised use of that information to the detriment of the party communicating it' *(Coco v AN Clark (Engineers) Ltd* (1969) RPC 41, at 47). The question then, when the executive government seeks the protection given by equity, is: What detriment does it need to show?

The equitable principle has been fashioned to protect the personal, private and proprietary interests of the citizen, not to protect the very different interests of the executive government. It acts, or is supposed to act, not according to standards of private interest, but in the public interest. This is not to say that equity will not protect information in the hands of the government, but it is to say that when equity protects government information it will look at the matter through different spectacles.

It may be a sufficient detriment to the citizen that disclosure of information relating to his affairs will expose his actions to public discussion and criticism. But it can scarcely be a relevant detriment to the government that publication of material concerning its actions will merely expose it to public discussion and criticism. It is unacceptable in our democratic society that there should be a restraint on the publication of information relating to government when the only vice of that information is that it enables the public to discuss, review and criticize government action.

Accordingly, the court will determine the government's claim to confidentiality by reference to the public interest. Unless disclosure is likely to injure the public interest, it will not be protected.

The court will not prevent the publication of information which merely throws light on the past workings of government, even if it be not public property, so long as it does not prejudice the community in other respects. Then disclosure will itself serve the public interest in keeping the community informed and in promoting discussion of public affairs. If, however, it appears that disclosure will be inimical to the public interest because national security, relations with foreign countries or the ordinary business of government will be prejudiced, disclosure will be restrained. There will be cases in which the conflicting considerations will be finely balanced, where it is difficult to decide whether the public's interest in knowing and expressing its opinion, outweighs the need to protect confidentiality.

Notes

(1) To the extent that Mason J's judgment implies that the plaintiff must show that unauthorised disclosure must always result in detriment for the plaintiff, it is probably incorrect. The better view is that expressed by Gummow J in the extract from *Smith Kline & French* (at [12.2.2a] above).

(2) Mason J's comments reflect equity's primary concern with private law; that is, disputes between citizens rather than disputes between the government and citizens. While the government is entitled to seek equitable relief in appropriate cases, it is not judged on the same footing as a private citizen. A government cannot be 'embarrassed' in the same way as a person can. Similar considerations may apply to corporations.

12.3 Defences

A claim of breach of confidence may be susceptible to a defence of disclosure in the public interest. The concept of 'public interest' may encompass both notions of disclosures of crimes and misdeeds (iniquities) and broader public concerns such as health and security.

12.3a *Australian Football League v The Age Co Ltd* (2006) 15 VR 419

Background and decision

See [12.2.1.1a] above.

Kellam J

The submission of the defendants as to iniquity

The defendants contend further that there is no confidence recognised by the law in circumstances of iniquity. Put another way, Mr Marks of Senior Counsel for the defendants, contends that the information the AFL seeks to have remain confidential is information that reveals that AFL players have committed a criminal offence [use of prohibited drugs]. … Mr Marks argues that the law in Australia is that information concerning a crime, wrong or misdeed of public importance will not be recognised by the law as being confidential. He submits that persons privy to such information cannot, by agreement or otherwise, prevent its disclosure by reverting to the equitable doctrine of breach of confidence. He submits that there is simply no confidence in equity as to the disclosure of an iniquity. …

In my view, the position advanced by Mr Marks … is too wide. I accept the submission of the plaintiffs that in order to rely upon the so-called iniquity rule so as to eradicate the protection that would otherwise be granted in equity in respect of confidential information, it is necessary for the person relying upon that defence to establish that:

> **(a)** the proposed disclosure will in fact disclose the existence of or the real likelihood of, the existence of an iniquity that is a crime, civil wrong, or serious misdeed of public importance;
>
> **(b)** that the iniquity to be disclosed is of a character of public importance, in the sense that what is to be disclosed affects the community as a whole, or affects the public welfare; and
>
> **(c)** that the person who is seeking to protect the confidence is so doing in order to prevent disclosure to a third party with a real and direct interest in redressing the alleged crime, wrong or misdeed.

In my view the disclosure of names of players who have tested positive … will not disclose any iniquity of a serious criminal nature. At the highest, such disclosure may establish that the players at some stage had traces of illicit drugs in their urine and thus the information may be relevant to the possibility of, or the suggestion of, a crime having been committed by one of them. However, no crime … could possibly be proved by such information alone.

Furthermore, even if the information can be said to disclose an iniquity, there is no suggestion that it is the intention of the defendants to disclose such matters to a third party with a real interest in redressing any such possible crime. The defendants seek to disclose the information for the purposes of what might be described as an 'interesting story' for football fans and for other readers, and for no other purpose.

Public interest

The submission of the defendants as to public interest

However, in addition to the iniquity argument, the defendants contend that they are entitled to publish the identity of the AFL players … because it can be inferred from the positive tests that they have used drugs and engaged in seriously wrongful conduct. It is argued that it is in the public interest that such seriously wrongful conduct not be hidden … It is submitted … that it is clear law that the disclosure of information which has been imparted in circumstances otherwise requiring an obligation of confidence, can be justified when it is in the public interest so to do. Mr Marks concedes that the precise scope of the public interest exception is unclear upon the authorities, but he contends that in a case where the information sought to be kept confidential discloses anti-social and criminal conduct on the part of the AFL players the public interest dictates that the defendants have a right to publicise such disclosure. Mr Marks submits that a number of categories of disclosure of information, including breach of national security, crime, fraudulent or serious misdeeds, and breach of statute, are public interest exceptions well supported by authority. In relation to crimes and wrongful conduct he submits that the public interest defence is closely related to, but not the same as, the iniquity rule. He relies upon the statement of Lord Denning MR (with whom the other members of the Court of Appeal agreed) in *Frazer v Evans* [1969] 1 All ER 8 at 11:

> I do not look on the word 'iniquity' as expressing a principle. It is merely an instance of just cause or excuse from breaking confidence. There are some things which may be required to be disclosed in the public interest, in which event no confidence can be prayed in aid to keep them secret. …

Conclusion as to the question whether or not the public interest is relevant to the publication of the names of the players

It is true that the existence of, and/or the extent of, any public interest defence to a breach of confidentiality is by no means clear and settled in Australia. It would appear that in the UK an approach of balancing public interest with the interests served by confidentiality has developed. The decision in *Lion Laboratories Ltd v Evans* [1985] QB 526 establishes that proposition. Griffiths LJ said:

> The first question to be determined is whether there exists a defence of public interest to actions for breach of confidentiality … and if so, whether it is limited to situations in which there has been serious wrongdoing by the plaintiffs – the so-called 'iniquity' rule. … I can see no sensible reason why this defence should be limited to cases in which there has been wrongdoing on the part of the plaintiffs. I believe that the so-called iniquity rule evolved because in most cases where the facts justified a publication in breach of confidence, it was because the plaintiff had behaved so disgracefully or criminally that it was judged in the public interest that his behaviour should be so exposed. No doubt it is in such circumstances that the defence will usually arise, but it is not difficult to think of instances where, although there has been no wrongdoing on the part of the plaintiff, it may be vital in the public interest to publish a part of his confidential information. …

In *David Syme & Co Ltd v General-Motors-Holden Ltd* [1984] 2 NSWLR 294 at 309, Samuels JA agreed with the notion that the public interest involved a balance between a countervailing public interest and the public interest in maintaining a right to confidentiality. …

Samuels JA said, however, that in determining whether or not the public interest outweighs the duty of confidence, it is necessary to look to the character of the information which is sought to be disclosed and to compare it with the nature of the interest that it is argued requires revelation.

This approach of balancing of interests received support from Kirby P in *Attorney-General (UK) v Heinemann Publishers Australia Pty Ltd* (1988) 10 NSWLR 86 …

However, the defence of public interest in those terms has been rejected by Gummow J on two occasions, the first being the 1987 case of *Corrs Pavey Whiting & Byrne v Collector of Customs (Vic)* (1987) 14 FLR 434, and secondly, in 1990, in *Smith Kline & French Laboratories (Australia) Ltd v Secretary, Department of Community Services and Health* (1990) 22 FLR 73 …

In *Sullivan v Sclanders* (2000) 77 SASR 419 at 425–427, Gray J considered a number of the above authorities and said, in relation to the facts then before him:

> I … conclude, upon review of the relevant material, that I can discern no case of iniquity. As a result, whether the iniquity rule or the balancing of public interest approaches apply the result is the same. However, as a matter of strict legal principle I consider the application of the iniquity rule to be the correct approach. Equitable principles are best developed by reference to what conscionable behaviour demands of the defendant rather than by balancing those demands with matters of public interest. This approach avoids the ad hoc judicial idiosyncrasy associated with deciding whether, on the facts overall, it is better to respect or override the obligation of confidence. …

I have concluded already that there is insufficient evidence of iniquity of such a nature that 'makes legitimate the publication of confidential information … so as to protect the community from destruction or harm' … I respectfully adopt the approach of Gummow J in *Corrs Pavey Whiting & Byrne* and Gray J in *Sullivan v Sclanders* in relation to the narrower 'iniquity rule' on the basis that equity 'is best developed by reference to what conscionable behaviour demands'. However, if I am incorrect in this view, and even if the correct approach is the balancing of public interests, I would take the view that the balance falls in favour of the plaintiffs. …

In the end result, it appears to me that there is nothing other than the satisfaction of public curiosity in having the confidentiality of the names of those who have tested positive breached by being released. It may well be a wonderful front page story for the newspapers and a scoop for other sections of the media. … However, I can see nothing that is in the public welfare or the interests of the community at large which can be served by any identification, and perhaps to a degree the vilification and shaming of those who agreed to be tested randomly … on the basis that such testing would remain confidential until such time as there were to be three positive tests. Accordingly, even if there is a public interest defence to the claim of confidentiality made by the plaintiffs I do not conclude that it outweighs the public interest in having the information remain confidential.

Note

Notice the strict interpretation of 'public interest' adopted in the extract above. Courts draw a distinction between 'what is interesting to the public and what it is in the public interest to make known': *Sullivan v Sclanders & Goldwell International Pty Ltd* (2000) 77 SASR 419, 426 (Raff J). Only the latter qualifies.

Questions

(1) If disclosure of an iniquity must be made to a person who has a real interest in redressing the iniquity, can the defence ever be pleaded successfully where the proposed publication is to the general public (eg in a newspaper publication)? Consider the facts of *AB v CD & EF* [2017] VSCA 338. A barrister, who was a registered police informer, acted on behalf of numerous accused persons, while passing on information about their alleged crimes to the police. Are the accused persons the only people with sufficient interest in redressing the iniquity, or should the information be revealed to the public at large?

(2) A researcher alleged that Mary Mallon ('Typhoid Mary') was a likely carrier of typhoid fever based on epidemic 'mapping'. Mallon did not believe she was a carrier (she had no symptoms of the disease herself). Her employment as a cook made it highly likely that, if she was a carrier, she would pass the frequently fatal illness on to others. Apply the current Australian law on iniquity and public interest to this scenario. Should the researcher be able to publish what might otherwise be confidential information (such as Mallon's medical or employment records) in order to protect the public? Can the situation be resolved by applying the 'iniquity' rule?

12.4 Remedies

An extensive range of equitable remedies is available when a breach of confidence is made out. The exception here is the equitable proprietary remedy, the constructive trust. In Australia, constructive trusts are not an available remedy, as the plaintiff has no pre-existing property right in the subject matter of the alleged trust, given that information is not 'property'. Canadian courts have awarded constructive trusts in such cases: see *LAC Minerals Ltd v International Corona Resources Ltd* [1989] 2 SCR 574.

Injunctive or declaratory relief is typically sought where the confidence has not yet been broken; however, injunctive relief may still be necessary to prevent further breach, as the extract from *Bluescope Steel* below shows.

Accounts of profits are frequently sought when the confidential information has a commercial value, again demonstrated in the *Bluescope Steel* case. The availability of the remedy of account of profits distinguishes the equitable obligation of confidence from any contractual obligations of confidence.

In cases where the breach of confidence has caused loss to the plaintiff, equitable compensation can be obtained. *Lord Cairns' Act* damages may also be available. *Giller v Procopets* (see [12.4b] below) discusses these issues.

12.4a *Bluescope Steel Ltd v Kelly* (2007) 72 IPR 289

Background

Kelly worked in the steel industry for over 40 years, mostly for Bluescope Steel. After 1988, he was heavily involved in a research project for Bluescope, called 'Project M'. Kelly retired in 1999, and started seeking consultancy work. He was approached by Danieli to work in a technology group. Kelly incorporated a company (K.Con) to provide consultancy services to Danieli. There was no dispute between the parties that Kelly and K.Con had conveyed extensive information learned from Project M to Danieli and were held to be in breach of confidence. What remedies were appropriate?

Decision

Injunctions to restrain future disclosures of information and account of profit orders were granted.

Emmett J

Injunctions

… Having regard to the execution of ex *parte* orders and the seizure of substantial quantities of material from Mr Kelly's home, it is probably unlikely that Mr Kelly retains any further written material containing confidential information belonging to Bluescope … Nevertheless, while there may be considerable know how that Mr Kelly has acquired in his extensive experience in steel making, there must be a reasonable risk that there is specific confidential information relating to Project M that could still be disclosed to Danieli or other parties. Mr Kelly has not proffered any undertaking to make no further disclosures … Further, Mr Kelly maintains his stance that all of the information he has disclosed, either directly or through K.Con, is in the public domain.

I consider, therefore, that there should be injunctions restraining Mr Kelly and K.Con from disclosing to any person, or otherwise using, any technical engineering operational, commercial or other information relating to Project M communicated to him or received directly by him from Bluescope. … However, that restraint should not relate to information that:

- at the time of disclosure to Mr Kelly, was in the public domain as evidenced by printed publication or otherwise;
- after the time of disclosure to Mr Kelly, has become or becomes part of the public domain by printed publication or otherwise, through no fault of K.Con or Mr Kelly. …

Account of profits

[The plaintiffs] have elected to claim an account of the profits derived by K.Con and Mr Kelly from the breach of confidence. However the manner of taking the account is not without difficulties.

The claim by Bluescope … for an account of profits requires a determination of the profit derived by Mr Kelly and K.Con from any wrongful use or disclosure of the relevant information. The Court, in calculating the quantum of profit, must make such approximation as will do justice to the parties *(Dart Industries Inc v Décor Corporation Pty Ltd* [1993] HCA 54; (1993) 179 CLR 101 at 119).

K.Con received sums totalling $1,484,238.16 from Danieli. K.Con paid $333,802 … and incurred travelling and other expenses of $41,934.37. [The plaintiffs] assert that the net amount of $1,108,501.79 is the profit derived by Mr Kelly and K.Con from their wrongful use or disclosure of the relevant information.

While that calculation of profit makes an allowance for … expenses, it makes no other allowance for the cost of deriving the fees. Nor does it make allowance for information provided to Danieli that did not consist of confidential information relating to Project M. …

[The plaintiffs] contend that, without the confidential information relating to Project M, neither Mr Kelly nor K.Con would have been retained by Danieli at all. They say that the whole arrangement … came about only by the wrongful use of the confidential information obtained by Mr Kelly from Bluescope. They say that Danieli only paid K.Con in exchange for receiving confidential Project M information. Had K.Con not been in a position to provide confidential … information, Danieli would have paid nothing at all. Accordingly, they say the net amount represents profit obtained by K.Con from unlawful conduct. …

… [The plaintiffs] do not contend, and they have certainly not established, that all of the information imparted by Mr Kelly … involved a breach of Mr Kelly's obligation of confidence. On the other hand, it is for Mr Kelly to demonstrate the extent to which any benefit he received in connection with any breach of duty is attributable to his own effort, expertise and know how beyond mere disclosure of confidential information.

The object of the taking of accounts in a case such as this is to determine the profit derived by the wrong doer from the use of confidential information. Whether it is appropriate to make an allowance in respect of Mr Kelly's skill, expertise and other expenses is a matter of judgment. As a general rule, consistently with the principle that a fiduciary must not profit from a breach of fiduciary duty, the Court will make allowance for skill, expertise and other expenses (*Warman International Ltd v Dwyer* [1995] HCA 18; (1995) 182 CLR 544 at 562). The grant of an allowance will normally be a substitute for an apportionment of profits where a wrong doer mingled profits attributable to breach of duty and profits attributable to a wrong doer's efforts. That suggests that the onus of establishing that an allowance for skill, expertise and other expenses is called for, is on the wrong doer *(Harris v Digital Pulse Pty Ltd* [2003] NSWCA 10; (2003) 56 NSWLR 298 at [335]).

[His Honour went on to order the defendants to account for two-thirds of certain of the fees earned.]

Questions

(1) Remedies granted in this case included an account of profits and continuing injunctions to prevent further disclosure of confidential information. What is the overall remedial aim of the court when breach of confidence is established?

(2) Where does the onus of proof lie in considering profits derived and any allowance to be made to the defendant? See *Ancient Order of Foresters in Victoria Friendly Society Ltd v Lifeplan Australia Friendly Society* [2018] HCA 43; (2018) 265 CLR 1, extract at [4.2b].

12.4b *Giller v Procopets* (2008) 24 VR 1

Background

See [3.4.3a] for facts and decision.

Giller sought monetary remedies for breach of confidence. She did not originally seek an injunction preventing further disclosure, as there was no risk of further disclosure. The trial judge held that Giller was not entitled to monetary compensation for the breach of confidence. Giller had suffered no economic loss through the breach, although she had suffered mental distress. It was held that equitable compensation was not available for mental distress. It was further held that Giller was not entitled to *Lord Cairns' Act* damages, in lieu of an injunction, because no application for an injunction had been made. The Victorian Court of Appeal overturned both of these conclusions concerning compensation, and held that both equitable compensation and *Lord Cairns' Act* damages could include a component for aggravated damages. *Lord Cairns' Act* damages are discussed in chapter 3 at [3.4].

Decision

Neave JA

Damages for 'mere distress'?

For reasons which follow, I have concluded that his Honour was also wrong to hold that damages for breach of confidence could not be awarded for 'mere distress' not amounting to psychiatric injury.

[Her Honour then discussed English authority on the issue.]

The Australian position appears to be at large on this issue. I am not aware of any appellate court decision which has considered it. As one commentator puts it:

> In truth, the availability of damages for distress, or injury to feeling, in actions for breach of confidence is completely unresolved. It is therefore unclear whether actions for breach of confidence should be regarded, in the same light as actions for defamation, as exceptions to the general rule that damages are not ordinarily recoverable for distress or injury to feelings. Recent English decisions in breach of confidence cases, however, have found no difficulty whatsoever in awarding damages for distress.

On what basis are 'damages' recoverable?

As I have said, English authorities assume that 'damages' are recoverable for 'mere distress' not amounting to psychiatric injury, but do not explain whether the basis for such an award is an order for equitable compensation, damages under *Lord Cairns' Act,* or on some other basis. Accordingly, it is necessary to decide on what basis 'damages' may be awarded.

I begin by discussing whether equitable principles support the making of an order for equitable compensation to a person who suffers distress or embarrassment as the result of a breach of confidence. I then consider the availability of damages under s 38 of the *Supreme Court Act 1986* as an alternative remedy in these circumstances.

(a) Equitable compensation?

In *Smith Kline & French Laboratories (Australia) Ltd v Department of Community Services and Health* (1990) 22 FCR 73, 83, Gummow J said the conferring of equitable jurisdiction on a court:

> … brings with it, in a case such as the present, the inherent jurisdiction to grant relief by way of monetary compensation for breach of an equitable obligation, whether of trust or confidence.

Equitable remedies such as injunctions are available to prevent publication of confidential material because of its private nature. It is unnecessary in such applications to show that, if unrestrained, the breach of confidence will cause financial loss or psychiatric injury. By parity of reasoning there should be no barrier to the making of an order for equitable compensation to compensate a claimant for the embarrassment or distress she has suffered as a result of a breach of an equitable duty of confidence which has already occurred. As Morland J said in *Cornelius v De Taranto* [2001] EMLR 12, [66]–[67] and [69]:

> … [I]t would be a hollow protection … if in a particular case in breach of confidence without consent details of the confider's private and family life were disclosed by the confidant to others and the only remedy that the law of England allowed was nominal damages. In this case an injunction or order for delivery up of all copies of the medico-legal report against the defendant will be of little use to the claimant. The damage has been done. … In cases of commercial or business breach of confidence the powers of the court are not barren. Such remedies as injunction, delivery up, account of profits and damages may be available … similarly in the case of personal confidences exploited for profit or peddled to the media … In the present case in my judgment recovery of damages for mental distress caused by breach of confidence, when no other substantial remedy is available, would not be inimical to considerations of policy but indeed to refuse such recovery would illustrate that something was wrong with the law.

I respectfully agree with that view. An inability to order equitable compensation to a claimant who has suffered distress would mean that a claimant whose confidence was breached before an injunction could be obtained would have no effective remedy. …

(B) CAN AGGRAVATED DAMAGES BE AWARDED FOR BREACH OF CONFIDENCE?

… There is academic support for the view that, in a claim for equitable compensation, it is possible to recover aggravated damages. I can see no reason in principle why this should not be so. Nor is there any reason why damages awarded under s 38 of the *Supreme Court Act 1986,* in lieu of an injunction, could not include a component for aggravation. …

I am satisfied that Mr Procopets breached his duty of confidence with the deliberate purpose of humiliating, embarrassing and distressing Ms Giller, and that his conduct had that effect. I therefore consider it appropriate to include a component for aggravation in the award of compensation.

Note

Giller was followed in *Wilson v Ferguson* [2015] WASC 15, where a defendant published explicit private photographs on social media. An award of equitable compensation included an amount for distress. The plaintiff did not seek *Lord Cairns' Act* damages. See also W Khun, 'Equity's Weregeld: Monetary Remedies for Emotional Distress by way of the Equitable Obligation of Confidence' (2020) 42(2) *Sydney Law Review* 181.

Part E

Express trusts

13

The concept of the express trust

13.1 Introduction

13.2 Towards a definition of the trust

13.3 The existence of trust obligations

13.4 Distinguishing trusts from similar concepts

13.1 Introduction

Trusts come in all shapes and sizes. They are used for multifarious purposes; by individuals and families, by financial institutions and other businesses, by charities and foundations and by the courts. The trust is, as Maitland once famously observed, 'An institute of great elasticity and generality; as elastic, as general as contract' (FW Maitland, *Equity: A Course of Lectures*, ed J Brunyate (Cambridge University Press, 2nd ed, 1936) 23). It is usually neither difficult nor controversial to recognise the existence of a trust. However, as we shall see, this is not always the case.

This chapter first presents a description of express trusts in terms of the main characteristics with which they are typically associated. It then approaches the question from the opposite direction, by contrasting the legal archetype to other legal concepts, such as equitable charges, debts and partnerships that have points of similarity but also points of difference. The picture of the institution we know as an express trust that emerges through these two perspectives, though perhaps not deserving the title 'definition', will provide some guidance as to the nature and form of this most elastic of legal concepts.

13.2 Towards a definition of the trust

Attempts by the courts and commentators at exhaustively and authoritatively defining the institution we have come to know as a 'trust' have struggled to encompass the wide variety of circumstances in which trusts are employed. One of the most useful descriptions is found in *Re Scott* [1948] SASR 193. In that case, Mayo J offered the following description:

> The word 'trust' refers to the duty or aggregate accumulation of obligations that rest upon a person described as trustee. The responsibilities are in relation to property held by him, or under his control. That property he will be compelled by a court in its equitable jurisdiction to administer in the manner lawfully prescribed by the trust instrument, or where there be no specific provision written or oral, or to the extent that such provision is invalid or lacking, in accordance with equitable principles. As a consequence the administration will be in such a manner that the consequential benefits and advantages accrue, not to the trustee, but to the persons called cestuis que trust, or beneficiaries, if there be any; if not for some purpose which the law will recognise and enforce. A trustee may be a beneficiary, in which case advantages will accrue in his favour to the extent of his beneficial interest.

Notes

(1) There are some features of trusts that the description offered by Mayo J does not capture. For instance, it does not recognise that there might be more than one trustee of a particular trust, holding title to the property and exercising their powers jointly. It also does not allude to the fact that there is a species of trust, the bare trust, in which the trustee has only pared-back powers (and equally very few obligations) to administer or manage the assets of the trust, as noted in *Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271. Are there any other features of trusts that are not mentioned by Mayo J?

(2) The description also assumes that a trust has been created either for identified beneficiaries, each of whom is entitled to a distinct equitable interest in the trust property (known as a fixed trust), or for a purpose, usually a charitable purpose. A trust can also confer a discretion on the trustees to benefit one or more of a class of beneficiaries (known as a trust power, or by the more popular but non-technical term of discretionary trust). No individual member of the class is entitled to an interest in the trust property until the trustees have exercised their discretion in his or her favour. The members of the class are known as the objects of the trust. The trustees have a discretion to appoint income, and in certain circumstances to advance trust capital, to the objects. In *Kafataris v Deputy Commissioner of Taxation* (2008) 172 FCR 242, Lindgren J noted at [44] that even though the objects of a power of appointment under a discretionary trust 'do not have a beneficial interest in any property the subject of a "discretionary" trust prior to a distribution or appointment of income or capital, they are freely referred to as beneficiaries'. It is also the case that very often the remedy sought by a beneficiary will not involve a claim to specific property; see, for instance, *Schmidt v Rosewood* (see [17.3.6c]).

(3) It is sometimes assumed that the trust is a concept peculiar to common law systems (cf Maitland who considered 'the development from century to century of the trust idea' as 'the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence': FW *Equity: A Course of Lectures*, ed J Brunyate (Cambridge University Press, 2nd ed, 1936) 23). But non-common law systems, including the People's Republic of China, Japan and South Korea, have enacted trusts law codes even though their legal systems do not recognise the distinction between legal and equitable interests in property. See Lusina Ho and Rebecca Lee, *Trust Law in Asian Civil Law Jurisdictions: A Comparative Analysis* (Cambridge University Press, 2013). The *Hague Convention on the Laws Applicable to Trusts and on their Recognition* (the Convention) makes provision for the recognition and enforcement of these trusts. The Convention was ratified by Australia and brought into force by the *Trusts (Hague Convention) Act 1991* (Cth). Article 2 of the Convention defines a trust as follows:

> For the purpose of this Convention, the term 'trust' refers to the legal relationship created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

In *Hutchinson v Bank of Scotland Plc* [2012] QSC 28, a trust of residuary estate was created by a will executed by a Scottish-born testator who had lived in Australia for 55 years. The trust included shares in Australian corporations and money held in accounts in Australian banks. It was held to be governed by the Scottish law of trusts under the Convention even though Scottish law, while recognising the institution of the trust, does not recognise the concept of an equitable proprietary interest.

Question

How does the definition of the trust in the *Convention* differ from the description given by Mayo J in *Re Scott*?

13.3 The existence of trust obligations

In many cases, the existence of an express trust is clear and uncontroversial; for example, where it is created and defined by deed or in a will. There are, however, situations where the arrangements are not unambiguously classified as a trust and where the characterisation matters.

Re Scott (at [13.2]) was one such case. In that case, it was the would-be trustee who was trying to establish the existence of the trust. A testator bequeathed her residuary estate to the General Assembly of the Presbyterian Church of South Australia for certain charitable purposes. The General Assembly, having received payment of the bequest, but being in doubt as to the manner in which it should be applied, applied to the Court under the *Administration and Probate Act 1919* (SA) s 69 for advice and direction. Only if the General Assembly could

establish that it was a trustee of the property could it secure access to the Court's guidance in this way. Compliance with the Court's advice and direction would shield the General Assembly from any later claim that it had acted improperly, so approaching the Court was, in essence, a risk management strategy. The Court held that the General Assembly was a 'trustee' within the meaning of s 69 and was therefore entitled to apply for advice and direction.

Alternatively, it may be that the beneficiaries are attempting to assert a claim on the property that has priority over personal creditors of the trustee; for instance, if the trustee files for bankruptcy or insolvency. *Barclays Bank Ltd v Quistclose Investments Ltd* (see [13.3.1a] below) is an example of this type of situation. In other situations, it may be that characterising the circumstances under examination as a trust will give the plaintiff standing or other procedural rights that they would not otherwise have. *Trident General Insurance Co Ltd v McNiece Brothers Pty Ltd* (see [13.4.3a] below) is an example of this.

Finally, the existence and nature of the trust may have consequences arising from statute for those involved. Some examples offered by Leeming (Mark Leeming, 'What is a Trust?' (2008) 31(2) *Australian Bar Review* 211) of situations in which the finding of a trust has been consequential are:

- *Clay v Clay* (2001) 202 CLR 410: whether a defendant can take the benefit of a limitation period not expressed to run against a trustee;
- *Chang v Registrar of Titles* (1976) 137 CLR 177: whether a vendor is a trustee against whom a vesting order may be sought; and
- *Bathurst City Council v PWC Properties Pty Ltd* (1998) 195 CLR 566: whether land is subject to a trust for a public purpose and therefore more readily able to be sold or leased by a council.

There are, in addition, a great many instances in taxation legislation where the existence of a trust is important.

For more on the relationship between trusts and statutes, see Hon Chief Justice Robert French AC, 'Statutes and Trust' (2015) 39(2) *Melbourne University Law Review* 629.

13.3.1 Quarantining assets from creditors of the 'trustee'

13.3.1a *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567

Background

Rolls Razor Ltd borrowed money from Quistclose Investments Ltd in order to pay a dividend to its shareholders. At the time, Rolls Razor was substantially indebted to Barclays Bank. A new account was opened at Barclays to hold the money. Barclays had notice of the arrangement between Rolls Razor and Quistclose. Rolls Razor went into liquidation before it could pay the dividend. Barclays attempted to exercise its right to combine accounts and set off the money in the Quistclose account against other overdrawn accounts. Quistclose argued that the amounts it had provided were provided for a specific purpose and, that purpose having been frustrated, the amounts were impressed with a trust in its favour.

Decision

The House of Lords held that the arrangement between Quistclose and Rolls Razor created a trust in favour of Quistclose when it became impossible to pay the dividend, and that Barclays, having notice of the trust, could not apply the money to reduce Rolls Razor's indebtedness to the bank.

Lord Wilberforce

It is not difficult to establish precisely upon what terms the money was advanced by the respondents to Rolls Razor Ltd. There is no doubt that the loan was made specifically in order to enable Rolls Razor Ltd to pay the dividend. There is equally, in my opinion, no doubt that the loan was made only so as to enable Rolls Razor Ltd to pay the dividend and for no other purpose. This follows quite clearly from the terms of the letter of Rolls Razor Ltd to the bank of July 15, 1964, which letter, before transmission to the bank, was sent to the respondents under open cover in order that the cheque might be (as it was) enclosed in it. The mutual intention of the respondents and of Rolls Razor Ltd, and the essence of the bargain, was that the sum advanced should not become part of the assets of Rolls Razor Ltd, but should be used exclusively for payment of a particular class of its creditors, namely, those entitled to the dividend. A necessary consequence from this, by process simply of interpretation, must be that if, for any reason, the dividend could not be paid, the money was to be returned to the respondents: the word 'only' or 'exclusively' can have no other meaning or effect.

That arrangements of this character for the payment of a person's creditors by a third person, give rise to a relationship of a fiduciary character or trust, in favour, as a primary trust, of the creditors, and secondarily, if the primary trust fails, of the third person, has been recognised in a series of cases over some 150 years.

In *Toovey v Milne* part of the money advanced was, on the failure of the purpose for which it was lent (viz., to pay certain debts), repaid by the bankrupt to the person who had advanced it. On action being brought by the assignee of the bankrupt to recover it, the plaintiff was non suited and the non suit was upheld on a motion for a retrial. In his judgment Abbott CJ said, at p 684:

> I thought at the trial, and still think, that the fair inference from the facts proved was that this money was advanced for a special purpose, and that being so clothed with a specific trust, no property in it passed to the assignee of the bankrupt. Then the purpose having failed, there is an implied stipulation that the money shall be repaid. That has been done in the present case; and I am of opinion that that repayment was lawful, and that the non suit was right.

The basis for the decision was thus clearly stated, namely, that the money advanced for the specific purpose did not become part of the bankrupt's estate. This case has been repeatedly followed and applied.

Note

See also chapter 22 on resulting trusts for failure of basis, especially [22.5]–[22.6]. There is substantial academic literature on the Quistclose trust. See W Swadling (ed), *The Quistclose Trust: Critical Essays* (Hart Publishing, 2002).

Questions

(1) Why did Quistclose argue that the loan to Rolls Razor created a trust?

(2) Why did Lord Wilberforce hold a trust had been created? Who were the beneficiaries of the trust?

(3) Leila borrows $50,000 from Croesus Bank to help her daughter, Hala, pay a deposit on a house she wants to buy. Hala fails to buy the house. Does the arrangement constitute a trust of the $50,000?

13.3.2 Trusts as 'entities' in a statutory context

Statutes engage with trusts in a variety of ways. Although generally quite respectful of the general law of trusts, they do sometimes fall into the trap of describing the fund of assets held by the trustee as an 'entity', as if it had a legal identity separate to the trustee. One reason for this is that trusts are often used in circumstances where it might alternatively be possible to use an incorporated entity, which is a separate legal entity. See also Nuncio D'Angelo, 'The Trust as a Surrogate Company: The Challenge of Insolvency' (2014) 8(3) *Journal of Equity* 299, 301–3.

Legal practitioners can be led astray by this. Leeming J noted in *Kelly v Mina* [2014] NSWCA 9:

> Secondly, it may readily be inferred that neither party had a correct understanding of the legal nature of a trust, despite their academic and professional qualifications, and despite the fact that the accountancy practice was conducted by the trustee of a unit trust. A trust is not a legal person; a private trust is a relationship comprising various rights and obligations, personal and proprietary, between trustee, beneficiaries and trust property. The incorrect but prevalent notion that a trust is a legal person was reflected throughout the trial. It was seen not merely in the 'Structure' contained in the parties' 'Partnership Agreement'. It was also seen in the appellant's principal affidavit (she had sworn that 'the Mina Family Trust [sic] and Eastern Suburbs Accounting entered into an agreement to form an entity partnership [sic] called the Kelly and Mina Unit Trust'). Indeed, the proposed pleading the subject of the amendment application alleged a partnership between 'Eastern Suburbs Accounting Services Pty Limited and The Mina Family Trust'.

Leeming J did, however, go on to observe in *Kelly v Minna* [104]:

> The fact that inaccurate language (which is encouraged by some tax legislation) has been used to describe the legal structures by which a business is operated does not of itself mean that the transactional documents, or indeed documents filed in a court, lack legal efficacy: cf *HP Mercantile Pty Ltd v Commissioner of Taxation* [2005] FCAFC 126; (2005) 143 FCR 553, [2]).

13.3.3 Public policy in relation to trusts

The law of trusts, like other law, raises fundamental questions of public policy. Issues considered in the materials in this part of the book include whether it is possible to settle property on trust so as to avoid having to satisfy the settlor's or a beneficiary's creditors (chapter 15); whether a charitable trust can promote political purposes (chapter 16); and whether the terms of a trust can be varied with the objective of avoiding a potential liability to pay tax (chapter 24). Technical arguments concerning, for example, the nature of a trustee's right of indemnity from the trust assets (chapter 19) may in practice determine the outcome of a dispute as to whether trust creditors will be entitled to trust money in priority to the claims of employees of a business run by an insolvent trustee company of a trading trust for unpaid wages (*Carter Holt Harvey Woodproducts Australian Pty Ltd v Commonwealth* (2019) 268 CLR 524).

The exploitation of trusts in order to avoid potential tax impositions is as old as the application of the medieval use to avoid liability to pay the feudal incidents which were then levied in connection with tenures of land. The enactment of the *Statute of Uses* in 1535, which 'executed' the use by deeming the beneficiary to be the legal owner of the property held in use, was designed to prevent the loss of Crown revenues caused by the widespread adoption of the use by landowners. Contemporary wealth planning may involve the creation of tax minimisation trusts, including the transfer of wealth to be held on trusts governed by the laws of non-tax jurisdictions, a practice highlighted by the 'Panama Papers' disclosures, following the anonymous leaking of documents belonging to a Panamanian law firm. The utilisation of trusts

for the avoidance of tax, creditors and family court orders has been critically examined in Brooke Harrington, *Capital Without Borders* (Harvard University Press, 2016) which identifies at 173–6 three strategic features of trusts which facilitate avoidance activities:

(1) Secrecy. 'The identities of trust beneficiaries, and the existence of the trust itself, are not publicly registered. This creates a useful obscurity and uncertainty with respect to ownership.'

(2) Sparseness of regulation, particularly in comparison with the regulation of corporations. 'The reduction or absence of such constraints helps wealth managers protect clients' fortunes from being "frittered away" in transaction and compliance costs'.

(3) Flexibility of design. 'Trusts offer even greater flexibility than contracts do, because contracts must account for contingencies; but over the multigenerational time frame envisioned in trust structures, there is no way to predict, let alone specify, all the contingencies that will arise. So the pragmatic solution has been to dispense with contracting altogether and instead endow professionals with broad discretionary powers within the general remit of managing assets in the best interests of the trust's beneficiaries.'

Questions

(1) Do the social and economic advantages of trusts outweigh the social and economic costs?

(2) Can equity play a role in preventing the use of trusts for socially undesirable purposes, or should it be left to the legislature to define and proscribe these purposes?

13.4 Distinguishing trusts from similar concepts

Generating a definition of a trust that is useful and valid across all circumstances in which trusts are found is probably impossible. Nevertheless, as *Barclays Bank Ltd v Quistclose Investments Ltd* ([13.3.1a] above) shows, it can be important to identify when the circumstances under examination are properly characterised as a trust and when they point to the existence of some other legal concept. Comparisons between trusts and related legal concepts are drawn in the cases in this section.

13.4.1 Agency

An agent acts on behalf of another, the principal, and may, in certain circumstances, come into possession of property belonging to that other person. Crucially, although an agent will owe fiduciary duties in the performance of its role, unlike a trustee, the agent will not gain legal title to any such property. A further difference is that an agent acts on behalf of a principal when contracting within the authority of the agency, and hence is not a party to any such contract, whereas a trustee acts as principal. See textbook at [13.22] on trust and agency.

13.4.1a *Cohen v Cohen* [1929] HCA 15; (1929) 42 CLR 91

Background

A wife sued her estranged husband for payment of six amounts of money arising from a variety of sources. The claims in respect of two of these would have failed under the *Statute of Limitations 1623* (Imp) unless they could be characterised as arising under a trust. These were the proceeds of the sale of furniture owned by the wife and part of the proceeds of an insurance claim relating to some of the wife's jewellery. A third claim concerning the proceeds of jewellery purchased in Germany with funds provided by the wife and imported to the UK by the husband as a means of bypassing the legal constraints on moving funds from Germany to the UK in the aftermath of WW1. The latter claim would fail unless the personal debt was acknowledged within the statutory limitation period.

Decision

The High Court held in favour of the wife in respect of each of these three claims.

Dixon J

The plaintiff entrusted the sale of her furniture to the defendant and authorized him to receive the proceeds as and for her property on her behalf. I think he was intended to account specifically for the proceeds. He was not merely to take the money, mix it with other funds as his own and treat his wife simply as his creditor whose debt, like other debts, was to be met out of his general resources. If the auctioneer or dealer paid him one cheque for the proceeds of his own and his wife's furniture she would be entitled to be paid out of the proceeds of that cheque, whatever her share was. I think a similar position arose in the case of the claim against the insurer. He was avowedly receiving on her behalf moneys which represented her property, and again I think he was not intended to deal otherwise than specifically with what he received. In neither case do I think he could reasonably conceive himself as receiving money as his, incurring a mere debt to his wife. In the case of these spouses, the nature of their matrimonial and financial relations affords no ground for supposing that the wife would be likely to exchange willingly any specific thing she could get for a debt due by her husband to her. I think neither of these two causes of action is barred by the direct operation of the statute or by analogy to it.

On the other hand, I consider it clear in the case of the German marks that the defendant was not accountable specifically for the money he received nor the goods into which it was transformed or the proceeds of these goods. This cause of action is, therefore, subject to the time bar. But in answer to the *Statute of Limitations* … the plaintiff pleaded an acknowledgment in writing dated 6th September 1922. She says that just before her husband's departure for Australasia she told him that she would like some acknowledgment of the money she had lent him; that he asked her what she wanted; that she answered that he ought to know as a business man what to give her – 'Give me an IOU'. He sat down and wrote out the following document: 'In case of my becoming bankrupt and death I owe you £1,000 for money lent'. He put a twopenny stamp upon it, and wrote across the stamp his signature and the date; and then handed the document to her. [His Honour then found on the facts that this met the requirements of the *Statute of Limitations* for acknowledgement within the limitation period.]

13.4.2 Equitable charge

An equitable charge is created when the legal owner of property (the 'chargor') makes that property available to another (the 'chargee') to secure performance of an obligation owed to the chargee. Although the charge is an equitable interest, the rights of the chargee are less extensive than those enjoyed by a beneficiary of a trust (see textbook at [13.24]–[13.27]).

13.4.2a *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* [2000] HCA 25; (2000) 202 CLR 588

Background

The case involved a 'retention of title' clause designed to protect the financial interests of a supplier of steel to a manufacturer in the event that the manufacturer became insolvent. The retention of title clause included a proceeds sub-clause which provided that the proceeds of sale of any product incorporating the supplier's steel were to be held on trust for the supplier.

Decision

The High Court, Kirby J dissenting, held that the proceeds sub-clause created a valid trust and did not in substance create a charge. In the course of construing the clause, the High Court described the features of the arrangement that distinguished the express trust they found to have been created from the notion of an equitable charge.

Gaudron, McHugh, Gummow and Hayne JJ

The issues in this court principally concern the construction and effect of a paragraph in a retention of title, or 'Romalpa', clause. The text and scope of clauses which have come to be so described are not uniform. Reference to the vague and undifferentiated, such as the categorical phrase 'Romalpa clause', is no substitute for a particularised application of the relevant principles of law and equity to the construction and operation of the text at hand. It is possible to decide which of the submissions made to this court is correct only by paying close regard to those matters.

In dismissing the appeal to the Court of Appeal, Sheller JA (with whom Beazley and Stein JJA concurred) held that the material paragraph of the retention of title clause, which is set out later in these reasons, was a 'charge' within the meaning of s 9 of the *Corporations Law* (the Law) …

Section 266(1) of the Law provides that, where the registration requirements have not been satisfied, such a charge on property of a company (here the first respondent) will be void as against the liquidator or administrator of the company or, where a deed of company arrangement has been executed, the administrator of the deed. On the hypothesis that the material paragraph of the retention of title clause was a registrable charge created by the first respondent in favour of the appellant, the relevant registration obligation was the lodgment of a notice under s 263 of the Law within the prescribed period (s 266(1)(c)). This was not done. …

The Law does not render a trust or agreement to constitute a trust void against the administrators or liquidator of the first respondent for want of registration. Nor does the legislation require the registration of trusts or agreements to create trusts. The distinction between the institutions of the trust and the charge is thus essential for this appeal.

… It is the operation of the fifth paragraph of the clause (the proceeds subclause) which is of prime importance for this appeal. …

[That paragraph read:]

> In the event that the [Buyer] uses the goods/product in some manufacturing or construction process of its own or some third party, then the [Buyer] shall hold such part of the proceeds of such manufacturing or construction process as relates to the goods/product in trust for the [Seller]. Such part shall be deemed to equal in dollar terms the amount owing by the [Buyer] to the [Seller] at the time of the receipt of such proceeds. …

This is not one of those cases where the language employed by the parties for the transaction is inexplicit so that the court is left to infer the relevant intention from other language used by them, from the nature of the transaction and from the circumstances attending the relationship between the parties. An express obligation upon the buyer to keep the 'proceeds' separate would have pointed to the existence of a trust if none had been explicit. This would have been because, as McPherson ACJ has put it, such an obligation 'is a hallmark duty of a trustee'. But where the existence of a trust is explicit, the absence of an express obligation to keep trust moneys separate does not deny the trust. Rather, there being a trust, it follows that equity imposes various obligations and duties on the trustee. One of these is the obligation to get in the trust property and keep it distinct from the property of the trustee and from property held on other trusts. No question presently arises of the variation or abrogation of such obligations by statute or by express provision in a settlement.

In the present case there is nothing to suggest, at this subjective level, that the parties in their written instrument did not mean what they said, or did not say what they meant. There is no suggestion of a sham. It must follow that the terms of the invoices embodied the intentions of the parties. …

The proceeds subclause is an agreement to constitute a trust of future-acquired property. It is therefore not a 'charge' within the meaning of s 9 of the Law and the detailed provisions of the Law governing charges thus do not apply to it.

Note

Kirby J dissented on the ground that the proceeds subclause was in substance, if not in form, a registrable charge. Subsequent legislation has vindicated Kirby J on this point. Section 12(2)(d) of the *Personal Property Securities Act 2009* (Cth) provides that 'a conditional sale agreement (including an agreement to sell subject to retention of title)' is a security interest governed by the Act. Section 32(1) creates a statutory right to proceeds. The Act prescribes priority rules for resolving competing claims to the security held under reservation of title clauses, which supersede the equitable rules. See Anthony Duggan and David Brown, *Australian Personal Property Securities Law* (LexisNexis Butterworths, 2015) [11.3]–[11.7].

13.4.3 Trust and contract

Contractual and trust obligations can coexist on the same facts. Commercial arrangements that employ express trusts, such as financing and investment schemes, are often brought into being and defined by contracts. The parties to those arrangements will therefore be able to enforce a range of legal rights (flowing from contract and perhaps statute) and equitable rights (flowing from the trust).

There are, however, a number of important differences:

- The interest held by a beneficiary of a trust is often, although not invariably, a proprietary one. That is to say, encroachments on that interest can in appropriate circumstances be remedied not just by monetary awards or by personal non-proprietary remedies (such as injunctions and specific performance) but by remedies relating directly to the property that is the subject of the trust: see textbook at [2.8]–[2.11].
- The beneficiaries of a trust may be 'volunteers' in the sense that they have not provided consideration for the interests to which they have become entitled.
- It is the intention of the settlor, not the mutual agreement of the parties, to which the court turns in respect of questions of creation (see chapter 14) or construction. Where, as in the case of the *Quistclose* trust, the settlor has contracted with the intended trustee, the terms of that contract will be relevant.

13.4.3a *Trident General Insurance Co Ltd v McNiece Brothers Pty Ltd* [1988] HCA 44; (1988) 165 CLR 107

Background

A crane driver injured on a worksite recovered damages against the employer (McNiece Bros) of the site engineer under whose direction he was working. At the time of the claim, McNiece Bros was a contractor to Blue Circle Cement and, as such, was accommodated within the definition of the 'insured' in the contract of general insurance taken out by Blue Circle Cement with Trident General Insurance. McNiece Bros had not been a contractor at the time the policy was originally issued by Trident. The premiums paid by Blue Circle were calculated on the basis that contractors were covered by the insurance policy.

Decision

The High Court held by a majority of 4:2 that McNiece could enforce the contract, even though they were not strictly a party to it. The decision is reported on the analysis of the role of the trust in enabling third parties to enforce rights under contracts.

Mason CJ and Wilson J

Trident's case in this Court is that the rules that only a party to a contract can sue on it and that consideration must move from the promisee are fundamental principles of the common law of contract. These principles evolved in the course of the nineteenth century in the development in England of the law of contract and they have been consistently applied, not only in England but also in Australia, to contracts for the benefit of third parties, including insurance contracts. The argument is that the principles are so well accepted and so embedded in our law of contract that they should not be overturned by judicial decision, even if their application to contracts for the benefit of third parties is not altogether satisfactory, a matter which Trident by no means concedes. According to Trident, the recognition in appropriate circumstances by the courts of the trust of a contractual promise provides an adequate mechanism for protecting the rights of the third party under a third party contract.

The concept of the trust of a contractual promise, it is said, overcomes any serious problem which might otherwise arise if the common law principles alone were to govern third party contracts …

Then there is the trust of the contractual promise on which the appellant places particular reliance as a palliative of the difficulties generated by the common law principles. Despite the insistence in *Vandepitte* and *In re Schebsman*, on the need for a clear expression of intention to create a trust and the warning that such an intention cannot necessarily be inferred from general words, there are a number of authorities which justify the difficulty expressed by Fullagar J in understanding the reluctance of the courts sometimes to infer trusts: *Wilson*. In *Robertson v Wait*; *Lloyd's v Harper*; *Les Affniteurs Reunis Societe Anonyme v Leopold Walford (London) Ltd* and *Williams v Baltic Insurance Association of London Ltd* the courts readily inferred the existence of a trust from the circumstance that the contract was made for the benefit of a third party. The contrast between *Vandepitte* and *Williams* is striking. Both cases concerned motor vehicle insurance policies expressed to cover persons driving the vehicle apart from the insured. Fullagar J's comment followed a reference to the two decisions … As we have seen, critics of the common law rules have pointed to the uncertainty surrounding the circumstances in which the courts will recognize a trust in contracts for the benefit of third parties as a reason for rejecting the trust concept as a sufficient answer to the difficulties caused by those rules.

This apparent uncertainty should be resolved by stating that the courts will recognize the existence of a trust when it appears from the language of the parties, construed in its context, including the matrix of circumstances, that the parties so intended. We are speaking of express trusts, the existence of which depends on intention. In divining intention from the language which the parties have employed the courts may look to the nature of the transaction and the circumstances, including commercial necessity, in order to infer or impute intention: see *Eslea Holdings Ltd v Butts*. But, even if adherence to this approach produces greater consistency of outcome, there are still the cases where the third party has no remedy because there is no sufficient intention to create a trust.

And there are other consequences which flow from recognizing the existence of a trust. It may circumscribe the freedom of action of the parties to the contract, especially the promisee, to a greater extent than the existence of a right to sue on the part of the third party. How can the promisee terminate the trust once it is created? Lest it be overlooked, we should mention that the creation of a third party trust rests on ascertaining the intention of the promisee, rather than on the intention of the contracting parties. And in the ultimate analysis it seems incongruous that we should be compelled to import the mechanism of a trust to ensure that a third party can enforce the contract if the intention of the contracting parties is that he should benefit from performance of the contract. A fortiori is that so if the intention common to the parties is that the third party should be able to sue the promisor.

Notes

(1) A plaintiff seeking to enforce a trust arising from a contract in which it is alleged there is an intention to benefit a third party must demonstrate that there is in fact a trust in his or her favour. In *Marks v CCH Australia Ltd* [1999] 3 VR 513, the plaintiff sought orders that would require CCH, a publishing company, to continue funding a professorial chair he had occupied for ten years. Professor Marks' employment contract expressly provided that he should hold the chair only for so long as CCH continued to provide funding. When CCH terminated its contract with the university, the university in turn terminated Professor Marks' appointment. Professor Marks sought an order from the Court compelling CCH to continue funding the chair. The Court held that CCH's promise was for the benefit of the university and not Professor Marks, and hence that Professor Marks could not compel CCH to continue the funding. There was no intention to create a trust for Professor Marks' benefit.

(2) Contracts can create trusts or can complement existing trusts. This is particularly pertinent in the commercial and investment sphere; see M Scott Donald, 'Parallel Streams? The Roles of Contract, Trust, Tort and Statute in Superannuation Funds and Managed Investment Schemes' (2020) 14(2) *Journal of Equity* 151.

(3) Contracts and trusts can coexist in other ways too. For example, a chose in action arising from contractual arrangements can be held on trust. Bank accounts are perhaps the most common example, such as a trust account where the benefit of the bank's contract

with its customer is held on trust for a third party. Debts are another common example, although a more complex one as it is not necessarily the case that the beneficiaries of a trust can compel their trustee to pursue satisfaction of the debt; for instance, if the trustee properly comes to the conclusion that the costs of pursuit of payment outweigh the expected benefits.

13.4.4 Trust and debt

The seminal case examining the distinction between trusts and debts was presented briefly above: *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567. A number of more recent cases have considered Lord Wilberforce's approach in *Quistclose*. One of these, *Re Australian Elizabethan Theatre Trust*, is presented below. A second, *Twinsectra Ltd v Yardley*, is considered in chapter 22. A third, *Raulfs v Fishy Bite Pty Ltd*, is examined at [13.4.5] below. Each case highlights the importance of careful examination of the circumstances in which the putative trust arises when trying to ascertain the rights of the parties (and potentially of third parties).

13.4.4a *Re Australian Elizabethan Theatre Trust* (1991) 30 FCR 491

Background

The Australian Elizabethan Theatre Trust (AETT) was a company limited by guarantee; one of its objects was to promote the arts in Australia. Certain gifts to the AETT in the relevant period were 'allowable deductions' under the *Income Tax Assessment Act 1936* (Cth). This classification permitted tax-paying donors to offset donations to the AETT against their taxable income, and thereby reduce the amount of income tax they owed. This treatment applied even when the donations received by AETT were passed to other arts bodies that could not themselves offer the same tax benefits to donors. By 1989, over 700 arts bodies, including the Australian Opera, Australian Ballet Foundation and Victorian Tapestry Workshop, were using the AETT to solicit donations. The AETT was placed in provisional liquidation in March 1991. One of the questions that arose was whether the donations provided to the AETT were held on express trust for the arts bodies nominated on the forms completed by donors.

Decision

Gummow J held that the donations received by AETT were not held on trust for arts bodies. Although donors had expressed a preference for their donations to benefit specific arts organisations, the preference did not amount to a declaration of trust.

Gummow J

The first submission of the Opera, the Ballet and the Workshop was that, before the appointment of the provisional liquidator, each had become a beneficiary of a fully constituted express trust of the respective sums I have mentioned, and that in so far as moneys had been paid by the AETT into its operating account with the bank those moneys nevertheless were earmarked as trust moneys and the bank took with notice of those trusts. On this footing, there are thus two questions, the first whether express trusts arose and the second, if so, whether the bank took subject to those trusts.

Express trust and 'purpose' trust

I turn to consider the first question. It is plain that conditions precedent or subsequent may be attached to a gift: *Halsbury's Laws of England*, 4th ed, vol 20, pp 29–32. Property may also be transferred without consideration to be held by the transferee upon trust: Halsbury pp 23–4. In neither case is the gift unfettered. But in the present case it is to be observed that the donations were expressed by the donors as being given 'unconditionally' to the AETT. There was also a statement that the donor would appreciate a particular 'preference' being given by the AETT in its allocation of the donation. But the system which had operated for some years had been posited upon the obtaining by donors of the deduction provided for in s 78(1)(a)(xiii) of the *Tax Act*, and therefore, in a practical sense, upon observance of rulings given from time to time by the Commissioner as to what he regarded as requisite for the obtaining of such a deduction. It was not for nothing that the AETT standard form was headed in bold letters 'Tax Deductibility

Program'. The essence of the attitude consistently taken by the Commissioner was that, in order to qualify, a donation must be 'unconditional' and 'unfettered'.

Further, the donations were not received on terms that they be earmarked by the AETT and, for example, kept separate from its other funds and placed in an account kept for the particular purpose. Nor, in practice, did the AETT segregate the donations by placing them in a separate bank account. This is a significant factor tending against the conclusion that a trust arose: see *Re Associated Securities Ltd and the Companies Act* [1981] 1 NSWLR 742 at 749; *Re Multi Guarantee Co Ltd* [1987] BCLC 257 at 266; *Walker v Corboy* (1990) 19 NSWLR 382 at 385, 389, 397–8. …

[The] essential reason the insolvency law did not strike at the transaction in question in *Quistclose* was that the moneys represented by the cheque drawn by Quistclose in favour of Rolls Razor and banked in the special account of Rolls Razor never at any stage became the beneficial property of Rolls Razor. It acquired no more than what Dixon J called a dry legal interest: see *Commissioner of Stamp Duties (NSW) v Perpetual Trustee Co Ltd*, supra, at 510. On its part, Quistclose had both a contractual right to repayment out of the general assets of Rolls Razor, as a general creditor, and the beneficial interest in a fund, whether by way of resulting trust or as the second limb of an express trust …

The *Quistclose* decision has been the subject of criticism as a departure from basic trust law and, on the other hand, seen as providing the welcome foundation for a new species of trust … Some of these doctrinal tensions were apparent in counsel's submissions in this case. Thus, it was suggested that the donations were given to the AETT with a purpose in mind, and that this 'purpose' characterised the trusts which allegedly arose in favour of the Opera, the Ballet and the Workshop.

However, in my view, it would be an error to treat the references by Lord Wilberforce in *Quistclose* (and by Gibbs ACJ in *Australasian Conference Association Ltd v Mainline Constructions Pty Ltd (in liq)* (1978) 141 CLR 335 at 353) to 'purpose' as characterising an express trust which did not have to satisfy the ordinary requirements for any private (as distinct from public) trust. There was, on Lord Wilberforce's analysis of the facts, a trust fund held by a trustee on certain terms for a class of ascertained beneficiaries, with a limitation (whether as an express or resulting trust) back to the settlor in specified circumstances. The expression 'purpose' was apt to describe the end sought to be achieved by the settlor, Quistclose, and accepted by the trustee, Rolls Razor. This was formulated in the terms stipulating the conditions upon which the shareholders might take a beneficial interest in the fund. The use of the expression 'purpose' should not be read as heralding a new era for the non-charitable purpose trust. This is a concept which has not struck deep roots in this country: see, for example, *Tidex v Trustees Executors and Agency Co Ltd* [1971] 2 NSWLR 453 at 465–6.

In *Quistclose*, it appears to have been a condition of the primary trust that the shareholders acquire and retain vested equitable rights in the fund only to the extent to which they had a present right to payment of the dividend by Quistclose in the ordinary course, that is to say before 24 July. That condition to their entitlement could not be fulfilled after the company went into liquidation. The gift over, the 'secondary' trust then operated in favour of Quistclose. Hence, Hodgson J's comment in relation to the conditions attaching to the primary trust that to speak of the trust as one for a specific 'purpose' may be merely another way of putting the same thing: *Rose v Rose* (1986) 7 NSWLR 679 at 685–6. Interestingly enough, the letters outlining the arrangement in *Quistclose* used the term 'conditions': see the text set out [1968] Ch at 549–51.

The striking feature of the *Quistclose* litigation was that whilst previously it might have been thought that debt and trust were distinct and disparate norms, it was thereafter clear that in a given case the transaction under analysis might bear a dual character.

The question as to the existence of any express trust will always have to be answered by reference to intention. An example of that basic proposition at work in this court is the decision of Lockhart J in *Re Wall; Ex parte Official Receiver v Kemmis* (1979) 25 ALR 615 at 624–5. Ordinarily, the relevant intention is that of the alleged settlor, but where the subject matter of the trust is contractual rights against the settlor, conferred by the settlor upon the alleged trustee, the objective (or 'purpose') of the transaction being to benefit third parties, it may be appropriate to look to the mutual intention of settlor and trustee. This is consistent with the approach by Deane J to a similar question in *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 80 ALR 574; 165 CLR 107 at 149, but cf Mason CJ, Wilson J at 121. At all events, and as I have said, in *Quistclose*, supra, at 580, Lord Wilberforce looked to 'the mutual intention' of Quistclose and Rolls Razor and to 'the essence' of their bargain.

The relevant intention is to be inferred from the language employed by the parties in question and to that end the court may look also to the nature of the transaction and the relevant circumstances attending the relationship between them: *Walker v Corboy* (1990) 19 NSWLR 382; Scott, *The Law of Trusts*, 4th ed, 1987, s 25.2. There is no need for particular caution in drawing the inference that a trust was intended: *Bahr v Nicolay (No 2)* (1988) 164 CLR 604 at 618–19; 78 ALR 1. However, it also is important to appreciate both the flexibility of the institution of the express trust and the range of equitable institutions which fall short of but have some of the characteristics of a trust.

In *Quistclose*, the debate was whether that material disclosed a trust with the terms I have described or merely a loan; no other result was suggested. But the facts in such cases are susceptible of infinite variation and the trust is a supple instrument. …

To speak of a *Quistclose* trust as if it were a new legal institution, rather than an example of the particular operation of principle upon the facts as found, is to set the listener or reader off on a false path. So it is that one sees what in truth are pointless debates in some of the commentaries as to whether a *Quistclose* trust may arise where the money is lent not to pay the borrower's debts, but to buy equipment (as in *Re EVTR* [1987] BCLC 646), or not lent but paid to subscribe for shares, as in *Re Associated Securities Ltd and the Companies Act*, supra. …

The fundamental issue is whether the donations in question in this proceeding were received by the AETT and banked by it, impressed with any of the equitable proprietary obligations contended for by counsel for the three organisations. As I have indicated, each case is to be determined in accordance with the language used as interpreted in the light of the circumstances. It is well settled that formal words are not necessary for the creation of a trust. But if the statement of 'preference' by the donors upon the AETT standard form or its adaptations were but a statement of the donor's motive or expectation, then the AETT bore no legal or equitable obligation to fulfil that expectation: see *Countess of Bective v FCT*, supra; *Dean v Cole* (1921) 30 CLR 1 at 8; Scott, *The Law of Trusts*, supra. …

In *Quistclose*, supra, Lord Wilberforce emphasised that the form of words used indicated that the loan moneys were to be used 'exclusively' or 'only' in a particular way. Here, the word 'unconditionally' as used in the AETT standard form has a primary meaning calculated to lead to the opposite result. It suggests an absence of qualification or obligation. The promotion and use of the tax deductibility program was premised upon donors obtaining the income tax deduction and that required gifts to be made outright. The most that was permissible if the deduction was not to be imperilled was a statement of 'preference'. In the circumstances, this was to indicate motive or expectation, in the light perhaps of past experience of the handling of gifts by the AETT, but not to impose a legal or equitable obligation. Likewise, the phrase in the AETT standard form 'it would be appreciated' is precatory rather than imperative. Even then, the obtaining of the deduction was not assured because the Commissioner had certain requirements as to the characteristics to be possessed by an arts organisation before it might be considered a 'preferred arts organisation' within the ambit of the tax deductibility program. As I have indicated, the manner of administration and handling by the AETT of donations when received is suggestive also that no trust came into being.

Question

How did Gummow J distinguish the process of identifying the relevant intention to enter the contract and the intention to create a trust? What do you think the parties making the donations to the AETT were 'intending'? Does that matter?

13.4.5 Trust and partnership

Express trusts and partnerships share a number of superficial similarities. Both are typically created under some form of private arrangement, often expressed formally in a deed or other documentary instrument. The responsibilities and rights of participants are subject to the terms of that arrangement, supplemented by duties and rights imposed by equity. Both are commonly used in commercial contexts, especially in schemes for collective investment such as hedge funds. There are, however, some important differences. *Raulfs v Fishy Bite Pty Ltd* highlights some of these, as well as providing a useful summary of the approach taken by the courts in respect of arrangements found in *Barclays Bank Ltd v Quistclose Investments Ltd* (at [13.3.1a] above).

13.4.5a *Raulfs v Fishy Bite Pty Ltd* [2012] NSWCA 135

Background

Mrs Raulfs entered into a partnership agreement with Fishy Bite Pty Ltd to operate a take-away fish and chip shop. Fishy Bite Pty Ltd was owned and controlled by Mr Ajaka. Mrs Raulfs contributed $400,000 in exchange for a 35 per cent share in the assets and any

profits or losses of the partnership. It was uncontested that Mr Ajaka misapplied that money for his personal benefit. Mrs Raulfs sought to have the partnership wound up and the money, plus interest, returned to her. One of the grounds she argued was based on *Barclays Bank Ltd v Quistclose Investments Ltd.*

Decision

The New South Wales Court of Appeal held that the $400,000 had not been paid on *Quistclose* terms. In the course of rejecting the arguments put by the appellant, Campbell JA (with whom Meagher and Barrett JJA agreed) articulated a number of principles relevant to both *Quistclose* trusts and partnership interests.

Campbell JA

Mr Einfeld submits that Mrs Raulfs paid the $400,000 for a specific purpose, namely for use as capital in the partnership. He submits that that purpose failed when Mr Ajaka withdrew the money and used it for his own private purposes, and that thereupon a resulting trust for Mrs Raulfs arose …

The trial judge … accepted the relevant principle as being that 'if one person makes a payment to another for a certain purpose, and that person takes the money knowing that it is for that purpose, he must apply it to the purpose for which it was given': *Gibert v Gonard* (1884) 54 LJ CL 439 at 440 per North J, cited with approval by Lord Millett in *Twinsectra Ltd v Yardley* [2002] UKHL12; [2002] UKHL 12; [2002] 2 AC 164 at [76].

[T]he primary judge rejected the *Quistclose* trust submission for two reasons:

> … The first is that the payment to Fishy Bite was intended to be the payment of the $400,000 as partnership funds that Mrs Raulfs had agreed to pay. In other words, the money 'was paid and received with the intention that it should become the absolute property' of the partnership: see *Twinsectra* per Lord Millett … On receipt by Fishy Bite, the monies were beneficially owned by the partnership, not Fishy Bite, and when the $400,000 was paid out to Mr Ajaka, wrongly on Mrs Raulfs' case, what was paid out were assets of the partnership. The second point is the obverse of the first. If Fishy Bite were to now pay back $400,000 to Mrs Raulfs, then she would not have contributed the $400,000 which she was obliged to contribute and she would be required to pay over to the receiver that same amount (subject to the resolution of the remaining issues). …

In *Re Australian Elizabethan Theatre Trust; Lord v Commonwealth Bank of Australia*, Gummow J said … that Lord Wilberforce's finding of a mutual intention pursuant to which there was a primary trust, and a secondary trust, was:

> … indicative of an express trust with two limbs rather than an express trust in favour of the shareholders and a resulting trust in favour of Quistclose which arose by reason of an incomplete disposition by Quistclose of the whole of its interest in the money lent to Rolls Razor.

That remark concerns the analysis of the particular fact situation revealed in *Quistclose*. It does not purport to be, and should not be taken as, a statement about whether a 'Quistclose trust' is 'really' an express trust or a resulting trust, nor about whether there is any such legal institution as a 'Quistclose trust'.

Gummow J said … that the money banked into the special account 'never at any stage became the beneficial property of Rolls Razor. It acquired no more than what Dixon J called a dry legal interest …'

… Gummow J said that the references to 'purpose' by Lord Wilberforce in *Quistclose* and Gibbs ACJ in *Mainline* should not be regarded as recognising:

> … an express trust which did not have to satisfy the ordinary requirements for any private (as distinct from public) trust. There was, on Lord Wilberforce's analysis of the facts, a trust fund held by a trustee on certain terms for a class of ascertained beneficiaries, with a limitation (whether as an express or resulting trust) back to the settlor in specified circumstances. The expression 'purpose' was apt to describe the end sought to be achieved by the settlor, Quistclose, and accepted by the trustee, Rolls Razor. This was formulated in the terms stipulating the conditions upon which the shareholders might take a

> beneficial interest in the fund. The use of the expression 'purpose' should not be read as heralding a new era for the non-charitable purpose trust.

... Gummow J recognised the truism of trust law, that 'the question as to the existence of any express trust will always have to be answered by reference to intention'. After some discussion of whose intention was the relevant one, he said:

> The relevant intention is to be inferred from the language employed by the parties in question and to that end the court may look also to the nature of the transaction and the relevant circumstances attending the relationship between them ... There is no need for particular caution in drawing the inference that a trust was intended ...

Notwithstanding some earlier uncertainty arising from the decision in *Commissioner of Stamp Duties (Qld) v Jolliffe* [1920] HCA 45; (1920) 28 CLR 178, it is now clear that in deciding whether there is an intention to create a trust, the court ascertains that intention by inference from the outward manifestations of intention: *Byrnes v Kendle* [2011] HCA 26; (2011) 243 CLR 253 at [53]–[59], [102]–[115]. Thus, the task of ascertaining whether there is an intention to create a trust and, if so, on what terms is a similar one to ascertaining the intention of parties to a contract for the purpose of deciding whether there is an intention to enter contractual relations and the terms of any contract that has been entered. The sort of factors that Gibbs ACJ considered in *Mainline* are relevant to whether there is the sort of trust that was recognised in *Quistclose*.

Young, Croft and Smith, *On Equity* (Lawbook Co, 2009) [6.1020] said, correctly:

> Cases in this area will often depend on a close analysis of the facts, and in particular, whether the person who provided the money annexed a trust or equitable obligation that it was only to be used for the nominated purpose. The mutual intention of the parties ... will be important. A trust will not necessarily arise just because a lender inquires into the purpose for which a loan is sought and money is paid over for that particular purpose.

A footnote to the last sentence of that passage refers to Lord Millett in *Twinsectra* at 185. In paras [73]–[74] on 185, his Lordship said:

> A Quistclose trust does not necessarily arise merely because money is paid for a particular purpose. A lender will often enquire into the purpose for which a loan is sought in order to decide whether he would be justified in making it. He may be said to lend the money for the purpose in question, but this is not enough to create a trust; once lent the money is at the free disposal of the borrower. Similarly payments in advance for goods or services are paid for a particular purpose, but such payments do not ordinarily create a trust. The money is intended to be at the free disposal of the supplier and maybe used as part of his cashflow. Commercial life would be impossible if this were not the case.
> The question in every case is whether the parties intended the money to be at the free disposal of the recipient ...

In my respectful view, this statement by his Lordship has the potential to mislead in two respects. The first is in its assumption that there is such a thing as 'a Quistclose trust'. Rather, consistently with *Byrnes v Kendle*, and the remarks of Gummow J in *Australian Elizabethan Theatre Trust*, one needs to analyse an individual fact situation for the purpose of deciding whether there is an intention to create a trust, and, if so, on what terms. *Quistclose* recognises that sometimes there can be a trust whose terms are that the trust property is to be paid to particular people, and if it is not paid to those people, it is to be held for someone else. That is a matter arising from analysis of the facts of the particular case in accordance with well established principles for identifying when there is a trust, not because there is any separate legal institution known as a 'Quistclose trust'. Further, it is a gloss upon the law concerning identification of the terms of a trust to say that the 'question in every case is whether the parties intended the money to be at the free disposal of the recipient'. That suggests that being at the free disposal of the recipient marks a dividing line between a 'Quistclose trust' and something else. Facts about the intention with which a person has parted with an item of property cannot usefully be categorised in such a cut and dried fashion. However, the more limited statements in the passage I have quoted from *On Equity* are correct.

In the present case, there was no basis for inferring that the parties had an objective intention that the $400,000 that Mrs Raulfs paid to Fishy Bite would be repaid to her in any circumstances. Neither of the partners said anything about repayment. They signed

a partnership agreement that acknowledged, in clause 4.4, that the $400,000 had been paid as a contribution towards the capital of the partnership.

[His Honour then described the rights of a partner in partnership property as being not a title to specific property subject to the partnership but rather a right, enforceable at equity, to a defined proportion of the surplus after realization of the assets and payment of the debts and liabilities of the partnership. He continued, quoting Mason J in *United Builders Pty Ltd v Mutual Acceptance Ltd* (1980) 144 CLR 673, 688:]

> … It follows that so long as the partnership business is carried on, its assets may be disposed of in the ordinary course of that business free of any claim to title by the holder of a mortgage or charge over a partner's share in the partnership … Although it creates no specific interest in the partnership assets until dissolution, this is not because the charge is dormant; it is because the rights conferred by the charge relate to the existing chose in action and that the security over the chose in action confers no entitlement to the assets of the partnership until dissolution.

The partnership agreement prescribed the manner in which the assets of the partnership would be applied. It made explicit provision, in Clause 23, for the manner in which the assets of the partnership would be applied when the partnership came to an end. Mrs Raulfs had no right to receive or recover the $400,000 prior to the determination of the partnership. While Clause 23.1(b)(iv) might result in her receiving an amount of $400,000 from the partnership assets upon termination of the partnership, whether she actually received any such sum would depend upon whether there were sufficient assets available upon termination of the partnership, and in any event, even if she were to receive such a sum, it would not be the same $400,000 that she paid to Fishy Bite.

A significant factor in the absence of any intention that the $400,000 would be held on trust to be repaid to Mrs Raulfs is that there was no requirement that it be paid into a separate account. Rather, it was paid into the account into which the takings of the partnership business were deposited, and from which at least some of the expenses of the partnership were paid. A trust always requires that there be identifiable trust property, and the absence of a requirement to keep the supposed trust property separate is a powerful indication that no trust was intended. There was no objective circumstance known to Mrs Raulfs that could have suggested to her when the payment was made that the business was at risk of failing, nor any objective circumstance that could have suggested to her at that time that there was a real risk that the money might be misappropriated.

The present case is not, however, a case like that considered by Lord Millett in *Twinsectra*, where the money paid was at the free disposal of Fishy Bite. Upon Mrs Raulfs passing her cheque over, Fishy Bite was subject to a fiduciary obligation to apply the cheque and its proceeds for the purposes of the partnership. It is inherent in the notion of a sum of money paid as working capital of a business enterprise that the money might be expended in the course of conducting that enterprise. That is why I say that the $400,000 was paid subject to a fiduciary obligation to apply it for the purposes of the partnership, not that it was held on trust. Upon payment, the $400,000 became subject to the obligations more specifically set out in s 20(1) *Partnership Act 1892*:

> All property, and rights and interests in property, originally brought into the partnership stock or acquired, whether by purchase or otherwise, on account of the firm, or for the purposes and in the course of the partnership business, are called in this Act partnership property, and must be held and applied by the partners exclusively for the purposes of the partnership, and in accordance with the partnership agreement.

For the purpose of ascertaining whether it was partnership property, it is unimportant that title to the $400,000 was held by Fishy Bite. Fletcher, *The Law of Partnership in Australia*, 9th ed (2007) Lawbook Co, correctly observes at 141–2:

> While transfer of title from the original owner to all partners jointly would be evidence that the property is partnership property, no adverse inference is drawn from a failure to make such a transfer. The question to be determined is whether the original owner retains both legal and beneficial interest in the property or whether the title-holder has transferred the beneficial interest in favour of the partners collectively. The inquiry is essentially a search for evidence of intention …

Similarly to the $400,000, other items that were being brought into the partnership, such as, perhaps, the lease of the premises, and whatever rights Fishy Bite had concerning the fittings and fixtures, continued to be held in the name of Fishy Bite, although thenceforth it would hold them for the benefit of the partnership.

In the present case, the partnership deeds provide the clearest evidence that it was the intention of both Mrs Raulfs and Fishy Bite that the $400,000 should be partnership property.

Mr Ajaka caused Fishy Bites to breach its obligations as a partner when he misappropriated the $400,000. However, the judge was right in holding that the consequence of that misappropriation is that Mr Ajaka and Fishy Bite have an obligation to account to the receiver of the partnership for the $400,000. If the receiver receives that $400,000, it will then be applied in accordance with the partnership agreement.

As Barrett JA pointed out in the course of argument, once Mrs Raulfs' cheque for $400,000 was paid, nothing further needed to be done to make the $400,000 the absolute property of the partnership. It may be that legal title to it was in Fishy Bite (ignoring for the moment, as the parties seem to have consented to do, the fact that it was held as part of a mixed fund and not as a separate asset capable of being held as trust property) but it was held by Fishy Bite subject to fiduciary obligations to apply it for the partnership. … For these reasons, the submission that there is a 'Quistclose trust' in favour of Mrs Raulfs fails.

Question

Which aspects of the arrangements between Mrs Raulfs and Fishy Bite did Campbell JA rely on in coming to his decision that there was no 'Quistclose' trust?

14

Certainty requirements in the law of trusts

14.1 Introduction

14.2 Certainty of intention to create a trust

14.3 Certainty of subject-matter

14.4 Certainty of object

14.1 Introduction

The Court of Chancery required 'three certainties' in order to recognise a valid private express trust. These are: (1) certainty of intention to create a trust; (2) certainty of subject matter of a trust (trust property); (3) and certainty of object (those who are or may be entitled to trust property). Each of the certainties is crucial, for varying reasons. Unless the certainty requirements can be satisfied, an enforceable trust will not have been created. Each of the three certainties will be considered separately.

14.2 Certainty of intention to create a trust

Unilateral express trusts can be created in one of three ways (see chapter 15). Trusts may be established by will (testamentary trusts) or created during the settlor's lifetime (inter vivos trusts). Inter vivos trusts can be created by the settlor declaring that the settlor holds property for beneficiaries. Alternatively, the settlor can create a trust by transferring property to another to act as trustee on behalf of beneficiaries. Whichever method of creation is adopted, it is essential that an intention to create a trust be shown.

Trusts can also be created bilaterally, by agreement between two parties. In such cases, the mutual intention of the parties is critical. *Quistclose* trusts, discussed in chapter 22, are an example of trusts formed by two parties.

One reason that intention to create a trust is required for inter vivos trusts is the proprietary outcome for the settlor. Creation of a trust means that the settlor has given away their own interest in the property, unless they have retained a right to revoke the trust: *Mallott v Wilson* [1903] 2 Ch 494. Another reason is that the settlor may have intended to create some kind of legal relationship other than a trust; for example, a conditional gift. This is true of both testamentary provisions and inter vivos dealings. Further, trust obligations, which vary in content depending on the type of trust in question, carry a high degree of responsibility. This is not necessarily true of other obligations; for example, those imposed solely by contract. A trust should only be recognised where the creator of the obligations wants to impose that degree of responsibility on a title holder of property.

No particular form of words is required to create a trust. Therefore, a court must interpret the evidence available to decide whether the settlor intended to create a legal relationship which has the characteristics of a trust. In cases where formal, unambiguous written documents exist, this is relatively easy. Where explicit documents exist, the words used are judged objectively. Where there are no written documents, or the documents are ambiguous, the court must examine the words and actions of the settlor to see if an objective intention to create a trust was manifested.

If no intention to create a trust exists, alternative constructions must be considered. The settlor may have intended some kind of a gift, possibly expressed with words that impose no obligation (precatory words), or a gift on an enforceable condition, or some other transaction.

14.2a *Byrnes v Kendle* [2011] HCA 26; (2011) 243 CLR 253

Background

A couple purchased a house in the husband's name, as he was able to obtain a Defence Services loan on preferential terms. The husband signed a deed stating that he held a half share in the house on trust for his wife. The house was leased to the husband's son from a previous marriage. After the marriage broke down, the husband failed to collect rent from the son. In proceedings for breach of trust, the husband argued that he had never intended to create a trust for the wife.

Decision

The High Court held that the deed objectively showed that the husband intended to create a trust.

Gummow and Hayne JJ

Was there a trust?

The 1997 Deed was effective in its terms to vest in Mrs Byrnes as beneficiary a one undivided half interest as tenant in common in Rachel Street. …

In *Bahr v Nicolay (No 2)* (1988) 164 CLR 604 at 618 Mason CJ and Dawson J approved of the expression of the 'traditional attitude' by du Parcq LJ that 'unless an intention to create a trust is clearly to be collected from the language used and the circumstances of the case, I think that the court ought not to be astute to discover indications of such an intention'. In the present case there was no degree of informality, the trust being manifested and proved by deed using the technical term 'upon trust'. Accordingly, to adopt what was said in *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd (in liq)* (2002) 202 CLR 588 at 605:

> This is not one of those cases where the language employed by the parties to the transaction is inexplicit so that the court is left to infer the relevant information from other language used by them, from the nature of the transaction and from the circumstances attending the relationship between the parties.

However, … Mr Kendle relies upon the statement by the trial judge … [that the court could look at evidence outside the Trust Deed to determine the alleged settlor's intention.] …

Counsel for the appellants emphasised the exiguous and equivocal oral evidence given by Mr Kendle as to his intention upon which the trial judge relied. In addition, and more fundamentally, evidence of this nature was inadmissible. In that regard, it is important to observe that the trust asserted against Mr Kendle was not said to further or be associated with an illegal purpose. Nor was the 1997 Deed said to be a 'sham' … and there was no plea of non est factum … Nor was there any claim to rescission of the 1997 Deed upon any of the grounds upon which that remedy is available in equity. Finally, the maxim that 'equity looks to the substance rather than the form' would be misapplied and misunderstood if used to warrant 'the substitution of a different transaction for the one into which the parties [to the 1997 Deed] have entered'.

The fundamental rule of interpretation of the 1997 Deed is that the expressed intention of the parties is to be found in the answer to the question, 'What is the meaning of what the parties have said?', not to the question, 'What did the parties mean to say?' …

Where an express inter vivos trust respecting land or any interest therein is manifested and proved by some informal writing, or an express inter vivos trust of personalty is said to have been created by informal writing or orally, then a dispute as to the presence of the necessary intention, despite inexplicit language, is resolved by evidence of what the Court in *Kauter v Hilton* (1953) 90 CLR 86 at 100 identified as '[a]ll the relevant circumstances'.

But the object of this evidentiary odyssey does not change, and the nature of the intention of the alleged settlor does not differ. The question, as Megarry J put it, 'is whether in substance a sufficient intention to create a trust has been manifested'. …

In *Commissioner of Stamp Duties (Qld) v Jolliffe* (1920) 28 CLR 178, the primary judge … had admitted evidence given by Mr Jolliffe that he had opened a savings bank account for his wife (now deceased) … for the sole purpose of procuring interest not payable by the bank if the account stood in his name alone. The issue identified on the grant of special leave to appeal had been whether the effect of the *Queensland Government Savings Bank Act 1916* (Qld) ('the 1916 Act') and the written evidence precluded Mr Jolliffe from averring that he was not trustee of the money in the account at the death of his wife.

In *Jolliffe* the passage from *Lewin on Trusts* … was relied upon by the majority (Knox CJ and Gavan Duffy J), in the absence of citation of any other authority, as denying the proposition that 'by using any form of words a trust can be created contrary to the real intention of the person alleged to have created it'. … In *Hyhonie Holdings Pty Ltd v Leroy* [2003] NSWSC 624 at [38], Young CJ in Eq referred to the 17th edition of *Lewin on Trusts,* where it was said that today the dissenting reasons of Isaacs J in *Jolliffe* would be preferred in England to those of the majority.

… What is important for the present case is that *Jolliffe* should not be regarded as retaining any authority it otherwise may have had for the proposition that where the creation of an express trust is in issue, regard may be had to all the relevant circumstances not merely to show the intention manifested by the words and actions comprising those circumstances, but to show what the relevant actor meant to convey as a matter of 'real intention'.

Heydon and Crennan JJ

… [I]n both English and Australian law the surrounding circumstances are material to the questions whether the words used created a trust and what its terms are. Accordingly, Conaglen was correct to say:

> The court's focus when construing the terms of [a] bilateral arrangement [creating a trust] is on the objective meaning that those terms would convey to a reasonable person, just as it is when construing contractual arrangements. The question is what the settlor or settlors did, not what they intended to do.

That truth tends to be obscured by constant repetition of the need to search for an 'intention to create a trust'. That search can be seen as concerning the first of the three 'certainties' – what Dixon CJ, Williams and Fullagar JJ called in *Kauter v Hilton* (at 97):

> the established rule that in order to constitute a trust the intention to do so must be clear and that it must also be clear what property is subject to the trust and reasonably certain who are the beneficiaries.

But the intention referred to is an intention to be extracted from the words used, not a subjective intention which may have existed but which cannot be extracted from those words. This is as true of unilateral declarations of alleged trust as it is of bilateral covenants to create an alleged trust. It is as true of alleged trusts which are not wholly in writing as it is of alleged trusts which are wholly in writing. In relation to alleged trusts which are not wholly in writing, the need to draw inferences from circumstances in construing the terms of conversations may in practice widen the extent of the inquiry, but it does not alter its nature.

As with contracts, subjective intention is only relevant in relation to trusts when the transaction is open to some challenge or some application for modification – an equitable challenge for mistake or misrepresentation or undue influence or unconscionable dealing or other fraud in equity, a challenge based on non est factum or duress defences, an application for modification by reason of some estoppels, an allegation of illegality, an allegation of 'sham', a claim that some condition has not been satisfied, or a claim for rectification. But subjective intention is irrelevant both to the question of whether a trust exists and to the question of what its terms are.

Jolliffe's case. The majority in *Jolliffe's* case relied on a passage in the eleventh edition of *Lewin on Trusts* stating that the court will not impute a trust where the settlor did not mean to create one. In light of the authorities discussed above, that statement is wrong. …

Notes

(1) Heydon and Crennan JJ's judgment distinguishes bilateral from unilateral trust declarations. 'Unilateral' declarations of trust are made by the settlor, without any necessary involvement of the potential beneficiary, and involve the settlor gifting the property on trust. 'Bilateral' declarations of trust involve both the settlor and the beneficiary and are supported by consideration. Objective certainty suffices for bilateral trusts: see *Shortall v White* [2007] NSWCA 372. *Byrnes v Kendle* aligns certainty for bilateral and unilateral trusts.

(2) In *Byrnes v Kendle*, the parties' intentions were manifested in explicit, unambiguous writing. Where the meaning of writing is unclear, the court must discover the objective intention of the settlor in the context of the evidence at hand. For example, in *Re Armstrong* [1960] VR 202 (see textbook at [14.6]), limited, informal written words were used. Did titles on bank accounts 'George Armstrong in re William Armstrong/Bernard Armstrong' indicate that George (since deceased) had intended to create a trust for his sons? It was held that George had intended to benefit the sons; the bank manager's evidence showed he intended to create a 'trust', although that word was not used. In cases where a trust is created orally, the court can only look to contextual evidence. The court must examine all the relevant surrounding circumstances: *Dencio v Dencio* [2020] ACTSC 250, [50]. An example is *Paul v Constance* [1977] 1 WLR 527 (see textbook at [14.7]). A man deposited a damages award into a personal bank account. However, the bank manager gave evidence after the man's death that he had wished to open a joint account with his de facto, but had been advised by the manager that this was inappropriate. The man stated on more than one occasion in the presence of witnesses that the money in the account was as much the de facto's as his own; his use of the account appeared to support that statement. Had he declared a trust over the bank account? The Court of Appeal held that the words used, and evidence of the other circumstances, supported that conclusion.

(3) In contractual relationships, there are frequently written documents. If a written contract does not explicitly demonstrate an intention to create a trust, can one be inferred? In *Korda v Australian Executor Trustees (SA) Ltd* [2015] HCA 6; (2015) 255 CLR 62 (see textbook at [14.21]–[14.24]), Gageler J said at [109]: 'where parties to a contract have refrained from contractual use of the terminology of a trust, an intention to create a trust will be imputed to them only if, and to the extent that, a trust is a legal mechanism which is appropriate to give legal effect to the relationship … as established or acknowledged by the express or implied terms of the contract. The question is whether recognition and enforcement of a trust is appropriate to give effect in law to entitlements and obligations which the parties, according to ordinary principles of contractual interpretation, can be taken together to have intended to exist in fact.'

Questions

(1) What factors indicate an intention to create a trust? What factors indicate that there was no intention to create a trust? See the discussion of the *Quistclose* trust at [13.3.1].

(2) When will the settlor's objective intention not be regarded as determinative?

(3) What theoretical and policy reasons exist for adopting an objective test for certainty of intention? See discussion in *Byrnes v Kendle*, [56]–[59] (Gummow and Hayne JJ), [95]–[112] (Heydon and Crennan JJ).

(4) It is frequently said that there is no magic in the use of the word 'trust': *Tito v Waddell (No 2)* [1977] 1 Ch 106, 211. Has one of the effects of *Byrnes v Kendle* been to make the use of the term virtually conclusive? See *Markopoulos v Marco* [2020] WASC 79.

14.2b *Re Williams* [1897] 2 Ch 12

Background

Dr Williams left his estate to his wife 'absolutely, in the fullest confidence that she will carry out my wishes'. Dr Williams' wishes were that his wife leave by her will an insurance policy on her own life for £1,000, and the proceeds of an insurance policy on his life for £300 to their daughter, Lucy. When Mrs Williams died, her will bequeathed the £300 to Lucy, but bequeathed Mrs Williams' insurance policy proceeds to someone else. Dr Williams' executors asked the Court to determine whether Mrs Williams was obliged to leave her life insurance proceeds to Lucy.

Decision

The Court held that the will did not create a trust of the proceeds of the insurance policy for Lucy.

Lindley LJ

… [E]quitable obligations, whether trusts or conditions, can be imposed by any language which is clear enough to show an intention to impose an obligation, and is definite enough to enable the court to ascertain what the precise obligation is and in whose favour it is to be performed. There is also abundant authority for saying that, if property is left to a person in confidence that he will dispose of it in a particular way as to which there is no ambiguity, such words are amply sufficient to impose an obligation. … But still in each case the whole will must be looked at; and unless it appears from the whole will that an obligation was intended to be imposed, no obligation will be held to exist; …

I return to the testator's will. He has in terms given his property to his wife absolutely in the confidence she will herself leave the policy moneys by her will to her daughter … These circumstances show, and I think conclusively show, that he did not intend his wife to be tenant for life only of the £300 policy. The £1000 policy not being payable until her own death, she cannot be tenant for life of that.

… I have, moreover, no doubt that [the wife] took [the estate] absolutely, in the sense of taking it free from the control of her co-trustee. But further, I think that … 'absolutely' may refer to the extent of the interest, but it may mean a great deal more, and that its natural grammatical meaning is unfettered and unlimited in respect of any consideration or trust. …

The particularity with which the testator has stated what his wishes were removes all difficulty in giving effect to those wishes if they are expressed in language which is shewn by the will to be intended to be imperative; but such particularity does not supply the want of imperative language. The testator has employed the same language with respect to his own policy as with respect to his wife's. He has shown no intention of imposing an obligation on her in respect of one of them and not in respect of the other. … [O]ur task is to construe the will before us, and other cases are useless for that purpose except so far as they establish some principle of law. There is no principle except to ascertain the intention of the testator from the words he has used, and to ascertain and give effect to the legal consequences of that intention …

I have arrived at the conclusion that the testator has not used language sufficiently clear to impose upon his widow an obligation to leave either policy to his daughter. … [H]e refrained from such language imperative in its terms, such as upon trust or upon condition, and … he really intended to trust his widow's discretion with respect to his daughter, and not to provide for his daughter himself by putting a legal fetter on his widow's power of disposition of her own policy or of the property which he left her. I read the will as expressing a wish that his daughter should have both policies unless his widow should see reasons for otherwise disposing of them, and I do not find in the will a command to his widow to leave the policies to his daughter. …

Note

The term 'precatory words' means words of prayer or, more colloquially, words that express a hope or wish, without intending to impose enforceable obligations on the recipient of property. Precatory words are usually found in testamentary trusts, but can also arise in inter vivos trusts: see *Chang v Tjiong* [2009] NSWSC 122.

Questions

(1) What is the essential difference between a gift on trust for the benefit of another, and mere precatory words in favour of another?

(2) What construction aids does Lindley LJ employ to determine the nature of the term in question?

14.2c *Cobcroft v Bruce* [2013] NSWSC 774; (2013) 9 ASTLR 397

Background

Cobcroft died in 2005, leaving his wife Denise 'my shares in public companies, to deal with as she in her absolute discretion sees fit, but otherwise on condition that she ultimately gives those shares, or the remainder thereof, to my nephews David … and Niklas'. Denise died in 2010. Her will left the remaining shares (valued at $6–7 million) as part of her residuary estate to four charities. Did Cobcroft's will create a trust in favour of the nephews, or impose an enforceable obligation, short of a trust, on Denise?

Decision

The Court held that Cobcroft's will imposed an equitable condition on Denise to leave the shares to the nephews.

Young AJ

… [A]s a matter of legal analysis there are a number of possibilities as to the true construction of clause 9 of Gavin Cobcroft's will. The principal possibilities are that:

> **(1)** the widow takes the shares absolutely and that the balance of the provision is … void;
>
> **(2)** the widow takes the shares absolutely but subject to an equitable condition which can be policed by an order for equitable compensation or specific performance. This analysis would require that the shares remaining at the date of her death be given to her nephews;
>
> **(3)** the widow has a life estate only, coupled with a power to resort to capital, and that after her death the property passes to her nephews; or
>
> **(4)** the shares were a gift to the widow for life with a general power of appointment. …

The present benefaction to the nephews is not in defeasance of the gift nor is it a gift which takes effect on the termination of an absolute gift. It is to my mind an obligation imposed on the widow or alternatively some sort of precatory trust or even a proper trust imposed on the widow.

The leading case … is *Gill v Gill* (1921) 21 SR NSW 400. In that case, a farm and homestead was devised to a son 'on condition that he keep the homestead as a home and provide board and residence for his sisters …'. Harvey J (at 406) distinguished that condition from a condition precedent of forfeiture and also said that with the condition in the will in that case the requirements of certainty were not as strict. At 407, his Honour stated that in some cases of this nature the court may think that the testator intended to attach a charge or trust upon the property and in other cases that a personal liability alone was intended. This will depend partly on the language used to describe the obligation partly on the nature of the property given to the obligee and partly on the nature of the obligation. Where the obligation is merely personal then the court (even if it could not grant specific performance) would grant a relief by way of equitable damages or equitable compensation.

Of course, the words used in any particular will may not create such a condition, they may merely be words expressing the testator's desires, precatory words. …

However, when one gets to a *Gill v Gill* condition one may get a trust, one may get a charge, or one may get an equitable obligation.

Mr Willmott cited the decision of Needham J in *Hayes v National Heart Foundation of Australia* [1976] 1 NSWLR 29 in which the will provided that the testator's daughter was to take the balance of his estate including his shares; 'these shares [are] to be retained by her as a source of income on the understanding that she write into her will that, at her death, these shares are to be sold and the capital received to be divided in equal parts between' three named charities. The learned judge considered that the words were sufficiently definite to make it clear that the limitation on the power of ownership was not merely a request, but a legal restriction.

Although there was little in the will to guide the judge into deciding whether there was a trust, or a gift subject to a condition, he thought that the will indicated that full legal title vested in the daughter. She received the property pursuant to an obligation to hold them on trust after her death for the three charities.

In the High Court, Dixon J had to consider an analogous situation in the income tax case of the *Countess of Bective v Federal Commissioner of Taxation* [1932] HCA 22; (1932) 47 CLR 417. He said there were at least four different possibilities where one had made a gift testamentary, or otherwise directing a payment to one person and expressing a purpose beneficial to another person. In summary these were:

> **(a)** the expression of the purpose may be taken merely as a statement of motive or expectation in which case the first person takes the gift absolutely and incurs no legal or equitable obligation to fulfil the purpose;
>
> **(b)** the purpose may be stated so as to amount to a condition, in which case by accepting the gift the donee incurs the equitable duty to perform a condition;
>
> **(c)** the first person may take the gift beneficially, but the statement of purpose may operate as an equitable charge in favour of another;
>
> **(d)** the direction to pay the first person may be regarded as conferring no beneficial interest on him but means that he receives the gift strictly in the character of a trustee.
>
> In my view, the command that the widow took her benefaction on condition that she gave the shares to the testator's nephews is a *Gill v Gill* condition imposing an equitable obligation on the widow to either; give the shares during her life, or alternatively, to make provisions on her death for the shares to pass to the nephews. …

Note

Unless consideration has been received, the settlor's intention must be an intention to create a trust immediately, and not at some future time.

Questions

(1) What factors will guide a court's selection among the possibilities listed by Young AJ?

(2) How should a court interpret the following provision: 'I leave the residue of my estate to my brother David, on condition he ensures that John my youngest son never wants for anything'? See *Hammond v Hammond* (2007) 13 BPR 24,619.

14.2d *Harpur v Levy* [2007] VSCA 128; (2007) 16 VR 587

Background

Rand died on 7 October 1997. A month earlier, he had executed a will. Under its terms, Mr and Mrs Harpur were entitled to live in one of Rand's properties for a period of time, and a bequest was made to Guy Harpur. The bulk of the estate was left to Rand's partner for life, with capital to go to charities. A month after Rand's death, the Harpurs' solicitors sent the executors a copy of a deed of trust executed in August 1997. It was said that the original document had been stolen from the Harpurs' accountant. Under the deed's terms, Rand declared himself trustee of his property for the beneficiaries of the Harpur family trust. If the trust of August 1997 was valid, Rand would have had virtually nothing to leave by his will. Rand's executors commenced proceedings against the Harpurs, claiming that the deed of trust was not authentic. Moreover, it was claimed that, even if the deed was authentic, the declaration of trust was ineffective. The deed (allegedly executed in August 1997) stated that it was to have a commencement date of 1 October 1997. The executors argued that the deed therefore did not manifest a sufficient intention to create a trust.

Decision

A majority of the Victorian Court of Appeal held that no trust had been created because the settlor had not expressed a clear intention to create an immediately operative trust.

Maxwell P (dissenting)

In my opinion, the deed was effective as an immediate declaration of trust, with the properties to be transferred in the future. I consider that the operative provisions of the deed clearly evince an intention on the part of Mr Rand that he become trustee then and there. At worst for the appellants, the operative provisions are ambiguous, and reference to the recitals – justified in a case of ambiguity – confirms that Mr Rand intended to create a trust immediately.

Neave JA

Both the appellants and the respondents agree that the effect of the deed depends on whether … clause 1 of the trust deed, read in the context in which it appears, expresses the deceased's intention 'to create a trust in the future' or, on the other hand, expresses an intention to create a trust immediately 'with a postponement of enjoyment by the beneficiaries'.

In the former case, equity will not assist a volunteer by enforcing an intention to create a future trust. In the latter case, a trust is created immediately, and can be enforced by volunteer beneficiaries, although their enjoyment may be postponed. For example, if an owner declares that she holds property on trust to pay the income to herself for life and after her death to pay the capital to specified beneficiaries, those beneficiaries have an immediately enforceable interest in the property, even though they will not be entitled to the capital of the fund until the settlor dies. …

Conclusion

The authorities cited by the appellants and the respondents do little more than re-state the fundamental proposition that if a person manifests an immediate intention to declare a trust, the trust is binding on its declarant, even though the enjoyment of the beneficiaries may be postponed until a future date. … None of these cases assists us in determining whether the deceased intended to create a trust immediately, or only to bind himself from the commencement date of 1 October 1997.

… The question that must be resolved is whether the words used in the trust deed were effective to dispose of an interest to the beneficiaries of the P & G R Harpur Trust. …

Despite the use of the words 'irrevocably declares' and 'holds' in clause 1, I am not satisfied, on the balance of probabilities, that clause 1 expresses an intention to create an immediately binding trust. As counsel for the respondents submitted, these words must be read in the context of the remainder of clause 1. …

In my view the unequivocal meaning of the clause read as a whole is that the deceased holds the property and assets … on trusts which come into operation on the 'commencement day' of 1 October 1997. Clauses 2 to 6 also make it clear that the trust does not operate until the commencement date. I can see no other reason why reference to 'the commencement day' could be included in these provisions. There is no provision in the deed that says Mr Rand is to be entitled to the income of the trust until the commencement date. Rather, the deed makes it clear that he retains both the legal and the beneficial interest in the property until that date.

The use of the words 'irrevocably declares' does not manifest a clear intention to create an immediately operative trust. The presence of these words cannot overcome a clear indication that the trust is not intended to come into effect immediately, as was the case in this trust deed. Further, a validly constituted trust can contain a power of revocation – most trust deeds contain such a power. The issue of whether a trust has been created is conceptually separate from the issue of whether it is revocable.

To purport to declare a trust, but to state that it will not come into operation until a later date, is inconsistent with an intention to relinquish the beneficial interest in the property from the date of execution of the deed. …

Courts may be prepared to find that an informal oral declaration of trust has passed an equitable interest to a beneficiary, where the court is 'dealing with simple people unaware of the subtleties of equity'. However this deed was drafted by Mr Harpur, who is a solicitor. A lawyer can reasonably be expected to understand the difference between expressing an intention to establish a trust in the future and creating a trust which operates immediately.

Notes

(1) As Redlich JA commented in his separate judgment (concurring generally with Neave JA), in the absence of valuable consideration a promise to create a trust at a later time is no more effective than a promise to make a gift in the future. If there is no consideration for the promise, equity sees no reason why the donor cannot change his mind. Here, the putative beneficiaries had not given any consideration for Rand's declaration of trust.

(2) For a postscript to the Rand estate litigation, see *Levy v Watt* [2012] VSC 539. In 2010, police removed a stolen painting from Levy's home. Levy had been left the painting in Rand's will. There was no suggestion Levy knew the painting was stolen. The painting had been stolen in 1991 from Watt (who knew Rand), by persons unknown. Watt's estate recovered the painting, partly because Levy was unable to prove Rand had been a bona fide purchaser of the painting. (See chapter 21 on tracing.)

Question

Rand was deceased when the Harpurs attempted to enforce the trust in the above case. Should evidence from a settlor of an inter vivos trust as to their own intention be determinative? If not, why not?

14.3 Certainty of subject-matter

A trust cannot be enforced unless the property held on trust can be identified. Some attempted trusts fail because the 'property' is not property at all; for example, a mere expectancy, such as the expectation of receiving property under a will of someone who has not yet died, cannot be the subject of a trust: *Re Rule's Settlement* [1915] VLR 670. If the property concerned is 'future' property (see textbook at [9.19]), it cannot be the subject-matter of a voluntary trust. Other trusts fail because the property is too poorly described to be identifiable. One particular problem concerning certainty of subject-matter arises when a settlor declares a trust over part of fungible property, such as shares.

14.3a *Hunter v Moss* [1994] 1 WLR 452

Background

Moss owned 950 of the 1000 issued shares in Moss Electrical Limited. Hunter was employed by Moss Electrical. Moss orally agreed to give Hunter a five per cent shareholding in the company. Later, Moss refused to transfer the shares to him. The primary judge held that a trust had been established. Moss appealed, partly on the basis there was insufficient certainty of subject matter for a valid trust.

Decision

The Court of Appeal held that a trust of a percentage of a shareholding was sufficiently certain to constitute the subject matter of a trust.

Dillon LJ

[T]here must be certainty of subject matter. All these shares were identical in one class: five percent was 50 shares and Mr Moss held personally more than 50 shares. …

In the present case there was no question of an imperfect transfer. What is relied on is an oral declaration of trust. Again, it would not be good enough for a settlor to say, 'I declare that I hold 50 of my shares on trust for B', without indicating the company he had in mind of the various companies in which he held shares. There would be no sufficient certainty as to the subject matter of the trust. But here the discussion is solely about the shares of one class in the one company.

It is plain that a bequest by the defendant to the plaintiff of 50 of his ordinary shares … would be a valid bequest on the defendant's death which his executors or administrators would be bound to carry into effect. [Counsel for the defendant] sought to dispute that and to say that, if for instance, a shareholder had 200 ordinary shares in ICI and wanted to give them to A, B, C and D equally he could do it by giving 200 shares to A, B, C and D as tenants in common, but he could not validly do it by giving 50 shares to A, 50 shares to B, 50 shares to C and 50 shares to D, because he has not indicated which of the identical shares A is to have and which B is to have. I do not accept that …

Just as a person can give, by will, a specified number of his shares in a certain class in a certain company, so equally, in my judgment, he can declare himself trustee of 50 of his ordinary shares in … whatever the company may be and that is effective to give a beneficial proprietary interest to the beneficiary under the trust.

Background

During the breakdown of their de facto relationship, the defendant wrote to the plaintiff, confirming that he held 222,000 of 1.5 million Unitract shares in trust for the plaintiff. (He was unable to transfer them directly to the plaintiff, as they were still in escrow.) He later disputed the validity of the trust, claiming lack of intention to create it, and uncertainty of subject-matter.

Decision

The Court held that a valid trust of the 220,000 shares had been created for the plaintiff.

Campbell J

The declaration of trust that the defendant made is, in substance, that, of those shares in Unitract that he held, 222,000 of them were held in trust for the plaintiff. In my view, that is, in substance, that 220,000 of the shares he held were on trust for the plaintiff, and the rest were on trust for himself. The trust in relation to the rest of the shares is the type of trust that one infers must have been intended, if the trust that definitely was intended concerning the 220,000 shares is to operate. …

Once a finding has been made that there was an intention to hold 220,000 shares on trust, that intention needs to be given effect in the way that is appropriate to the kind of property … Given the types of rights that are involved in holding shares in a company, the way that rights of a shareholder need not be identified only in terms of owning particular identified shares, how identification of individual shares can be unimportant for a transfer of some of the shares in a shareholding, and how these particular shares in Unitract were in any event not numbered and were held as an undifferentiated balance in a share register, there is nothing in the nature of the trust property that is inconsistent with recognising the validity of the trust. To recognise the trust is not to perfect an imperfect gift – because there is no transfer of any property involved in a declaration of trust, but rather the declarer of the trust states the terms on which, henceforth, he will hold certain property that he already holds.

… Given the nature of shares in a company, it is perfectly sensible to talk about an individual having a beneficial interest in 222,000 shares out of a parcel of 1.5 million, even if it is not possible to identify individual shares that are held on trust. …

In the present case, one can identify the property that is subject to the trust (the entire shareholding), one can identify the trustee (the defendant), and one can identify the beneficiaries (the plaintiff as to 220,000 shares, the defendant as to the rest). That is all that is needed for a valid trust.

Notes

(1) *White v Shortall* was affirmed on appeal, but the only issue considered was certainty of intention: see *Shortall v White* [2007] NSWCA 372.

(2) The decision in *Hunter v Moss* has, as Campbell J noted, attracted considerable academic analysis. For a criticism of the decision, see D Hayton, 'Uncertainty of Subject-matter of Trusts' (1994) 110(3) *Law Quarterly Review* 335.

(3) Campbell J's discussion of certainty of subject-matter was considered extensively by Jagot J (Siopsis J agreeing) in *Ellison v Sandini Pty Ltd* (2018) 263 FCR 460. The facts of the case concerned whether a change in ownership had resulted from a Family Court order that 2,115,000 unnumbered shares in a public company be transferred from a larger holding and did not involve a trust. Her Honour noted at [135] that the success of declaration of trust in *White v Shortall* depended upon it being a declaration that the whole shareholding was held in trust for the plaintiff and the defendant in identifiable proportions. Her Honour mentioned the potential taxation difficulties that could arise due to times of acquisition and cost base, identified by Campbell J in *White v Shortall*. Jagot J's conclusion at [148] was that '(i)n terms of principle, the weight of authority is that there can be a valid trust over a fungible pool of assets provided the assets and the relevant proportions for the different beneficiaries are identified with sufficient certainty. The better view is that for the requirement of certainty to be satisfied the trust must be over all of the fungible assets in the pool, the beneficial co-ownership proportions reflecting the respective interests of the beneficiaries.' Jagot J commented at [150] '… the resolution Campbell J reached in *White*

v Shortall works only if it can be said that the trust is created over the whole of the fund … Otherwise the inferred intention of the declarer of the trust or the parties, as relevant, may be bedevilled by capital gains tax issues as a result of rollover relief provisions'. See also textbook at [14.34].

Questions

(1) Dillon LJ analogised a declaration of trust over part of a bulk to a testamentary disposition of part of a bulk. Can different treatment for each of those dispositions be justified?

(2) Both *Hunter v Moss* and *White v Shortall* involved declarations that the defendants held property for the benefit of others. Would the same conclusion have been reached if the defendants had been attempting to create trusts by transfer?

(3) How relevant was it to the validity of the trusts in *Hunter v Moss* and *White v Shortall* that the shares were of the same class? Would these cases have been decided differently if the defendants had held different classes of shares? What if shares of the same class had been acquired at different times, the first tranche for $1 per share, and the second tranche for $2 per share?

(4) Is Campbell J's 'mechanical' solution (that the defendant has declared a trust over the whole bulk, holding part for the plaintiff and the rest for himself) justifiable? Did the defendant intend to impose trustee's obligations on himself concerning the rest?

14.4 Certainty of object

Private express trusts must be in favour of named or identifiable individuals. This allows the court to identify who has standing to enforce the trust: *Morice v Bishop of Durham* (1804) 9 Ves 399, 405–5; 32 ER 656, 658.

Two tests have been settled for object identification. They relate to the type of trust, and the degree of certainty necessary for the trustee to properly carry out its obligations.

Fixed trusts (see textbook at [14.43]), where the trustee has no discretion to select who is to receive trust property, or how much they are to receive, require '*list certainty*'. The trustee must be able to draw up a full list of the beneficiaries entitled to the trust property at the time of distribution. This is because the trustee is obliged to account for the trust property only to those entitled to receive it. Unless a list will be able to be constructed, the trust will be invalid: *Inland Revenue Commissioners v Broadway Cottages Trust* [1955] Ch 20.

On the other hand, discretionary trusts (see textbook at [14.44]), where the trustee is given a discretion to select amongst beneficiaries, only require '*criterion certainty*' be achieved. The trustee must be able to say whether any given person is inside or outside of the class described. The same is true of bare powers of appointment (see textbook at [14.35]), where the trustee is given a discretion to appoint property amongst potential beneficiaries, but is under no obligation to do so. In both cases, the trustee's obligations will be breached if the property is paid over to someone who is outside of the described class.

Practically, this means that the words used to describe any class must have a sensible meaning (linguistic or conceptual certainty – see textbook at [14.41]). For discretionary trusts, it also means that the class described cannot be so large that a court, if called upon, would not be able to carry out the appointment (administrative workability) (see textbook at [14.47]–[14.51]).

Charitable trusts (chapter 16) do not require identification of individual beneficiaries. Instead, they require that the proposed trust be for a valid charitable purpose or object.

14.4a *Re Gulbenkian's Settlement Trusts* [1970] AC 508

Background

Calouste Gulbenkian made settlements intended to benefit and protect his son, Nubar. A clause conferring on the trustees a special power to appoint income to Nubar and persons with whom he had associated was poorly drafted, and 'did not make sense', according to Lord Reid. Was the class of potential beneficiaries so uncertain that the trustees would be unable to perform the trust?

Decision

The House of Lords held that the special power was valid since, in spite of the poor drafting, it was possible for the trustees to say of any person under consideration that the person either did or did not come within the terms of the power.

Lord Reid

I think that it is reasonably clear that this clause is a result of carelessly telescoping two separate clauses – (1) any person by whom Mr Gulbenkian may from time to time be employed, and (2) any person in whose house or in whose company or under whose care or with whom he may from time to time be residing. …

If the clause is read in the way in which I think it must be read then it is not suggested that there is any uncertainty about the first limb – any person by whom Mr Gulbenkian may be employed – but it is argued that the other limb is bad for uncertainty. It would be bad if it purported to impose on the trustees duties which, even with the aid of the court, they could not properly carry out. So one must first see what their duties are. One argument … is that because this is admitted to be a mere power, it really imposes no duties on them at all. I find that difficult to understand. It is a power given not to the individuals who happen also to be trustees but to the trustees as such … In my view, it must follow that the trustees are to act in their fiduciary capacity. They are given an absolute discretion. So if they decide in good faith at appropriate times to give none of the income to any of the beneficiaries the court cannot pronounce their reasons to be bad. … But 'their absolute discretion' must, I think, be subject to two conditions. It may be true that when a mere power is given to an individual he is under no duty to exercise it or even to consider whether he should exercise it. But when a power is given to trustees as such, it appears to me that the situation must be different. A settlor or testator who entrusts a power to his trustees must be relying on them in their fiduciary capacity so they cannot simply push aside the power and refuse to consider whether it ought in their judgment to be exercised. And they cannot give money to a person who is not within the class of persons designated by the settlor: the construction of the power is for the court.

If the beneficiaries are not defined with sufficient particularity to enable the court to determine whether a particular person is or is not, on the facts, at a particular time, within one of the classes of beneficiaries, then the power must be bad for uncertainty. … And it must be possible to determine the validity of the power immediately it comes into operation. … So if one can reasonably envisage cases where the court could not determine the question the power must be bad for uncertainty. But it is not bad merely because such determination may be difficult in a particular case.

Lord Upjohn

If a donor (be he a settlor or testator) directs trustees to make some specific provisions for 'John Smith', then to give legal effect to that provision, it must be possible to identify 'John Smith'. If the donor knows three John Smiths then by the most elementary principles of law neither the trustees nor the court in their place can give effect to that provision; neither the trustees nor the court can guess at it. It must fail for uncertainty unless of course admissible evidence is available to point to a particular John Smith as the object of the donor's bounty.

Then taking it one stage further, suppose a donor directs that a fund be equally divided between members of a class. That class must be as defined as the individual: the court cannot guess at it. Suppose the donor directs that a fund be divided equally between 'my old friends', then unless there is some admissible evidence that the donor has given some special 'dictionary' meaning to that phrase which enables the trustees to identify the class with sufficient certainty, it is plainly bad as being too uncertain. … Then, suppose the donor does not direct an equal division of his property among the class, but gives a power of selection to his trustees among the class; exactly the same principles must apply. The trustees have a duty to select the donees of the donor's bounty from among the class designated by the donor …

But when mere or bare powers are conferred upon donees of the power (whether trustees or others) the matter is quite different. As I have already pointed out, the trustees have no duty to exercise it in the sense that they cannot be controlled in any way. … The result is … even if the class of appointee among whom the donees of the power may appoint is clear and ascertained and they are

all of full age and *sui juris,* nevertheless they cannot compel the donees of the power to exercise it in their collective favour. If, however, it is a trust power, then those entitled are entitled (if they are of full age and *sui juris)* to compel the trustees to pay the fund over to them, unless the fund is income and the trustees have the power to accumulate it for the future.

… It is a matter of construction whether the power is a mere power or a trust power and the use of inappropriate language is not decisive: *Wilson v Turner* (1883) 22 Ch D 521 at 525.

So, with all respect to the contrary views, I cannot myself see how, consistently with principle, it is possible to apply to the execution of a trust power the principles applicable to the permissible exercise by the donees (even if trustees) of mere powers; that would defeat the intention of donors completely.

But with respect to mere powers, while the court cannot compel the trustees to exercise their powers, yet those entitled to the fund in default must clearly be entitled to restrain the trustees from exercising it save among those within the power. So the trustees or the court must be able to say with certainty who is within and who is without the power.

Notes

(1) Lord Reid distinguishes between classes described in such a way that members cannot be identified, and classes described clearly, but where it is difficult to identify or locate the members of the class. This difference is referred to as 'semantic' or 'linguistic' certainty, as opposed to 'evidentiary' certainty. Semantic certainty is required for validity; evidentiary certainty is not, and the court can give directions as to what evidence is required: see *McPhail v Doulton* [1971] AC 424, at [14.4b] below.

(2) The decision in *Re Gulbenkian* was that for mere powers, a class was certain where its description allowed the trustee or court to say whether a person was inside or outside the class described (criterion certainty), but that the stricter test of list certainty should apply to trust powers. This aspect of the decision was overruled just two years later in *McPhail v Doulton.* See textbook at [14.39]–[14.44] on powers of appointment, trust powers (or discretionary trusts) and fixed trusts.

Questions

(1) Is a special power of appointment conferred on trustees to appoint trust income 'to anyone in the world they consider deserving' valid?

(2) When is the question of uncertainty of object to be determined? See Lord Reid's judgment, above.

14.4b *McPhail v Doulton* [1971] AC 424

Background

Baden established a discretionary pension fund for the employees of Matthew Hall & Co Ltd. When he died, his executors challenged the validity of the trust instrument. (If the trust was invalid, property settled on the trust would form part of the Baden estate.) The relevant clause described the class of potential beneficiaries as 'any of the officers and employees or ex-officers or ex-employees of the company or … any relatives or dependants of such persons.' The initial question was whether the clause gave the trustees a mere power or a trust power. If the clause created a trust power, the class described would have failed the 'list certainty' test, as it would be impossible to construct a list of 'relatives' of such persons. The clause might, however, satisfy the 'criterion certainty' test, if the terms 'relatives' and 'dependants' were linguistically certain.

Decision

The House of Lords, Lords Hodson and Guest dissenting, held that the trust power would be valid if the objects satisfied the criterion certainty test.

Lord Wilberforce

Before dealing with these two questions some general observations, or reflections, may be permissible. It is striking how narrow and in a sense artificial is the distinction, in cases such as the present, between trusts or as the particular type of trust is called, trust powers, and [mere] powers. … A layman and, I suspect, a logician, would find it hard to understand what difference there is.

It does not seem satisfactory that the entire validity of a disposition should depend on such delicate shading. And if one considers how in practice reasonable and competent trustees would act, and ought to act, in the two cases, surely a matter very relevant to the question of validity, the distinction appears to be even less significant. To say that there is no obligation to exercise a mere power and that no court will intervene to compel it, whereas a trust is mandatory and its execution may be compelled, may be legally correct enough but the proposition does not contain an exhaustive comparison of the duties of persons who are trustees in the two cases. A trustee of an employee's benefit fund, whether given a [mere] power or a trust power, is still a trustee and he would surely consider in either case that he has a fiduciary duty: he is most likely to have been selected as a suitable person to administer it from his knowledge and experience, and would consider he has a responsibility to do so according to its purpose. It would be a complete misdescription of his position to say that, if what he has is a power unaccompanied by an imperative trust to distribute, he cannot be controlled by the court unless he exercised it capriciously, or outside the field permitted by the trust. Any trustee would surely make it his duty to know what is the permissible area of selection and then consider responsibly, in individual cases, whether a contemplated beneficiary was within the power and whether, in relation to other possible claimants, a particular grant was appropriate.

Correspondingly a trustee with a duty to distribute, particularly among a potentially very large class, would surely never require the preparation of a complete list of names, which anyhow would tell him little that he needs to know. He would examine the field, by class and category; might indeed make diligent and careful inquiries, depending on how much money he had to give away and the means at his disposal, as to the composition and needs of particular categories and of individuals within them; decide upon certain priorities or proportions, and then select individuals according to their needs or qualifications. If he acts in this manner, can it really be said that he is not carrying out the trust?

Differences there certainly are between trust (trust powers) and powers, but as regards validity, should they be so great as that in one case complete, or practically complete, ascertainment is needed, but not in the other? Such distinction as there is would seem to lie in the extent of the survey which the trustee is required to carry out: if he has to distribute the whole of a fund's income, he must necessarily make a wider and more systematic survey than if the duty is expressed in terms of a power to make grants. But, just as in the case of a power, it is possible to underestimate the fiduciary obligation of the trustee to whom it is given, so, in the case of a trust (trust power), the danger lies in overstating what the trustee requires to know or inquire into before he can properly execute his trust. …

[His Lordship held that the terms of the clause created a trust power.]

This makes it necessary to consider whether … the Court should proceed on the basis that the relevant [certainty] test is that laid down in *IRC v Broadway Cottages Trust* [1955] Ch 20 or some other test.

That decision gave the authority of the Court of Appeal to the distinction between cases where trustees are given a power of selection and those where they are bound by a trust for selection. In the former case the position, as decided by this House, is that the power is valid if it can be said with certainty whether any given individual is or is not a member of the class and does not fail simply because it is impossible to ascertain every member of the class. But in the latter case it is said to be necessary, for the trust to be valid, that the whole range of objects … should be ascertained or capable of ascertainment.

The respondents invited your Lordships to assimilate the validity test for trusts to that which applies to powers. … The basis for the *Broadway Cottages* principle is stated to be that a trust cannot be valid unless, if need be, it can be executed by the court and … that the court can only execute it by ordering an equal distribution in which every beneficiary shares. …

Assuming, as I am prepared to do for present purposes, that the test of validity is whether the trust can be executed by the court, it does not follow that execution is impossible unless there can be equal division.

As a matter of reason, to hold that a principle of equal division applies to trusts such as the present is certainly paradoxical. Equal division is surely the last thing the settlor ever intended: equal division among all may, probably would, produce a result beneficial to none. Why suppose that the court would lend itself to a whimsical execution? … Equal division may be sensible and has been decreed, in cases of family trusts, for a limited class; here there is life in the maxim 'equality is equity', but the cases provide numerous examples where this has not been so, and a different type of execution has been ordered, appropriate to the circumstances. …

The conclusion which I would reach … is that the wide distinction between the validity test for powers and that for trust powers is unfortunate and wrong, that the rule recently fastened upon the courts by *IRC v Broadway Cottages Trust* ought to be discarded, and that the test for the validity of trust powers ought to be similar to that accepted by this House in *Re Gulbenkian's Settlement* for powers, namely, that the trust is valid if it can be said with certainty that any given individual is or is not a member of the class. …

Assimilation of the validity test does not involve the complete assimilation of trust powers with powers. As to powers, … although the trustee may, and normally will, be under a fiduciary duty to consider whether or in what way they should exercise their power, the court will not normally compel its exercise. It will intervene if the trustees exceeded their powers, and possibly if they are proved to have exercised it capriciously. But in the case of a trust power, if the trustees do not exercise it, the court will: … I would venture to amplify this by saying that the court, if called upon to exercise the trust power, will do so in the manner best calculated to give effect to the settlor's or testator's intentions. It may do so by appointing new trustees, or by authorising and directing representative persons of the class of beneficiaries to prepare a scheme of distribution, or even, should the proper basis for distribution appear by itself directing the trustees so to distribute. … Then, as to the trustee's duty of inquiry or ascertainment, in each case the trustees ought to make such a survey of the range of objects or possible beneficiaries as will enable them to carry out their fiduciary duty. A wider and more comprehensive range of inquiry is called for in the case of trust powers than in the case of powers.

Two final points: first, as to the question of uncertainty. I desire to emphasise the distinction clearly made and explained by Lord Upjohn between linguistic or semantic uncertainty which, if unresolved by the court, renders the gift void, and the difficulty of ascertaining the existence or whereabouts of members of the class, a matter with which the court can appropriately deal on an application for directions. There may be a third case where the meaning of the words used is clear but the definition of beneficiaries is so hopelessly wide as not to form 'anything like a class' so that the trust is administratively unworkable or in Lord Eldon's words one that cannot be executed. I hesitate to give examples for they may prejudice future cases, but perhaps 'all the residents of Greater London' will serve. I do not think that a discretionary trust for 'relatives' even of a living person falls within this category.

Notes

(1) The case was remitted to the Chancery Division to determine whether the terms 'relatives' and 'dependants' were linguistically certain. Brightman J's decision that the trust power was valid was upheld by the Court of Appeal: *Re Baden's Deed Trusts (No 2)* [1973] Ch 9. The term 'dependant' was construed to mean a person who was financially dependent upon another. The Court also held the term 'relative' to be sufficiently certain, but, not being required to determine the point, split as to its actual meaning. Stamp LJ's formulation of 'nearest blood relations' is most commonly referred to in subsequent Australian cases.

(2) Australian courts have assumed *McPhail v Doulton* to be binding authority, despite the absence of High Court confirmation: see *Horan v James* [1982] 2 NSWLR 376; *Re Blyth* [1997] 2 Qd R 567; *McCracken v Attorney-General (Vic)* [1995] 1 VR 67; P Creighton, 'Certainty of Objects of Trusts and Powers: The Impact of *McPhail v Doulton* in Australia' (2000) 22(1) *Sydney Law Review* 93.

(3) Despite the unusual New South Wales decision of *West v Weston* (1998) 44 NSWLR 657, it is generally accepted in Australia that list certainty is still required for valid fixed trusts.

(4) Lord Wilberforce's dicta concerning a description of beneficiaries that is so hopelessly wide as not to form 'anything like a class', making the trust administratively unworkable, probably adds another requirement, in addition to the necessary linguistic certainty. The 'administrative workability' test was applied in *R v District Auditor No 3 Audit District of West Yorkshire Metropolitan County Council* [1986] RVR 24 (see textbook at [14.47]–[14.51]). A local authority attempted to set up 'The West Yorkshire Trust'. The discretionary trust was to benefit 'any or all or some of the inhabitants of the County of West Yorkshire'. There were about 2.5 million inhabitants of West Yorkshire at that time. Lloyd LJ (with Taylor J agreeing) said that this provision came within the third class of case referred to by Lord Wilberforce in *McPhail v Doulton,* and that a class of that size was 'so hopelessly wide' as to be incapable of forming 'anything like a class'. See also *McCracken v Attorney-General (Vic)* [1995] 1 VR 67, 72; *Re Blyth* [1997] 2 Qd R 567, 577.

(5) It appears that the 'administrative workability' test does not apply to mere or bare powers, although in *Re Manisty's Settlement* [1974] Ch 17, 27 Templeman J suggested that a bare power in favour of 'an accidental conglomeration of people who had no discernible link to the settlor' might be invalidated on the grounds of capriciousness. To our knowledge, no mere or bare power has ever been invalidated on this ground.

Questions

(1) In both *Re Gulbenkian* and *McPhail v Doulton*, the trustees considered that the power or trust power could be administered without difficulty. Why are trusts and powers declared invalid for lack of certainty of objects when the trustees are willing to administer them?

(2) Why is less stringent identification of beneficiaries sufficient for mere powers of appointment and discretionary trusts, when more stringent certainty is required for fixed trusts? Are the reasons given in *McPhail v Doulton* convincing?

(3) How can a trustee make a sensible choice among potential objects from a numerically large group?

(4) Consider the validity of the following dispositions:

> **(a)** I leave my residuary estate to be held on trust for such of my business associates as my trustees consider deserving.
>
> **(b)** I leave half of my portfolio of shares [which comprises shareholdings in 20 Australian corporations] on trust for such persons as my trustees shall select, excluding my wife and other members of my family.
>
> **(c)** I leave Blackacre on trust to be sold and the proceeds divided between my relatives.

15

Creating an express trust

15.1 Introduction

15.2 Declaration of trust

15.3 Creating a trust by transfer to the intended trustee

15.4 Exceptions to statutory writing requirements

15.5 Testamentary trusts

15.6 Trusts and public policy

15.1 Introduction

Chapter 14 explained the prerequisites for creating a valid trust. This chapter examines how a trust is created. Two modes of creation are recognised: first, a settlor can declare herself trustee of her own property (creating a trust by self-declaration); second, a settlor can transfer property to another with the intention that the other shall hold the property as trustee (creating a trust by transfer). The authorities on certainty of intention set out in chapter 14 determine whether the trust has been declared. No formality is needed in order to create the trust, except where the *Statute of Frauds*, re-enacted in all States and Territories, imposes writing requirements.

In order for a trust to be validly created by transfer, the common law or statutory formalities necessary to transfer the title to the property to the intended trustee must be complied with. These formalities are discussed at [9.1]–[9.2]. A transfer that is invalid at law may be validated in equity by application of the principle of *Corin v Patton* (1990) 169 CLR 540 (see [1.4a]; [9.2b]); namely, that the settlor has done everything that it is necessary for her to do to transfer her interest in the property.

In addition, a trust will fail if it is contrary to public policy, including the policy of the rules against remoteness of vesting and indestructible trusts, known collectively as the 'rule against perpetuities'. See textbook at [15.26]–[15.39] for a discussion of these rules.

15.2 Declaration of trust

The words and acts of the settlor, objectively construed, determine whether a trust has been declared. A declaration of trust simply means that the trust satisfies the requirement of certainty of intention. See chapter 14 and, in particular, *Byrnes v Kendle* [2011] HCA 26; (2011) 243 CLR 253 and *Re Williams* [1897] 2 Ch 12. Many trusts, particularly those created as part of a commercial transaction, are created by contract: see JH Langbein, 'The Secret Life of the Trust: The Trust as an Instrument of Commerce' (1997) 107(1) *Yale Law Journal* 165. The interrelationship of contract and trust is examined in chapter 13. See, in particular, *Trident General Insurance Co Ltd v McNiece Brothers Pty Ltd*, at [13.4.3a].

15.2a *Conveyancing Act 1919* (NSW)

Section 23C: Instruments required to be in writing

(1) Subject to the provisions of this Act with respect to the creation of interests in land by parol:

(a) no interest in land can be created or disposed of except by writing signed by the person creating or conveying the same, or by the person's agent thereunto lawfully in writing, or by will, or by operation of law,

(b) a declaration of trust respecting any land or any interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by the person's will,

(c) a disposition of an equitable interest or trust subsisting at the time of the disposition, must be in writing signed by the person disposing of the same or by the person's will, or by the person's agent thereunto lawfully authorised in writing.

(2) This section does not affect the creation or operation of resulting, implied, or constructive trusts.

...

Notes

(1) Section 23C(1) re-enacts ss 3, 7 and 9 of the *Statute of Frauds 1677*. Equivalent provisions in other jurisdictions are: *Law of Property Act 2000* (NT) ss 10(1)(a), (b). *Property Law Act 1974* (Qld) ss 11(1)(a), (b); *Law of Property Act 1936* (SA) ss 29(1)(a), (b); *Conveyancing and Law of Property Act 1884* (Tas) ss 60(2) (a), (b); *Property Law Act 1958* (Vic) ss 53(1)(a), (b); *Property Law Act 1969* (WA) ss 34(1)(a), (b). In contrast, the *Civil Law (Property) Act 2006* (ACT) s 201(2) requires a declaration of trust in relation to an interest in land to be 'in writing' (and not 'manifested and proved by some writing'), signed by the person declaring the trust or by will. It has nonetheless been held that a declaration of a trust of land will be valid if is evidenced by writing, even if the declaration itself is not written: *Hurst-Meyers v Public Trustee and Guardian for the ACT* [2018] ACTSC 61, [24]–[32].

(2) In *Adamson v Hayes* (1973) 130 CLR 276, the High Court refused specific performance of an oral agreement to pool mineral claims – some held beneficially and others on trust. The pooling agreement created a new trust for the claimants. The High Court, Barwick CJ dissenting, held that the pooling agreement did not comply with the equivalent of s 23C(1) in the *Property Law Act 1969* (WA). Walsh, Gibbs and Stephen JJ held that s 23C(1)(a) applied to dispositions of equitable, as well as legal, interests in land. Menzies and Gibbs JJ treated any declaration of trust as coming under s 23C(1)(b), and did not consider s 23C(1)(a). Stephen J regarded both ss 23C(1)(a) and (b) as relevant to trusts of land. The decision illustrates both how these provisions overlap in their application to some transactions as well as differing judicial views on the relationship between the various subsections of s 23.

(3) Section 23C(1)(c) concerns assignments of equitable interests, and is considered more fully in chapter 9. Section 23C(1)(c) appears in div 3 of the *Conveyancing Act 1919* (NSW) which is headed 'Assurances of Land', a division which is otherwise exclusively concerned with dealings in land. In *PT Ltd v Maradona Pty Ltd (No 2)* (1992) 27 NSWLR 241, Giles J, applying earlier English authority (*Grey v Inland Revenue Commissioners* [1960] AC 1; *Vandervell v Inland Revenue Comissioners* [1967] 2 AC 291) stated at 251 that 'the better view' was that s 23C(1)(c) applied to dispositions of equitable interests in personal property, as well as to interests in land. In all other States and Territories, the equivalent provision is not set out in a section of property law legislation confined to assurances of land, although in *Adamson v Hayes* (1973) 130 CLR 276 Menzies J considered that the Western Australian provision (*Property Law Act 1969* s 34(1)(c)) applied only to dispositions of land. Gibbs J considered that the provision also applied to personal property; the other members of the High Court did not express a view on this question.

15.2b *Secretary, Department of Social Security v James* [1990] FCA 213; (1990) 20 ALD 5

Background

The respondent bought a home unit in order to accommodate her 35-year-old invalid daughter and her granddaughter. The unit was located near the respondent's own home. It enabled her to care for her daughter who nevertheless had a degree of independence. In her written application for an age pension, the respondent stated that title to the unit was retained in her name for her daughter's protection and that, under her will, the unit would go to her daughter alone. The Department of Social Security determined that for the purpose of applying for a pension, the value of the unit was to be included as part of the value of the respondent's property under s 8 of the *Social Security Act 1947* (Cth). On review, the Administrative Appeals Tribunal found that at the time of acquisition the respondent had declared an intention to hold the unit on trust for her daughter and granddaughter, and that the *Statute of Frauds* writing requirements were satisfied.

Decision

The Court held that there was evidence to justify the Tribunal's finding that the respondent had declared a trust of the unit for her daughter and granddaughter. Moreover, the Tribunal was entitled to find that the trust had been manifested and proved by a combination of documents. However, the Tribunal had confused the question as to whether there was enough evidence of a declaration of trust with the question as to whether the writing requirements of the *Statute of Frauds* had been met.

Lee J

In my view, the proper construction of ss 34(1)(a) and 34(1)(b) does not require a declaration of a trust in land to be treated as a special class of equitable interest only capable of being created in writing and further, to be manifested and proved by writing signed by the declarant. Section 34(1)(b) would be either an odd exception, or otiose, if s 34(1)(a) were to be construed as including the declarations of trust in respect of land specifically provided for in s 34(1)(b).

The applicant further submitted that s 34(1)(b) of the *Property Law Act 1969* (WA) had not been satisfied in that there was no writing which sufficiently set out the terms of the trust and described a clear intention to create a trust: *Smith v Matthews* (1861) 3 De GF & J 139 at 151; 45 ER 831 at 835; *Morton v Tewart* (1842) 2 Y & C Ch Cas 67 at 80; 63 ER 29 at 35.

The requirements of s 34(1)(b) may be satisfied by a combination of documents capable of being read together. Any informal writing may stand as evidence of the existence of a trust including correspondence from third parties, a telegram, an affidavit or an answer to interrogatories.

The date of creation of the writing is not material. It may come into existence at any time after the declaration of the trust.

The tribunal turned its attention to this question and found the necessary writing to be supplied in the letter from the respondent to the Department dated 23 November 1983 and in the submission the respondent had written in support of her application for a pension in December 1987.

Although the tribunal did not refer to it, it may have included in the combination of documents the written application for the review of the departmental decision signed by the respondent on 1 May 1988 which stated as follows:

> The unit is not used as an asset. I provided it as a home for my invalid-pensioner daughter … The deeds have been left in my name to protect her. There are instructions in my will to provide this home for her after my death. It will devolve eventually on her daughter, Miriam, if her mother dies after me.

In combination, those documents may have provided writing to confirm an intention to create a trust, to identify the daughter and granddaughter as objects of the trust, to identify the home unit as the property subject to the trust and to state the terms of the trust to be a life estate for the daughter with the remainder to the granddaughter. …

[Having considered the evidence for the existence of the trust and for the satisfaction of the writing requirements, his Honour continued:]

… It may be seen that in having regard to extrinsic evidence for the purpose of 'clarifying' the terms on which the trust was held, the tribunal had resort to oral evidence which augmented, rather than clarified, the writing upon which the respondent relied to satisfy the requirements of s 34(1)(b) of the *Property Law Act 1969* (WA). The parol evidence supplied elements that were missing in that writing. This was not a case of the parol evidence resolving a matter to which the writing had referred: see *Harewood v Retese*

[1990] 1 WLR 333 (Privy Council). The tribunal appeared to confuse the question of the sufficiency of the evidence required to persuade the tribunal that there had been a declaration of trust with the question whether there had been sufficient evidence to show that the requirements of s 34**(1)**(b) of the *Property Law Act* 1969 (WA) had been met. The tribunal did not confine its consideration of the latter question to whether such a declaration and the terms of the trust had been further manifested and proved by writing for the purposes of s 34**(1)**(b). It reached its conclusion that the paragraph was so satisfied by reliance upon the oral evidence.

Questions

(1) Would the confusion which vitiated the Tribunal's decision in *James* have been avoided if trusts of land were required to be in writing?

(2) The *Statute of Frauds* was enacted in 1677, when the law of evidence was undeveloped. Is the Act necessary in the twenty-first century when the legal machinery for proving that a disposition has been made is more sophisticated? If writing still provides a sound evidential basis for proving the existence of a trust, why should the writing requirement be confined to trusts of land and not (say) a trust of valuable securities? For reform proposals, see Victorian Law Reform Commission, *Review of the Property Law Act 1958* (Final Report No 20, October 2010).

15.3 Creating a trust by transfer to the intended trustee

A settlor who appoints another as the trustee of her property must vest title to the property in the trustee. Title to property can only be vested in, or transferred to, another by complying with formal requirements applicable to the type of property in question. Failure to comply with the requirements will usually result in failure to create the trust: *Milroy v Lord* (1862) 4 De GF & J 264; 45 ER 1185 (see [9.2a]), unless the principle articulated in *Corin v Patton* (1990) 169 CLR 540 (see [9.2b]) applies.

The declaration of trust and vesting of property in the intended trustee will usually be simultaneous. If the settlor vests title to the property in the intended trustee before declaring the trust, a gift will have been made unless the circumstances surrounding the transfer attract the presumption of resulting trust (see chapter 22). Conversely, if the settlor declares a trust of the property before vesting title to the property in the intended trustee, the later vesting of title will complete the previously incomplete trust: *Re Bowden* [1936] Ch 71; *Re Ralli's Will Trusts* [1964] Ch 288.

The following case demonstrates how a trust may exceptionally be valid even though neither procedure for creating a valid trust has been fully complied with.

15.3a *T Choithram International SA v Pagarani* [2001] 1 WLR 1

Background

Thakurdas Choithram Pagarani (TCP) was a successful businessman who made numerous large donations for charitable purposes. TCP wanted to set up a charitable foundation to which he would transfer much of his wealth. A trust deed was drawn up with TCP named as one of the trustees. TCP announced that he had transferred his wealth to the foundation, although at the time of the announcement no transfer had been made. He died before executing the documents necessary to transfer legal title to the various assets named in the trust deed to the trustees. After TCP's death, his widow and some of his children challenged the validity of the trust of his property.

Decision

The Privy Council held that the trust of his property had been created even though TCP had not declared himself sole trustee of his own property and had not transferred his property to the trustees of the charitable foundation before he died.

Lord Browne-Wilkinson

Their Lordships then turn to the central and most important question: on the basis that TCP intended to make an immediate absolute gift 'to the foundation' but had not vested the gifted property in all the trustees of the foundation, are the trusts of the foundation trust deed enforceable against the deposits and the shares or is this (as the judge and the Court of Appeal held) a case where there has been an imperfect gift which cannot be enforced against TCP's estate whatever TCP's intentions?

The judge and the Court of Appeal understandably took the view that a perfect gift could only be made in one of two ways, viz (a) by a transfer of the gifted asset to the donee, accompanied by an intention in the donor to make a gift; or (b) by the donor declaring himself to be a trustee of the gifted property for the donee. In case (a), the donor has to have done everything necessary to be done which is within his own power to do in order to transfer the gifted asset to the donee. If the donor has not done so, the gift is incomplete since the donee has no equity to perfect an imperfect gift: *Milroy v Lord* (1862) 4 De GF & J 264; *Richards v Delbridge* (1874) LR 18 Eq 11; *In re Rose; Midland Bank Executor and Trustee Co Ltd v Rose* [1949] Ch 78; *In re Rose; Rose v Inland Revenue Commissioners* [1952] Ch 499. Moreover, the court will not give a benevolent construction so as to treat ineffective words of outright gift as taking effect as if the donor had declared himself a trustee for the donee: *Milroy v Lord* (1862) 4 De GF & J 264. So, it is said, in this case TCP used words of gift to the foundation (not words declaring himself a trustee): unless he transferred the shares and deposits so as to vest title in all the trustees, he had not done all that he could in order to effect the gift. It therefore fails. Further it is said that it is not possible to treat TCP's words of gift as a declaration of trust because they make no reference to trusts. Therefore the case does not fall within either of the possible methods by which a complete gift can be made and the gift fails.

Though it is understandable that the courts below should have reached this conclusion since the case does not fall squarely within either of the methods normally stated as being the only possible ways of making a gift, their Lordships do not agree with that conclusion. The facts of this case are novel and raise a new point. It is necessary to make an analysis of the rules of equity as to complete gifts. Although equity will not aid a volunteer, it will not strive officiously to defeat a gift. This case falls between the two common form situations mentioned above. Although the words used by TCP are those normally appropriate to an outright gift – 'I give to X' – in the present context there is no breach of the principle in *Milroy v Lord* if the words of TCP's gift (i.e. to the foundation) are given their only possible meaning in this context. The foundation has no legal existence apart from the trust declared by the foundation trust deed. Therefore the words 'I give to the foundation' can only mean 'I give to the trustees of the foundation trust deed to be held by them on the trusts of foundation trust deed'. Although the words are apparently words of outright gift they are essentially words of gift on trust.

But, it is said, TCP vested the properties not in all the trustees of the foundation but only in one, i.e. TCP. Since equity will not aid a volunteer, how can a court order be obtained vesting the gifted property in the whole body of trustees on the trusts of the foundation? Again, this represents an over-simplified view of the rules of equity. Until comparatively recently the great majority of trusts were voluntary settlements under which beneficiaries were volunteers having given no value. Yet beneficiaries under a trust, although volunteers, can enforce the trust against the trustees. Once a trust relationship is established between trustee and beneficiary, the fact that a beneficiary has given no value is irrelevant. It is for this reason that the type of perfected gift referred to in class (b) above is effective since the donor has constituted himself a trustee for the donee who can as a matter of trust law enforce that trust.

What then is the position here where the trust property is vested in one of the body of trustees, viz TCP? In their Lordships' view there should be no question. TCP has, in the most solemn circumstances, declared that he is giving (and later that he has given) property to a trust which he himself has established and of which he has appointed himself to be a trustee. All this occurs at one composite transaction taking place on 17 February. There can in principle be no distinction between the case where the donor declares himself to be sole trustee for a donee or a purpose and the case where he declares himself to be one of the trustees for that donee or purpose. In both cases his conscience is affected and it would be unconscionable and contrary to the principles of equity to allow such a donor to resile from his gift. Say, in the present case, that TCP had survived and tried to change his mind by denying the gift. In their Lordships' view it is impossible to believe that he could validly deny that he was a trustee for the purposes of the foundation in the light of all the steps that he had taken to assert that position and to assert his trusteeship. In their Lordships' judgment in the absence of special factors where one out of a larger body of trustees has the trust property vested in him he is bound by the trust and must give effect to it by transferring the trust property into the name of all the trustees.

Questions

(1) Why had the trust not been created by either of the two recognised methods for creating a valid trust?

(2) Why was the trust held nonetheless to have been validly created? Would it have been created if the settlor had not been one of the trustees?

(3) The Privy Council left open the question as to whether a trust of 'all my wealth' was invalid for uncertainty of subject-matter. Do you think that such a trust is too uncertain? See [14.3].

15.4 Exceptions to statutory writing requirements

Section 23(2) of the *Conveyancing Act 1919* (NSW) (above) and counterpart legislation in other States and Territories exempt resulting, implied and constructive trusts from having to comply with the *Statute of Frauds* writing requirements. A settlor, or recipient of property from the settlor, may also be estopped from relying on the absence of writing. The principle that equity does not allow a statute to be used as an instrument (or cloak) for fraud also prevents a party from establishing that a trust of land is unenforceable for want of statutory writing.

15.4a *Last v Rosenfeld* [1972] 2 NSWLR 923

Background

The plaintiffs and defendants were joint tenants of a house. The plaintiffs transferred their interests in the house to the defendants at cost price. They had previously orally agreed to transfer their interests to the defendants in return for the promise that the interests would be transferred back to the plaintiffs, also at cost price, if the defendants did not personally occupy the house within 12 months. Instead of occupying the house, the defendants sold the house to a third party who took a mortgage from the defendants. The defendants argued that their promise to re-transfer to the plaintiffs the interests they had previously held in the house was unenforceable for lack of writing as required by s 23C of the *Conveyancing Act 1919* (NSW).

Decision

The Court held that the oral agreement between the parties was enforceable, applying the principle that equity will not allow a statute to be used as an instrument for fraud. The defendants were ordered to pay the plaintiffs half the proceeds of sale of the house. In addition, the plaintiffs were awarded a half interest in the mortgage the defendants had taken over the property, subject to the plaintiffs repaying the defendants the price the plaintiffs had received for their share of the property.

Hope J

I think that the additional circumstances established by the plaintiffs do bring them within the scope of the relevant principles. Suppose that A transferred property to B by way of gift, on terms that B should hold the property beneficially, but should hold it in trust for the donor if he did not live in it within twelve months. I would have thought that such a case fell squarely within the relevant general principles, and that A could enforce the trust in the relevant events, even though it were only oral. In other words, the mere fact that the trust only arises upon some event occurring after the transfer of the property does not prevent the enforcement of the trust if that event occurs: cf. *Hampton v Spencer* (1693) 23 ER 785. The trust in the assumed case is simply a limited beneficial interest which it was said in *Bannister v Bannister* [1948] 2 All ER 133 was not, for relevant purposes, to be distinguished from the entire beneficial interest. The fact that B had paid valuable consideration for the transfer to him would not prevent the enforcement of the oral trust and, of course, *Bannister v Bannister* is ample authority for this.

In such a case, does the circumstance that A must repay to B the money paid by B for the property in the first instance prevent the general principle from applying? I would have thought that it did not in many, if not all, cases, but, whatever may be the position in other cases, I do not think that it does in the instant one. The transaction was of a special nature based on the relationship between the parties and the confidence which the plaintiffs had in the defendants, and on the desire of the plaintiffs to afford the defendants an opportunity to reside in the property. The arrangement was part of the basis of the defendants' acquisition of the plaintiffs' interest; it was not some agreement made or trust created after that acquisition or after the agreement for that acquisition, or an arrangement made in relation to the acquisition of property from some third person. The price paid by the defendants was what the original purchase had cost the plaintiffs and it was this price which the plaintiffs had to repay to the defendants; the transaction was not an ordinary commercial transaction in any sense. The effect of the defendants' oral promise was that there should be a mutual restitution if the purpose of the transaction failed, the plaintiffs not having a mere option to repurchase but being bound to repay the purchase price to the defendants as the defendants were bound to re-transfer their half interest to them.

I think that it can be properly said that upon the failure of the defendants to reside in the property within twelve months, they held the property as to a one-half interest therein upon trust to transfer the same to the plaintiffs, subject to the obligation of the plaintiffs to pay the agreed sum to the defendants, but whether the defendants' obligation can properly be described as a trust or not, I think that the circumstances are such that the defendants' reliance upon the absolute nature of the written contract and transfer and the lack of writing to defeat the plaintiffs' claim constitutes fraud, and that the plaintiffs are entitled to establish the defendants' obligation, and the court to enforce it, despite the lack of writing.

Note

Last v Rosenfeld involved an oral contract for the disposition of an interest in land, required to be evidenced by a memorandum in writing under s 54A of the *Conveyancing Act 1919* (NSW). However, the judgment makes clear that the principles apply to oral trusts of interests in land.

15.5 Testamentary trusts

A trust created by will must comply with the formalities for creating a will prescribed by State and Territory legislation. The formalities are explained in texts on succession law. Equitable doctrine will be relevant if property is left to a legatee under a will on the faith of the legatee's promise to apply the property for the benefit of a third party. Upon receipt of the legacy, the legatee will not be permitted to take the property absolutely but must hold the property on trust for the intended beneficiary. If property is left absolutely to the legatee, the trust is known as a secret trust. If the property is not left absolutely to the legatee, but in the capacity of trustee (such as 'I leave $1,000 to X for the purposes I have communicated to him'), the precise terms of the trust not being set out in the will, the trust is known as a 'half-secret (or semi-secret) trust'.

15.5a *Voges v Monaghan* [1954] HCA 63; (1954) 94 CLR 231

Background

George Gill carried on a successful business as a chemist in Hamilton, Victoria. His will left his entire estate to the appellant, a friend, who had helped him manage his business. His wife, who died not long after he did, was left nothing. In addition, nothing was left to the first respondent, Miss Monaghan, who had worked as a domestic servant in Mr Gill's household for 35 years for low pay, although Mr Gill had informed her that she would be looked after when he died. Moreover, no provision was made for Mrs Answerth, the second respondent, a niece of Mr Gill's wife, who had been financially assisted by Mr Gill for many years. Mr Gill had also promised to see that Mrs Answerth was looked after when he died.

The appellant gave evidence that, on several occasions, Mr Gill had asked her to 'look after' Mrs Gill when he died, which the appellant agreed to do. There was also evidence that Mr Gill had asked the appellant to look after the respondents. After Gill's death, the appellant read out a note (later lost) in which Mr Gill's wish that the respondents be provided for was recorded. Both respondents received regular payments from Mr Gill's estate, accompanied by letters stating that the payments had been made in accordance with Mr Gill's wishes. After four years, the payments ceased, after claims for unpaid tax had been made on the estate. The appellant insisted that the payments had been made in the exercise of a discretion which Mr Gill had conferred on her, and that the respondents had no right to the payments.

Decision

The High Court held that there was sufficient evidence to justify the finding that Mr Gill had created a secret trust. Although the bequest of Mr Gill's estate to the appellant was an absolute gift, the appellant's acceptance of the obligation imposed by Mr Gill to provide for the respondents created a trust for their benefit, and equity would prevent fraud by preventing the appellant from asserting her absolute title to the gift.

Fullagar and Kitto JJ

The case for the respondents was that the testator in his lifetime expressed to the appellant a wish that after his death each of the respondents should receive from his estate the sum of three pounds a week for life, and that it was in reliance upon an undertaking by the appellant to carry that wish into effect, the undertaking being either expressed or implied by conduct, that he left his estate to the appellant. The jurisdiction thus appealed to was that which the House of Lords confirmed in *McCormick v Grogan* (1869) LR 4 HL 82. A passage in the judgment of Lord Davey in *French v French* [1902] 1 IR 172 at 230 contains probably as clear an exposition of the principle as is to be found in the books.

> It is now well established … and has been settled since the time of Lord Hardwicke, that if a testator communicates in his lifetime to a proposed devisee or legatee that he has left him his property, and expresses a wish that the property should be disposed of in a particular manner, and the legatee or devisee by acquiescence, or even by silence, accepts that communication, and the testator dies without any repudiation, a trust is fastened upon his conscience, as it is said, and he cannot afterwards either appropriate the property to his own use or dispose of it otherwise than in accordance with the wishes which were thus communicated to him, and which he has accepted. My Lords, it is said that this jurisdiction is based upon fraud, and so it is, because if you once get to this, that it is a trust which is imposed upon the conscience of the legatee, then if the legatee betrays the confidence in reliance upon which the bequest was made to him, then it is what I should think everybody would consider a fraud, though I take the liberty to say that the moral turpitude of any particular case must vary infinitely according to the circumstances of the particular case. My Lords, the basis of it is of course that the testator has died, leaving the property by his will in a particular manner on the faith and in reliance upon an express or implied promise by the legatee to fulfil his wishes, and your Lordships will at once see that it makes no difference whatever whether the will be made before the communication to the legatee or afterwards, because, as was said, I think, by Turner V-C in one of the cases which were cited, the presumption is that the testator would have revoked his will and made another disposition if he had not relied upon the promise, express or implied, made by the legatee to fulfil his wishes. …

… [I]t was well open to the learned judge to deduce from the appellant's evidence of her conversations with the testator, in which he expressed positive wishes about many things to be done by her in connection with his estate, that he was induced by her acquiescence to rest assured that she would pay each of the respondents three pounds a week for life. To describe what he said in this respect as a suggestion, and to include in it the somewhat artificial phrase 'subject to your discretion', was to introduce an element incongruous with the general tone of the requests (if indeed they should not be called directions or instructions) which the testator was stating to his executrix. It was a conclusion not only open on the evidence but with the weight of probability in its favour that what the appellant read from the piece of paper on the day the testator died was accurately recounted by Miss Monaghan and was an accurate record of the wishes which the testator had stated to the appellant and she had agreed to fulfil.

Then, too, in the undated letter to Mrs Morris and in the letter of 27th August 1946 to Mrs Answerth the appellant used language utterly inconsistent with a belief on her part that the respondents' annuities were gifts from herself and could be discontinued by her whenever she might choose. Enough has been said in discussing the details of the evidence to show that there is ample support for the conclusion that when the appellant claimed a discretion to terminate the annuities, first in the solicitors' letters accompanying the initial annuity payments and ultimately in her refusals to continue the payments in view of the unexpected depletion of the estate, she was taking advantage of the position created by the absence from the will of anything to qualify the apparently absolute bequest to her, and was going back upon an undertaking which was part of the inducement to the testator to leave his estate in her hands.

Questions

(1) Distinguish a secret trust from a half-secret trust. What type of trust was enforced in *Voges v Monaghan?*

(2) Is a secret trust an express trust or a constructive trust imposed by law?

(3) What burden of proof must be satisfied to establish a secret trust? If the purpose of the trust is to prevent fraud, should the burden be higher than the ordinary civil standard of proof? See on this question *Re Snowden (deceased)* [1979] Ch 528; *Howell v Hyde* (2003) 47 ACSR 230. On the relevance of the uniform *Evidence Act* to establishing the onus of proof, see *Edwards v Crawford* [2020] TASSC 20.

15.6 Trusts and public policy

15.6.1 Non-statutory public policy

15.6.1a *Thrupp v Collett (No 1)* (1858) 26 Beav 125; 53 ER 844

Background

John Collett by his will left £5,000 to pay the fines of convicted poachers.

Decision

The bequest was declared void.

Romilly MR

I cannot support this bequest. It is impossible not to see that the effect of it would be to give immunity and protect persons in the commissions of acts, which are treated by the Legislature as offences, and for which penalties by fine are imposed. This Court could not support a charity which would protect persons from the commission of this offence, any more than of others of a different nature, which might even amount to a felony.

Looking at this bequest in a plain commonsense view, it is obviously calculated to encourage offences prohibited by the Legislature. This is against public policy, and the Court cannot carry such an object into effect.

Question

Give other examples of trusts which will be declared void as being contrary to public policy, even though they do not infringe any statute. Can a court recognise a new head of non-statutory public policy?

15.6.2 Statutory public policy: the application of trusts to avoid creditors

15.6.2a *Conveyancing Act 1919* (NSW)

Section 37A: Voluntary alienation to avoid creditors voidable

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

(2) This section does not affect the law of bankruptcy for the time being in force.

(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 intent to defraud creditors.

Note

Equivalent provisions in the States and Territories are: *Civil Law (Property) Act 2006* (ACT) s 239; *Law of Property Act 2000* (NT) s 208; *Property Law Act 1974* (Qld) s 228; *Law of Property Act 1936* (SA) s 86; *Conveyancing and Law of Property Act 1884* (Tas) s 40; *Property Law Act 1958* (Vic) s 172; *Property Law Act 1969* (WA) s 89. All derive from the Statute 13 Eliz I c 5, enacted in 1571. Its long

title was 'An Act against fraudulent Deeds, Gifts, Alienations etc' and it is nowadays referred to as the 'Elizabethan Statute'. The legislation applies to attempts by debtors to create express trusts of their property in order to prevent the property from being applied to the payment of their debts, as well as to transfers of property by debtors to third parties with intent to defraud creditors. *Marcolongo v Chen* (below) concerned a direct transfer of property by a debtor to a third party having, as one of its motives, the avoidance of a damages award made against the debtor. The principles of the decision, however, apply to a debtor's settlement of property on trust that would otherwise be available to discharge the debt.

15.6.2b *Marcolongo v Chen* [2011] HCA 3; (2011) 242 CLR 546

Background

Mrs Marcolongo had obtained an unsatisfied award of damages against Lym International Ltd for Lym's removal of support to her property in the course of completing a redevelopment project. Ms Yang, a director of Lym who was resident in New Zealand, approved the transfer by Lym of a property subject to another development, which was Lym's only substantial asset, to Mr Chen. Ms Yang's husband had been detained by authorities in China and Ms Yang was concerned about steps the Chinese authorities might take against her family and assets she owned. Mr Chen persuaded Ms Yang that the transfer of the property to him was in her best interests and made all the arrangements to complete the transaction. Mrs Marcolongo applied to have the transfer set aside under s 37A of the *Conveyancing Act 1919* (NSW).

Decision

The High Court affirmed the trial judge's decision to set aside the transfer of the property to Mr Chen on the ground that it had been made by Ms Yang with intent to avoid creditors even though she had other motives for agreeing to his proposal. Moreover, Mr Chen was not a good faith purchaser. The extract below explains the history and policy of s 37A.

French CJ, Gummow, Crennan and Bell JJ

The provenance of s 37A

The Elizabethan Statute with respect to the transferor used the terms 'purpose and intent' and contained a proviso in favour of what might be called innocent third parties, who purchased without 'any manner of notice or knowledge of such … fraud or collusion'. A succinct description of the operation of the Elizabethan Statute as understood in 1912 was given by Parker J in *Glegg v Bromley* [1912] 3 KB 474 at 492. His Lordship said:

> Now the scheme of that statute is this: By it all conveyances and assignments made with intent to hinder and delay creditors are rendered void against all creditors hindered or delayed by their operation. There is, however, a proviso for the protection of a purchaser for good consideration without notice of the illegal intention. In the authorities which deal with the statute it is not always clear whether the judges are dealing with the operative part of the Act or with the proviso. The illegal intent under the operative part is a question of fact for the jury or the judge sitting as a jury. On the one hand the want of consideration for the conveyance or assignment is a material fact in considering whether there was any illegal intent, but it is not conclusive that there existed any such intent. In the same way consideration was by no means conclusive that there was no illegal intent. When, however, one comes to deal with the proviso, it is quite clear that any person relying on the proviso must prove both good consideration and the fact that he had no notice of the illegal intent. …

In *Re Cummins; Richardson v Cummins* (1951) ABC 185 at 191 Clyne J observed of s 37A that it 'says nothing about an intent to hinder or delay creditors', and concluded that, while Mr Cummins 'did hinder or delay his creditors' by leasing his property to his wife for a three-year term, the lease was not made 'with intent to defraud his creditors'.

However, the better view of the abbreviated terms employed in … s 37A is that of Pennycuick V-C in *Lloyds Bank Ltd v Marcan* [1973] 1 WLR 339 at 344. This is that … the term 'defraud' was designed to reproduce the meaning of the expression 'delay, hinder

or defraud' in the Elizabethan Statute. That statute was understood as if it read 'delay, hinder or [otherwise] defraud'. The contrary has not been suggested in the present case.

From this legislative history two things of immediate relevance appear. The first is that an understanding of the issues in this appeal is assisted by consideration of the case law upon the Elizabethan Statute which had been built up before that statute's repeal and restatement in s 37A. The second is that, in accordance with that case law, exemplified by remarks of Lord Mansfield *(Cadogan v Kennett* (1776) 98 ER 1171 at 1172), and more recently of Arden LJ *(Giles v Rhind (No 2)* [2009] Ch 191 at 199), the provision and its modern representatives should receive a liberal construction in effecting their purpose of suppressing fraud.

There is one relevant qualification where, as here, the subject matter is a contract for the sale of land under the provisions of the *Real Property Act* which has been completed and the transfer registered. In *Regal Castings Ltd v Lightbody* [2009] 2 NZLR 433, a majority of the Supreme Court of New Zealand held that the indefeasibility provisions of the Torrens system allowed for the enforcement against the registered proprietor of *in personam* remedies given by the Elizabethan Statute and its local representative. The contrary was not contended for on the present appeal. The view taken in New Zealand had earlier been accepted by Hogg and Kerr in their works on the Torrens system.

In his treatise on equity jurisprudence, Story had seen the object of the Elizabethan Statute as the protection of creditors 'from those frauds which are frequently practised by debtors under the pretence of discharging a moral obligation [to] wives, children, and other relations' (*Commentaries on Equity Jurisprudence* 13th ed (1886), vol 1, §353). But the term 'voluntary' did not appear in the statute and the case law established that its application was not so limited. On appeal from the Supreme Court of New South Wales, the Privy Council in *Godfrey v Poole* (1888) 13 App Cas 497 at 503 had approved the statement of principle respecting the operation of the Elizabethan Statute which had been made by Kindersley V-C in *Thompson v Webster* (1859) 62 ER 241 at 242. The Vice-Chancellor said:

> The language of [the Elizabethan Statute] being that any conveyance of property is void against creditors, if it is made with *intent* to defeat, hinder or delay creditors, the Court is to decide in each particular case whether, on all the circumstances, it can come to the conclusion that the *intention* of the settlor, in making the settlement, was to defeat, hinder or delay his creditors. (emphasis in original)

The Vice-Chancellor (like Parker J in the passage from *Glegg v Bromley* set out above) had also been at pains to point out that to attract the Elizabethan Statute it was not sufficient, of itself, merely to show that the deed was voluntary; nor, on the other hand, was it necessary in order to set aside a voluntary deed that the settlor should actually be insolvent.

Notes

(1) Many other statutes include anti-avoidance provisions empowering courts to set aside dispositions, including trusts, made with the purpose of defeating an existing or anticipated court order, or which may have the effect of defeating a court order even if it is not the aim of the disposition: see, for example, *Family Law Act 1975* (Cth) s 106B.

(2) A voluntary transfer of property for illegal purposes may also raise the question of whether the transferee holds the property on resulting trust for the transferor: see *Nelson v Nelson* [1995] HCA 25; (1995) 184 CLR 538 ([2.2c] and [22.3.2f]).

Questions

(1) What do the words 'with intent to defraud creditors' mean in s 37A? Does the term include (a) preferring the claim of one creditor over the claim of others, and (b) an intent to delay payment to a creditor?

(2) What situations are covered by s 37A (and its counterparts in other States and Territories) which are not covered by federal bankruptcy and corporate insolvency legislation?

(3) Does equity adopt a consistent policy to attempts by settlors to employ the trust as a creditor avoidance device? Contrast *Marcolongo v Chen* with the statutory recognition of protective trusts, which are primarily utilised to avoid the impact of bankruptcy: see *Trustee* Act *1925* (NSW) s 45; *Trustee* Act *1958* (Vic) s 39.

16

Trusts for charitable and non-charitable purposes

16.1 Introduction

16.2 What is a charitable purpose?

16.3 Trusts for the relief of poverty

16.4 Trusts for the advancement of education

16.5 Trusts for the advancement of religion

16.6 Trusts for other purposes beneficial to the community

16.7 The requirement of public benefit: 'benefit'

16.8 The requirement of public benefit: 'public or section of the public'

16.9 Trusts for non-charitable purposes

16.1 Introduction

Charitable trusts are created for social purposes, rather than for the benefit of identifiable persons. The beneficiary principle (*Morice v Bishop of Durham* (1804) 9 Ves 399; 32 ER 656) requires express trusts to have identifiable persons as their object, primarily so that there is someone with sufficient standing to enforce the trust in court. Charitable trusts are an exception to this principle, and thus do not require certainty of object. In order to be valid, however, they must be for the benefit of the public. Additionally, the social purpose they perform must be legally recognised as being charitable.

As Dixon and Evatt JJ said in *Attorney-General (NSW) v Perpetual Trustee Co Ltd* (1940) 63 CLR 209, 222:

> A charitable trust is a trust for a purpose, not for a person. The objects of ordinary trusts are individuals, either named or answering a description, whether presently or at some future time. To dispose of property for the fulfilment of ends considered beneficial to the community is an entirely different thing from creating equitable estates and interests and limiting them to beneficiaries. In this fundamental distinction sufficient reason may be found for many of the differences in treatment of charitable and ordinary trusts.

The law concerning charitable purposes is over 500 years old, and sourced in general terms from the Preamble to the Elizabethan *Statute of Charitable Uses 1601*. Since *Pemsel's case* in 1891 (*Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531), charitable purposes are grouped into four headings: trusts for the relief of poverty, the advancement of education, the advancement of religion, and for other purposes beneficial to the community. For purposes of Commonwealth legislation, whether a purpose is charitable is now determined according to s 12 of the *Charities Act 2013* (Cth).

Charitable trusts can continue in perpetuity. Sometimes, it is not clear whether the creator's charitable purpose can be achieved, either because the terms of the trust are unclear, or because the purpose is impossible or impracticable to perform. In the first case, a court can order a scheme for administration of the trust. Where the purpose is impossible or impracticable to perform, the court can order a cy-près scheme, but timing of the failure is crucial. Under the doctrine of cy-près, the court orders the fund to be applied to a charitable purpose as

close as possible to that intended by the settlor. If failure of the purpose is present from the commencement of the trust, the court must determine whether the settlor exhibited a general charitable intention which would allow the fund to be used for a similar purpose. This is a question of construing the settlor's intention; the more specific the gift, the less likely a *general* intention has been shown. When the original charitable purpose fails after commencement of the trust, the court will order an appropriate cy-près scheme; there is no need to show a general charitable intention (see textbook at [16.40]–[16.43]).

Additionally, where a trust has been drafted so that it could include both a charitable and a non-charitable application of the funds, modern legislation allows the severance of any non-charitable component: see *Charitable Trusts Act 1993* (NSW) s 23; *Trusts Act 1973* (Qld) s 104; *Trustee Act 1936* (SA) s 69A; *Variation of Trusts Act 1994* (Tas) ss 4(2), (3); *Charities Act 1978* (Vic) s 7M; *Trustees Act 1962* (WA) s 102.

Questions for consideration

(1) How does a court determine whether the purpose of the trust is a valid charitable purpose?

(2) What is meant by 'public benefit'? This term is both qualitative and quantitative. A charitable trust must be of benefit; and it must benefit the public or a section of the public.

(3) In some cases, the 'benefit' aspect of the trust is assumed. Why is this so? Can a trust's beneficial nature be challenged?

(4) What is the dividing line between trusts for the benefit of identifiable individuals and trusts that benefit a section of the public?

(5) What is the status of trusts for political purposes? Are all political purposes of benefit to the public?

16.2 What is a charitable purpose?

16.2a Preamble to the *Statute of Charitable Uses 1601* (Statute of Elizabeth)

[The Preamble contained the following non-exhaustive list of charitable purposes:]

Relief of aged, impotent and poor people; maintenance of sick and maimed soldiers and mariners, schools of learning, free schools and scholars in universities; repair of bridges, ports, havens, causeways, churches, seabanks and highways; education and preferment of orphans; relief stock or maintenance of houses of correction; marriages of poor maids; support aid and help for young tradesmen, handicraftsmen and persons decayed; relief or redemption of prisoners or captives; aid and ease of any poor inhabitants concerning payment of fifteens, setting out soldiers and other taxes.

Notes

(1) This list was rationalised at the end of the nineteenth century into four broad 'heads' of charity. In *Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531 at 583, Lord Macnaghten said:

> 'Charity' in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.

(2) In *Bathurst City Council v PWC Properties Pty Ltd* (1998) 195 CLR 566, [34], the High Court said:

The decision of the Privy Council in *Brisbane City Council v Attorney-General (Qld)* is illustrative of two relevant principles: that the spirit and intendment of the Preamble to the statute of Elizabeth should be given no narrow or archaic construction, and that the understanding of judges in the community in which they live of what a particular activity … involves may be accepted as a proper understanding of the nature of that activity.

(3) Section 12 of the *Charities Act* 2013 (Cth) defines 'charitable purpose'.

12 Definition of charitable purpose

(1) In any Act:

charitable purpose means any of the following:

(a) the purpose of advancing health;

(b) the purpose of advancing education;

(c) the purpose of advancing social or public welfare;

(d) the purpose of advancing religion;

(e) the purpose of advancing culture;

(f) the purpose of promoting reconciliation, mutual respect and tolerance between groups of individuals that are in Australia;

(g) the purpose of promoting or protecting human rights;

(h) the purpose of advancing the security or safety of Australia or the Australian public;

(i) the purpose of preventing or relieving the suffering of animals;

(j) the purpose of advancing the natural environment;

(k) any other purpose beneficial to the public that may reasonably be regarded as analogous to, or within the spirit of, any of the purposes mentioned mentioned in paragraphs (a) to (j); …

(l) the purpose of promoting or opposing a change to any matter established by law, policy or practice in the Commonwealth, a State, a Territory, or another country, if:

(i) in the case of promoting a change – the change is in furtherance of one or more of the purposes listed in paragraphs (a) to (k); or

(ii) in the case of opposing a change – the change is in opposition to, or in hinderance of, one or more of the purposes mentioned in those paragraphs.

(2) Paragraph (l) of the definition of *charitable purpose* in subsection (1) is the only paragraph of that definition that can apply to the purpose of promoting or opposing a change to any matter established by law, policy or practice in the Commonwealth, a State, a Territory or another country.

(3) For the purposes of this section, it does not matter whether a purpose is directed to something in Australia or overseas.

Questions

(1) Are Lord Macnaghten's four broad heads a fair reflection of the list of charitable uses contained in the Preamble?

(2) Are there any purposes specified by the *Charities Act* definition which would not be charitable purposes under Lord Macnaghten's four heads?

16.3 Trusts for the relief of poverty

16.3a *Downing v Commissioner of Taxation (Cth)* [1971] HCA 38; (1971) 125 CLR 185

Background

A clause in a will stated that property was to be used for 'the amelioration of the conditions of the dependants' of members or former members of the Armed Services. The word 'poverty' was not used. Was the gift charitable in nature?

Decision

The High Court upheld the gift as being charitable for the relief of poverty.

Walsh J

It was argued that the word 'amelioration' does not convey necessarily the notion of providing relief from poverty nor does the word 'dependants' point necessarily to persons who are impoverished. …

The question thus raised is one of some difficulty. The terms of the clause contain no express reference to necessitous circumstances or to poverty. But an intention to provide for the relief of persons from poverty need not be stated in express terms. It may be implicit in a gift: see *Union Trustee Co of Australia Ltd v Federal Commissioner of Taxation* (1962) 108 CLR 451 at 456. The question is whether or not such an implication can be obtained from the words used in the clause with which we are now concerned. In my opinion, it can. A person may be in need without being destitute. The word 'poverty' and similar expressions, as used in the law in relation to charities, refer to persons who, although they may not be in abject poverty, are subject to some degree of financial necessity. … When the clause refers to the amelioration of the conditions of the dependants, I think it is right to regard those words, in their context as part of the whole trust which, in my opinion, has a character that is predominantly charitable, as indicating that the object of the amelioration clause is to benefit persons whose lot needs improvement. …

Note

There is no territorial aspect to charitable trusts. Thus, trusts can be established in Australia for relief of poverty in foreign countries.

Questions

(1) Why is complete 'destitution' not required in trusts for the relief of poverty? What are the public policy reasons for recognising trusts that provide comparative relief?

(2) What kinds of activities qualify as being for the purpose of relieving poverty? Are trusts for hospitals for the relief of poverty or for other purposes beneficial to the community? See *Re Resch's Will Trusts* [1969] 1 AC 514, 540 (Lord Wilberforce):

> A gift for the purposes of a hospital is prima facie a good charitable gift. This is now clearly established in Australia and in England, not merely because of the use of the word 'impotent' in the preamble to [the Statute of Elizabeth], though the process of referring to the preamble is one often used for reassurance, but because the provision of medical care for the sick is, in modern times, accepted as a public benefit suitable to attract the privileges given to charitable institutions.

16.4 Trusts for the advancement of education

Education can be advanced by the building of schools or libraries, providing scholarships or bursaries, endowing professorial chairs at universities, and providing funds for scientific research. These trusts must, however, have some educative value and 'advance' education in the sense that knowledge should not merely be created; it must also be disseminated. These matters are judged by the court, rather than by the creator of the trust: *Re Pinion (deceased)* [1965] Ch 85, 108.

16.4a *Re Shaw (deceased)* [1957] 1 All ER 745

Background

George Bernard Shaw's will contained attempted trusts to investigate and encourage the use of a new English alphabet, which was to contain at least 40 letters. Was this a valid trust for the advancement of education?

Decision

It was held that the trust was not educational since there was no element of teaching in the gift.

Harman J

The first object of the alphabet trusts is to find out by inquiry how much time could be saved … by the use of the proposed British alphabet and so to show the extent of the time and labour wasted by the use of our present alphabet, and, if possible, further to state this waste of time in terms of loss of money. The second is to transliterate one of the testator's plays 'Androcles and the Lion', into the proposed British alphabet … and to advertise and publish the transliteration in a page by page version in the proposed alphabet on one side and the existing alphabet on the other, and, by the dissemination of copies and, in addition by advertising and propaganda, to persuade the government or the public or the English speaking world to adopt it. This was described by the Attorney General as a useful piece of research beneficial to the public, because it would facilitate the education of the young and the teaching of the language … In my opinion, if the object be merely the increase of knowledge, that is not in itself a charitable object, unless it be combined with teaching or education …

The research and propaganda enjoined by the testator seem to me merely to tend to the increase of public knowledge in a certain respect, namely, the saving of time and money by the use of the proposed alphabet. There is no element of teaching or education combined with this, nor does the propaganda element in the trusts tend to more than to persuade the public that the adoption of the new script would be 'a good thing', and that, in my view, is not education. …

Note

The High Court upheld a trust for 'the advancement of scientific research generally' in *Taylor v Taylor* (1910) 10 CLR 218. In *Re Hopkins' Will Trusts* [1965] Ch 669, Wilberforce J upheld as charitable a gift to the Francis Bacon Society for the purpose of 'finding the Bacon-Shakespeare manuscripts'. The principal object of the Society was to prove that Francis Bacon wrote Shakespeare's plays.

Questions

(1) It is evident that value judgments play a large part when courts decide whether a purpose has any educative value: see *Re Pinion (deceased)* [1965] Ch 85, 111 (Russell LJ). Are courts (or experts appointed by litigants) properly equipped to make such value judgments?

(2) Is the explanation for the decisions in cases like *Re Shaw* and *Re Pinion* possibly referable to an argument that society's scarce resources should not be wasted on costly but futile endeavours? See *Re Pinion* [1965] Ch 85, 97 (Wilberforce J). How relevant is the fact that both cases involved testamentary trusts rather than inter vivos trusts?

16.5 Trusts for the advancement of religion

Trusts for the advancement of religion must have the direct effect of advancing religion. The initial question to be resolved is what is a 'religion'? This matter was considered by the High Court in the following case.

16.5a *Church of the New Faith v Commissioner of Pay-roll Tax (Vic)* [1983] HCA 40; (1983) 154 CLR 120

Background

The Church of the New Faith (Scientology) sought exemption from payroll tax in Victoria, claiming to be an exempted religious institution. At first instance, and on appeal to the Victorian Court of Appeal, it was held that Scientology (a belief 'discovered, developed and organized' by science fiction writer L Ron Hubbard) was not a religion.

Decision

The High Court held that the Church was entitled to exemption on the ground that it was a religious institution.

Mason ACJ and Brennan J

We would … hold that, for the purposes of the law, the criteria of religion are twofold: first, belief in a supernatural Being, Thing or Principle; and second, the acceptance of canons of conduct in order to give effect to that belief, although canons of conduct which offend against the ordinary laws are outside the area of any immunity, privilege or right conferred on the grounds of religion. Those criteria may vary in their comparative importance, and there may be a different intensity of belief or of acceptance of canons of conduct among religions or among the adherents to a religion. …

… We would hold the test of religious belief to be satisfied by belief in supernatural Things or Principles and not to be limited to belief in God or in a supernatural Being …

Murphy J

The truth or falsity of religions is not the business of officials or the courts. If each purported religion had to show that its doctrines were true, then all might fail. Administrators and judges must resist the temptation to hold that groups or institutions are not religious, because claimed religious beliefs or practices seem absurd, fraudulent, evil or novel: or because the group or institution is new, the number of adherents small, the leaders hypocrites, or because they seek to obtain the financial and other privileges which come with religious status. In the eyes of the law, religions are equal. …

… The better approach is to state what is sufficient, even if not necessary, to bring a body which claims to be religious within that category. Some claims to be religious are not serious, but merely a hoax …, but to reach this conclusion requires an extreme case. On this approach, any body which claims to be religious, whose beliefs or practices are a revival of, or resemble, earlier cults, is religious. Any body which claims to be religious and to believe in a supernatural Being or Beings, whether physical and visible, such as the sun or the stars, or a physical invisible God or spirit, or an abstract God or entity, is religious. For example, if a few followers of astrology were to found an institution based on the belief that their destinies were influenced or controlled by the stars, and that astrologers can, by reading the stars, divine these destinies, and if it claimed to be religious, it would be a religious institution. Any body which claims to be religious, and offers a way to find meaning and purpose in life, is religious. The Aboriginal religion of Australia and of other countries must be included. The list is not exhaustive; the categories of religion are not closed.

Wilson and Deane JJ

One of the more important indicia of 'a religion' is that the particular collection of ideas and/or practices involves belief in the supernatural, that is to say, belief that reality extends beyond that which is capable of perception by the senses. If that be absent, it is unlikely that one has 'a religion'. Another is that the ideas relate to man's nature and place in the universe and his relation to things supernatural. A third is that the ideas are accepted by adherents as requiring or encouraging them to observe particular standards or codes of conduct or to participate in specific practices having supernatural significance. A fourth is that, however loosely knit and varying in beliefs and practices adherents may be, they constitute an identifiable group or identifiable groups. A fifth, and more controversial indicium (cf *Malnak v Yogi* (1979) 592 F (2d) 197) is that the adherents themselves see the collection of ideas and/or practices as constituting a religion.

As has been said, no one of the above indicia is necessarily determinative of the question whether a particular collection of ideas and/or practices should be objectively characterized as 'a religion'. They are no more than aids in determining that question and the assistance to be derived from them will vary according to the context in which the question arises. … Putting to one side the case of the parody or sham, it is important that care be taken, in the exercise of that judgment, to ensure that the question is approached and determined as one of arid characterization not involving any element of the assessment of the utility, the intellectual quality, or the essential 'Truth' or 'worth' of tenets of the claimed religion.

Note

Advancement of the living of a moral or ethical life (either divorced from religion or in loose association with religion) does not qualify as 'advancement of religion'. In *United Grand Lodge of Ancient and Accepted Masons of England v Holborn Borough Council* [1957] 1 WLR 1080, Donovan J said: 'a man may persuade his neighbour by example to lead a good life without at the same time leading him to religion. … To advance religion means to promote it, to spread its message ever wider among mankind; to take some positive steps to sustain and increase religious belief; and these things are done in a variety of ways which may be comprehensively described as pastoral and missionary'.

Question

Our legal system regards the spreading of religion as beneficial to mankind. Should this view be open to challenge? See S Woodfield, 'Doing God's Work: Is Religion Always Charitable?' (1996) 8(1) *Auckland University Law Review* 25; J Chevalier-Watts, 'Charitable Trusts and the Advancement of Religion: On a Whim and a Prayer' (2012) 43(3) *Victoria University of Wellington Law Review* 403.

16.5b *Roman Catholic Archbishop of Melbourne v Lawlor* [1934] HCA 14; (1934) 51 CLR 1

Background

The testator left property to the Archbishop to found a 'Catholic daily newspaper'. Did the bequest have the purpose of *advancing* the Catholic religion?

Decision

The High Court was equally divided on the question whether the gift advanced religion. In accordance with High Court practice at the time, the decision of the Victorian Supreme Court invalidating the gift was confirmed.

Dixon J

In order to be charitable, the purposes themselves must be religious; it is not enough that an activity or pursuit in itself secular is actuated or inspired by a religious motive or injunction: the purpose must involve the spread or strengthening of spiritual teaching with a wide sense, the maintenance of the doctrines upon which it rests, the observances that promote and manifest it … The purpose may be executed by gifts for the support, aid or relief of clergy and ministers or teachers of religion, the performance of whose duties will tend to the spiritual advantage of others by instruction and edification; by gifts for ecclesiastical buildings, furnishings, ornaments, and the like; by gifts to provide for religious services, for sermons, for music, choristers and organists and so forth; by gifts to religious bodies, orders or societies, if they have in view the welfare of others. A gift made for any particular means of propagating a faith or religious belief is charitable; … But, whether defined widely or narrowly, the purpose must be directly and immediately religious. It is not enough that they arise out of or have a connection with a faith, a church or a denomination, or that they are considered to have a tendency beneficial to religion, or to a particular form of religion. The law has found a public benefit in the promotion of religion as an influence upon human conduct; but it has no standard by which to estimate what public benefit of that order is produced indirectly or incidentally by means which, although they may be considered to contribute to the good of religion, are not in themselves religious and do not serve directly a religious object. …

… The character of the journal contemplated by the testator is indicated only by the phrase 'a Catholic daily newspaper'. There are no expressions referring to the purpose of religion. It is only such expressions that should be presumptively construed as charitable.

16.6 Trusts for other purposes beneficial to the community

The fourth head of charity referred to in *Pemsel's case* (*Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531) is the most compendious. The benefit of such purposes must be positively established.

16.6a *Incorporated Council of Law Reporting (Qld) v Commissioner of Taxation (Cth)* [1971] HCA 44; (1971) 125 CLR 659

Background

The Council produced reports of cases before superior courts in Queensland. Any profits it made were distributed to the Supreme Court Library. Was this a valid charitable purpose?

Decision

The High Court held that the publication of law reports was charitable as being for the benefit of the community.

Barwick CJ

… [I]t is a matter of judgment whether the trust or purpose fairly falls with the equity, or as it is sometimes said, 'within the spirit and intendment' of the preamble to the *Charitable Uses Act 1601* (Imp).

The instances given in that preamble are not exhaustive. Charity is not limited to activities eiusdem generis with those instances, if indeed a genus is really to be found in them. But the preamble does give an indication and, it would seem, a definitive indication, of what will be charitable …

The question here is whether the production not for private gain of law reports, recording the decisions of a superior court in a judicial system in which the decision of an earlier case may itself in terms or by analogy, or in association with other such decisions determine the result of a later case, is a purpose beneficial to the community within the scope of the fourth head of charity as expressed in *Pemsel's Case* [1891] AC 531 …

In Queensland, the only available reports of the decisions of the Supreme Court of Queensland are those produced by the council. Without them it would not be possible to ascertain what in any particular field of law had been decided without a time-consuming search of court records, assuming that the reasons given in decided cases are kept by the offices of the court not as part of the formal record of the case but as archival material. … Thus, in my opinion, it can confidently be said that in modern times without the availability of law reports in book form the law could not be adequately administered. Justice according to law would be in danger of being supplanted by justice according to whim which is in reality a contradiction in terms. Thus the production of law reports, is, in my opinion, clearly beneficial to the whole community because of the universal importance of maintaining the socially sustaining fabric of the law.

Yet it must be considered whether that benefit is charitable in the Elizabethan sense. Out of certain of the instances given in the preamble to the Act of 1601 a broad concept emerges of the kind of object of public utility which will satisfy the quality of charity. Any notion that the concept is of an eleemosynary nature is seen to be untenable by some of those very instances themselves, e.g., the repair of bridges, havens, causeways, seabanks and highways and the setting out of soldiers. Further, these instances seem to regard the provision of some of the indispensables of a settled community as charitable. … The sustenance of the law is a benefit of a material kind which enures for the benefit of the whole community. Is not its administration, with regularity, and with as much consistency as a system based on human judgment can attain, as socially fundamental as the instances which I have taken from the preamble? Surely it is. …

Thus, to my mind, … the production of law reports of a superior court is within the equity and the spirit and intendment of the preamble and thus capable of forming a charitable purpose.

Notes

(1) Purposes beneficial to the public which have been held to be charitable include purposes such as:

- **(a)** disaster relief: *Re Darwin Cyclone Tracy Relief Fund Trust* (1979) 39 FLR 260
- **(b)** a free public car park: *Bathurst City Council v PWC Properties Pty Ltd* (1998) 195 CLR 566
- **(c)** animal protection: *Re Wedgwood* [1915] 1 Ch 113, but cf *Murdoch v Attorney- General (Tas)* (1992) 1 Tas R 117.

(2) Barwick CJ specifically held that the purpose of production of law reports was not educational, '(h)owever much a student may and should profit by reading the law reports'. Windeyer J thought that '(t)he existence of a well-stocked library of law books available for … students of law is a means of advancing legal learning'. (After many years teaching in law schools across the country, the authors of this work are able to confirm that law reports serve little educative function.)

(3) For a modern expression of a fourth head charity for the benefit of the public, see *Aid/Watch Inc v Commissioner of Taxation* [2010] HCA 42; (2010) 241 CLR 539, extracted below at [16.7b].

Question

Barwick CJ suggests that public infrastructure projects are charitable in purpose. How is the court to judge the public benefit in cases where sections of the public disagree on the benefit of the project? Recent examples of disagreement over benefits of infrastructure projects include proposals for a second airport in Sydney, and proposals for new major roads in Melbourne.

16.7 The requirement of public benefit: 'benefit'

16.7a *Gilmour v Coats* [1949] AC 426

Background

A gift was made to an order of cloistered nuns, who devoted their lives to prayer and religious observance entirely within the convent. They performed no work outside of the convent.

Decision

The House of Lords held that the work of the order did not satisfy the public benefit test because it did not involve contact with the public.

Lord Simonds

My Lords, I would speak with all respect and reverence of those who spend their lives in cloistered piety, … But … whether I affirm or deny, whether I believe or disbelieve, what has that to do with the proof which the court demands that a particular purpose satisfies the test of benefit to the community? Here is something which is manifestly not susceptible of proof. But, then it is said, this is a matter not of proof but of belief; for the value of intercessory prayer is a tenet of the Catholic Faith, therefore in such prayer there is benefit to the community. But it is just at this 'therefore' that I must pause. It is, no doubt, true that the advancement of religion is, generally speaking, one of the heads of charity. But it does not follow from this that the court must accept as proved whatever a particular church believes. The faithful must embrace their faith believing where they cannot prove; the court can act only on proof. A gift to … cloistered nuns in the belief that their prayers will benefit the world at large does not from that belief alone derive validity any more than does the belief of any other donor for any other purpose …

I turn to the second of the alleged elements of public benefit, edification by example. And I think that this argument can be dealt with very shortly. It is in my opinion sufficient to say that this is something too vague and intangible to satisfy the prescribed test. The test of public benefit has, I think, been developed in the last two centuries. Today it is beyond doubt that that element must be present. No court would be rash enough to attempt to define precisely or exhaustively what its content must be. But it would assume a burden which it could not discharge if now for the first time it admitted into the category of public benefit something so indirect, remote, imponderable and, I would add, controversial as the benefit which may be derived by others from the example of pious lives …

Note

In *Crowther v Brophy* [1992] 2 VR 97, Gobbo J held that a trust for intercessory prayers at Mass promoted public benefit, and was therefore a valid charitable trust. His Honour distinguished *Gilmour v Coats* on the grounds that the prayers in that case were private, whereas the proposed Mass was to be public. Gobbo J commented as follows:

> Lord Simonds in *Gilmour v Coats,* at 448, spoke of the court requiring proof that the particular purpose satisfies the test of benefit to the community and said that the gift to a contemplative order was a purpose manifestly not susceptible of such proof. With great respect to that distinguished judge, it may be that the test of the success of intercessory prayers is an inappropriate test and that the enhancement in the life, both religious and otherwise, of those who found comfort and peace of mind in their resort to intercessory prayer was a more appropriate consideration to adopt.

His Honour thought that intercessory prayers reinforced and enhanced the religious life of the congregation, and that payment for Masses contributed to the support of priests, and thus advanced religion.

Questions

(1) Can there be a *benefit* to the public if there is no connection to the public?

(2) Is 'comfort and peace of mind' to some religious adherents sufficient benefit, or should benefit require a more tangible outcome?

16.7b *Aid/Watch Inc v Commissioner of Taxation (Cth)* [2010] HCA 42; (2010) 241 CLR 539

Background

Aid/Watch's charitable status under federal law for taxation purposes was revoked in 2006 on the grounds that its political aims meant it was not a charitable institution. On appeal to the High Court, the parties agreed that the purpose of Aid/Watch was to promote the effectiveness of Australian and multinational aid in foreign countries by means including investment programs, projects and policies. (Heydon J, in dissent, noted that Aid/Watch described itself as 'an activist group' and an 'activist and solidarity organisation'.) The Full Federal Court accepted that Aid/Watch's activities were directed to the relief of poverty, but concluded that the inherent political purposes necessarily involved invalidated the charitable aspect.

Decision

The High Court, Heydon and Kiefel JJ dissenting, held that Aid/Watch was not disqualified from charitable status for political purposes.

French CJ, Gummow, Hayne, Crennan and Bell JJ

In *Royal North Shore Hospital of Sydney v Attorney-General (NSW)* (1939) 60 CLR 396, … Dixon J … remarked at 426:

> The case law dealing with the distinction between charitable purposes and political objects is in an unsatisfactory condition, but the basal ideas upon which it rests may be seen. It is, of course, quite clear that any purpose that is contrary to the established policy of the law cannot be the subject of a good charitable trust. But there is a further consideration arising from the very nature of the doctrine by which charitable trusts are supported. Under all four heads of the well-known classification to which such trusts are referred, an essential element is the real or imputed intention of contributing to the public welfare. A coherent system of law can scarcely admit that objects which are inconsistent with its own provisions are for the public welfare. Thus, when the main purpose of a trust is agitation for legislative or political changes, it is difficult for the law to find the necessary tendency to the public welfare, notwithstanding that the subject of the change may be religion, poor relief, or education. When the subject matter is none of these and the case must fall under the fourth class, viz. that of undefined purposes for the public good, the difficulty becomes even greater. …

This reasoning appears to proceed by the following steps: (i) a purpose contrary to the established policy of law cannot be recognised as a charitable purpose; (ii) even if (i) does not apply, the purpose in question must have the real or imputed intention of contributing to the public welfare; (iii) when the main purpose of the trust is 'agitation' for legislative or political change, with respect to religion, poor relief or education, 'it is difficult' for the law to find that (ii) is satisfied; and (iv) the source of that difficulty is the apparent paradox in a 'coherent system of law' treating as for the public welfare 'objects which are inconsistent with its own provisions'.

Proposition (iv) invites further examination, particularly in the light of recent decisions in this court. In Australia, the foundation of the 'coherent system of law' of which Dixon J spoke in *Royal North Shore Hospital* is supplied by the Constitution. The provisions of the Constitution mandate a system of representative and responsible government with a universal adult franchise, and s 128 establishes a system for the amendment of the Constitution in which the proposed law to effect the amendment is to be submitted to the electors. Communication between electors and legislators and the officers of the executive, and between electors themselves, on matters of government and politics is 'an indispensable incident' of that constitutional system. While personal rights of action are not

by these means bestowed upon individuals in the manner of the *Bivens* (403 US 388 (1971)) action known in the United States, the Constitution informs the development of the common law. Any burden which the common law places upon communication respecting matters of government and politics must be reasonably appropriate and adapted to serve a legitimate end in a manner which is compatible with the maintenance of that system of government.

The system of law which applies in Australia thus postulates for its operation the very 'agitation' for legislative and political changes of which Dixon J spoke in *Royal North Shore Hospital*. There is none of the 'stultification' of which Tyssen wrote in 1888 … Rather, it is the operation of these constitutional processes which contributes to the public welfare. A court administering a charitable trust for that purpose is not called upon to adjudicate the merits of any particular course of legislative or executive action or inaction which is the subject of advocacy or disputation within those processes.

The submissions by Aid/Watch

It was with this understanding of the system of law that applies in Australia that Aid/Watch submitted that the generation by it of public debate as to the best methods for the relief of poverty by the provision of foreign aid has two characteristics indicative of its charitable status. The first is that its activities are apt to contribute to the public welfare, being for a purpose beneficial to the community within the fourth head identified in *Pemsel*. The second is that whatever else be the scope today in Australia for the exclusion of 'political objects' as charitable, the purposes and activities of Aid/Watch do not fall within any area of disqualification for reasons of contrariety between the established system of government and the general public welfare.

Conclusions

These submissions by Aid/Watch should be accepted. … This is because the generation by lawful means of public debate, in the sense described earlier in these reasons, concerning the efficiency of foreign aid directed to the relief of poverty, itself is a purpose beneficial to the community within the fourth head in *Pemsel*.

It also is unnecessary for this appeal to determine whether the fourth head encompasses the encouragement of public debate respecting activities of government which lie beyond the first three heads (or the balance of the fourth head) identified in *Pemsel* and, if so, the range of those activities. What, however, this appeal should decide is that in Australia, there is no general doctrine which excludes from charitable purposes 'political objects' and has the scope indicated in England by *McGovern v Attorney-General* [1982] Ch 321 at 340.

It may be that some purposes which otherwise appear to fall within one or more of the four heads in *Pemsel* none the less do not contribute to the public welfare in the sense to which Dixon J referred in *Royal North Shore Hospital*. But that will be by reason of the particular ends and means involved, not disqualification of the purpose by application of a broadly expressed 'political objects' doctrine.

Kiefel J (dissenting)

It may be accepted that what is regarded as charitable may develop or change, according to the needs of society. What the different conceptions of charitable purposes, under the general law, have in common is that they all contain the provision of a benefit to the public. …

It could scarcely be denied … that it may be necessary for organisations, whose purposes are directed to the relief of poverty or the advancement of education, to agitate for change in the policies of government or in legislation in order to best advance their charitable purposes. No one would suggest that charitable and political purposes are mutually exclusive. A charitable institution may have charitable and political purposes, provided that the political purpose is not the main or predominant purpose of the organisation. Here, the appellant's main purposes are to agitate for change in the programmes and policies of the Government or its agencies, by putting forward the views of its members.

I agree that there is no reason, in principle, that the political nature of an organisation's main purpose should mean its outright disqualification from charitable status. In each case it is necessary to consider the stated purposes and activities of the organisation, in order to determine whether the main purpose is for the public benefit, the feature common to all classes referred to in *Pemsel*. However, reaching a conclusion of public benefit may be difficult where the activities of an organisation largely involve the assertion of its views, as is here the case. It might have been otherwise were those activities, and the stated purposes, capable of being charac-

terised as for the advancement of education, or as having some other evident benefit to society. A mere connection between those activities and the charitable purposes of others, to render aid, will not suffice as a public benefit. …

The law assumes that the purposes of the relief of poverty and the advancement of education, the first and second classes referred to in *Pemsel*, are for the public benefit. Such an assumption does not apply to the fourth class there referred to 'other purposes beneficial to the community, not falling under any of the preceding heads'. A likely benefit to the public must be evident from the stated purposes and activities of an organisation.

It is the fourth class which falls for consideration in this case, because the appellant's main purposes do not qualify under the first two. …

The submission by the appellant, that its purposes are for the public benefit because it generates public debate, cannot be accepted at a number of levels. Its assertion of its view cannot, without more, be assumed to have that effect. Its activities are not directed to that end. If they were directed to the generation of a public debate about the provision of aid, rather than to the acceptance by the government and its agencies of its views on the matter, the appellant might be said to be promoting education in that area. But it is not. Its pursuit of a freedom to communicate its views does not qualify as being for the public benefit.

Questions

(1) Where an organisation claims its purposes include 'educating the population' as to the need for a change in the law, will those aims be regarded automatically as charitable? Consider Kiefel J's dissent in answering this question as well as the majority judgment.

(2) Is the approach of the majority to 'benefit' in *Aid/Watch* more in keeping with the views of Lord Simonds in *Gilmour v Coats* (at [16.7a] above) or those of Gobbo J in *Crowther v Brophy* (see note following [16.7a] above)?

16.8 The requirement of public benefit: 'public or section of the public'

Background

A trust was established for the education of children of employees and former employees of a company. The employees and former employees numbered over 110,000. Did the size of the class of potential recipients mean that the trust was for the benefit of a section of the public; or did the nexus between the potential recipients and the company remove any 'public' benefit?

Decision

The House of Lords, Lord MacDermott dissenting, held that the fact that all the potential beneficiaries were linked by their parents' employment with a common employer meant that the trust did not meet the public benefit test.

Lord Simonds

… It is a clearly established principle of the law of charity that a trust is not charitable unless it is directed to the public benefit. This is sometimes stated in the proposition that it must benefit the community or a section of the community. Negatively, it is said that a trust is not charitable if it confers only private benefits. … With a single exception, to which I shall refer, this applies to all charities. We are apt now to classify them by reference to Lord Macnaghten's division in *Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531, 583, and … it was at one time suggested that the element of public benefit was not essential except for charities falling within the fourth class, 'other purposes beneficial to the community'. This is certainly wrong except in the anomalous case of trusts for the relief of poverty with which I must specifically deal. In the case of trusts for educational purposes the condition of public benefit must be satisfied. The difficulty lies in determining what is sufficient to satisfy the test …

If I may begin at the bottom of the scale, a trust established by a father for the education of his son is not a charity. The public element, as I will call it, is not supplied by the fact that from that son's education all may benefit. At the other end of the scale the establishment of a college or university is beyond doubt a charity. … So also the endowment of a college, university or school by the creation of scholarships or bursaries is a charity, and none the less because the competition may be limited to a particular class of persons. It is upon this ground, as Lord Greene MR pointed out in *Re Compton* [1945] Ch 123, 136, that the so-called Founders Kin cases can be rested. The difficulty arises where the trust is not for the benefit of any institution …, but for the benefit of a class of persons at large. Then the question is whether that class of persons can be regarded as such a 'section of the community' as to satisfy the test for public benefit. These words 'section of the community' have no special sanctity but they conveniently indicate first, that the possible (I emphasise the word 'possible') beneficiaries must not be numerically negligible, and secondly, that the quality that distinguishes them from other members of the community, so that they form by themselves a section of it, must be a quality that does not depend on their relationship to a particular individual. It is for this reason that a trust for the education of members of a family, or as in *Re Compton*, a number of families, cannot be regarded as charitable. A group of persons may be numerous, but, if the nexus between them is their personal relationship to a single propositor or to several propositi, they are neither the community nor a section of the community for charitable purposes.

I come, then, to the present case where the class of beneficiaries is numerous but the difficulty arises in regard to their common and distinguishing quality. That quality is being children of employees … I can make no distinction between children of employees and the employees themselves. In both cases the common quality is found in employment by particular employers. … *Re Hobourn Aero Components Ltd's Air Raid Distress Fund* [1940] Ch 194, is direct authority for saying that such a common quality does not constitute its possessors a section of the public for charitable purposes. In … *Re Compton,* Lord Greene MR by way of illustration placed members of a family and employees of a particular employer on the same footing, finding neither in common kinship nor in common employment the sort of nexus which is sufficient. My Lords, I am so fully in agreement with what was said by Lord Greene in both cases … that I am in danger of repeating without improving upon their words.

Background

Dingle's will left part of the residuary estate to be used for the purpose of 'applying the income thereof in paying pensions to poor employees of E Dingle & Co Ltd' who were either aged or incapacitated. By the time proceedings commenced, E Dingle & Co Ltd had approximately 1,000 full-time and part-time employees and was paying pensions to 89 ex-employees. The trustees asked the Court whether the provision was valid.

Decision

The House of Lords held that the trust satisfied the public benefit test even though employment by one employer linked all potential beneficiaries.

Lord Cross

… [T]he 'poor members' and 'poor employees' decisions were a natural development of the 'poor relations' decisions and to draw a distinction between different sort of 'poverty' trusts would be quite illogical and could certainly not be said to be introducing 'greater harmony' into the law of charity. … So it seems to me it must be accepted that whatever else it may hold sway the *Compton* rule has no application in the field of trusts for the relief of poverty and that there the dividing line between a charitable trust and a private trust lies where the Court of Appeal drew it in *In re Scarisbrick's Will Trusts* [1951] Ch 622 …

To establish a trust for the education of the children of employees in a company in which you are interested is no doubt a meritorious act; but however numerous the employees may be the purpose which you are seeking to achieve is not a public purpose. It is a company purpose and there is no reason why your fellow taxpayers should contribute to a scheme which by providing 'fringe benefits' for your employees will benefit the company by making their conditions of employment more attractive. The temptation to enlist the assistance of the law of charity in private endeavours of this sort is considerable … and the courts must do what they can to discourage such attempts. In the field of poverty, the danger is not so great as in the field of education – for while people are keenly alive to the need to give their children a good education and to the expense of doing so they are generally optimistic enough not to entertain serious fears of falling on evil days much before they fall on them. Consequently the existence of company 'benevolent funds' the income of which is free of tax does not constitute a very attractive 'fringe benefit'. This is a practical justification … for the special treatment accorded to poverty trusts in charity law. For the same sort of reason a trust to promote some religion among the employees of a company might perhaps safely be held to be charitable provided that it was clear that the benefits were to be purely spiritual. On the other hand, many 'purpose' trusts falling under Lord Macnaghten's fourth head … if confined to a class of employees would clearly be open to the same sort of objection as educational trusts.

Notes

(1) It is obvious that the terms 'public' or 'section of the public' do not depend upon size per se, or else the *Oppenheim* class might have qualified. The characterisation of the *Oppenheim* trust (explained in *Dingle v Turner)* as being, effectively, a scheme to provide fringe benefits to employees may have been critical.

(2) In *Re Income Tax Acts (No 1)* [1930] VLR 211, Lowe J described 'a section of the public' in the following terms:

> Having regard to the composition of the public, certain large groups may readily be recognized, the members of which have a common calling, or adhere to a particular faith, or reside in a particular geographical area. There is no bar which admits some members of the public to those groups and rejects others. Any member of the public may, if he will, follow a particular calling, adhere to a particular faith, or reside within a particular area. Of the members of such a group it may be said in a real sense that they are primarily members of the public, and such a group may well constitute a section of the public. They stand on one side of the line. Each group, it is true, may consist of many individuals, but the number alone is not the criterion by which to determine whether the group constitutes a section of the public. A club, a literary society, a trade union may all have numerous members, but I think that

none of these could properly be called a section of the public. … The distinguishing feature of each of these latter bodies is that it is an association which takes power to itself to admit or exclude members of the public according to some arbitrary test which it sets up in its rules or otherwise. Each of them does oppose a bar to admission within it.

Questions

(1) When will a trust for 'poor relatives' cease to be a public trust, and instead be a private express trust? Is potential application of the rule in *Saunders v Vautier* (1841) 4 Beav 115; 49 ER 282 (see [24.2a]) relevant to this question? See also *Re Segelman (deceased)* [1996] Ch 171.

(2) What public policy drivers dictate that trusts for the relief of poverty are not limited by link to a named individual or company, but trusts for the advancement of education are? Does the private nature of the individual or company matter? For example, would a trust for the education of the children of employees of the Commonwealth Public Service be valid; or would it remain objectionable because of its characterisation as a 'fringe benefit'?

16.9 Trusts for non-charitable purposes

Background

A trust allowed income to be distributed 'for or towards all or any of the objects or purposes' listed in a Schedule to the settlement. A lengthy list of objects or purposes included establishment maintenance and improvement of good understanding between nations; the preservation of the independence and integrity of newspapers; and the promotion of the freedom independence and integrity of the press. The parties agreed the purposes were non-charitable. The question arose whether the non-charitable trusts were void.

Decision

The trusts were void.

Roxburgh J

Mr Jennings and Mr Buckley have submitted that [the trusts] are void on two grounds (1) that they are not trusts for the benefit of individuals; (2) that they are void for uncertainty.

Lord Parker considered the first of these two questions in his speech in *Bowman v Secular Society Ltd* [1917] AC 406 and I will cite [this] important passage …: 'A trust to be valid must be for the benefit of individuals … or must be in that class of gifts for the benefit of the public which the courts in this country recognise as charitable in the legal as opposed to the popular sense of that term.'

… I will first consider whether Lord Parker's proposition can be attacked from a base of principle.

The typical case of trust is one in which the legal owner of property is constrained by a court of equity so as to deal with it as to give effect to the equitable rights of another. … Prima facie, therefore, a trustee would not be expected to be subject to an equitable obligation unless there was somebody who could enforce a correlative equitable right, and the nature and extent of that obligation would be worked out in proceedings for enforcement. This is what I understand by Lord Parker's first proposition.

[Roxburgh J then explained the Attorney-General's role as the enforcer of charitable trusts.]

But if the purposes are not charitable, great difficulties do arise both in theory and in practice. In theory, because, having regard to the historical origins of equity, it is difficult to visualise the growth of equitable obligations which nobody can enforce, and in practice, because it is not possible to contemplate with equanimity the creation of large funds devoted to non-charitable purposes which no court and no department of state can control, or in the case of maladministration reform. … [Further] … no case has been found in the reports in which the court has ever directly enforced a non-charitable purpose against a trustee. Indeed where, as in the present case, the only beneficiaries are purposes … it is difficult to see who could initiate such proceedings. If the purposes are valid trusts, the settlors have retained no beneficial interest and could not initiate them. It was suggested that the trustees might proceed ex parte to enforce the trusts against themselves. I doubt that, but at any rate, nobody could enforce the trusts against them.

… [There] is a group of cases relating to horses and dogs, graves and monuments – matters arising under wills and intimately connected with the deceased – in which the courts have found means of escape from … general propositions … The rest may, I think, properly be regarded as anomalous and exceptional … I hold that the trusts here in question are void on the first of the grounds submitted by Mr Jennings and Mr Buckley.

… [W]hile I have reached my decision on two separate grounds, both, I think, have their origin in a single principle, namely, that a court of equity does not recognise as valid a trust which it cannot both enforce and control.

Note

Re Astor's Settlement Trusts (above) is an English decision. Non-charitable purpose trusts are equally rare in Australia. As Gummow J commented in *Re Australian Elizabethan Theatre Trust* (1991) 30 FCR 491 at [31], '[t]he use of the expression "purpose" should not be read as heralding a new era for non-charitable purpose trust. This is a concept that has not struck deep roots in this country'.

Part F

Performing the trust

17

Trustees' duties and powers

17.1 Introduction

17.2 Sources of the trustees' duties and powers

17.3 Trustees' duties

17.1 Introduction

Trustees are empowered specifically to administer the trusts entrusted to them. They must obey the terms of the trust instrument, if there is one, to give effect to the trust. At the same time, they must conduct themselves in conformity with a range of qualities which protect the interests of beneficiaries of the trusts, such as care, diligence, impartiality and loyalty. Failure to observe either the express terms of the trust instrument or the qualitative duties may constitute a breach of trust.

Questions for consideration

(1) How do the duties imposed on trustees safeguard the interests of beneficiaries of a trust?

(2) How do the various statutory provisions and general law rules interact in practice?

(3) How do the circumstances surrounding the trust affect the substantive content of the duties owed by the trustees of that trust?

17.2 Sources of the trustees' duties and powers

The equitable duties outlined below provide additional overlay to the terms of the trust which the trustee must enforce. Often, they provide default rules where the trust instrument is silent. They also regulate the way in which the trustee undertakes its role by imposing certain qualities of conduct on trustees. Importantly, though, with only a few exceptions (such as where the provisions are contrary to law or public policy, or unduly encroach upon an 'irreducible core' of trustee obligations: *Armitage v Nurse* [1998] Ch 241), those rules have scope to operate only within the terms of the trust specified in the trust instrument.

The situation with statutory duties is a little more complex. Some statutory rules act in concert with provisions in the trust instrument. Others override or modify the trust instrument. This is particularly common where the trust in question is of a type that accepts money from the public, such as a registered managed investment scheme or a superannuation fund.

17.3 Trustees' duties

The duties imposed by equity on trustees are capable of being expressed in a variety of forms. Moreover, the equitable duties imposed by the courts can and do overlap. Therefore, unlike their statutory analogues, there is no definitive set of equitable 'duties'. Courts and commentators have sought to divide the landscape in different ways according to the demands of the case or the purpose of the analysis.

17.3.1 Duty to adhere to the terms of the trust

The primary duty of trustees of an express trust is to adhere strictly to the terms of the trust (*Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR 484). Trustees must ensure that they become thoroughly acquainted with the terms of the trust when they assume office. Ignorance of the terms of the trust is no defence to an allegation that a trustee failed to adhere to its terms, even if the trustee has acted honestly (*Turner v Turner* [1984] Ch 100). One practical reason this is important is that a failure to act (for instance, to exercise a discretion vested in them) may in certain circumstances constitute a breach of trust, so awareness of all that is required of them is essential.

It will not always be possible or desirable for the trustee to give effect to the trust strictly on its terms. A trustee has a variety of options available to it where it is undesirable, impossible, impracticable or contrary to law to give effect to the terms of the trust. It may be able to bring the trust to an end at the unanimous request of the beneficiaries, as long as the beneficiaries are each *sui juris* (*Saunders v Vautier* (1841) 4 Beav 115; 49 ER 282). The trustees of a charitable trust can apply to the court for a cy-près scheme if the specific purpose of the trust is frustrated and a viable alternative is available (see chapter 16). It is also open to trustees to approach the court to vary the terms of the trust, either in respect of a specific transaction or permanently, in order to permit a course of action that would otherwise constitute a breach of trust (*Trustee Act 1925* (NSW) s 81; *Trustee Act 1958* (Vic) ss 63 and 63A). Finally, the court can exercise its discretion in certain circumstances to excuse breaches of trust (see chapter 20).

17.3.2 Duty to 'get in' the trust assets

A trustee must have control of the property over which it is expected to exercise trusteeship. An incoming trustee may therefore need to take steps to perfect its title; for instance, by completing formal registration of its interest. Thereafter, it must ensure that title documents remain within its control, although as *Field v Field* (below) demonstrates, not necessarily within its possession.

17.3.2a *Field v Field* [1894] 1 Ch 425

Background

A trust fund had been invested on a mortgage of a building estate, the development of which would involve frequent reference to the title deeds.

Decision

It was held that the trustees were justified in depositing the deeds with their solicitor for administrative convenience in these circumstances.

Kekewich J

The general principle, in my opinion, is that trustees must have their muniments of title, as well as their securities, under their own control. … They are intrusted with the custody of them, and they are bound within reasonable limits to see that the deeds are kept in a safe place, and that no one else can take them away. But to that obligation there must be reasonable limits. In order to realize the trust estate, the deeds must be in the custody of the solicitor to the trustees. He has to make abstracts of them, to make an examination of the deeds abstracted, and, if the property is sold in lots, the purchasers must have the opportunity of examining the deeds with the abstracts, if they wish, and even a second and a third examination may be necessary before completion. It would be a monstrous thing to say that the trustees have to keep the deeds all that time in a box with perhaps three or four keys, so that if any purchaser wishes to consult the deeds all the trustees will have to attend in person. That strikes one immediately as shewing that reasonable limits to the trustees' obligation should be applied.

Note

In practice today, title to many types of assets does not depend on physical documentation (for example, 'dematerialised securities'). However, this does not relieve the trustee of the need to ensure that whatever indicium of ownership is required does in fact accurately reflect the trustee's interest.

17.3.3 Investment of trust funds

The duties relevant to the investment of trust assets are discussed in chapter 18.

17.3.4 Duty to keep assets separate

The duty to keep trust assets separate is often described as 'a hallmark duty of a trustee' (*Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000) 202 CLR 588, [34]. See [13.4.2a] for background and decision). It facilitates identification of the assets held on trust in circumstances where, for instance, the trustee becomes insolvent on its own account, or where there are policy or regulatory considerations at play, such as in the calculation of a trustee's capital adequacy for *Corporations Act 2001* (Cth) purposes.

The fact that complex analysis may be required to identify the proper beneficial owner where trust assets have been mixed was vividly illustrated in *Re Lehman Brothers International (Europe) (No 2)* – a case associated with the failure in 2008 of major international investment bank, Lehman Brothers.

Background

Lehman Brothers operated a wide range of financial services businesses that accepted money from clients. In some circumstances, the monies were held on trust; in other circumstances, clients had merely an unsecured contractual claim against the firm. Some of the complexity facing the Court is manifest in the excerpts reproduced below.

Decision

Briggs J

[Cited with approval by Lord Walker in the Supreme Court]

In an ideal world, the flawless operation of the scheme created by the [regulatory] rules would ensure first, that the client's money could not be used by the firm for its own account and secondly, that upon the firm's insolvency, the clients would receive back their money in full (subject only to the proper costs of its distribution), free from the claims of the firm's creditors under the statutory insolvency scheme. The rules would achieve those twin objectives by ensuring that, promptly upon receipt, client money was held by a firm as trustee, separately and distinctly from the firm's own money and other assets, and therefore out of the reach both of the firm (for the conduct of its business) and of the firm's administrator or liquidator upon its insolvency (for distribution among its creditors).

In the imperfect and hugely complex real world occupied by LBIE and its numerous clients, there has on the facts which I am invited to assume for present purposes been a falling short in the achievement of both of those objectives on a truly spectacular scale. This shocking underperformance has occurred for a number of reasons, of which two stand out as prime causes. The first is that (again on the facts which I am invited to assume) LBIE failed to identify as client money, and therefore also failed to segregate, vast sums received from or on behalf of a significant number of its clients. In this respect, the most significant group of clients whose money LBIE failed to segregate were its own affiliates, that is members of the Lehman Brothers group of companies of which Lehman Brothers Holdings Inc (LBHI) is the ultimate parent. Those affiliates have advanced client money claims against LBIE in aggregate exceeding $3bn. To put that extraordinary amount in perspective, the aggregate of the amounts actually held by LBIE in segregated accounts for clients for which it recognised a segregation obligation pursuant to CASS7 when it went into administration on the morning of 15 September 2008 had a face value of only $2.16bn approximately. To the unsegregated affiliates' claims in excess of $3bn must be added claims of independent clients of LBIE who have challenged LBIE's treatment of its relationship with them as one of debtor/creditor rather than trustee and beneficiary, pursuant to the terms of its standard form contracts. The amount of under-segregation which may be attributable to that failure (if failure it be) has not been identified. In addition, LBIE routinely treated otherwise than as client money sums deriving from options and derivative over-the-counter (OTC) transactions with its clients, regardless of the terms of the agreements pursuant to which LBIE conducted such trading for those clients. The amount of potential segregation failure in respect of option transactions alone is said to have been $146m.

The second main reason for under-achievement of the objectives behind the CASS7 rules lies in the insolvent failure of another LBIE affiliate, Lehman Brothers Bankhaus AG (Bankhaus), with which LBIE had deposited no less than $1bn of segregated client money … The administrators have been unable even to hazard a guess at the amount, if any, of client money which may be recovered from Bankhaus. Thus, even if there were no claims at all by clients whose client money LBIE failed to segregate, there exists a real risk that the shortfall on client account will exceed 40% due to the Bankhaus failure, quite apart from the costs and charges liable to be levied against the segregated fund in connection with its distribution, including the very large costs of this application.

17.3.5 Keeping and rendering accounts

The keeping of proper financial accounts is a necessary incident of trusteeship. The duty requires creating appropriate vouchers for payments made by the trustee and the periodic preparation of appropriate financial statements. Where necessary, the trustee can employ an accountant to assist in this task or to audit the books, the latter being expressly provided in statute in most Australian States.

The trustee must also be prepared to render those accounts to the beneficiaries or court when requested. As *Kemp v Burn* shows, the rule is taken seriously by the courts.

17.3.5a *Kemp v Burn* (1863) 4 GIFF 348; 66 ER 740

Background

A trustee refused to render an account to a solicitor representing the beneficiaries under a will for the costs of the solicitor initiating proceedings in court to receive that account. The defendant trustees alleged that the solicitor was actuated by an ulterior motive in seeking the information.

Decision

It was held that, notwithstanding the motivation of the request, the trustees had acted in breach of trust in refusing to render an account.

Stuart V-C

In a case like the present, where an account is demanded of trustees and executors of a will by a residuary legatee, there seems to me no doubt what the duty of the executors is. Their duty is to keep proper accounts, and to have them always ready when called upon to render them. …

There must be strong reason to justify any executor and trustee in refusing to allow the solicitor of a residuary legatee to interfere in the matter of the accounts. The reason assigned here is some benevolent or good feeling entertained towards the Plaintiff … [The defendant] says he had reason to know that the solicitor who made the application on behalf of the Plaintiffs made it for no purpose really useful to the Plaintiffs, but to serve a purpose of his own … It has been said, but not proved, that this solicitor had advanced money to the Plaintiffs. That may have been the most kind and proper thing to do; at any rate, I cannot say it was anything improper, or which would justify the Defendant, Burn, in not rendering an account …

It is a hard thing to be obliged to punish an executor and trustee for any mistake he may have made in doing his duty honestly; but, with every consideration towards honest executors and trustees, if they fail in so important a matter for the beneficiaries to file a bill, it seems that the person failing such a duty ought to be made to pay the costs of the suit …

17.3.6 Duty to give information to beneficiaries

There are two important dimensions of the trustee's duty to provide information to beneficiaries: the nature of the interest sufficient to give rise to the right to information, and the type of information to which the right (and the concomitant duty on the trustee) extends. The first of these issues remains contested, as shown by the extracts below from two New South Wales Supreme Court decisions, *Avanes v Marshall* [2007] NSWSC 191; (2007) 68 NSWLR and *McDonald v Ellis* [2007] NSWSC 1068; (2007) 72 NSWLR 605. The second is the question of which documents fall within the ambit of the 'trust documents' to which beneficiaries can have access.

17.3.6a *Spellson v George* (1987) 11 NSWLR 300

Background

An object of a discretionary family trust sought information from its trustees. In ordering disclosure, the Court recognised the right of a mere object to demand information (on which see, below, *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709 at [17.3.6c]; *Avanes v Marshall* [2007] NSWSC 191; (2007) 68 NSWLR 595 at [17.3.6d]; and *McDonald v Ellis* [2007] NSWSC 1068; (2007) 72 NSWLR 605 at [17.3.6e]), and articulated clearly the basis for the right to disclosure.

Decision

Powell J

At the risk of being regarded as overly simplistic, it is well to start with the fundamental proposition that one of the essential elements of a private trust, be it a discretionary trust or some other form of trust, is that the trustee is subject to a personal obligation to hold, and to deal with, the trust property for the benefit of some identified, or identifiable, person or group of persons … It is, so it seems to me, a necessary corollary of the existence of that obligation that the trustee is liable to account to the person, or group of persons for whose benefit he holds the trust property … and, that being so, the trustee is obliged not only to keep proper accounts and allow a cestui que trust to inspect them, but he must also, on demand, give a cestui que trust information and explanations as to the investment of, and dealings with, the trust property.

17.3.6b *Re Londonderry's Settlement* [1965] Ch 918

Background

The case involved a trust established by the seventh Marquess of Londonderry in 1934 for his descendants. The defendant was an object of discretionary powers of appointment in respect of both income and capital and had an interest in the income in default. Unusually, the case was brought by the trustee, rather than beneficiary. The trustees issued a summons asking the Court which of various categories of documents had to be disclosed to the beneficiaries.

Decision

The Court of Appeal held that the trustees were bound to disclose the minutes of the meetings of the trustees of the settlement, agendas and other documents prepared for the purposes of the meetings of the trustees or otherwise for the consideration of the trustees, as well as correspondence relating to the administration of the trust property. On the other hand, the Court found that the trustees were not bound to disclose to the defendant correspondence passing between the trustees and appointors, correspondence passing between the said trustees and appointors and the beneficiaries, minutes of meetings of the trustees or appointors, and other documents disclosing the deliberations of the trustees as to the manner in which they should exercise the discretionary powers conferred upon them.

Salmon LJ

The defendant beneficiary undoubtedly believes that she has been harshly treated by the plaintiff trustees. She considers that they should have appointed larger sums to her under the settlement than they have in fact appointed. It is not unusual for a disappointed beneficiary to persuade herself that she has a real grievance. Whether or not there is any justification for the present defendant's view, I do not know and have no means of knowing. Whether or not the court, if it knew all the facts known to the trustees, would

have acted as they did, again I do not know – nor is it material. The settlement gave the absolute discretion to appoint to the trustees and not to the courts. So long as the trustees exercise this power with the consent of persons called appointors under the settlement and exercise it bona fide with no improper motive, their exercise of the power cannot be challenged in the courts – and their reasons for acting as they did are, accordingly, immaterial. This is one of the grounds for the rule that trustees are not obliged to disclose to beneficiaries their reasons for exercising a discretionary power. Another ground for this rule is that it would not be for the good of the beneficiaries as a whole, and yet another that it might make the lives of trustees intolerable should such an obligation rest upon them: *In re Beloved Wilkes Charity*; *In re Gresham Life Assurance Society, Ex parte Penney*. Nothing would be more likely to embitter family feelings and the relationship between the trustees and members of the family, were trustees obliged to state their reasons for the exercise of the powers entrusted to them. It might indeed well be difficult to persuade any persons to act as trustees were a duty to disclose their reasons, with all the embarrassment, arguments and quarrels that might ensue, added to their present not inconsiderable burdens.

Together with the rule enunciated in the authorities to which I have referred marches the rule no less firmly established that beneficiaries have a proprietary interest in, and a right to see, all trust documents: *O'Rourke v Darbishire*. The problem which arises in the present case is to reconcile these two rules – a problem which apparently the courts have never before been called upon to solve. I agree with the solution proposed by my Lords, namely, that all parts of any trust documents (if they are trust documents, and I will refer to this point again presently) which contain information to which the beneficiary is not entitled should be covered up before being shown to the beneficiary. It would need the clearest authority to persuade me that whilst trustees are not compelled to disclose their reasons or any information which might affect their reasons so long as nothing is put on paper, yet once the reasons or the information are reduced to writing, the writing must be disclosed to the beneficiaries. There is no such authority and I would expect to find none, for if it existed it would in my view be entirely contrary to reason and common sense. …

The position is quite different where the beneficiary seeks disclosure of documents from the trustees in the air, as in this case, from the position where the beneficiary seeks discovery of documents in an action in which allegations are being made against the bona fides of the trustees. If the documents in question are in the possession or power of the trustees and are relevant to the issues in the action, they must be disclosed whether or not they are trust documents. In some instances, however, the fact that they are trust documents may nullify the privilege that would otherwise exist, as for example if the document consists of counsel's opinion taken before the issue of the writ, clearly the beneficiary is entitled to see any opinion taken on behalf of the trust. In the present case there is no suggestion of any kind, and certainly not a shred of evidence, that the trustees acted otherwise than with the utmost propriety.

17.3.6c *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709

Background

The nineteen-year-old son of a Russian oil company executive who died intestate was attempting to uncover information about assets secreted by his father in trusts resident in a variety of jurisdictions. He sought information from the trustee of the trusts (amounting to over US$105 million) resident in the Isle of Man as part of that search. He was only the object of a power of appointment in respect of the trusts, and the trustees opposed disclosure on the ground that he did not have a proprietary interest in the trust property.

Decision

The Privy Council held that it was fundamental to the law of trusts that the court had an inherent jurisdiction to supervise and, if appropriate, intervene in the administration of a trust, including a discretionary trust such as those before it. The case was remitted to the trial judge to determine which documents should be disclosed.

Lord Walker

The Board cannot regard it as a reasoned or binding decision that a beneficiary's right or claim to disclosure of trust documents or information must always have the proprietary basis of a transmissible interest in trust property …

Their Lordships consider that the more principled and correct approach is to regard the right to seek disclosure of trust documents as one aspect of the court's inherent jurisdiction to supervise, and if necessary to intervene in, the administration of trusts. The right to seek the court's intervention does not depend on entitlement to a fixed and transmissible beneficial interest. The object of a discretion (including a mere power) may also be entitled to protection from a court of equity, although the circumstances in which he may seek protection, and the nature of the protection he may expect to obtain, will depend on the court's discretion: see Lord Wilberforce in *Gartside v IRC* and in *McPhail v Doulton*, Templeman J in *Re Manisty's Settlement* and Warner J in *Mettoy Pension Trustees Ltd v Evans*. Mr Brownbill's submission to the contrary effect tends to prove too much, since he would regard the object of a discretionary trust as having a proprietary interest even though it is not transmissible (except in the special case of collective action taken unanimously by all the members of a closed class).

Their Lordships are therefore in general agreement with the approach adopted in the judgments of Kirby P and Sheller JA in the Court of Appeal of New South Wales in *Hartigan Nominees Pty Ltd v Rydge*.

That was a case concerned with disclosure of a memorandum of wishes addressed to the trustees by Sir Norman Rydge (who was in substance, but not nominally, the settlor). Kirby P said:

> I do not consider that it is imperative to determine whether that document is a 'trust document' (as I think it is) or whether the respondent, as a beneficiary, has a proprietary interest in it (as I am also inclined to think he does). Much of the law on the subject of access to documents has conventionally been expressed in terms of the 'proprietary interest' in the document of the party seeking access to it. Thus, it has been held that a cestui que trust has a 'proprietary right' to seek all documents relating to the trust: see *O'Rourke v Darbishire*. This approach is unsatisfactory. Access should not be limited to documents in which a proprietary right may be established. Such rights may be sufficient; but they are not necessary to a right of access which the courts will enforce to uphold the cestui que trust's entitlement to a reasonable assurance of the manifest integrity of the administration of the trust by the trustees …

It will be observed that Kirby P said that for an applicant to have a proprietary right might be sufficient, but was not necessary. In the Board's view it is neither sufficient nor necessary. Since *Re Cowin* well over a century ago the court has made clear that there may be circumstances (especially of confidentiality) in which even a vested and transmissible beneficial interest is not a sufficient basis for requiring disclosure of trust documents; and *Re Londonderry's Settlement* and more recent cases have begun to work out in some detail the way in which the court should exercise its discretion in such cases. There are three such areas in which the court may have to form a discretionary judgment: whether a discretionary object (or some other beneficiary with only a remote or wholly defeasible interest) should be granted relief at all; what classes of documents should be disclosed, either completely or in a redacted form; and what safeguards should be imposed (whether by undertakings to the court, arrangements for professional inspection, or otherwise) to limit the use which may be made.

17.3.6d *Avanes v Marshall* [2007] NSWSC 191; (2007) 68 NSWLR 595

Background

The plaintiff sought disclosure of certain documents relating to the administration of a trust in which she had an interest as life tenant. In the course of discovery, the defendant trustees claimed client legal privilege with respect to those documents.

Decision

It was held that the plaintiff was not entitled to disclosure of the documents, some of which were covered by lawyer–client privilege and others because they concerned deliberations by trustees which were protected from disclosure under the principles of *Re Londonderry's Settlement* and *Schmidt v Rosewood*.

Gzell J

… It seems to me, however, that the approach adopted in *Schmidt* requires a reappraisal of *Re Londonderry's Settlement*. For example, in discussing the balancing exercise that the Court must undertake, Lord Walker highlighted the significance of prospective entitlement of an applicant to benefit under a trust, whereas in *Re Londonderry's Settlement* it was assumed that access to trust documents was limited to beneficiaries with proprietary interests. Further, the decision in *Re Londonderry's Settlement* proceeded on the basis that there is an entitlement to inspection of trust documents subject to exceptions, whereas the reasoning in *Schmidt* concluded that there is no right to inspection of trust documents and it is for the Court to decide whether inspection should be granted by balancing competing interests.

In my view, the approach in *Schmidt* should be adopted by Australian courts. The decision should not be regarded as abrogating the trustee's duty to keep accounts and to be ready to have them passed, nor the trustee's obligation to grant a beneficiary access to trust accounts. But when it comes to inspection of other documents there should no longer be an entitlement as of right to disclosure of any document. It should be for the Court to determine to what extent information should be disclosed. I propose to adopt that approach in determining this application.

The documents in question fall into two categories – correspondence between the barrister and the solicitors for the trustees and correspondence between the solicitors for the trustees and accountants. …

The trustees submit that the Court should, in its inherent jurisdiction of supervision of the administration of trusts upon which the decision in *Schmidt* is based, protect the trustees' confidential dealings with the legal and accounting advisers. …

Having perused the documents, I am of the view that the first document in item 1 is a confidential communication by barrister to solicitor for the personal guidance of the trustees and should not be disclosed. The other document accompanied the opinion of counsel and, again, was for the personal guidance of the solicitors and should not be disclosed. In my view the documents do not relate to the exercise of any discretion or power the trustees possess under the settlement. Having no relevance to any discretion or power, the interests of the trustees in keeping confidential communications between their solicitors and counsel outweigh any requirement of openness between the trustees and the life tenant.

In *Armitage v Nurse* [1998] Ch 241 at 253–254, Millett LJ said there are irreducible trust obligations, and (at 261) he indicated that the result of one such obligation is that every beneficiary is entitled to trust accounts.

In my view, those principles are unaffected by the decision of *Schmidt*. But the documents numbered 2 to 3 and 5 to 9 are preparatory to the preparation of the trust accounts. They comprise requests for advice by the accountants of the solicitors on matters of law and advice by the accountants to the solicitors on matters of accounting affecting the presentation of the accounts and the presentation to the solicitors of draft accounts and explanations of how they were compiled.

In my view, these documents go to the deliberations of trustees. This includes the accountants' presentation of a reconciliation of work undertaken for consideration by the trustees in arriving at a decision as to what fees should be paid …

Since deliberations by the trustees precede their determination to have trust accounts drawn up, I see the balancing process as coming down in favour of protecting the trustees from scrutiny of their deliberations leading up to the drawing up of the accounts. That part of their administration should not become the subject of a fishing expedition by beneficiaries.

In my view, none of the documents is discoverable under the principle in *Re Londonderry's Settlement* excluding from inspection the reasoning process of the trustees or under the balancing process enunciated in *Schmidt*.

17.3.6e *McDonald v Ellis* [2007] NSWSC 1068; (2007) 72 NSWLR 605

Background

A will created a trust to pay the net annual income from a block of flats to a beneficiary during her lifetime. On her death, the block was to pass to her children. After the trust had been in operation for some years, one of the children sought an order that the trustees provide her with the accounts relating to the estate assets.

Decision

Bryson AJ held that the beneficiary, who had a vested interest in the trust property, was entitled to information about the management of the block of flats. He took issue with the way in which the Privy Council (in *Schmidt v Rosewood*) and Gzell J (in *Avanes v*

Marshall) addressed the right of beneficiaries to gain disclosure of trust documents from their trustees.

Bryson AJ

In my opinion, judges at first instance in New South Wales should treat the majority judgments in *Hartigan Nominees* as authoritative. While not all matters susceptible of doubt are settled, the starting point, at which the beneficiary is entitled to see trust documents and have information about trust property, and that entitlement has a proprietary basis, is not open to question.

The facts in the present case do not raise even the potential difficulties which might be thought to exist where the entitlement of the beneficiary is contingent or subject to a discretionary decision, or involve a decision of trustees which might raise a conflicting principle.

The subject under decision in *Schmidt v Rosewood Trust Ltd* was the appellant's claim for fuller disclosure of trust accounts and information about trust assets in which the appellant claimed discretionary interests or expectations in right of himself and of his deceased father. Under 'Disclosure to discretionary beneficiaries: the recent cases', the Judicial Committee made a wide survey of case law, including New South Wales case law, and stated its general agreement with the approach adopted in the judgments of Kirby P and Shelley JA in *Hartigan Nominees*. The judgment of Kirby P, to which their Lordships referred at some length, was of course a dissenting decision and reached its conclusion on the basis of the beneficiary's right of inspection without examining or indeed referring to judicial decisions … This was, I must respectfully say, a slight basis indeed for discarding an established right of beneficiaries with vested interests to inspection of documents of such primary importance as the accounts of the trustees. A decision that all access to trust documents should be in the discretion of the Court is a drastic solution to whatever problems might be perceived in supposing a proprietary basis for discretionary interests, and whatever problems may be perceived in delimiting which documents should be treated as trust documents and in protecting from access documents access to which involves some conflicting principle.

An obiter dictum in the Privy Council about trust law in the Isle of Man has in my opinion very little claim to be followed at first instance in New South Wales where a different view has been accepted …

The opinion of Lord Walker does not, to my reading, identify any error in earlier opinion, or state any respect in which it might be said to be significantly unsatisfactory. No earlier judicial decisions adopting the basis on which the Privy Council reset the law were referred to, nor were any text writers. Nor to my reading were any significant policy considerations favouring departure from the previous rules set out. The only matter indicated was an opinion that the rule enounced was a better rule. It was not explained, with any significant reasoning, why it was a better rule. In my opinion it is not a better rule, because it introduces discretion and promotes resistance and debate in substitution for a rule which is relatively concrete. The tendency will be that only the determined and litigious beneficiary will find out about his own affairs. Where there is a judicial discretion, there is room for litigious debate about the exercise of the discretion. There is no certainty on so elementary a matter as whether or not a beneficial owner is entitled to information about property in which the beneficial owner has an equitable interest. In the previous rule, in my interpretation, equity followed the law in treating as proprietary an equitable entitlement to trust property. Treating the equitable interest as proprietary brings with it an entitlement to information, unless there is a conflict with some other principle which equity must recognize, such as the principle protecting the trustee's discretionary considerations. Treating the entitlement to information as an aspect of the Court's discretionary exercise of its supervising power over trusts is a departure from the relatively concrete concept of equitable interests in trust property which has been adopted for some centuries.

In *Avanes v Marshall*, Gzell J after review of authorities, including recent authorities in Australia in which reference has been made to *Schmidt*, expressed the view that the approach in *Schmidt* should be adopted by Australian courts. I respectfully do not agree. It might be that the approach of *Schmidt* is appropriate where the interest of the beneficiary is no higher than those of the potential objects of a discretionary trust, although opinion in New South Wales is otherwise. However that may be, in the present case where the plaintiff's right is already vested in interest, it would be a departure from clearly established opinion in New South Wales not to treat the claim to information as based on a proprietary interest, or to withhold enforcement of it except so as to enforce some competing entitlement, such as that of the trustees considered in *Re Londonderry's Settlement*, which required such departure.

Notes

(1) The contrasting approaches taken in *McDonald* and *Avanes* continue to be unresolved by Australian courts. See, for instance:

- *Webster v Murray Goulburn Co-Operative Co Ltd (No 3)* [2018] FCA 990 and *Wright v Stevens* [2018] NSWSC 548 (and the cases cited therein), following the approach in *Avanes* and *Schmidt v Rosewood*; and
- *Deutsch v Trumble* (2016) 52 VR 108 (and the cases cited therein) following the approach in *McDonald* and *Re Londonderry's Settlement*.

In New Zealand, see *Erceg v Erceg* [2017] NZSC 28, in which the Supreme Court adopted the approach in *Schmidt v Rosewood*.

(2) The position that beneficiaries of a trust have a right only to see 'trust documents' has been appropriately criticised as begging the question: what, then, is a trust document? In some circumstances, the answer will be clear. The trust instrument, the annual accounts of the trust, and any title deeds for trust property are clearly within that description. Personal letters between the trustees are unlikely to be a trust document. However, there are grey areas because, as Salmon LJ noted in *Re Londonderry's Settlement* (not included in the extract above) the category has not been 'comprehensively defined'. The courts have, for instance, held that the minutes of trustee meetings would ordinarily be regarded as trust documents, but that sensitive issues relating to the reasons why decisions were taken could be redacted prior to disclosure to beneficiaries. There are also nuances where the trustee is attempting to assert legal professional privilege in proceedings involving the beneficiaries, as to which see *Hancock v Rinehart (Trust documents)* [2018] NSWSC 1684; affirmed in *Rinehart v Rinehart* [2019] NSWCA 54. *Rinehart* also highlights that a wider range of documents are likely to be recognised as 'trust documents' when the question relates to the provision of documents by a retiring trustee to its successor, rather than the more familiar contest between a trustee and the beneficiaries.

(3) In *Crowe v Stevedoring Employees Retirement Fund Pty Ltd* [2003] VSC 316, the Court was asked to consider whether the principle in *Re Londonderry's Settlement* applied to superannuation funds in which the beneficiaries are not volunteers but have provided consideration for their interest. Balmford J held that the principle would apply, notwithstanding the commercial context, but that the actuarial reports sought by the plaintiff did not contain information that revealed the trustees' reasoning processes. For commentary suggesting that *Re Londonderry* ought not be applied in the superannuation context, see Lisa Butler, 'Reviewing Trustees' Discretions: The Right to Reasons' (1999) 7(1) *Australian Property Law Journal* 1.

(4) The general law rights enjoyed by beneficiaries in the superannuation context to information are supplemented by s 101 of the *Superannuation Industry (Supervision) Act 1993* (Cth), which requires trustees to supply written reasons for any of its decisions that relate to a complaint made by a beneficiary to the Australian Financial Complaints Authority.

Question

Is it necessarily the case that the approach taken in *Schmidt v Rosewood Trust Ltd* and *Avanes v Marshall* will assist the party seeking disclosure? On what grounds might a court decline to order disclosure to a beneficiary who would have been entitled to disclosure under the traditional approach represented by *McDonald v Ellis*? See Joseph Campbell, 'Access by Trust Beneficiaries to Trustees' Documents and Reasons' (2009) 3 *Journal of Equity* 97. See also Charles Mitchell, 'Disclosure of Information to Discretionary Beneficiaries' (1999) 115 *Law Quarterly Review* 206; Georgia Dawson, 'A Fork in the Road for Access to Trust Documents' (2009) 3 *Journal of Equity* 1.

17.3.7 Duty of care

Trustees owe a duty of care in equity over all aspects of the administration of the trust. The standard of care expected of a trustee will typically be that of the 'prudent person of business' (see *Speight v Gaunt*, below at [17.3.7a]) unless:

- the trustee is exercising its power of investment, in which case there are specific statutory provisions which may apply (see chapter 18);
- the trustee has been appointed for their professional expertise or resources (see *Bartlett v Barclays Bank* (below at [17.3.7b] and, in respect of investment, chapter 18); or
- the context is one in which specific statutory provisions apply, such as managed investment schemes or superannuation funds.

17.3.7a *Speight v Gaunt* (1883) 22 Ch D 727

Background

A trustee employed a stockbroker to invest money in certain debentures. The stockbroker stole the money. There was evidence of discrepancies in the paperwork submitted by the stockbroker that might have alerted the trustee to the theft earlier. It was also argued that the trustee breached its trust in not acting personally but in appointing an agent (as to which see [17.3.9a] below).

Decision

The Court of Appeal found on the facts that the trustee had not breached its duty in either respect.

Jessel MR

In the first place, I think we ought to consider what is the liability of a trustee who undertakes an office which requires him to make an investment on behalf of his cestui que trust. It seems to me that on general principles a trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee. In other words, a trustee is not bound because he is a trustee to conduct business in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt further and better precautions than an ordinary prudent man of business would adopt, or to conduct the business in any other way. If it were otherwise, no one would be a trustee at all. He is not paid for it. He says, 'I take all reasonable precautions and all the precautions which are deemed reasonable by prudent men of business, and beyond that I am not required to go'.

Lindley LJ

The first observation to be made is that this is a case in which the trustee is not even accused of having acted in any way with a view to his own benefit, or otherwise than with perfect bona fides and honesty, a remark which of course is important, because one approaches such a case in a different state of mind from that with which one would approach a case if one were dealing with a dishonest trustee ...

I now come to the bought note, which is a very important document, and I confess I cannot look at it from the same point of view as Vice-Chancellor Bacon did. The bought note is a printed form, filled up, of course, with a pen. Judging from the words of the document, and from the appearance of it, and bringing to bear upon it the knowledge which everyone has of the ordinary transactions of business, I confess this document would have completely misled me. I could not possibly, looking at it with the utmost care and vigilance, such as an ordinary man would exercise, extract from this document the slightest information or notice that this was a purchase other than in the ordinary course of business upon the Stock Exchange. If it would mislead a person like myself, why should it not mislead others? I am quite aware that experts have been called who say that, to their experienced eyes, there are signs on this document which indicate, to them at any rate, irregularities; but the question is not whether experts like brokers or those who are accustomed to deal in these things see irregularities; the question is, whether these signs of irregularity are such as would attract the attention of an ordinary prudent man of business.

There is no irregularity of that sort at all in it that I can discern. It is a question of fact, and not a question of law, whether upon the face of this document there are or are not such signs of impropriety as to excite the suspicion of anybody. Nobody suggests any, except that the experts say there are signs which would put them on inquiry.

Background

Barclays Bank acted as trustee of a trust which held almost all (99.8%) of the shares in a private (proprietary) company involved in property development. The trustee was not represented on the board of directors of the private company and only received reports of the financial state of the company at the company's annual general meeting. Two major development projects were undertaken; one was wildly successful and the other financially disastrous. Brightman J held that the trustee was in breach but could set off the losses from the failed project against the profits from the successful one.

Decision

Brightman J

The cases establish that it is the duty of a trustee to conduct the business of the trust with the same care as an ordinary prudent man of business would extend towards his own affairs: see *Re Speight, Speight v Gaunt*. In applying this principle, Lindley LJ added in *Re Whiteley*:

> … care must be taken not to lose sight of the fact that the business of the trustee, and the business which the ordinary prudent man is supposed to be conducting for himself, is the business of investing money for the benefit of persons who are to enjoy it at some future time, and not for the sole benefit of the person entitled to the present income. The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide. …

So far, I have applied the test of the ordinary prudent man of business. Although I am not aware that the point has previously been considered, except briefly *in Re Waterman's Will Trusts*, I am of opinion that a higher duty of care is plainly due from someone like a trust corporation which carries on a specialised business of trust management. A trust corporation holds itself out in its advertising literature as being above ordinary mortals. With a specialist staff of trained trust officers and managers, with ready access to financial information and professional advice, dealing with and solving trust problems day after day, the trust corporation holds itself out, and rightly, as capable of providing an expertise which it would be unrealistic to expect and unjust to demand from the ordinary prudent man or woman who accepts, probably unpaid and sometimes reluctantly from a sense of family duty, the burdens of a trusteeship. Just as, under the law of contract, a professional person possessed of a particular skill is liable for breach of contract if he neglects to use the skill and experience which he professes, so I think that a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have. The advertising literature of the bank was not in evidence (other than the scale of fees) but counsel for the bank did not dispute that trust corporations, including the bank, hold themselves out as possessing a superior ability for the conduct of trust business, and in any event I would take judicial notice of that fact. Having expressed my view of the higher duty required from a trust corporation, I should add that the bank's counsel did not dispute the proposition.

In my judgment the bank wrongfully and in breach of trust neglected to ensure that it received an adequate flow of information concerning the intentions and activities of the boards of [the development company].

Notes

(1) There are several statutory provisions that recalibrate the standard of care expected of trustees in specific contexts; for example, s 601FC of the *Corporations Act 2001* (Cth) and s 52(2)(b) of the *Superannuation Industry (Supervision) Act 1993* (Cth). For an international perspective on this recalibration, see Ronald P Davis, 'Balancing Competence and Representation: Trustees and Fiduciaries in an Era of Financial Engineering' (2011–12) 33(1) *Comparative Labor Law and Policy Journal* 49.

(2) Trust instruments often expressly seek to curtail the operation of the general law duty of care by limiting the liability of the trustee for certain types of breaches. See further chapter 20.

(3) There is an ongoing debate whether the trustee's duty of care is fiduciary (as opposed to merely equitable) in nature. The better view is that it is an equitable duty. For perspectives on the debate, see Robert Austin, 'Moulding the Content of Fiduciary Duties' in AJ Oakley (ed), *Trends in Contemporary Trust Law* (Clarendon, 1996); Antony Goldfinch, 'Trustee's Duty to Exercise Reasonable Care: Fiduciary Duty?' (2004) 78(10) *Australian Law Journal* 678.

(4) Many trustees are today constituted as corporations. This means that the human actors are, in law, directors of the trustee company. The precise way in which the standards of care expected of individuals acting as trustees is transformed when those individuals act as directors of the company was briefly considered by Finn J in *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504, 517, where he noted: 'where the trustee is itself a company the requirements of care and caution are in no way diminished. And here, unlike with companies in general, these requirements have a flow-on effect into the duties and liabilities of the directors of such a company. It was early established … that at least when, and to the extent that, directors of a trustee company are themselves "concerned in" the breaches of trust of their company, they are liable to the company according to the same standard of care and caution as is expected of the company itself'. See further Pamela Hanrahan, 'Managed Investment Schemes: The Position of Directors under Chapter 5c of the Corporations Law' (1999) 17(7) *Companies and Securities Law Journal* 67. There are also subtle questions about the nature of delegations by and within the trustee that can arise; M Scott Donald, 'Delegation by Superannuation Fund Trustees' (2020) 37(5) *Company and Securities Law Journal* 319. See further [17.3.9] below.

Questions

(1) What is the basis of the higher standard of care where the trustee is a professional? Is it the existence of remuneration, in which case would an expert trustee acting without compensation be expected to meet the higher standard? Or is it the holding out of expertise, in which case would it be necessary to demonstrate that the trustee did in fact represent itself as skilful, and to whom would such a representation need to be made?

(2) What was the breach of which the trustee in *Bartlett v Barclays Bank Trust Co Ltd* was guilty? Why was it not found to have invested imprudently?

17.3.8 Duty to act impartially

Customarily, the trustee must act impartially as between beneficiaries within a class, as well as between different classes of beneficiaries. As the cases presented below demonstrate, this duty can arise in a variety of contexts, some of them quite indirect.

17.3.8a *Tanti v Carlson* [1948] VLR 401

Background

After the Second World War, the Australian Government temporarily regulated property sale prices. The trustees of a deceased estate containing a house and two cottages decided to sell one of the properties at the regulated, and much lower, price to one of the eight residuary beneficiaries. Several of the beneficiaries had offered to purchase the property at the regulated price. The other beneficiaries complained that this was an improper preference on the part of the trustee towards that beneficiary, arguing that the trustees ought not to have sold the property until the government regulations were lifted and a higher price achieved. Herring CJ found that the trustees had indeed breached their trust in acting preferentially.

Decision

Herring CJ

The restriction on the sale price does, of course, raise difficulties for trustees, who hold property on trust for sale. With a free market such trustees go far to establish their bona fides, if they are able to show that they have sold at the best price obtainable. But when the market is not free, when they are disposing of an asset recognised as worth more than the price at which they are allowed to sell, the situation is very different, for it is known that that price is below the value of the property. …

What then are trustees for sale to do? There is no difficulty, of course, where the beneficiaries are all of age and in agreement. Where this is not so, the trustees should consider the question of postponing the sale. Obviously a sale to one beneficiary, where there are more than one, will lead to some trouble, unless the matter is handled tactfully, and some measure of agreement reached. Quite often no doubt it will be necessary to seek directions from the Court.

In this case the trustees … seem from the very outset to have made up their minds to sell the property to [the beneficiary] … The trustees do not seem to have understood that their duty was to carry out the trusts as set forth in the will and codicil, and that it was no part of their business to prefer one residuary legatee to the others, because of some added devotion, actual or supposed, on her part towards the testatrix …

By selling the property to [the beneficiary] at £950 the trustees have virtually made a present to her, the property being worth more than that sum. The measure of that gift is the difference between its value and £950. The making of this gift to [the beneficiary] was a breach of trust, and it was a serious one in all the circumstances of this case. For it is the duty of trustees to deal with the trust property in accordance with the trusts declared and not to give it away. And it is also their duty always to be impartial in the execution of their trust and not to exercise their powers so as to confer an advantage upon one beneficiary at the expense of all the others. And the breach in this instance was all the more serious, because the trustees selected the wife of one of themselves as the person who should be advantaged at the expense of all the other beneficiaries.

Background

This case is described in more detail in chapter 18. One of the arguments raised by the plaintiff was that the investment strategy followed by the trustee favoured the interests of the income beneficiary (her uncle) because it was over-invested in conservative fixed interest securities (gilts). Hoffmann J, at first instance, found that the trustee bank had properly considered the different interests and expectations of the beneficiaries. The Court of Appeal ([1993] 1 WLR 1260) agreed on this point.

Decision

Hoffmann J

This brings me to the second principle on which there was general agreement, namely that the trustee must act fairly in making investment decisions which may have different consequences for different classes of beneficiaries.

There are two reasons why I prefer this formulation to the traditional image of holding the scales equally between tenant for life and remainderman. The first is that the image of the scales suggests a weighing of known quantities whereas investment decisions are concerned with predictions of the future … The second reason is that the image of the scales suggests a more mechanistic process than I believe the law requires. The trustees have in my judgment a wide discretion. They are for example entitled to take into account the income needs of the tenant for life or the fact that the tenant for life was a person known to the settlor and a primary object of the trust whereas the remainderman is a remoter relative or a stranger. Of course these cannot be allowed to become the overriding considerations but the concept of fairness between classes of beneficiaries does not require them to be excluded. It would be an inhuman law which required trustees to adhere to some mechanical rule for preserving the real value of the capital when the tenant for life was the testator's widow who had fallen upon hard times and the remainderman was young and well off.

Notes

(1) Another common context in which the issue of impartiality arises is where repairs are required to maintain the value of the trust's assets. It would be tempting from a practical perspective for the trustee to use trust income to pay for the repairs, but then money that would otherwise be distributed to income beneficiaries is effectively being used to support the value of the asset to which the capital beneficiaries are beneficially entitled. The trustee must distinguish repairs (which can be paid for from income) and improvements (which must be paid from capital). See *Wilkie v Equity Trustees Executors and Agency Co Ltd* [1909] VLR 277.

(2) A number of statutory provisions restate the general law duty of impartiality in different contexts. Section 14B(c) of the *Trustee Act 1925* (NSW) imposes a duty to act impartially towards beneficiaries and between different classes of beneficiaries 'except to the extent that they are inconsistent with this or any other Act or the instrument (if any) creating the trust'. In contrast, both s 52(2)(e) of the *Superannuation Industry (Supervision) Act 1993* (Cth), which applies to superannuation funds, and s 601FC of the *Corporations Act 2001* (Cth), which applies to registered managed investment schemes, override any contrary provision in the trust instrument, reflecting the regulatory role of those latter two statutory regimes. In New Zealand, s 35 of the *Trusts Act 2019* requires trustees to 'act impartially in relation to the beneficiaries, and … not be unfairly partial to one beneficiary or group of beneficiaries to the detriment of the others'. It further clarifies that the 'section does not require a trustee to treat all beneficiaries equally (but all beneficiaries must be treated in accordance with the terms of the trust)'.

Questions

(1) In *Tanti v Carlson*, the beneficiary whose interest was preferred by the trustee also happened to be the wife of the trustee. What other equitable principle might this aspect of the case enliven?

(2) How does the duty of impartiality operate in the context of a discretionary trust? How can a trustee exercising a power of appointment (which is inherently discriminatory) also act impartially? See *Edge v Pensions Ombudsman* [1998] Ch 512.

17.3.9 Duty to act personally

Trustees must exercise all powers invested in them personally. They must not delegate their authority, appoint agents, or act under direction from another unless authorised to do so by the trust instrument or by relevant legislation. They also must not bind themselves in advance to a course of action – termed 'fettering their discretion'. If there are multiple trustees, they must act unanimously unless the trust is for a charitable purpose (see chapter 16) or unless provision for some other decision-making process is made in the trust instrument.

These restrictions are arguably more relevant to a small family trust than to some of the complex commercial arrangements constituted as trusts today. In particular, it is commonplace today for trustees to appoint agents to undertake at least some of the myriad of tasks required of a trustee in the administration of a trust. *Speight v Gaunt*, encountered above in respect of the duty imposed on trustees to act carefully, illustrates the court's approach. There are now also various statutory provisions that regulate aspects of the trustee's duty to act personally.

Background

See [17.3.7a] above for the facts.

The extract below from the judgment of Lindley LJ discusses whether it was proper for the trustee, Gaunt, to appoint the broker (who was personally responsible for the fraud that resulted in the loss to the trust) to assist in the purchase of the securities on behalf of the trust.

Decision

Lindley LJ

Was it proper for the trustee to employ Mr Cooke in the transaction at all? Because if it was not I take it that the trustee must be responsible for the consequences. A trustee has no business to cast upon brokers or solicitors or anybody else the duty of performing those trusts and exercising that judgment and discretion which he is bound to perform and exercise himself. On the other hand, a trustee is not bound to do everything himself. A trustee is entitled to employ brokers and solicitors to do that which in the ordinary course of business other people would employ brokers and solicitors to do.

The real importance of this case is, that it lies between these two propositions – that a trustee cannot delegate his trust, and that, on the other hand, he is entitled to employ persons to do that which an ordinary man of business would employ an agent to do. Now, looking at the matter fairly and properly as a business man would look at it, can it be said to be an improper thing on the part of a trustee who is desirous of investing £15,000 in this class of securities to go to a broker? That he might have acted otherwise is plain enough; but was it a reasonable and proper thing not to apply to the secretaries or treasurers of these corporations, but to employ a broker for that purpose? So far as the evidence goes, it appears to me that on the balance of the evidence it is impossible to say that this was an improper step for a trustee to take. …

I wish most emphatically to say that if trustees are justified by the ordinary course of business in employing agents, and they do employ agents in good repute and whose fitness they have no reason to doubt, and employ those agents to do that which is in the ordinary course of their business, I protest against the notion that the trustees guarantee the solvency or honesty of the agents employed.

Notes

(1) The degree of control an individual has over an asset, or the income derived from that asset, is often a key issue in the taxation context. An active industry exists in some parts of the common law world which uses various trust structures to separate the indicia of legal ownership from control and enjoyment of benefits. These include the use of a 'protector', a third party ostensibly independent of the settlor to whom the trustee must refer certain types of decisions. (See further David Hayton, 'The Irreducible Core Content of Trusteeship' in A Oakley (ed), *Trends in Contemporary Trust Law* (Clarendon, 1996) 47–62.)

(2) Many modern superannuation funds offer different investment 'options' into which members can choose to have their contributions placed. Section 58(2)(d) of the *Superannuation Industry (Supervision) Act 1993* (Cth) excludes such member directions from the statutory prohibition on superannuation fund trustees acting under dictation in s 58(1) of that Act, and (by virtue of s 350 of the same Act) the equivalent general law prohibition. The trustee will still, however, be under a duty to give effect to directions properly communicated in a timely and efficient manner: *Perpetual Trustees Australia Ltd v Wallace* [2007] FCA 527.

Questions

(1) The trustees of many superannuation funds today appoint expert investment management firms to advise them on the investment of trust assets. Does the retention of such a service constitute a delegation of discretion? If not, why not?

(2) In some contexts, it may be desirable to separate the custodianship of the assets from the decisions relating to how the income of the trust is to be distributed. Charitable trusts in which the recipients of the trusts income from time to time are to be selected by an expert scientific panel or by a specifically constituted eleemosynary committee are a good example of this. Are the members of such panels or committees actually trustees? If not, what duties might they owe and to whom might those duties be owed?

17.3.10 Duty to consider exercise of powers

Trustees cannot be compelled by the beneficiaries, the original settlor, or even the court to exercise a discretionary power vested in them by the trust instrument. They cannot, however, ignore the existence of the power: *Re Hay's Settlement Trusts* [1982] 1 WLR 202. Trustees must periodically consider whether or not to exercise it.

17.3.10.1 Trustees' powers

Trustees are empowered to act in respect of the property that is the subject-matter of the trust. Sometimes, the settlor's expectations are expressed as mandatory instructions, in which case it is common to call them 'duties' because the trustee is required to perform them. In many other cases, however, the settlor's intentions give the trustee discretion as to whether and how to act in respect of the property. Statute and the general law may also confer such power. Common examples of these sorts of powers are the appointment power to choose amongst potential objects of a discretionary trust and the power to invest.

The scope of these sorts of powers, and the obligations they place on the trustee, will depend on the precise terms of the grant of power. Purported exercises of a power outside the express ambit of the power (for instance, by making an appointment to a person not within the class of potential objects) will be void. There may be restrictions placed on the exercise of the power, such as decision-making criteria with which the trustee will need to comply.

Trustees are required to exercise their powers for the purpose for which those powers were granted, and not in pursuit of some ancillary or ulterior purpose. Beyond that, the courts are very reluctant to interfere with a trustee's exercise of discretion. *Karger v Paul* [1984] VR 161 (below at [17.3.10.1a]) is the most frequently cited Australian authority on the grounds on which the courts are prepared to intervene. The grounds are primarily directed towards ensuring that the decision-making process undertaken by the trustee is sound. In some circumstances, a difficult distinction must be made between decisions taken by the trustee that are truly discretionary and those that are the consequence of the application of pre-determined rules where the trustee does not, in truth, have discretion but is simply applying the rules to the facts before it. *Finch v Telstra Super Pty Ltd* [2010] HCA 36; (2010) 242 CLR 254 (below at [17.3.10.1b]) identifies this distinction.

A question much litigated in recent English decisions concerns the effect in equity of a trustee's failure to exercise its discretion properly in exercising powers conferred by the trust instrument. At one extreme, decisions taken by a trustee who was under the control of the settlor and who failed to appreciate he had a discretion to exercise will be void: *Turner v Turner* [1984] Ch 100. At the other extreme are cases in which trustees have ignored relevant considerations, or who have taken into account irrelevant considerations, but where the same decision would have been made even if the trustees had exercised their discretion properly. In between are decisions in which trustees would have made a different decision, very often because the original decision has resulted in adverse tax consequences for the trust. The court's power to set aside decisions in this third category involves what English courts have termed the principle of *Re Hastings-Bass* [1975] Ch 25. The principle was confirmed, in more limited terms, by the Supreme Court of the United Kingdom in *Pitt v Holt* [2013] UKSC 26; [2013] 2 AC 108 where it was held that a decision taken in consequence of the flawed exercise of discretion, if it amounted to a breach of fiduciary duty, was voidable but not void.

17.3.10.1a *Karger v Paul* [1984] VR 161

Background

A testatrix appointed her husband and a solicitor trustees of a testamentary trust, empowering them with an 'absolute and unfettered' discretion to transfer the capital to the husband upon his request. The residual interest in the trust was vested in the testatrix's niece. The husband made the request and the trustees (of which he was one) complied with the request and transferred the capital to him. The niece challenged the trustees' decision.

Decision

It was held that the trustees had not exercised their discretion improperly in authorising the transfer of capital to the husband.

McGarvie J

In my view, in this case it is open to the Court to examine the evidence to decide whether there has been a failure by the trustees to exercise the discretion in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred. As part of the process of, and solely for the purpose of, ascertaining whether there has been any such failure, it is relevant to look at evidence of the inquiries which were made by the trustees, the information they had and the reasons for, and manner of, their exercising their discretion. However, it is not open to the Court to look at those things for the independent purpose of impugning the exercise of discretion on the grounds that their inquiries, information or reasons or the manner of exercise of the discretion, fell short of what was appropriate and sufficient. Nor is it open to the Court to look at the factual situation established by the evidence, for the independent purpose of impugning the exercise of the discretion on the grounds that the trustees were wrong in their appreciation of the facts or made an unwise or unjustified exercise of discretion in the circumstances. The issues which are examined by the Court are limited to whether there has been a failure to exercise the discretion in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred. In short, the Court examines whether the discretion was exercised but does not examine how it was exercised.

I regard it as an inherent requirement of the exercise of any discretion that it be given real and genuine consideration. To borrow a phrase from a passage quoted in *Partridge v The Equity Trustees Executors and Agency Co Ltd*, there must be the 'exercise of an active discretion'. It has been held that when the occasion for the exercise of a discretionary power has arisen, trustees, while not bound to exercise the discretion, are bound to consider whether it ought in their judgment to be exercised: *Klug v Klug*; *In re Gulbenkian's Settlement*. I think that it goes without saying that they must give real and genuine consideration. It seems to me that it is in this sense only that the Court can examine whether the trustees gave 'proper' consideration to the exercise of the discretion … The courts will examine whether a discretion has been exercised irresponsibly, capriciously or wantonly: *Lutheran Church of Australia South Australia District Incorporated v Farmers' Co-operative Executors and Trustees Ltd*. This is another way of saying that there may be an examination as to whether trustees have exercised their discretion on real and genuine consideration: *Pilkington v Inland Revenue Commissioners*.

17.3.10.1b *Finch v Telstra Super Pty Ltd* [2010] HCA 36; (2010) 242 CLR 254

Background

A member of a superannuation fund challenged the trustee's decision that he was not eligible to receive disability benefits under the fund's rules. The decision made by the trustee was characterised in argument by the parties as being an exercise of discretion on the part of the trustee.

Decision

The High Court held that the decision was not discretionary but depended upon the proper construction of the term 'Total and Permanent Invalidity' in the trust instrument. The case was remitted to the trustee for determination of the member's claim.

French CJ, Gummow, Heydon, Crennan and Bell JJ

The Court of Appeal treated the decision of the trustee to form or not form an opinion under limb (b) of the definition of 'Total and Permanent Invalidity' as a 'discretionary decision'. The Court of Appeal said (at [65]):

> The Court has power to set aside the discretionary decision of a trustee if the relevant discretion was not exercised by the trustee in good faith, upon real and genuine consideration, and in accordance with the purposes for which the discretion was conferred. However, the mere fact that a trustee makes an error as to a fact or some other matter or does not make all inquiries that may have been open to be made is not sufficient reason for the court to set aside a determination that was made in good faith, upon real and genuine consideration, and for a proper purpose. …

A discretionary decision?

In *Dwyer v Calco Timbers Pty Ltd* (2008) 234 CLR 124; 244 ALR 257; [2008] HCA 13 at [37]–[40] the court emphasised that while the term 'discretion' is used in the description or characterisation of varied acts or omissions in the law, the term may be an inadequate description of an inquiry which requires the identification and evaluation of factual matters. The present is not a case involving a 'discretion'. The trustee had to consider whether to reach two opinions. One was whether a member had ceased to be an employee. That is scarcely a discretionary decision. It is no more discretionary than the decision of a judge in conventional litigation about whether a contract of employment has come to an end. The second opinion was whether the member was unlikely ever to engage in 'gainful Work'. In the forming of an opinion on that subject there are no doubt factors to be examined which are difficult to weigh, impressions to be formed, and judgments to be made, but the field is quite different from fields in which the competing claims of potential candidates for bounty are compared.

The trustee was trustee of a trust. It had a duty to distribute to those who fell within the definition of 'Total and Permanent Invalidity' and a duty not to distribute to those who did not. That affected its role in relation to the forming of its opinion under limb (b). Forming that opinion was not a matter of discretionary power to think one thing or the other; it was an ingredient in the performance of a trust duty. That duty was owed to the members, including the applicant.

The applicant was not the object of a discretionary power of appointment. He was the beneficiary of a trust, and although the precise form and quantum of his beneficial interest was contingent on particular events, he did have a beneficial interest.

That conclusion is supported by various aspects of the context. [Their Honours then described the nature of Telstra as a 'large' employer of labour and the importance of superannuation from a personal financial perspective as well as from the broader industrial relations, employment and public policy perspectives.] …

Thus the public significance of superannuation and the close attention paid to it through statutory regulation support the conclusion that the decisions of superannuation trustees are not likely to be largely immunised from judicial control without clear contrary language in the relevant trust document. Decisions like those which the trustee made in this case are not discretionary decisions in the sense used in *Karger*.

Notes

(1) The distinction between exercises of discretion and decisions based on facts was highlighted immediately prior *to Finch v Telstra* by Campbell J, writing extra-curially: Joseph Campbell, 'Exercise by Superannuation Trustees of Discretionary Powers' (2009) 83(3) *Australian Law Journal* 159. Although now widely accepted, the difficulty of applying it in practice has been noted in Geraint Thomas, *Thomas on Powers* (Oxford University Press, 2nd ed, 2012) [11.35]–[11.39].

(2) A number of commentators have criticised the application of *Karger v Paul* to commercial contexts such as superannuation funds. See, for example, Lisa Butler, 'The Legitimate Bounds of a Trustee's Discretion' (1999) 11(1) *Bond Law Review* 14.

Question

In the United Kingdom, there has been some enthusiasm for applying the so-called *Wednesbury* irrationality test (from *Associated Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223) from public law to the review of trustee discretions; see David Pollard, *Pensions, Contracts and Trusts: Legal Issues on Decision Making* (Bloomsbury Professional, 2020). The *Wednesbury* test requires that the decision-maker (i) have regard for all appropriate matters and not for any inappropriate matters; and (ii) reach a decision not so unreasonable that no reasonable decision-maker could have come to it. Inspired by *Braganza v BP Shipping Ltd* [2015] 1 WLR 1661, this proposition contradicts the warning against the adoption of public law notions in the private law of trusts in both the Court of Appeal and Supreme Court in *Pitt v Holt* (extracted on a different point below) and has yet to be adopted in any Australasian jurisdiction. However, how, in practice, might such a test differ from the principles articulated in *Karger v Paul*, extracted above?

17.3.10.2 The consequences of an invalid exercise of power

17.3.10.2a *Pitt v Holt* [2013] UKSC 26; [2013] 2 AC 108

Background

In *Futter*, trustees, acting on the advice of their solicitors, had distributed all the capital of the trust in exercise of a power of appointment. The trustees believed that the beneficiaries would not incur a tax liability as a result of the distribution. In fact, a considerable tax liability to capital gains tax was incurred because a relevant statutory provision had been overlooked. In *Pitt v Holt*, the plaintiff had received a substantial damages award for personal injuries as a result of a road accident. The damages were settled on trust for the plaintiff. In structuring the trust, the plaintiff's advisers, who owed fiduciary duties to the plaintiff, took no account of the trust's liability to inheritance tax and a significant tax liability was incurred. In both cases, application was made for the decision of the trustees (or, in the case of *Pitt v Holt*, the decision of the plaintiff's advisers in establishing the trust) to be declared void on the ground that they were the result of an improper exercise of fiduciary discretion.

Decision

The Supreme Court of the United Kingdom held that the exercise of discretion in both cases was valid. Neither involved a breach of fiduciary duty. If the exercise of discretion had amounted to a breach of fiduciary duty, the decision would have been voidable, not void. In the case of *Pitt v Holt*, however, the trust was set aside on the ground that it had been made as a result of a mistake entitling the plaintiff to equitable relief.

Lord Walker

In my view [the trial judge] was right to hold that …the inadequate deliberation on the part of the trustees must be sufficiently serious to amount to a breach of fiduciary duty. Breach of duty is essential (in the full sense of that word) because it is only a breach of duty on the part of the trustees that entitles the court to intervene…It is not enough to show that the trustees' deliberations have fallen short of the highest possible standards, or that the court would, on a surrender of discretion by the trustees, have acted in a different way. Apart from exceptional circumstances (such as an impasse reached by honest and reasonable trustees) only breach of fiduciary duty justifies judicial intervention…

…It is undoubtedly correct that trustees may be liable for breach of trust even though they have acted in accordance with skilled professional advice. Such advice cannot protect trustees from potential liability for a loss to the trust fund resulting from a decision that is, judged objectively, beyond the trustees' powers and detrimental to the trust (though professional advice may lead to their obtaining relief under section 61 of the Trustee Act 1925). An example mentioned in argument is *Dunn v Flood* (1885) 28 Ch D 586, in which trustees had sold by auction 73 plots of freehold land at Reading, subject to special conditions which the court held to be severely depreciatory (as Fry LJ put it at p594, 'eminently calculated to frighten away purchasers'). The Court of Appeal, upholding

North J, refused to force a doubtful title on a reluctant purchaser. The fact that the trustees had consulted respectable solicitors was no excuse. It was not a reasonable exercise of discretion… But the trustees' breach of duty was not in the manner of their decision-making (as to which we know nothing other than that they consulted respectable solicitors) but the loss to the trust property that their unreasonable decision appears to have caused.

Further examples are provided by the decision of the Court of Appeal in *Perrins v Bellamy* [1899] 1 Ch 797 and that of the Privy Council, on appeal from the Supreme Court of Victoria, in *National Trustees Co of Australasia Ltd v General Finance Co of Australasia Ltd* [1905] AC 373. These cases, discussed by Lloyd LJ at para 124 of his judgment, were both examples of action taken by trustees on professional advice which was unequivocally incorrect: one a sale of leaseholds when the trustees had no power of sale; the other a distribution (resulting from 'some extraordinary slip' by solicitors of high standing) of a deceased beneficiary's vested share to persons who were not entitled to it under the intestacy law of Victoria in force at the beneficiary's death. As Lloyd LJ observed, the issue in these cases:

> is altogether different, as it seems to me, from the question whether, if trustees take advice properly, and act on that advice in a manner which is within their powers, the fact that the advice has misled them as to the true position in a relevant respect means that they acted in breach of fiduciary duty.

I respectfully agree. Trustees may be liable, even if they have obtained apparently competent professional advice, if they act outside the scope of their powers (excessive execution), or contrary to the general law (for example, in the Australian case, the law regulating entitlement on intestacy). That can be seen as a form of strict liability in that it is imposed regardless of personal fault. Trustees may also be in breach of duty in failing to give proper consideration to the exercise of their discretionary powers, and a failure to take professional advice may amount to, or contribute to, a flawed decision-making process. But it would be contrary to principle and authority to impose a form of strict liability on trustees who conscientiously obtain and follow, in making a decision which is within the scope of their powers, apparently competent advice which turns out to be wrong….

VOID OR VOIDABLE?

Counsel on both sides readily admitted that they had hesitated over this point, but in the end they were all in agreement that Lloyd LJ was right in holding (para 99) that,

> if an exercise by trustees of a discretionary power is within the terms of the power, but the trustees have in some way breached their duties in respect of that exercise, then (unless it is a case of a fraud on the power) the trustees' act is not void but it may be voidable at the instance of a beneficiary who is adversely affected.

In my judgment that is plainly right…

Notes

The consequences of a breach of a trustee's duty to consider the exercise of a discretion, such as a power of appointment, will depend on the nature of the breach. The following situations should be distinguished:

(1) The trustee who exercises a power of appointment in favour of a person not within the class of permissible objects of the power. Such an appointment would be ultra vires and hence void.

(2) The trustee who does not consider the exercise of discretion at all but who acts at the direction of the settlor or some other third party. Any appointment made by the trustee under the power of appointment will be void: *Turner v Turner* [1984] Ch 100.

(3) The trustee who exercises the discretion for improper purposes; for example, by deliberately providing an ancillary benefit to some third party not entitled to a benefit under the trust or refusing to pay income to a discretionary beneficiary solely because the trustee disapproves of a marriage the beneficiary has contracted: *Klug v Klug* [1918] 2 Ch 67. Such an appointment is described as a 'fraud on a power' – a term with the potential to mislead because in some cases the appointment may have been made in good faith. The appointment will be void.

(4) An appointment made within the terms of the power conferred by the trustees, but where the trustees in exercising the power have ignored relevant considerations or taken into account irrelevant considerations. *Futter v Futter* involved the trustees' (and, in the case of *Pitt v Holt*, a fiduciary's) failure to take into account tax considerations to the detriment of the beneficiaries. The decision of the trustees in this case will only be set aside if it amounts to a breach of trust. In both cases, it was held that no such breach had been committed because reliance had been placed on apparently competent professional advice. The appointments were therefore upheld, although the solicitors involved in structuring the arrangements might be liable for professional negligence.

Questions

(1) What is the practical difference between voidness and voidability in the context of a trustee's improper exercise of powers?

(2) Should courts intervene solely on the ground that a trustee's exercise of discretion had unexpected and adverse tax consequences?

18

Investment of trust funds

18.1 Introduction

18.2 Sources and content of trustees' investment powers

18.3 Trustee duties in the context of investment

18.4 The modern approach to 'prudence'

18.5 The case for trustees having regard to ethical considerations

18.6 Compensation for loss

18.1 Introduction

Many trusts are established specifically to facilitate investment activity. Many managed investment schemes and most superannuation funds, for instance, employ the legal architecture of the trust. Parties may also create specialised trust structures that are not open to the public in order to arrange their investment affairs. The trust is a convenient device to enable a collection of investor monies under the management control of a party with experience and skills in the business of investing.

The need for a trustee to invest trust assets can arise in other circumstances. The most obvious of these is where the trust is expected to exist for some time and has assets that are not specifically nominated in the trust instrument as assets that must be held by the trustee. In this situation, a trustee is likely to be subject to a duty, implied from the circumstances of the trust, to invest unallocated assets.

This chapter examines the rules that apply to the investment of trust funds. It takes the statutory regime as its starting point but also illustrates the interplay between the statutory and general law rules that apply in different contexts.

18.2 Sources and content of trustees' investment powers

The power to invest will often be granted to a trustee in the trust instrument. A power to invest would, in most cases, be implied even if no such power was expressly granted. In any case, there is legislation in all States and Territories of Australia equivalent to s 14 of the *Trustee Act 1925* (NSW), which provides:

> **14 Powers of investment**
> A trustee may, unless expressly forbidden by the instrument (if any) creating the trust:
>
> **(a)** invest trust funds in any form of investment, and
>
> **(b)** at any time vary any investment.

The terms 'invest' and 'investment' are not defined. The equivalent provision in the trustee legislation of other States and Territories are: ACT s 14; NT s 5; Qld s 21; SA s 6; Tas s 6; Vic s 5; WA s 17.

The verb to 'invest' was often historically contrasted with the act of speculation. Trustees were prohibited from 'speculating' with trust assets (see, for example, *Doneley v Doneley* [1998] Qd R 602). The distinction was never sharp and has evolved over time to the point where 'speculating' (if it means anything) might be thought to connote an almost reckless state of mind on the part of the trustee.

The noun 'investment' was historically used to distinguish the types of assets that trustees could properly acquire on behalf of the trust (such as government bonds) and those that they could not. This too has evolved over time. For instance, Chantal Stebbings, *The Private Trustee in Victorian England* (Cambridge University Press, 2002) has traced the way that the 'Authorised Lists' used by the Chancery courts in respect of monies entrusted to them influenced the types of assets that were customarily regarded as appropriate for trust investment. It is largely to address this issue that s 14 was drafted in such an expansive way.

Note

In some contexts, the terms are defined. For instance, s 10 of the *Superannuation Industry (Supervision) Act 1993* (Cth) defines 'invest' as:

> **(a)** apply assets in any way; or
>
> **(b)** make a contract;
>
> for the purpose of gaining interest, income, profit or gain.

Questions

(1) Does s 14 actually empower trustees to purchase a broad range of types of assets or is that wishful thinking on the part of some commentators? What does a literal interpretation of that section permit?

(2) Assume that there is a trust the governing rules of which prohibit investment in assets overseas. Would the trustee be able to use s 14 of the *Trustee Act 1925* (NSW) to make such an investment? How would the principles relating to the exercise of powers discussed in chapter 17 apply?

18.3 Trustee duties in the context of investment

The exercise of an investment power by a trustee is subject to the same general law duties as apply to other administrative powers. There are also a range of statutory provisions that may apply, depending on the circumstances and the type of the trust. For instance, the *Trustee Act 1925* (NSW) provides:

> **14A Duties of trustee in respect of power of investment**
>
> **(1)** This section has effect subject to the instrument (if any) creating the trust.
>
> **(2)** A trustee must, in exercising a power of investment:
>
> **(a)** if the trustee's profession, business or employment is or includes acting as a trustee or investing money on behalf of other persons, exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing the affairs of other persons, or
>
> **(b)** if the trustee is not engaged in such a profession, business or employment, exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons.
>
> **(3)** A trustee must exercise a power of investment in accordance with any provision of the instrument (if any) creating the trust that is binding on the trustee and requires the obtaining of any consent or approval with respect to trust investments.
>
> **(4)** A trustee must, at least once in each year, review the performance (individually and as a whole) of trust investments.
>
> **14B Law and equity preserved**

(1) Any rules and principles of law or equity that impose a duty on a trustee exercising a power of investment continue to apply except to the extent that they are inconsistent with this or any other Act or the instrument (if any) creating the trust.

(2) Without limiting the generality of subsection (1), a duty imposed by any rules and principles of law or equity includes the following:

(a) a duty to exercise the powers of a trustee in the best interests of all present and future beneficiaries of the trust,

(b) a duty to invest trust funds in investments that are not speculative or hazardous,

(c) a duty to act impartially towards beneficiaries and between different classes of beneficiaries,

(d) a duty to take advice.

(3) Any rules and principles of law or equity that relate to a provision in an instrument creating a trust that purports to exempt, limit the liability of, or indemnify a trustee in respect of a breach of trust, continue to apply.

(4) If a trustee is under a duty to take advice, the reasonable costs of obtaining the advice are payable out of trust funds.

14C Matters to which trustee is to have regard when exercising power of investment

(1) Without limiting the matters that a trustee may take into account when exercising a power of investment, a trustee must, so far as they are appropriate to the circumstances of the trust, if any, have regard to the following matters:

(a) the purposes of the trust and the needs and circumstances of the beneficiaries,

(b) the desirability of diversifying trust investments,

(c) the nature of, and the risk associated with, existing trust investments and other trust property,

(d) the need to maintain the real value of the capital or income of the trust,

(e) the risk of capital or income loss or depreciation,

(f) the potential for capital appreciation,

(g) the likely income return and the timing of income return,

(h) the length of the term of the proposed investment,

(i) the probable duration of the trust,

(j) the liquidity and marketability of the proposed investment during, and on the determination of, the term of the proposed investment,

(k) the aggregate value of the trust estate,

(l) the effect of the proposed investment in relation to the tax liability of the trust,

(m) the likelihood of inflation affecting the value of the proposed investment or other trust property,

(n) the costs (including commissions, fees, charges and duties payable) of making the proposed investment,

(o) the results of a review of existing trust investments in accordance with section 14A(4).

(2) A trustee may, having regard to the size and nature of the trust, do either or both of the following:

(a) obtain and consider independent and impartial advice reasonably required for the investment of trust funds or the management of the investment from a person whom the trustee reasonably believes to be competent to give the advice,

(b) pay out of trust funds the reasonable costs of obtaining the advice.

(3) A trustee is to comply with this section unless expressly forbidden by the instrument (if any) creating the trust.

The equivalent provisions in the trustee legislation of other jurisdictions are: ACT ss 14A–14C; NT ss 6–8; Qld ss 22–24; SA ss 7–9; Tas ss 7–9; Vic ss 6–8; WA ss 18–20.

Notes

(1) The *Trustee Act 1925* (NSW), and its equivalents in other jurisdictions, makes frequent use of terms and concepts familiar to the common law. The term 'prudence' employed in s 14A(2) is discussed below. Other terms, such as 'impartiality' and 'best interests', are also informed by their general law meanings (as to which see *Nestle v National Westminster Bank plc* (1996) 10 TLI 112 and *Cowan v Scargill* [1985] Ch 270 at [18.4b] and [18.5a] respectively, below).

(2) Some Acts deem investments under the Acts to be investments that satisfy the prudent person test. See, for example, s 39 of the *Public Authorities (Financial Arrangements) Act 1987* (NSW).

(3) Trustees of superannuation funds are required to 'have regard' for a list of factors similar to, but not exactly the same as, those listed in s 14C of the *Trustee Act 1925* (NSW) (ss 52(6) and 52B(2)(f) of the *Superannuation Industry (Supervision) Act 1993* (Cth) for APRA-regulated and self-managed superannuation funds respectively). Crucially, the trustees of such funds must have close regard for the specific objectives of the trust, and, most importantly, the role played by such vehicles in the accumulation of retirement savings by individuals (see further below in *Cowan v Scargill* [1985] Ch 270 (at [18.5a]), which considers the analogous case of occupational pension plans in the United Kingdom.)

Questions

(1) In the United Kingdom, s 5 of the *Trustee Act 2000* requires trustees to obtain and consider advice from an appropriately qualified source unless they reasonably consider it unnecessary or inappropriate to do so. How does this differ from the requirements in ss 14B(2)(d) and 14C(2) of the *Trustee Act 1925* (NSW), above?

(2) The Victorian equivalent of s 14C – s 8 of the *Trustee Act 1958* (Vic) – does not include the words 'subject to the instrument creating the trust'. Why do you think this is? Does it matter?

18.4 The modern approach to 'prudence'

Section 14A of the *Trustee Act 1925* (NSW) expressly calibrates the standard of care by reference to a 'prudent' person. This reference is apt to mislead. Historically, the courts expected trustees to invest the funds entrusted to them very conservatively. It is now recognised, however, that there may be situations in which a prudent businessperson may have to take considerable risk with the capital of the trust in order to achieve the objectives of the trust. This may, for example, apply to some superannuation funds. Moreover, the advent of inflation in the middle of the twentieth century placed pressure on this approach as it effectively favoured current beneficiaries over those whose interests were expected to vest at some future date, at which time the real value of those interests may have been significantly eroded by inflation. At the same time, more sophisticated theories of investment markets and of investment risk (such as those emanating from modern portfolio theory and its offshoots) inspired new types of investment strategies and the development of new types of financial instrument. The way that the court adapted to these challenges is vividly illustrated in the approaches taken in two approximately contemporaneous cases: the conservative, and now largely superseded, approach (in *Will of Buckland*, extracted below) and the modern approach (*Nestle v National Westminster Bank plc* (1996) 10 TLI 112, at [18.4b]).

18.4a *Will and Estate of William Lionel Buckland (deceased)* (Supreme Court of Victoria, Nathan J, 11 August 1993)

Background

The trustees of a charitable foundation sought to have the Court vary the terms of the trust to widen the set of permissible investments. The trustees brought evidence from several experts of contemporary investment technologies to support their application.

Decision

Certain aspects of the proposed widening of the investment clause were rejected because some of the categories of security in which the trustees wished to invest were too speculative.

Nathan J

The trustees are persons of unquestioned expertise and probity. They seek orders, under the terms of the *Trustee Act 1958*, s 63, to vary the powers of the trustees under Cl 8(f) of Mr Buckland's will, dated 8 August 1960, by authorising the Trustees:

> (a) to invest the Trust funds in shares, debentures and securities of companies including companies having mining purposes as their principal object; (mining) (b) to invest in futures and options traded on the Australian Futures Exchange; (futures and options) (c) to lend scrip forming part of the assets of the Trust Fund, subject to such loans being secured by the guarantee of a Bank licensed under the Banking Act (Commonwealth); (scrip lending) (d) to invest part of the Trust funds in shares, debentures and securities traded on the stock markets of the United States of America, Japan, the United Kingdom, Germany, France, Canada, Switzerland, Netherlands, Italy and Spain provided that the proportion of the Trust funds so invested shall not at any time exceed 20 per cent of the total value of the Trust funds; (off shore trading) (e) subject to 1(d) to manage currency exposure arising by the acquisition and sale of currency or currency instruments limited to the currencies of Australia and the currencies set out in CL1(d) hereof (currency hedging).

The responsibility of the Court is not to vary the terms of the trust so as to maximise its returns or as might increase its capital base, but is, so far as may be reasonable, to vary the conditions to enable the purposes of the trust to be fulfilled but in a manner as shall prevent speculative and/or imprudent investment (see *Re Baker deceased; Rouse v Attorney General for Victoria* [1961] VR 641 and *Riddle v Riddle* (1952) 85 CLR 202).

[Having reviewed the approach taken in the United States, His Honour considered each of the proposed extensions in turn. A sub-set of these are extracted below as illustrations of the Court's traditional approach.]

Mining company shares

The mining sector of the Australian share market has expanded significantly since Mr Buckland made his will. That increase reflects its national importance and Australia's reliance upon it for export income. More than that, some of the nation's largest and most successful companies are now diversified mining companies, some with overseas interests. The market capitalisation of the largest of these companies exceeds that of some of the leading industrial companies. Further, it is a matter of common knowledge that the largest mining companies are often integrated upstream from the extractive sources and are bolstered by significant research and development staffs. I consider that the soundness of mining companies is now established, they are not as subject to the vagaries of fluctuating world commodity prices as they were in 1960, although they are still vulnerable. Accordingly, I am satisfied that a prudent investor in Australia would, now, have no hesitation in committing funds to most mining shares, not merely to gather revenue but also to spread portfolio risk in line with the so called modern portfolio theory.

However, the general proposition must be subject to an important exception. Companies whose sole or principle objectives are the exploration for and mining of gold, diamonds or other precious metals or stones are not of that soundness or security as would, as a general principle, attract a prudent investor's funds …

Hence, although I will vary the trust to include mining companies I shall exclude from that provision those companies whose sole or predominant purpose is the exploration for and mining, refining, marketing of gold, diamonds or other precious metals or stones …

Futures and options

These so called 'Risk Management Products' or the 'derivatives markets' are used by institutional investors to limit the volatility of returns …

I am not persuaded that because the use of Futures and Options appears in the Management Guidelines for Superannuation Funds and Authorities as published by the Victorian Department of Treasury that they should, because of that, be available to the trustees of charities. Because a facility is available it does not mean that it should be used. As money market management or so called financial services have become more diverse and sophisticated, a wider range of investment options now exists than in the past. The categories of investments suitable for trustees will expand and contract as the shape of the market changes. All the Court can do is examine the facilities available at a given time, and assess them against the standard of a prudent investor committed to

safeguarding the corpus, but obtaining an optimum return thereon, on a long term basis. Futures remain too highly speculative, the perceived benefits, as a general rule do not outweigh the risks of loss.

I will vary the trust to permit investment on no more than 10 percent of funds in the 'Futures and Options Exchange' in Options only. I shall not vary the terms to allow investments in Futures.

Off shore trading

I will not vary the trust to enlarge the number of off shore markets upon which the Foundation may trade. The will permitted investments in United Kingdom companies as well as Australian securities. That may reflect the Anglophilia of earlier times, but it was the considered choice of Mr Buckland. He could have, if he had wished, widened the range to those countries now sought to be included but he chose not to.

However, this is not the major reason why I reject the proposed variation. It is not the function of the trustees to search the world to find the securities offering the highest return. The results of their efforts in the last three decades show they have done very well within the Australian domestic market. They have not been able to show they would have done better, or achieved greater security if they had have been able to invest overseas in the interim. Indications are that the basket of overseas markets cited in the Motion performed only slightly better than Australia in the given period, although those markets were less volatile. The trustees have not sought permission to trade in the so called Asian tiger markets which have recently been out pacing Australia. I cannot accept that Spain might be preferable to Singapore. …

Further the expertise required to wisely invest in the smaller Australian market is much less than that required to trade globally. No single person or group could easily expect to attain such expertise or be able to retain it if they could. Trustees would need continued expert and no doubt expensive advice, if they were required to properly oversee such a wide range of investments. Instead of exercising their own competent, and in this case, expert judgment they would perforce have to rely on others, and at a cost to the trust …

There are further objections to domestic charities trading off shore. One of the objectives of the Act is to render Victorian charities amenable to Victorian law and this Court. If a significant portion of a charity's funds were invested in foreign enterprises, those funds would have passed, not entirely out of the reach, but beyond the ready oversight of this Court. The charity might become party to all sorts of foreign suits, and the charity's funds accessible to foreign action. This Court's function could thus be compromised …

Therefore the trustees have not established (a) the need for, or (b) the desirability of, trading off shore and (c) that to do so would not comprise the Court's oversight of the charity's operation. Such utility as might be derived from off shore trading would be marginal when weighed against those deficits.

A prudent investor in the trustees' position, having no need, and seeing no established advantage of trading off shore, would not do so. For all of these reasons this part of the motion will be entirely denied.

Order

The trustees should not abdicate any significant part of their decision making power in favour of any investment manager, no matter how expert. I accept that in this case, Mr Nolan is a man of exceptional talent, but neither he nor the current trustees will be in place forever (as will be the Foundation). A court cannot displace the whole of a trustee's responsibility upon the shoulders of retained investment managers …

Nothing I have now said should preclude the trustees returning to this Court as new financial service products emerge or as the markets change shape.

18.4b *Nestle v National Westminster Bank plc* (1996) 10 TLI 112

Background

The plaintiff was the remainder beneficiary of a testamentary trust established by the will of her grandfather in 1922. When she became absolutely entitled to her interest in 1986, the value of the trust fund amounted to almost £270,000. She argued that proper administration of the trust by the bank acting as trustee would have resulted in the value of the fund being worth more than £1,800,000.

Decision

The trustee bank had acted prudently in pursuing its investment policy for the beneficiaries even if other policies might be shown to have been more profitable for the plaintiff. The Court of Appeal ([1994] 1 All ER 118) affirmed Hoffmann J's finding against the plaintiff.

Hoffmann J

There was no dispute over the general principles to be applied. First there is the prudence principle. The classic statement is that of Lindley LJ (*Re Whiteley* (1886) 33 Ch D 347, 355):

> The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider, the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.

This is an extremely flexible standard capable of adaptation to current economic conditions and contemporary understanding of markets and investments. For example, investments which were imprudent in the days of the gold standard may be sound and sensible in times of high inflation. Modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than risk attaching to each investment taken in isolation. (This is not to say that losses on investment made in breach of trust can be set off against gains in the rest of the portfolio but only that an investment which in isolation is too risky and therefore in breach of trust may be justified when held in conjunction with other investments.) But in reviewing the conduct of trustees over a period of more than 60 years, one must be careful not to endow the prudent trustee with prophetic vision or expect him to have ignored the received wisdom of his time.

Mr Gerard Wright, who appeared for Miss Nestle, referred me to another passage in *Re Whiteley* at p 350 in which Cotton LJ said:

> Trustees are bound to preserve the money for those entitled to the corpus in remainder, and they are bound to invest it in such a way as will produce a reasonable income for those enjoying the income for the present.

In 1886 what Cotton LJ had in mind was the safety of the capital in purely monetary terms. But Mr Wright submitted than in the conditions which prevail a century later, the trustees were under an overriding duty to preserve the real value of the capital. In my judgment this cannot be right. The preservation of the monetary value of the capital requires no skill or luck. The trustees can discharge their duties, as they often did until 1961, by investing the whole fund in gilt-edged securities. Preservation of real values can be no more than an aspiration which some trustees may have the good fortune to achieve. Plainly they must have regard to the interests of those entitled in the future to capital and such regard will require them to take into consideration the potential effects of inflation, but a rule that real capital values must be maintained would be unfair to both income beneficiaries and trustees.

This brings me to the second principle on which there was general agreement, namely that the trustee must act fairly in making investment decisions which may have different consequences for different classes of beneficiaries. There are two reasons why I prefer this formulation to the traditional image of holding the scales equally between tenant for life and remainderman. The first is that the image of the scales suggests a weighing of known quantities whereas investment decisions are concerned with predictions of the future … The second reason is that the image of the scales suggests a more mechanistic process than I believe the law requires. The trustees have in my judgment a wide discretion … It would be an inhuman law which required trustees to adhere to some mechanical rule for preserving the real value of the capital when the tenant for life was the testator's widow who had fallen upon hard times and the remainderman was young and well off.

… [His Honour then assessed the evidence provided by four expert witnesses, some of which related to the practices of, and results obtained by, pension funds and unit trusts.]

I accept that the objectives of life assurance and pension funds will differ from those of a family trust just as those of one family trust will differ from those of another. But they share features of having beneficiaries with real rather than purely monetary needs and potential conflicts between the interests of classes of beneficiaries … They are therefore some guide to the kind of balance which skilled investment managers from time to time thought that prudence required …

In the end, however I must record my view that the action is and always has been hopeless. … The claim is founded upon a complete misconception of the duties of trustees. Trustees like the Bank act for reward and therefore owe duties of professional skill, but the engagement into which they enter is not one of insurance. They do not guarantee results. … In my view the Bank had acted conscientiously, fairly and carefully throughout the administration of this trust and the action must therefore be dismissed.

Notes

(1) The evolution of the courts' approach to investment in the nineteenth century can be found in Chantal Stebbings, *The Private Trustee in Victorian England* (Cambridge University Press, 2002). See also Andrew Butler, 'Modern Portfolio Theory and Investment Powers of Trustees: The New Zealand Experience' (1995) 7(1) *Bond Law Review* 119; M Scott Donald, 'Prudence under Pressure' (2010) 4(1) *Journal of Equity* 44.

(2) The advent of inflation and the growth of trusts such as mutual funds and superannuation funds that are dedicated to the accumulation (rather than simply the preservation) of assets has encouraged commentators to recognise the possibility that trustees could breach their duties by investing too conservatively; that is, not taking enough risk. See, for example, Frank Finn and Paul Zeigler, 'Prudence and Fiduciary Obligations in the Investment of Trust Funds' (1987) 61(7) *Australian Law Journal* 329. This is an important reminder that the prudence of an investment strategy must be judged relative to the objectives and circumstances of the trust and that, for many trusts, it is simply not correct to say that the trustee must invest conservatively.

(3) Diversification is one of the hallmarks of modern portfolio theory. However, the notion that it would be imprudent to 'place all your eggs in one basket' is not of recent origin. Modern investment theories merely formalise techniques for assessing the impact of any diversification (or lack of it) on the riskiness of an investment portfolio. Failure to consider diversification was one component of a deficiency in care by the trustee in *Re CCR* [2006] QCAAT 45 and *HBL v Trust Co Ltd* [2010] QCAT 40. It was discussed, in obiter, in *Cowan v Scargill* [1985] Ch 2 270 and *Harries v Church Commissioners for England* [1993] 2 All ER 300 (at [18.5a] and [18.5b] below).

(4) Trustees are continually challenged to consider new types of investments. In recent decades that has included various types of derivatives, commodities, hedge funds and bespoke vehicles housing 'alternative assets' such as private equity and infrastructure assets; see Paul Ali, Geof Stapledon and Martin Gold, *Corporate Governance and Investment Fiduciaries*, (LawBook Co, 2003) chs 4, 5 and 6. Most recently, the challenges faced by trustees interested in investing in cryptocurrencies such as bitcoin have come into focus; see Kelvin Low 'Trusts of Cryptoassets' (2021) 34(4) *Trust Law International* 191 and Tang Hang Wu, 'Trustees' Investment Duties and Cryptoassets' (2020) 26(2) *Trusts & Trustees* 183, addressing cases such as *Ruscoe v Cryptopia Ltd (in liq)* [2020] NZHC 728 (HC (NZ)) and *Quoine Pte Ltd v B2C2 Ltd* [2020] SGCA (I) 2 (CA (Sing)).

Question

Many trustees today are commercial entities offering their services for a fee. The standard of care in such cases is, not surprisingly, set higher: *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515; *Wallace Funds Management Pty Ltd v Wallace Absolute Return Ltd* (2009) 69 ACSR 711. Does that necessarily mean that the courts expect them to earn 'above average' returns?

18.5 The case for trustees having regard to ethical considerations

In recent times, there have been calls for the trustees of various types of investment trusts to have regard to ethical issues in the investment of trust assets. This pressure has, however, a much longer history than is sometimes realised; it has been an active issue in respect of the investment of charities' monies for centuries. *Harries v Church Commissioners for England* [1993] 2 All ER 300 highlights the way in

which the principles enunciated in *Cowan v Scargill* [1985] Ch 270 for pension schemes are applied to modern charities. The approach taken in *Harries* was recently endorsed by the High Court of England and Wales in *Butler-Sloss v Charity Commission* [2022] EWHC 974 (Ch), a case in which two trustees of charitable trusts (successfully) sought approval for an approach to investment that had regard for the impact of climate change.

18.5a *Cowan v Scargill* [1985] Ch 270

Background

The case involved the mineworkers' pension scheme set up by the National Coal Board in the UK. The trust was administered by a management committee comprising ten trustees – five appointed by the National Coal Board (the employer) and five appointed by the National Union of Mineworkers. The National Coal Board (NCB) and the Union (NUM) were, at the time, in the midst of a bitter industrial dispute. The NCB-appointed trustees sought to persuade the Court that the union-appointed trustees were in breach of their obligations as trustees when they blocked adoption of the investment strategy designed for the fund. Specifically, the union-appointed trustees sought to amend the strategy to preclude investment in companies associated with South Africa, a move targeted to put pressure on the Apartheid system then in place in South Africa. The union-appointed trustees also sought to preclude investment overseas and in other energy technologies, such as oil, that competed with the coal industry. Both were policies promoted by the NUM. The NCB-appointed trustees argued that the pursuit of NUM policies by the union-appointed trustees was inconsistent with the independence from outside influence expected of trustees.

Decision

It was held that the union-appointed trustees would be in breach of duty if they refused to adopt the investment strategy for the reasons they had given. One element of Megarry V-C's judgment that has proved especially important in respect of the ethical investment debate is the way in which the definition of the best interests of members must be identified specifically with their 'financial' best interests (perhaps, more accurately, their financial interest in their capacity as beneficiaries).

Megarry V-C

I can see no reason for holding that different principles apply to pension fund trusts from those which apply to other trusts. Of course, there are many provisions in pension schemes which are not to be found in private trusts, and to these the general law of trusts will be subordinated. But subject to that, I think that the trusts of pension funds are subject to the same rules as other trusts. The large size of pension funds emphasises the need for diversification, rather than lessening it, and the fact that much of the fund has been contributed by members of the scheme seems to me to make it even more important that the trustees should exercise their powers in the best interests of the beneficiaries. In a private trust, most, if not all, of the beneficiaries are the recipients of the bounty of the settlor, whereas under the trusts of a pension fund many (though not all) of the beneficiaries are those who, as members, contributed to the funds so that in due time they would receive pensions. It is thus all the more important that the interests of the beneficiaries should be paramount, so that they may receive the benefits which in part they have paid for. I can see no justification for holding that the benefits to them should run the risk of being lessened because the trustees were pursuing an investment policy intended to assist the industry that the pensioners have left, or their union. …

When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. In the case of a power of investment, as in the present case, the power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question …

In considering what investments to make, trustees must put on one side their own personal interests and views. Trustees may have strongly held social or political views. They may be firmly opposed to any investment in South Africa or other countries, or they may object to any form of investment in companies concerned with alcohol, tobacco, armaments or many other things. In the conduct of their own affairs, of course, they are free to abstain from making such investments. Yet under a trust, if investments of this type would be more beneficial to the beneficiaries than other investments, the trustees must not refrain from making the investments by reason of the views that they hold …

Notes

(1) The courts have, on occasions, tempered the apparent stringency of their approach. In *Martin v City of Edinburgh District Council* (1988) SLT 329, Lord Murray took the view of the approach outlined in *Cowan v Scargill* that 'if it means that each individual trustee in genuinely applying his mind and judgment to a trust decision must divest himself of all personal preferences, of all political beliefs, and all moral, religious or other conscientiously held principles, then I do not think that this proposition is either reasonable or practical'. How might this qualification operate in practice? Is it reconcilable with *Cowan v Scargill*?

(2) Although there is no requirement in Australia that the trustees of investment or superannuation funds have regard for ethical issues when making investment decisions, they are required to disclose in their promotional documents and ongoing reporting the extent to which labour standards or environmental, social or ethical issues are considered in their decision processes: see s 1013D(1)(l) *Corporations Act 2001* (Cth). ASIC's requirements in respect of those disclosures is specified in ASIC *Regulatory Guide 65: Section 1013DA disclosure guidelines* (November 2011).

(3) To some extent, the vigour of the push for trustees of investment trusts to consider ethical investments has been overtaken by a broader policy push for consideration of environmental, social and governance (ESG) risks: see, for example, UN Global Compact, *Conference Report: Investing for Long-term Value – Integrating Environmental, Social and Governance value drivers in asset management and financial research* (2005). See BJ Richardson, 'Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?' (2007) 22(2) *Banking and Finance Law Review* 145; Sarah Barker, Mark Baker-Jones, Emilie Barton and Emma Fagan, 'Climate change and the fiduciary duties of pension fund trustees–lessons from the Australian law' (2016) 6(3) *Journal of Sustainable Finance and Investment* 211; Lloyd Brown '*Cowan v Scargill* and the Fiduciary Duty of Investment: Has the Nature of the Investment Duty Changed and What is Currently Driving "socially responsible investing" in Pension Schemes?' (2020) 26(8–9) *Trusts & Trustees* 756. Recent litigation involving the climate change strategies of the trustees of the Retail Employees Superannuation Trust was settled out of court: see M Scott Donald, 'Between a Rock and a Hot Place; Super Fund Trusteeship at the Coalface' (2021) 32(10) *Australian Superannuation Law Bulletin* 171.

18.5b *Harries v Church Commissioners for England* [1993] 2 All ER 300

Background

The Church Commissioners for England is a charitable body corporate. The Commissioners administered a fund containing estates and assets worth some £2.645 billion in 1991, from which they derived income of approximately £164 million. That income was applied to pay almost half the costs of the stipends of the clergy of the Church of England, as well as covering most of their housing costs and almost all their pension costs. The plaintiffs brought proceedings against the Commissioners seeking declarations that the Commissioners were obliged to have regard to the object of promoting the Christian faith through the established Church of England and not to act in a manner which would be incompatible with that object when managing their assets; that, in making investment decisions, the Commissioners attached overriding importance to financial considerations; and that their policy was erroneous in law in that they were only prepared to take non-financial considerations into account to the extent that such considerations did not significantly jeopardise or interfere with accepted investment principles.

Decision

The Court declined to grant the declarations sought on the grounds that when a trust (or equivalent, as here) is established for the purpose of generating money to be applied in support of a charity's aims, then the circumstances in which the trustees might properly make a financially disadvantageous investment decision for ethical reasons are extremely limited. Moreover, the Court found that the Commissioners did have an ethical investment policy and that, in managing their investments, they did seek to have regard to the object for which they were established; namely, to achieve the promotion of the Christian faith through the established Church of England.

Nicholls V-C

For some time there have been voices in the Church of England expressing disquiet at the investment policy of the commissioners. They do not question either the good faith or the investment expertise of the commissioners. Their concern is not that the commissioners have failed to get the best financial return from their property and investments. Their concern is that, in making investment decisions, the commissioners are guided too rigorously by purely financial considerations, and that the commissioners give insufficient weight to what are now called 'ethical' considerations. …

Charity trustees and investment powers

Before going further into the criticism made of the commissioners I will consider the general principles applicable to the exercise of powers of investment by charity trustees. It is axiomatic that charity trustees, in common with all other trustees, are concerned to further the purposes of the trust of which they have accepted the office of trustee. That is their duty. To enable them the better to discharge that duty, trustees have powers vested in them. Those powers must be exercised for the purpose for which they have been given: to further the purposes of the trust. That is the guiding principle applicable to the issues in these proceedings …

Broadly speaking, property held by charity trustees falls into two categories. First, there is property held by trustees for what may be called functional purposes. The National Trust owns historic houses and open spaces. The Salvation Army owns hostels for the destitute. And many charities need office accommodation in which to carry out essential administrative work. Second, there is property held by trustees for the purpose of generating money, whether from income or capital growth, with which to further the work of the trust. In other words, property held by trustees as an investment. Where property is so held, prima facie the purposes of the trust will be best served by the trustees seeking to obtain therefrom the maximum return, whether by way of income or capital growth, which is consistent with commercial prudence. That is the starting point for all charity trustees when considering the exercise of their investment powers. Most charities need money; and the more of it there is available, the more the trustees can seek to accomplish.

In most cases this prima facie position will govern the trustees' conduct. In most cases the best interests of the charity require that the trustees' choice of investments should be made solely on the basis of well-established investment criteria, having taken expert advice where appropriate and having due regard to such matters as the need to diversify, the need to balance income against capital growth, and the need to balance risk against return.

In a minority of cases the position will not be so straightforward. There will be some cases, I suspect comparatively rare, when the objects of the charity are such that investments of a particular type would conflict with the aims of the charity. Much-cited examples are those of cancer research charities and tobacco shares, trustees of temperance charities and brewery and distillery shares, and trustees of charities of the Society of Friends and shares in companies engaged in production of armaments. If, as would be likely in those examples, trustees were satisfied that investing in a company engaged in a particular type of business would conflict with the very objects their charity is seeking to achieve, they should not so invest. Carried to its logical conclusion the trustees should take this course even if it would be likely to result in significant financial detriment to the charity. The logical conclusion, whilst sound as a matter of legal analysis, is unlikely to arise in practice. It is not easy to think of an instance where in practice the exclusion for this reason of one or more companies or sectors from the whole range of investments open to trustees would be likely to leave them without an adequately wide range of investments from which to choose a properly diversified portfolio.

There will also be some cases, again I suspect comparatively rare, when trustees' holdings of particular investments might hamper a charity's work either by making potential recipients of aid unwilling to be helped because of the source of the charity's money, or by alienating some of those who support the charity financially. In these cases the trustees will need to balance the difficulties they would encounter, or likely financial loss they would sustain, if they were to hold the investments against the risk of financial detriment if those investments were excluded from their portfolio. The greater the risk of financial detriment, the more certain the trustees should be of countervailing disadvantages to the charity before they incur that risk.

Another circumstance where trustees would be entitled, or even required, to take into account non-financial criteria would be where the trust deed so provides.

No doubt there will be other cases where trustees are justified in departing from what should always be their starting point. The instances I have given are not comprehensive. But I must emphasise that of their very nature, and by definition, investments are held by trustees to aid the work of the charity in a particular way: by generating money. That is the purpose for which they are held. That is their raison d'être. Trustees cannot properly use assets held as an investment for other, viz. non-investment, purposes. To the extent that they do they are not properly exercising their powers of investment. This is not to say that trustees who own land may not act as responsible landlords or those who own shares may not act as responsible shareholders. They may. The law is not so cynical as to require trustees to behave in a fashion which would bring them or their charity into disrepute … On the other hand, trustees must act prudently. They must not use property held by them for investment purposes as a means for making moral state-

ments at the expense of the charity of which they are trustees. Those who wish may do so with their own property, but that is not a proper function of trustees with trust assets held as an investment.

I should mention one other particular situation. There will be instances today when those who support or benefit from a charity take widely different views on a particular type of investment, some saying that on moral grounds it conflicts with the aims of the charity, others saying the opposite. One example is the holding of arms industry shares by a religious charity. There is a real difficulty here. To many questions raising moral issues there are no certain answers. On moral questions widely differing views are held by well-meaning, responsible people. This is not always so. But frequently, when questions of the morality of conduct are being canvassed, there is no identifiable yardstick which can be applied to a set of facts so as to yield one answer which can be seen to be 'right' and the other 'wrong'. If that situation confronts trustees of a charity, the law does not require them to find an answer to the unanswerable. Trustees may, if they wish, accommodate the views of those who consider that on moral grounds a particular investment would be in conflict with the objects of the charity, so long as the trustees are satisfied that course would not involve a risk of significant financial detriment. But when they are not so satisfied trustees should not make investment decisions on the basis of preferring one view of whether on moral grounds an investment conflicts with the objects of the charity over another. This is so even when one view is more widely supported than the other.

I have sought above to consider charity trustees' duties in relation to investment as a matter of basic principle. I was referred to no authority bearing directly on these matters. My attention was drawn to *Cowan v Scargill* [1984] 2 All ER 750, [1985] Ch 270, a case concerning a pension fund. I believe the views I have set out accord with those expressed by Megarry V-C in that case, bearing in mind that he was considering trusts for the provision of financial benefits for individuals. In this case I am concerned with trusts of charities, whose purposes are multifarious …

The statement of policy records that the commissioners do not invest in companies whose main business is in armaments, gambling, alcohol, tobacco or newspapers. Of these, newspapers fall into a category of their own. The commissioners' policy regarding newspapers is based on the fact that many newspapers are associated, to a greater or lesser extent, with a particular political party or political view. Leaving aside newspapers, the underlying rationale of the commissioners' policy on these items is that there is a body of members of the Church of England opposed to the businesses in question on religious or moral grounds. There are members who believe these business activities are morally wrong, and that they are in conflict with Christian teaching and its moral values. But this list has only to be read for it to be obvious that many committed members of the Church of England take the contrary view. To say that not all members of the Church of England eschew gambling, alcohol or tobacco would be an understatement. As to armaments, the morality of war, and the concept of a 'just war', are issues which have been debated for centuries. These are moral questions on which no single view can be shown to be 'right' and the others 'wrong'. As I understand the position, the commissioners have felt able to exclude these items from their investments despite the conflicting views on the morality of holding these items as investments because there has remained open to the commissioners an adequate width of alternative investments …

Question

Nicholls V-C described an ethical investment policy as 'an investment policy which is not guided solely by financial criteria but which takes into account non-financial considerations deduced from Christian morality'. Though clearly conditioned on the circumstances before him in *Harries*, how might this have been phrased so that it would have more universal application? (See, further, Lord Nicholls of Birkenhead, 'Trustees and their Broader Community: Where Duty, Ethics and Morality Converge' (1995) 9(3) *Trust Law International* 71.)

18.6 Compensation for loss

Clearly, not all losses incurred on trust investments constitute breaches of trust. As Lindley LJ noted in *Re Chapman* [1896] 2 Ch 763,

> a trustee is not: a surety, nor is he an insurer; he is only liable for such wrong done by himself, and loss of trust money is not per se proof of such wrong. There is no rule of law which compels the Court to hold that an honest trustee is liable to make good loss sustained by retaining an authorized security in a falling market, if he did so honestly and prudently, in the belief that it was the best course to take in the interests of all parties. Trustees acting honestly, with ordinary prudence and within the limits of their trust, are not liable for mere errors of judgment.

Similarly, not all breaches of trust give rise to a compensable loss. There are a number of reasons for this:

(1) The trust instrument may contain an exculpatory clause which excuses the trustee from liability to compensate the trust in certain circumstances (see chapter 17 for a discussion of such clauses).

(2) It may be the case, as the Court of Appeal found in *Nestle v National Westminster Bank plc* (1993) 1 WLR 1260, that no loss recognisable by the court occurred, notwithstanding the deficiencies in the trustee's administration of the trust. In that case, the trust assets had appreciated in value but the plaintiff was unable to persuade the court that the investment performance achieved was below that which ought to be expected from a professional trustee.

(3) The breach of trust may have occasioned both losses and gains, which the court may set off against each other. This principle is now enshrined in s 90A of the *Trustee Act 1925* (NSW), which provides:

> **90A Power of Court to set off gains and losses arising from investment**
>
> **(1)** The Court may, when considering an action for breach of trust arising out of or in respect of an investment by a trustee where a loss has been or is expected to be sustained by the trust, set off all or part of the loss resulting from that investment against all or part of the gain resulting from any other investment whether in breach of trust or not.
>
> ...

Equivalent provisions in the trustee legislation of other States and Territories are: ACT s 89A; NT s 10F; Qld s 30C; SA s 13D; Tas s 12E; Vic s 12D; WA s 26C. See also *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515.

19

Trustees' rights and liabilities

19.1 Introduction

19.2 Nature of the trustee's right of indemnity

19.3 'Properly incurred' expenses

19.4 Recovery against beneficiaries personally

19.5 Right to seek directions from the Court

19.1 Introduction

The trustee's position is both simple and highly complex. The trustee is the legal owner of the trust property, and therefore has all the rights and responsibilities that come with complete ownership. The trustee is regarded as personally liable for debts incurred on behalf of the trust unless documents contain clear and unambiguous words excluding that conclusion: see *Helvetic Investment Corporation Pty Ltd v Knight* (1984) 9 ACLR 773.

But in equity the trustee only holds the property for those beneficially entitled to it. Thus, trustees may potentially incur personal liability in performing trust business without taking personal benefit from the expense. Few would take on the responsibilities of trusteeship without some financial relief from that outcome. Equity, and more recently, statute, has dealt with the situation by recognising the trustee's right to be indemnified out of trust assets for expenses incurred in carrying out the trust. Practically, this means the trustee can pay the trust expense directly out of trust funds (called the 'right of exoneration') or pay the expense out of personal funds, and then be reimbursed for it (called the 'right of recoupment').

However, a right of indemnity can only be claimed in respect of expenses properly incurred in performing the trust. Further, the value of the trustee's right of indemnity may be reduced if the trustee has, in breach of trust, caused a loss to the trust fund: *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 268 CLR 524, [31] (Kiefel CJ, Keane and Edelmann JJ).

In most Australian jurisdictions, if the trust estate is insufficient to satisfy the amount owed to the trustee, equity may permit the trustee to recover against the beneficiaries themselves.

In addition, equity's general interest in seeing justice done between the parties results in particular rights being conferred on the trustee, which can be seen as reinforcing the trustee's right to indemnification. For example, where a beneficiary has participated in a breach of trust, its beneficial interest (or part thereof) may be impounded so that the trustee can be indemnified out of it: see textbook at [19.25].

One of the trustee's other important rights is the right to approach the court for directions. The ability to seek the court's directions and the trustee's right to indemnification for properly incurred expenses intersect, as the extract from the *Macedonian Orthodox Community Church St Petka Inc v His Eminence Petar the Diocesan Bishop of the Macedonian Orthodox Diocese of Australia and New Zealand* [2008] HCA 42; (2008) 237 CLR 66, below at [19.5a], shows.

Questions for consideration

(1) How does the trustee's right of indemnity operate on the trust estate? What rights over trust property are given to the trustee?

(2) What are the implications of the right of indemnity in the case of insolvency of the trustee?

(3) When will the trustee be permitted to recover against the beneficiaries themselves?

(4) When will a trust expense be 'properly incurred'?

(5) When should a trustee approach the court for its advice and directions?

19.2 Nature of the trustee's right of indemnity

Background

Ad valorem stamp duty (state government taxation) pursuant to s 66 of the *Stamp Duties Act 1920* (NSW) was assessed on the unencumbered value of a trust property. There was an undischarged trustee's right of indemnity over the property. Did this form an 'encumbrance' on the property for the purposes of calculating stamp duty?

Decision

The High Court held that the right of indemnity did not constitute an encumbrance.

The Court

The entitlement of a trustee who has borrowed money for application to trust purposes has been described as follows *(Scott on Trusts,* 4th ed (1988), vol 3A, §246):

> Where the trustee acting within his powers makes a contract with a third party in the course of the administration of the trust, although the trustee is ordinarily personally liable to the third person on the contract, he is entitled to indemnity out of the trust estate. If he has discharged the liability out of his individual property, he is entitled to reimbursement; if he has not discharged it, he is entitled to apply the trust property in discharging it, that is, he is entitled to exoneration.

In aid of that right to reimbursement or exoneration for liabilities properly incurred in the administration of the trust, the trustee cannot be compelled to surrender the trust property to the beneficiaries until the claim has been satisfied. In that sense, the entitlement to reimbursement or exoneration confers a priority in the further administration of the trust. … [I]f it appears probable that the trust fund will be insufficient for the full recoupment of the trustee, the trustee is entitled to the insertion in the order for administration of a direction that there be payment in the appropriate order of priority.

Until the right to reimbursement or exoneration has been satisfied, 'it is impossible to say what the trust fund is' *(Dodds v Tuke* (1884) 25 Ch D 617 at 619). The entitlement of the beneficiaries in respect of the assets held by the trustee which constitutes the 'property' to which the beneficiaries are entitled in equity is to be distinguished from the assets themselves. The entitlement of the beneficiaries is confined to so much of those assets as is available after the liabilities in question have been discharged or provision has been made for them. To the extent that the assets held by the trustee are subject to their application to reimburse or exonerate the trustee, they are not 'trust assets' or 'trust property' in the sense that they are held solely upon trusts imposing fiduciary duties which bind the trustee in favour of the beneficiaries.

The entitlement to reimbursement and exoneration was identified by Lindley LJ as 'the price paid by *cestuis que trust* for the gratuitous and onerous services of trustees' (*Re Beddoe* [1893] 1 Ch 547 at 558). The right of the trustee has been described as a first charge upon the assets vested in the trustee …, as one upon the 'trust assets' (*Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360 at 367), and as conferring upon the trustee an 'interest in the trust property [which] amounts to a proprietary interest' (*Octavo Investments* at 370).

… The interests of the beneficiaries are not 'encumbered' by the trustee's right of exoneration or reimbursement. Rather, the trustee's right to exoneration or reimbursement 'takes priority over the rights in or in reference to the assets of the beneficiaries or others who stand in that situation' (*Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319 at 335). A court of equity may authorise the sale of assets held by the trustee so as to satisfy the right to reimbursement or exoneration. In that sense, there is an equitable charge over the 'trust assets' which may be enforced in the same way as any other equitable charge. However, the enforcement of the charge is an exercise of the prior rights conferred upon the trustee as a necessary incident of the office of trustee. It is not a security interest or right which has been created, whether consensually or by operation of law, over the interests of the beneficiaries so as to encumber them.

Notes

(1) Australian jurisdictions differ as to whether it is possible to exclude a right of indemnity out of trust assets by a term in the trust instrument: see textbook at [19.15].

(2) Because a right of indemnity gives rise to a proprietary right in the trustee, it survives termination of his trusteeship: *Dimos v Dikeakos Nominees Pty Ltd* (1996) 68 FCR 39.

Questions

(1) What consequences flow from the fact that it is impossible to say what the trust estate is while the trustee has an undischarged right of indemnity? Consider the following scenarios:

> **(a)** Can beneficiaries exercise their right to wind up the trust under the rule in *Saunders v Vautier* (1841) 4 Beav 115; 49 ER 282 (see [24.2a])? See *Apostolou v VA Corporation of Australia Pty Ltd* (2010) 77 ACSR 84.
>
> **(b)** Can a holder of a unit in a property trust be assessed for land tax in respect of the land holdings of that trust? See *CPT Custodian Pty Ltd v Commissioner of State Revenue (Vic)* [2005] HCA 53; (2005) 224 CLR 98.

(2) Modern professional trustees charge fees for their services, and are frequently protected from liability for breach by the terms of the trust instrument. Should the trustee's right of indemnity still be described as 'the price paid by *cestuis que trust* [beneficiaries] for the gratuitous and onerous services of trustees' (Re *Beddoe* [1893] 1 Ch 547, 558)? Is this traditional explanation now undermined?

(3) In the extract above, no distinction is drawn on the basis of how the right of indemnity arises. Should different proprietary analyses apply where the trustee has already paid the debt and is seeking reimbursement (right of recoupment) or has yet to pay the debt and is seeking to pay it out of the trust assets (right of exoneration)? Decisions in Australia were divided: see Re *Byrne Australia Pty Ltd* [1981] 1 NSWLR 394; *Re Suco Gold Pty Ltd* (1983) 33 SASR 99; *Re Enhill Pty Ltd* [1983] 1 VR 561. The High Court has indicated in obiter its preference for the view expressed in *Re Suco Gold*: see *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 268 CLR 524, [44] (Kiefel CJ, Keane and Edelmann JJ), [92] (Bell, Gageler and Nettle JJ), [153]–[154] (Gordon J). Thus, when a trustee is exercising a right of *exoneration*, the trust assets realised can only be used to discharge trust creditors.

19.3 'Properly incurred' expenses

19.3a *Re Raybould* [1900] 1 Ch 199

Background

A trustee carried on a colliery (coal mining) business. Due to a contractor's negligence, earthworks at the colliery damaged an adjoining property. The adjoining property owners obtained judgment against the trustee for damages and costs, and sought an order that the judgment debt be paid directly out of the trust property.

Decision

It was held that the damages for negligence and costs were subject to the trustee's right of indemnity against the trust estate.

Byrne J

The first question I have to consider is whether the same principle ought to be applied to the case of a trustee claiming a right to indemnity for liability for damages for a tort, as is applied to simpler cases of claims made against a trustee by ordinary business creditors, where they have been allowed the benefit of his right to indemnity, by proving directly against the [trust] assets: … It has been argued that there is no authority to justify me in holding that, where damages have been recovered against a trustee in respect of a tort, the person so recovering can avail himself of the trustee's right to indemnity, and so go direct against the trust estate; but the authority of *Benett v Wyndham* (1862) 4 De GF & J 259 goes to shew that if a trustee in the course of the ordinary management of his testator's estate, either by himself or his agent, does some act whereby some third person is injured, and that third person recovers damages against the trustee in an action for tort, the trustee, if he has acted with due diligence and reasonably, is entitled to be indemnified out of his testator's estate. When once a trustee is entitled to be thus indemnified out of his trust estate, I cannot myself see why the person who has recovered judgment against the trustee should not have the benefit of this right to indemnity and go direct against the trust estate or the assets, as the case may be, just as an ordinary creditor of a business carried on by a trustee or executor has been allowed to do, instead of going through the double process of suing the trustee, recovering damages from him and leaving the trustee to recoup himself out of the trust estate. … [A]ssuming that a proper case for indemnifying [the trustee] is made out by the evidence, I think [the trustee's] claim should be allowed.

The next question I have to decide is whether this trustee has worked the colliery in such a way as to be entitled to be indemnified. Having considered all the evidence, I am not prepared to say that the injury done to the applicants' land was occasioned by reckless or improper working, or otherwise than by the ordinary and reasonable management of the colliery; and I therefore come to the conclusion that the trustee is entitled to be indemnified out of the assets against the damages … It follows, therefore, … that [the applicants] are entitled to stand in the trustee's place for the purpose of obtaining this indemnity direct from this testator's estate.

Notes

(1) Notice that, at least in the case of a right to exoneration (where the trustee has not already satisfied the debt), the third party can 'stand in the shoes of the trustee' and claim the debt directly against the trust estate. This is an application of subrogation.

(2) A right of indemnity may not arise in trusts created by statute: see *Re MF Global Australia Ltd (in liq)* (2012) 267 FLR 27, [149].

Question

Does the term 'reasonably' used by Byrne J in the extract above have the same meaning as it would in torts law? Compare the approaches in the two following extracts.

Background

The former trustee's agent made deceptive and misleading representations concerning the profitability of trust business in breach of s 52 of the *Trade Practices Act 1974* (Cth). The Federal Court held the trustee vicariously liable for the agent's misrepresentation and ordered damages for the breach against the former trustee. The former trustee sought indemnification for the damages from the current trustee.

Decision

The New South Wales Court of Appeal held that the trustee should be indemnified from the trust property for the payment of damages.

Spigelman CJ

In this appeal … the Appellant relied on the summary of American law in *Scott on Trusts* vol 3A, 4th ed (1988) where in pars [244] and [245] the learned authors state the relevant propositions in terms that a trustee may recover expenses 'properly incurred' but may not recover expenses 'not properly incurred'.

With respect to the issue of liability in tort, which as I have said is the analogy that was used in submissions in the present case, *Scott on Trusts* refers to *Benett v Wyndham* and *Raybould* as authority for the proposition stated in [247] as follows:

> A trustee who has incurred a liability in tort to a third person is entitled to indemnity out of the trust estate if the liability was incurred in the proper administration of the trust and the trust was not personally at fault in incurring it.

The reference in this passage to the 'proper administration of the trust' begs the relevant question. The issue is what is 'proper'. The proposition that the trustee was not 'personally at fault' is stated too widely.

It is clear that the right of indemnity cannot be availed of if expense was incurred by conduct outside the scope of the trust or in excess of the powers conferred by the trust. The same result should ensue when a trustee incurs expenses as a result of conduct in breach of a duty which the trustee owed to the trust, including the duty to execute the trust with reasonable diligence and care. It was in this way that Brooking J explained the passages in *Benett v Wyndham* and *Re Raybould* on which the Appellant relies. (See *RWG Management Limited* at 396.)

To similar effect is the observation of Lord Selborne LC with respect to the contractual rights of indemnity of a mortgagee or trustee:

> These rights, resting substantially upon contract, can only be lost or curtailed by such inequitable conduct on the part of the mortgagee or trustee as may amount to a violation or culpable neglect of his duty under the contract. (*Cotterall* v *Stratton* (1872) 8 Ch 295 at 302.)

This passage was quoted with approval by Griffith CJ, then Chief Justice of Queensland, in *Corrigan v Farrelly* (1897) QLJ 105 at 111–112, … His Honour applied the test in the following terms at 112:

> The only question, therefore, is whether the executors' conduct in this case has been such as to amount to a violation or culpable neglect of their duty.

I find this general approach more helpful than the use of the conclusory terminology of whether or not conduct was 'proper' or 'reasonable' as if it were a test.

On the above analysis, it is necessary to set out and consider the actual conduct of the trustee that led the trustee to incur the relevant expenses.

… [Section] 52 of the *Trade Practices Act* … covers conduct of such a wide range of moral obloquy that the mere fact of contravention cannot of itself be determinative of the right to seek indemnity on the part of a trustee. For much the same reasons, a breach of a duty to a third party to exercise reasonable care cannot be determinative of whether there has been a breach of a trustee's duty to exercise reasonable care in the management of a trust. …

[His Honour then discussed the nature of the misrepresentations made, and noted the trial judge's finding that there had been no deliberate fraud by the former trustee.]

Nothing in [the trial judge's] findings of fact … suggests that the conduct of the trustee was of the requisite character to disentitle the trustee to its right to indemnity on the basis of the principles I have discussed above.

Mason P

The corporate trustee has power to carry on a business … It obviously had to use agents. The conduct that attracted the award of damages in the Federal Court was hardly commendable, but unremarkable in its heinousness. The individual agents were acting in the course of their employment in the trust enterprise. In these circumstances, it is not unjust for the trust assets to take the burden of the consequences of the respondent's conduct, just as it would have taken its benefit …

I prefer to express no view on the broader issue of whether a trustee's conduct must be 'reasonable' and/or 'proper' before the right of indemnity will be upheld … The terms are notoriously open-ended, but I would need to be persuaded that they are meaningless in the present situation. Like all such terms, they embody judgments to be made in context. Some outer limit needs to be drawn in order to recognise that certain types of grossly improper frolics by trustees will put them outside the presently uncertain boundary of the right now in question.

Meagher JA

It is well settled that [the trustee's] right to indemnification extends to reimbursement of the trustee for damages awarded against him for torts committed by him in the course of carrying on the trust business. … In the present case the trustee argued successfully that damages under the consumer protection provisions of the *Trade Practices Act* should, for this purpose, be equated with damages for common law torts. I quite agree with this submission.

What are the limits to be placed on this right to indemnification? … Presumably, if the activity which generated the liability in question were a breach of trust, the right to an indemnity under the general law would no longer exist; similarly if it were criminal in nature, but no criminal offences were charged against [the former trustee]. Again, one must in principle incline to the view that if the activity in question had been fraudulent the law would withhold the right to indemnification; but in the present case [the trial judge] expressly negatived fraud. I find it difficult to formulate any other limitations. United States authorities … might be read as establishing either or both these propositions: (a) that the activity in respect of which indemnity is claimed must be 'reasonable', and (b) that the activity must be 'proper'. In my view, neither such limitation exists in Australian law. As to the former, it is in the circumstances, meaningless; no conduct has to be castigated as 'unreasonable' unless one has a clear criterion of what constitutes reasonableness, and here there is none. As to the latter, it is almost as meaningless to endeavour to apply some hypothetical standard of propriety in ordinary commercial life, absent fraud and crime. I find it difficult to view occasional breaches of Trade Practices legislation as anything other than incidental aspects of ordinary commercial life.

Note

Some Australian jurisdictions specifically limit the trustee's right of indemnity to expenses 'reasonably incurred': see *Trusts Act 1973* (Qld) s 72; *Trustees Act 1962* (WA) s 71. This does not appear to affect the general law.

Questions

(1) In deciding whether a trustee should be denied a right of indemnity from trust property, why, if at all, is the nature of a trustee's conduct towards third parties relevant?

(2) Can a distinction be drawn between a trustee's behaviour that benefits the trust and incidentally impacts on third parties, and a trustee's behaviour that could expose the trust to risk, without having any potential to benefit the trust?

19.3c *Nolan v Collie* (2003) 7 VR 287

Background

During lengthy legal proceedings concerning a real estate purchase, it was argued that a trustee (Merlaw) was not entitled to indemnification because the relevant expense had not been properly incurred in the administration of the trust. Warren J held at an earlier stage of proceedings that the trustee had negligently remortgaged a property, in a manner that was in breach of trust. Counsel argued that, as the property had been mortgaged in breach of trust, the trustee had no right of indemnification for expenses arising through the mortgage.

Decision

The Court of Appeal held that the trustee was entitled to indemnification from the trust assets.

Ormiston JA

First, however, it is necessary to deal with an argument … to the effect that there was no right of indemnity … because the obligation in question had not been 'properly incurred' in the administration of the relevant trust … it was argued, a liability arising out of a breach of trust could not, ex hypothesi, be characterised as one which had been properly incurred in the administration of that trust. …

The assumed legal premise for these contentions … was that the trustee's right of indemnification against the trust estate is confined to liabilities and expenses which have been properly incurred in carrying out the trust. That test, at least at one time, seemed to be expressed in terms uniformly accepted: … Such an approach seemed, until a few years ago, also largely accepted by the two principal texts in this country on the law of trusts, as well as the standard English texts … In very recent times, however, doubt has been cast on that simple proposition, in particular by the New South Wales Court of Appeal in *Gatsios Holdings Pty Ltd v Nick Kritharas Holdings Pty Ltd* [2002] NSWCA 29.

[His Honour referred to passages in the *Gatsios* judgments, [19.3b] above, concerning whether the activity in respect of which the indemnity is claimed must be 'reasonable' and 'proper'.]

With the greatest of respect, it is by no means clear why a majority of their Honours in *Gatsios Holdings* seemed to sanction so significant a departure from accepted principle as to leave the trustee's right largely unconstrained. It is possible that their views were prompted by the fact that the claim there in question resulted from a judgment obtained in an action in tort, which has always posed problems in relation to questions of indemnification. The form of their Honours' discussion tends to make it unlikely that their intention was so limited … Again, with respect, the majority's view would appear to leave this important area of trust law rudderless and in a state where mischievous trustees might seize upon an almost unfettered right of indemnity as justifying improper depredations of trust funds, contrary to their obligation not to abuse their position by making it 'a means of profit or benefit' to themselves.

To my way of thinking the conventionally stated test as to expenses 'properly incurred' is merely a convenient shorthand to describe those restraints applicable to trustees who would seek to look to trust funds for the payment of their expenses and other trust liabilities. It also has the advantage of succinctly expressing the notion of propriety as underpinning a trustee's relationship with the trust estate and the beneficiaries. One must not forget, moreover, that in *Re Beddoe* [1893] 1 Ch 547, seen as one of the leading authorities, Lindley LJ explained that in cases of doubt the trust estate should bear the trustee's costs, and that: 'The words "properly

incurred" in the ordinary form of the order are equivalent to "not improperly incurred"'. The proposition was converted by another respected judge, Bowen LJ, who was perhaps more familiar with courts of common law, into 'a proposition in which the word "properly" means reasonably as well as honestly incurred'. His Lordship added that, while trustees ought not to bear expenses and liabilities incurred personally 'on account of mere errors in judgment which fall short of negligence of unreasonableness', nevertheless 'mere *bona fides* is not the test'. ...

Re Beddoe or the principles stated therein has been cited and applied in Australia on numerous occasions. In the High Court it was used in *National Trustees Executors & Agency Co of Australia Ltd v Barnes* (1941) 64 CLR 268 as the basis for Rich ACJ and Williams J to support the proposition that a trustee is entitled to be indemnified out of the trust estate 'against all his proper costs, charges and expenses incident to the execution of the trust' ... Subsequently, in a judgment in which Dixon J formed part of the majority, his Honour said in *Vacuum Oil Co* that, where an executor has acted under an appropriate authority, the executor has a 'right to be indemnified out of the assets in respect of liabilities he has incurred in the proper performance of his duties or exercise of his powers'.

In two later cases in the High Court, principles as to the indemnification of trustees were stated without specific reference to the 'proper' incurring of costs or expenses but in terms which would not deny the applicability of the rule, especially having regard to the reliance on the authorities referred to above in support of the propositions discussed in those later cases. In *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, the majority (Stephen, Mason, Aickin and Wilson JJ) referred on four occasions to *Vacuum Oil Co* with approval and without in any way suggesting that the test as to proper incurrence no longer applied. Likewise in *Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226 the High Court again referred with approval to the passage cited above from *Vacuum Oil Co* and also to *Re Beddoe* itself, without there being any suggestion that the tests laid down in that case were no longer apposite.

... With great respect, I am by no means confident that, in using the term 'reasonably', Bowen LJ was intending to impose so stringent a test as has now been suggested, for he also observed 'that trustees ought not to be visited with personal loss on account of mere errors in judgment ...'. Likewise, and also with great respect, the test stated by Brooking J should be seen as intended as no more than a shorthand for the conventional statement of a trustee's duty.

Perhaps the rule will not pose difficulties where the issue relates merely to costs and expenses, although even in that area it has frequently been said that trustees should not be deprived of their right of reimbursement unless they have clearly been shown to have acted improperly, with the onus resting on those who seek to deny the right. But the rule relating to indemnification also applies to the incurring of liabilities and, by necessity, a considerable proportion of those must be incurred where in some way a trustee has been found to have acted in error. Doubtless liability in tort poses its own particular problems, as the cases, especially *Gatsios Holdings*, demonstrate. With respect, I would prefer therefore, at least for the time being, to confine what was said in that case to liabilities in tort incurred by trustees and the circumstances in which they should be so indemnified.

The answer to what now seems to be a degree of confusion as to the nature of costs, expenses and liabilities for which a trustee can seek indemnification may well lie in the simple proposition of Lindley LJ in *Re Beddoe* to the effect that the words 'properly incurred' are equivalent to the words 'not improperly incurred', a proposition so abundantly obvious that it tends to obscure some of the complications which have been overlooked from time to time. In my opinion the use of the negative is intended to show that what is 'proper' and 'improper' must be answered by reference to the circumstances and in particular by reference to the duty with which a trustee was obliged to comply or the power which a trustee is intending to exercise. The content of trustees' duties vary considerably, as do the obligations taken on when a power is exercised. A significant number of trustees' duties require strict compliance so that failure to comply with that duty will necessarily lead to the conclusion that a particular cost, expense or liability has not been properly incurred. On the other hand, the more day to day functions of a trustee in the management of a trust require only that the trustee 'exercise the same care as an ordinary prudent person of business would exercise in the conduct of that business were it his or her own': per Gummow J in *Breen v Williams* (1996) 186 CLR 71 at 137. The proposition is derived from a number of well-known authorities such as *Speight v Gaunt* (1883) LR 9 App Cas 1 at 19, *Austin v Austin* (1906) 3 CLR 516 at 525, and *Fouche v The Superannuation Fund Board* (1952) 88 CLR 609 at 641. That test has been accepted for many years as providing an objective but not over-strict standard and it has been stated on many occasions that it does not require a subjective standard of diligence and care which an individual trustee might exercise in the management of his or her own affairs, but only the objective standard of the 'ordinary prudent' business person taking on the role of a trustee: see Jacobs. In my opinion it was that latter obligation to which Bowen LJ was referring in *Re Beddoe,* so that to rely on what his Lordship said there may be misleading, even allowing for the fact that it has frequently been taken as expressing Lindley LJ's test in different terms. But that case was concerned solely with the costs of litigation and Bowen LJ's comments were confined explicitly to 'costs, charges and expenses'. 'Reasonably' must therefore be understood in the context of the particular duty which is in issue.

On the other hand, expenses and liabilities may be incurred where a trustee is engaged in activities which extend beyond mere management. The trustee may then be held to account far more strictly, in all senses. Conventionally, a contrast is drawn with the performance of what have been called proscriptive and prescriptive duties such as the duty to keep and render accounts, the duty not to allow a conflict between duty and interest and the duty not to obtain an unauthorised benefit from the trust. Again, it seems to have been accepted that a higher standard is demanded, subject to any statutory provisions, when making investments on behalf of the trust: see *Re Whiteley* (1886) 33 Ch D 347 at 355. For present purposes one may mention only one further strict duty recently described in the High Court as the duty 'to adhere to the terms of his trust in all things great and small, important, and seemingly unimportant': see *Youyang Pty Ltd v Minter Ellison Morris Fletcher* [2003] HCA 15 at [33]. The fact that such breaches can now be excused under s 67 of the *Trustee Act 1958* was there noted by the High Court as indicating merely the strictness of the obligation and the need for legislation to relieve trustees who breached it. It would follow that expenses or liabilities incurred as a result of a breach of that duty must ordinarily be characterised as improperly incurred, without regard to the reasonableness of the trustee's acts. It is obvious that there would be other breaches of these stricter duties which would lead to expenses and liabilities which were incapable of indemnification because each could be said to have been improperly incurred.

A test, therefore, based on whether a cost, expense or liability has been 'properly incurred' takes on some meaning, even if the answer depends on an analysis of the act which gives rise to the particular cost, expense or liability and the duty whose performance or breach may have led to that consequence. Naturally the vast majority of costs and expenses will not arise out of any breach of trust but will be merely incurred in the ordinary day to day management of it, but some will arise out of breaches of trust many of which will lead to denial of indemnification because the relevant breach of duty will be characterised as having been improperly incurred. There will remain, nevertheless, some breaches of duty giving rise to expenses and liabilities about which that cannot be said automatically, so that one must examine those particular breaches individually in the context of the stated duty or power … The negative test is the relevant test, that is to allow indemnification for what has not been shown to have been improperly incurred. Thus it may be shown that a particular act is either outside the relevant power, done in bad faith, or exercised with an absence of the care and diligence that a person of ordinary prudence should exercise. … It would follow that the test of 'reasonableness' is primarily concerned with the standard of ordinary diligence and care required in the management of trust affairs which might be expected of a trustee as objectively but not over-zealously enforced. That is why Bowen LJ insisted that in matters of management and the like 'mere errors of judgment' should not deny the right to indemnification but, with the greatest of respect, his insistence on a test of unreasonableness goes beyond what equity would demand. So far as costs and expenses are concerned, at least those which are the subject of taxation as 'indemnity costs', no question of reasonableness applies in the first instance as to the nature of the costs and expenses which the trustee may claim (at least in ordinary cases), but the test of reasonableness is imposed on the quantum of the amount claimed by a trustee.

Note

Ormiston J held on the facts that the trustee's liability arose out of a 'mundane performance', and that the negligence involved in that performance was a 'mere slip'. The trustee's performance was negligent, but that did not determine whether the trustee was entitled to indemnification. Here, the lack of prudence should not deprive the trustee of indemnification.

Questions

(1) What are the substantive differences in the approach taken by Spigelman CJ in *Gatsios* above and Ormiston JA in *Nolan v Collie?* Hypothetically applying the test adopted by the Victorian Court of Appeal, would the trustee in *Gatsios* have been entitled to indemnification?

(2) The Victorian Court of Appeal regarded the duty to invest (subject to any statutory provisions) as one of the 'stricter' duties faced by a trustee. There has been substantial statutory alteration of the trustee's general law investment duty referred to in the judgment above: see chapter 18. How will the statutory regime in place across Australia affect application of the test for 'properly' or 'improperly' incurred expenses?

(3) Who bears the onus of showing that an expense is 'proper' or 'improper'?

19.4 Recovery against beneficiaries personally

19.4a *Hardoon v Belilios* [1901] AC 118

Background

The plaintiff had 50 partly-paid shares in a bank placed in his name by his employer, who was the beneficial owner of the shares. The employer later assigned its equitable interest in the shares, which came into the hands of the defendant. When the plaintiff received dividends on the shares, he paid these over to the defendant. When calls were made on shareholders to fund the face value of the shares, the plaintiff paid these personally. The bank went into liquidation, and the plaintiff sought to recover calls paid by him from the defendant. (No indemnification could have been obtained from the 'trust' estate, as the shares were worthless.)

Decision

The Privy Council held that all that was required to create a trustee-beneficiary relationship between the plaintiff and the defendant was to prove that legal title to the shares was in the plaintiff, and equitable title was in the defendant, which was satisfied on the facts. The trustee was then entitled to be indemnified from the beneficiary, as the trust estate was insufficient to satisfy a right to reimbursement.

Lord Lindley

The next step is to consider on what principle an absolute beneficial owner of trust property can throw upon his trustee the burdens incidental to its ownership. The plainest principles of justice require that the [beneficiary] who gets all the benefit of the property should bear its burden unless he can shew some good reason why his trustee should bear them himself. The obligation is equitable and not legal … Even where trust property is settled on tenants for life and children, the right of their trustee to be indemnified out of the whole trust estate against any liabilities arising out of any part of it is clear and indisputable; … But where the only [beneficiary] is a person sui juris, the right of the trustee to indemnity by him against liabilities incurred by the trustee by his retention of the trust property has never been limited to the trust property; it extends further, and imposes upon the [beneficiary] a personal obligation enforceable in equity to indemnify his trustee. …

Where … a trustee seeks indemnity in respect of transactions in which he need not have engaged and which were not within the scope of his trust, he must prove that his [beneficiary] either authorised or ratified such transactions. But if he has incurred liability within the scope of his trust, and for the benefit of his [beneficiary], *Ex parte Chippendale* (1853) 4 De G M & G 19 shews that nothing more is required.

… As regards shares, this right of a trustee to be indemnified by his [beneficiary] against calls has been repeatedly recognised and enforced on the principles applicable to the equitable ownership of property …

It is quite unnecessary to consider in this case the difficulties which would arise if these shares were held by the plaintiff on trust for tenants for life, or for infants, or upon special trusts limiting the right to indemnity. In those cases there is no beneficiary who can be justly expected or required personally to indemnify the trustee against the whole of the burdens incident to his legal ownership; and the trustee accepts the trust knowing that under such circumstances and in the absence of special contract his right to indemnity cannot extend beyond the trust estate, that is, beyond the respective interests of his [beneficiaries]. In this case their Lordships have only to deal with a person sui juris beneficially entitled to shares which he cannot disclaim.

19.4b *JW Broomhead (Vic) Pty Ltd (in liq) v JW Broomhead Pty Ltd* [1985] VR 891

Background

A company acting as trustee of a trading trust became insolvent. At that time, there were five unit-holders (beneficiaries): JW Broomhead Pty Ltd (42%); Baroy Industries Pty Ltd (10%); Graham Wood and Lynette Wood (24% jointly); and Accordo Investments Pty

Ltd (24%). The trustee company had an undischarged right of indemnity. Trust assets were insufficient to discharge it, and the shortfall was expected to be approximately $70,000. The liquidator sought to recover indemnification from the unit-holders.

Accordo Investments Pty Ltd had itself gone into liquidation. Lynette Wood had no knowledge of the trust and promptly disclaimed her interest. Graham Wood claimed to have declared a sub-trust of his interest in favour of infant beneficiaries. Were the unit-holder beneficiaries required to indemnify the trustee, and if so, in what amounts?

Decision

It was held that the beneficiaries, except one who had disclaimed her interest, were liable to indemnify the trustee on principles explained in the judgment.

McGarvie J

Consequence of Lynette Wood's disclaimer

The consequence of the disclaimer by Lynette Wood is that in law she is treated as retrospectively disentitled to the interest declared for her benefit in the trust deed. However, in the working out of legal rights the law does not disregard the fact that until she disclaimed she had a right to the beneficial interest. …

As Lynette Wood, by her disclaimer, became retrospectively disentitled to the beneficial interest in her name under the trust deed, she is freed from all burdens which would have gone with acceptance of the interest: … Thus she is free of liability to indemnify the plaintiff.

It is necessary to look at the legal consequences upon other beneficial interests of Lynette Wood's disclaimer. …

When one of two persons jointly entitled as donees of an interest disclaims, the whole interest goes to the other person. It is a general principle that where a gift fails as to one joint donee the other takes the whole interest. This is so where the failure is due to the death of a joint donee in the lifetime of a testator, revocation or invalidity: (authorities excluded). The position is the same where the gift to one joint donee fails through disclaimer. …

The result is that from 28 September 1976 until a few days before she gave evidence, Lynette Wood, without her knowledge, had vested in her a joint interest and her position now is as though she had never become entitled to it. Graham Wood is now solely entitled to the beneficial interest in 24 per centum of the trust fund. …

The principle of *Hardoon v Belilios*

I now consider whether the plaintiff is entitled under the principle applied in *Hardoon v Belilios* [1901] AC 118 to the indemnities claimed. That general principle is that a trustee is entitled to an indemnity for liabilities properly incurred in carrying out the trust and that right extends beyond the trust property and is enforceable in equity against a beneficiary who is *sui juris*. The basis of the principle is that the beneficiary who gets the benefit of the trust should bear its burdens unless he can show some good reason why his trustee should bear the burdens himself.

The general principle was not in issue before me. There are exceptions to the general principle and the defendants argued that their situation fell within a number of exceptions.

Several beneficiaries

It was argued that the general principle applies only where there is a sole beneficiary. In *Hardoon v Belilios* [1901] AC 118, at p 124 the Privy Council stated the law as it applies where the only beneficiary is a person *sui juris*. …

Neither the submissions of counsel nor the cases have revealed to me any consideration of principle, concept, fairness or practicality which would justify its restriction to the case of a sole beneficiary. …

I consider that the general principle in *Hardoon v Belilios* applies where there are several beneficiaries.

In any event in this case the defendants other than Lynette Wood requested the plaintiff to become trustee for them and are also liable on that basis to indemnify the trustee. …

Sub-trusts

It was argued that the defendants Graham and Lynette Wood could not in any event be liable to indemnify the plaintiff because any beneficial interest they may have under the trust deed is held on trust for infants under their family trust.

I do not regard this situation as conferring immunity on Graham Wood. While minors are not personally liable to indemnify a trustee they are not protected from the adverse financial impact of other orders for indemnity. A trustee's right to indemnity out of the trust estate is exercisable against property held on trust for minors. No authority was cited to me and I see no principle to support the view that Graham Wood would not be liable to indemnify the plaintiff if he held his beneficial interest on trust for minors. In this case he would not be able to pass on his liability to minors for whom he held on trust. That, however, is a usual incident of the office of a trustee who holds property on trust for minors.

Defendants liable

The result is that each of the defendants except Lynette Wood is liable to indemnify the plaintiff.

Shares of indemnity to be borne

Submissions were made as to the share of the indemnity which the respective defendants should bear if liable to indemnify. This arises in the first instance because Accordo is in liquidation and, I assume, insolvent. For the plaintiff it is put that the whole of its liability should be allocated, in proportion to their respective shares in the trust, between the defendants liable to indemnify. … For the defendants it is put that a defendant whose interest in the trust fund is, for example, 42 per centum, should be liable to indemnify the plaintiff for no more than 42 per centum of the plaintiff's liability. …

In a case such as the present there is no justification for treating any one beneficiary as liable to pay the full amount of the trustee's indemnity. The beneficiaries were not jointly entitled to the whole fund. Each one was separately entitled to a separate part. The principles of contribution which make allowance for the insolvency of a beneficiary liable to contribute, have no application.

… It seems to follow that where there are several beneficiaries entitled to separate benefits, a beneficiary who gets a proportion of the benefit of the property should bear that proportion of its burdens unless he can show why a trustee should bear that proportion of them himself.

Under the trust deed, beneficiaries such as JWB and Baroy were separately entitled to their respective proportionate shares of 42 per centum and 10 per centum in the trust fund and no more. I see no principle of justice which would require them to provide an indemnity for more than those percentages of the trustee's liability to creditors.

Accordo is in liquidation and unable to pay any amount of indemnity. Where a trustee accepts a trust for minors or a special trust excluding the right to indemnity, no injustice is regarded as being involved in his having no right of indemnity from the beneficiaries personally. He accepted the trust knowing the position: *Hardoon v Belilios* [1901] AC 118, at p 127. By a parity of reasoning a trustee who accepts a trust knowing that his right to personal indemnity from a sole beneficiary or from one of several beneficiaries is only as good as the ability of the beneficiary to pay it, it is not to be regarded as suffering injustice if the beneficiary is unable to pay.

… The principle which leads to a fair result is that a beneficiary entitled to a separate proportion of the fruits of the trustee's service should pay the same proportion of the price of those services. The proportionate liability of a separate beneficiary should be the same as was his proportionate right to benefit. He should bear the proportion of the trustee's indemnity for liabilities incurred, which corresponds to the proportion of his beneficial interest when the liabilities were incurred. His share of liability is to be limited to that proportion, even though other beneficiaries are not liable to indemnify or are unable through insolvency to meet their liability.

I need to consider, in the light of Lynette Wood's disclaimer, the liability of Graham Wood to indemnify the plaintiff.

If Lynette Wood had not disclaimed, Graham Wood and she would have been jointly liable to indemnify the plaintiff for 24 per centum of its liabilities … In view of her disclaimer he is now treated as having been solely entitled to the 24 per centum interest since the making of the trust deed.

… At the time when the plaintiff incurred the liabilities through conducting the building business, Graham Wood and Lynette Wood were jointly entitled to 24 per centum of the trust fund.

… I consider that it would be unjust and inconsistent with the principle mentioned above, to impose on Graham Wood, as a result of a disclaimer occurring years later, an obligation of indemnity double that which he would have borne if beneficial interests had remained as they were when liabilities were incurred.

Note

The trustee does not seem to be required to exhaust trust assets before seeking indemnification from beneficiaries. However, as the trustee is usually the legal owner of the trust estate, common sense suggests that should be depleted first.

Questions

(1) Had one of the beneficiaries in *Broomhead* been an infant, what would be the effect on the trustee's right to recover from the beneficiaries personally?

(2) Trust creditors can be subrogated to the trustee's right to indemnification from trust property. Should trust creditors also be able to 'stand in the shoes' of the trustee and pursue beneficiaries? Should trust assets have to be depleted first? See textbook at [19.24].

19.4c *Trustee Act 1925* (NSW)

Section 100A Limitation of liability of beneficiaries in respect of trustees

(1) The rule of equity known as the rule in *Hardoon v Belilios* is abolished. …

(2) Accordingly, a beneficiary under a trust (whether created before, on or after the commencement day) is not liable to indemnify the trustee or make any payment to the trustee or any other person for any act, default, obligation or liability of the trustee arising on or after the commencement day unless–

(a) the beneficiary has agreed in writing to be liable, or

(b) subsection (3) applies.

(3) This section does not prevent a trustee of an investment trust from recovering any amount that a beneficiary under the trust is liable to pay for a right, interest or other entitlement to profits, income or other returns generated by the trust.

(4) To avoid any doubt, this section does not affect any liability that a beneficiary under a trust may have in a capacity other than as a beneficiary.

(5) In this section –

commencement day means the day on which this section commenced.

investment trust means any trust (however described) created for the purpose of generating profits, income or other returns for its beneficiaries using funds provided by them, and includes a unit trust scheme within the meaning of the Duties Act 1997.

Note

Abolition of the rule in *Hardoon v Belilios* was discussed in New South Wales Law Reform Commission, *Laws Relating to Beneficiaries of Trusts* (Report No 144, May 2018).

Questions

(1) Consider the reasons for abolition of the rule in *Hardoon v Belilios* canvassed in New South Wales Law Reform Commission, *Laws Relating to Beneficiaries of Trusts* (Report No 144, May 2018) and JC Campbell, 'The Undesirability of the Rule in *Hardoon v Belilios*' (2020) 34(3) *Trust Law International* 131. Which of those reasons do you find convincing?

(2) When will a beneficiary still be liable to a trustee, despite s 100A? See JC Campbell, 'The New Section 100A *Trustee Act 1925* (NSW): When a Beneficiary is Personally Liable to Indemnify a Trustee' (2020) 14(2) *Journal of Equity* 103.

19.5 Right to seek directions from the Court

19.5a *Macedonian Orthodox Community Church St Petka Inc v His Eminence Petar the Diocesan Bishop of the Macedonian Orthodox Diocese of Australia and New Zealand* [2008] HCA 42; (2008) 237 CLR 66

Background

Land was originally held on trust but was transferred to the Community Church Association on its incorporation. In 1997, the Association sacked its priest, Father Mitrev. He and the Bishop then commenced proceedings, in part alleging a breach of trust in relation to the land, and seeking removal of the Association as trustee (referred to in the judgment as 'the main proceedings').

As trustee, the Association applied to the Court for judicial advice as to whether it was justified in defending the main proceedings, and expending trust funds in that defence. Unless the trustee could access the trust property for its legal costs, it had no other means of conducting a defence. Trustees' legal costs are usually an indemnifiable expense, but here there was a risk that the legal costs would deplete the trust fund entirely.

At first instance, Palmer J gave the advice sought; the Association was justified in defending the proceedings against it, and was entitled to have recourse to trust property in that defence. This advice order was set aside by the New South Wales Court of Appeal, holding that it was generally inappropriate for a court to give judicial advice in adversarial proceedings.

Decision

The High Court held that the fact that there were ongoing adversarial proceedings between the parties was no reason why judicial advice should be withheld. The High Court proceeded to explain the principles applicable to giving judicial advice to trustees.

Gummow ACJ, Kirby, Hayne and Heydon JJ

The legislation

The following legislative provisions are relevant to this appeal.

Section 63

Section 63 of the [*Trustee Act 1925* (NSW)] provides:

> **(1)** A trustee may apply to the Court for an opinion advice or direction on any question respecting the management or administration of the trust property, or respecting the interpretation of the trust instrument.

> **(2)** If the trustee acts in accordance with the opinion advice or direction, the trustee shall be deemed, so far as regards the trustee's own responsibility, to have discharged the trustee's duty as trustee in the subject matter of the application, provided that the trustee has not been guilty of any fraud or wilful concealment or misrepresentation in obtaining the opinion advice or direction.
>
> …
>
> **(11)** Subject to subsection (10), and subject to any appeal, any person on whom notice of any application under this section is served, or to whom notice is given in accordance with subsection (8), shall be bound by any opinion advice direction or order given or made under this section as if the opinion advice direction or order had been given or made in proceedings to which the person was a party.

Section 85

Section 63 is significant in relation to s 85(1) and (2) of the Act. They provide:

> **(1)** Where a trustee is or may be personally liable for any breach of trust, the Court may relieve the trustee either wholly or partly from personal liability for the breach.
>
> **(2)** The relief may not be given unless it appears to the Court that the trustee has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the direction of the Court in the matter in which the trustee committed the breach. …

The legislative scheme, then, is that it is desirable that trustees in doubt as to a course of action should not proceed with it and seek relief under s 85 afterwards, but rather seek s 63 advice first. That is because one of the things which a trustee invoking s 85 requires to be excused from is failure to seek s 63 advice. …

General points about s 63

It is proposed to make eight general points about s 63.

Implications not be read in. First, the following much cited statement of this Court in *Owners of 'shin Kobe Maru' v Empire Shipping Co Inc* [1994] HCA 54 is relevant to s 63:

> It is quite inappropriate to read provisions conferring jurisdiction or granting powers to a court by making implications or imposing limitations which are not found in the express words.

No implied limitations on power to give advice. Secondly … There are no express words in s 63, and no implications from the express words which are used in s 63, that automatically preclude the court from giving the advice which the Association sought. There is nothing in s 63 which limits its application to 'non-adversarial' proceedings, or proceedings other than those in which the trustee is being sued for breach of trust, or proceedings other than those in which one remedy sought is the removal of a trustee from office. …

Only one jurisdictional bar to s 63 relief exists: the applicant must point to the existence of a question concerning the management or administration of the trust property or a question respecting the interpretation of the trust instrument. The Court of Appeal did not deny that both kinds of question existed in the present case. Hence, as the Court of Appeal recognised and as the plaintiffs accept, the dispute in this appeal relates only to the question whether Palmer J erred in the exercise of his discretion.

No implied limitations on discretionary factors. Thirdly, there are no express words in s 63, and no implications from the express words which are used in s 63, making some discretionary factors always more significant or controlling than others. In particular, s 63 does not provide that the adversarial nature of the advice of the proceedings about which the advice is sought, the tendency of the advice to foreclose an issue in those proceedings, or the fact that the trustees seeking the advice are being sued for breach of trust are of special significance. Hence the discretion is confined only by the subject-matter, scope and purpose of the legislation. While it was accepted by the Court of Appeal that the court has power under s 63 to give advice even if the proceedings are 'ad-

versarial' in character, their approach was to give that consideration very great significance as pointing to an exercise of the discretion against granting advice.

The Attorney-General submitted that the fact that a court may rely on a written statement of the trustee or use other material 'instead of evidence' by reason of s 63**(3)** undoubtedly gives rise to discretionary considerations of substantial weight where the question for advice is in form or substance an application which will determine or affect questions that could also be resolved in ordinary adversarial litigation. He also submitted that it may be the case that the court would properly decline judicial advice, if, for example, a contested construction suit, constituted by the disputing parties and resolved by a judge acting on evidence, appeared to be more apt to the resolution of a question concerning the interpretation of the trust instrument. He further submitted, however, that the discretion of the court to consider applications brought under s 63 should not be yoked to a general first principle that, where there is a contest, or where there are adversaries, it is not appropriate to give advice. Those submissions are correct …

Summary character of s 63 procedure. A fourth noteworthy aspect of s 63 procedure is what Lord St Leonards described as its 'summary' character. …

On 11 June 1857 … Lord St Leonards said that he proposed:

> to give trustees a summary right of petition, without rendering it necessary to file bills, to obtain the opinion of the Court of Chancery upon any point which might arise in the administration of the trust estate. This would be a great benefit to trustees, and, by substituting a cheap and simple process of determining questions, prevent the necessity of expensive suits. …

Private and personal advice. A fifth matter, closely related to the fourth, is that s 63 operates as 'an exception to the Court's ordinary function of deciding disputes between competing litigants'; it affords a facility for giving 'private advice'. It is private advice because its function is to give personal protection to the trustee.

Section 63(2) precludes any trustee, who acts in accordance with the private advice, from being held liable for breach of trust in the event that in conventional proceedings it is later held that the legal position does not correspond with the advice given, so long as the proviso to s 63(2) is satisfied. …

Role of context in applying s 63. Sixthly, the application of s 63 will tend to vary with the type of trust involved. Where there is a non-charitable private trust involving a conflict between beneficiaries, or between beneficiaries alleging a breach of trust out of which a trustee has profited and that trustee, and where the defendants in the proceedings have a personal capacity to fund the defence, it might not be correct to give the trustee an opinion, advice or direction. The position is not necessarily the same where the trust is for a charitable purpose, where the public interest is involved since ex hypothesi the trust is beneficial to the public; where none of the contestants in the litigation about the trust is suing or defending in order to augment, defend or seek restoration of personal assets, and where a crucial question is the precise terms of the purpose for which the trust exists.

Nor is the position necessarily the same where the charitable trust is for religious purposes: since religious controversies do not commonly come before the courts unless they involve disputes about property rights they will often take the form of an allegation of breach of trust and a claim that the trustee be removed. That circumstance may have less weight against the grant of the opinion, advice or direction than it would in disputes about a private trust.

Relationship of s 63 to rights of indemnity. Seventhly, *Lord St Leonards' Act* was enacted in England at a time when the legal and practical burdens on trustees were increasing and against a background conception which continues to possess vitality. The conception is that the office of trustee is a gratuitous one unless a special arrangement to the contrary is made. Provision was made for procedures of the kind embodied in the two legislative schemes because '[i]t is an inflexible rule of a Court of Equity that a person in a fiduciary position … is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict'. But as Danckwerts J said (*In re Grimthorpe* [1958] Ch 615 at 623):

> persons who take the onerous and sometimes dangerous duty of being trustees are not expected to do any of the work on their own expense; they are entitled to be indemnified against the costs and expenses which they incur in the course of their office; of course, that necessarily means that such costs and expenses are properly incurred … The general rule is quite plain; they are entitled to be paid back all that they have had to pay out.

While trustees acting gratuitously are entitled … to an indemnity out of the trust assets for expenses incurred in administering the trust, it was understandable that the legislature should enact provisions enabling them to take advice before embarking on any course which might carry a risk of incurring costs that might be outside the indemnity.

In particular, trustees who are sued, particularly for breach of trust, may sometimes experience uncertainty about whether they will be able to obtain indemnity as to the costs of their defence … Perhaps they will if their breach is excused under s 85(2); but they cannot be sure, in advance, that the court's discretionary power to excuse the breach will be exercised in their favour, and one of the matters to be excused is their failure to obtain the court's direction under s 63 or otherwise. This points strongly to the conclusion that an application under s 63 by a trustee sued for breach of trust (including a breach of trust alleged to arise in the very defence of the proceedings) is not be to be seen as one which should rarely if ever succeed. Instead it should be seen as a standard instance to which s 63 can in appropriate circumstances apply.

… Obtaining judicial advice resolves doubt about whether it is proper for a trustee to incur the costs and expenses of prosecuting or defending litigation. No less importantly, however, resolving those doubts means that the interests of the trust will be protected; the interests of the trust will not be subordinated to the trustee's fear of personal liability for costs.

The fact that one of the purposes of proceedings for judicial advice is to protect the interests of the trust has particular importance where, as in this case, the trust concerned is a charitable purpose trust. In litigation brought by private persons having a particular view about the terms of the trust, the trustee will ordinarily be joined as a necessary and proper party to the proceedings. Unless some other party will act as contradictor, the burden of defending the suit will fall upon the trustee. If, as will often be the case with a charitable purpose trust, there is no other party that will act as contradictor, the claims made about the terms of the trust will go unanswered unless the trustee can properly resort to the trust funds to meet the costs of defending the litigation. And even if there is another party that will act as contradictor, it is almost always desirable, even necessary, for the trustee to take an active part in the proceedings so that the issues are properly ventilated and argued.

A necessary consequence of the provisions of s 63 of the Act is that a trustee who is sued should take no step in defence of the suit without first obtaining judicial advice about whether it is proper to defend the proceedings. In deciding that question a judge must determine whether, on the material then available, it would be proper for the trustee to defend the proceedings. But deciding whether it would be proper for a trustee to defend proceedings instituted about the trust is radically different from deciding the issues that are to be agitated in the principal proceedings. The two steps are not to be elided. In particular, the judicial advice proceedings are not to be treated as a trial of the issues that are to be agitated in the principal proceedings.

Notes

(1) The plurality discussed the contextual importance of the charitable nature of the trust in question, 'where public interest is involved since ex hypothesi the trust is beneficial to the public'. Nevertheless, their comments concerning advice to the trustee do not appear to be limited to charitable trusts only.

(2) Section 63(10) of the *Trustee Act 1925* (NSW) entitles any beneficiary claiming to be prejudiced by a trustee acting on the judicial advice in distributing trust property to apply to the court for an order or directions. Subject to this provision and to any appeal against the advice, any person to whom notice of the application has been given will be bound by the advice, just as if it had been a judicial decision.

Equivalent provisions in other jurisdictions are less detailed: ACT s 63; Qld s 96; SA s 91; *Supreme Court (General Civil Procedure) Rules 2005* (Vic) r 54.02; WA s 92. The Northern Territory and Tasmania have no equivalent provision but rely on the court's inherent jurisdiction to give directions.

Section 63 and its counterparts do not enact a defence to an action for breach of trust. However, trustees who act on judicial advice will be protected if the advice turns out to be incorrect. There is an important link between s 63 and s 85: the latter section, discussed in chapter 20, excuses trustees for the breach of trust 'and for omitting to obtain the direction of the Court in the matter in which he committed the breach'. A trustee defending a claim for breach of trust must therefore justify not only the breach but also his failure to seek judicial advice before committing the breach.

Questions

(1) Can the trustee seek advice relating to any question concerning the trust? When will it be inappropriate for the trustee to seek the court's advice?

(2) If the trustee's defence of proceedings for breach of trust (particularly in the case of a charitable trust) is as important as the plurality implies, why is it necessary for the trustee to seek directions before taking any step in defence of the suit? Will the trustee's application for directions merely incur unnecessary legal costs in connection with that application? Is this risk overridden by the trustee's right to attempt to protect itself from incurring unrecoverable expenses?

Part G

Breach of trust

20

Breach of trust: defences and remedies

20.1 Introduction

20.2 Who can sue for breach of trust?

20.3 Defences

20.4 The beneficiary's consent to a breach of trust: statute and equity

20.5 Remedying a breach of trust: removing the trustee

20.1 Introduction

The principal responsibility for remedying any breach of trust rests with the trustee who must compensate the trust for any loss caused by the breach or account for any profit arising from the breach. Where loss to the trust estate has been caused by the commission of a tort or breach of contract by a third party, the duty to obtain compensation from the third party also rests on the trustee, and failure to seek compensation may itself constitute a breach of trust on the part of the trustee unless it would be impracticable to litigate. If the trustee fails to pursue the third party, the beneficiary can bring a claim, joining the trustee as co-defendant. The principles are explained in *Young v Murphy* [1969] 1 VR 279 below.

Liability for breach of trust is, in principle, strict, although liability for failure to exercise reasonable care and skill – for example, in making trust investments – requires proof of fault, applying, as the context requires, equitable or statutory standards of care. The rigour of the trustee's strict liability persuaded legislatures, first in England, and later in the Australian States, to introduce exculpatory legislation in the late nineteenth century. Trustee legislation also includes provisions excusing trustees from personal liability in cases where the principal wrongdoer is co-trustee or an agent of the trust and the trustee has not behaved improperly. The scope of these statutory provisions is examined in this chapter.

The remedies for breach of trust are explained in chapters 3 to 5, and the bars to their award are discussed in chapter 6. The discussion of the remedies of equitable compensation and the account of profits in chapter 4 are particularly important in view of recent decisions on both these remedies. In addition to this armoury of equitable relief, a court may exercise its inherent or statutory jurisdiction to remove the trustee from office.

20.2 Who can sue for breach of trust?

20.2a *Young v Murphy* [1996] 1 VR 279

Background

A trustee company of an investment trust, BPTC, was replaced by new trustees. The latter sued the trustee company, which by then was in liquidation, for various breaches of trust. The directors of the trustee company were also sued for knowingly assisting the trustee company to commit the breaches, as well as for breaches of their fiduciary duties and of duties of care and skill that they owed to the trustee company. The directors of the former trustee company challenged the new trustees' standing to sue for breach of trust.

Decision

The Victorian Court of Appeal held that the new trustees had standing to sue the directors of the trustee company for knowingly assisting the trustee company's breaches of trust, since the trustees were under a continuing duty to make good the losses suffered by the trust as a result of the breaches. The new trustees had, however, no standing to sue the former directors for breaches of the fiduciary duties they owed to the trustee company or for the breaches of their duties of care and skill, since these rights of action were not trust property.

Phillips J

I think that probably the appellants [the directors] are correct in suggesting that the basis for this claim is really the second limb of *Barnes v Addy* (1874) LR 9 Ch App 244; it is a claim made by the new trustee against one who is alleged to have knowingly participated in a breach of trust by the former trustee. On that basis, the appellants argue that, although the participant may be liable to the beneficiaries, and may be jointly liable with the defaulting trustee, he is not liable to the defaulting trustee, who, by virtue of his own wrongdoing, is precluded from suing. The only authorities cited for this proposition were *US Surgical Corporation v Hospital Products International* [1982] 2 NSWLR 766 at 817 and *Catt v Marac Australia Ltd* (1986) 9 NSWLR 639 at 660–661. In my view, neither of these is sufficient to sustain the proposition of law which otherwise has been consistently rejected … A defaulting trustee remains obliged, notwithstanding his own wrongdoing, to make good the trust property and, if necessary, to institute proceedings against those who participated in the wrongdoing to make good the loss. Whatever the consequences might be in respect of his own liabilities, the trustee does not cease to be so obliged; certainly he does not become disqualified from proceeding …

… The business activity of BPTC as trustee of these trusts was itself the framework within which the directors came to perform the duties which they owed to the company by virtue of their office as director; but the duties which were owed are nonetheless general duties and are not owed to the company in some specific role or character – or at least they are not owed to the company in some specific role or character when the duties are alleged to have arisen only in virtue of the office which is held. In this, such duties may be contrasted with some specific contractual obligation undertaken by a third party to the company and undertaken to the company when acting in some particular capacity. Thus a valuer may contract with an individual who is in fact acting as executor of an estate; or he may contract with a company which is in fact acting as trustee of a trading trust. In such cases, the benefit of the contractual obligation may well be held by the executor or by the trustee for and on behalf of the deceased estate or the trust, as the case may be; but no sufficient basis is made here for any such conclusion in relation to the directors' duties which arose simply in virtue of the office.

It follows that if there be a breach by the directors of the duties which they did owe to the company, being the former trustee BPTC, and if the company was thereby damnified, BPTC might have a right of action against the directors for breach of their duties. In so far as those duties were founded in the common law, there might be a right of damages and, if they be fiduciary duties, there might be a right to equitable compensation. Either way, it is the company in which the right of action is vested. The plaintiffs now claim to have succeeded to that right of action by virtue of their appointment as new trustees, but by what right can that be so? The right of action held by the former trustee cannot be shown to have been trust property; there is no basis upon which to conclude that it was. Unlike the valuer whom I have used for illustration, the directors cannot be said on the pleading in this case to have owed their duties to the company only in relation to some particular trust or trusts; nor were those duties imposed upon them in relation to some particular item or items of trust property as such. Rather the existence of both the trusts and the trust property was but the context in which the duties fell to be discharged by those who owed duties to the company generally as its officers. There is no basis, then, for supposing that the right of action was trust property in the hands of BPTC or for supposing that the right of action passed to the new trustees, upon their appointment as such.

On that basis, it follows that any right of action against the former directors for breaches of duties said to have been owed to BPTC remains with that company. That company is now in liquidation and so it is a matter for the liquidator whether to pursue the directors for those alleged breaches of duty. Whether he could be persuaded to bring such proceedings (perhaps, if indemnified as

to costs) is a matter which does not fall for decision. But the benefit of such proceedings would belong to the creditors generally, in the liquidation, consistently with my view that the directors owed their duties to BPTC and not to BPTC in a particular capacity.

Notes

(1) For an analysis of *Young v Murphy,* see *Agricultural Land Management Ltd v Jackson (No 2)* (2014) 48 WAR 1, [319]–[331].

(2) A beneficiary can sue for breach of trust in its own name, joining the trustee as co-defendant, if the trustee refuses to sue in its own name to recover misappropriated assets or to obtain compensation for loss to the trust caused by a third party. The joinder of the trustee as co-defendant is known as the 'Vandepitte procedure', after the leading case *Vandepitte v Preferred Accident Insurance Corporation of New York* [1933] AC 70.

(3) Legislation in Queensland and Western Australia confers standing on 'any person who has, directly or indirectly, an interest, whether vested or contingent, in any trust property or who has a right of due administration in respect of any trust' to seek review of 'any act, omission or decision of a trustee or other person in the exercise of any power': *Trusts Act 1973* (Qld) s 8(1); *Trustees Act 1962* (WA) s 94. The provision is construed broadly in determining standing to apply for review of an act, omission, or decision of a trustee: *Re Whitehouse* [1982] Qd R 196, 203–4 (Macrossan J). The section does not, however, entitle a court to substitute the exercise of a judge's discretion for that of a trustee: *Tierney v King* [1983] Qd R 580, 583.

Questions

(1) Xenia holds a McCubbin painting on trust for Yvonne. Zamit damages the painting when it is in transit to a special exhibition. Does Xenia or Yvonne have title to sue Zamit in tort for the damage? Or do both have title to sue?

(2) Xenia holds $10,000 on trust for Yvonne. The $10,000 is misappropriated by Zamit. Who has title to sue Zamit?

(3) Xenia holds Rosewood Cottage on trust for Yvonne. Xenia contracts with Zamit to have the property redecorated. Zamit is negligent and Xenia has to pay someone else to have the redecoration done properly. Who can sue Zamit for breach of contract? Suppose Zamit has not been paid for his work. How can Zamit recover payment?

(4) As a result of negligence committed by directors of a trustee company, a considerable amount of trust money is lost. The trust company is replaced by new trustees. Advise the new trustees whether the directors of the trust company can be sued for: (a) breach of trust; (b) knowingly assisting the trustee company to commit a breach of trust; or (c) failure to exercise care and skill in the management of the trustee company. Who will sue for these breaches?

(5) Can a trustee sue a third party for having knowingly assisted the trustee to commit a dishonest breach of trust? Is the trustee relying on his or her own fraud in these circumstances? See *Nicholson Street Pty Ltd v Letten and Lane* [2016] VSCA 157, [75]–[85].

20.3 Defences

Liability for breach of trust is strict. But a trust instrument may contain an exculpation clause excluding or limiting the liability of the trustees for breach of trust. Many exculpation clauses are drafted in broad terms, excluding the trustee's liability to compensate for any loss except loss caused by fraud. An important policy question is whether the power to exclude liability should be restricted either in equity or by amendment of State trustee legislation.

The trustee legislation of all States and Territories contains provisions empowering a court to excuse a breach of trust. The legislation is derived from s 3 of the *Judicial Trustees Act 1896* (UK). Trustees who have committed an honest breach of trust and who satisfy other conditions may be excused from personal liability. In applying the section, the court balances the interests of a trustee who has committed a

breach through no genuine fault of his own against the interests of the beneficiaries who have suffered financial loss as a result of the breach.

20.3.1 Exculpation clauses

20.3.1a *Armitage v Nurse* [1998] Ch 241

Background

Paula Armitage, a beneficiary of a trust, alleged that the trustees had committed a number of breaches of trust. Clause 15 of the trust instrument provided: 'No trustee shall be liable for any loss or damage which may happen to Paula's fund or any part thereof or the income thereof at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud'. One of the trustees' defences to the claim was that clause 15 excluded liability for breach.

Decision

The Court of Appeal held that clause 15 excused the trustees from liability for breach of trust except in cases of dishonesty. Paula had not alleged dishonesty but would be allowed to examine the trust documents and investigate the trust administration to see if a claim based on dishonesty could be made out.

Millett LJ

In my judgment, the meaning of the clause is plain and unambiguous. No trustee can be made liable for loss or damage to the capital or income of the trust property caused otherwise than by his own actual fraud. 'Actual fraud' means what it says. It does not mean 'constructive fraud' or 'equitable fraud'. The word 'actual' is deliberately chosen to exclude them.

Counsel for Paula submits that in a settlement the context requires the word 'fraud' to be given the extended meaning which the courts of equity came to give it. The distinction between fraud properly so-called and other cases to which the Court of Chancery, in his own words, 'undoubtedly did apply the term "fraud", although I think unfortunately' is expounded in the speech of Viscount Haldane LC in *Nocton v Lord Ashburton* [1914] AC 932, 953. As he explained: 'In Chancery the term "fraud" thus came to be used to describe what fell short of deceit, but imported breach of a duty to which equity had attached its sanction.' It is worthy of note that he himself used the expression 'actual fraud' throughout his speech to distinguish cases of common law fraud or deceit from these other cases. Lord Dunedin did the same when he said, at p 963: 'if based on fraud, then, in accordance with the decision in *Derry v Peek* (1889) 14 App Cas 337, the fraud proved must be actual fraud, a mens rea, an intention to deceive'. *Derry v Peek* established that nothing short of a fraudulent intention in the strict sense will suffice for a case of deceit or fraud properly so-called. It requires proof of dishonesty. Nothing less will do. Gross and culpable negligence is not enough. This was confirmed in *Nocton v Lord Ashburton,* which also established that dishonesty is not a necessary factor in cases of so-called equitable fraud.

In my judgment, therefore, clause 15 is apt to exclude liability for breach of trust in the absence of a dishonest intention on the part of the trustee whose conduct is impugned. I would have added nothing further but for the confusion which appears to have been engendered in the attempt to apply the concept of actual fraud to an allegation of breach of trust. The common law knows no generalised tort of fraud. *Derry v Peek* was an action for damages for deceit, that is to say, for fraudulent misrepresentation. In such a case fraud must be proved by showing that the false representation was made knowingly, that is to say, without an honest belief in its truth, or recklessly, that is to say, not caring whether it was true or false. Care needs to be taken when these concepts are applied not to a representation but to a breach of trust. Breaches of trust are of many different kinds. A breach of trust may be deliberate or inadvertent; it may consist of an actual misappropriation or misapplication of the trust property or merely of an investment or other dealing which is outside the trustees' powers; it may consist of a failure to carry out a positive obligation of the trustees or merely of a want of skill and care on their part in the management of the trust property; it may be injurious to the interests of the beneficiaries or be actually to their benefit. By consciously acting beyond their powers (as, for example, by making an investment which they know to be unauthorised) the trustees may deliberately commit a breach of trust; but if they do so in good faith and in the honest belief that they are acting in the interest of the beneficiaries their conduct is not fraudulent. So a deliberate breach of trust is not neces-

sarily fraudulent. Hence the remark famously attributed to Selwyn LJ by Sir Nathaniel Lindley MR in the course of argument in *Perrins v Bellamy* [1899] 1 Ch 797, 798: 'My old master, the late Selwyn LJ, used to say, "The main duty of a trustee is to commit judicious breaches of trust".' The expression 'actual fraud' in clause 15 is not used to describe the common law tort of deceit. As the judge appreciated it simply means dishonesty. I accept the formulation put forward by Mr Hill on behalf of the respondents which (as I have slightly modified it) is that it:

> connotes at the minimum an intention on the part of the trustee to pursue a particular course of action, either knowing that it is contrary to the interests of the beneficiaries or being recklessly indifferent whether it is contrary to their interests or not.

It is the duty of a trustee to manage the trust property and deal with it in the interests of the beneficiaries. If he acts in a way which he does not honestly believe is in their interests then he is acting dishonestly. It does not matter whether he stands or thinks he stands to gain personally from his actions. A trustee who acts with the intention of benefiting persons who are not the objects of the trust is not the less dishonest because he does not intend to benefit himself. In my judgment clause 15 exempts the trustee from liability for loss or damage to the trust property no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as he has not acted dishonestly …

… I accept the submission made on behalf of Paula that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient. As Mr Hill pertinently pointed out in his able argument, a trustee who relied on the presence of a trustee exemption clause to justify what he proposed to do would thereby lose its protection: he would be acting recklessly in the proper sense of the term.

It is, of course, far too late to suggest that the exclusion in a contract of liability for ordinary negligence or want of care is contrary to public policy. What is true of a contract must be equally true of a settlement. It would be very surprising if our law drew the line between liability for ordinary negligence and liability for gross negligence. In this respect English law differs from civil law systems, for it has always drawn a sharp distinction between negligence, however gross, on the one hand and fraud, bad faith and wilful misconduct on the other. The doctrine of the common law is that: 'Gross negligence may be evidence of mala fides, but is not the same thing': see *Goodman* v *Harvey* (1836) 4 A & E 870, 876, per Lord Denman CJ. But while we regard the difference between fraud on the one hand and mere negligence, however gross, on the other as a difference in kind, we regard the difference between negligence and gross negligence as merely one of degree …

… At the same time, it must be acknowledged that the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence … If clauses such as clause 15 of the settlement are to be denied effect, then in my opinion this should be done by Parliament.

Notes

(1) See *Green v Wilden Pty Ltd* [2005] WASC 83, [482]–[502] (reversed on the application of the clause to the facts: *Wilden Pty Ltd v Green* (2009) 38 WAR 429); *Crossman v Sheahan* (2016) ACSR 130, [304]–[310]; *Australian Securities and Investments Commission v Drake (No 2)* (2016) 340 ALR 75, [281]–[285] for discussions of the application of *Armitage v Nurse* to trust instruments in Australia.

(2) *Armitage v Nurse* was also considered by the Privy Council in *Spread Trustee Co Ltd v Hutcheson* [2012] 2 AC 194 where Lady Hale, dissenting, wished to keep open the question whether it had been rightly decided.

(3) Legislation prohibits the modification or exclusion of some statutory obligations imposed on trustees. See, for example, s 52 of the *Superannuation Industry (Supervision) Act 1993* (Cth) which imposes 'non-excludable' covenants on the trustee of a superannuation trust.

Questions

(1) What obligations of a trustee comprise the 'irreducible core' of obligations which, in the opinion of Millett LJ, cannot be excluded by an exculpation clause? Do they include a trustee's duty of good faith? Or the 'no conflict' and 'no profit' fiduciary obligations?

(2) What is meant by 'actual fraud'? How does 'actual fraud' differ from 'constructive fraud' or 'equitable fraud'?

(3) Do you think courts should apply an equitable discretion to modify or invalidate exculpation clauses which exclude a trustee's liability for negligence? Should a court of equity allow a trustee to escape liability for gross negligence by relying on an exculpation clause?

20.3.2 Statutory exculpation

20.3.2a *Trustee Act 1925* (NSW)

Section 85: Excusable breaches of trust

(1) Where a trustee is or may be personally liable for any breach of trust, the Court may relieve the trustee either wholly or partly from personal liability for the breach.

(2) The relief may not be given unless it appears to the Court that the trustee has acted honestly and reasonably and ought fairly to be excused for the breach of trust and for omitting to obtain the direction of the Court in the matter in which the trustee committed the breach.

...

Note

Equivalent provisions in the trustee legislation of other jurisdictions are: ACT s 85; NT s 49A; Qld s 76; SA s 56; Tas s 50; Vic s 67; WA s 75.

Background

A husband was entitled to the whole of his wife's interest under a family trust upon her death. He mortgaged the interest to the respondent finance company as security for repayment of a loan. The appellant company was appointed trustee of the family trust. Acting on incorrect advice given by its solicitors, the appellant paid two-thirds of the wife's interest to her children and one-third into court. The respondent sued the appellant trustee company for breach of trust in paying the two-thirds interest to the children. The trial judge and the Full Court of the Supreme Court of Victoria found that the trustee company had committed a breach of trust but had acted honestly and reasonably in paying the children.

Decision

The Privy Council held that, even though the trustee company had acted honestly and reasonably, it was not fair to excuse the company from personal liability for breach of trust. Application of the statutory excusing power would result in the respondent, as mortgagee of the equitable interest, losing part of its security through no fault of its own.

Privy Council opinion

The Courts in the Colony have found that the appellants acted honestly and reasonably, and their Lordships are prepared to deal with the case upon that footing. [Counsel for the appellants] contended that these two things being established, the right to relief followed as a matter of course; but that is clearly not the construction of the Act. Unless both are proved the Court cannot help the trustees; but if both are made out, there is then a case for the Court to consider whether the trustee ought fairly to be excused for the breach, looking at all the circumstances. It is a very material circumstance that the appellants are a limited joint stock company, formed for the purpose of earning profits for their shareholders; part of their business is to act as trustees and executors; and they are paid for their services in so acting by a commission which the law of the Colony authorizes them to retain out of trust funds administered by them, in addition to their costs. What they now ask the Court to do is to allow them to retain a sum of money to which the respondents' title is clear, in order thereby to relieve the trust company from a loss they have incurred in the course of their business by reason of having paid a like sum to wrong parties. The position of a joint stock company which undertakes to perform for reward services it can only perform through its agents, and which has been misled by those agents to misapply a fund under its charge, is widely different from that of a private person acting as gratuitous trustee. And without saying that the remedial provisions of the section should never be applied to a trustee in the position of the appellants, their Lordships think it is a circumstance to be taken into account, and they do not find here any fair excuse for the breach of trust, or any reason why the respondents, who have committed no fault, should lose their money to relieve the appellants, who have done a wrong and denied the respondent's title.

And that is not quite all. If trustees do unfortunately lose part of a trust fund by a breach of trust, the least that can be expected of them is that they should use their best endeavours to recover the fund, or so much thereof as is practicable, for their cestui que trusts. In the present case there seems to be some ground for thinking that other proceedings were open to the trust company by which any loss to them might have been averted, at any rate to some extent; but it does not appear that the trust company have taken any such steps, or made any attempt whatever to replace the fund or relieve the respondents from loss; nor have they condescended to give the Court any explanation or reason why they have abstained from doing so. It may be that the solicitors would be willing or might be compelled to make good the loss, if the trust company should find they cannot obtain relief elsewhere.

Notes

(1) The emphasis placed by the Privy Council on the trustee company's professional status is comparable to the differential standards of care imposed on professional and unpaid trustees in determining whether the trustee has invested prudently in equity and under the investment provisions of trustee legislation, such as s 14A of the *Trustee Act 1925* (NSW): see chapter 18.

(2) There is an important connection between relieving a trustee from personal liability under s 85 and the trustee's power to obtain judicial advice discussed at [195]. The power to relieve a trustee under s 85 is given for *both* breach of trust *and* omitting to obtain the directions of the Court in the matter resulting in the breach of trust. A relevant consideration will therefore be whether the trustee should have obtained judicial advice before engaging in the conduct constituting a breach of trust.

Questions

(1) Why did the Privy Council hold that it was not fair to excuse the trustee from having to pay compensation for its breach of trust?

(2) How relevant are the following factors to establishing fairness: (a) the trustee is a corporation; (b) the trustee is paid; (c) the trustee relied on legal advice before making a payment held to be in breach of trust? On the application of the provision to individual trustees of a charitable trust acting gratuitously, see *Re Umpherston (deceased)* (1990) 53 SASR 293.

(3) 'It is futile for courts to hold professional trustees to higher standards of care since the courts also permit the same professional trustees to rely on broadly drafted exculpation clauses to escape liability for breach'. Do you agree?

20.3.2c *Trustee Act 1925* (NSW)

Section 59: Implied indemnity

> **(1)** A trustee shall be chargeable only for money and securities actually received by the trustee, notwithstanding the trustee's signing any receipt for the sake of conformity.
>
> **(2)** A trustee shall be answerable and accountable only for the trustee's own acts, receipts, neglect or defaults, and not for those of any other trustee, nor those of any bank, broker or other person with whom any trust money or securities may be deposited, nor for the insufficiency or deficiency of any securities, nor for any other loss, unless the same happens through the trustee's own wilful neglect or default.
>
> ...

Note

The equivalent provisions in the trustee legislation of other States and Territories are: ACT s 59; NT s 26; Qld s 71 (which does not require the default to be wilful); SA s 35; Tas s 27; Vic s 36(1); WA s 36. Section 35 of the *Trustee Act 1936* (SA) makes no explicit reference to a trustee's liability for the acts of agents, and s 35(1a)(b) provides that a trustee is not liable for any loss of trust property unless 'the loss occurred as a result of circumstances that the trustee could reasonably be expected to have foreseen and to have avoided'.

Background

Blackmore, a solicitor, and Melville were executors and trustees under a will. They decided to sell some of the trust's shares to finance the payment of legacies. Melville signed transfers of shares in blank and gave them to Blackmore to arrange the sale. Blackmore sold the shares, misappropriated the proceeds, and absconded. The beneficiaries sued Melville for breach of trust.

Decision

It was held that Melville was liable to compensate the trust for the value of the shares. He had acted in 'wilful default' and was therefore not entitled to the indemnity provided by s 59. Moreover, he was not entitled to be excused from compensating the trust under s 85.

Long Innes J

Mr Melville certainly did not suspect that his co-trustee, who was a solicitor of this Court, was a thief, or would yield to temptation and become a thief, but that does not conclude the matter. He admits that he knew that it was his duty to protect the estate and safeguard the interests of the beneficiaries. Whatever his previous experience may have been, I see no reason to doubt that he had the ordinary knowledge of an ordinary citizen. He knew that it was his duty … to protect the estate and the interests of the beneficiaries, and he did not protect that estate or those interests. In omitting to take the precautions or to do the acts which he must have known were available, he was grossly negligent. I am of opinion that he must have known that he was negligent; if so, he must have known that, in omitting to take the precautions which he ought to have taken, he was committing a breach of his duty, and whether he was recklessly careless or not is immaterial. He was, I think, prepared to take the risk, and to allow the estate to take the risk …

Reliance has been placed on the decision of Maugham J in *In re Vickery; Vickery v Stephens* ([1931] 1 Ch 572). That decision, in the result, was, however, only a decision on the facts. The trustee in that case was described as a person who had spent his life as a missionary in the City of London and was completely ignorant of business affairs. It is obvious, I think, that he was a simple-minded person with less than the average knowledge of business and of what a prudent business person should do and should insist upon; while in the present case I have no reason whatever to suspect Mr Melville of being a person of less than average ability. His business experience may not have been very great, but from what I have seen of him and have heard of his career I should certainly regard him as being at least up to the ordinary standard. He was perfectly competent, in my opinion, to know, and I am confident he did know, what precautions might have been taken by an ordinary prudent man, and what precautions should have been taken by him in the present case.

I hold that Mr Melville has been guilty of wilful neglect and default within the meaning of s 59(2) of the *Trustee Act 1925,* and that he is not safeguarded from responsibility for his breach of trust by the provisions of that sub-section.

I am equally satisfied that he is not entitled to the protection of s 85(2). It is conceded that he acted honestly throughout but in order to get relief under that sub-section it is also necessary that he should have acted reasonably. In my view he did not act reasonably. With his knowledge and experience he ought at least to have taken certain precautions which … would have suggested themselves to a most simple-minded person of any business experience at all. If he had been entirely ignorant on the matter, and not willing to take the risk, he should at least have asked the advice of competent people. Had he asked for advice on a question of law from a competent legal adviser and had acted pursuant to that advice, that might have entitled him to the protection of this particular sub-section.

Note

Dalrymple v Melville concerned the liability of a trustee who had facilitated a breach committed by a co-trustee. The decision confirms that failing to supervise the activities of a co-trustee or agent is just as much a breach of trust as active malfeasance: *Bahin v Hughes* (1886) 31 Ch D 390. A trustee in breach who is ordered to compensate the trust can obtain a contribution from a co-trustee who is solvent and within the jurisdiction of the court, subject to two exceptions: (1) a trustee–beneficiary who concurs in a breach of trust is not

entitled to a contribution from a co-trustee unless the loss exceeds the value of the trustee–beneficiary's interest (*Chillingworth v Chambers* [1896] 1 Ch 685); (2) there is no right of contribution between trustees, all of whom have participated in a fraudulent breach of trust. In addition, a solicitor–trustee must indemnify a co-trustee for loss caused by a breach of trust unless the co-trustee's participation in the breach did not involve any reliance on the solicitor's professional knowledge and skill: *Head v Gould* [1898] 2 Ch 250.

In Victoria, amendments to the *Wrongs Act* enable contribution to be ordered in cases of breach of trust where it is 'just and equitable having regard to the extent of that person's responsibility for the damage': *Wrongs Act 1958* (Vic) s 24. See *Alexander v Perpetual Trustees WA Ltd f* (2004) 216 CLR 109.

Questions

(1) What does 'wilful' mean for the purposes of s 59? Is the test for establishing wilfulness objective or subjective? Would the section be easier to apply if the word 'wilful' were to be omitted (as in Queensland and South Australia)?

(2) Why was the trustee in *Dalrymple v Melville* not excused from liability? Was it because he had not acted honestly, or not acted reasonably, or because it was not fair to excuse him from liability?

20.4 The beneficiary's consent to a breach of trust: statute and equity

This section should be studied in conjunction with chapter 6 (Bars to relief).

A beneficiary's consent to a breach of trust is a defence to an action for breach. Trustee legislation in all jurisdictions provides that where a trustee has committed a breach of trust at the instigation or request or with the written consent of the beneficiary, the court may, if it thinks fit, make such order as the court deems just for impounding all or any part of the interest of the beneficiary in the trust estate: ACT s 86(1); NSW s 86(1); NT s 50; Qld s 77; SA s 57; Tas s 53; Vic s 68; WA s 76.

In equity, which will be relevant if the beneficiary's consent to the trustee's breach was not given in writing, the consent will not result in the impounding of her interest to compensate for the breach of trust unless the beneficiary is also a co-trustee (*Chillingworth v Chambers* [1896] 1 Ch 685, above), but consent is a discretionary ground for refusing relief.

20.4a *Spellson v George* (1992) 26 NSWLR 666

Background

A beneficiary of a family trust, who was also a solicitor, was asked by his strong-willed and overbearing father-in-law, who controlled the trust, to consent to a rearrangement which involved terminating the existing trusts and transferring their assets to a new trust. The transfer of assets was a breach of trust. The father-in-law sent the beneficiary a memorandum outlining the proposed changes. The beneficiary made comments on the changes but did not oppose them. Previous plans had not been implemented, and the beneficiary was unsure whether this plan would proceed. After the rearrangement was carried out, the beneficiary claimed that the transfer had reduced the value of the trust assets. The trustees applied to have the claim struck out on the ground that the beneficiary had consented to the breach.

Decision

The New South Wales Court of Appeal refused to strike out the claim as there was evidence that the beneficiary had not given informed consent.

Handley JA

It is established by long standing authority that the consent of a beneficiary to conduct by trustees which would otherwise be a breach of trust may be a defence to any action by that beneficiary for that breach. However, as the other judgments demonstrate, the same authorities establish that consent is only a prima facie defence and that the Court must consider in detail 'all the circumstances' in order to determine whether it would be 'fair and equitable' for that beneficiary to be permitted to complain of that breach …

The reported cases in which the defence has been considered contain surprisingly little analysis of the defence or the manner in which it operates.

In the present case the defence, if successful, would operate to extinguish or release the appellant's interest in the trust possibly without consideration or perhaps in exchange for a similar interest in the Sir Arthur George Family Trust.

The defence upheld by Bryson J was that of consent, strictly so-called, not estoppel or acquiescence. In principle consent must be a good defence to proceedings in a court of conscience for breach of trust. There is no reason for a Court of Equity to enforce an equitable obligation in favour of a party who consented to its breach against a party who acted with knowledge of that consent.

Consent may take various forms. These include active encouragement or inducement, participation with or without direct financial benefit, and express consent. Consent may also be inferred from silence and lack of activity with knowledge. However consent means something more than a state of mind. The trustee must know of the consent prior to the breach.

In the present case the consent relied upon seems essentially to have arisen from silence and inactivity after the appellant had obtained knowledge of the material facts. Reliance was also placed on certain conduct by the appellant as involving participation by him in the breaches.

There is authority for the proposition that consent to a breach of trust operates as an estoppel. …

If this defence does operate by way of estoppel it would require proof of inducement and reliance thereon by the trustee. There was no evidence to this effect from the present defendants and on an application such as this it would be quite wrong to fill any gaps in the defendants' case by inference.

A beneficiary cannot be held to have consented to a breach of trust unless he or she had full knowledge of all the material facts: see in *Re Pauling's Settlement Trusts; Younghusband v Coutts & Co* [1962] 1 WLR 86 at 106–108; [1961] 3 All ER 713 at 728–730, *Life Association of Scotland v Siddal* (1861) 3 De G F & J 58 at 74; 45 ER 800 at 806; *Farrant v Blanchford* (1863) 1 De G J & S 107 at 119; 46 ER 42 at 46–47.

Because the appellant was a solicitor there is no need in this case to consider any requirement that may exist, in some cases, for the consenting beneficiary to have some knowledge of his or her rights …

Young A-JA

Underhill's Law relating to Trusts and Trustees, 13th ed (1979), at 738, says that the rule, to which there are several provisos, is that: 'A beneficiary who has assented to, or concurred in, a breach of trust, or who has subsequently released or confirmed it, or even acquiesced in it, cannot afterwards charge the trustees with it'. It is obvious from this passage and from the authorities cited in the footnotes that this defence covers a number of distinct, but superficially similar, situations.

First, the matter which disqualifies the beneficiary from bringing an action may be something that the beneficiary has done before or *eo instanti* with the breach. Alternatively, after the breach the beneficiary may have done something which operates as a release in equity of his or her right to complain. Looking at it another way, there may be at least six different categories where concurrence by a beneficiary might deprive that beneficiary of rights. These could be shortly listed as (1) acquiescence, (2) connivance, (3) election, (4) estoppel, (5) waiver, and (6) consent. Although there may be some overlapping and some authorities may use words in slightly different senses, essentially these are different categories … [I]t is clear that in the instant case the Court is not concerned with acquiescence strictly so-called, or estoppel, but with consent of a kind that disqualifies a person who participates or concurs in a breach of trust from thereafter obtaining equitable relief in respect of that breach.

It seems abundantly clear that a person who has induced or encouraged the breach of trust or has received a pecuniary benefit from it cannot obtain relief in respect of that breach. As Lord Cranworth, LC said in *Lockhart v Reilly* (1856) 25 LJ Ch 697 at 701, 'It is a proposition revolting to one's common understanding that a person should desire his trustee to do a particular act, he being sui juris, and under no influence, and then afterwards file a bill against him for having done that which he desired him to do'. However, a beneficiary may be disentitled to relief on this ground where he or she received property as a result of a breach instigated by someone else: see, e.g., *Stafford v Stafford* (1857) 1 De G & J 193 at 199–201; 44 ER 697 at 700. The degree of participation in the breach

and the matters which may constitute such participation will need to be considered in more detail later in these reasons. It is, however, clear that mere knowledge of a pending breach of trust and a failure to protest will not in itself amount to an operative consent to or participation in that breach … at least until a time when the beneficiary is called upon to make some election. Thus if a breach of trust becomes apparent at a company meeting and a beneficiary was present and did not protest, one might conclude that the beneficiary at that stage had acquiesced. Likewise if there was such a meeting before the breach of trust occurred at which the trustee indicated what was about to occur, there may be participation in the breach. That question, however, does not arise in the instant appeal and should be put aside for another day.

Notes

(1) In *Byrnes v Kendle* (2011) 243 CLR 253, [25] (see [14.2a]), the observation (with which Hope AJA agreed) of Handley JA that consent was a discretionary defence was referred to without disapproval. It was held that unwillingness to insist that the trustee enforce debts due to the trust did not amount to consent by the beneficiary to the trustee's inaction.

(2) Consent is distinguishable from acquiescence as discussed at [6.3].

Questions

(1) Should consent be classified as a defence to an action of breach of trust, or as a discretionary bar to relief? Compare the bars discussed in chapter 6.

(2) How does the equitable defence (or bar) of consent differ from the statutory defence of consent set out above?

(3) Is consent simply an application of estoppel principles?

20.5 Remedying a breach of trust: removing the trustee

The principles governing the award of equitable remedies examined in chapters 2–5 apply to a breach of an express trust. See also [20.30]–[20.46] of the textbook. If a monetary award is made for breach of trust, the sum assessed will be paid to the trustees to be held on the terms of the trust. It is not paid to the beneficiary unless the trust has been terminated and the beneficiary is absolutely entitled to that sum.

An important question arising upon proof of a breach of trust, or if it is otherwise shown that a trustee is not fit to continue, is whether the trustee should be removed from office and replaced. The trust instrument may provide for the removal of a trustee. Alternatively, equitable and statutory jurisdictions to replace trustees may be invoked. Statutory provisions empower the court to appoint new trustees in certain circumstances: ACT s 70; NSW s 70; NT s 27; Qld s 80; SA s 36; Tas s 32; Vic s 48; WA s 77, empowering the court to remove a trustee on the grounds (among others) that the trustee 'refuses or is unfit to act' or 'is incapable of acting'. The circumstances in which a trustee can be removed are not confined to a breach of trust; they also include bankruptcy and conviction for a serious offence. Moreover, a trustee who commits a breach of trust will not necessarily be removed; the gravity of the breach will be a relevant consideration.

The equitable jurisdiction to remove a trustee was applied by the High Court in *Miller v Cameron.*

Background

A trustee of a family trust, who was also a solicitor, had incurred considerable debts in running a dairy farm. He had to be rescued by his co-partner in legal practice, who was also a co-trustee. The trustee entered into a scheme of arrangement whereby his property was administered for the benefit of his creditors. Although no complaint had been made against the trustee's administration of the family trust, the settlor and the beneficiaries applied to have him removed from office.

Decision

The High Court held that the trustee's indebtedness justified his removal from office.

Latham CJ

It has long been settled that, in determining whether or not it is proper to remove a trustee, the Court will regard the welfare of the beneficiaries as the dominant consideration (*Letterstedt v Broers* (1884) 9 App Cas 371 at 387). Perhaps the principal element in the welfare of the beneficiaries is to be found in the safety of the trust estate. Accordingly, even though he has been guilty of no misconduct, if a trustee is in a position so impecunious that he would be subject to a particularly strong temptation to misapply the trust funds, the Court may properly remove him from his office as trustee. No distinction in this connection can be drawn between a bankruptcy and an assignment for the benefit of creditors. A trustee who becomes bankrupt is removed almost as of course (*Bainbrigge v Blair* (1839) 48 ER 1032). There may be exceptions under special circumstances to this rule, but the rule is generally applied (*In re Barker's Trusts* (1875) 1 Ch D 43). If the bankruptcy is explained by financial misfortune without moral fault and the trustee has recovered from pecuniary distress he may be allowed to retain his office (*In re Adams' Trust* (1879) 12 Ch D 634).

Dixon J

The jurisdiction to remove a trustee is exercised with a view to the interests of the beneficiaries, to the security of the trust property and to an efficient and satisfactory execution of the trusts and a faithful and sound exercise of the powers conferred upon the trustee. In deciding to remove a trustee the Court forms a judgment based upon considerations, possibly large in number and varied in character, which combine to show that the welfare of the beneficiaries is opposed to his continued occupation of the office. Such a judgment must be largely discretionary. A trustee is not to be removed unless circumstances exist which afford ground upon which the jurisdiction may be exercised. But in a case where enough appears to authorize the Court to act, the delicate question whether it should act and proceed to remove the trustee is one upon which the decision of a primary Judge is entitled to especial weight.

Notes

(1) Recent applications of *Miller v Cameron* include *Waterhouse v Waterhouse* (1998) 46 NSWLR 449; *Mansour v Mansour* (2009) 24 VR 498; *Blenkinsop v Blenkinsop Nominees Pty Ltd* [2015] WASC 463; and *Piper v Fraser* [2020] SASC 239, [144]–[152]. Section 120 of the *Superannuation Industry (Supervision) Act 1993* (Cth) provides that an insolvent under administration is disqualified from being a trustee of a superannuation trust.

(2) If a trustee is removed, a distinct question will be the suitability of a replacement trustee. In *Hancock v Rinehart* (2015) 106 ACSR 207, where the trustee had resigned from her trusteeship, Brereton J considered at [120]–[124] the criteria for the appointment of a replacement trustee. A relevant consideration was stated, at [124], to be 'whether the appointment would promote or impede the execution of the trust'. In preferring the daughter of the original trustee to trustee companies as the replacement for the original trustee, Brereton J had regard to the likely independence of the proposed replacement trustee, particularly from the original trustee, the costs that the companies would charge in administering the trust, their willingness to accept appointment and the wishes of the beneficiaries.

Question

Angelo, Bella and Cesar are the trustees of the Familia family trust. The trust was constituted by their parents as a discretionary trust for the benefit of such the trustees' children and grandchildren as the trustees, in their absolute discretion, consider appropriate. In the five years since the trust was constituted, no payments have been made to, or for the benefit of, any child or grandchild of Angelo, Bella and Cesar even though all three have children, and Angelo has two grandchildren. The following events have occurred:

(a) Angelo, a property developer, on two occasions withdrew $100,000 from the trust fund to pay business creditors. On each occasion, he repaid the trust from the proceeds of a successful property sale;

(b) Bella has been convicted of assaulting a police officer who was attempting to arrest her at a demonstration;

(c) Cesar has fallen out with Angelo and Bella, and has refused to participate in the management of the trust.

Angelo's eldest child, Davina, who is aged 30 and is the mother of Angelo's grandchildren, considers that the three trustees should be replaced, and that she should be one of the replacement trustees. The other children, whose ages range from 15 to 28, agree with Davina's proposal. The grandchildren are too young to have a view on the matter.

Advise Davina on (1) whether there are grounds from removing Angelo, Bella and Cesar as trustees, and (2) whether the court is likely to approve Davina's appointment as a replacement trustee.

21

Tracing

21.1 Introduction

21.2 Fiduciary requirement?

21.3 Mixing money in a bank account: competition between fiduciary and beneficiary

21.4 Mixing money in a bank account: competition between beneficiaries

21.5 The lowest intermediate balance rule

21.6 Mixing by recipients of property from the fiduciary

21.7 Tracing into profits

21.8 Defences to equitable tracing claims

21.1 Introduction

Tracing is the process of identifying one asset as a substitute for another. Identification (or tracing) rules are needed if property is removed from the trust (usually, but not necessarily, as a result of a breach of trust) and mixed or exchanged with other property. For example, trust money that a trustee pays into his personal bank account can be traced into the bank account as well as into property purchased with money withdrawn from the account. Once identified, the trust money can be recovered from the trustee's personal account, or from property purchased with the money, or from both. Note that the beneficiary does not literally 'recover' the trust money. Tracing entitles her to new personal or proprietary rights enforceable against the contractual right the trustee has to payment from his bank, or against any right in property purchased by the trustee with the trust money. If the trustee pays trust money to a third party who applies it in the purchase of a painting, tracing enables the beneficiary to obtain proprietary rights in the painting, unless (if the tracing claim is equitable) the purchaser is a good faith purchaser for value without notice of the beneficiary's right to enforce the trust.

If the money is successfully invested by the trustee, the trust is entitled to a share of the investment. Equity developed tracing rules to resolve disputes to property between a trustee and beneficiary, as well as to solve problems created by competition between beneficiaries, where the trust assets are insufficient to meet all claims in full. Property can be traced at common law as well as in equity: *Taylor v Plumer* (1815) 105 ER 721 (see L Smith, 'Tracing in *Taylor v Plumer:* Equity in the Court of King's Bench' [1995] *Lloyd's Maritime & Commercial Law Quarterly* 240). The remedies available to recover traced property are more extensive in equity than at law. This chapter focuses on tracing in equity.

It is important to emphasise that tracing is simply the process for identifying the plaintiff's property rights in an exchange-substitute; it is not a remedy. The choice of remedy at the conclusion of the tracing exercise is a separate question. The remedy may be a constructive trust imposed over the property. Alternatively, an equitable lien (or charge) may be imposed over the property to secure repayment of trust money to the trust. If a 'knowing receipt' claim under the first limb of *Barnes v Addy* has been brought (see chapter 11), the tracing exercise may result in an award of equitable compensation, assessed as the value of the property received.

In addition to the sources set out in this chapter, and chapter 21 of the textbook, the student is encouraged to read the Hon J Edelman, 'Understanding Tracing Rules' (2016) 16(2) *QUT Law Review* 1 (the 2015 WA Lee Lecture).

Tracing is distinguishable from following property. The distinction was explained by Lord Millett in *Foskett v McKeown*.

Background

The plaintiffs were investors in a property development scheme in Portugal. The developer, Murphy, in breach of trust, used £20,440 of the plaintiffs' money to pay two annual premiums of a life insurance policy, amounting to two-fifths of the premiums paid. There was a dispute as to whether trust money had been used to pay another premium. Murphy later declared himself trustee of the insurance policy for the benefit of his three children. When he committed suicide two years later, his children received £1 million under the life insurance policy.

The plaintiffs claimed that they were entitled to a share of the payment made to the children, since the insurance policy had been purchased in part with their money. The trial judge held that the investors were entitled to the proportion to which their money had contributed to the investment value of the policy at the date of Murphy's death. A majority of the Court of Appeal reversed this decision, holding that the investors were not entitled to an equitable interest in the insurance payment, but were limited to a charge to secure repayment of the £20,440 applied in the purchase of the premiums.

Decision

A majority of the House of Lords, Lord Steyn and Lord Hope dissenting, held that the investors were entitled to an equitable interest, proportionate to the premiums paid with their money, in the payment to the children.

Lord Millett

Tracing and following

The process of ascertaining what happened to the plaintiffs' money involves both tracing and following.

These are both exercises in locating assets which are or may be taken to represent an asset belonging to the plaintiffs and to which they assert ownership. The processes of following and tracing are, however, distinct. Following is the process of following the same asset as it moves from hand to hand. Tracing is the process of identifying a new asset as the substitute for the old. Where one asset is exchanged for another, a claimant can elect whether to follow the original asset into the hands of the new owner or to trace its value into the new asset in the hands of the same owner. In practice his choice is often dictated by the circumstances. In the present case the plaintiffs do not seek to follow the money any further once it reached the bank or insurance company, since its identity was lost in the hands of the recipient (which in any case obtained an unassailable title as a bona fide purchaser for value without notice of the plaintiffs' beneficial interest). Instead the plaintiffs have chosen at each stage to trace the money into its proceeds, viz. the debt presently due from the bank to the account holder or the debt prospectively and contingently due from the insurance company to the policy holders.

Having completed this exercise, the plaintiffs claim a continuing beneficial interest in the insurance money. Since this represents the product of Mr Murphy's own money as well as theirs, which Mr Murphy mingled indistinguishably in a single chose in action, they claim a beneficial interest in a proportionate part of the money only. The transmission of a claimant's property rights from one asset to its traceable proceeds is part of our law of property, not of the law of unjust enrichment. There is no 'unjust factor' to justify restitution (unless 'want of title' be one, which makes the point). The claimant succeeds if at all by virtue of his own title, not to reverse unjust enrichment. Property rights are determined by fixed rules and settled principles. They are not discretionary. They do not depend upon ideas of what is 'fair, just and reasonable'. Such concepts, which in reality mask decisions of legal policy, have no place in the law of property.

A beneficiary of a trust is entitled to a continuing beneficial interest not merely in the trust property but in its traceable proceeds also, and his interest binds everyone who takes the property or its traceable proceeds except a bona fide purchaser for value without notice. In the present case the plaintiffs' beneficial interest plainly bound Mr Murphy, a trustee who wrongfully mixed the trust money with his own and whose every dealing with the money (including the payment of the premiums) was in breach of trust. It similarly binds his successors, the trustees of the children's settlement, who claim no beneficial interest of their own, and Mr Murphy's children, who are volunteers. They gave no value for what they received and derive their interest from Mr Murphy by way of gift.

Tracing

We speak of money at the bank, and of money passing into and out of a bank account. But of course the account holder has no money at the bank. Money paid into a bank account belongs legally and beneficially to the bank and not to the account holder. The bank gives value for it, and it is accordingly not usually possible to make the money itself the subject of an adverse claim. Instead a claimant normally sues the account holder rather than the bank and lays claim to the proceeds of the money in his hands. These consist of the debt or part of the debt due to him from the bank. We speak of tracing money into and out of the account, but there is no money in the account. There is merely a single debt of an amount equal to the final balance standing to the credit of the account holder. No money passes from paying bank to receiving bank or through the clearing system (where the money flows may be in the opposite direction). There is simply a series of debits and credits which are causally and transactionally linked. We also speak of tracing one asset into another, but this too is inaccurate. The original asset still exists in the hands of the new owner, or it may have become untraceable. The claimant claims the new asset because it was acquired in whole or in part with the original asset. What he traces, therefore, is not the physical asset itself but the value inherent in it.

Tracing is thus neither a claim nor a remedy. It is merely the process by which a claimant demonstrates what has happened to his property, identifies its proceeds and the persons who have handled or received them, and justifies his claim that the proceeds can properly be regarded as representing his property. Tracing is also distinct from claiming. It identifies the traceable proceeds of the claimant's property. It enables the claimant to substitute the traceable proceeds for the original asset as the subject matter of his claim. But it does not affect or establish his claim. That will depend on a number of factors including the nature of his interest in the original asset. He will normally be able to maintain the same claim to the substituted asset as he could have maintained to the original asset. If he held only a security interest in the original asset, he cannot claim more than a security interest in its proceeds. But his claim may also be exposed to potential defences as a result of intervening transactions. Even if the plaintiffs could demonstrate what the bank had done with their money, for example, and could thus identify its traceable proceeds in the hands of the bank, any claim by them to assert ownership of those proceeds would be defeated by the bona fide purchaser defence. The successful completion of a tracing exercise may be preliminary to a personal claim (as in *El Ajou v Dollar Land Holdings plc* [1993] 3 All ER 717) or a proprietary one, to the enforcement of a legal right (as in *Trustees of the Property of F C Jones & Sons v Jones* [1997] Ch 59) or an equitable one.

Given its nature, there is nothing inherently legal or equitable about the tracing exercise. There is thus no sense in maintaining different rules for tracing at law and in equity. One set of tracing rules is enough. The existence of two has never formed part of the law in the United States: see *Scott on Trusts,* 4th ed (1989), section 515, at pp 605–609. There is certainly no logical justification for allowing any distinction between them to produce capricious results in cases of mixed substitutions by insisting on the existence of a fiduciary relationship as a precondition for applying equity's tracing rules. The existence of such a relationship may be relevant to the nature of the claim which the plaintiff can maintain, whether personal or proprietary, but that is a different matter. I agree with the passages which my noble and learned friend, Lord Steyn, has cited from Professor Birks's essay 'The Necessity of a Unitary Law of Tracing', and with Dr Lionel Smith's exposition in his comprehensive monograph *The Law of Tracing* (1997): see particularly pp 120–130, 277–279 and 342–347 ...

The cause of action

As I have already pointed out, the plaintiffs seek to vindicate their property rights, not to reverse unjust enrichment. The correct classification of the plaintiffs' cause of action may appear to be academic, but it has important consequences. The two causes of action have different requirements and may attract different defences.

A plaintiff who brings an action in unjust enrichment must show that the defendant has been enriched at the plaintiff's expense, for he cannot have been unjustly enriched if he has not been enriched at all. But the plaintiff is not concerned to show that the defendant is in receipt of property belonging beneficially to the plaintiff or its traceable proceeds. The fact that the beneficial ownership of the property has passed to the defendant provides no defence; indeed, it is usually the very fact which founds the claim. Conversely, a plaintiff who brings an action like the present must show that the defendant is in receipt of property which belongs beneficially to him or its traceable proceeds, but he need not show that the defendant has been enriched by its receipt. He may, for example, have paid full value for the property, but he is still required to disgorge it if he received it with notice of the plaintiff's interest.

Furthermore, a claim in unjust enrichment is subject to a change of position defence, which usually operates by reducing or extinguishing the element of enrichment. An action like the present is subject to the bona fide purchaser for value defence, which operates to clear the defendant's title.

Note

The distinction between tracing, following and claiming is explained in Lionel Smith, *The Law of Tracing* (Clarendon Press, 1997) 6–14. See P Ridge, 'Tracing and Associated Claims in Australian Law' (2020) 14(1) *Journal of Equity* 32, arguing that Lord Millett's model of tracing is inconsistent with the Australian authorities.

Questions

(1) Distinguish tracing from following and claiming. What does a tracing claim trace? Is it (a) property; (b) the value of property; or (c) rights in property? See T Cutts, 'Tracing, Value and Transactions' (2016) 79(3) *Modern Law Review* 381.

(2) T holds a valuable painting on trust for B. In breach of trust, he sells the painting to X for $10,000, which he pays into his bank account. Explain how tracing and following apply to these facts. Can B recover the painting at common law or in equity? Can B recover both the painting and the $10,000? See *Creak v James Moore & Sons Pty Ltd* [1912] HCA 67; (1912) 15 CLR 426, and at [21.2a] below.

(3) Lord Millett states that tracing 'is part of our law of property, not of the law of unjust enrichment'. Why is tracing part of property law? Why does it matter where tracing belongs?

(4) Explain how trust money can be traced into and out of a bank account.

21.2 Fiduciary requirement?

It has long been assumed that a prerequisite of tracing in equity is that title to the original asset must have been held by a fiduciary (*Re Diplock* [1948] 1 Ch 465; *Agip (Africa) Ltd v Jackson* [1991] Ch 547, 566). The extract from Lord Millett's judgment in *Foskett v McKeown* (above at [21.1a]) doubts the necessity for insisting on a fiduciary relationship, although claims based on equitable tracing principles are commonly brought for breach of fiduciary duty.

Stolen property gives rise to a tracing claim where the thief, or a recipient of the property from the thief, has mixed the property with his own. It is well established that a thief holds stolen money on trust for the victim (see *Black v S Freedman & Co* (1910) 12 CLR 105, at [23.6a]) even though the relationship between them is not fiduciary. There is some doubt, however, as to whether the trust is resulting or constructive in character: *Robb Evans of Robb Evans & Associates v European Bank Ltd* (2004) 61 NSWLR 75, [112] (Spigelman CJ). *Creak v James Moore & Sons Pty Ltd* (below) illustrates the application of identification principles to stolen property.

21.2a *Creak v James Moore & Sons Pty Ltd* [1912] HCA 67; (1912) 15 CLR 426

Background

The plaintiff company employed a salesman, Watson, who stole company property, including 21 cases of galvanised iron. An accomplice, Quine, sold four of the cases to the defendant for £31. The defendant paid for the iron with a cheque made out to Watson, and the £31 was credited to Watson's bank account. Watson and Quine were later arrested by a detective, Lonsdale, to whom Watson

gave authority to have the £31 transferred into the plaintiff's bank account. The plaintiff later claimed the value of the galvanised iron from the defendant in an action for conversion.

Decision

The High Court, Isaacs J dissenting, held that the plaintiff could not recover the value of the iron in a claim for conversion, having previously received the proceeds of sale of the iron.

Griffith CJ

During the argument, I put the case of an agent employed to sell goods and collect money, who remits to his principal a sum of £100, being in fact indebted to him to a larger amount, and on the following day informs the principal that £50 of the £100 represents the price of property of the principal which he had sold without authority, and I asked whether in such a case the principal would be bound to elect to affirm or disaffirm the sale, that is to say, whether he could keep the £50 and also recover the property sold or its value. To my mind the answer seems plain enough. Although the receipt of the £100, including the £50, was right and proper at the time, the retention of it would not be consistent with common honesty unless the principal intended to affirm the sale, or unless in the meantime some new fact had occurred which had altered his position with regard to the debtor. …

In my opinion the owner of stolen goods which have been sold by the thief may follow the fund representing the proceeds, if they can be identified, into the hands of a third person who cannot set up a better title, as was done apparently without objection in the case of *Rice v Reed* [1900] 1 QB 54, and as this Court did in the case of *Black v S Freedman & Co* (1910) 12 CLR 105. If, in this case, the money had not been handed over to Lonsdale and by him to the plaintiffs, the Court before which Watson was convicted would have ordered it to be paid to them. …

In the present case the proceeds of the stolen goods are sufficiently 'earmarked', so it is said, and are identified in the hands of the plaintiffs, who were also the owners of the goods. The question is whether they can set up a better title to the money than as such owners. The title set up is that they received the money as part payment of a debt and in ignorance of their independent equitable title to it. If they so received it, they in fact came into possession of a sum of money to which they were already entitled, although they did not then know it.

In my opinion the following proposition is good law: – If a man, having received a sum of money which is identified as being in fact the proceeds of property of his that has been sold without his authority, afterwards becomes aware of the fact, he is *prima facie* bound to elect whether he will affirm or disaffirm the sale. That is to say, he cannot keep the money and recover the full value of the goods.

How long then does the obligation to elect continue? If it ever exists, the only limit that can be set is the happening of some new fact which would alter his position to his prejudice if he were still called upon to elect. Merely spending the money would not be such a fact. Possibly the same principle would be applied that is applicable in the case of an agent who has received money which he may under certain circumstances be personally liable to return, and who before notice of any such circumstance has paid it over to his principal.

In this case the plaintiffs are in no better position than the principal in the case supposed, for an agent acting without authority is a wrongdoer, and it is immaterial whether the wrong does or does not include criminal intent.

Isaacs J (dissenting)

The appellant … says that, at all events, when in December 1911 his solicitor informed respondents the £31 had come from him, they were bound to elect whether they would have the money or the goods – and that they could not have both. But why? If the iron was still theirs, the title never having passed; and if the money was theirs since 7th September for the reasons above mentioned, where was the necessity of election? The principle of what is called 'approbate and reprobate' was stated by Honyman J in *Smith v Baker* (1873) LR 8 CP 350 at p 357 in these terms – that a man 'cannot say at one time that the transaction is invalid, and thereby obtain some advantage, to which he could only be entitled on the footing that it is valid, and at another time say it is void for the purpose of securing some further advantage'. The word 'thereby' is all important. This was accepted as the true principle by the Court of Appeal in *Roe v Mutual Loan Fund* (1887) 19 QB 347, at 350.

The present case is untouched by that. The sum of £31 was not obtained by Moore saying the sale was valid, but in respect of another legal right; and so there is nothing inconsistent in retaining that sum, and at the same time in still insisting, as they always have insisted, on maintaining their title to their own property – the iron. A man is not called on to elect between two items of his own property. And so far as forming and announcing an actual intention to apply the money to liabilities of Watson other than the iron is concerned, that was done in the most unmistakable manner before any notification was received by the respondents that the money represented Creak's payment for the iron. In respondents' letters to Creak of 25th October and 13th November they claimed from him the value of the goods. This could only be consistent with the appropriation of the whole £46 to other delinquencies than the theft of the iron. And of itself it destroys all otherwise possible basis for the argument that, after the receipt of the letter of 20th December, it was too late to so appropriate the money.

Note

The claim in this case arose out of theft of chattels. A significant commercial context, in which tracing the proceeds of chattels can occur, concerns the practice of inserting reservation of title clauses into contracts for the supply of material which is to be mixed with other material during a manufacturing process. The reservation of title clause will provide that property in the supplier's material does not pass to the manufacturer until the supplier has been paid in full. An extended reservation of title clause extends the supplier's property right to include the proceeds of sale of any product incorporating the material until the supplier has been paid. See *Aluminium Industrie Vaassen BV v Romalpa Aluminium Ltd* [1976] 1 WLR 676; *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000) 202 CLR 588 extracted at [13.4.2a]. The relationship between a supplier and manufacturer is not ordinarily fiduciary. Why, and for what purpose, was it found to be fiduciary in these cases? Note that tracing issues in these decisions did not arise from an initial breach of fiduciary duty since the manufacturer's mixing of the supplier's materials and later sale of the finished product were authorised by the supplier

A reservation of title clause now constitutes a security interest under s 12(2)(d) of the *Personal Property Securities Act 2009* (Cth). Section 32(1)(b) automatically extends the reservation of title clause to the proceeds of sale of the product unless the security agreement provides otherwise. Section 31(1) invokes the concept of tracing by defining 'proceeds' to mean 'identifiable or traceable personal property' derived directly or indirectly from a dealing with the product. Section 32(2) overcomes a possible limitation on equitable tracing by enacting that proceeds 'are traceable whether or not there is a fiduciary relationship between the person who has a security interest in the proceeds, as provided in s 32, and the person who has rights in or who has dealt with the proceeds'.

Questions

(1) Is *Creak v James Moore & Sons Pty Ltd* a case on tracing, or following, or both?

(2) What reasons did Isaacs J give for dissenting? Do you think that the plaintiff in this case was trying to obtain double recovery for one theft, or that two separate claims were involved?

21.3 Mixing money in a bank account: competition between fiduciary and beneficiary

21.3a *Re Hallett's Estate* (1880) 13 Ch D 696

Background

Mr Hallett, a solicitor, had settled money on trust for himself, his wife and his children under the terms of a marriage settlement. The trustees of the settlement transferred some of the trust property to Mr Hallett to invest. He did so, but later sold the investments and

paid the proceeds into his bank account. A client, Mrs Cotterill, had given him money to buy some bonds for her. He purchased the bonds but later sold them and paid the proceeds into his bank account. Various payments were later made from and into the account. Mr Hallett died insolvent. Claims were made by the trustees of his marriage settlement, by Mrs Cotterill, and by his unsecured creditors to the remaining money in Mr Hallett's bank account.

Decision

The Court of Appeal held that Mr Hallett was presumed to have acted honestly in spending his own money first, before spending money he held in a fiduciary capacity. The claims of the trustees and Mrs Cotterill, to whom he owed fiduciary obligations, must be satisfied (and were, in fact, met in full) before the claims of his unsecured creditors.

Jessel MR

There is no doubt, therefore, that Mr Hallett stood in a fiduciary position towards Mrs Cotterill. Mr Hallett, before his death, I regret to say, improperly sold the bonds and put the money to his general account at his bankers. It is not disputed that the money remained at his bankers mixed with his own money at the time of his death; that is, he had not drawn out that money from his bankers. In that position of matters Mrs Cotterill claimed to be entitled to receive the proceeds, or the amount of the proceeds, of the bonds out of the money in the hands of Mr Hallett's bankers at the time of his death, and that claim was allowed by the learned Judge of the Court below, and I think was properly so allowed. Indeed, as I understand the doctrines of Equity, it would have been too clear a case for argument, except for another decision of that learned Judge himself, *Re West of England & South Wales District Bank; Ex parte Dale & Co* (1879) 11 Ch D 772. The modern doctrine of Equity as regards property disposed of by persons in a fiduciary position is a very clear and well-established doctrine. You can, if the sale was rightful, take the proceeds of the sale, if you can identify them. If the sale was wrongful, you can still take the proceeds of the sale, in a sense adopting the sale for the purpose of taking the proceeds, if you can identify them. There is no distinction, therefore, between a rightful and a wrongful disposition of the property, so far as regards the right of the beneficial owner to follow the proceeds. But it very often happens that you cannot identify the proceeds.

The proceeds may have been invested together with money belonging to the person in a fiduciary position, in a purchase. He may have bought land with it, for instance, or he may have bought chattels with it. Now, what is the position of the beneficial owner as regards such purchases? I will, first of all, take his position when the purchase is clearly made with what I will call, for shortness, the trust money, although it is not confined, as I will shew presently, to express trusts. In that case, according to the now well-established doctrine of Equity, the beneficial owner has a right to elect either to take the property purchased, or to hold it as a security for the amount of the trust money laid out in the purchase; or, as we generally express it, he is entitled at his election either to take the property, or to have a charge on the property for the amount of the trust money. But in the second case, where a trustee has mixed the money with his own, there is this distinction, that the cestui que trust, or beneficial owner, can no longer elect to take the property, because it is no longer bought with the trust money simply and purely, but with a mixed fund. He is, however, still entitled to a charge on the property purchased, for the amount of the trust money laid out in the purchase; and that charge is quite independent of the fact of the amount laid out by the trustee. The moment you get a substantial portion of it furnished by the trustee, using the word 'trustee' in the sense I have mentioned, as including all persons in a fiduciary relation, the right to the charge follows. That is the modern doctrine of Equity …

… Now that being the established doctrine of Equity on this point, I will take the case of the pure bailee. If the bailee sells the goods bailed, the bailor can in Equity follow the proceeds, and can follow the proceeds wherever they can be distinguished, either being actually kept separate, or being mixed up with other moneys. I have only to advert to one other point, and that is this – supposing, instead of being invested in the purchase of land or goods, the moneys were simply mixed with other moneys of the trustee, using the term again in its full sense as including every person in a fiduciary relation, does it make any difference according to the modern doctrine of Equity? I say none. It would be very remarkable if it were to do so. Supposing the trust money was 1000 sovereigns, and the trustee put them into a bag, and by mistake, or accident, or otherwise, dropped a sovereign of his own into the bag. Could anybody suppose that a Judge in Equity would find any difficulty in saying that the cestui que trust has a right to take 1000 sovereigns out of that bag? I do not like to call it a charge of 1000 sovereigns on the 1001 sovereigns, but that is the effect of it.

Notes

(1) See G Virgo, 'Re Hallett's Estate (1879–1880)' in C Mitchell and P Mitchell (eds), *Landmark Cases in Equity* (Hart Publishing, 2012) 357 for an analysis of the decision, placing it in the context of nineteenth-century solicitor fraud.

(2) The principles laid down in *Re Hallett's Estate* are not confined to the mixing of money in bank accounts. See *Brady v Stapleton* (1952) 88 CLR 322 for their application to a transfer of shares.

Questions

(1) The decision in *Re Hallett's Estate* was based on the principle that a fiduciary is presumed to have acted honestly. How realistic is the presumption? Should the presumption have a role to play in the application of the tracing rules?

(2) Jessel MR states that the beneficiary is entitled to a charge over property acquired with money from a mixed fund. What is the difference between a charge and a constructive trust? Do you consider that the beneficiary should be entitled to a charge to secure repayment of the trust money misapplied by the fiduciary, or to a constructive trust over the property? See *Scott v Scott* (1963) 109 CLR 649; *Foskett v McKeown* [2001] 1 AC 102 (and, respectively, at [21.7a] and [21.7b] below).

(3) What is the policy justification for preferring the claims of beneficiaries to the claims of the trustee's unsecured creditors in the trustee's bankruptcy?

21.3b *Re Oatway* [1903] 2 Ch 356

Background

A solicitor who was a trustee of a family trust paid £3,000 of trust money into his own bank account. He later withdrew £2,137 from the account to buy shares in the Oceana Company in his own name. Shortly afterwards, the solicitor died insolvent, his only substantial asset being the shares.

Decision

It was held that the trust was entitled to a charge over the shares to secure repayment of the £3,000 trust money.

Joyce J

Trust money may be followed into land or any other property in which it has been invested; and when a trustee has, in making any purchase or investment, applied trust money together with his own, the cestuis que trust are entitled to a charge on the property purchased for the amount of the trust money laid out in the purchase or investment. Similarly, if money held by any person in a fiduciary capacity be paid into his own banking account, it may be followed by the equitable owner, who, as against the trustee, will have a charge for what belongs to him upon the balance to the credit of the account. If, then, the trustee pays in further sums, and from time to time draws out money by cheques, but leaves a balance to the credit of the account, it is settled that he is not entitled to have the rule in *Clayton's Case* ((1816) 1 Mer 572) applied so as to maintain that the sums which have been drawn out and paid away so as to be incapable of being recovered represented pro tanto the trust money, and that the balance remaining is not trust money, but represents only his own moneys paid into the account. It is, in my opinion, equally clear that when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having been afterwards dissipated by him, he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust. In other words, when the private money of the trustee and that which he held in a fiduciary capacity have been mixed in the same banking account, from which various payments have from time to time been made, then, in order to determine to whom any remaining balance or any investment that may have been paid for out of the account ought to be deemed to belong, the trustee must be debited with all the sums that have been withdrawn and applied to his own use so as to be no longer recoverable, and the trust money in like manner be debited with any sums taken out and duly invested in the names of the proper trustees. The order of priority in which the various withdrawals and investments may have been respectively made is wholly immaterial. I have been referring, of course, to cases where there is only one fiduciary owner or set of cestuis que trust claiming whatever may be left as against the trustee. In the present case there is no balance left. The only investment or property remaining which represents any part of the mixed moneys paid into the banking account is the Oceana shares purchased for £2137. Upon these, therefore, the trust had a charge for the £3000 trust money paid into the account. That is to say, those shares and the proceeds thereof belong to the trust.

Questions

(1) Who has the burden of proof of showing (a) whose money, as between a trustee and beneficiary, remains in a bank account in which the money of both has been mixed; and (b) whose money was spent when money from the account is used to buy an asset?

(2) T pays $5,000 of trust money into her bank account which was $2,000 in credit at the time of the payment. T withdraws $3,000 from the account to buy a stock of vintage wine which she stores in her cellar. The wine is now worth $4,000. Advise the beneficiaries on their entitlement to the wine and the money in the bank account.

21.3.1 Backward tracing

Tracing is usually straightforward where a trustee has misappropriated trust money which is then directly applied to buy land or a chattel. It is more complex and controversial when the trust money is used to pay for property which had previously been bought by the trustee. Suppose that T buys a car on credit before misappropriating trust money. When payment to the credit provider is due, T pays off the debt with trust money. Can the beneficiaries trace the trust money into T's car? The trust money has not been directly used to buy the car, but it has enabled T to pay off the debt previously incurred to the credit provider in buying it. These facts raise a question of what is termed 'backward tracing'.

In *Federal Republic of Brazil v Durant International Corporation* [2016] AC 297, the Privy Council rejected the application of 'backward tracing' techniques to identify and recover trust money. Lord Toulson stated at [33]:

> The courts should be very cautious before expanding equitable proprietary remedies in a way which may have an adverse effect on other innocent parties. If a trustee on the verge of bankruptcy uses trust funds to pay off an unsecured creditor to whom he is personally indebted, in the absence of special circumstances it is hard to see why the beneficiaries' claim should take precedence over those of the general body of unsecured creditors.

Backward tracing might be recognised, however, where there was 'a close causal and transactional link' (Lord Toulson at [34]) between the incurring of the debt and the application of trust money to discharge it. The link was established in *Durant*, where bribes received by the mayor of Sao Paulo were laundered through bank accounts involving debits and credits between account holders. In such a case, 'it should not matter that, either as a deliberate part of the choreography or possibly because of the incidents of the banking system, a debit appears in the bank account of an intermediary before a reciprocal credit entry' (Lord Toulson at [38]). See also L Smith, 'Tracing into the Payment of a Debt' (1995) 54(2) *Cambridge Law Journal* 290; M Conaglen, 'Difficulties with Tracing Backwards' (2011) 127(3) *Law Quarterly Review* 432.

21.4 Mixing money in a bank account: competition between beneficiaries

A trustee mixes money to which two or more beneficiaries are entitled in his bank account. The relevant principles were explained by Campbell J in the following case.

21.4a *Re French Caledonia Travel* (2003) 59 NSWLR 361

Background

Airlines required travel agents who received payment for air tickets on behalf of the airlines to deposit the payments into a trust account prior to passing the money onto the airlines. A travel agent mixed his business account and trust account, making deposits to and withdrawals from both. Proper documentation of the transfers was not kept. When the company went into liquidation, there was insufficient money to repay all the customers whose money had been paid into the trust accounts.

Decision

Campbell J rejected the application of the rule in *Clayton's* case (1816) 1 Mer 572; 35 ER 781, which had been applied in some previous cases. This rule would have required the court to attribute the first payments made into the trust accounts to the first payments out of the accounts. If it had been applied, later customers would have been favoured at the expense of earlier customers. In the following extract, he identifies alternative principles applicable to determine the share in the mixed fund that each beneficiary is to take.

Campbell J

Having concluded that the liquidator should not apply *Clayton's Case* does not of itself lead to a conclusion about what manner of distribution the liquidator should adopt. To say that he should adopt a 'pari passu distribution' glosses over some questions of principle, and of evidence. …

Equality is equity?

The maxim 'equality is equity' does not require that the available funds be divided between all people who can establish that, at one time, they had a claim on a bank account in which property held on trust for several people have been mixed. It can readily enough be accepted that if several people have an equal right to be paid from a particular fund, and the fund proves insufficient, their claims will abate rateably. This happens in relation to general legacies *(Re Farmer; Nightingale* v *Whybrow* [1939] Ch 573; *Re Wilson (decd); Hartley v Marie Curie Hospital* [1940] Ch 966), and with the proportionate abatement of provable debts which creditors sustain in a bankruptcy or winding up. Rateable abatement does not automatically apply whenever there is a mixed fund because there is a preliminary question, the answer to which cannot be assumed, of whether all the claimants on the fund, in the form the fund takes at the time of trial, have claims which are equal.

There are two senses of 'have claims which are equal' which apply here.

The first concerns whether, in relation to the amount of money of a beneficiary which has gone into a mixed fund, and for which that beneficiary has in one sense a claim, the beneficiary has a charge over whatever property remains from that fund for the whole of the amount of his money which went in. If it can be demonstrated that some beneficiaries have a charge over those assets for the whole amount of their money which went into the fund, while others have a charge over those assets for only part of their money which went into the fund, their claims are not equal. An example of how this happens is found in the extract from *Re Walter J Schmidt & Co; Ex parte Feuerbach* 298 F 314 (1923) contained in the quotation from *Re Registered Securities Ltd* ([1991] 1 NZLR 545). Modifying the example so that it talks of charges, rather than proportions, at the beginning of February A has a charge on the fund for $3000 and B has a charge on the fund for $5000. The depletion during February means that A's charge on the fund is reduced to one for $1500, and B's charge is reduced to one for $2500. At the beginning of March A and B have those charges for $1500 and $2500 respectively, and C has a charge for his full $5000. Thus, even though A, B and C each has a claim for $5000, because the charges they can demonstrate over the fund at the beginning of March are not equal, their claims as at that date are not equal.

The other sense in which claims might be unequal arises once the amount of the various charges of beneficiaries on the fund has been established. Then a question arises of whether in accordance with the equitable principles concerning priorities, or indeed whether by reference to any personal equities whatever which exist between the various claimants, there is any reason to treat any of the claimants as postponed to any of the others. …

The appropriate way of dividing available assets between beneficiaries whose money has been mixed in an account might also depend upon what other remedies *in rem* the various beneficiaries have. If there is a situation where the money of A and B is mixed in an account, some of it is withdrawn and used to purchase an asset, and then the money of C is placed in the account, and both the asset, and the account, are available at the time of trial, a liquidator might be directed to administer the fund in accordance with principles of marshalling, so that A and B satisfied themselves from the asset (which only they could trace into) to the extent that they could, leaving C to claim a higher percentage of his claim from the account balance than A and B are permitted to claim from the account balance. In *Re Global Finance Group Pty Ltd* (2002) 26 WAR 385, McLure J held that, on the facts of the case before her, a division of available monies pari passu between all claimants was inappropriate.

These examples show how it cannot be said that, as a matter of law, a fund in which assets of several beneficiaries have become mixed should always be distributed amongst all beneficiaries, pro rata to their claims.

Tracing principles applied to classes

… [I]t is possible for there to be tracing which does not depend upon identifying the transmogrifications which the assets of a particular beneficiary have gone through.

Sometimes, a liquidator seeking to administer a fund will know nothing more than that the fund is held on trust, and that there are a number of potential claimants to the fund, whose merits he cannot on any rational basis distinguish between. In such a situation, it may be appropriate for the court to direct a liquidator that he is justified in distributing the fund amongst the claimants proportionately to their claims …

Sometimes, however, there might be facts which show that claimants fall into particular classes, such that the amount of the charge which one class has on the assets which remain is likely to be a smaller proportion of the amount of their money which went

in than is the case with another class. If, for instance, there was a time when a trust account was completely depleted, beneficiaries whose money went into that trust account before the day of depletion could not have any equitable right at all to the sum which stands in the account at the date of trial. If the account in which the mixing occurred at any time reached a particularly low level, it may be that those people whose money was paid into the account before that low level was reached ought be accorded a smaller dividend on the amount of their claim than people whose money was paid in after that low level was reached. In carrying out such calculations, estimation and inference can be appropriate if precise evidence is not available.

Sometimes, likewise, there might be facts which showed that claimants fall into particular classes such that one class has a higher priority for the charge it can establish than does the other class.

While a liquidator must distribute funds of the company, or under his control through the company being trustee of trusts, in accordance with legal entitlements of people to those funds, the Court's findings about what legal entitlements exist depend upon the evidence which is placed before the Court, and inferences properly drawn from that evidence. When distribution of a fund is made by reference to classes of claimants, the available evidence is frequently evidence about the nature of a fund and the types of contribution which have gone into it. It is because the evidence is at this level of generality that the Court reaches conclusions about the beneficial ownership of the fund by saying that it is divided amongst claimants in some particular way. If ever the Court is able to give a remedy founded on tracing some individual claimants, it is because evidence is available which enables the property of those individual claimants to be more specifically traced. It should not be a cause for surprise that evidence of these different types can lead to different types of conclusion. …

In the present case, the liquidator puts no facts before the Court which lead to a conclusion that the various claimants ought be divided into various classes which are given different dividends. There is no reason to believe that there are any assets purchased from the accounts, into which some beneficiaries can trace but not others. The funds available are comparatively small, and likely to be completely, or substantially, depleted by the liquidator's own costs if the liquidator tried to carry out a more extensive analysis of the accounts. In these circumstances, the liquidator is justified in distributing amongst all the claimants, proportionately to their claims as assessed by him.

Questions

(1) What is the rule in *Clayton's* case? When does it apply? Why have courts rejected the application of the rule to resolve competing claims by beneficiaries to the assets of an insolvent trustee?

(2) In what circumstances, according to Campbell J, will the beneficiaries not be entitled to a rateable share in the assets of an insolvent trustee? Can the extract be fairly summarised by the proposition that a beneficiary will be entitled to recover such amount of the assets as the court considers just and equitable? Should a beneficiary's proprietary entitlement depend on the exercise of this kind of equitable discretion?

21.5 The lowest intermediate balance rule

21.5a *Caron v Jahani (No 2)* [2020] NSWCA 117; (2020) 102 NSWLR 537

Background

Courtenay House accepted funds from investors for investment in foreign exchange trading. It undertook to invest in strategies associated with political events, such as the USA presidential elections and Brexit. Based on findings made in other litigation, Courtenay House was assumed to be holding deposits on trust for individual investors. The arrangement was, in fact, a Ponzi scheme. Almost no foreign exchange trading was undertaken, and early investors were paid out of money deposited by later investors. The Australian

Securities and Investment Commission (ASIC) obtained an ex parte freezing order on 21 April 2017 over Courtenay House's assets, including the trust accounts. Some investors who were unaware of the freezing order made further investments on and after 21 April.

After the schemes had been placed in liquidation, there was a dispute as to how investors' funds paid into a Westpac account should be distributed. The contest was between investors who had invested prior to the granting of the freezing order on 21 April and investors who deposited funds after that date. The post-21 April investors consisted of two classes, being those who deposited funds on the same day but before $60,000 had been withdrawn from the Westpac account, and investors who had deposited funds after the $60,000 had been withdrawn. The $60,000 itself could not be recovered.

The primary judge ordered the funds held in the Westpac account to be divided rateably among all the investors.

Decision

The New South Wales Court of Appeal, allowing the appeal, held that tracing principles determined the entitlement of each investor. These principles included the application of the lowest intermediate balance rule whereby an investor can trace and recover no more than the lowest amount to which the bank account is in credit between the date of the investor's deposit and the date when the claim is brought. Since the deposits made by the post-21 April investors could be specifically identified in the Westpac account, that money should be returned to those investors, leaving any money remaining to be divided among the pre-21 April investors. As for the $60,000 withdrawal from the account on 21 April, the onus rested on an investor depositing money that day to show that the deposit had been made after the $60,000 had been withdrawn. Only investors who had deposited money into the account after that withdrawal were entitled to restitution of their entire investment.

Bell P

The conundrum concerns how limited funds in a bank account are to be distributed between investors whose funds were deposited into and co-mingled in that account over a number of years, and where there were innumerable deposits into and withdrawals from the account over that time.

In Australia and a number of other common law jurisdictions, application of the rule in *Devaynes v Noble* [1816] EngR 677; (1816) 1 Mer 529; (1816) 35 ER 767 (*Clayton's Case*) by which the earliest deposit into the bank account is presumed to have been the first withdrawn (that is, 'first in, first out') has been rejected as an appropriate solution to the conundrum which involves dealing with the interests *inter se* of investors or clients who invariably have been either defrauded or left short of funds by incompetent management. The rule in *Clayton's Case* favours later investors over earlier investors.

At least two other approaches are available and, as shall be seen, there are variations on these approaches. Indeed, what I describe below as the second alternative may fairly and best be understood as a variation on the first alternative as opposed to a true alternative to it.

The first alternative approach is to distribute the fund rateably by reference to the amount of individual investments proportionate to the remaining limited funds in the bank account. This is described as the *pari passu ex post facto* (pari passu) approach. It is also described as the *pro rata* or 'simple' *pari passu* approach.

Unlike application of the rule in *Clayton's Case*, the *pari passu* approach tends to favour earlier investors over later investors because it turns a blind eye to the fact that withdrawals from the fund over time will have proportionately reduced the quantum of deposits made prior to the withdrawals. Most graphically, where the account has been overdrawn, the *pari passu* approach ignores the fact that all deposits prior to the withdrawal that sends the account into debit will have been dissipated (assuming the withdrawn funds cannot be traced into a further asset or repository of value). On the other hand, the *pari passu* approach has the merit of arithmetic simplicity and consequent ease of application: all that is required in order to ascertain a claimant's share is to divide the fund by the same proportion as one unpaid depositor's contribution to the fund bears to that of other claimants.

The second approach does not ignore the withdrawal of amounts from the fund over time, but treats any given depositor's share as rateably reduced whenever there is any withdrawal from the fund. It is in that sense a variation of the *pari passu* approach, but will yield a different outcome depending on the time that individual deposits were made and any subsequent movements in the account. This is called the 'lowest intermediate balance', North American or 'rolling charge' approach, (see *Barlow Clowes International Ltd (in liq) v Vaughan* [1991] EWCA Civ 11). The reference to 'North American' is because of the approach's association with the well-known decision of Learned Hand J in *In re Walter J Schmidt & Co* 298 F. 314 (1923), but in truth it had been employed in a number of earlier decisions of United States' courts as noted by Professor Scott: see AW Scott, "The right to follow money wrongfully mingled with other money" (1913) 27 Harvard Law Review 125 at 134, fn 25.

The lowest intermediate balance approach is most consistent with the principles or rules of tracing, and has been considered by some judges and commentators as likely to produce the most equitable result, in the sense of a fair distribution between depositors, as it reflects the accounting reality as disclosed by a running bank account. It will favour more recent depositors or investors over earlier depositors or investors, not by means of a fiction or presumption of the kind animating the rule in *Clayton's Case*, but rather by reason of the historical reality that later contributors' deposits will not have been subject to as much dissipation by the fraudster or defaulting trustee or fiduciary as earlier contributors' deposits will have been.

A practical problem with the lowest intermediate balance approach, however, is that, depending on the number of depositors whose funds have been invested or deposited into a mixed or blended fund and depending on the extent of movements in that fund over time, including withdrawals, enormous complexity may (but will not always) arise in ascertaining the proportionate entitlement of persons with similar equitable claims over the fund. Given that this situation typically arises in an insolvency context, the costs involved in making the relevant calculations may be considered by liquidators to be too great so as to make the exercise worthwhile. In other words, the cost of the accounting exercise may exhaust or significantly erode the remaining fund so that the purpose of so doing may be wholly or partially frustrated.

Which of the three different approaches is applied matters, because each approach yields a different financial outcome for depositors in or contributors to the mixed or co-mingled fund. The different financial outcomes resulting from the different approaches are well illustrated in the decision of Williams J in *Re International Investment Unit Trust* [2005] 1 NZLR 270 at [24], and in the Annex to the decision of Audrey Lim JC in *Pars Ram Brothers (Pte) Ltd v Australian & New Zealand Banking Group Ltd* [2018] 4 SLR 1404; [2018] SGHC 60; see also the examples given in S Kinsey and L Papaelia, "Distribution over a mixed fund – pragmatism prevails over esoteric tracing principles" (2012) 20 *Insolvency Law Journal* 264 at 268–269.

There is room for debate as to which approach is the fairest and most consistent with principle or, as Williams J perhaps more aptly put it in *International Investment Unit Trust* at [73], which approach is 'the least unfair result for the investors, bearing in mind that, regrettably, no method of distribution will result in perfect justice for all.' …

… The lowest intermediate balance rule or rolling charge approach was accurately described in *Law Society of Upper Canada Toronto Dominion v Toronto Dominion Bank* (1998) 169 DLR (4th) 353 (at [14]) as stating that:

> … a claimant to a mixed fund cannot assert a proprietary interest in that fund in excess of the smallest balance in the fund during the interval between the original contribution and the time when a claim with respect to that contribution is being made against the fund.

In *Barlow Clowes International Ltd v Vaughan* [1991] EWCA Civ 11 at [35], the rule was described by Woolf LJ as treating the mixed or blended fund as a 'cocktail', with the result that when a withdrawal is made from the account it is treated as a withdrawal in the same proportions as the different interests of depositors in the account bear to each other at the moment before the withdrawal is made. As Audrey Lim JC points out in *Pars Ram Brothers (Pte) Ltd v ANZ Banking Group Ltd* [2018] 4 SLR 1404 at [15], the rolling charge method requires a contributor or depositor or investor's rateable interest in the mixed fund vis-à-vis the other contributors to be recalculated after each and every withdrawal, whereas the simple *pari passu* approach only requires one calculation to be made at the point or time of distribution …

… Whilst accepting that the authorities are not all one way, for the main part, the case law ties the application of the lowest intermediate balance rule in any given case to the availability of evidence to ascertain it, and the cost and complexity of assembling and analysing such evidence. In circumstances where either the parties have agreed that that would be too costly or complex (as in *Barlow Clowes*) or where the court reaches that view, the simple *pari passu* approach has been followed, not because it is superior as a matter of principle, but rather as a default position, being simpler in its application compared to the lowest intermediate balance rule and less arbitrary in its application than the rule in *Clayton's Case*.

But even where a liquidator and/or a court has formed the view that it is too costly or impractical to apply the lowest intermediate balance rule to the co-mingled fund as a whole for distribution purposes, that is not to deny the potential significance of the lowest intermediate balance rule to the case of a mixed fund in circumstances where an investor or contributor to the fund seeks to follow or trace into that fund to identify an equitable proprietary interest.

The corollary of the lowest intermediate balance rule is that relatively clear property interests are not to be altered by reference to some notion of common misfortune …

… Subject perhaps only to the existence of knowledge and intention on the part of investors whose funds have been co-mingled that their funds were always going to be treated as such (see [89]–[97] above), the lowest intermediate balance rule recognises the

continuing vitality of 'clearly discernible separate property rights' (*Russell-Cooke Trust Co v Prentis* [2002] EWHC 2227(Ch) at [35]), and is a means of identifying them.

The value of particular investors' interests in the co-mingled fund falls to be determined 'on available evidence': *Re Sonray Capital Markets Pty Ltd (in liq)* (2012) 288 ALR 240 at [86]. Where evidence is available … the lowest intermediate balance rule has been applied and provides what, in my opinion, is the fairest, most equitable and principled outcome for the allocation of limited funds between investors.

True it is that more recent investors will do better than earlier investors under this method, but that result follows from the application of established principle and respects the historical operation of the account in which funds have been co-mingled and the investors' underlying proprietary interests. This quintessentially factual approach is superior to the fiction or presumption upon which the so-called rule in *Clayton's Case* rests, and is also superior to the simple *pari passu* approach because, whilst incorporating a modified form of rateability, it is more consistent with equitable principle and the rules of tracing. The simple pari passu approach may also result in later investors whose funds were not, or were not significantly, dissipated, cross-subsidising earlier investors whose funds had, at least to some extent, been lost prior to any involvement of later investors.

As Gordon J explained in *Sonray* (at [86]), 'if a claimant can establish a remedy founded on tracing, the Court will grant relief founded on that evidence because it permits it to reach a different conclusion in respect of that claimant' compared to the result that would follow upon the application of a simple *pari passu* approach …

… If a claimant insists on exercising a right to trace into a mixed fund, authorities such as *French Caledonia*…recognise that he, she or it may do so (even though the liquidator otherwise seeks the Court's blessing for a *pari passu* distribution). This is an exercise in the vindication of proprietary rights or interests. Unlike the liquidator seeking directions, such a claimant will need to be able to establish, on the balance of probabilities, the proprietary interest claimed (as well as the fact that that interest is not required to be subordinated to that of other contributors by reason of the application of the principle of hotchpot or some other disentitling equitable consideration: see *French Caledonia* at [177]–[178]).

The identification of an equitable proprietary interest as a result of tracing will generally be easier for those depositors or investors who have made their investments at a later point in time, because such deposits will either not have been eroded by withdrawals, or only rateably diminished by a smaller number of withdrawals than will be the case for earlier depositors.

Whilst a liquidator might conclude that it would be impractical or excessively and counter-productively costly to engage in a full analysis of movements in the co-mingled fund or funds, including applying the lowest intermediate balance rule at the time of each withdrawal and to adjust the value of individual investors' claims accordingly in order reliably to ascertain the claims of all investors, the exercise may not be nearly so daunting or expensive for those investors who have come late to the party, as it were.

Notes

(1) In his concurring judgment, Bathurst CJ stated at [5] that 'the determination of distribution in accordance with the lowest intermediate balance method may be of such complexity that a liquidator would be justified and entitled to distribute on a pari passu basis'. For recent decisions considering *Caron v Jahani (No2)* but rejecting, on the facts, the application of the intermediate balance rule, see *Re Direct FX Trading Pty Ltd* [2020] NSWSC 1338, [27]–[31]; *Kelly in the matter of Halifax Investment Services Pty Ltd (in liq) v Loo* (2021) 390 ALR 669, [240]–[251].

(2) Bell P stated that any amounts received, or receivable, by beneficiaries from their participation in the investment scheme would be taken into account in calculating the amounts recoverable under the equitable doctrine of hotchpot. The doctrine reflects the equitable maxims that 'equality is equity' and that a claimant 'who seeks equity must do equity': *Australian Securities and Investments Commission v Idylic Solutions Ltd* (2009) 76 ACSR 129, cited by Bell P at [56]. In the case of a Ponzi scheme, any returns on investment would have been made by early investors, and not by late investors in the position of the plaintiffs.

(3) The lowest intermediate balance rule does not apply if, after the date on which the balance of the fiduciary's bank account is at its lowest (including being in overdraft), the fiduciary pays additional money into the account with a view to making restitution to the trust fund: *Roscoe (Bolton) Ltd v Winder* [1915] 1 Ch 62, 69.

Questions

(1) What is the justification for the lowest intermediate balance rule? When can the rule be ignored when tracing into a mixed fund?

(2) Why was rateable distribution ordered in *Re French Caledonia Travel* but the lowest intermediate balance rule applied in *Caron v Jahani (No 2)*?

(3) If the tracing principles vindicate property rights, as Lord Millett stated in *Foskett v McKeown,* is the fact that ascertaining those rights might be difficult a good reason for not enforcing them?

(4) T is an investment manager. On 1 April, T receives $10,000 from A for investment, on 2 April, T receives $10,000 from B, and on 3 April he receives $10,000 from C. A separate trust for each of A, B and C is created on the date of receipt, although all the money is automatically paid into a trust account opened by T at the XYZ Bank before A's investment was deposited. This is authorised by a provision in the trust instruments permitting mingling of invested funds. On 2 April, T withdrew $5,000 to pay for a holiday he had booked in Vanuatu. T has since been made bankrupt on the application of his unsecured creditors and it has been discovered that no investments have been made. Advise A, B and C on their entitlement to the $25,0000 remaining in the trust account.

21.6 Mixing by recipients of property from the fiduciary

21.6a *Re Diplock* [1948] 1 Ch 465

Background

Caleb Diplock left his residuary estate to his executors 'for such charitable institutions or other charitable or benevolent object or objects' as they should in their absolute discretion think fit. The executors distributed a large part of the estate among 139 charities before Diplock's next-of-kin challenged the bequest. The House of Lords held in *Chichester Diocesan Fund v Simpson* [1944] AC 341 that the gift was void because the objects were not exclusively charitable, and that therefore an invalid non-charitable purpose trust had been created.

The next-of-kin were unable to recover all the misapplied money from the executors, so they brought personal and proprietary claims against the charities which had received money from the estate. The basis of the claims was that the charities had received money as a result of breaches of fiduciary duty committed by the executors in distributing money under a void bequest. The proprietary claims are considered in the extract below.

The Court of Appeal held that the charities were personally liable to repay the distributions they had received from Diplock's estate, insofar as the amounts had not been recovered from the executors. The decision on this point was upheld by the House of Lords: *Ministry of Health v Simpson* [1951] AC 251.

On the assumption that the next-of-kin failed to recover in full the amounts for which the charities were personally liable, the Court of Appeal proceeded to consider whether the next-of-kin were entitled to a proprietary remedy over the money received by the charities, or over property acquired with the money, to the extent that the money or other property were traceable.

Decision

The Court made a number of rulings on tracing into the bank accounts and other property of the charities:

(i) The tracing principles apply to mixing by both fiduciaries and third parties who have received money or other property from trustees and other fiduciaries.

(ii) A third-party volunteer (i.e. someone who has not paid for the property and who therefore is not a good faith purchaser for value without notice) who has honestly mixed trust property with her own property shares the product of the mixing rateably with the beneficiary.

(iii) Where an innocent volunteer mixes trust money with her own money in a bank account, the rule in *Clayton's* case determines title to the money and to property purchased from the mixed account.

(iv) Where an innocent volunteer buys property with her own money and with trust money, without the money being mixed in a bank account, the property will be rateably apportioned between the beneficiary and the volunteer.

(v) Money used to pay off a secured or unsecured debt cannot be traced.

(vi) Money used by an innocent volunteer to improve property cannot be traced.

The Court

Where the contribution of a volunteer to a mixed fund or the acquisition of what we may call a 'mixed asset' is in the form of money, it is, as we hope to have shown, inequitable for him to claim the whole fund or the whole asset. The equitable charge given to the other claimant in respect of the money contributed by him results merely in the division of the mixed fund between the two of them or the reduction of the asset by sale to its original components, i.e., money which is then divisible in the same manner. The volunteer gets back what he put in, i.e., money. On this basis, if a charity had used a mixed fund, consisting in part of its own money and in part of Diplock money, in the acquisition of property, whether (for example) land or stock, the application of the equitable remedy would have presented no particular difficulty. The Diplock money and the charity money could each have been traced. A charge enforced by sale and distribution would have been effective as well as fair to both parties. The charity would not, as the result of the mixture, have been deprived of anything that it had before.

In the present cases, however, the charities have used the Diplock money, not in combination with money of their own to acquire new assets, but in the alteration and improvement of assets which they already owned. The altered and improved asset owes its existence, therefore, to a combination of land belonging to the charity and money belonging to the Diplock estate. The question whether tracing is possible and if so to what extent, and also the question whether an effective remedy by way of declaration of charge can be granted consistently with an equitable treatment of the charity as an innocent volunteer, present quite different problems from those arising in the simple case above stated. In the case of the purchase of an asset out of a mixed fund, both categories of money are, as we have said, necessarily present throughout the existence of the asset in an identifiable form. In the case of adaptation of property of the volunteer by means of trust money, it by no means necessarily follows that the money can be said to be present in the adapted property. The beneficial owner of the trust money seeks to follow and recover that money and claims to use the machinery of a charge on the adapted property in order to enable him to do so. But in the first place the money may not be capable of being followed. In every true sense, the money may have disappeared. A simple example suggests itself. The owner of a house who, as an innocent volunteer, has trust money in his hands given to him by a trustee uses that money in making an alteration to his house so as to fit it better to his own personal needs. The result may add not one penny to the value of the house. Indeed, the alteration may well lower its value; for the alteration, though convenient to the owner, may be highly inconvenient in the eyes of a purchaser. Can it be said in such cases that the trust money can be traced and extracted from the altered asset? Clearly not, for the money will have disappeared leaving no monetary trace behind: the asset will not have increased (or may even have depreciated) in value through its use.

But the matter does not end here. What, for the purposes of the inquiry, is to be treated as 'the charity property'? Is it to be the whole of the land belonging to the charity? Or is it to be only that part of it which was altered or reconstructed or on which a building has been erected by means of Diplock money? If the latter, the result may well be that the property, both in its original state and as altered or improved, will, when taken in isolation, have little or no value. What would be the value of a building in the middle of Guy's hospital without any means of access through other parts of the hospital property? If, on the other hand, the charge is to be on the whole of the charity land, it might well be thought an extravagant result if the Diplock estate, because Diplock money had been used to reconstruct a corner of it, were to be entitled to a charge on the entirety.

But it is not merely a question of locating and identifying the Diplock money. The result of a declaration of charge is to disentangle trust money and enable it to be withdrawn in the shape of money from the complex in which it has become involved. This can only

be done by sale under the charge. But the equitable owner of the trust money must in this process submit to equality of treatment with the innocent volunteer. The latter too, is entitled to disentangle his money and to withdraw it from the complex. Where the complex originates in money on both sides there is no difficulty and no inequity. Each is entitled to a charge. But if what the volunteer has contributed is not money but other property of his own such as land, what then? You cannot have a charge for land. You can, it is true, have a charge for the value of land, an entirely different thing. Is it equitable to compel the innocent volunteer to take a charge merely for the value of the land when what he has contributed is the land itself? In other words, can equity, by the machinery of a charge, give to the innocent volunteer that which he has contributed so as to place him in a position comparable with that of the owner of the trust fund? In our opinion it cannot. In the absence of authority to the contrary our conclusion is that as regards the Diplock money used in these cases it cannot be traced in any true sense; and, further, that even if this were not so, the only remedy available to equity, viz., that of a declaration of charge would not produce an equitable result and is inapplicable accordingly.

We now consider two claims of a different class. They arise in connexion with the alternative case above mentioned of the Heritage Craft Schools (action IV. B) and the Leaf Homeopathic Hospital (action II. C) as regards £6,000 further part of the hospital's total grant of £7,500. In the former case the alternative claim was that the judicial trustee is entitled by way of subrogation to stand in the shoes of Colonel Warren in respect of his loan of £500 2sh which was said to have been paid off out of the Diplock grant. In the latter case the claim is to have the benefit of a charge for £6,000 on property of the hospital formerly held by Barclays Bank, Ltd., as security for a fixed loan for that amount which was paid off out of the Diplock grant under the terms on which that grant was made. Both claims were rejected by Wynn-Parry J. The facts in relation to this £500 2sh do not appear to have been clearly ascertained. But assuming that it was used to repay Colonel Warren, the result apparently was to enable the charity to apply the sum borrowed from Colonel Warren for the purpose of executing the works in question. There is no suggestion that Colonel Warren's loan was a secured loan. The payment to Colonel Warren can only have operated to extinguish the debt owing to him and the money which he had advanced was consequently available for use by the charity for the purposes indicated without there being any obligation to repay it. The case cannot, we think, be regarded as a case of subrogation. We agree with the view of Wynn-Parry J that in such a case the debt was extinguished so that in order to give effect to the equitable doctrine said to be applicable it would be necessary to revive the debt in some way. We do not see how it can be said to be unconscientious on the part of the charity to object to this being done. In substance the Diplock money was used for the purpose of carrying out works on the land of the charity and, in our opinion the appellants are in no better position than they are in the cases of works carried out on lands of a charity which we have already discussed.

The case of the Leaf Homeopathic Hospital is different in that (a) the loan was a secured loan, (b) the grant was made in terms for the purpose of enabling the charity to pay off the loan, and (c) the £6,000 in question cannot be said to have been used indirectly in the execution of works as in the case of the Heritage Craft Schools: it was used simply and solely for the purpose of clearing off an existing encumbrance.

Here, too, we think that the effect of the payment to the bank was to extinguish the debt and the charge held by the bank ceased to exist. The case cannot, we think, be regarded as one of subrogation, and if the appellants were entitled to a charge it would have to be a new charge created by the court. The position in this respect does not appear to us to be affected by the fact that the payment off of this debt was one of the objects for which the grant was made. The effect of the payment was that the charity, which had previously held only an equity of redemption, became the owners of unencumbered property. That unencumbered property derived from a combination of two things, the equity of redemption contributed by the charity and the effect of the Diplock money in getting rid of the encumbrance. If equity is now to create a charge (and we say 'create' because there is no survival of the original charge) in favour of the judicial trustee, it will be placing him in a position to insist upon a sale of what was contributed by the charity. The case, as it appears to us, is in effect analogous to the cases where Diplock money is expended on improvements on charity land. The money was in this case used to remove a blot on the title; to give the judicial trustee a charge in respect of the money so used would, we think, be equally unjust to the charity who, as the result of such a charge, would have to submit to a sale of the interest in the property which it brought in. We may point out that if the relief claimed were to be accepted as a correct application of the equitable principle, insoluble problems might arise in a case where in the meanwhile fresh charges on the property had been created or money had been expended upon it.

As regards the main action, the only appeal made to this court relates to the claim against St George's Hospital. That charity received a grant of £8,000 on March 20, 1937. By a letter dated October 19, 1939, addressed to the solicitors for the executors, the assistant secretary stated that this sum 'has been invested in the name of the rebuilding fund of St George's Hospital'. This letter is admitted in para 4 of the defence but it is denied 'that any part of the investments in the name of the rebuilding fund of this defendant' in fact represents the said sum of £8,000 or forms part of the 'testator's estate'. According to correspondence which is before us it would appear that the £8,000 was paid into the charity's 'rebuilding appeal account' with the Westminster Bank, Knightsbridge,

on March 21, 1937. The correspondence shows that certain sums (apparently small) were drawn from this account and spent and that investments were from time to time made by means of money drawn from the account. In the case of Dr Barnardo's Homes we think (as later appears) that the rule to be applied in order to give effect to the appellant's equity would be the same as that applied in *Clayton's case* ((1816)1 Mer 572). In the case of Dr Barnardo's Homes we have before us the relevant banking account, showing all the dealings, in and out, since the receipt of the Diplock money. In the case of St George's Hospital we have not before us the corresponding banking account; but it appears to us that on principle the same rule would prima facie be applicable. In any case it seems to us reasonably clear that the £8,000 or some part of it can be traced into the investments.

Questions

(1) *Re Diplock* is a leading authority on equitable tracing principles, but the rulings on the applications of Diplock money by the charities are controversial. Consider the following:

(a) Should the rule in *Clayton's* case have been applied to determine title to money mixed in the charities' bank accounts and to property purchased from mixed funds? Contrast the solution reached in *Re Diplock* with that reached in *Re French Caledonia Travel* and in *Caron v Jahani (No 2)*.

(b) Was the Court of Appeal correct in holding that tracing was impossible once a beneficiary's money had been used to discharge a debt? There is earlier Australian authority to the same effect: *Moffatt v Crawford* [1924] St R Qd 241, but see the discussion of 'backward tracing' at [21.3.1] above.

(c) Can a distinction be drawn in this respect between tracing into secured and unsecured debts? If a charity had given security to a bank for repayment of a debt, and the debt had later been paid off with Diplock money, why could not the Diplock next-of-kin have taken over the security from the bank? Just as tracing allows one asset to stand in the place of another, equitable subrogation allows one claimant to stand in the place of another. Should the next-of-kin have been subrogated to the rights of a charity's secured creditor? On equitable subrogation, see C Mitchell and S Watterson, *Subrogation: Law and Practice* (Oxford University Press, 2007), and *Boscawen v Bajwa* [1996] 1 WLR 328, 335.

(d) Do you agree with the Court of Appeal that it is impossible to trace into improvements of a building? Should the Court have imposed a charge over the hospital building to secure repayment of the beneficiaries' money spent on making the improvements? Consider this solution: 'Justice did not require the withholding of any remedy, but only that the charge … should not be enforceable until the hospital had had a reasonable opportunity to obtain a fresh advance on suitable terms from a willing lender, perhaps from the bank which had held the original security': *Boscawen v Bajwa* [1996] 1 WLR 328, 341 (Millett LJ).

(e) The Court of Appeal's refusal to allow the next-of-kin to trace into improvements of the hospital which used the money to construct two children's wards has been rationalised on the following grounds:

(i) that it would be inequitable to allow tracing into the improvements, or

(ii) that the defence of change of position applied, in other words that the hospital had in good faith changed its position in reliance on the validity of the bequest. On change of position, see E Bant, *The Change of Position Defence* (Hart Publishing, 2009), especially 204–9 on the application of the defence to proprietary claims.

How convincing are these rationalisations?

(2) The charities in *Re Diplock* acted in good faith in receiving and applying the Diplock money. What would have been the next-of-kin's entitlement if the charities had accepted the Diplock money knowing there were doubts about the validity of the will? Consider liability for 'knowing receipt' discussed in chapter 11.

21.7 Tracing into profits

In some cases, the fiduciary will have successfully invested the plaintiff's money, or sold the plaintiff's property and successfully invested the proceeds. Two questions then have to be answered. First, is the plaintiff entitled to any part of the successful investment? And secondly, if so, what remedy enforces that entitlement?

21.7a *Scott v Scott* (1963) 109 CLR 649

Background

The most substantial asset held by a trust was the family home. One of the trustees, WH Scott, purchased a new home to enable him to live near his daughter. The price of the new home was £1,700. WH Scott sold the family home and applied £1,014 of the proceeds of sale towards the purchase of the new property. This application of trust money was a breach of trust since neither the terms of the trust nor trustee legislation at that time permitted trustees to invest trust money in the purchase of real property. WH Scott repaid the £1,014 before he died. At his death, the new property was valued at £3,750.

The settlor's children and grandchildren, who were beneficiaries of the trust, claimed that the trust was entitled to a proportion of the appreciated value of that property.

Decision

The High Court upheld the order of the trial judge that the estate of WH Scott account for a profit of £2,236, being 1014/1700 of the present value of the new property. The account of profits was to be secured by an equitable charge over the property.

The Court

The trust funds were improperly applied in the purchase, it was the duty of the trustee to remedy the breach of trust and, unless the repayment of the sum of £1,014 in 1959 constituted a remedying of the breach, he had failed to do so before his death. But if all that the remainderman were entitled to was repayment to the estate of the amount misapplied then the effect of the remedy that would have been available against WH Scott in his lifetime would have been merely to confirm the misapplication of that sum and to condone the breach of trust. This would mean, in effect, that the trustee was, in 1942, at liberty to use trust moneys in conjunction with moneys of his own in purchasing the property subject only to a liability to account for the trust moneys so used and to keep for himself the whole of the profit made upon any resale of the property. The proposition has only to be stated not only to realize its injustice but also to show that it is completely inconsistent with the proposition that has been consistently stated on so many occasions over the last two centuries and which was reformulated comparatively recently in *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378. In that case Lord Porter said that: 'The legal proposition may … be broadly stated by saying that one occupying a position of trust must not make a profit which he can acquire only by use of his fiduciary position, or, if he does he must account for the profit so made' (at 395). In the same case Lord Macmillan spoke of the equitable doctrine invoked in that case as being 'one of the most deeply rooted in our law' (at 391). The relevant principle is stated in *Underhill's Law of Trusts and Trustees* 11th ed (1959) p 390 and its application is abundantly illustrated by the many and diverse cases which are cited in the following pages. It is sufficient to observe, in relation to the present case, that 'a trustee must not use or deal with trust property for his own advantage' and that if he does so and a profit results a constructive trust thereof will arise. As was said as long ago as 1778 by Lord Kames, 'Equity prohibits a trustee from making any profit by his management, directly or indirectly' *(Principles of Equity* 3rd ed (1778) vol 2, p 87). …

What must be borne in mind in the case is that the order appealed from rests upon a twofold basis and it is on this basis that the respondent's argument primarily attempts to support it. It rests upon the liability of WH Scott to make good a breach of trust and also upon his liability to account for a profit which accrued to him, or to his estate, as the result of his misuse of trust funds. These are two different and distinct notions. A trustee's liability to account for profits accruing to him may arise without any positive breach of trust; on the other hand, a trustee may become liable to make good a misapplication of trust moneys with interest even though he

has made no profit by the misapplication. But where the expenditure of moneys constitutes a breach of trust the remedies may overlap for the beneficiaries may have both a proprietary and personal remedy and, of course, if they choose to pursue the former this will be the full measure of the relief available to them.

There is, of course, abundant authority for the proposition that if trust moneys have been exclusively used in the purchase of property the beneficiary may elect to take the property itself. There is also authority for the proposition that if trust funds from two different estates are exclusively used by a common trustee in the purchase of land in his name which has increased in value each estate will be held entitled to a proportionate part of the increase: *The Lord Provost etc of Edinburgh v Lord Advocate* (1879) 4 App Cas 823. In such a case it would be unthinkable that each estate should be entitled merely to a charge for the amount misapplied with, perhaps, some allowance for interest, and the trustee left with a residual profit. Why, then, should a trustee who has mixed moneys of his own with trust moneys for the purpose of purchasing lands which have greatly increased in value be held entitled, upon repayment of the trust moneys misapplied, to retain the whole of any profit which has resulted, at least in part, from the misuse of the trust moneys?

Considerations such as these carried considerable weight with the learned trial judge and in a careful and learned judgment he discussed the classic cases of *Docker v Somes* (1834) 2 My & K 655 and *Vyse v Foster* (1874) 7 HL 318 not only for the purpose of emphasizing that a trustee may not make a profit out of the trust, but also to show that his duty to account is not necessarily confined to cases where trust funds have been wrongly embarked in the trustee's business but extends to 'all profits received by a trustee who deals with the trust fund for his own advantage'. It is, we think, important to observe that the liability of a trustee to account in such cases is not confined to a limited group of categories but extends to all cases where such a profit has, in fact, been made. We agree with his Honour's analysis of the cases to which he referred and we agree with his conclusion. The argument to the contrary is, we think, based upon an erroneous conception of the true principle. No doubt it is true to say that in this case the estate was entitled to assert a lien upon the property purchased with the mixed fund to secure the amount misapplied. But it is erroneous to say that in the circumstances of this case this was the full measure of the relief to which the estate was entitled. It was, of course, conceded that where property is, in breach of trust, bought exclusively with trust moneys the beneficiaries may, instead of pursuing their personal right against the trustee, elect to take the property. Again it was conceded that where property is purchased, in breach of trust, with a 'mixed fund' the beneficiaries may, if the property is 'specifically severable', elect to take such part thereof as bears the same proportion to the whole as the misapplied trust moneys bore to the purchase price. Property may be thought to be 'specifically severable' where it consists of bonds or a parcel of shares: *Brady v Stapleton* (1952) 88 CLR 322. This may also be the position if the property purchased consists of a flock of sheep or a herd of cattle or so many bales of wool and so on though difficulties might arise where the severance could not be made at a point precisely commensurate with the amount of trust moneys misapplied. This, however, is by the way. In its final analysis the appellant's argument on this branch of the case seems to rest upon the assertion that it cannot be said that there was any liability to account for any part of the profit which accrued to the trustee or, ultimately, to his estate, unless it can be established that the estate of the testatrix became entitled to a beneficial interest in the property which WH Scott purchased. This, it was said, could not upon the authorities be established. Upon this latter proposition we will make some observations presently. But for the moment we are content to assume that this could not be established for the basic contention finds no support in the innumerable and varied cases in which trustees have been held liable to account for profits arising from the misapplication of trust moneys. …

We have spoken of the profit which accrued to the trustee but it is said that if there was a profit in his lifetime it was an unrealized profit and that no obligation could arise until he had sold the property at an enhanced price and so realized a profit. But we think that this argument is without substance. Clearly enough the estate was entitled as against WH Scott to seek an order for sale to enforce its lien and upon any such sale the profit would have been realized. It is true, no doubt, that if the property had not increased in value the trustee, in his lifetime, might have chosen to avoid a sale by repayment of the amount for which the lien subsisted. But no such choice can be said to have been open to him in this case for he could not be allowed to escape his liability to account merely by repayment of the amount of trust moneys misapplied. Accordingly, we take the view that repayment of the sum of £1,014 in 1959 did not operate to defeat the beneficiaries' right to a sale; this, we think, could have been defeated only by an accounting for profits as on a notional sale. For this purpose the learned judge of first instance took the value of the property as at the commencement of the suit. As it was then worth somewhat less than it was at the date of WH Scott's death and there is no cross-appeal it is unnecessary for us to express any opinion concerning the time at which the value of the property should be ascertained. …

The matter which we reserved for subsequent comment was concerned with the second ground upon which the respondent sought to support the order. It was, in effect, that, notwithstanding the fact that the property which WH Scott purchased could not be said to be 'specifically severable' property, the estate, nevertheless, became entitled to claim a proportionate interest in it. We think, in principle, that there is much to be said for this proposition. Some support may, perhaps, be found for it in *Lord Provost etc of Edin-*

burgh v Lord Advocate (1879) 4 App Cas 823 and we observe that equity has had no difficulty in holding parties beneficially entitled to proportionate shares in property where they have jointly provided the purchase money and title is taken in the name of one only: *The Venture* [1908] P 218 at 229; *Diwell v Farnes* [1959] 2 All ER 379; *Bull v Bull* [1955] 1 QB 234; and *Gravesend Corporation v Kent County Council* [1935] 1 KB 339. It was said in argument that the principle applied in these cases rests upon the intention, or the presumed intention, of the parties. But if this be a fundamental distinction it introduces a curious anomaly into the law as will appear from the following illustration. If A contributes one-half of the purchase price for the purpose of purchasing Blackacre and B, providing the other one-half, takes Blackacre in his own name they will each be beneficially entitled to a one-half interest. But if B in breach of trust, purchases, not Blackacre, but Whiteacre, A will be denied any right to a like proportionate interest in that property. This, of course, would follow from the appellant's argument and we confess to some difficulty in seeing why this should be so. It is, however, unnecessary for us to pronounce upon the respondent's alternative argument but we cannot fail to observe that the Courts of the United States have carried the matter to its logical conclusion. In effect, they have held that where trust moneys are mixed with moneys of the trustee and the mixed fund is used in acquiring other property which is not 'specifically severable', the beneficiaries are, nevertheless, entitled to claim a proportionate interest in the property. The matter is dealt with at length in *Scott on Trusts* 2nd ed p 3289 *et seq* and a number of cases are cited in support of the proposition. We think it necessary to refer, however, only to passages in the *Restatement of the Law, Trusts,* vol 1, (1935) pp 540, 541 and the *Corpus Juris Secundum* vol 90, pp 844–849 and an interesting judgment of Learned Hand J in *Primeau v Granfield* (1911) 184 Fed R 480 in which he rejects the contention that the proposition in question is in conflict with observations made in *In re Hallett's Estate* (1880) 13 Ch D 696. However, as we have already said, it is unnecessary to express any concluded view on the point and it may well be left for further consideration.

21.7b *Foskett v McKeown* [2001] 1 AC 102

Background

See [21.1a] above for a statement of the facts. The judgment of Lord Millett below discusses the beneficiaries' entitlement to a proportionate share of the payment received by the fiduciary's children on his death.

Decision

Lord Millett

The simplest case is where a trustee wrongfully misappropriates trust property and uses it exclusively to acquire other property for his own benefit. In such a case the beneficiary is entitled at his option either to assert his beneficial ownership of the proceeds or to bring a personal claim against the trustee for breach of trust and enforce an equitable lien or charge on the proceeds to secure restoration of the trust fund. He will normally exercise the option in the way most advantageous to himself. If the traceable proceeds have increased in value and are worth more than the original asset, he will assert his beneficial ownership and obtain the profit for himself. There is nothing unfair in this. The trustee cannot be permitted to keep any profit resulting from his misappropriation for himself, and his donees cannot obtain a better title than their donor. If the traceable proceeds are worth less than the original asset, it does not usually matter how the beneficiary exercises his option. He will take the whole of the proceeds on either basis. This is why it is not possible to identify the basis on which the claim succeeded in some of the cases.

Both remedies are proprietary and depend on successfully tracing the trust property into its proceeds. A beneficiary's claim against a trustee for breach of trust is a personal claim. It does not entitle him to priority over the trustee's general creditors unless he can trace the trust property into its product and establish a proprietary interest in the proceeds. If the beneficiary is unable to trace the trust property into its proceeds, he still has a personal claim against the trustee, but his claim will be unsecured. The beneficiary's proprietary claims to the trust property or its traceable proceeds can be maintained against the wrongdoer and anyone who derives title from him except a bona fide purchaser for value without notice of the breach of trust. The same rules apply even where there have been numerous successive transactions, so long as the tracing exercise is successful and no bona fide purchaser for value without notice has intervened.

A more complicated case is where there is a mixed substitution. This occurs where the trust money represents only part of the cost of acquiring the new asset. As James Barr Ames pointed out in 'Following Misappropriated Property into its Product' (1906) 19 *Harv L Rev* 511, consistency requires that, if a trustee buys property partly with his own money and partly with trust money, the beneficiary should have the option of taking a proportionate part of the new property or a lien upon it, as may be most for his advantage. In principle it should not matter (and it has never previously been suggested that it does) whether the trustee mixes the trust money with his own and buys the new asset with the mixed fund or makes separate payments of the purchase price (whether simultaneously or sequentially) out of the different funds. In every case the value formerly inherent in the trust property has become located within the value inherent in the new asset. The rule, and its rationale, were stated by Samuel Williston in 'The Right to Follow Trust Property when Confused with other Property' (1888) 2 *Harv L Rev* 28, 29:

> If the trust fund is traceable as having furnished in part the money with which a certain investment was made, and the proportion it formed of the whole money so invested is known or ascertainable, the *cestui que trust* should be allowed to regard the acts of the trustee as done for his benefit, in the same way that he would be allowed to if all the money so invested had been his; that is, he should be entitled in equity to an undivided share of the property which the trust money contributed to purchase – such a proportion of the whole as the trust money bore to the whole money invested. The reason in the one case as in the other is that the trustee cannot be allowed to make a profit from the use of the trust money, and if the property which he wrongfully purchased were held subject only to a lien for the amount invested, any appreciation in value would go to the trustee.

If this correctly states the underlying basis of the rule (as I believe it does), then it is impossible to distinguish between the case where mixing precedes the investment and the case where it arises on and in consequence of the investment. It is also impossible to distinguish between the case where the investment is retained by the trustee and the case where it is given away to a gratuitous donee. The donee cannot obtain a better title than his donor, and a donor who is a trustee cannot be allowed to profit from his trust.

Questions

(1) Lord Millett in *Foskett v McKeown* stated that the beneficiary is entitled to a 'proportionate share' of the profits made by a trustee from the trustee's breach of duty. Is the 'proportionate share' enforceable by an account of profits, a constructive trust, a resulting trust, or is it simply treated as an accretion to the express trust on which the trustee already holds property for the beneficiary? If it is a constructive trust, is it a remedial constructive trust? See chapter 23.

(2) What are the practical differences between the account of profits secured by a charge awarded in *Scott v Scott* and the proportionate share remedy ordered in *Foskett v McKeown?*

(3) Given the stringency of equity's proscription of unauthorised profit-making by fiduciaries (see *Boardman v Phipps* [1967] 2 AC 46 at [10.5.2a]), should the beneficiaries have been entitled to all the appreciation in the value of the new house in *Scott v Scott*, and to all the insurance payment to the children (except for the cost of the premiums paid by the developer with his own money) in *Foskett v McKeown?*

(4) What is the justification for the beneficiary's right to trace profits? Is it based on:

(a) the unjust enrichment of the trustee, or of those claiming under the trustee (such as the developer's children in *Foskett v McKeown*)

(b) the beneficiary's equitable property rights to the original trust property, or

(c) the trustee's breach of duty to make and hold profits for the beneficiary?

21.8 Defences to equitable tracing claims

See textbook at [21.28].

Part H

Resulting and constructive trusts

22

Resulting trusts

22.1 Introduction

22.2 Overview of resulting trusts

22.3 Presumed resulting trusts

22.4 Incomplete dispositions of a beneficial interest

22.5 *Quistclose* trusts

22.6 Rationale of resulting trusts

22.1 Introduction

Resulting trusts arise when title to property is transferred and the provider of property does not intend to benefit the recipient. The trust thus identified is a bare trust under which the essential duty of the legal owner is to act in relation to the property as the beneficiary directs. Resulting trusts are often described by distinguishing them from their siblings, express trusts and constructive trusts. Unlike express trusts, which give effect to the settlor's positive intention to benefit the recipient, a resulting trust arises in the absence of the provider's positive intention. Whilst the juridical basis of some constructive and resulting trusts may be contested, it is nonetheless certain that constructive trusts are raised in response to equitable wrongdoing such as breach of fiduciary duty, and that resulting trusts are *not* a proprietary response to equitable wrongs. See textbook at [22.1]–[22.4], [22.5]–[22.8].

There are two families of resulting trust:

- resulting trusts in which equity presumes a declaration of trust or the fact of the settlor's manifestation of intention to declare a trust. These include trusts described as *'presumed resulting trusts'*, *'purchase money resulting trusts'* and *'voluntary transfer resulting trusts'*.
- resulting trusts which arise when there has been an incomplete disposition of a beneficial interest in a trust. For example, resulting trusts which arise upon failure of an express trust, when the purpose of a trust fails or where there is an unexhausted residue in the fund held on trust for identified purposes after satisfaction of those purposes. These are sometimes described as *'automatic resulting trusts'*.

There is a third category of trust following *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567. This category is discussed separately below at [22.5].

Questions for consideration

(1) Who is the settlor, who is the beneficiary, and who is the trustee of a resulting trust?

(2) What is the role of presumptions? What is the fact being presumed?

22.2 Overview of resulting trusts

22.2a *Anderson v McPherson (No 2)* [2012] WASC 19; (2012) ASTLR 321

Background

Carol and Bruce Anderson paid for most of the purchase price of property that was put into their names (joint tenants of half a share) as tenants in common with their son Troy and his wife Stephannie (joint tenants of the other half share). The parties agreed that Carol and Bruce would pay the bulk of the purchase price, and Troy and Stephannie would make all the mortgage repayments, including the loan repayments attributable to the cost of building a rear residence on the property where Carol and Bruce would live. Other expenses would be shared. Troy and Stephannie later separated and Bruce and Carol claimed that the half share in the property held by Troy and Stephannie was held on resulting trust for them, in proportion to their contributions. Troy took no part in the proceedings and agreed to abide by the decision of the Court. Stephannie argued that a presumption of advancement arose in her favour.

Decision

It was held that on the evidence the half share in the property was transferred to Stephannie and Troy for their own benefit.

Edelman J

Why does a resulting trust arise?

An important preliminary question is why a resulting trust arises. The answer to that question in this case dictates the facts which must be proved by a defendant to rebut the 'presumption of resulting trust'.

The Supreme Court of Canada has recently observed that 'there is not much one can say about resulting trusts without a well-grounded fear of contradiction. There is debate about how they should be classified and how they arise, let alone about many of the finer points': *Kerr v Baranow* [2011] SCC 10; [2011] 1 SCR 269 [16] (Cromwell J for the court).

The view of Professor Chambers in *Resulting Trusts* (2007) 4, following the late Professor Birks, is that the label 'resulting trust', from the Latin *resalire,* invokes a metaphor of rights 'jumping back' to the settlor: see also J D Heydon and M J Leeming, *Jacobs' Law of Trusts* (7th ed, 2006) 234 [1201].

The metaphor of jumping back is misleading. For instance, where a legal right of ownership of land is transferred and a resulting trust arises, a new equitable interest is created in favour of the settlor. The absolute owner in fee simple who transfers title did not previously hold both legal and equitable estates. He held only a legal estate; no equitable estate existed prior to the transfer which could 'jump back': *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties (NSW)* [1982] HCA 14; (1982) 149 CLR 431, 463 (Aickin J); *Commissioner of Taxation v Linter Textiles Australia Ltd (in liq)* [2005] HCA 20; (2005) 220 CLR 592, 606 [30] (Gleeson CJ, Gummow, Hayne, Callinan & Heydon JJ); *Peldan vAnderson* [2006] HCA 48; (2006) 227 CLR 471, 485 [37] (Gummow ACJ, Kirby, Hayne, Callinan & Crennan JJ).

An alternative view which does not invoke this metaphor suggests that 'resulting' ought merely to be understood as 'resulting' from the circumstances of the case: *Black Uhlans Inc v New South Wales Crime Commission* [2002] NSWSC 1060 [131] (Campbell J, as his Honour was then).

If 'resulting' is understood as arising from the circumstances of the case then there is little difference, as a matter of labelling, between 'resulting' and 'constructive'. Quoting from Professor Scott, a joint judgment in the High Court of Australia has said that for a constructive trust, a court 'construes the circumstances in the sense that it explains or interprets them': *Giumelli v Giumelli* [1999] HCA 10; (1999) 196 CLR 101, 111 [2] (Gleeson CJ, McHugh, Gummow & Callinan JJ).

Indeed, the historically close association between resulting and constructive trusts meant that they were originally used interchangeably, particularly by Lord Nottingham LC. For instance, in *Grey v Grey* (1677) 2 Swan 594, 598; (1677) 36 ER 742, 743, Lord Nottingham LC spoke interchangeably of a use by implication (now, resulting trust) and a constructive trust; see also M Macnair 'Coke v Fountaine (1676)' in C Mitchell and P Mitchell (eds) *Landmark Cases in Equity* [(2012)] ch 2. Historical separation may have occurred with the epexegetical interpretation of the word 'construction' in the expression in the *Statute of Frauds* 1677 'by the implication or construction of law': W Holdsworth, *A History of English Law* (1924) VI, 643.

Therefore, whether the label 'resulting trust' is concerned with a trust which 'jumps back' or 'results from the circumstances of the case', the label does not assist in understanding why the trust arises. However, two matters are well established for resulting trusts *inter vivos* (amongst the living). First, the resulting trust is a trust in favour of the settlor himself or herself. Secondly, resulting trusts are not mono-causal. In other words, resulting trusts arise for a number of different reasons.

For centuries, the most common instance in which resulting trusts have arisen has been where the settlor's objectively manifested intention is that the rights which the settlor transferred to another, or purchased in the name of another, should be held on trust for the settlor. If this intention is proved by evidence the trust is usually described as an express trust. But where the intention is proved by presumption the trust is described as a resulting or implied trust.

In this sense, resulting trusts have been described as 'intent enforcing' like express trusts: *Black Uhlans Inc v New South Wales Crime Commission* [133] (Campbell J). Campbell J's decision was described by Young CJ in Eq as 'the latest authoritative discussion' in *Salvo v New Tel Limited* at [2005] NSWCA 281 [92].

The intention to be discerned in a resulting trust is an objective, manifest intention; it is not an unexpressed subjective intention: *Calverley v Green* (261) (Mason & Brennan JJ), (270) (Deane J); *Byrnes v Kendle* (286–287) [105]–[106] (Heydon & Crennan JJ); *Re Vandervell's Trusts (No 2)* [1974] Ch 269, 294 (Megarry J).

But resulting trusts also arise for reasons other than (presumed) manifestations of intention to create a trust. There are numerous examples where a resulting trust has been imposed by law even despite clear and manifest evidence that the settlor did not intend that the rights be held on trust for him or her. Sometimes these resulting trusts which are imposed by law are described as 'automatic' resulting trusts.

A well recognised example of a resulting trust which is imposed by law is where an attempt to create an express trust fails: see the discussion in *Knudsen v Kara Kar Holdings Pty Ltd* [2000] NSWSC 715 [49] (Austin J); and *Yard v Yardoo Pty Ltd* [2006] VSC 109 [298] (Cummins J), discussion not considered on appeal in either *Yard v Yardoo Pty Ltd* [2007] VSCA 35 or *Kara Kar Holdings Pty Ltd v Knudsen* [2001] NSWCA 276. See also J D Heydon and M J Leeming *Jacobs' Law of Trusts* (7th ed, 2006) 236 [1205].

Another example of a resulting trust imposed by law is where a transfer of legal title occurs 'about which the transferor was entirely unaware': *Robb Evans of Robb Evans & Associates v European Bank Limited* [2004] NSWCA 82; (2004) 61 NSWLR 75, 99–100 [111]–[113] (Spigelman CJ).

In these cases of resulting trusts imposed by law, the justification for the trust sometimes proceeds on the flawed basis … that the transferor held both a legal and equitable interest and divested only the legal interest: W Swadling 'Explaining Resulting Trusts' (2008) 124 LQR 72, 99–100 discussing *Vandervell v Inland Revenue Commissioners* [1967] 2 AC 291, 313 (Lord Upjohn), 329 (Lord Wilberforce).

A better explanation for the imposition of a resulting trust in these cases focuses upon the lack of intention, usually by the immediate transferor, to benefit the recipient: *Robb Evans of Robb Evans & Associates v European Bank Limited* (99–100) [111]–[113] (Spigelman CJ) citing R Chambers *Resulting Trusts* (1997); *Air Jamaica Ltd v Charlton* [1999] 1 WLR 1399, 1412 (Lord Millett). These resulting trusts are imposed as a legal response to prevent the recipient having the use and enjoyment of rights for his or her own benefit where that use and enjoyment was not intended.

In this case it is not necessary to consider the imposition of this type of resulting trust which is imposed by law … Counsel for the plaintiffs clarified that their case was brought solely on the basis of a resulting trust which arises as a result of a presumption of objectively manifested intention …

The focus of the claim for a resulting trust in this case is therefore only upon the presumed or manifested intention of Bruce and Carol in their purchase of the Anstey Road property.

22.3 Presumed resulting trusts

In finding an express trust, equity requires the settlor's objectively manifested intention to create a trust (see chapter 14 and textbook at [14.5]–[14.19]). The same is true in resulting trusts, in which there is 'a presumption of a declaration of trust; the rebuttable presumption is of the fact of a manifest declaration [of trust]' (Edelman J in *Anderson v McPherson (No 2)* [2012] WASC 19; (2012) 8 ASTLR 321, [106]). However, when there is sufficient evidence of the settlor's contrary intention, or where a presumption of advancement arises, this presumption of declaration will not apply.

22.3.1 Presumption of resulting trust

22.3.1a *Anderson v McPherson (No 2)* [2012] WASC 19; (2012) 8 ASTLR 321

Background

For a statement of the facts, see above at [22.2a].

Decision

Edelman J

What is 'presumed' in the 'presumption of resulting trust'

In the class of 'intent enforcing' resulting trust cases, judgments almost invariably refer to a 'presumption of resulting trust'. … But the reference to a 'presumption of resulting trust' is shorthand for a presumption of a declaration of trust; the rebuttable presumption is of the fact of a manifest declaration. The presumption is not of the legal institution of the trust itself (which is the conclusion of law): W Swadling 'Explaining Resulting Trusts' (2008) 124 LQR 72, 79. Nor is there a presumption of the existence of the trust property conveyed, a matter which is essential to the trust, and which is proved by evidence.

In *Cook v Fountain* (1676) 3 Swan 585, 591; 36 ER 984, 987, the Lord Chancellor, Lord Nottingham, giving the opinion of himself and two Chief Justices, said of the presumption of a declaration of trust:

> [E]xpress trusts are declared either by word or writing; and these declarations appear either by direct and manifest proof, or violent and necessary presumption. These last are commonly called presumptive trusts; and that is, when the Court, upon consideration of all circumstances presumes there was a declaration, either by word or writing, though the plain and direct proof thereof be not extant.

The presumption of a declaration of trust applied not merely to voluntary conveyances of title, or purchases in the name of another, but also in cases where the legal title was held in a proportion different from the contribution to the price: *Lake v Gibson* (1729) 1 Eq Ca Abr 291; 21 ER 1052; *Lake v Craddock* (1732) 3 P Wms 158; 24 ER 1011.

In *Dyer v Dyer* (1788) 2 Cox Eq Cas 92, 93; 30 ER 42, 43, Eyre CB said that the rule that the 'trust of a legal estate … results to the man who advances the purchase-money' developed by strict analogy from the rule which applied to the predecessor of the trust, the use. That rule was that where a feoffment was made without consideration, the use would result to the feoffor. The rule was extended to advances of part of the consideration by Sir Thomas Plumer in *Wray v Steele* (1814) 2 Ves & B 388; 35 ER 366.

The feoffment to uses, and later the trust, was extremely common from the fifteenth until the seventeenth centuries for a number of reasons. Lord Hardwicke LC explained two of the reasons for the popularity of the use or trust. These were to avoid wardship, and to avoid escheat and forfeiture to the Crown particularly during the Wars of the Roses: see *Lloyd v Spillet* (1740) 2 Atk 148, 150;

26 ER 493, 494 and the essay (as *Sanders on Uses and Trusts* was then) commended by Atkyns in his report, F Sanders *An essay on the nature and laws of uses and trusts* (1791) 109–110, 127–134.

It is easy to see why this presumption of a declaration of trust arose in historic circumstances where the only facts proved were that title to land had been voluntarily conveyed from one person to another, or purchased in the name of another whose contribution to the purchase price did not correspond with his or her legal interest.

The obvious inference historically from those facts was that a trust had been declared since 'almost all the lands in England were conveyed to Uses' to evade 'the hardships of the feudal tenures … [and] to secure estates from forfeitures for high treason': W Cruise *An Essay on Uses* (1795) 30; see also T Plucknett and J Barton *St German's Doctor and Student* (1523; ed 1974) p 222, ch 22, 'Howe uses of lande began and by what law and the cause why so moche lande is put in use'.

With almost all land conveyed to uses and in circumstances in which it was not usual to include words of trust on the conveyance, common experience suggested that a trust had been declared when there was a voluntary conveyance of land to another, or a purchase in the name of another whose contribution did not correspond with his or her legal interest: W Swadling 'Explaining Resulting Trusts' (2008) 124 LQR 72, 80.

It is more difficult today to justify why a declaration of trust should be presumed where land is voluntarily conveyed or where contributions to a joint title are not equal. The New South Wales Court of Appeal has remarked that it 'seems rather ridiculous that troubles in England at the end of the Middle Ages should be the basis, in the late twentieth century, for making findings of fact': *Dullow v Dullow* (1985) 3 NSWLR 531, 535 (Hope JA, Kirby P & McHugh JA agreeing). And in *Calverley v Green* ([1984] HCA 81 at 264), Murphy J said that the presumption should be discarded.

However anachronistic the presumption may be, Australian courts have said that it is a well-entrenched landmark in the law of property which cannot be disregarded by judicial decision: *Calverley v Green* (266) (Deane J); *Brown v Brown* (1993) 31 NSWLR 582, 588 (Gleeson CJ); see also *Charles Marshall Pty Ltd v Grimsley* [1956] HCA 28; (1956) 95 CLR 353, 364 (Dixon CJ, McTiernan, Williams, Fullagar & Taylor JJ) '[t]he law applicable to cases of this nature can … no longer be the subject of argument'. Further, '[m]any disputes have been resolved and transactions effected on [the] foundation' of the presumption: *Nelson v Nelson* [1995] HCA 25; (1995) 184 CLR 538, 548 (Deane & Gummow JJ), see also 602 (McHugh J) 'the better course is to leave reform … to the legislature' (*Nelson v Nelson* [1995]).

As developed from these historical origins, the presumption of a declaration of trust which is relevant to this case means that 'a resulting trust arises in favour of the purchaser, or in favour of two purchasers in the proportions in which they contributed the purchase money … subject to the exception created by the presumption of advancement': *Calverley v Green* (247) (Gibbs CJ), see also (258) (Mason & Brennan JJ), (269) (Deane J).

22.3.1b *Calverley v Green* [1984] HCA 81; (1984) 155 CLR 242

Background

Mr Calverley and Ms Green were de facto partners. They made a joint financial commitment in purchasing a house in joint names as joint tenants. The purchase price was $27,750 which was financed as follows:

- Mr Calverley paid $9,000 deposit, plus a further $250: total $9,250
- $18,000 was borrowed by them jointly. As agreed between them, all loan repayments were made by Mr Calverley. The loan was secured by a mortgage over the property.

Mr Calverley and Ms Green lived together in the property but in 1978 their relationship broke down. Ms Green brought an action in the Supreme Court of New South Wales seeking an order for compulsory sale of the house and equal distribution of the proceeds between her and Mr Calverley. Mr Calverley cross-claimed arguing that Ms Green held her interest in the house on trust for him and asked the Court for an order directing that Ms Green transfer her interest in the property to him.

Decision

A majority of the High Court, Murphy J dissenting, declared it was presumed that a trust had been declared in proportions representing a $9,250 contribution by Mr Calverley and equal contributions as to the balance.

Gibbs CJ

[T]he general rule that in the situations mentioned it is presumed that a resulting trust arises in favour of the purchaser, or in favour of two purchasers in the proportions in which they contributed the purchase money, is subject to the exception created by the presumption of advancement. …

Mason and Brennan JJ

Unless an equitable presumption of a trust is displaced by a counter-presumption or it is rebutted or qualified by evidence of the intention of the party paying the purchase price or of the common intention of the parties who contribute that price, the presumption determines the conclusion to be reached: *Stewart Dawson & Co (Vic) Pty Ltd v Federal Commissioner of Taxation* (1933) 48 CLR 683, at 689–691; *Carkeek v Tate-Jones* [1971] VR 691, at 695–696. Once it was found that both parties had contributed to the purchase price, the conclusion had to conform to the relevant equitable presumption unless it was displaced, rebutted or qualified. When two or more purchasers contribute to the purchase of property and the property is conveyed to them as joint tenants the equitable presumption is that they hold the legal estate in trust for themselves as tenants in common in shares proportionate to their contributions unless their contributions are equal …

The Court of Appeal correctly took the time of the acquisition of the … property as the material time for determining the beneficial interests of the parties. The evidentiary material from which the court might have drawn an inference as to the intention of the parties included their acts and declarations before or at the time of the purchase, or so immediately after it as to constitute a part of the transaction. Evidence of those acts and declarations were admissible either for or against the party who did the act or made the declaration, but any subsequent declarations would have been admissible only as admissions against interest: *Shephard v Cartwright* [1955] AC 431, at 445; *Charles Marshall Pty Ltd v Grimsley* (1956) 95 CLR 353, at 365. In some cases it is possible to treat the concurrence of one party with the other's payment of the mortgage instalments as an admission of the former's exclusive interest, but the circumstance attending the payment of mortgage instalments is no more than one of the relevant facts. Another relevant fact is the relationship between the parties at the time. In the present case there was evidence of both of those facts. The Court of Appeal, having regard to those facts, inter alia, found that there was no common intention between the plaintiff and defendant that the plaintiff was to hold her interest in trust for the defendant. Nor did they find any other common intention. Their Honours held that the legal interests of the parties must prevail. The error in this approach is not in the refusal to find a common intention but in the failure first to apply the presumption that comes into play when the legal owners who are unequal contributors to the purchase price are not shown to have a common intention inconsistent with a tenancy in common in shares proportionate to their contributions. Applying the relevant presumption, the Court of Appeal should have held the parties to be equitable tenants in common in the … property in proportion to the contribution each made to the purchase price. That proportion has not been precisely ascertained. The matter will have to be remitted to the Supreme Court to determine that proportion if the parties are unable to agree upon it.

Notes

(1) A resulting trust arises from the date of the facts or circumstances giving rise to the presumption, assuming that the presumption of trust is not displaced by advancement or evidence of the settlor's intentions. However, in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 705–6, Lord Browne-Wilkinson stated:

> 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.

In this extract, 'implied trusts' include resulting trusts. Given that resulting trusts arise by operation of law, why should the knowledge of the trustee be relevant? This point has particular significance if, as argued by Chambers, resulting trusts are raised to reverse unjust

enrichment. Liability in unjust enrichment is not directly a function of the conscience or conduct of the recipient. It is not a species of wrongdoing. (See below at [22.6] and chapter 23 at [23.7].)

(2) What contributions will be counted towards acquisition cost for the purpose of the presumption of resulting trust? The position is summarised in *Zhang v Metcalf* [2020] NSWCA 228 (extracted below at [22.3.2a]), [49]–[51] (Gleeson JA):

> The purchase money is taken to include the incidental expenses of buying the property, that is, "the totality of the money which the purchasers have in truth outlaid to obtain the property": *Ryan v Dries* [2002] NSWCA 3; (2002) 10 BPR 19497 at acts or statement subsequent to the transaction (Hodgson JA); *Black Uhlans Incorporated v Crime Commission (NSW)* [2002] NSWSC 1060 at [144] (Campbell J); *Amit Laundry Pty Ltd v Jain* [2017] NSWSC 1495 at [103] (Ward CJ in Eq).
> Except in unusual situations, the subsequent payment of instalments under a mortgage over the property is not regarded as a payment of the purchase price, but rather a payment towards securing the release of the charge which the parties created over the property purchased: *Calverley v Green* at 257–258 (Mason and Brennan JJ); *Black Uhlans* at [141]–[142].
> The exceptional case is where the parties intend to acquire not the title to the land subject to mortgage, but the land freed of the mortgage: *Bloch v Bloch* (1981) 180 CLR 390; [1981] HCA 56 at 402.

(3) It is therefore important to distinguish between the debt incurred to provide a contribution to acquisition cost and the subsequent repayment of that debt as agreed in the loan contract and/or mortgage. See the following from *Buffrey v Buffrey* [2006] NSWSC 1349; (2006) 12 BPR 23,619, [14] (7) (Palmer J):

> **(a)** the acquisition cost of property includes the costs, fees and disbursements incidental to its acquisition
>
> **(b)** a party contributes to acquisition cost by borrowing funds necessary to make up the acquisition cost, whether or not that party subsequently contributes to payment of principal and interest due on the borrowing;
>
> **(c)** parties borrowing jointly in order to make up the acquisition cost are treated as having contributed the borrowed capital in equal shares; and
>
> **(d)** a party who does not borrow funds to make up the acquisition cost but who subsequently pays, or contributes to payment of, principal and interest on such a borrowing does not, by that fact alone, make a contribution to acquisition cost.

Questions

(1) In what circumstances does equity presume a declaration of resulting trust?

(2) What factors will go to determine the shares in which property is held on trust?

(3) When must the proportionate beneficial interests be determined?

(4) In cases where mortgage instalments have been paid by the plaintiff, how might the Court recognise these amounts if they are not eligible to be reflected in beneficial title via the presumption of resulting trust?

(5) Where the subject-matter of a resulting trust is land, must the trust satisfy the formal requirements as to writing?

22.3.2 When does the presumption of resulting trust not apply?

A presumption of declaration of (resulting) trust may be rebutted by evidence which reveals the objective intention of the purchaser or transferor of the relevant property. Alternatively, the relationship between the parties may describe a set of facts to which the presumption of resulting trust has been held not to apply. This is often (mis)labelled the 'presumption of advancement'.

Background

Ms Zhang and Mr Metcalf were de facto partners who, in March 1994, purchased as tenants in common in equal shares a factory unit at Alexandria which was used as Mr Metcalf's business premises. The price was $248,000 made up of Ms Zhang's $70,000 cash contribution and Mr Metcalf's $14,400 cash contribution, plus $173,000 he borrowed from a bank, secured by a mortgage over the property given by both Mr Metcalf and Ms Zhang (as guarantor and mortgagor). There were also transaction costs paid out of their contributions. At the time of purchase, Ms Zhang and Mr Metcalf also entered into a deed which recorded their intention to hold the property beneficially as tenants in common in equal shares. The relationship between Ms Zhang and Mr Metcalf had broken down by 2002. On the sale of the factory unit in September 2016 for $1.8 million, a dispute arose as to Ms Zhang's dealings with the proceeds of sale.

Decision

The trial judge was not in error in finding that the factory unit was beneficially owned by Ms Zhang and Mr Metcalf equally. The presumption of resulting trust in the proportion of their respective contributions to the acquisition cost was rebutted by direct evidence of the parties' acts and declarations in declaring a deed which recorded their actual intentions to hold the property as tenants in common in equal shares.

Gleeson JA (with whom Payne JA and White JA agreed)

Ms Zhang contended that she paid a disproportionately greater contribution to the Alexandria property reflected by her payment of a 30 per cent deposit and her two-thirds payment to the loan and accordingly she holds a 71 per cent beneficial interest in the Alexandria property.

The prima facie position is that the beneficial ownership of real property is commensurate with the legal title: *Currie v Hamilton* (1984) 1 NSWLR 687 at 690 (McLelland J).

However, where two persons contribute in different shares to the cost of acquisition of real property which is conveyed to them in equal shares, there is a rebuttable presumption of a resulting trust in the proportions in which they contributed the purchase money: *Calverley v Green* at 247, 258, 266.

The presumption of a resulting trust may be rebutted by direct evidence or inferences drawn from the circumstances. The evidentiary material from which a court may draw an inference as to the intention of the parties includes their acts and declarations before or at the time of purchase, or so immediately after it so as to constitute part of the transaction: *Charles Marshall Pty Ltd v Grimsley* (1956) 95 CLR 353 at 366; [1956] HCA 28; *Nelson v Nelson* at 600; *Caverley v Green* at 251, 262, 269; Bryson v Bryant (1992) 29 NSWLR 188 at 215 (Sheller JA).

In this case, the presumption of a resulting trust was rebutted by direct evidence of the parties' acts and declarations in executing the deed. Although the actual date of execution is not entirely clear, his Honour can be taken to have proceeded on the basis that the deed was executed before or at the time of the purchase, or so immediately after it as to constitute part of the transaction. There is no challenge to that view of the evidence.

The deed evidences the parties' intentions that the Alexandria property was to be owned beneficially as tenants in common in equal shares. Having executed the deed, and not having been induced to do so by fraud, mistake or misrepresentation, Ms Zhang cannot complain that she is not bound by the agreement recorded in it: *Equuscorp Pty Ltd v Glengallen Investments Pty Ltd* (2004) 218 CLR 471; [2004] HCA 55 at [33]. Her submission that the deed 'has no legal binding effect on us as domestic partners' should be rejected.

Notes

(1) Careful consideration of the evidence is required in order to determine whether the presumption of resulting trust has been rebutted, and the evidence required will vary according to the circumstances. In *Foundas v Arambatzis* [2020] NSWCA 47, [51], White JA restat-

ed the position (with the agreement of Bell P and Basten JA) as follows:

> The presumption of a resulting trust may be rebutted by evidence as to the parties' actual intentions, but does not yield to slight circumstances (*Shepherd v Cartwright* [1955] AC 431 at 445; *Charles Marshall Pty Ltd v Grimsley* (1956) 95 CLR 353 at 365; [1956] HCA 28; *Brown v Brown* (1993) 31 NSWLR 582 at 596). In principle, the presumption should be less strong where land is conveyed to the purchasers as tenants in common in defined shares. Nonetheless, the decision of this court in *Ryan v Dries* [2002] NSWCA 3 shows that the presumption of a resulting trust applies, whether the land is transferred to one party only, or to both parties as joint tenants, or to both parties as tenants in common.

(2) The relevant evidence will be as to the intention of the party transferring title or making the contribution to acquisition cost. The 'Court is more assisted in determining the subjective intention … by evidence of that person's contemporaneous statements of intention, subsequent admissions against interest, subsequent dealings with the property, and by evidence of other relevant surrounding circumstances' (*Buffrey v Buffrey* [2006] NSWSC 1349; (2006) 12 BPR 23,619, [14] (Palmer J)). Are acts or statement subsequent to the transaction relevant? In *Calverley v Green* [1984] HCA 81; (1984) 155 CLR 242, 269 (extracted below at [22.3.2c]), Deane J stated that 'evidence of the relationship – both legal and factual – between the parties will always be admissible'. Therefore, 'whilst evidence of subsequent statements of intention, not being admissions against interest, are inadmissible, evidence of facts as to subsequent dealings and of surrounding circumstances of the transaction may be received' (*Trustee of the Property of Cummins v Cummins* [2006] HCA 6; (2006) 227 CLR 278, [65] (the Court) (extracted below at [22.3.2d])). Such evidence, whilst admissible, may or may not carry weight. See also *Charles Marshall Pty Ltd v Grimsley* (1956) 95 CLR 353; *Martin v Martin* (1959) 110 CLR 297; and *Damberg v Damberg* (2001) 52 NSWLR 492.

22.3.2b *Anderson v McPherson (No 2)* [2012] WASC 19; (2012) 8 ASTLR 321

Background

For a statement of the facts, see above at [22.2a].

Decision

Edelman J

The meaning and basis of the 'presumption of advancement'

One difficulty with the language of 'presumption of advancement' is that it is not limited to advancement. Another difficulty … is that it is not a presumption.

The word 'advancement' has been described as a legal expression which had 'a limited range of meaning, since it was thought to convey the idea of some step in life of permanent significance': *Pilkington v Inland Revenue Commissioners* [1964] AC 612, 634 (Viscount Radcliffe, giving examples of an apprenticeship, the purchase of a commission in the army or an interest in business).

Historically, the primary basis asserted for the presumption of advancement in circumstances such as a purchase by a person in the name of another was that the purchaser was 'under a species of natural obligation to provide for the nominee': *Murless v Franklin* (1818) 1 Swan 13, 17; 36 ER 278, 280 (Lord Eldon). A distinction was drawn between a father–child relationship to which the presumption of advancement applied and a mother–child relationship to which it did not, because there was 'no obligation according to the rules of equity – on a mother to provide for her child': *Bennet v Bennet* (1879) 10 Ch D 474, 478 (Sir George Jessel MR).

A distinction was also drawn between a son who had been married and provided for (advanced) and a son who was 'unprovided for': *Elliot v Elliot* (1677) 2 Cas in Ch 231, 232; 22 ER 922, 923 (Lord Nottingham LC). But this distinction disappeared in the late 18th Century after *Dyer v Dyer,* albeit against the strong views of Sir Edward Sugden, the later Lord St Leonards: J Glister 'The presumption of advancement' in C Mitchell (ed) *Constructive and Resulting Trusts* (2010) 289, 299.

In *Wirth v Wirth* [1956] HCA 71; (1956) 98 CLR 228, 237, Dixon CJ argued that the presumption of advancement had moved to a different foundation. The Chief Justice said that in the course of growth of the presumption it 'obtained a foundation or justification

in the greater prima facie probability of a beneficial interest being intended'. That view was endorsed by Gibbs CJ in *Calverley v Green* (249).

But this modern rationale proposed by Dixon CJ has not yet been accepted. In *Nelson* v *Nelson* [1995], Deane and Gummow JJ referred to the historical foundation of the presumption as the obligation to provide, but did not reject this historical foundation, saying only that the appeal should be approached on the basis that the presumption of advancement also extended to the relationship of mother and child (548, 549). Dawson J thought that the presumption of advancement should apply to the relationship of mother and child whether its basis was moral obligation or the probability rationale of Dixon CJ (576). And Toohey J considered the probability rationale of Dixon CJ to 'have a question begging aspect' as evidenced by the fact that Gibbs CJ was the only judge in *Calverley v Green* to extend the presumption of advancement to a de facto relationship (586).

The state of the law … is that the presumption of advancement does not necessarily require either a relationship where advancement might be expected or one where a moral duty to provide was recognised in equity.

The presumption of advancement applies even between a parent and his or her adult children. For instance, in *Nelson v Nelson* [1995] the two children of Mrs Nelson who asserted a presumption of advancement were aged 33 and 37 at the time of the transaction (542). In this sense it might be better described as a 'presumption of gift': *Nelson v Nelson* [1995] (548) (Deane & Gummow JJ).

On the other hand, despite the suggestions of Dixon CJ, the presumption of advancement also does not extend to every relationship where the ties of love and affection might give rise to a probability, or expectation based upon common experience, that a gift was intended.

At this stage of development of the law in relation to the 'presumption of advancement', all that can be said is that it provides for a list of relationships where the presumption of resulting trust does not apply.

The 'presumption of advancement' is not a genuine presumption

In *Wirth v Wirth* [(1956) 98 CLR 228 at 237] Dixon CJ quoted from Sir William Page Wood VC [in *Soar v Foster* (1858) 4 K & J 152; 70 ER 64] to the effect that the presumption of advancement was 'to preclude a resulting trust from arising for the purchaser'.

In this sense, the presumption of advancement is not a presumption at all. It is simply a description of facts where the presumption of resulting trust (or, more accurately, the presumption of a declaration of trust) does not arise.

On the other hand, there have been suggestions in some cases, and by some judges, that the presumption of advancement is a genuine presumption of a manifest intention to make a gift. These suggestions presuppose a confused evidentiary process where the presumption of advancement would need to be rebutted by the transferor, which would then reinstate a presumption of a declaration of trust in favour of the transferor, which the recipient would then need to rebut. This was the view of Maitland and Holdsworth: see F W Maitland, *Equity: A Course of Lectures* (1910) 79–80, also (1936, 2nd ed) 77–80; William Holdsworth, *A History of English Law* (1924) VI, 644. See also the discussion of some of the authorities to this effect in J Glister 'Is there a presumption of advancement?' (2011) 33 *Sydney Law Rev* 39.

The dominant Australian approach, however, is that of Dixon CJ: the 'presumption of advancement' is not a presumption but is simply a circumstance in which the 'presumption of resulting trust' does not arise. Thus, in *Martin v Martin* [1959] HCA 62; (1959) 110 CLR 297, the High Court (Dixon CJ, McTiernan, Fullagar & Windeyer JJ) explained that the presumption of resulting trust did not apply where a husband purchased land in the name of his wife: 'as she was his wife the fact that he found the purchase money for the land raised no presumption in his favour of a resulting trust as it would or might have done had she been a stranger' (303). The court explained that the presumption 'is called a presumption of advancement but it is rather the absence of any reason for assuming that a trust arose' (303).

The presumption of advancement does not apply to Stephannie

But the relationship between Stephannie and her parents in law, although close and warm, was not a parent-child relationship. Bruce and Carol were, and are, generous, warm and welcoming people. Ms Gallagher's evidence was that their kindness extended beyond Stephannie to other friends … As she was their daughter-in-law, Stephannie was treated with even greater kindness and warmth. But even though Stephannie was partly estranged from her mother and father, Bruce and Carol did not take the place of her parents.

Stephannie also relied upon Bruce having 'given her away' at her wedding to Troy … as evidence of their relationship being akin to parent and child. But in counsel's submissions he omitted to refer to all of the evidence of Bruce on this matter. Bruce said that

he had not immediately agreed to walk Stephannie down the aisle. He asked why her father was not doing it. He asked why her brothers were not doing it. He only agreed when she explained that she did not want them to do it and that her father would not be at the wedding (it turned out that he was present) …

A presumption of advancement does not apply in relation to Stephannie.

22.3.2c *Calverley v Green* [1984] HCA 81; (1984) 155 CLR 242

Background

For a statement of the facts, see above at [22.3.1b].

Decision

Gibbs CJ

… [I]t is presumed that a resulting trust arises in favour of the purchaser, or in favour of two purchasers in the proportions in which they contributed the purchase money, is subject to the exception created by the presumption of advancement. 'It is called a presumption of advancement but it is rather the absence of any reason for assuming that a trust arose or in other words that the equitable right is not at home with the legal title': *Martin v Martin* (1959) 110 CLR 297, at 303; in other words, it is 'no more than a circumstance of evidence which may rebut the presumption of resulting trust': *Pettitt v Pettitt* (1970) AC 777, at 814. The presumption arises when a husband makes a purchase in the name of his wife, or a father in the name of his child or other person to whom he stands in loco parentis. The authorities have denied that it arises where a wife makes a purchase in the name of her husband *(Mercier v Mercier* (1903) 2 Ch 98), or a mother in the name of her child *(Bennet v Bennet* (1879) 10 Ch D 474; *Scott v Pauly* (1917) 24 CLR 274; *Pickens v Metcalf and Marr* [1932] NZLR 1278) or where the purchase is taken in the name of a sister *(Noack v Noack* [1959] VR 137, at 140), nephew *(Russell v Scott* (1936) 55 CLR 440), son-in-law *(Knight v Biss* [1954] NZLR 55) or grandchild *(Soar v Foster* (1858) 70 ER 64, at 66), unless the purchaser is in loco parentis to the nominee. The principle on which these decisions have been rested is not altogether satisfactory. Lord Eldon said in *Murless v Franklin* (1818) 36 ER 278, at 280 that the presumption of advancement arises 'where the purchaser is under a species of natural obligation to provide for the nominee'. In *Bennet v Bennet* Jessel MR also said that the presumption arises from the existence of an obligation on the one person to make a provision for the other; he went on to say that 'the presumption of gift arises from the moral obligation to give'; later he referred to it as a 'moral legal obligation … [an] obligation according to the rules of equity'. Isaacs J in *Scott v Pauly,* at 282, seems to have thought that in a case where the purchaser is the father the presumption of advancement 'is an inference which the Courts of equity in practice drew from the mere fact of the purchaser being the father, and the head of the family, under the primary moral obligation to provide for the children of the marriage, and in that respect differing from the mother'. However, *Soar v Foster* is authority for the proposition that the existence of a moral obligation to support the person in whose name the purchase is taken is not enough to give rise to a presumption of advancement. In that case the purchaser had gone through a form of marriage with his deceased wife's sister after the passing of *Lord Lyndhurst's Act* which rendered null and void all marriages within the prohibited degrees of consanguinity or affinity; thereafter they cohabited together and treated each other as man and wife. It was submitted that if the purchaser had a moral obligation to provide for the other party, that could raise a presumption of advancement. Page Wood V-C rejected the submission. He said (at 161):

> Then how does the inference arise that the purchase was intended as a provision for the Defendant? Not upon the ground of his being under a moral obligation to provide for the Defendant, for that argument would be equally applicable, if, instead of an invalid marriage of this description, the case had been one of bigamy by a person representing himself to be unmarried. In such a case there would be a clear moral duty incumbent upon the person supposed to provide for a woman whom he had so grossly deceived. The same argument would apply to a case of mere cohabitation without any form of marriage whatever. Any moralist would say that a man was bound to make provision for the woman with whom he had so cohabited. But it would be impossible for this Court to hold, if in either of the cases supposed an investment had been made by the man in the names of himself and the woman, that, upon the mere ground of his being under such moral obligation, the purchase could be presumed to have been intended by him as a provision of advancement.

The principle upon which the presumption of advancement rests does not seem to me to have been convincingly expounded in the earlier authorities, nor do the two presumptions, of a resulting trust and advancement, together always lead to a result which coincides with that which one would expect to occur in ordinary human experience. For example, a lady who placed deposits, each of £150, in the names of her niece and nephew, aged respectively two and six years, would not ordinarily be thought to intend that the infants should hold the deposits as trustees for her, but that is the result to which the authorities led Northcroft J in *In re Muller; Cassin v Mutual Cash Order Co Ltd* [1953] NZLR 879.

In *Wirth v Wirth* (1956) 98 CLR 228 Dixon CJ put the law on a more rational basis. That was not a case of a purchase in the name of another, but one of a voluntary transfer by an existing owner. The question whether a resulting trust is presumed in the latter case is not without complications, but it is unnecessary to discuss it here. Dixon CJ who accepted, or at least was content to assume, the correctness of the view expressed by Cussen J in *House v Caffyn* [1922] VLR 67, at 78, that if the land is under the Torrens system there is a presumption of a resulting trust, went on to hold, following *Moate v Moate* (1948) 2 All ER 486, that a transfer of property by a prospective husband to his intended wife in contemplation of the marriage for which they had contracted raised a presumption of advancement. Dixon CJ said:

> While the presumption of advancement doubtless in its inception was concerned with relationships affording 'good' consideration, it has in the course of its growth obtained a foundation or justification in the greater prima facie probability of a beneficial interest being intended in the situations to which the presumption has been applied.

He referred to *Soar v Foster,* but noted that in *Murdock v Aherne* (1879) 4 VLR(E) 244, Molesworth J seems to have regarded the relation between a man and a woman whom the man had bigamously married and who knew it as within the presumption of advancement. Dixon CJ went on to say, at 238:

> No doubt in *Moate v Moate* Jenkins J applied the presumption of advancement where it had not hitherto been applied. But the application was not inconsistent with any decided case and it accords with reason. To say that a transfer of property to an intended wife made in contemplation of the marriage raised a presumption of a resulting trust but a similar transfer made immediately after the celebration of the marriage raised a presumption of advancement involves almost a paradoxical distinction that does not accord with reason and can find a justification only on the ground that the doctrine depends in categories closed for historical reasons. That is not characteristic of doctrines of equity.

Neither of the other members of the Court in that case found it necessary to decide whether there was a presumption of advancement when the property was transferred to the intended wife.

However, the principle as stated by Dixon CJ is intelligible and is likely to lead to a just result and should in my opinion be accepted. The presumption should be held to be raised when the relationship between the parties is such that it is more probable than not that a beneficial interest was intended to be conferred, whether or not the purchaser owed the other a legal or moral duty of support. It is true that this may require a reconsideration of the correctness of the actual results reached in some of the earlier cases, but to regard that as a barrier to acceptance of the principle would be to treat the established categories as frozen in time.

Notes

(1) The presumption of advancement now applies to transfers from mothers to children. See *Brown v Brown* (1993) 31 NSWLR 582; *Nelson v Nelson* (1994) 33 NSWLR 740 – a conclusion unchallenged by the reasoning in the High Court: *Nelson v Nelson* [1995] HCA 25; (1995) 184 CLR 538, 548–9 (Deane and Gummow JJ), 574 (Dawson J), 586 (Toohey J) and 601 (McHugh J). See also *Anderson v McPherson (No 2)* [2012] WASC 19; (2012) 8 ASTLR 321, [140]–[141] (Edelman J). In Canada, *Pecore v Pecore* [2007] SCC 17 confirms that the presumption is expanded to include transfers from mothers as well as from fathers.

(2) Courts vary in the extent to which the presumption of advancement applies to a transfer from a parent to an adult child. Factors to weigh in the balance may include the child's degree of independence, whether the child has a disability or serious medical condition, and the parent's own need for support. See *Brown v Brown* (1993) 31 NSWLR 582; *Nelson v Nelson* (1994) 33 NSWLR 740 and [1995]

HCA 25; (1995) 184 CLR 538. The Supreme Court of Canada in *Pecore v Pecore* [2007] SCC 17 held by majority that 'given that a principal justification for the presumption of advancement is parental obligation to support their dependent children … the presumption [of advancement] should not apply in respect of independent adult children' ([36] Rothstein J). Abella J dissented in the reasoning (at [102]):

> Since the presumption of advancement emerged no less from affection than from dependency, and since parental affection flows from the inherent nature of the relationship, not of the dependency, the presumption of advancement should logically apply to all gratuitous transfers from parents to any of their children regardless of the age or dependence of the child or the parent. The natural affection parents are presumed to have for their adult children when both were younger, should not be deemed to atrophy with age.

Questions

(1) To which sets of facts, or list of relationships disclosed by those facts, does the presumption of resulting trust not arise? See textbook at [22.5]–[22.8].

(2) How, if at all, can these categories be reconciled? The rationale proposed by Dixon CJ in *Wirth v Wirth* and endorsed in *Calverley v Green* by Gibbs CJ has not been accepted. See textbook at [22.10]–[22.13] and the above extract from *Anderson v McPherson (No 2)* [2012] WASC 19; (2012) 8 ASTLR 321, [128]–[129] (Edelman J).

22.3.2d *Trustee of the Property of Cummins v Cummins* [2006] HCA 6; (2006) 227 CLR 278

Background

A barrister and his wife married in 1964. The husband had not lodged income tax returns since about 1955, this timeframe encompassing the whole period for which he practised as a barrister. In 1987, the husband transferred to his wife his legal and beneficial interest as joint tenant in their family home ('the Hunters Hill property'). The husband was declared bankrupt in 2001 on the application of the Australian Taxation Office (ATO).

By 2002, they had formally separated, pending proceedings in the Family Court. The ATO sought a declaration that the 1987 transfer of the Hunters Hill property was void against the husband's trustee in bankruptcy as being a disposition of property with the intention to defraud creditors. The wife claimed a 76 per cent interest in the Hunters Hill property based on her contributions to the purchase price, which would have left the ATO's claim to be met out of her husband's portion (24%).

Decision

The High Court unanimously held that the wife and husband each held a 50 per cent share in the Hunters Hill property, the presumption of resulting trust based on the payment of contributions was rebutted on the facts. The ATO had recourse only against the husband's portion.

The Court (Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ)

> The purchase moneys were contributed … in the proportions 76.3 per cent (Mrs Cummins) and 23.7 per cent (Mr Cummins). A mortgage over the Hunters Hill property executed by Mr and Mrs Cummins in favour of the Commonwealth Savings Bank of Australia on 16 July 1971 secured an advance to them jointly of $8,000 on a covenant that they would erect and complete within six months of that date a dwelling house at a cost of not less than $33,500. The tax return by Mrs Cummins for the year ended 30 June 1971 but lodged by her tax agent in 1972 showed the Hunters Hill property as her place of residence.
>
> The 'transaction' to which attention must be directed, in the sense given in *Charles Marshall Pty Ltd v Grimsley* [1956] HCA 28 respecting the principles of resulting trusts, is a composite of the purchase of the Hunters Hill property followed by construction of a

dwelling house occupied as the matrimonial home for many years preceding the August transactions. The relevant facts bearing upon, and helping to explain, the nature of the joint title taken on registration on 10 August 1970 include the other elements in that composite. To fix merely upon the unequal proportions in which the purchase moneys were provided for the calculation of the beneficial interests in the improved property which was dealt with subsequently in August 1987 would produce a distorted and artificial result, at odds with practical and economic realities. Looked at in this way, this is not a case which requires consideration of the authorities where an equitable lien or charge secures expenditure on improvements made but no beneficial interest in the land is conferred. …

The present case concerns the traditional matrimonial relationship. Here, … Professor Scott's work respecting beneficial ownership of the matrimonial home should be accepted:

> It is often a purely accidental circumstance whether money of the husband or of the wife is actually used to pay the purchase price to the vendor, where both are contributing by money or labor to the various expenses of the household. It is often a matter of chance whether the family expenses are incurred and discharged or services are rendered in the maintenance of the home before or after the purchase.

To that may be added … in the same work:

> Where a husband and wife purchase a matrimonial home, each contributing to the purchase price and title is taken in the name of one of them, it may be inferred that it was intended that each of the spouses should have a one-half interest in the property, regardless of the amounts contributed by them.

That reasoning applies with added force in the present case where the title was taken in the joint names of the spouses. There is no occasion for equity to fasten upon the registered interest held by the joint tenants a trust obligation representing differently proportionate interests as tenants in common. The subsistence of the matrimonial relationship, as Mason and Brennan JJ emphasised in *Calverley v Green* (1984) 155 CLR 242, supports the choice of joint tenancy with the prospect of survivorship. That answers one of the two concerns of equity, indicated by Deane J in *Corin v Patton* (1990) 169 CLR 540, which founds a presumed intention in favour of tenancy in common. The range of financial considerations and accidental circumstances in the matrimonial relationship referred to by Professor Scott answers the second concern of equity, namely the disproportion between quantum of beneficial ownership and contribution to the acquisition of the matrimonial home.

In the present litigation, the case for the disinclination of equity to intervene through the doctrines of resulting trusts to displace the incidents of the registered title as joint tenants of the Hunters Hill property is strengthened by further regard to the particular circumstances. Solicitors acted for Mr and Mrs Cummins on the purchase in 1970. The conveyance was not uneventful. The contract was dated 14 April 1970 and was settled on 27 July 1970, but only after the issue by the solicitors for the vendor on 10 July of a notice to complete. It is unrealistic to suggest that the solicitor for the purchasers, Mr and Mrs Cummins, did not at any point advise his clients on the significance of taking title as joint tenants rather than as tenants in common. Secondly, use of the valuation obtained in 1987 to fix what was shown as the purchase price for the acquisition by Mrs Cummins of the interest of her husband is consistent, as already indicated, with the conventional basis of their dealings which treated the matrimonial home as beneficially owned equally.

Finally, there is the question of the funding of the building operations which were necessary for the use of the previously vacant land as the matrimonial home. Reference is made earlier in these reasons to the treatment of the purchase of the unimproved land and the subsequent building operations as the one transaction for the purpose of considering the principles respecting resulting trusts. Since October 1967, Mr and Mrs Cummins had owned as joint tenants a property at 12A Ferdinand Street, Hunters Hill. This was sold in December 1971. The proceeds of that sale were paid on 22 December 1971 into a bank account styled 'John Daniel Cummins and Mrs Mary Elizabeth Cummins Fully Drawn Loan Account'. Sackville J held that in these circumstances it appeared likely that the net proceeds of sale of the Ferdinand Street property had been paid to Mr and Mrs Cummins jointly. While there was no finding to this effect by the primary judge, there is force in the submission in this Court by counsel for the Trustees that the likely source of funds for the building operations were, first, the joint borrowing of $8,000 on the mortgage to the Commonwealth Savings Bank of Australia, supplemented after December 1971 by the joint proceeds of the sale of the other property.

Questions

(1) How did the wife seek to establish her interest in the Hunters Hill property?

(2) Did the High Court find the presumption of resulting trust established? What facts were relevant to establishing its existence?

(3) Did the presumption of advancement have any role in the reasoning of the Court? Why, or why not?

(4) Distinguish between joint tenancy and tenancy in common. Why was this relevant in the Court's reasoning?

22.3.2e *Bloch v Bloch* [1981] HCA 56; (1981) 180 CLR 390

Background

A son became the registered proprietor of a block of flats which had been purchased for $24,000. His parents had contributed $6,000 to the purchase price, the son put in $5,900 from his own resources, and the balance of $11,000 was lent by the bank and secured by a mortgage over the property. The mortgage was discharged in 1970, the funds having been raised by rental from the flats, the son's own income, and a further $1,000 contribution by the parents. The parties agreed the flats would be sold and the proceeds divided as to two-thirds (son) and one-third (parents). The flats were sold for $52,000 in 1976, but the son refused to account to his parents for their share of the money. The parents claimed a declaration that they were entitled to one-third of the proceeds of sale.

Decision

The High Court found the son held the block of flats on resulting trust for his parents in proportion to their contribution to the purchase price.

Wilson J

[The appellant argued that the facts did not] establish an express trust which fails for want of writing. Reliance is placed on the conversation between the appellant and his father with respect to the purchase of some flats as an investment … to the effect that, in the words of the father, 'whatever we put in, that is what we will receive in the proceeds from the flats – we will separate it correctly'. This conversation must be seen in its context. It was directed entirely to the future, there being no particular property in contemplation, and no discussion as to the person or persons by whom the conveyance would be taken. It was some months after the appellant had left the country that his father found and purchased the flats in Gresham Street. It was the father's decision to put the property in the son's name because 'I wanted him secure so I could not cheat him and sell the flats'. While it is true that no particular form is necessary for the creation of an express trust, the intention of the settlor to create a trust must be explicit. In every case it is a question of fact for the court to determine whether an intention to create a trust is sufficiently evinced.

The learned trial judge concluded his consideration of the nature of the trust which he found to exist with these words:

> In the circumstances I do not think the parties gave any consideration to the legal effect of the arrangement to acquire the flats. Being father and son and having a good relationship with each other, the father was anxious to help the son obtain a better return on the surplus money which the latter was earning by way of salary, and the son was keen that his father and mother have a home in which to reside and to live there so as to enable them to take care of the son's investment. In such a situation they went ahead with their financial dealings in an atmosphere of mutual confidence and trust. … The father and son did not expressly envisage … that the son held the property on a trust which could be said to be a declared or an express trust.

His Honour decided that the circumstances were such as to give rise to a resulting trust. He had already found the presumption of advancement to be rebutted … I do not think that his Honour's reasoning can be faulted in any way. The circumstances surrounding the acquisition of the flats do not yield with sufficient certainty the expression of an intention to create a trust. On the other hand, the facts present a classic illustration of the creation of a resulting trust. The property was conveyed into the name of the son, with the father having contributed part of the purchase price in circumstances which rebutted the presumption that the contribution was intended to advance or benefit the son. The contribution was not a gift. It was not a loan. The inference then arises that the father intended the son to hold the property in trust for him in a proportion corresponding to the proportion of the purchase price which was contributed by him.

Question

How was the presumption of advancement displaced?

22.3.2f *Nelson v Nelson* [1995] HCA 25; (1995) 184 CLR 538

Background and decision

See chapter 2 at [2.2c].

Deane and Gummow JJ

See chapter 2 at [2.2c].

Note

Equity will refuse a remedy if the particular transaction or conduct is illegal. Consistently with the position that 'a man must come into a Court of Equity with clean hands: but when this is said, it does not mean a general depravity, it must have an immediate and necessary relation to the equity sued for; it must be a depravity in the legal as well as in a moral sense' (*Dering v Earl of Winchelsea* (1787) 1 Cox Eq 318, 319–20 (Eyre CB)), equitable relief will be refused. This includes the case where a purported declaration of trust is itself for an illegal purpose. For example, a statute itself may prohibit the creation of a trust. Such declarations are void. See generally chapter 24.

As emphasised by the majority in *Nelson v Nelson* [1995] HCA 25; (1995) 184 CLR 538, in understanding this area it is important to distinguish between transactions or conduct which are themselves prohibited and thus illegal, and those which are not prohibited but are nonetheless illegal, because the transactions or conduct are *associated* with some illegal purpose. Thus, in *Nelson,* the purpose behind the legislation was found to be 'provision of public moneys to facilitate the purchase of housing by eligible persons, but on the footing that the eligible person not own another dwelling' (570 (Deane and Gummow JJ)). The transaction by which Mrs Nelson provided the purchase moneys for a house which was transferred into the names of her children, Elizabeth and Peter, was tainted by illegality because the transaction was 'associat[ed] with or in furtherance of a purpose … contrary to the policy of the law as indicated by the scheme of the Act' (571 (Deane and Gummow JJ)).

Notice in *Nelson* that the majority held that in this type of case equity may examine the public policy manifested by the statute, and the particular circumstances of the case, in order to 'attain a result which eschews harsh extremes' (559 (Deane and Gummow JJ)). Thus, for example, as was ordered in *Nelson*, equitable relief including a resulting trust may be available, albeit on terms.

Question

To what extent does illegality affect a plaintiff's ability to assert a resulting trust or rely on the presumption of advancement?

22.4 Incomplete dispositions of a beneficial interest

A resulting trust may arise when there has been an incomplete disposition of a beneficial interest. This may occur if an express trust fails at the outset and a resulting trust arises by operation of law in favour of the settlor; for example, if the class of beneficiaries fails to satisfy the rules for certainty of objects (see chapters 14 and 15). Similarly, the purpose of a trust may fail or there may be surplus value remaining after that purpose has been fulfilled. The trusts which arise are sometimes described as 'automatic resulting trusts'. As explained by Lord Millett

in *Air Jamaica Ltd v Charlton* [1999] 1 WLR 1399, 1412, 'a resulting trust … responds to the absence of any intention on [the settlor's] part to pass a beneficial interest to the recipient'. Equity presumes that the transferor would not intend the recipient to take the property beneficially when the original trust fails to dispose of the entire interest in the property. This presumption may be displaced by actual evidence of the settlor's contrary intention to dispose of the beneficial interest in the property. See textbook at [22.22]–[22.26].

22.4a *Re the Trusts of the Abbott Fund* [1900] 2 Ch 326

Background

Dr Abbott died leaving funds in trust for the support of his family, including two deaf women, Katherine and Frederica Abbott. On the death of the trustee, the funds were found to have disappeared. Subsequent public appeals for funds for the maintenance of Katherine and Frederica were successful. The funds were held in a separate bank account called 'The Abbott Fund' overseen by trustees. A list was maintained of subscribers to the appeal. Katherine and Frederica Abbott had both died by June 1899, leaving a surplus in the fund. The defendant, FC Abbott, was their sole legal personal representative. The question for the Court was who should be beneficially entitled to this surplus.

Decision

It was held that the money remaining in the fund should be returned to subscribers via a resulting trust.

Stirling J

The ladies are both dead, and the question is whether, so far as this fund has not been applied for their benefit, there is a resulting trust of it for the subscribers. I cannot believe that it was ever intended to become the absolute property of the ladies so that they should be in a position to demand a transfer of it to themselves, or so that if they became bankrupt the trustee in the bankruptcy should be able to claim it. I believe it was intended that it should be administered by Mr Smith, or the trustees who had been nominated in pursuance of the circular. I do not think the ladies ever became absolute owners of this fund. I think that the trustee or trustees were intended to have a wide discretion as to whether any, and if any what, part of the fund should be applied for the benefit of the ladies and how the application should be made. That view would not deprive them of all right in the fund, because if the trustees had not done their duty – if they either failed to exercise their discretion or exercised it improperly – the ladies might successfully have applied to the Court to have the fund administered according to the terms of the circular. In the result, therefore, there must be a declaration that there is a resulting trust of the moneys remaining unapplied for the benefit of the subscribers to the Abbott Fund.

Questions

(1) What was the intention of the donors?

(2) Why did the resulting trust arise?

22.4b *Air Jamaica Ltd v Charlton* [1999] 1 WLR 1399

Background

Air Jamaica's pension scheme had been funded by members' contributions and matching payments from the company. In 1994, Air Jamaica was privatised and no further contributions were made to the trust fund. The pension plan was discontinued and after the defined benefits had been paid out, a $400 million surplus remained in the fund. The company amended the trust deed to permit the surplus to be paid to the company. The question for the Court was whether this surplus could be paid to the company or was held on resulting trust for contributors.

Decision

The Privy Council held that the balance in the fund was held on resulting trust for contributors, and that so much of the surplus as was attributable to members and deceased members should be divided amongst them pro rata according to their respective contributions to the fund.

Lord Millett

Prima facie the surplus is held on a resulting trust for those who provided it. This sometimes creates a problem of some perplexity. In the present case, however, it does not. Contributions were payable by the members with matching contributions by the company. In the absence of any evidence that this is not what happened in practice, the surplus must be treated as provided as to one half by the company and as to one half by the members.

The Attorney-General contended that neither the company nor the members can take any part in the surplus, which has reverted to the Crown as *bona vacantia*. He argued that clause 4 of the trust deed precludes any claim by the company, while the members cannot claim any part of the surplus because they have received all that they are entitled to. There is authority for both propositions. Their Lordships consider that they can be supported neither in principle nor as a matter of construction.

In *In re ABC Television Ltd Pension Scheme* (unreported), 22 May 1973 Foster J held that a clause similar to clause 4 of the present trust deed 'negatives the possibility of implying a resulting trust'. This is wrong in principle. Like a constructive trust, a resulting trust arises by operation of law, though unlike a constructive trust it gives effect to intention. But it arises whether or not the transferor intended to retain a beneficial interest – he almost always does not – since it responds to the absence of any intention on his part to pass a beneficial interest to the recipient. It may arise even where the transferor positively wished to part with the beneficial interest, as in *Vandervell v Inland Revenue Commissioners* [1967] 2 AC 291. In that case the retention of a beneficial interest by the transferor destroyed the effectiveness of a tax avoidance scheme which the transferor was seeking to implement. The House of Lords affirmed the principle that a resulting trust is not defeated by evidence that the transferor intended to part with the beneficial interest if he has not in fact succeeded in doing so. As Plowman J had said in the same case at first instance [1966] Ch 261, 275: 'As I see it, a man does not cease to own property simply by saying "I don't want it". If he tries to give it away the question must always be, has he succeeded in doing so or not?'

Lord Upjohn [1967] 2 AC 291, 314 expressly approved this.

Consequently their Lordships think that clauses of this kind in a pension scheme should generally be construed as forbidding the repayment of contributions under the terms of the scheme, and not as a pre-emptive but misguided attempt to rebut a resulting trust which would arise dehors the scheme. The purpose of such clauses is to preclude any amendment that would allow repayment to the company. Their Lordships thus construe clause 4 of the trust deed as invalidating the 1994 amendments, but not as preventing the company from retaining a beneficial interest by way of a resulting trust in so much of the surplus as is attributable to its contributions.

The members' contributions stand on a similar footing. In *Davis v Richards & Wallington Industries Ltd* [1990] 1 WLR 1511 Scott J held that the fact that a party has received all that he bargained for is not necessarily a decisive argument against a resulting trust, but that in the circumstances of the case before him a resulting trust in favour of the employees was excluded. The circumstances that impressed him were twofold. He considered that it was impossible to arrive at a workable scheme for apportioning the employees' surplus among the different classes of employees and he declined, at p 1544, to 'impute to them an intention that would lead to an unworkable result'. He also considered that he was precluded by statute from 'imputing to the employees an intention' that they should receive by means of a resulting trust sums in excess of the maximum permitted by the relevant tax legislation.

These formulations also adopt the approach to intention that their Lordships have already considered to be erroneous. Their Lordships would observe that, even in the ordinary case of an actuarial surplus, it is not obvious that, when employees are promised certain benefits under a scheme to which they have contributed more than was necessary to fund them, they should not expect to obtain a return of their excess contributions. In the present case, however, the surplus does not arise from overfunding but from the

failure of some of the trusts. It is impossible to say that the members 'have received all that they bargained for'. One of the benefits they bargained for was that the trustees should be obliged to pay them additional benefits in the event of the scheme's discontinuance. It was the invalidity of this trust that gave rise to the surplus. Their Lordships consider that it would be more accurate to say that the members claim 'such part of the surplus as is attributable to their contributions because they have not received all that they bargained for'.

Pension schemes in Jamaica, as in England, need the approval of the Inland Revenue if they are to secure the fiscal advantages that are made available. The tax legislation in both countries places a limit on the amount which can be paid to the individual employee. Allowing the employees to enjoy any part of the surplus by way of resulting trust would probably exceed those limits. This fact is not, however, in their Lordships' view a proper ground on which to reject the operation of a resulting trust in favour of the employees. The Inland Revenue had an opportunity to examine the pension plan and to withhold approval on the ground that some of its provisions were void for perpetuity. They failed to do so. There is no call to distort principle in order to meet their requirements. The resulting trust arises by operation of the general law, dehors the pension scheme and the scope of the relevant tax legislation.

Scott J was impressed by the difficulty of arriving at a workable scheme for apportioning the surplus funds among the members and the executors of deceased members. This was because he thought it necessary to value the benefits that each member had received in order to ascertain his share in the surplus. On the separate settlement with mutual insurance analysis which their Lordships have adopted in the present case, however, no such process is required. The members' share of the surplus should be divided pro rata among the members and the estates of deceased members in proportion to the contributions made by each member without regard to the benefits each has received and irrespective of the dates on which the contributions were made.

Notes

(1) Where the surplus is held pursuant to a charitable trust, the trust may be saved by the doctrine of cy-près in which the funds are used for a purpose 'close by' that originally specified by the trust's creator. See textbook at [16.40]–[16.44].

(2) Lord Millet in *Twinsectra Ltd v Tardley* [2002] 2 AC 1164 includes in the category resulting trust the trust which arises when money is lent for an identified purpose which fails (*Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567). As discussed below at [22.5c], Australian authority does not uniformly classify such trusts as resulting.

22.5 *Quistclose* trusts

There are different characterisations of the trust arising in *Quistclose*. As the extracts from the case show, Lord Wilberforce himself describes a primary trust for shareholders and, when that trust could not be carried out, the funds were held on a secondary trust for the lender. It is unclear if the trust is an express trust or a resulting trust subject to the borrower's power or mandate to distribute to the shareholders.

22.5a *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567

Background and decision

For a statement of the facts and the decision, see chapter 13 at [13.3.1a].

22.5b *Twinsectra Ltd v Yardley* [2002] 2 AC 164

Background

Yardley was a property developer who required bridging finance. Two firms of solicitors were involved in arranging a loan of £1 million from Twinsectra Ltd to Yardley. Yardley dealt with Paul Leach & Co (Leach), and a second firm, Sims & Roper (Sims), dealt with Twinsectra. Sims received the £1 million on terms that it would be 'utilised solely for the acquisition of property by our client and no other purpose', kept by Sims and not released until 'such time as they are applied in the acquisition of property by our client [Yardley]'. Sims released the money in breach of the undertaking. Sims received an assurance by Yardley that the money would so be applied and, on this basis, Sims paid the funds to Leach. Leach then released the funds on Yardley's instructions without taking steps to ensure that it was utilised solely for the acquisition of property by Yardley as agreed. Of the total, £357,720 was used for non-property related purchases. The loan was not repaid and Sims went bankrupt. Twinsectra Ltd brought an action against Leach alleging dishonest assistance in breach of trust. Yardley's companies were in administration.

Decision

The House of Lords unanimously held that the money had been held by Sims on trust for Twinsectra, subject to a power to apply it by way of loan to Yardley in accordance with the terms of the assurances given, and that this trust had been breached by Sims. By majority (Lord Millett dissenting), the House allowed an appeal in respect of the accessorial liability of Leach to whom Sims had paid the money.

Lord Millett

These passages suggest that there are two successive trusts, a primary trust for payment to identifiable beneficiaries, such as creditors or shareholders, and a secondary trust in favour of the lender arising on the failure of the primary trust. But there are formidable difficulties in this analysis, which has little academic support. What if the primary trust is not for identifiable persons, but as in the present case to carry out an abstract purpose? Where in such a case is the beneficial interest pending the application of the money for the stated purpose or the failure of the purpose? There are four possibilities: (i) in the lender; (ii) in the borrower; (iii) in the contemplated beneficiary; or (iv) in suspense.

(i) *The lender.* In 'The Quistclose Trust: Who Can Enforce It?' (1985) 101 LQR 269, I argued that the beneficial interest remained throughout in the lender. This analysis has received considerable though not universal academic support … It was adopted by the New Zealand Court of Appeal in *General Communications Ltd v Development Finance Corporation of New Zealand Ltd* [1990] 3 NZLR 406 and referred to with apparent approval by Gummow J in *In re Australian Elizabethan Theatre Trust* (1991) 102 ALR 681. Gummow J saw nothing special in the *Quistclose* trust, regarding it as essentially a security device to protect the lender against other creditors of the borrower pending the application of the money for the stated purpose.

On this analysis, the *Quistclose* trust is a simple commercial arrangement akin (as Professor Bridge observes) to a retention of title clause (though with a different object) which enables the borrower to have recourse to the lender's money for a particular purpose without entrenching on the lender's property rights more than necessary to enable the purpose to be achieved. The money remains the property of the lender unless and until it is applied in accordance with his directions, and insofar as it is not so applied it must be returned to him. I am disposed, perhaps pre-disposed, to think that this is the only analysis which is consistent both with orthodox trust law and with commercial reality. Before reaching a concluded view that it should be adopted, however, I must consider the alternatives.

(ii) *The borrower.* It is plain that the beneficial interest is not vested unconditionally in the borrower so as to leave the money at his free disposal. That would defeat the whole purpose of the arrangements, which is to prevent the money from passing to the borrower's trustee-in-bankruptcy in the event of his insolvency. It would also be inconsistent with all the decided cases where the contest was between the lender and the borrower's trustee-in-bankruptcy, as well as with the *Quistclose* case itself: …

The borrower's interest pending the application of the money for the stated purpose or its return to the lender is minimal. He must keep the money separate; he cannot apply it except for the stated purpose; unless the terms of the loan otherwise provide he must return it to the lender if demanded; he cannot refuse to return it if the stated purpose cannot be achieved; and if he becomes bankrupt it does not vest in his trustee in bankruptcy. If there is any content to beneficial ownership at all, the lender is the beneficial owner and the borrower is not.

(iii) *In the contemplated beneficiary.* In the *Quistclose* case itself [1970] AC 567, as in all the reported cases which preceded it, either the primary purpose had been carried out and the contest was between the borrower's trustee-in-bankruptcy or liquidator and the person or persons to whom the borrower had paid the money; or it was treated as having failed, and the contest was between

the borrower's trustee-in-bankruptcy and the lender. It was not necessary to explore the position while the primary purpose was still capable of being carried out and Lord Wilberforce's observations must be read in that light.

The question whether the primary trust is accurately described as a trust for the creditors first arose in *In re Northern Developments Holdings Ltd* (unreported) 6 October 1978, where the contest was between the lender and the creditors. The borrower, which was not in liquidation and made no claim to the money, was the parent company of a group one of whose subsidiaries was in financial difficulty. There was a danger that if it were wound up or ceased trading it would bring down the whole group. A consortium of the group's banks agreed to put up a fund of more than £500,000 in an attempt to rescue the subsidiary. They paid the money into a special account in the name of the parent company for the express purpose of 'providing money for the subsidiary's unsecured creditors over the ensuing weeks' and for no other purpose. The banks' object was to enable the subsidiary to continue trading, though on a reduced scale; it failed when the subsidiary was put into receivership at a time when some £350,000 remained unexpended. Relying on Lord Wilberforce's observations in the passages cited above, Sir Robert Megarry V-C held that the primary trust was a purpose trust enforceable (inter alios) by the subsidiaries' creditors as the persons for whose benefit the trust was created.

There are several difficulties with this analysis. In the first place, Lord Wilberforce's reference to *In re Rogers* 8 Morr 243 makes it plain that the equitable right he had in mind was not a mandatory order to compel performance, but a negative injunction to restrain improper application of the money; for neither Lindley LJ nor Kay LJ recognised more than this. In the second place, the object of the arrangements was to enable the subsidiary to continue trading, and this would necessarily involve it in incurring further liabilities to trade creditors. Accordingly the application of the fund was not confined to existing creditors at the date when the fund was established. The company secretary was given to understand that the purpose of the arrangements was to keep the subsidiary trading, and that the fund was 'as good as share capital'. Thus the purpose of the arrangements was not, as in other cases, to enable the debtor to avoid bankruptcy by paying off existing creditors, but to enable the debtor to continue trading by providing it with working capital with which to incur fresh liabilities. There is a powerful argument for saying that the result of the arrangements was to vest a beneficial interest in the subsidiary from the start. If so, then this was not a *Quistclose* trust at all.

In the third place, it seems unlikely that the banks' object was to benefit the creditors (who included the Inland Revenue) except indirectly. The banks had their own commercial interests to protect by enabling the subsidiary to trade out of its difficulties. If so, then the primary trust cannot be supported as a valid non-charitable purpose trust: see *In re Grant's Will Trusts* [1980] 1 WLR 360 and cf *In re Denley's Trust Deed* [1969] 1 Ch 373.

The most serious objection to this approach is exemplified by the facts of the present case. In several of the cases the primary trust was for an abstract purpose with no one but the lender to enforce performance or restrain misapplication of the money. … The present case is another example. It is simply not possible to hold money on trust to acquire unspecified property from an unspecified vendor at an unspecified time. There is no reason to make an arbitrary distinction between money paid for an abstract purpose and money paid for a purpose which can be said to benefit an ascertained class of beneficiaries, and the cases rightly draw no such distinction. Any analysis of the *Quistclose* trust must be able to accommodate gifts and loans for an abstract purpose.

(iv) *In suspense.* As Peter Gibson J pointed out in *Carreras Rothmans Ltd v Freeman Matthews Treasure Ltd* [1985] Ch 207, 223 the effect of adopting Sir Robert Megarry V-C's analysis is to leave the beneficial interest in suspense until the stated purpose is carried out or fails. The difficulty with this (apart from its unorthodoxy) is that it fails to have regard to the role which the resulting trust plays in equity's scheme of things, or to explain why the money is not simply held on a resulting trust for the lender. …

Thus all the alternative solutions have their difficulties. But there are two problems which they fail to solve, but which are easily solved if the beneficial interest remains throughout in the lender. One arises from the fact, well established by the authorities, that the primary trust is enforceable by the lender. But on what basis can he enforce it? He cannot do so as the beneficiary under the secondary trust, for if the primary purpose is fulfilled there is no secondary trust: the pre-condition of his claim is destructive of his standing to make it. He cannot do so as settlor, for a settlor who retains no beneficial interest cannot enforce the trust which he has created.

Note

There is limited support in Australia for classification of the *Quistclose* trust as resulting; for example, *Frontier Touring Co Pty Ltd v Rodgers* (2005) 223 ALR 433, [34] (Barrett J), where Lord Millett's characterisation was referred to as 'applicable'. See also *Drakeford v Bromhead* [2003] NSWSC 296, [39] (Barrett J) and *Rahnam Investments Pty Ltd v Esplin* [2004] NSWSC 529, [59] (Barrett J).

Questions

(1) In Lord Millett's analysis, who holds the beneficial interest and rights of enforcement in a *Quistclose* trust?

(2) On this view, when does the trust arise – when the money is first transferred or when the purpose fails?

(3) Does the potential object of the fund have any rights?

22.5c *Raulfs v Fishy Bite Pty Ltd* [2012] NSWCA 135

Background and decision

For a statement of the facts and the decision, see chapter 13 at [13.4.5a].

Notes

(1) The High Court has approved the principles on which the *Quistclose* trusts rests but has yet definitively to consider the character of the *Quistclose* trust in Australia. See obiter in *Legal Services Board v Gillespie Jones* (2013) 249 CLR 493, [112] (Bell, Gageler and Keane JJ): '[t]he terminology of a "*Quistclose* trust" is helpful as a reminder that legal and equitable remedies may co-exist. The terminology is not helpful if taken to suggest the possibility apart from statute of a non-express trust for non-charitable purposes'. Federal Court authority also confirms the preference for an express trust analysis. See *Burdett-Baker v National Australia Bank Ltd* [2013] FCA 799, [168] (Dodds-Streeton J):

> While Lord Wilberforce's reference to a primary and secondary trust perhaps suggested a novel species exempt from the usual preconditions of an express trust, Australian courts have analysed the *Quistclose* trust according to conventional principles as a single express trust in which the beneficial interest may be held subject to a power or mandate. Orthodox trust principles, albeit flexibly applicable to a great variety of facts, accordingly remain relevant [citing *Re Australian Elizabethan Theatre Trust*].

Intermediate Courts of Appeal have similarly followed Gummow J in *Re Australian Elizabethan Theatre Trust* (1991) 30 FCR 491 (extracted at [13.4.4a]) and favour the express trust analysis; for example, *Raulfs v Fishy Bite Pty Ltd* [2012] NSWCA 135 at [22.5c] above, *Coolbrew Pty Ltd v Westpac Banking Corporation* [2015] NSWCA 135, [8], [12] and [13] (the Court); as do extensive surveys of the authorities in *George v Webb* [2011] NSWSC 1608, [266]–[283], especially [282] (Ward J) and *Compass Resources Ltd v Sherman* (2010) 42 WAR 1, 10–11 (Beech J). In *Salvo v New Tel* [2005] NSWCA 281, Spigelman CJ held [47] that it was not necessary to decide whether the resulting trust theory applies in Australia and that, on the facts, found [53] an express trust had been declared. Young CJ in Eq [96] similarly preferred to decide the case on the basis of an express trust. Handley JA (in dissent as to reasons but not result, [77]–[78]) held a *Quistclose* trust had been established, which his Honour characterised as resulting.

(2) Campbell JA in *Raulfs v Fishy Bite Pty Ltd* [2012] NSWCA 135, [61] highlights that '[a] trust always requires that there be identifiable trust property'. Thus, whilst a significant factor in determining the existence of a *Quistclose* trust is whether the recipient of the money is required to keep the money in a separate account (as was the case in *Quistclose*), this may not be determinative if sufficient evidence supports the identifiability of the money alleged to be held on trust, even if held in a mixed fund. See, for example, *Quince v Varga* [2009] 1 Qd R 359 (QCA), [28], [34]–[40] (Douglas J) with whom Holmes J and Mackenzie AJA agreed and *Cook v Alto Prestige Pty Limited* (2010) 5 ASTLR 481, [148] and [154] (Bergin CJ in Eq).

Questions

(1) What possible characterisations of a *Quistclose* trust are identified by the Court in *Raulfs v Fishy Bite?*

(2) Is any one of these characterisations preferred and why?

22.6 Rationale of resulting trusts

Professor Chambers, following initial work by Professor Birks (P Birks, 'Restitution and Resulting Trusts' in P Birks and F Rose (eds), *Restitution and Equity* (Mansfield Press, 2000) vol 1, 265–83), suggests that resulting trusts always arise to effect restitution of unjust enrichment. See textbook at [23.7] and [23.47]–[23.49], which briefly explains unjust enrichment as a source of rights and obligations.

22.6a R Chambers, 'Tracing and Unjust Enrichment' in J Neyers et al (eds), *Understanding Unjust Enrichment* (Hart Publishing, 2004) 263, 286–7

First, the enrichment must be an asset which is capable of being the subject matter of a property right. … If the enrichment consists of services performed or goods consumed, there is no asset to which a property right might attach. Although these things may have great value, they cannot be transferred to the claimant and the only possible form of restitution is by payment of their value. … All kinds of assets can be held in trust, including personal rights such as bank accounts. However, some forms of value cannot be the subject of a trust or of any other kind of property right. …

Secondly, if the enrichment consists of an asset that can be transferred to the claimant, property restitution is possible but will not be permitted if the defendant acquires full beneficial ownership of that asset before the right to restitution arises. In almost all of the cases in which the claimant had a property right to an unjust enrichment, that right arose immediately when an asset was transferred to the defendant. The defendant was unjustly enriched by receipt of that asset, possibly because it was transferred by mistake, under duress, or in response to undue influence. The defendant may have obtained the asset by taking advantage of some factor which affected the claimant's ability to make decisions. In some cases, the claimants were completely unaware of the unauthorised transfer of their assets to the defendants. Also, resulting trusts can arise when it is proved or presumed that a transfer was not intended as a gift. In some of these cases, a trust arose at the outset, returning beneficial ownership to the claimant immediately. In others, the claimant immediately acquired a power to recover beneficial ownership of the asset … At no time did the defendant acquire unfettered beneficial ownership of the asset, free of the claimant's right to recover it.

Questions

(1) When, according to Professor Chambers' thesis, do resulting trusts arise?

(2) Do resulting trusts respond to all unjust factors?

22.6b W Swadling, 'A New Role for Resulting Trusts' (1996) 16(1) *Legal Studies* 110–31

The usual vehicle of proprietary restitution is the constructive trust. … But … Professor Birks has put forward the novel suggestion that the resulting trust has been overlooked as a route to restitution and that, when not forgotten, equity could effect restitution via the resulting trust in most, though not all, of those situations in which the common law presently gives relief. Indeed, it is one of the themes of his paper that equity could go further than the common law does at present and effect restitution in situations in which it is presently doubtful or denied.

His argument centres around the fact that, at least in the area of autonomous unjust enrichment, the majority of enrichments received by restitutionary defendants will consist of transfers of wealth for which no reciprocal value has been given. Although the argument is directed specifically to mistaken gifts and failures of consideration, it can equally be applied to mistaken liability payments. Suppose a customer pays a gas bill twice. The customer will receive no value in respect of the second payment. According to Birks, the customer will have two claims. As well as having an undoubted restitutionary claim at common law in respect of the second payment, he argues that the second payment will be held on resulting trust for the customer by the Gas Board. A presumption of resulting trust arises because the payment amounts to a transfer of property without consideration between parties who are outside the range of any presumption of advancement. And since there is no positive evidence of an intention to make a gift, that presumption remains unrebutted. The same, he argues, can also be said for mistaken gifts, payments under duress and most failures of consideration. Indeed, it is only with some admitted artificiality that he manages to exclude from his analysis failures of consideration which result from the defendant's breach of contract. These apart, Birks claims that virtually all cases of common law restitution which involve a direct transfer of wealth from plaintiff to defendant will also give rise to claims in equity under a resulting trust.

… It is the thesis of this article that [Birks] is wrong and that the resulting trust has little or no part to play in the law of restitution. Essentially, the argument which will be put is that Birks is wrong to admit of only one type of evidence which will rebut the presumption of resulting trust which arises in the case of a gratuitous transfer, *viz* positive evidence of a donative intent. An examination of the historical origins of the resulting trust reveals that *any* evidence which is inconsistent with the presumption that the transferee is to be a trustee will suffice. And proof that the payment was made by mistake or for some other reason which makes its receipt unjust will always contradict that presumption of trust. In other words, proof of the unjust factor will itself be the evidence which rebuts the presumption of resulting trust.

Resulting trusts and mistaken gifts

The problem of mistaken gifts

Professor Birks begins by pointing out that at common law a plaintiff who wants to recover a mistaken payment is still on difficult ground if he is unable to point to a liability mistake. The traditional view is that a mistaken payment is only recoverable if the mistake made by the plaintiff was as to a fact which, if true, would have rendered him liable to make the payment in question. It is obvious, he says, that in this state of the common law the recovery of a gift vitiated by mistake is bound to seem problematic.

But equity, he points out, takes a more generous view. In *Lady Hood of Avalon v Mackinnon* a mother anxious to treat her daughters equally executed a deed giving a sum of £8,600 to her elder daughter. The mother had forgotten that she had already made an allocation to that daughter and, on the basis that her intention to transfer was vitiated by mistake, Eve J rescinded the second deed.

He then uses the case of *Fairhurst v Griffiths* … as a bridge between his discussion of mistaken gifts and the attitude generally of equity to gifts. … [A] husband gave away £33,000 to a friend rather than see it go to his estranged wife. The husband and wife were later reconciled but the friend refused to give the money back. The husband's claim to recover it failed, the judge holding that the money was given as 'an absolute gift' and was not the 'subject of any class of trust'.

Birks says that it is not completely clear whether the judge:

> Conceived himself to be asking whether there was any affirmative evidence of intention that the money be held upon trust by the defendant or whether there was evidence to rebut a presumption of resulting trust … The finding of evidence of an intention, however foolish in retrospect, to make an absolute gift can be understood in either sense.

And later:

> … equity approaches gifts with suspicion. Outside the relationships, few and narrow, within which gift-giving is to be expected – relationships, that is, which generate the presumption of advancement – it presumes that the 'gift' is not one. In short the apparent donor gets his gift back unless, when the matter is double-checked, his intention to give is evident. It is simply not true … that in the absence of all circumstances of suspicion 'a donor can *only* get back property which he has given away by showing that he was under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property given to him'. Mistake is quite unnecessary. He gets his property back, it jumps back to him under a resulting trust, unless there is affirmative proof that he intended it not to.

But, with the greatest respect, it is not 'orthodox equity' to say that a transfer of property without consideration will generate a presumption of resulting trust which can only be displaced by positive evidence of a donative intent. Such an approach would, it is submitted, contradict the true nature of this particular type of resulting trust.

The nature of resulting trusts

We know from Megarry J … in *Re Vandervell (No 2)* that there are two types of resulting trusts, automatic and presumed. Since an automatic resulting trust cannot be rebutted by evidence of an intention to give, it is clearly a presumed resulting trust which Professor Birks has in mind. But it is misleading to label such a trust simply as a 'presumed resulting trust'. Since what is being 'presumed' is an intention on the part of the transferor to create a trust, it is more accurately called a 'presumed *intention* resulting trust'. That 'presumed intention resulting trust' is the correct description of the type of trust in operation here will be demonstrated through an historical examination of the origin of such trusts.

Rebutting the presumption

The point that the presumption of resulting trust is simply a device which shifts the burden of disproving a trust on to the transferee is crucial, for once we accept that the trust which arises in the case of a transfer made without consideration does so because of a presumption that this is what the parties actually intended, the Birks thesis can no longer be sustained. The reason for this is simple; the implication of a trust in favour of the donor in the case of a mistaken gift can hardly be said to reflect the true intentions of the parties to such a transaction.

Conclusion

Let us first recall Professor Birks's thesis. It is his contention that a transfer of property without consideration between parties who are outside the range of any presumption of advancement will, in the absence of positive evidence of an intention to make a gift, give rise to a resulting trust in favour of the transferor. He then applies it specifically to the case of a mistaken gift and to payments for which the consideration subsequently fails.

In the case of a mistaken gift made to a party to whom the donor does not stand in a relationship generating a presumption of advancement, Birks argues that because the transfer is made without consideration and (by reason of the mistake) with no positive evidence of an intention to give, the donee will hold on resulting trust for the donor. In the case of the payment made for a reason which later fails, he argues for a resulting trust on four grounds: first, that any other result would be inconsistent with his earlier conclusion in respect of mistaken gifts; second, that any other result would be inconsistent with the law relating to transfers on express trust which later fail; third, that the situation is covered by *Barclays Bank Ltd v Quistclose Investments Ltd;* and fourth, that the situation is covered by *Sinclair v Brougham.* I have argued that Professor Birks is wrong in his analysis both of mistaken gifts and payments made for a consideration which later fails.

In the case of mistaken gifts, my objection turns on the implication of a resulting trust in the teeth of evidence which shows that the donee was not intended by the parties to hold on trust for the donor. In the end, it boils down to a debate as to the types of evidence which will rebut the presumption of resulting trust in the case of a gratuitous transfer outside any relationship of advancement. For Professor Birks, only one type of evidence will do, *viz,* evidence of a positive intention to give. My argument has been that the presumed intention resulting trust which arises in the case of a gratuitous transfer is a presumption of actual intent and therefore *any* evidence that the parties intended something other than a transfer on trust will suffice. Evidence of a mistaken intent to give will therefore rebut the presumption of resulting trust in such a case.

If that is right, there would then be no inconsistency between mistaken gifts and failures of consideration. Professor Birks's first reason for finding a resulting trust where property is transferred on a basis which later fails would therefore fall away. As to the other three justifications, the authorities on transfers on express trusts which later fail were shown to be weak, *Quistclose* was shown to be confined to the specific area of fraudulent preferences in bankruptcy and laid down no principle of general application, and *Sinclair v Brougham* was no authority at all, since the question whether property passed was conceded by counsel in the House of Lords and not raised in the courts below.

The article then went on to discuss the implications of Professor Birks's thesis. It put forward three reasons why it must be treated with caution. First, it would elevate most restitutionary plaintiffs from mere claimants *in personam* at law to claimants *in rem* in equity.

The essential point which should be borne in mind throughout is the far-reaching effect of Birks's thesis. Although applied by him to two specific areas, mistaken gifts and failures of consideration, if correct it would apply across virtually the whole spectrum of autonomous unjust enrichment. The second reason for caution was that it would destroy much of the substance of the present law since it has no room for the fine-tuning which currently takes place. It can, for example, draw no distinction between the types of pressure or mistake which should or should not give rise to a restitutionary claim. This leads on to the third and final reason for caution. If correct, Professor Birks's thesis would introduce a novel ground of claim, no consideration, and, as the example of the fully executed void contract shows, give restitution to a totally undeserving plaintiff. And at the same time, it would propel us into a system similar to that which prevails in civilian systems, which Professor Birks himself deprecates, where the focus is on the 'absence of juristic cause' for an enrichment rather than a 'down to earth' enquiry into the reasons for restitution. The argument is that this conclusion can and should be resisted and that the presumed intention resulting trust has little or no role to play in the English law of restitution.

Note

Professor Swadling's analysis in *Legal Studies* was preferred by the House of Lords in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 which confirmed that resulting trusts are not general proprietary remedies raised to reverse a failure of basis. As stated by Lord Browne-Wilkinson (at 716): 'the resulting trust is an unsuitable basis for developing proprietary restitutionary remedies'; his Honour preferred 'the remedial constructive trust … since the remedy can be tailored to the circumstances of the particular case, innocent third parties would not be prejudiced'. Lord Millett has since confirmed in *Twinsectra Ltd v Yardley* [2002] 2 AC 164, [92], [102]: 'Like all resulting trusts, the trust in favour of the lender arises when the lender parts with the money on terms which do not exhaust the beneficial interest. It is not a contingent reversionary or future interest. It does not suddenly come into being like an 18th century use only when the stated purpose fails. It is a default trust which fills the gap when some part of the beneficial interest is undisposed of and prevents it from being "in suspense".'

Questions

(1) When, according to Professor Swadling, do resulting trusts arise?

(2) According to this thesis, what is presumed in a resulting trust?

23

Constructive trusts

23.1 Introduction

23.2 Common intention constructive trusts

23.3 Unconscionability based constructive trusts

23.4 Constructive trusts as a remedy for estoppel

23.5 Constructive trusts raised in response to a breach of fiduciary obligation

23.6 Constructive trusts imposed over stolen money and its proceeds

23.7 Constructive trusts as a restitutionary remedy for unjust enrichment

23.8 Constructive trusts and mutual wills

23.9 Constructive trusts imposed over property transferred under specifically enforceable contracts

23.1 Introduction

In understanding constructive trusts, it is essential to be clear about labelling. First, not all judicial remedies labelled 'constructive trust' are in substance *proprietary* remedies. An example is the use of a so-called constructive trust as a personal remedy to compensate the plaintiff for loss incurred where the defendant has knowingly assisted in the commission of a breach of fiduciary obligation: see *Giumelli v Giumelli* [1999] HCA 10; (1999) 196 CLR 101, [4]; and *Bofinger v Kingsway Group Ltd* (2009) 239 CLR 269, [48]; discussed generally in chapter 11. Secondly, a chapter on constructive trusts necessarily assumes a sensible delineation between trusts labelled constructive and those labelled resulting. To the extent that resulting trusts are seen as being imposed by operation of law, rather than arising from the intentions (or vitiation of intention) of the transferor of property, a separate chapter devoted to each type of trust may seem unnecessary. However, for ease of exposition, this book deals separately with resulting (chapter 22) and constructive trusts.

Two forms of constructive trust are often juxtaposed: remedial constructive trusts and institutional constructive trusts. This distinction is said to be maintained by the following elements, which themselves may overlap (see E Bant and M Bryan, 'Constructive Trusts and Equitable Proprietary Relief: Rethinking the Essentials' (2011) 5(3) *Journal of Equity* 171, 185–92):

- Whether the availability of the trust is highly discretionary. For example, the constructive trust imposed over property acquired in breach of fiduciary obligation is often cited as the paradigm example of institutional constructive trust. Contrast this with other constructive trusts awarded on a more strongly discretionary basis. However, as Bant and Bryan note (at 187):

> A binary division between cases where it is practically certain that a court will order a constructive trust and other cases where relief is discretionary exaggerates both the predictability of the former category and the discretion available in the latter. The availability of proprietary relief in both categories depends on the exigibility of property over which the trust can be imposed and on the absence of equitable bars to the award of relief. Moreover, the discretion exercisable in considering an award of a remedial constructive trust is not a 'strong' discretion, unconstrained by the exercise of established equitable principle. The grounds for refusing a 'remedial' proprietary constructive trust are often, if not always, grounds for withholding any kind of proprietary remedy,

such as the fact that there is no traceable residue of the original trust property or that third party rights preclude the making of the proprietary order.

- The date from which the trust takes effect. Constructive trusts taking effect from the date of satisfying the legal criteria giving rise to their imposition are regarded as institutional, whereas those taking effect from the date of a court's judgment are remedial.
- The existence of the court's discretion to award personal relief may signify that the trust is remedial. Arguably, all constructive trusts are remedial to the extent that a court could award a personal remedy as an alternative to the imposition of proprietary relief.

It is also necessary to be precise about the differences between express and constructive trusts. Whilst the intentions or expectations of the parties may be relevant to the *facts* giving rise to a constructive trust, as a formal matter constructive trusts depend on a court order and/or the application of equitable principle. Consistently with this position, constructive trusts are not subject to a requirement of certainty of intention. Thus, in *Korda v Australian Executor Trustees (SA) Ltd* [2015] HCA 6; (2015) 255 CLR 62, [8], French CJ cautioned against eliding the role of intention in express and constructive trusts:

> The implication of intention precedes the ascertainment of an express trust. Failure to appreciate that sequence may lead to the imputation of a trust without proper consideration of intention. The ascertainment of an express trust may come to resemble the imposition of a constructive trust, which has been described by this Court as 'a remedy which equity imposes regardless of actual or presumed intention' (*Bathurst City Council v PWC Properties Pty Ltd* (1998) 195 CLR 566 at 584 [40]; referring to *Baumgartner v Baumgartner* (1987) 164 CLR 137 at 148 per Mason CJ, Wilson and Deane JJ, 152 per Toohey J, 157 per Gaudron J). Although it has been suggested that 'unconscious express trusts', like constructive trusts, are 'imposed by the court, in truth, in recognition of a factor affecting the conscience of the common law owner of the property' (Hudson, *Equity & Trusts,* 3rd ed (2003) at 961 [36.3.2]), ascertainment is not a vehicle for imposition.

The writing requirements derived from the *Statute of Frauds 1677* do not apply to constructive trusts in the same way that they apply to express trusts of land. For example, the *Conveyancing Act 1919* (NSW) s 23C(2) states that '[t]his section does not affect the creation or operation of resulting, implied, or constructive trusts'. However, (declared) trusts of land must be evidenced in writing. For example, the *Conveyancing Act 1919* (NSW) s 23C(1)(b) requires that 'a declaration of trust respecting land or any interest therein must be manifested and proved by some writing'. Trusts of land not evidenced in writing are unenforceable by the intended beneficiaries against the settlor until written evidence of the trust is supplied. As discussed by Hope J in the extract from *Last v Rosenfeld* [1972] 2 NSWLR 923 at [15.4a], the principle that equity does not allow a statute to be used as an instrument or cloak for fraud prevents a party from establishing that a trust of land is unenforceable for want of (statutory) writing. However, relevantly for this chapter, the conduct of the parties may also engage other equitable doctrines, including the common intention constructive trust and equitable estoppels. See generally textbook at [15.5]–[15.8].

Finally, it is necessary to consider the duties of constructive trustees. In considering this matter, it is necessary to start with the circumstances and purpose for which the particular constructive trust was raised. Most narrowly conceived, constructive trustees are subject to the obligation to disgorge or (re)convey trust property to the beneficiaries. Constructive trustees are also subject to the duty to account and preserve trust property. In respect of fiduciary obligations, in *Lonrho v Fayed (No 2)* [1992] 1 WLR 1, 12, Millet J said '[i]t is a mistake to suppose that in every situation in which a constructive trust arises the legal owner is necessarily subject to all the fiduciary obligations and disabilities of an express trustee'. However, the facts of the case may permit the conclusion that fiduciary obligations exist in respect of the narrow scope delimited by the trust property.

This chapter adopts a structure classifying constructive trusts according to their remedial objective. For a deeper analysis, see G Elias, *Explaining Constructive Trusts* (Clarendon Press, 1990); R Chambers, *Resulting Trusts* (Clarendon Press, 1997) 220–33; R Chambers, 'Constructive Trusts in Canada' (1999) 37(1) *Alberta Law Review* 173. Other taxonomies of constructive trusts are possible; for example, E Bant and M Bryan, 'Constructive Trusts and Equitable Proprietary Relief: Rethinking the Essentials' (2011) 5(3) *Journal of Equity* 171.

Questions for consideration

When reading the cases in this chapter, consider the following questions:

(1) What event gave rise to the trust?

(2) To what extent are the requirements of these constructive trusts similar? In particular, does the defendant's knowledge of the facts giving rise to the trust play a role?

(3) Would a personal remedy have been sufficient to satisfy the plaintiff's equity?

(4) What discretionary factors did the Court take into account when awarding a constructive trust?

23.2 Common intention constructive trusts

These constructive trusts give effect to the common intention or understanding of the parties that ownership of the property is to be held in a particular way. Usually, the intention is that the plaintiff will acquire an interest in the property.

23.2a *Allen v Snyder* [1977] 2 NSWLR 685

Background

The male plaintiff lived with the female defendant, who was at that time married to someone else. She obtained a divorce in 1969. They lived together in broken periods for approximately 13 years, having met in 1955. For a long time, both intended and assumed that on the defendant's divorce they would marry, but this never happened. In 1966, the plaintiff acquired a home in which they lived together until 1974. Before the purchase, they lived in rented accommodation, and the defendant suggested that the plaintiff should finance the purchase of the property through the War Service Homes Department. She made a statutory declaration that she was living with, and financially dependent on, the plaintiff. Without this declaration, the plaintiff would not have obtained a loan to purchase the property. The statutory scheme did not permit title to the property to be placed in the name of a de facto wife. The defendant furnished the home out of her own funds and the plaintiff made his will in her favour prior to the purchase of the house so that, should he die before they were married, she would have title to the property.

In 1974, the plaintiff commenced proceedings to evict the defendant. The defendant remained living alone in the property until 1977. She resisted eviction, arguing that, although he held legal title, the beneficial interest in the property was shared equally between them.

Decision

The New South Wales Court of Appeal found that there was insufficient evidence to show a common intention on the part of the plaintiff and the defendant that she should have a beneficial half interest in the property.

Glass JA

Constructive trusts arise where it would be a fraud for the legal owner to assert a beneficial interest. …

It is into this settled framework of doctrine that it is necessary to fit recent decisions involving disputes between spouses when the matrimonial home is in the name of one of them, but the other claims an interest. *Pettitt v Pettitt* [1970] AC 777, and *Gissing v Gissing* [1971] AC 886, are two decisions of the House of Lords, each of which rejected a claim by a spouse to a beneficial interest in the

matrimonial home held in the name of the other. In the course of their judgments their Lordships expressed numerous obiter opinions, of which I believe the following represents a consensus.

> **(1)** The Court merely declares the rights of the parties, and has no power to vary them in accordance with considerations of fairness: *Pettitt v Pettitt*. This corresponds with what the High Court has laid down. See *Hepworth v Hepworth* [1963] HCA 49 and cases there cited.
>
> **(2)** Except for the presumption of advancement, the principles governing equitable interests are the same in disputes between spouses as in a dispute between other parties: *Pettitt v Pettitt; Gissing v Gissing*.
>
> **(3)** In the absence of writing to prove an express trust, the Court will give effect to an agreement as to the manner in which the beneficial interest is to be held: *Gissing v Gissing*. The oral agreement so enforced is one under which the claimant spouse, by contributions of one kind or another, has facilitated the acquisition of the home: Ibid.
>
> **(4)** The common intention to which the Court gives effect may be expressed in such an oral agreement, or it may be inferred from the conduct of the parties: *Gissing v Gissing*. What is enforced is an actual intention, inferred as a matter of fact (Ibid), not an imputed intention which they never had *(Gissing v Gissing,* op. cit.), but would have had, if they had applied their minds to it: Ibid; *Pettitt v Pettitt*.
>
> **(5)** The Court gives effect to the trust created by the agreement or common intention that, if the spouses contribute as contemplated, the beneficial interest will be held in accordance with their agreement or common intention: *Gissing v Gissing*.
>
> **(6)** An agreement that a spouse in whom the title is not vested shall have a beneficial interest, without requiring any contribution from her, would be a voluntary declaration of trust and unenforceable: *Gissing v Gissing*. …
>
> **(7)** Financial arrangements between spouses will appear in many different forms. They may involve payments, loans, gifts or services: *Gissing v Gissing*. They may relate to the deposit, the balance purchase price, the mortgage payments, the furniture, the household expenditure: Ibid. Whether the arrangement discloses an agreement or common intention referable to the beneficial enjoyment of the home is a problem of evidence, not of law.
>
> **(8)** Proof of expenditure or services for the benefit of the household, or the provision of furniture, is insufficient, standing alone, to show a common intention as to the ownership of the home: *Gissing v Gissing*.
>
> **(9)** By appropriate evidence, it may be proved that an agreement or common intention arose after the home had been acquired: *Gissing v Gissing*.
>
> **(10)** A relevant common intention may be inferred from conduct, although it has not been the subject of any express communication between the parties: *Gissing v Gissing*.

Samuels JA

Accordingly, not only are resulting and constructive trusts to be regarded as distinct, but the distinction mainly resides in the necessity for common intention in the one case, and its general irrelevance in the other. Whatever the precise sense in which the word 'implied' is used in the collocation 'resulting, implied or constructive' … it cannot … mean a trust raised by an intention yielded by inference from the words and conduct of the parties. An intention derived in this way would lead to the creation of an express trust. It is yielded by applying the same method as that which finds express intention to contract, or express contractual terms, by inference from conduct, or from language which is indirect. Moreover, if A holds property in which B claims a beneficial interest which A denies, recourse may be had to parol evidence in order to prove the existence of a trust, because equity will not permit a statute requiring writing to be used as an instrument of fraud: *Rochefoucauld v Boustead* [1897] 1 Ch 196; *Cadd v Cadd* [1909] HCA 59, per Isaacs J. In such cases, the constructive trust may represent the remedy by which the plaintiff seeks to vindicate an express trust founded upon a common intention which the defendant later repudiates. Or it may be seen as a separate class of trust raised by the existence of some fiduciary or other relevant relationship between the parties, or by the defendant's unconscionable conduct. The

distinction is certainly not without importance and difficulty: see the ambiguity demonstrated in *Bannister v Bannister* [1948] 2 All ER 133. It is, however, not of direct relevance in the present case, save in one respect. The failure to pay regard to the principles which govern the constructive trust has led to its employment as a device for the separation of family assets in circumstances where its doctrine has no plausible operation.

Mahoney JA

… [I]t has frequently been suggested that a trust is to be imposed if, e.g., justice, equity or good conscience require it. But this may be misleading. It does not mean that in each case in which, in the popular sense, there is a situation in which the failure to impose a trust would lead to an inequity, a trust will be imposed. … Not all cases in which, in the popular sense, there is a sense of unfairness or injustice, will be appropriate for this remedy. There are, in matrimonial and analogous relationships, inequities, in the popular sense of the term, which are incidental to the relationships. I do not see the imposition of a trust as being appropriate to the removal or smoothing of all of these. …

This does not mean that the range of situations in which a trust will be appropriate will not, in the ordinary process of development of the law by judicial decision, be extended. … There are kinds of situations which occur in matrimonial and analogous contexts which must often be considered for present purposes. A husband may pay for the matrimonial home and cause the legal title to be vested in the wife. The wife may earn money and use it in defraying household expenses, thus relieving the family budget and allowing the husband to pay mortgage instalments on the home. It will be necessary, from time to time, to determine whether, in such situations, the failure to recognize that the one or the other has a proprietary interest in the home is so contrary to justice and good conscience that a trust or other equitable obligation should be imposed.

23.2b *Green v Green* (1989) 17 NSWLR 343

Background

The plaintiff was a de facto wife of the defendant (now deceased). The defendant was survived by one lawful wife and two de-facto wives (including the plaintiff, the mother of two of his children) and five other children. The plaintiff was born in Thailand of Chinese and Thai descent. She and the defendant had first met when she was a young teenager residing with her grandmother (she had no living parents) in Bangkok. Communicating via an interpreter, the defendant persuaded her to leave her grandmother and move to Australia. The defendant owned or had an interest in five residential properties and maintained simultaneous domestic arrangements with his three different families. Ultimately, the plaintiff and defendant had two children together and maintained a home in one of the houses the defendant owned (the 'Kirrawee property') in relation to which the defendant told the plaintiff: 'This is your house, I bought this for you'. Subsequently, the family moved to another house (the 'Blakehurst property') and the defendant repeated his representation or promise to the plaintiff. However, despite instructing his solicitor in 1976 to transfer title, the defendant died in 1981 without transferring to the plaintiff title to the Blakehurst property. On the ending of their relationship by his death, the plaintiff asserted an equitable proprietary interest in the Blakehurst property.

Decision

By majority (Gleeson CJ and Priestly JA, Mahoney JA dissenting), the New South Wales Court of Appeal held that a constructive trust had been established. The defendant held his registered title to the Blakehurst title on constructive trust for both of them as joint tenants.

The defendant had, over the entire period of the relationship, represented to the plaintiff that it was his intention that she should have some form of proprietary interest in the homes provided for her and, following the move to the Blakehurst property, it was the common intention of the parties that she should have a proprietary interest in the Blakehurst property.

The plaintiff had acted to her detriment in relation to their joint lives on the faith of the relevant promises or representations. The outcome of the decision was that the plaintiff was, by survivorship, entitled to the full beneficial interest in the Blakehurst house.

Gleeson CJ (with whom Priestly JA agreed)

An important case in this area of the law is the decision of the Court of Appeal in *Grant v Edwards* [1986] Ch 638. That case was approved and applied by the Privy Council, in an appeal from New South Wales, in *Austin v Keele* (1987) 10 NSWLR 283; 61 ALJR 605; 72 ALR 579. It was also approved by the Privy Council, although not in a New South Wales appeal, in *Maharaj v Jai Chand* [1986] AC 898. In the latter case (at 907) their Lordships said:

> As to the principles of law to be applied to those facts, references were made in argument to cases where constructive trusts, carrying beneficial interest in land, arise between parties who are man and wife, whether de jure or de facto, on or after the acquisition of their home. The authority now classic is the speech of Lord Diplock in *Gissing v Gissing* [1971] AC 886, 903–911, and later English cases are reviewed in the judgments of the Court of Appeal in *Grant v Edwards* [1986] Ch 638 which concerned an unmarried couple. In such cases a contract or an express trust as at the time of the acquisition may not be established, because of lack of certainty or consideration or non-compliance with statutory requirements of writing, but a constructive trust may be established by an inferred common intention subsequently acted upon by the making of contributions or other action to the detriment of the claimant party. And it has been held that, in the absence of evidence to the contrary, the right inference is that the claimant acted in the belief that she (or he) would h se and not merely out of love and affection.

In the judgment of Vice-Chancellor Browne-Wilkinson in *Grant v Edwards* his Lordship identified as two matters to be demonstrated when a party seeks to establish a constructive trust based on actual intention, first, that there was a common intention that both should have a beneficial interest, and secondly, that the claimant acted to his or her detriment on the basis of that common intention.

His Lordship pointed out that proof of such common intention can be direct, as for example, by evidence of express agreement or the making of admissions, or such common intention can be inferred from the making of contributions to the cost of a property, or meeting expenses in maintaining it. That, however, is merely one of the ways, but not the only way, in which the evidentiary basis for inferring a common intention can be laid. As was earlier observed, such conduct may also be of considerable factual importance in establishing an acting to detriment, but once again, in that respect its status is evidentiary and it is not a matter of legal necessity.

Addressing the question of the quantification of the plaintiff's right, his Lordship pointed out that even after it has been established that the parties had a common intention that both should have a beneficial interest in the said property and that the claimant has acted to his or her detriment there will still remain a question as to the extent of the claimant's beneficial interest. Here again, if contributions have been made they may be of importance in the resolution of that question. Even in a case where a court can infer an actual intention to share ownership of real estate it is, of course, extremely rare that the parties will be people of such sophistication that they advert to or contemplate some particular form of legal title. Thus the court may have to resort to the application of such principles as that expressed in the maxim 'equality is equity': *Gissing v Gissing* (at 908) per Lord Diplock. The Vice-Chancellor said ([1986] Ch 638 at 657):

> Where, as in this case, the existence of some beneficial interest in the claimant has been shown, prima facie the interest of the claimant will be that which the parties intended: *Gissing v Gissing* [1971] AC 886, 908G. In *Eves v Eves* [1975] 1 WLR 1338, 1345G, Brightman LJ plainly felt that a common intention that there should be a joint interest pointed to the beneficial interests being equal. However, he felt able to find a lesser beneficial interest in that case without explaining the legal basis on which he did so. With diffidence, I suggest that the law of proprietary estoppel may again provide useful guidance. If proprietary estoppel is established, the court gives effect to it by giving effect to the common intention so far as may fairly be done between the parties. For that purpose, equity is displayed at its most flexible: see *Crabb v Arun District Council* [1976] Ch 179.

There is another important aspect of the reasoning in *Grant v Edwards* that should be mentioned. Mustill LJ (at 651) observed that although a number of judgments in this area refer, for simplicity of expression, to intention or conduct 'on acquisition' of the relevant property, in a given case the relevant events leading to the finding of an interest in the claimant may occur after acquisition, and beneficial interests may change in the course of the relationship between the parties. This observation was expressly approved by the Privy Council in *Austin v Keele* 290; (at 609; 587).

Application of principles to present case

… the evidence establishes that the deceased, over the entire period of his relationship with the respondent, represented to her that it was his intention that she should have some form of proprietary interest in the homes he provided for her and that, by the time they moved into the Blakehurst property, and at all times thereafter up until the death of the deceased, it was their common intention that the respondent should have a proprietary interest in the Blakehurst property. This view is strengthened by the consideration that the move to the Blakehurst property was made for the purpose of accommodating one aspect of the deceased's somewhat tangled family problems, and depended to some degree upon the acquiesce of the respondent, who was giving up congenial accommodation at Kirrawee.

… I would be unwilling to accept that it was the representation of the deceased, or the common intention of the parties, that the respondent should simply have the absolute beneficial ownership of either the Kirrawee property or the Blakehurst property. My reason for this relates to the position in which that would have left the deceased. I cannot accept that he would have intended that he himself should have no interest in the properties or that he could be excluded from them by the respondent during his lifetime.

… the evidence establishes an acting by the respondent to her detriment on the faith of the relevant promises or representations. That finding was challenged in this Court on a basis that turned upon an unduly narrow view of the term 'detriment' and involved the notion that life in Sydney is so obviously more attractive than life in Bangkok that everything that the respondent did, far from being to her detriment, was to her great advantage. An additional and more formidable argument was to the effect that the explanation of the respondent's conduct was to be found in natural love and affection. For reasons that have earlier been mentioned a consideration such as this will often pose a difficulty in the way of a successful claim to a proprietary interest in a matrimonial home by a spouse or de facto partner. In the present case however, I consider that there was the relevant acting by the respondent to her detriment on the faith of the deceased's promises or representations. He brought her to Australia from her own country as a child, set her up as his de facto wife, and persuaded her not to return to her home with promises that he would care for her, that they would have children, and that he would provide her with a house. He persuaded her to move from the Kirrawee house to the Blakehurst house by telling her, inter alia, that the Blakehurst house would be hers, and shortly thereafter, he repeated this promise to her and to his solicitors, and instructed his solicitors to set about transferring title to her. She for her part, especially in the later years of their association, and at a time when her own commercial and financial awareness was increasing, repeatedly raised with him the issue of ownership of the Kirrawee and Blakehurst houses, which was evidently of importance to her, and he consistently reassured her of his intentions in that regard.

Furthermore, although it is not strictly necessary for her to do so, the respondent is in my view entitled to rely upon the principles enunciated by the Vice-Chancellor in *Grant v Edwards* (at 657) in the following terms:

> In many cases of the present sort, it is impossible to say whether or not the claimant would have done the acts relied on as a detriment even if she thought she had no interest in the house. Setting up house together, having a baby, making payments to general housekeeping expenses (not strictly necessary to enable the mortgage to be paid) may all be referable to the mutual love and affection of the parties and not specifically referable to the claimant's belief that she has an interest in the house. As at present advised, once it has been shown that there was a common intention that the claimant should have an interest in the house, any act done by her to her detriment relating to the joint lives of the parties is, in my judgment, sufficient detriment to qualify. The acts do not have to be inherently referable to the house. … The holding out to the claimant that she had a beneficial interest in the house is an act of such a nature as to be part of the inducement to her to do the acts relied on. Accordingly, in the absence of evidence to the contrary, the right inference is that the claimant acted in reliance on such holding out and the burden lies on the legal owner to show that she did not do so: see *Greasley v Cooke* [1980] 1 WLR 1306.

Notes

(1) There is considerable debate as to the true juridical basis of the common intention constructive trust. In particular, the role of intention in a common intention constructive trust does not easily align with the observation in *Muschinski v Dodds* (1985) 160 CLR 583, 613 (Deane J) that unlike express and implied trusts, 'the constructive trust … arises regardless of intention.'

In *Allen v Snyder* [1977] 2 NSWLR 685, Glass JA concluded that the trust is an express trust enforceable despite the absence of writing. However, in *Shepherd v Doolan* [2005] NSWSC 42, [35] (White J), not being required to decide the question, held:

> [i]t is unnecessary to enter the debate as to whether a trust based on the parties' common intention is properly characterised as a constructive trust, or whether it should be characterised as an express trust which is enforceable notwithstanding the want of writing as it would be an equitable fraud for the legal owner to rely on the absence of writing to deny the beneficiary's interest. (*Allen v Snyder* at 692–3; 699). In later cases, e.g. *Grant v Edwards* [1989] Ch 638; *Maharaj v Chand* [1986] AC 898 at 907; *Green v Green* (1989) 17 NSWLR 343; *Brandling v Weir* [2003] NSWSC 723; *Parianos v Melluish* (2003) 30 Fam LR 524, this class of trust has been classified as a constructive trust, even though it is based on the parties' actual intentions, rather than imposed despite their intentions.

There is also tension in the relationship between the common intention constructive trust and a constructive trust arising from proprietary estoppel. As discussed in *Bijerk Investments Pty Ltd v Bikic* [2020] NSWSC 1336, [116]–[120] (Leeming JA):

> It is perhaps significant that Lord Oliver [in *Austin v Keele* (1987) 10 NSWLR 283 (PC)] stated at 290 that "[i]n essence the doctrine is an application of proprietary estoppel", and proceeded on the basis that the intention could be formed later than the time of acquisition. I mention this because there seems to be a large question whether this doctrine of common intention constructive trusts survives, following developments in Australian law over the last 35 years. This has generated more academic literature than case law: … Mr Alexander accepted that while there was "no proprietary estoppel pleaded, but I do accept that the very elements that would get a party up on a proprietary estoppel would also get one up on a common intention constructive trust".
> If one were to approach the question from first principle, it will be seen that the common intention constructive trust reflects an English response to the problem which was addressed by the High Court in *Muschinski v Dodds* (1985) 160 CLR 583; [1985] HCA 78 and *Baumgartner v Baumgartner*. In the latter case, the High Court identified a constructive trust which did not turn on a common intention but rather the pooling of resources for the purposes of the de facto couple's joint relationship. That may be seen in the reasoning at 146–147, where may be found:
>
> **(1)** the conclusion that the finding by the majority of the Court of Appeal that "there was a common subjective intention to create a trust cannot be sustained",
>
> **(2)** the rejection of what had been said by the majority of this Court in *Allen v Snyder* [1977] 2 NSWLR 685 as to the need for there to be an "actual understanding or reciprocal intention", and
>
> **(3)** the ultimate conclusion that the constructive trust was imposed as a remedy to circumvent the unconscionable conduct where there was no intention to create a trust or to hold the property on trust.
>
> It would be odd if equity would yield a different conclusion for a common intention constructive trust as opposed to a constructive trust based on estoppel – especially if, as Lord Oliver said, the common intention constructive trust is in essence an application of proprietary estoppel. Yet I could readily contemplate cases where a plaintiff's reliance fell short of the "life-changing decisions" which often characterise such claims in intimate relationships, and might not be entitled to relief based on an estoppel to fulfil the representation, but might nonetheless make out a case based on a common intention constructive trust: *Sidhu v Van Dyke* (2014) 251 CLR 505; [2014] HCA 19 at [84]. I have in mind in particular the emphasis given by Mr Coles in final address on what had been said in *Grant v Edwards* [1986] Ch 638 at 657 approved in *Green v Green* at 357 as to what amounted to sufficient detriment to qualify for relief.
> I do not express any concluded view, because none of this was argued, nor have I attempted to do more than sketch the position, but it may be that this form of trust no longer survives in Australian law as an institution separate from an entitlement in estoppel. Nonetheless, it was said in *Michael Gregory Jones as Liquidator of SBH Australia Pty Ltd (in liq) v Cummins* [2018] NSWSC 606 at [76]:
>
> > One recognised class of case in which equity will intervene is where the parties have agreed that the claimant should have an interest in the property acquired by the other and has acted to his or her detriment on the basis of that agreement (*Grant v Edwards* [1986] Ch 638; *Green v Green* (1989) 17 NSWLR 343; *Maharaj v Chand* [1986] AC 898 at 907; *Lloyds Bank plc v Rosset* [1991] 1 AC 107 at 129).

(2) Common intention constructive trusts involve the court inferring or deducing the parties' intention from the facts. As stated in *Shepherd v Doolan* [2005] NSWSC 42, [37]–[39] (White J):

> The intention may be established in various ways. There may be an agreement between the parties as to how the property should be held. There may be express statements as to their intention. Their intention may be inferred from their conduct. The question of what acts demonstrate an agreement or common intention referable to the beneficial enjoyment of the property is one of evidence, not law. (*Allen v Snyder* at 691; *Green v Green* at 355). A common intention that a party have a beneficial interest in a property owned by another will not be inferred merely from their joint occupation of property, nor the carrying out of household duties, nor the

bringing up of children on the property, nor the doing of repairs, renovations, maintenance, decoration or improvement, nor the provision of furniture. (*Pettitt v Pettitt* [1970] AC 777 at 805–806, 811, 818, 826; *Gissing v Gissing* [1971] AC 886 at 900, 910; *Burns v Burns* [1984] Ch 317 at 326, 328, 342).

The intention may be inferred from financial contributions, direct or indirect, to the acquisition of property, including the paying off of mortgages, or the payment of expenses which free up funds for that purpose. (*Burns v Burns* at 328–329; *Gissing v Gissing* at 900, 902–903, 906–907; *Grant v Edwards* at 647, 648–649, 653–654, 655; *Green v Green* at 355). This is a wider enquiry than whether a contribution was made to the purchase money such as to give rise to a presumption of a resulting trust. Whilst both enquiries address the inferences to be drawn as to the parties' actual intentions, a contribution to the purchase price creates a presumption of beneficial ownership in the proportion which the amount contributed bears to the price. For a "common intention" constructive trust, a contribution, direct or indirect, to the costs of acquisition of the property is a matter from which an intention that the claimant have a beneficial interest in the property might be inferred. There is a difference between a fact from which an inference can be drawn, and a fact from which a rebuttable presumption arises. The significance of the difference will depend upon the strength of the presumption. In the case of the "common intention" constructive trust, there is no presumption that the beneficial interest is in proportion with the contribution to the purchase price.

Other evidence from which conclusions may be drawn about the intentions of the parties include declarations of the parties before or at the time of the transaction or so close in time after the transaction as to constitute a part of it. Subsequent declarations of intention are only admissible against interest. (*Calverley v Green* (1984) 155 CLR 242 at 262 and 269; *Charles Marshall Pty Ltd v Grimsley* (1956) 95 CLR 353 at 365; *Bryson v Bryant* (1992) 29 NSWLR 188 at 215).

(3) The plaintiff must act to their detriment in a manner consistent with their intended ownership. As explained in *Cambouya Pty Ltd v Buchanan* [2005] NSWSC 743, [39] (White J): 'a constructive trust may arise … where the parties have an actual intention that one of them should have a beneficial interest in property whose legal title is held by the other and where the former party has acted to his or her detriment in a way referable to the parties' agreement or intention that he or she have an interest in the property (*Green v Green* (1989) 17 NSWLR 343; *Brandling v Weir* [2003] NSWSC 723; *Carruthers v Manning* [2001] NSWSC 1130, [124]; *Parianos v Melluish* (2003) 30 Fam LR 524; *Grant v Edwards* [1986] Ch 638)'.

(4) Consistently with the view that the court is giving effect to the actual or inferred intentions of the parties, the quantum of beneficial interests in the property should also reflect this agreement.

(5) The common intention constructive trust takes effect from the date the plaintiff has acted to his or her detriment, not from the date of the court's judgment. This may have important consequences in situations of value shortage, such as insolvency, death or divorce. As stated in *Parsons v McBain* (2001) 109 FCR 120, [13]: 'the notion that a "common intention constructive trust" first comes into existence when so declared by the court must be rejected'. In *Parsons,* two brothers were partners in a business that became bankrupt. Prior to the bankruptcy, each brother transferred title to his matrimonial home to his wife, in order to keep the properties out of the reach of their creditors. The brothers' trustee in bankruptcy sued, seeking to have the transfers declared void under s 120 or s 121 of the *Bankruptcy Act 1966* (Cth). The Court held that the wives' beneficial interests in the homes were not affected by those provisions. The common intention constructive trust arose without any court order. Although the beneficiary's interest under a common intention constructive trust can be deferred to later interests in accordance with the principles governing priority between competing equitable interests, the wives' equitable interests were not 'defeated merely because the legal title has passed to a trustee in bankruptcy, for he stands in the shoes of the bankrupt'.

(6) The *Family Law Act 1975* (Cth) provides for the alteration of interests in the property of parties to a marriage or de facto relationship: ss 79, 90SM. Various legislation contains similar provisions with respect to other domestic relationships, including carers: *Property (Relationships) Act 1984* (NSW) ss 5, 20; *Domestic Partners Property Act 1996* (SA) ss 9–13; *Domestic Relationships Act 1994* (ACT) ss 3, 10–17; *Relationships Act 2003* (Tas) ss 6, 10. As a practical matter, such legislation may limit the circumstances in which a constructive trust will be relevant to the resolution of spousal and de facto property disputes. Nonetheless, the common intention constructive trust may also arise and, in addition, may be relevant in other circumstances, such as between friends or business partners.

Questions

(1) 'The common intention constructive trust will enter centre stage where the formalities for a contract or express written trust are not satisfied, and the other paths are either not pleaded or are not satisfied.' (*Imam Ali Islamic Centre v Imam Ali Islamic Centre Inc* [2018] VSC 413, [406] (McMillan J). Do you agree?

(2) To what extent does the common intention constructive trust enforce a bargain or agreement between the parties? Is the trust protecting the claimant's expectations or undoing the effect of the defendant's wrongdoing? Are there any other remedial objectives being satisfied?

(3) What are the differences, if any, between the doctrines of common intention constructive trusts and proprietary estoppel?

23.3 Unconscionability based constructive trusts

Constructive trusts may be raised to prevent or reverse unconscionable conduct. The unconscionability may, on some facts, be revealed by conduct which resiles from a previously agreed bargain or common understanding. Thus, a course of dealing between the plaintiff and defendant which sets up a reasonable expectation of an interest in property might lay the foundations for a common intention constructive trust. However, the whole of the conduct between the parties is taken into account in considering whether an unconscionability based constructive trust will exist.

23.3a *Muschinski v Dodds* [1985] HCA 78; (1985) 160 CLR 583

Background

Hilga Muschinski and Ronald Dodds had been living together since 1972. In 1976, they purchased a property at Picton, for which Mrs Muschinski paid the purchase price. They planned to erect a kit home in which they would live and renovate the old cottage existing on the land to be used by Mrs Muschinski as an 'arts and craft' business. Additionally, part of the land was to be subdivided and sold. The property was conveyed to them as tenants in common in equal shares. Mr Dodds' financial contribution was intended to be made later; it was proposed that he would pay for the kit home and put in the time and funds necessary to develop the property. None of these further plans eventuated. The local shire council refused the necessary permission to erect the kit home and the planned subdivision was not possible.

In 1980, their relationship broke down and Mrs Muschinski commenced proceedings for a declaration that she was the beneficial owner of the property and that Mr Dodds held his interest in trust for her. It was agreed between them that Mrs Muschinski had contributed $25,259.45 to the purchase and improvement of the property and Mr Dodds had contributed $2,549.77.

Decision

The High Court, Brennan and Dawson JJ dissenting, determined that the parties held their respective legal interests as tenants in common upon trust, after payment of any joint debts incurred in improvement of the property, to repay to each his or her contribution and as to the residue for both of them in equal shares.

Deane J

There was no express or implied agreement, arrangement or understanding between the parties that they should hold their legal interests upon trust for themselves in shares corresponding to their respective contributions. To the contrary, the evidence leads in-

exorably to the conclusion – expressed in concurrent findings of fact in the courts below – that it was their shared intention that, from the time of purchase, each should have a full one-half beneficial, as well as legal, interest in the property. Mrs Muschinski's intention was that her own and Mr Dodds' interest or, to use her word, 'status' in the whole venture should be equal: it should be a 'joint venture', a 'partnership'. The explanation of that intention lay in her expectation of Mr Dodds' future financial contributions and in her desire to use the arrangements in relation to the purchase and development of the property as a means of strengthening the stability of her relationship with him … Nor, upon a proper assessment of the evidence, is there room for a finding of an express or implied contract between Mrs Muschinski and Mr Dodds to the effect that, if things fell apart in respect of both their personal relationship and their planned development of the land, they would hold the property either upon trust to repay their respective contributions and then for themselves equally or upon trust for themselves in shares according to their respective contributions. …

In these circumstances, there is no occasion for recourse to the presumption of the law of equity that, where two or more persons advance the purchase price of property in different shares, the person or persons to whom the legal title is transferred holds or hold the property upon resulting trust in favour of those who provided the purchase price in the shares in which they provided it: *Calverley v Green* (1984) 59 ALJR 111, at 121. That presumption performs much the same function as a civil onus of proof. General statements to the effect that it is not lightly to be rebutted should not, in my respectful view, now be accepted as good law … That is not, of course, to deny that the facts which call the presumption into operation may, in the circumstances of a particular case, also lead to such a strong inference of an intended trust that convincing evidence would be necessary to rebut it: cf. *Wirth v Wirth* (1956) 98 CLR 228, at 241–242. Even in such a case however, the presumption operates by reference to the presumed intention of the party whose contribution exceeds his or her proportionate share; it cannot prevail over the actual intention of that party as established by the overall evidence, including the evidence of the parties' respective contributions.

It follows that no relief is available to Mrs Muschinski on the grounds of breach of express or implied agreement or of express or implied trust. The question remains whether the circumstances of the case are such as to entitle her to claim relief on some other ground. In particular, the question arises whether she is entitled to claim relief by way of declaration of, or order imposing, a constructive trust. It was submitted on behalf of Mrs Muschinski that she was entitled to a declaration of constructive trust based on broad notions of fairness and unjust enrichment. …

[W]here competing common law or equitable claims are or may be involved, a declaration of constructive trust by way of remedy can properly be so framed that the consequences of its imposition are operative only from the date of judgment or formal court order or from some other specified date. The fact that the constructive trust remains predominantly remedial does not, however, mean that it represents a medium for the indulgence of idiosyncratic notions of fairness and justice. …

Thus it is that there is no place in the law of this country for the notion of 'a constructive trust of a new model' which, '(b)y whatever name it is described, … is … imposed by law whenever justice and good conscience' (in the sense of 'fairness' or what 'was fair') 'require it' (per Lord Denning MR, *Eves v Eves* [1975] 1 WLR 1338, at 1341, 1342) … Under the law of this country – as, I venture to think, under the present law of England (cf. *Burns v Burns* [1984] Ch 317) – proprietary rights fall to be governed by principles of law and not by some mix of judicial discretion …, subjective views about which party 'ought to win' … and 'the formless void of individual moral opinion' (cf. *Carly v Farrelly* [1971] I NZLR 356, at 367; *Avondale Printers & Stationers Ltd v Haggie* [1979] 2 NZLR 124, at 154). Long before Lord Selden's anachronism identifying the Chancellor's foot as the measure of Chancery relief, undefined notions of 'justice' and what was 'fair' had given way in the law of equity to the rule of ordered principle which is of the essence of any coherent system of rational law. The mere fact that it would be unjust or unfair in a situation of discord for the owner of a legal estate to assert his ownership against another provides, of itself, no mandate for a judicial declaration that the ownership in whole or in part lies, in equity, in that other (cf. *Hepworth v Hepworth* (1963) 110 CLR 309, at 317–318). Such equitable relief by way of constructive trust will only properly be available if applicable principles of the law of equity require that the person in whom the ownership of property is vested should hold it to the use or for the benefit of another. That is not to say that general notions of fairness and justice have become irrelevant to the content and application of equity. They remain relevant to the traditional equitable notion of unconscionable conduct which persists as an operative component of some fundamental rules or principles of modern equity (cf., e.g., *Legione v Hateley* (1983) 152 CLR 406, at 444; *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447, at 461–644, 474–475).

The principal operation of the constructive trust in the law of this country has been in the area of breach of fiduciary duty. Some text writers have expressed the view that the constructive trust is confined to cases where some pre-existing fiduciary relationship can be identified … Neither principle nor authority requires however that it be confined to that or any other category or categories of case … Once its predominantly remedial character is accepted, there is no reason to deny the availability of the constructive trust in any case where some principle of the law of equity calls for the imposition upon the legal owner of property, regardless of actual or presumed agreement or intention, of the obligation to hold or apply the property for the benefit of another …

As has been said, the payments made by Mrs Muschinski on account of the price and associated costs of the property were made by her pursuant to the overall arrangement between herself and Mr Dodds. It was the common intention of the parties, at the time those particular payments were made, that the burden of them should be borne by Mrs Muschinski alone. As I presently see the matter, it follows that Mrs Muschinski had no right to claim re-imbursement from Mr Dodds in respect of an appropriate part of those payments under any doctrine of contribution …

… Like most of the traditional doctrines of equity, it operates upon legal entitlement to prevent a person from asserting or exercising a legal right in circumstances where the particular assertion or exercise of it would constitute unconscionable conduct …

… Those circumstances can be more precisely defined by saying that the principle operates in a case where the substratum of a joint relationship or endeavour is removed without attributable blame and where the benefit of money or other property contributed by one party on the basis and for the purposes of the relationship or endeavour would otherwise be enjoyed by the other party in circumstances in which it was not specifically intended or specially provided that that other party should so enjoy it. The content of the principle is that, in such a case, equity will not permit that other party to assert or retain the benefit of the relevant property to the extent that it would be unconscionable for him so to do: cf. *Atwood v Maude* (1868) 3 Ch App 369 and per Jessel MR, *Lyon v Tweddell* (1881) 17 Ch D 529, at 531.

The circumstances of the present case provide the necessary context for the operation of that general principle of the law of equity. Mrs Muschinski's payment of the purchase price of the Picton property, which was transferred into the joint names of Mr Dodds and herself, was made on the basis and for the purposes of their planned venture with respect to the land. The substratum of that planned joint endeavour was removed without attributable blame. Mr Dodds is left as a half owner of the property in circumstances (i.e. the collapse of the joint endeavour) to which the parties did not advert and in which it was not specifically intended or specially provided that Mr Dodds should enjoy such a benefit at Mrs Muschinski's expense. In these circumstances, the operation of the relevant principle is to preclude Mr Dodds from asserting or retaining, against Mrs Muschinski, his one-half ownership of the property to the extent that it would be unconscionable for him so to do.

In assessing whether or to what extent such an assertion or retention of legal entitlement by Mr Dodds would constitute unconscionable conduct, one is not left at large to indulge random notions of what is fair and just as a matter of abstract morality. Notions of what is fair and just are relevant but only in the confined context of determining whether conduct should, by reference to legitimate processes of legal reasoning, be characterized as unconscionable for the purposes of a specific principle of equity whose rationale and operation is to prevent wrongful and undue advantage being taken by one party of a benefit derived at the expense of the other party in the special circumstances of the unforeseen and premature collapse of a joint relationship or endeavour …

… If no more than the commercial relationship had been involved, Mr Dodds' conduct in seeking to catch and retain the unfair advantage of unforeseen circumstances by asserting his legal entitlement of a one-half interest in the property without assenting to any adjustment to compensate Mrs Muschinski for the unintended gross disproportion between their respective contributions would plainly be unconscionable for the purposes of the relevant principle of equity. Indeed, if the relationship between the parties had been merely a commercial one, such conduct on the part of Mr Dodds would be of the very type which the relevant principle exists to preclude.

As has been seen however, the relationship between the parties in the present case was not merely a commercial one. It was a mixture of the commercial and the personal. The personal relationship provided the context and explains the content of the planned commercial venture. If the personal relationship had survived for years after the collapse of the commercial venture and the property had been unmistakenly devoted to serve solely as a mutual home, any assessment of what would and would not constitute unconscionable conduct would obviously be greatly influenced by the special considerations applicable to a case where a husband and wife or persons living in a 'de facto' situation contribute, financially and in a variety of other ways, over a lengthy period to the establishment of a joint home. In the forefront of those special considerations there commonly lies a need to take account of a practical equation between direct contributions in money or labour and indirect contributions in other forms such as support, home-making and family care. In fact, of course, the personal relationship also failed in the present case …

It follows that equity requires that the rights and obligations of the parties be adjusted to compensate for the disproportion between their contributions to the purchase and improvement of the Picton property. In the absence of any suggestion of direct payment by Mr Dodds to Mrs Muschinski to achieve a like result, that adjustment requires, at the least, that the parties be proportionately repaid their respective contributions to the extent allowed by the proceeds of any sale. … The conclusion which I have reached in all the circumstances of the present case is, however, that Mrs Muschinski has failed to establish that it would be unconscionable conduct on the part of Mr Dodds to assert and retain the one-half share in the residue of the proceeds of sale of the Picton property to which his legal entitlement and the consensual arrangement between them otherwise entitles him.

There remains the question whether there should be a declaration that the Picton property is held by the parties upon constructive trust. In my view, there should. That property was acquired, in pursuance of the consensual arrangement between the parties, to be held and developed in accordance with that arrangement. The contributions which each party is entitled to have repaid to her or him were made for, or in connection with, its purchase or development. The collapse of the commercial venture and the failure of the personal relationship jointly combined to lead to a situation in which each party is entitled to insist upon realization of the asset, repayment of her or his contribution and distribution of any surplus. In these circumstances, the appropriate order to give effect to the rights and obligations of the parties is an order declaring that the Picton property is held by them upon constructive trust. Lest the legitimate claims of third parties be adversely affected, the constructive trust should be imposed only from the date of publication of reasons for judgment of this Court.

Notes

(1) Deane J referred to the 'substratum of the joint relationship or endeavour' which is removed, drawing on principles associated with the distribution of assets in the dissolution of partnerships, and on frustration of a contract, to identify the trust in the principal case. Importantly, this constructive trust does not rest on the implied or inferred intentions of the parties as to the beneficial ownership of the property.

(2) The elements identified by Deane J are: (a) that a joint venture or endeavour has failed; (b) that the plaintiff is not to blame for the failure; and (c) that the plaintiff has contributed money or other property which would not otherwise have been enjoyed by the defendant: see *Muschinski v Dodds* (1985) 160 CLR 583, 618. Despite its apparent dissonance with the no fault divorce provisions of modern family law, the requirement that the failure of the joint venture or endeavour must have occurred without blame attributable to the plaintiff remains an element to be satisfied. See, for example, *Raulfs v Fishy Bite Pty Ltd* [2012] NSWCA 135, [73]–[77], extracted at [13.4.5a], in which, although the Court assumed without deciding that the requirement of 'without attributable blame' had been satisfied on the facts, it did not dispute the need to meet this element of the constructive trust. The 'absence of attributable fault' requirement is broadly interpreted and in general does not require the court to work out which party or in what proportion(s) the parties are responsible for the ending of their joint venture, endeavour or relationship. Rather, the element is best understood as requiring that the joint endeavour or relationship must not have failed due to wrongdoing by the party asserting an equity for relief. As stated by Bryson J in *Bennett v Horgan* (New South Wales Supreme Court, Bryson J, 3 June 1994):

> The concept of attributable blame must be understood and applied with some tolerance; … it does not call for a judgment attributing blame among members of a family for the continuing relationship becoming intolerable, unless perhaps in particularly gross cases. Such judgment would be difficult and unreliable, as it is rare indeed that something or other which could be said to be a ground for blame cannot be identified and laid to the charge of each of the persons concerned. Leaving gross cases involving criminality or similarly reprehensible behaviour on one side, it should usually be understood … that where personal relationships deteriorate and the sharing of a dwelling becomes intolerable to some or all of those concerned, there is, within the meaning of Deane J's expression, no attributable blame and the case is one for an equitable adjustment.

In *Cetojevik v Cetojevik* [2006] NSWSC 431, the joint endeavour came to an end because of the untimely death of the plaintiff's son. Similarly, in *Australian Building & Technical Solutions Pty Ltd v Boumelhem* (2009) 2 ASTLR 336, the endeavour ended on one party's bankruptcy. In the latter case, Ward J, at [98]–[99], suggested that the requirement of 'without attributable blame' may be understood by reference to the court's inquiry into overall unconscionability:

> perhaps the answer is that if the joint endeavour comes to an end due to some wrongful conduct of the party seeking the imposition of a constructive trust this might impact on whether it is unconscionable for the other party in those circumstances to retain the benefits of the joint endeavour. In other words, a lack of focus on the 'without attributable blame' part of the *Muschinski* formulation of the test may be explicable if it is bound up in the question of unconscionability.

Question

Consider a joint venture between the plaintiff and the defendant which is ended by the plaintiff's *voluntary* entry into bankruptcy. Assuming the other elements of the unconscionability constructive trusts are met, would this meet the requirement that the relationship end 'without attributable blame'?

23.3b *Baumgartner v Baumgartner* [1987] HCA 59; (1987) 164 CLR 137

Background

Eileen and Leo Baumgartner commenced a de facto relationship in September 1978, which continued until August 1982 when Eileen and their child left their family home (Eileen had, by deed poll, changed her name to Baumgartner). They pooled their incomes for their living expenses and fixed commitments and lived at first in a home unit owned by Leo and subsequently, after discussion between them, in the Leumeah house built on land purchased in Leo's name. This property was purchased via a mortgage in Leo's name and Leo contributed the proceeds of the sale of his home unit. From their pooled resources and pay packets, Leo paid the ordinary expenses of running the household including mortgage repayments, entertainment and costs of the car. In aggregate, the earnings were pooled in a rough proportion of 55 per cent (Leo) and 45 per cent (Eileen). On the breakdown of the relationship, Leo asserted that the land was his sole property. Eileen argued that he held it on constructive trust for her.

Decision

The High Court agreed that Leo held the house on trust for Eileen in the proportions in which they had contributed their earnings to its acquisition, subject to a charge in Leo's favour for the net proceeds of the home unit.

Mason CJ, Wilson and Deane JJ

There was no suggestion that the respondent's contributions were paid and received by way of rent or a charge for use and occupation and for living expenses. …

In this context it would be unreal and artificial to say that the respondent intended to make a gift to the appellant of so much of her earnings as were applied in payment or mortgage instalments. There is no evidence which would sustain a finding that the respondent intended to make a gift to the appellant in this way.

The case is accordingly one in which the parties have pooled their earnings for the purposes of their joint relationship, one of the purposes of that relationship being to secure accommodation for themselves and their child. Their contributions, financial and otherwise, to the acquisition of the land, the building of the house, the purchase of furniture and the making of their home, were on the basis of, and for the purposes of, that joint relationship. In this situation the appellant's assertion, after the relationship had failed, that the Leumeah property, which was financed in part through the pooled funds, is his sole property, is his property beneficially to the exclusion of any interest at all on the part of the respondent, amounts to unconscionable conduct which attracts the intervention of equity and the imposition of a constructive trust at the suit of the respondent.

It therefore becomes necessary to determine the terms of that constructive trust. The facts that the Leumeah property was acquired and developed as a home for the parties and that, at least indirectly, it was largely financed out of money drawn from the pool of their earnings, this being one of the purposes which the pool was to serve, combine to support an equality of beneficial ownership at least as a starting point. Equity favours equality and, in circumstances where the parties have lived together for years and have pooled their resources and their efforts to create a joint home, there is much to be said for the view that they should share the beneficial ownership equally as tenants in common, subject to adjustment to avoid any injustice which would result if account were not taken of the disparity between the worth of their individual contributions either financially or in kind. The question which has caused us particular difficulty is whether any such adjustment is necessary in the circumstances of the present case to avoid any injustice which would otherwise result by reason of disparity between individual financial contributions. The conclusion to which we have come is that some such adjustment is necessary.

Although the present case is close to the borderline, we do not consider that it is possible to treat the respective financial contributions of the parties as being approximately equal. Even after crediting the respondent with the amount she would have earned during the period of three months during which the respondent was precluded from working by reason of having and caring for their child, it is agreed that the respective contributions were approximately 55 per cent as to the appellant and 45 per cent as to the respondent, that is to say, the appellant contributed almost a quarter more than the respondent. The Court should, where possible, strive to give effect to the notion of practical equality, rather than pursue complicated factual inquiries which will result in relatively insignificant differences in contributions and consequential beneficial interest. We do not think, however, that the difference in the present case can be regarded as relatively insignificant. Nor has it been suggested that the difference in the amount of the financial contributions was offset by the greater worth of the respondent's contribution in other areas. In these circumstances, though acknowledging that the case is close to the borderline, we consider that the constructive trust to be imposed should declare the beneficial interests of the parties in the proportions 55 per cent to the appellant and 45 per cent to the respondent.

There are, however, other adjustments which should be made in the interests of justice. .... The appellant should be entitled to receive from the proceeds of any sale of the property repayment of the contributions effectively made by him before and after the period during which the parties were living together and pooling their resources. ... [T]he appellant should be entitled to be paid the net proceeds of the sale of his unit ($12,883.41) which were devoted to the purchase of the property less the amount of payments of instalments under the mortgage over the unit which were made from the pooled earnings during the period of cohabitation. The appellant should also be entitled to be repaid the instalments under the mortgage over the property which he has paid during the period since the termination of the relationship between the respondent and himself subject to an off-setting adjustment to reflect any benefit enjoyed by the appellant through use and occupation of the property during that period. The final adjustment which should be made in the appellant's favour relates to the furniture which was taken by the respondent when her relationship with the appellant terminated. That furniture was largely acquired during the period of cohabitation ...

Notes

(1) The requirement of a 'joint relationship' does not mean that there must be a contract between the parties. An agreement between the parties may be part of the course of dealing to be assessed in determining whether or not there is a joint relationship or endeavour, but the absence of a formal or express agreement is not determinative. See, for example, *Brown v Manuel* [1996] QCA 65.

(2) This constructive trust does not apply where the parties specifically allocate the distribution of property rights on the ending of their relationship. See, for example, *West v Mead* (2013) 13 BPR 24,431, [63]–[64] (Campbell JA):

> If the parties have expressly contemplated the very situation which has arisen, and have, in advance, agreed how the assets built up as a result of their joint efforts should be divided in that situation, it would often be the case that there is nothing unconscionable in holding the parties to their agreement. A further way in which the intention of the parties is relevant is that the Baumgartner basis for a constructive trust arises only when there is a premature termination of the relationship. To decide whether this has happened, one must look at what the intention of the parties was, about how long their relationship would endure. ... [I]f one of the partners makes clear that he or she is making no commitment whatever to the relationship, and is free to walk out at any time and keep any property he or she has acquired during the relationship, it is hard to see how there is anything unconscionable in the property interests lying where they fall when the relationship ends.

(3) The focus in *Baumgartner v Baumgartner* (1987) 164 CLR 137 was upon the direct and indirect contributions made by the plaintiff to the acquisition of property. The plaintiff's financial contributions entitling her to a constructive trust may include direct contributions to the purchase price and also payment of mortgage instalments where the mortgage is incurred to finance the purchase of the property. However, following *Baumgartner*, courts have taken a more expansive notion of the plaintiff's contribution, which includes non-financial contributions, albeit that the plaintiff must still demonstrate that these contributions served to acquire or improve the property now claimed. Non-financial contributions which may only indirectly assist in the acquisition of assets are thus vulnerable to being excluded from the calculus. Although, on the facts in *Baumgartner*, the High Court took into account the plaintiff's financial contributions to the purchase of the house by paying her earnings into their pooled bank account from which mortgage payments and other regular bills were paid, her non-financial contributions were also recognised. She was 'credited' with 'the amount she would have earned during the period of three months during which [she] was precluded from working by reason of having and caring for their child' (Mason CJ, Wilson J and Deane J at 150. See also Gaudron J at 157). Thus, homemaker contributions referable to the acquisition of an interest in

property will count since they free the other party to earn income which may be applied to the purchase price and mortgage repayments (see, eg, *Parij v Parij* (1997) SASR 153, 163 (Debelle J)). Cf *Bryson v Bryant* (1992) 29 NSWLR 188. Relevant factors may therefore include the longevity of the relationship, the extent to which the parties shared responsibility for bringing up children, and the extent to which the earning capacity of the party who made financial contributions was enhanced by the homemaking contributions of the other party. See, for example, *Black v Black* (1991) 15 Fam LR 109, 117–118 (Clarke JA) cited in *Read v Nicholls* [2004] VSC 66, [61] (Nettle J).

(4) Note that if the plaintiff contributes money to the purchase of property, this may independently lay the foundation for a purchase money resulting trust: see [22.3] and textbook at [22.1]–[22.21].

Questions

Consider a joint enterprise between two friends, the purpose of which is to purchase land on which they will plant a vineyard. The parties agree that they should each have a half interest in the land. The defendant provides the deposit of $200,000 and the land is conveyed to them as tenants in common in equal shares. The balance of the purchase price ($200,000) is obtained by a loan taken out by the defendant and secured by a mortgage over the property. Mortgage repayments are made by the plaintiff and defendant equally. The plaintiff plants all of the vines, constructs agricultural buildings and infrastructure, and does all of the other work necessary for the success of their joint business enterprise. Evidence values the work done by the plaintiff at $150,000. Subsequently, the parties irreconcilably fall out. As a result of the plaintiff's work in improving the land, the land is now worth $600,000.

(1) To what extent will the plaintiff be able to rely on resulting trust doctrine to assert an equitable proprietary interest in the land?

(2) To what extent will the plaintiff be able to rely on an unconscionability based constructive trust to assert an interest in the land?

23.4 Constructive trusts as a remedy for estoppel

Estoppel is discussed in the textbook at [7.2]–[7.12] and in chapter 7 of this book. In broad terms, equity raises an estoppel when one party makes a representation that is relied on by another to their detriment. If the first party resiles from that representation in circumstances that equity deems unconscientious, an equity arises. Of relevance to this chapter is the question whether that equity is to be satisfied via a personal or proprietary remedy.

23.4a *Giumelli v Giumelli* [1999] HCA 10; (1999) 196 CLR 101

Background

For a statement of the facts, see [2.2a].

Decision

Gleeson CJ, McHugh, Gummow and Callinan JJ

Constructive trust and estoppel

In submissions to this Court, the term 'constructive trust' was used to identify the nature of the equitable remedy granted by the Full Court. Care is required in the use of the term 'constructive' in this context. Professor Scott has pointed out (*Scott on Trusts*):

> It is sometimes said that when there are sufficient grounds for imposing a constructive trust, the court 'constructs a trust.' The expression is, of course, absurd. The word 'constructive' is derived from the verb 'construe,' not from the verb 'construct'. … The court construes the circumstances in the sense that it explains or interprets them; it does not construct them.

The relief granted by the Full Court involved a trust that was 'constructive' in that way. The Full Court so interpreted the circumstances as obliging the appellants … not to retain their beneficial interest in the whole of the Dwellingup property and as requiring them to answer the respondent's equity by bringing about a subdivision of the Promised Lot and conveying the title to it.

The equity of the respondent was seen by the Full Court as sufficiently strong as not only to prevent the appellants from insisting upon their strict legal rights but also, in respect of the Promised Lot, to convey it to the respondent.

A constructive trust of this nature is a remedial response to the claim to equitable intervention made out by the plaintiff. It obliges the holder of the legal title to surrender the property in question, thereby bringing about a determination of the rights and titles of the parties.

The term 'constructive trust' is used in various senses when identifying a remedy provided by a court of equity. The trust institution usually involves both the holding of property by the trustee and a personal liability to account in a suit for breach of trust for the discharge of the trustee's duties. However, some constructive trusts create or recognise no proprietary interest. Rather there is the imposition of a personal liability to account in the same manner as that of an express trustee. An example of a constructive trust in this sense is the imposition of personal liability upon one 'who dishonestly procures or assists in a breach of trust or fiduciary obligation' … by a trustee or other fiduciary.

In the present case, the constructive trust is proprietary in nature. It attaches to the Dwellingup property. Such a trust does not necessarily impose upon the holder of the legal title the various administrative duties and fiduciary obligations which attend the settlement of property to be held by a trustee upon an express trust for successive interests. Rather, the order made by the Full Court is akin to orders for conveyance made by Lord Westbury LC in *Dillwyn v Llewelyn* (1862) 45 ER 1285 at 1287 and, more recently, by McPherson J in *Riches v Hogben* [1985] 2 Qd R 292 at 302.

The present case fell within the category identified by the Privy Council in *Plimmer v Mayor, &c, of Wellington* (1884) 9 App Cas 699 at 714 where 'the Court must look at the circumstances in each case to decide in what way the equity can be satisfied'. Before a constructive trust is imposed, the court should first decide whether, having regard to the issues in the litigation, there is an appropriate equitable remedy which falls short of the imposition of a trust. At the heart of this appeal is the question whether the relief granted by the Full Court was appropriate and whether sufficient weight was given by the Full Court to the various factors to be taken into account, including the impact upon relevant third parties, in determining the nature and quantum of the equitable relief to be granted.

However, the appellants correctly challenge the Full Court order on other grounds. Before making an order designed to bring about a conveyance of the Promised Lot to the respondent, the Full Court was obliged to consider all the circumstances of the case. These circumstances included the still pending partnership action, the improvements to the Promised Lot by family members other than Robert, both before and after his residency there, the breakdown in family relationships and the continued residence on the Promised Lot of Steven and his family. It will be recalled that Steven is a party to the partnership action but not to the present action.

When these matters are taken into account, it is apparent that the order made by the Full Court reflected what in *Verwayen* was described as the prima facie entitlement of Robert. However, qualification was necessary both to avoid injustice to others, particularly Steven and his family, and to avoid relief which went beyond what was required for conscientious conduct by Mr and Mrs Giumelli. The result points inexorably to relief expressed not in terms of acquisition of title to land but in a money sum. This would reflect, with respect to the third promise, the approach taken by RD Nicholson J when giving relief in respect of the second promise …

Conclusion

Whilst the holding of the Full Court with respect to the third promise should be upheld, the Full Court erred in the measure of relief which it granted in respect of the Promised Lot. This is a case for the fixing of a money sum to represent the value of the equitable claim of the respondent to the Promised Lot. It will be necessary for the matter to be remitted to a judge of the Supreme Court to take that step. The amount so ascertained, with interest, should be charged upon the whole of the Dwellingup property. There will be no requirement of a subdivision of the Promised Lot as part of the remedy.

Notes

(1) The remedy awarded in *Giumelli* was equitable compensation calculated by reference to the value of the 'Promised Lot', secured by a charge over the land. A constructive trust was not awarded.

(2) In *Sidhu v Van Dyke* [2014] HCA 19; (2014) 251 CLR 505 (extracted at [8.5b]), the High Court of Australia awarded equitable compensation and not the cottage promised to the plaintiff. The measure of this compensation was the value of the cottage, her lost expectation (French CJ, Kiefel, Bell and Keane JJ):

> The appellant's argument, rightly, sought no support from the discussion in cases decided before *Giumelli v Giumelli* of the need to mould the remedy to reflect the 'minimum relief necessary to "do justice" between the parties'. There may be cases where '[i]t would be wholly inequitable and unjust to insist upon a disproportionate making good of the relevant assumption'; but in the circumstances of the present case, as in *Giumelli v Giumelli*, justice between the parties will not be done by a remedy the value of which falls short of holding the appellant to his promises. While it is true to say that 'the court, as a court of conscience, goes no further than is necessary to prevent unconscionable conduct', where the unconscionable conduct consists of resiling from a promise or assurance which has induced conduct to the other party's detriment, the relief which is necessary in this sense is usually that which reflects the value of the promise.
> In the circumstances of the present case, no reason has been identified by the appellant to conclude that good conscience does not require that the appellant be held to his promises. In particular, it is no answer for the appellant to say that the performance of his promises was conditional on the completion of the subdivision and the consent of his wife to the transfer to the respondent. His assurances to the respondent were expressed categorically so as to leave no room for doubt that he would ensure that the subdivision would proceed and that the consent of the appellant's wife would be forthcoming.

(3) The essential criterion in awarding a constructive trust is the proportionality of the relief to the detriment suffered by the plaintiff. Alternatives to constructive trust relief may include equitable compensation (possibly secured by a lien) (*Giumelli* and *Sidhu v Van Dyke*, above), an irrevocable licence in the plaintiff to occupy the defendant's property (*Plimmer v Mayor of Wellington* (1884) 9 App Cas 699) and a conveyance to the plaintiff deferred until the plaintiff is discharged from bankruptcy, so avoiding the claims of the plaintiff's creditors on the property (*O'Brien v Sheahan* [2002] FCA 1292).

23.5 Constructive trusts raised in response to a breach of fiduciary obligation

Constructive trusts are activated by a breach of fiduciary duty, a species of equitable wrongdoing. In previous chapters, we have seen that there are other remedies which may also meet breach of fiduciary duty, such as equitable compensation or an account of profits: the proprietary response is not inevitable. This point is emphasised in *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1, [128]–[129] (French CJ, Gummow, Hayne, Heydon and Kiefel JJ):

> A constructive trust ought not to be imposed if there are other orders capable of doing full justice. … One point made in the *Giumelli v Giumelli* line of cases is that care must be taken to avoid granting equitable relief which goes beyond the necessities of the case. Another point in those cases is that third party interests must be borne in mind in deciding whether a constructive trust should be granted. That line of cases does not permit a constructive trust to be declared in a manner injurious to third parties merely because the plaintiff has no other useful remedy against a defendant.

23.5.1 Fiduciary obtains a benefit or profit where there was an actual or possible conflict of interest and duty

23.5.1a *Furs Ltd v Tomkies* [1936] HCA 3; (1936) 54 CLR 583

Background

Furs Limited ('Furs') manufactured furs and also tanned, dyed and dressed skins. Tomkies was managing director of Furs with special knowledge of the tanning, dyeing and dressing parts of the business including various secret formulae and modes of manufacture. Lumb was the promotor of a New Zealand company (Furs Developments Ltd) which ultimately purchased the tanning, dyeing and dressing branch of Furs. Lumb offered to purchase this part of Furs and indicated to Tomkies that, after purchase, Furs Developments Ltd would want to employ Tomkies to run the tanning and dyeing business. The price agreed between Lumb and Tomkies (acting for Furs) for sale of the business was £8,500. Although Tomkies disclosed to Furs that he would be going to work for Furs Developments, Tomkies did not disclose that in addition to his salary as an employee of Furs Developments, he would receive £5,000 to be made up of £1,000 in shares and £4,000 in promissory notes. After its incorporation, Furs Developments adopted the contract with Tomkies, issued the shares to him and gave him the promissory notes to the value of £4,000. Furs sued Tomkies alleging breach of fiduciary duty.

Decision

The High Court held that Tomkies had made an undisclosed profit in breach of the fiduciary obligations he owed Furs and granted a declaration ordering Tomkies to transfer the shares and promissory notes to Furs.

Rich, Dixon and Evatt JJ

An undisclosed profit which a director so derives from the execution of his fiduciary duties belongs in equity to the company. It is no answer to the application of the rule that the profit is of a kind which the company could not itself have obtained, or that no loss is caused to the company by the gain of the director. It is a principle resting upon the impossibility of allowing the conflict of duty and interest which is involved in the pursuit of private advantage in the course of dealing in a fiduciary capacity with the affairs of the company. If, when it is his duty to safeguard and further the interests of the company, he uses the occasion as a means of profit to himself, he raises an opposition between the duty he has undertaken and his own self-interest, beyond which it is neither wise nor practicable for the law to look for a criterion of liability. The consequences of such a conflict are not discoverable. Both justice and policy are against their investigation. With reference to a transaction arising out of another relation of confidence, Lord Eldon said: 'The general interests of justice' require 'it to be destroyed in every instance; as no Court is equal to the examination and ascertainment of the truth in much the greater number of cases' (*Ex parte James* (1803) 32 ER 385, 388). His language has been applied to, and illustrated by, the case of a fiduciary agent making undisclosed profits (*Panama & South Pacific Telegraph Co v India Rubber, Gutta Percha & Telegraph Works Co* (1875) LR 10 Ch App 515).

Note

Note that the Court specifically made the point that the trust may arise notwithstanding that the benefit is not one which could or would have been obtained by the principal. See also *Boardman v Phipps* [1967] 2 AC 46 at [10.5.2a].

Question

Is this trust discretionary? The language of the plurality judges (Rich, Dixon and Evatt LJ) is that the property claimed 'belongs in equity to the [plaintiff]'. How do you reconcile this with later dicta; for example, in *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; (2012) 200 FCR 296, [183] (the Court), that the remedy is 'at the beneficiary's election and subject to considerations of "appropriateness"' or in *John Alexander's Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1, [128]–[129] (French CJ, Gummow, Hayne, Heydon and Kiefel JJ), that '[a] constructive trust ought not to be imposed if there are other orders capable of doing full justice'. Note that in relation to the criteria of 'appropriateness', the Court in *Grimaldi* considered *Furs Ltd v Tomkies* [1936] HCA 3; (1936) 54 CLR 583, [184]–[185], emphasising that '[i]n making the orders and declarations sought against Tomkies – they were considered to be "appropriate": … equity's "inflexible rule" was applied'.

23.5.1b *Chan v Zacharia* [1984] HCA 36; (1984) 154 CLR 178

Background

For a statement of the facts, see [10.5.4a].

Decision

Deane J

Stated comprehensively in terms of the liability to account, the principle of equity is that a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain or (ii) which was obtained or received by use or by reason of his fiduciary position or of opportunity or knowledge resulting from it. Any such benefit or gain is held by the fiduciary as constructive trustee (see *Keith Henry & Co Pty Ltd v Stuart Walker & Co Pty Ltd* (1958) 100 CLR 342, at 350). That constructive trust arises from the fact that a personal benefit or gain has been so obtained or received and it is immaterial that there was no absence of good faith or damage to the person to whom the fiduciary obligation was owed. In some, perhaps most, cases, the constructive trust will be consequent upon an actual breach of fiduciary duty: e.g., an active pursuit of personal interest in disregard of fiduciary duty or a misuse of fiduciary power for personal gain. In other cases, however, there may be no breach of fiduciary duty unless and until there is an actual failure by the fiduciary to account for the relevant benefit or gain: e.g., the receipt of an unsolicited personal payment from a third party as a consequence of what was an honest and conscientious performance of a fiduciary duty. The principle governing the liability to account for a benefit or gain as a constructive trustee is applicable to fiduciaries generally including partners and former partners in relation to their dealings with partnership property and the benefits and opportunities associated therewith or arising therefrom (see, *Birtchnell v Equity Trustees* (1929) 42 CLR 384, at 395–397, 408–409; *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, at 394).

Note

Keech v Sandford (1726) Sel Cas Ch 61; 25 ER 223 concerned a trustee of a tenancy who obtained a right to renew the tenancy personally. The renewal was held on constructive trust for the beneficiaries. Deane J recognised the controversy surrounding whether this trust is founded on the prohibition against a fiduciary making a secret profit or whether the trust rested on the application of presumptions in general doctrines of equity. Deane J at 200–201 held:

One can point to impressive support both for the view that the rule in *Keech v Sandford* is an independent doctrine of equity with no more than an 'illusory' link with the general equitable principle governing the liability of a fiduciary to account for personal benefit or gain (see the discussion of both the rule and the general equitable principle in Finn, *Fiduciary Obligations* (1977) chs 21 and 23) and for the contrary view that that rule is no more than a manifestation of that general principle (see, for example, per Dixon CJ, McTiernan and Fullagar JJ, *Keith Henry & Co Pty Ltd v Stuart Walker & Co Pty Ltd* and per Lord Russell of Killowen, *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378). It would plainly be futile to attempt to reconcile all that has been said in the cases as to the nature and scope of the rule in *Keech v Sandford*. It is preferable to acknowledge the existence of unresolved difficulties and differences about both the precise nature of the rule and its application to persons who are not trustees. Those difficulties and differences are, however, such as to encourage rather than preclude the search in this Court for unity of principle. With all respect to those who have expressed a contrary view, I consider that the rule should not be seen as either a completely independent principle of equity or as a mere manifestation of the general principle governing the liability of a beneficiary to account for personal benefit or gain. The case itself is an illustration of that general principle: indeed, it is one of the cases which established it. The 'rule' in *Keech v Sandford* is, however, a rule concerned with the operation of presumptions in the application of that general principle to particular types of property … In its primary application to the renewal of a lease by a trustee, the rule in *Keech v Sandford* 'depends partly on the nature of leasehold property and partly on' the position of special opportunity which a trustee occupies (see per Parker J, *Griffith v Owen* [1907] 1 Ch 195, at 203, and per Collins MR, *In re Biss, Biss v Biss* [1903] 2 Ch 40, at 57). The effect of the rule in such a case is that there is an irrebuttable presumption (a presumption of law: per Collins MR, *Re Biss,* at 55) that the lease was obtained by use of the position of advantage which the trustee enjoyed as the tenant at law, that is to say, by the use by the trustee of his fiduciary position, with the result that he holds the new lease as constructive trustee under the general principle governing the liability of a fiduciary to account for a personal benefit or gain. The presumption which the rule creates in its application to a fiduciary other than a trustee is irrebuttable or rebuttable according to the nature of the powers and obligations of the fiduciary with respect to the leasehold property and the extent to which the interposition of the fiduciary represents, as it were, a barrier between the person to whom the fiduciary duty is owed and the lessor (cf, per Collins MR, *Re Biss,* at 57). In the extension, by analogy, of the rule in *Keech v Sandford* to certain 'special' non-fiduciary relationships under which a person is under an obligation to advance or preserve the interests of another, the presumption would appear, at least ordinarily, to be a rebuttable one (see per Romer LJ, *Re Biss,* at 61–67, cf. Collins MR at 56–57).

23.5.2 Bribes and secret commissions

23.5.2a *Lister & Co v Stubbs* (1890) 45 Ch D 1

Background

The plaintiff company was a manufacturer and dyer of silks. Stubbs was an employee of the company, entrusted with purchasing certain of its supplies. One of the suppliers was Varley & Co. Varley paid Stubbs monthly commissions, of which the plaintiff was unaware, on the goods Stubbs purchased for the plaintiff. Stubbs applied some of his corrupt earnings to the purchase of land and other investments, and some he retained in cash. Upon learning of the corrupt scheme, the plaintiff commenced proceedings against Stubbs, seeking, inter alia, to trace the corrupt earnings into his investments. The plaintiff attempted to obtain an interlocutory injunction to restrain Stubbs from disposing of the property pending trial of the action.

Decision

The Court of Appeal held that the plaintiff was not entitled to an interlocutory injunction.

Cotton LJ

… [T]his is not the money of the Plaintiffs, so as to make the Defendant a trustee of it for them, but it is money acquired in such a way that … when [the Plaintiffs] bring the action to a hearing, can get an order against the Defendant for the payment of that money to them. That is to say, there is a debt due from the Defendant to the Plaintiffs in consequence of the corrupt bargain which he entered into; but the money which he has received under that bargain cannot, in the view which I take, be treated as being money of the Plaintiffs, which was handed by them to the Defendant to be paid to Messrs Varley in discharge of a debt due from the Plaintiffs to Messrs Varley on the contract between them.

Lindley LJ

… [T]he relation between them is that of debtor and creditor; it is not that of trustee and *cestui que trust*. We are asked to hold that it is – which would involve consequences which, I confess, startle me. One consequence … would be that, if Stubbs were to become bankrupt, this property acquired by him with the money paid to him by Messrs Varley would be withdrawn from the mass of his creditors and be handed over bodily to Lister & Co. … Another consequence would be that, if the Appellants are right, Lister & Co could compel Stubbs to account to them, not only for the money with interest, but for all the profits which he might have made by embarking in trade with it. … It appears to me that those consequences shew that there is some flaw in the argument. If by logical reasoning from the premises conclusions are arrived at which are opposed to good sense, it is necessary to go back and look again at the premises and see if they are sound. I am satisfied that they are not sound – the unsoundness consisting in confounding ownership with obligation.

Questions

(1) What was the significance in *Lister* of the Court of Appeal's decision that the relationship between the parties to a bribe is that of debtor and creditor?

(2) Why would this not support the grant of an interlocutory injunction?

(3) If granted, would this in effect be to provide security for repayment of a debt before the debt had been established?

Background

Mr Reid was a New Zealand national who had served as a Crown prosecutor in Hong Kong. During his career, he accepted bribes as inducements for the abuse of his position, in breach of the fiduciary duty he owed as a servant of the Crown. He was ultimately arrested and convicted of a number of criminal offences for which he was sentenced to imprisonment and ordered to pay the Crown HK$12.4 million, representing the value of assets then controlled by him that could only have been derived from bribes. All of that sum remaining unpaid, the Attorney-General placed caveats on three freehold properties in New Zealand, which the Attorney alleged had been acquired by Mr Reid with the proceeds of the bribes, before being conveyed to Mr Reid's wife and solicitor. Upon application to renew the caveats, the Attorney-General argued that they supported the Crown's equitable interest under a constructive trust in the proceeds of the bribes.

Decision

The Privy Council held that the bribes had been obtained by Mr Reid in breach of fiduciary duties owed to the Crown, which was entitled to place the caveats to support its beneficial title to the properties under a constructive trust.

Lord Templeman

Bribery is an evil practice which threatens the foundations of any civilised society. In particular bribery of policemen and prosecutors brings the administration of justice into disrepute. Where bribes are accepted by a trustee, servant, agent or other fiduciary, loss and damage are caused to the beneficiaries, master or principal whose interests have been betrayed. …

When a bribe is offered and accepted in money or in kind, the money or property constituting the bribe belongs in law to the recipient. Money paid to the false fiduciary belongs to him. The legal estate in freehold property conveyed to the false fiduciary by way of bribe vests in him. Equity, however, which acts in personam, insists that it is unconscionable for a fiduciary to obtain and retain a benefit in breach of duty. The provider of a bribe cannot recover it because he committed a criminal offence when he paid the bribe. The false fiduciary who received the bribe in breach of duty must pay and account for the bribe to the person to whom that duty was owed. In the present case, as soon as the first respondent received a bribe in breach of the duties he owed to the Government of Hong Kong, he became a debtor in equity to the Crown for the amount of that bribe. So much is admitted. But if the bribe consists of property which increases in value or if a cash bribe is invested advantageously, the false fiduciary will receive a benefit from his breach of duty unless he is accountable not only for the original amount or value of the bribe but also for the increased value of the property representing the bribe. As soon as the bribe was received it should have been paid or transferred instanter to the person who suffered from the breach of duty. Equity considers as done that which ought to have been done. As soon as the bribe was received, whether in cash or in kind, the false fiduciary held the bribe on a constructive trust for the person injured. Two objections have been raised to this analysis. First it is said that if the fiduciary is in equity a debtor to the person injured, he cannot also be a trustee of the bribe. But there is no reason why equity should not provide two remedies, so long as they do not result in double recovery. If the property representing the bribe exceeds the original bribe in value, the fiduciary cannot retain the benefit of the increase in value which he obtained solely as a result of his breach of duty. Secondly, it is said that if the false fiduciary holds property representing the bribe in trust for the person injured, and if the false fiduciary is or becomes insolvent, the unsecured creditors of the false fiduciary will be deprived of their right to share in the proceeds of that property. But the unsecured creditors cannot be in a better position than their debtor. The authorities show that property acquired by a trustee innocently but in breach of trust and the property from time to time representing the same belong in equity to the cestui que trust and not to the trustee personally whether he is solvent or insolvent. Property acquired by a trustee as a result of a criminal breach of trust and the property from time to time representing the same must also belong in equity to his cestui que trust and not to the trustee whether he is solvent or insolvent.

When a bribe is accepted by a fiduciary in breach of his duty then he holds that bribe in trust for the person to whom the duty was owed. If the property representing the bribe decreases in value the fiduciary must pay the difference between that value and the initial amount of the bribe because he should not have accepted the bribe or incurred the risk of loss. If the property increases in value, the fiduciary is not entitled to any surplus in excess of the initial value of the bribe because he is not allowed by any means to make a profit out of a breach of duty.

Question

Lord Templeman's advice was that a constructive trust arose at the moment the bribes were received. How, in his view, was this trust justified?

23.5.2c *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; (2012) 200 FCR 296

Background

For a statement of the facts, see [10.3.3a].

Decision

The Full Federal Court found Mr Grimaldi to have been a de facto director of Chameleon Mining NL and to have been relevantly in a fiduciary relationship with it. Mr Grimaldi was also a director of and the controlling mind of Murchison. The payments made by Chameleon were clearly made for the benefit of Murchison and in breach of the fiduciary duties he owed Chameleon. The extract below relates only to the issue of bribery.

The Court

We have referred already to the quite different rule affirmed in *Furs Ltd v Tomkies*. Additionally, we would note by way of contrast with the approach taken in *Sinclair Investments*, the observations of Mason J in *Hospital Products* at 107–108 with which we respectfully agree:

> Any profit or benefit obtained by a fiduciary [in breach of the proscriptions on conflict of duty and interest or on misuse of position] is held by him as a constructive trustee: *Keith Henry & Co Pty Ltd* v *Stuart Walker & Co Pty Ltd* [at 350]. *Neither principle nor authority provide any support for the proposition that relief by way of constructive trust is available only in the case where a profit or benefit obtained by the fiduciary was one which it was an incident of his duty to obtain for the person to whom he owed the fiduciary duty. Once it is established that the fiduciary is liable to account for a profit or benefit which he has obtained there can be no objection to his being held to account as a constructive trustee of that profit or benefit.* It can make no difference that it was not his duty to obtain the profit or benefit for the person to whom the duty was owed. What is important is that the advantage has accrued to him in breach of his fiduciary duty or by his misuse of his fiduciary position. The consequence is that he must account for it and in equity the appropriate remedy is by means of a constructive trust. (Emphasis added by the Court in *Grimaldi*.)

To exclude the bribed fiduciary from the deterrent effect of the constructive trust is, in our view, to make it unavailable in the very situations where deterrence is likely to be the most needed. Bribery at its most naked breeds the crudest form of fiduciary infidelity. To privilege the dishonest fiduciary in this way is to create an incentive which should not be tolerated. This is particularly so in relation to public sector fiduciaries. In combating the corrupt public official, the full range of equity's remedies and techniques (including tracing and following illicit gains) are important instruments of deterrence. The courts in other common law countries have recognised this, as has the decision of the Privy Council in *Attorney-General for Hong Kong v Reid* [1994] 1 AC 324 *('Reid');* see e.g. *Carter; Sumitomo Bank Ltd v Kartika Ratna Thahir* [1993] 1 SLR 735 (Sing); *Insurance Corporation of British Columbia v Lo* (2006) 278 DLR (4th) 148 (applying *Reid's* case). …

Whatever may be the reasons for English law's continuing adherence to *Lister,* the weight of High Court decision and expressions of judicial opinion across the twentieth century preordain our rejection of it. We refer in particular to the judgment of Rich, Dixon and

Evatt JJ (with which McTiernan J agreed) in *Furs Ltd v Tomkies*, to the joint judgment in *Keith Henry & Co* (at 350) and to the observations of Mason J in *Hospital Products* (at 107–108) and to Deane J in *Chan* (at 198–199). We simply note that in the result Australian law matches that of New Zealand (Reid), Singapore *(Sumitomo Bank)*, United States jurisdictions *(Carter)* and Canada in accepting a proprietary remedy for bribes and secret commissions. Although the position in Canada appeared to remain uncertain for some time despite the considerable liberalisation of the constructive trust as a remedy in *Soulos v Korkontzilas* (1997) 146 DLR (4th) 214; see *Waters' Law of Trusts in Canada* (3rd ed, 2005), 500–504; the British Columbia Court of Appeal recently has accepted and applied *Reid's* case: *Insurance Corporation of British Columbia v Lo* [(2006) 278 DLR (4th) 148]. However, Australian law departs from the law as stated in *Reid* in one important respect. *Reid* has the constructive trust arising the moment the bribe is received. In Australia, the constructive trust in this setting is a discretionary remedy.

There are two additional comments we should make. First, to accept that money bribes can be captured by a constructive trust does not mean that they necessarily will be in all circumstances. As is well accepted, a constructive trust ought not to be imposed if there are other orders capable of doing full justice: see *John Alexander's Clubs* at [128] and the cases there footnoted. Such could be the case, for example, where a bribed fiduciary, having profitably invested the bribe, is then bankrupted and, apart from the investment, is hopelessly insolvent. In such a case a lien on that property may well be sufficient to achieve 'practical justice' in the circumstances. This said, a constructive trust is likely to be awarded as of course where the bribe still exists in its original, or in a traceable, form, and no third party issue arises.

Secondly, we have referred to this body of law at some length notwithstanding that we have concluded that the secret commission obtained by Grimaldi and Barnes under the Winterfall/Murchison agreements, was not a secret commission vis-á-vis Chameleon. It was simply an undisclosed personal interest in the making of the advance of the two cheques. We have taken this course both because the parties have made reference to *Sinclair Investments* and to *Reid* and lest it be said that *Lister v Stubbs* ought nonetheless be applied analogically in relation to the commission received by Grimaldi and Barnes.

23.5.2d *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45; [2015] AC 250

Background

FHR European Ventures LLP (FHR) purchased the issued share capital of Monte Carlo Grand Hotel SAM. The latter entity owned a long leasehold interest in the Monte Carlo Grand Hotel. FHR negotiated the purchase through its fiduciary agent, Cedar Capital Partners (Cedar). Cedar had also entered into an agreement with the vendor which provided for the payment to Cedar of a €10 million fee following successful completion of the sale and purchase agreement. On becoming aware of this commission, FHR sought to recover it from Cedar. Cedar had not obtained FHR's fully informed consent to the commission.

Decision

The Supreme Court of the United Kingdom held that Cedar acted in breach of fiduciary duty in obtaining the undisclosed commission and held the payment on constructive trust for FHR.

Lord Neuberger

The principal's right to seek an account undoubtedly gives him a right to equitable compensation in respect of the bribe or secret commission, which is the quantum of that bribe or commission (subject to any permissible deduction in favour of the agent – e.g. for expenses incurred). That is because where an agent acquires a benefit in breach of his fiduciary duty, the relief accorded by equity is, again to quote Millett LJ in the *Mothew* case, at p 18, 'primarily restitutionary or restorative rather than compensatory'. The agent's duty to account for the bribe or secret commission represents a personal remedy for the principal against the agent. However, the centrally relevant point for present purposes is that, at least in some cases where an agent acquires a benefit which came to his notice as a result of his fiduciary position, or pursuant to an opportunity which results from his fiduciary position, the equitable rule ('the rule') is that he is to be treated as having acquired the benefit on behalf of his principal, so that it is beneficially owned by

the principal. In such cases, the principal has a proprietary remedy in addition to his personal remedy against the agent, and the principal can elect between the two remedies.

Where the facts of a particular case are within the ambit of the rule, it is strictly applied. The strict application of the rule can be traced back to … *Keech v Sandford* (1726) Sel Cas Ch 61, where a trustee held a lease of a market on trust for an infant, and, having failed to negotiate a new lease on behalf of the infant because the landlord was dissatisfied with the proposed security for the rent, the trustee negotiated a new lease for himself. …

Since then, the rule has been applied in a great many cases. The question on this appeal is not so much concerned with the application of the rule, as with its limits or boundaries. Specifically, what is in dispute is the extent to which the rule applies where the benefit is a bribe or secret commission obtained by an agent in breach of his fiduciary duty to his principal. …

… In the end, it is not possible to identify any plainly right or plainly wrong answer to the issue of the extent of the rule, as a matter of pure legal authority. There can clearly be different views as to what requirements have to be satisfied before a proprietary interest is created. More broadly, it is fair to say that the concept of equitable proprietary rights is in some respects somewhat paradoxical. Equity, unlike the common law, classically acts in personam (see e.g. Maitland, *Equity,* p 9); yet equity is far more ready to accord proprietary claims than common law. Further, two general rules which law students learn early on are that common law legal rights prevail over equitable rights, and that where there are competing equitable rights the first in time prevails; yet, given that equity is far more ready to recognise proprietary rights than common law, the effect of having an equitable right is often to give priority over common law claims – sometimes even those which may have preceded the equitable right. Given that equity developed at least in part to mitigate the rigours of the common law, this is perhaps scarcely surprising. However, it underlines the point that it would be unrealistic to expect complete consistency from the cases over the past 300 years. It is therefore appropriate to turn to the arguments based on principle and practicality, and then to address the issue, in the light of those arguments as well as the judicial decisions discussed above.

… [I]t appears that other common law jurisdictions have adopted the view that the rule applies to all benefits which are obtained by a fiduciary in breach of his duties. In the High Court of Australia, Deane J said in *Chan v Zacharia* (1984) 154 CLR 178, 199 that any benefit obtained:

> in circumstances where a conflict … existed … or … by reason of his fiduciary position or of opportunity or knowledge resulting from it … is held by the fiduciary as constructive trustee.

More recently, the Full Federal Court of Australia has decided not to follow *Sinclair:* see *Grimaldi,* where the decision in *Reid* was preferred: see the discussion at paras 569–584. Although the Australian courts recognise the remedial constructive trust, that was only one of the reasons for not following *Sinclair.* As Finn J who gave the judgment of the court said, at para 582 (after describing *Heiron* and *Lister* as 'imposing an anomalous limitation … on the reach of *Keech v Sandford',* at para 569), 'Australian law' in this connection 'matches that of New Zealand …, Singapore, United States jurisdictions … and Canada'. As overseas countries secede from the jurisdiction of the Privy Council, it is inevitable that inconsistencies in the common law will develop between different jurisdictions. However, it seems to us highly desirable for all those jurisdictions to learn from each other, and at least to lean in favour of harmonising the development of the common law round the world.

Conclusions

The considerations of practicality and principle discussed … above appear to support the respondents' case, namely that a bribe or secret commission accepted by an agent is held on trust for his principal. … However, to put it at its lowest, the authorities do not preclude us adopting the respondents' case in that they do not represent a clear and consistent line of authority to the contrary effect. Indeed, we consider that, taken as a whole, the authorities favour the respondents …

Notes

(1) In *FHR*, the Court at [45] 'lean[ed] in favour of harmonising the development of the common law round the world'. Note that the constructive trust identified in *Attorney-General (Hong Kong) v Reid* [1994] 1 AC 324 arguably arises automatically on receipt of the secret commission or bribe, and in *FHR* the Court observed at [47] that the remedy is not a remedial constructive trust which 'has authoritatively been said not to be part of English law'. Contrast the approach taken in *Grimaldi v Chameleon Mining (No 2)* [2012] FCAFC 6;

(2012) 200 FCR 296 which points out that the constructive trust in this setting is a discretionary remedy and that an alternative remedy may achieve 'practical justice' in the circumstances.

(2) An unresolved issue is the interaction between the principle articulated in *FHR* and rescission. Take a fiduciary who borrows money from her principal via a loan contract in circumstances involving a breach of fiduciary duty. Will the principal have a proprietary claim in respect of any profits which the fiduciary generates from use of the loan funds? Taking the view that a breach of fiduciary duty renders a transaction voidable, the principal may rescind the loan transaction: see [5.3]. Beyond this mere equity to rescind, assuming the funds can traceably be identified, does the principal have a proprietary interest in the loan funds prior to rescission? To the extent that the loan funds are regarded as a 'secret commission', a strict application of *FHR* may suggest that these funds are held on trust.

23.6 Constructive trusts imposed over stolen money and its proceeds

23.6a *Black v S Freedman & Co* [1910] HCA 58; (1910) 12 CLR 105

Background

Over a six-month period, Mr Black stole between £1,300 and £1,400 from his employer. He deposited the majority of this money in his wife Isabella's bank account. The plaintiff company sought to recover the money from the Blacks. The Blacks argued that no evidence had been adduced to show that the money in Isabella's hands was the stolen money, or that Isabella had taken the money without consideration or with knowledge of the theft. They further argued that, in any event, once the money was deposited in her bank account it had passed into currency and could not be followed.

Decision

The High Court held that the plaintiff was entitled to a constructive trust over the money in Isabella's bank account.

Griffith CJ

This was an action by the respondents against the appellant Black and his wife to recover a sum of money alleged to have been stolen by him from them while in their employ. As against the wife they claimed to recover part of that money, which they say came into her possession and is identified as the stolen money, and which she received under such circumstances that she is bound to repay it to the plaintiffs. Now so far as the claim against the appellant Black is concerned, there was abundant evidence before the learned Judge to show that the appellant had stolen the money. It is not necessary to refer to it in detail. The only point that can be made is with respect to the wife. … Taking all these transactions together, I have no doubt the whole amount claimed by his wife, consisting of the four sums I have mentioned, can be identified as part of the stolen money.

Then the question is whether it can be claimed from her. It is suggested that in following trust property there is a distinction between real and personal property which gets into the hands of a volunteer. But the rule appears to be the same with respect to all kinds of property. It is so laid down in the old case referred to in *Lewin on Trusts,* and it is so stated in the last edition of *White and Tudor* in the notes to *Dyer v Dyer.* Dealing with this particular point, Sir George Jessel MR, in the case of *In re Hallett's Estate* (1880) 13 Ch D 696, 708, said this, amongst other things:

> The modern doctrine of equity as regards property disposed of by persons in a fiduciary position is a very clear and well established doctrine. You can, if the sale was rightful, take the proceeds of the sale, if you can identify them. If the sale was wrongful, you can still take the proceeds of the sale, in a sense adopting the sale for the purpose of taking the proceeds, if you can identify them.

He points out that you very often cannot identify the proceeds. In the present case I think they are sufficiently identified – I mean there is a sufficient *prima facie* case of identification in the absence of any explanation. Of course it is not sufficient if the money is taken by the other party *bona fide* for valuable consideration. There the money cannot be recovered back. But it has been laid down in cases decided long ago that if the alienee is a volunteer the estate may be followed into his hands whether he had notice of the trust or not. In the present case, did the wife take the money as a volunteer? In my opinion the proper inference to be drawn from the evidence is that the husband – supposing there was no question of stealing – presented the money to his wife. He intended her, no doubt, to keep it, in one sense, and that it should go to her account at the Savings Bank, where it became under the local law her money for her separate use, but that is quite irrelevant to the question whether she took it as a volunteer or not. I think that where a man pays a large sum of money to his wife, and no more appears, the inference is that it is a present. Therefore the doctrine of equity is applicable. The money is identified; it came into her hands as a volunteer, and she is liable to repay it. It was pointed out by Sir George Jessel, in a well known case, that a man may at a certain stage be innocent, but that, if he knows that he has got the advantage of a fraud to which he was no party and says he will keep it, then he becomes himself a party to the fraud and is liable to the jurisdiction of the Court of Equity. In the present case the wife says she holds this money for her separate use and claims it for herself, knowing now, at any rate, the circumstances under which it came to be given to her. In those circumstances I am of opinion that there was a case made on the plaintiffs' evidence for the defendants to answer. They thought, not unnaturally on the whole, that it was better not to go into the witness box, and they must take the consequences. In my opinion the learned Judge was quite right, and the appeal should be dismissed.

O'Connor J

… Where money has been stolen, it is trust money in the hands of the thief, and he cannot divest it of that character. If he pays it over to another person, then it may be followed into that other person's hands. If, of course, that other person shows that it has come to him *bona fide* for valuable consideration, and without notice, it then may lose its character as trust money and cannot be recovered. But if it is handed over merely as a gift, it does not matter whether there is notice or not. The only question therefore is: what were the plaintiffs obliged to prove in this case? Were they obliged to prove affirmatively that the wife had received this money as a volunteer? I think they were. I think they were bound to give *prima facie* evidence of that. But the circumstances afford *prima facie* evidence of it. There is no evidence to rebut the *prima facie* case which is to be inferred from the facts, which is this: The husband was stealing money regularly; he wanted to have some place in which to put it away safely, and for that purpose he gave up the account which he had in the Savings Bank and put a small balance of about 17s into an account which a month or so before his wife had opened; then apparently regularly the proceeds of his crime were paid into this account. It is absurd to put payments made under those circumstances on the same footing as payments made by the thief to a stranger. In this case they were paid into the wife's account; the wife dealt with them and allowed her account to be used for the purpose of this money being paid in, and there is no doubt that, when the catastrophe came at the end and he was obliged to go, she went with him to the bank, got the money out on her requisition as she was bound to do, and the circular notes were paid for out of that. When the husband is afterwards charged with the ownership of those notes, he says they are his own money. The wife is asked afterwards about this claim of her husband's to the circular notes and she says nothing. Considering that these circular notes were bought out of money which purported to be her money, paid for by her and afterwards claimed by her, and that she was asked in reference to this claim, surely she was under a duty to say something. She says nothing, and that is evidence that is entitled to be considered. In all the circumstances, I am of opinion that there was a *prima facie* case, that she was a volunteer, and that this money retains its character as trust money and she cannot be allowed to keep it.

Notes

(1) It is important to notice that, although the judgments extracted above agree as to result, their reasoning differs. The proprietary character of O'Connor J's remedy is seen in the last sentence of his reasons: 'I am of opinion that there was a *prima facie* case, that she was a volunteer, and that this money retains its character as trust money and she cannot be allowed to keep it'. Thus, O'Connor J placed no particular emphasis on the breach of fiduciary duty in justifying a proprietary remedy. Griffiths CJ, with whom Barton J agreed, relies on the statement of Jessel MR in *Re Hallett's Estate* (1880) 13 Ch D 696, 708 quoted above, to the effect that a fiduciary holds the proceeds of her equitable wrongdoing on trust for her principal.

(2) The rule established by *Black v Freedman* is that a thief immediately holds the traceable proceeds of stolen money on trust for her victim. That stolen money is held on trust has been confirmed by subsequent appellate decisions: for example, *Robb Evans of Robb Evans & Associates v European Bank Ltd* (2004) 61 NSWLR 75, [111]–[116] (Spigelman CJ, with whom Handley JA and Santow JA agreed); *Heperu Pty Ltd v Belle* (2009) 76 NSWLR 230, [130]–[133] (Allsop P, with whom Handley AJA and Campbell JA agreed); *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; (2012) 200 FCR 296, [255] (the Court) and *Fistar v Riverwood Legion and Community Club Ltd* (2016) 91 NSWLR 732 (CA), 741 (Leeming JA, with whom Bathurst CJ and Sackville AJA agreed).

(3) The constructive trust also arises when money is obtained by fraud. For example, in *Westpac Banking Corporation v Palasty* [2011] NSWSC 1478, [20], Bryson JA confirmed (referring to *Black v Freedman*): '[t]here is no exposition in the judgments in the High Court of what is there referred to as "stolen money" but I have no doubt that it extends to money obtained by fraudulent misrepresentations'. Thus, it is not necessary for the plaintiff to prove that the criminal offence of theft has been committed.

(4) There is a debate about the true nature of the stolen money trust; specifically, whether it should be understood as constructive or resulting. In *Robb Evans of Robb Evans & Associates v European Bank Ltd* [2004] NSWCA 82; (2004) 61 NSWLR 75, Spigelman CJ said at [112]–[115]:

> The trust so created is, in my opinion, better described as a presumed or resulting trust, rather than as a constructive trust. There is no authoritative statement as to when trusts should be classified as presumed, resulting or constructive. …
> A case of simple theft involves a transfer of property about which the transferor was entirely unaware. The transferee holds any property into which the stolen property has been converted on trust in a manner which should be seen as automatic. (See Chambers, *Resulting Trusts* esp at 22–23, 116–118.) The Australian authorities indicate that a trust arises immediately upon the acquisition of the property, not when recognised by a court. (As in *Black v S Freedman & Co*, see also *Rasmanis v Jurewitsch* (1969) 70 SR (NSW) 407.)
> As Millett J (as his Lordship was) said in a case involving fraudulent misappropriation: 'the trust which is operating in these cases is not some new model remedial constructive trust, but an old-fashioned institutional resulting trust'. *(El Ajou v Dollar Land Holdings plc* [1993] 3 All ER 717 at 734; see also PJ Millett, 'Tracing the Proceeds of Fraud' (1991) 107 *Law Quarterly Review* 71 at 81.)
> If appropriately characterised as 'constructive', the trust that arises upon receipt of stolen funds by an active participant in the theft is of an institutional rather than remedial character. (The terminological difficulties which plague this area of the law are discussed in PJ Millett, 'Restitution and Constructive Trusts' at 399–400, 402).

(5) In *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6; (2012) 200 FCR 296, the Court stated at [255]: 'Finally, it is well accepted in this country that, where property is acquired from another by theft, proprietary relief by way of imposition of a constructive trust should be granted if appropriate: *Black v S Freedman & Co*'. The requirement that relief be 'appropriate' therefore raises the further possibility that the trust, even if constructive, is understood not as arising automatically in response to the theft but rather is raised as a result of curial order. Compare *Wambo Coal Pty Ltd v Ariff* [2007] NSWSC 589; (2007) 63 ACSR 429, [40]–[41] (White J) below at [23.7b].

(6) If the stolen money does not traceably survive – for example, because it is dissipated by the thief – a proprietary remedy will not be available. However, personal remedies including an account of profits or equitable compensation (eg, for breach of fiduciary duty) or the personal restitutionary remedy of money had and received, may be available. See *Jones (as trustee of the property of Heather MacNeil-Brown, a bankrupt) v Southall & Bourke Pty Ltd* [2004] FCA 539, [77] (Crennan J).

23.7 Constructive trusts as a restitutionary remedy for unjust enrichment

That unjust enrichment may in some circumstances be reversed by a proprietary remedy is relatively uncontroversial (there are dissentients: see G Virgo, *The Principles of the Law of Restitution* (Oxford University Press, 3rd ed, 2015)). The classification of trusts raised to reverse unjust enrichment is more contentious: are such trusts properly understood to be constructive or resulting? Most judicial authority assumes such trusts are constructive, but the work of legal scholars suggests an alternative explanation. Notably, Chambers argues that, to the extent that the trust property results back to the party at whose expense it was unjustly obtained, these trusts are resulting (see R Chambers, *Resulting Trusts* (Clarendon Press, 1997)).

Unjust enrichment is 'a unifying legal concept which explains why the law recognizes, in a variety of distinct categories of case, an obligation on the part of a defendant to make fair and just restitution for a benefit derived at the expense of a plaintiff and which assists in the

determination, by the ordinary processes of legal reasoning, of the question whether the law should, in justice, recognise such an obligation in a new or developing category of case': *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221, 256–7 (Deane J), subsequently quoted with approval in *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353, 379 (Mason CJ, Deane, Toohey, Gaudron and McHugh JJ).

In Australia, unjust enrichment is not a 'definitive legal principle'; it does not supply 'a sufficient premise for direct application in a particular case' and to this extent is not the 'direct basis of restitutionary relief' (*Australian Financial Services and Leasing Pty Ltd v Hills Industries Ltd* (2014) 253 CLR 560, [78], [65]–[76] (Hayne, Crennan, Kiefel, Bell and Keane JJ) but rather serves an organising or taxonomical function. As explained by Edelman J in *Lampson (Australia) Pty Ltd v Fortescue Metals Group Ltd (No 3)* [2014] WASC 162, [50]–[55]:

> A comparison might be drawn with the category of torts. A plaintiff cannot plead that a defendant is liable for having committed a 'tort'. 'Torts' describes the category not the action (which might be assault, battery, conversion etc). At an even higher level of theory, the ultimate basis of restitutionary liability was expressed by the joint judgment in *Australian Financial Services and Leasing Pty Ltd v Hills Industries Ltd* [at [65]–[76] (Hayne, Crennan, Kiefel, Bell & Keane JJ)] as depending upon whether retention is against 'conscience'. Their Honours explained that 'conscience' does not invite subjective evaluation. Instead, it is 'a construct of values and standards against which the conduct of "suitors" – not only defendants – is to be judged' [at [76]].
>
> Provided that unjust enrichment is not applied as a direct source of liability, in Australia the taxonomic category of unjust enrichment has served a useful function and might continue to do so. Like the category of torts, the category of unjust enrichment assists in understanding even though it is not a direct source of liability. The category directs attention to a common legal foundation shared by a number of instances of liability formerly concealed within the forms of action or within bills in equity. The common features of actions within the 'label', 'concept', or 'notion' of unjust enrichment has generally been thought to be that, subject to defences, a plaintiff can prove its entitlement to restitution of the value of a benefit derived at the plaintiff's expense, if the Court is satisfied that the plaintiff has succeeded on any issues falling within three broad enquiries:
>
> **(i)** The defendant must be enriched.
>
> **(ii)** The enrichment must come at the expense of the plaintiff.
>
> **(iii)** The enrichment must be unjust.
>
> This three-fold approach to actions in the category of unjust enrichment was described by Kirby J as the 'generally accepted analysis' (*Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516, 568) …
>
> The label 'unjust factor' is not always used within the legal category of unjust enrichment to describe the established basis of 'injustice' or the recognised basis upon which retention is against conscience. But the label usefully directs attention to the requirement for a plaintiff in Australia to prove a reason for restitution or, in the words of the unanimous joint judgment of the High Court in 2007, 'the existence of a qualifying or vitiating factor falling into some particular category' (*Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, 156 [150] (per the Court)). As Gageler J explained in *Australian Financial Services and Leasing Pty Ltd v Hills Industries Ltd* (2014) 253 CLR 560, [141]:
>
> > 'Unjust' is the 'generalisation of all the factors which the law recognises as calling for restitution'. Because we need to search for *recognised* factors, examination of which involves an analysis of case law, the reference to 'injustice' as an element of unjust enrichment, is not a reference to judicial discretion. Normal judicial processes are involved and it is only in cases where there is no recognised basis for saying that injustice has arisen that problems can arise. [Emphasis in original.]
>
> The boundaries of what will count as an unjust factor are not fixed. Examples of unjust factors were given by Lord Mansfield in *Moses v Macferlan* (1760) 97 ER 676, 681:
>
> > money paid by mistake; or on a consideration which happens to fail; or for money got through imposition (express, or implied), or extortion; or oppression; or an undue advantage taken of the plaintiff's situation.
>
> A quarter of a millennium later, although it is well established that liability in the 'taxonomic' category of unjust enrichment requires the existence of an 'unjust factor', there is only limited judicial recognition of unjust factors beyond those in this list. …

In satisfying the three enquiries identified above, the following general observations are relevant:

(1) Enrichment will be relatively easy to establish where the benefit received is money since money is incontrovertibly enriching. However, where goods or services are received, the defendant may more easily argue that she has not chosen or should not be regarded as having chosen this benefit and thus should not be regarded as enriched. In any case, it is difficult to see how a proprietary claim reversing unjust enrichment could be made for the value of services, unless, for example, raised to recognise an improvement to proper-

ty, in which case the trust would be over the property (as substitute value) rather than value initially received. Enrichment is valued as at the date of receipt, subject to defences including change of position (see below).

(2) Enrichment must come 'at the expense of the plaintiff' in the sense that it comes from the plaintiff's labour, assets or store of wealth. It does not matter if the plaintiff passes the burden of this transaction onto third parties, so that the ultimate burden is borne by a third party. In this instance, the enrichment is nonetheless 'at the expense of' the plaintiff'. See *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516.

(3) Whether or not the enrichment is unjust is not a matter for the discretion of the court. The plaintiff must point to one of the recognised 'unjust factors' or a 'qualifying or vitiating factor falling into some particular category': *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89, 156 [150] (the Court). These include mistake (*David Securities Pty Ltd v Commonwealth Bank of Australia* (1992) 175 CLR 353); illegality (*Equuscorp Pty Ltd v Haxton* (2012) 246 CLR 498); duress (*Mason v New South Wales* (1959) 102 CLR 108); and failure of basis (*Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516).

(4) Once it is established that the defendant is enriched at the expense of the plaintiff, the plaintiff in general obtains a prima facie right to restitution of the benefit received. This right is subject to defences. Defences of general application, such as statutes of limitation, are relevant as well as specific unjust enrichment defences, notably change of position.

23.7a *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105

Background

Chase Manhattan (Chase) paid $2 million to Israel-British Bank through the New York interbank clearing system on 3 July 1974. Later on the same day, Chase made a further payment of $2 million to the defendant due to a clerical error. The error was discovered by an employee of Chase who gave instructions to other employees to correct the clerical problem. These instructions were only followed in part, and this failure was described by Goulding J as the 'proximate cause of the mistaken payment'. On 5 July, the defendant learned of the mistaken payment. In December 1974, the defendant obtained a winding up order and liquidators were appointed. Chase sued in mistake to recover the second payment. Given the defendant's insolvency, Chase asserted a proprietary claim via a constructive trust.

Decision

It was held that Chase was entitled to a constructive trust over the payment.

Goulding J

I am satisfied on a balance of probabilities that on July 5, 1974, the defendant learned of the mistaken payment, and either knew it was a mistake, or was put fully on inquiry by facts that should have indicated it might be a mistake. …

[T]he plaintiff is right in alleging that the defendant became a trustee for the plaintiff of the sum paid by mistake and that the plaintiff's equitable interest as cestui que trust was given (so far as the distinction has any meaning within the confines of New York law itself) by a rule of substantive law …

I will declare that on July 3, 1974, the defendant became trustee for the plaintiff of the sum …

Notes

(1) The unjust factor in Chase Manhattan was mistake which vitiated its intention to transfer wealth: Chase didn't really intend to make the second payment. The value of the enrichment was $2 million (the second payment). It was at the plaintiff's expense since it came from their hands, albeit via the clearing system.

(2) Goulding J gave little justification to explain what transformed Chase's claim from a claim for money had and received (a personal claim for value) into a proprietary claim (reflected in his judgment in the award of a constructive trust). The effect of the decision in the insolvency of the defendant was to give priority to Chase against other unsecured creditors of the defendant. In *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669, 715 Lord Browne-Wilkinson suggested that the right to proprietary restitution arises when the recipient's conscience is bound:

> However, although I do not accept the reasoning of Goulding J, *Chase Manhattan* may well have been rightly decided. The defendant bank knew of the mistake made by the paying bank within two days of the receipt of the moneys: … The judge treated this fact as irrelevant … but in my judgement it may well provide a proper foundation for the decision. Although the mere receipt of the moneys, in ignorance of the mistake, gives rise to no trust, the retention of the moneys after the recipient bank learned of the mistake may well have given rise to a constructive trust.

23.7b *Wambo Coal Pty Ltd v Ariff* [2007] NSWSC 589; (2007) 63 ACSR 429

Background

Wambo Coal Pty Ltd (Wambo) mistakenly made two payments totalling $46,130 to Singleton Earthmoving Pty Ltd (in liquidation) (Singleton). Ariff was appointed administrator of Singleton in September 2004 and became its liquidator in December of that year. Ariff caused most of the money paid by Wambo to Singleton to be transferred to an account held in the name of S Ariff Nominees Pty Ltd (a company controlled by Ariff) to reimburse it for disbursements it had paid on Ariff's direction in the liquidation of Singleton. It was common ground between the parties that the funds were paid by Wambo under a mistake and that Singleton was liable to repay. However, Wambo was not entitled to prove in Singleton's liquidation as its claim did not arise until after the day on which Singleton's winding up was taken to have begun (see *Corporations Act 2001* (Cth) s 553(1)). In any case, Singleton had an insolvent estate with insufficient value to meet all claims. The question therefore arose as to whether Singleton held any property on trust for Wambo.

Decision

White J held that the funds were held by Singleton on constructive trust for Wambo once Singleton knew of Wambo's mistake.

White J

The remedial constructive trust is part of the law of Australia. No such difficulty arises in Australia where the High Court has endorsed the remedial constructive trust in *Muschinski v Dodds* (1985) 160 CLR 583 and *Baumgartner v Baumgartner* (1987) 164 CLR 137 (and see *Bathurst City Council v PWC Properties* (1998) 195 CLR 566, [40]–[41]). However, I respectfully doubt whether a trust based on the retention of moneys known to have been paid by mistake would be properly categorised as a remedial constructive trust. Where property is stolen, the property is trust property in the hands of the thief and can be traced into the hands of a third party who receives the property otherwise than as a bona fide purchaser of the legal estate for value without notice. The property is trust property in the hands of the thief because the thief is bound in conscience to hold the property on behalf of its true owner. Whether the trust is characterised as a resulting trust (*Robb Evans of Robb Evans & Associates v The European Bank Ltd* (2004) 61 NSWLR 75 at 100–101), or as a constructive trust *(Westdeutsche Landesbank Girozentrale v Islington London Borough Council* per Lord Browne-Wilkinson at 716), the trust is of an institutional rather than a remedial character. It arises because the conscience of the thief is bound.

In the same way, where property is acquired by fraud and there is a complete failure of consideration, the trust arises immediately on the receipt of the property *(Orix Australia Corporation Ltd v Moody Kiddell & Partners Pty Ltd* [2005] NSWSC 1209 at [155]–[156] and cases cited). So, in *Neste Oy v Lloyds Bank plc* [1983] 2 Lloyd's Rep 658, referred to with apparent approval in *Re Goldcorp Exchange Ltd* [1995] 1 AC 74 at 104, where the payee received payment from its principal of moneys which were not impressed with an express trust, but which were to be used in performance of a contract which the payee knew could not take place, the payee held the payment on trust for the payer from the time of its receipt. The circumstances which created the trust in *Neste Oy* were that the payee knew (as was the fact) that there could be no performance under its contract, so that there was a total failure of consideration

for the payment, and the payment could not in conscience be retained. The trust was an institutional trust which attached to the moneys from the time of receipt.

I do not see why, in principle, a constructive trust arising from the retention of moneys known to have been paid by mistake, and for which there was no consideration, would not arise from the time the payee acquired such knowledge, if the moneys paid could still be identified at the time such knowledge was acquired. Such a trust is as much an institutional trust as a trust imposed on property in the hands of the thief.

The payments made by Wambo to Singleton Earthmoving were not only made by mistake. They were also made for no consideration. It would be against conscience for Singleton Earthmoving to use the moneys as its own once it knew of Wambo's mistake. Notwithstanding the criticism of this passage from the speech of Lord Browne-Wilkinson in *Meagher, Gummow and Lehane's Equity: Doctrine & Remedies* at [14-010], in my view, his Lordship's admittedly obiter statement is consistent with principle. It is consistent with those cases in which a constructive trust is declared over property obtained by fraud where no consideration was provided for the payment *(Bankers Trust Co v Shapira* [1980] 1 WLR 1274 at 1282; *Stocks v Wilson* [1913] 2 KB 235 at 245, 247; *Neste Oy v Lloyds Bank plc* at 665–666; *Westdeutsche* at 716; *Barrett & Sinclair v McCormack* [1999] VUCA 11 in the passage cited in *Orix Australia Corporation Ltd v Moody Kiddell & Partners Pty Ltd* at [158]). The recipient's conscience is bound only upon being aware of the mistake. But once the recipient is aware that, by a mistake, he has got something for nothing, a proprietary remedy is appropriate. The fact that the company is insolvent does not affect this conclusion. It would be an unwarranted windfall for the company's creditors to share in the payment (compare *Re Polly Peck International plc (in administration) (No 2); Marangos Hotel Co Ltd & Ors v Stone* [1998] 3 All ER 812 at 825–827). There is no question in this case of interfering with the statutory scheme for the order of priority of debts recoverable from the company.

Lord Browne-Wilkinson referred to the constructive trust as arising after the recipient 'learned' of the mistake. The emphasis is on the recipient having actual knowledge of the mistake so that its conscience is bound. A deliberate failure to inquire for fear of knowing that which the payee would rather not know may be equated with knowledge. Where the question is whether money becomes trust property because of the knowledge of the payee that it was paid by mistake and without consideration, as distinct from the question whether a recipient of property already impressed with a trust is bound by the trust, the appropriate question is whether the payee has such knowledge of the mistake as to affect his conscience because he is aware that he is not entitled to deal with the money as if he were the beneficial owner (see *Re Montagu's Settlement Trusts; Duke of Manchester v National Westminster Bank Ltd & Ors* [1987] Ch 264 at 278, 279, 285 (a case of liability of a recipient of trust property)). I am inclined to think that the appropriate analogy is with the knowledge required to render a third party liable as a constructive trustee under the second limb of *Barnes v Addy,* that is, for knowingly participating in a breach of trust, although not receiving trust property. For the purposes of the second limb of *Barnes v Addy* (at 251–252), a defendant will be treated as having knowledge of a dishonest and fraudulent design on the part of the trustee or fiduciary if the defendant has (a) actual knowledge, or (b) wilfully shuts his or her eyes to the obvious, or (c) wilfully and recklessly fails to make such inquiries as an honest and reasonable person would make, or (d) has knowledge of circumstances which would indicate the facts to an honest and reasonable person *(Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22 at [174]–[178]). …

Mr Ariff's liability as a recipient of trust property

… Singleton Earthmoving was bound by a constructive trust to account to Wambo for the moneys which it had retained and which it knew had been paid to it by mistake. It was a breach of that trust for the moneys to be paid to S Ariff Nominees Pty Ltd or to Mr Allen on Mr Ariff's direction.

Notes

(1) The level of knowledge required to satisfy this knowledge-based constructive trust is 'knowledge of circumstances which would indicate the facts to an honest and reasonable person' (*Wambo Coal*, [44] (White J)). Where the event giving rise to the trust, or the underlying claim, is founded on some equitable wrong, such as unconscionability, it is not difficult to see how this test might apply to the facts. However, assuming that the knowledge-based constructive trust is intended to apply to restitutionary claims other than those generated by mistake (note that *Wambo* was in mistake) – for example, a claim in duress – it is difficult to see why the test should apply. See also *Westpac Banking Corporation v Ollis* [2007] NSWSC 956, [32] (Einstein J), on appeal in *Shields v Westpac Banking Corporation* [2008] NSWCA 268, [19]–[20] (Hodgson JA, with whom Spigelman CJ and Macfarlan JA agreed).

In *AE Brighton Holdings Pty Ltd v UDP Holdings Pty Ltd* [2020] VSCA 235, [30] (the Court) (footnotes omitted) held: '[t]he payee in the above circumstances will be treated as having the requisite level of knowledge as to the mistake if he or she: has actual knowledge; wilfully shuts his or her eyes to the obvious; wilfully and recklessly fails to make such inquiries as an honest and reasonable person would make; or has knowledge of circumstances which would indicate the facts to an honest or reasonable person'.

(2) Fidelity with the knowledge-based constructive trust approach suggests that the trust takes effect from the date on which the recipient of the mistaken payment becomes aware that it has been paid under a mistake.

Question

Is there any inconsistency in the requirement of the unjust factor (mistake) which considers vitiation of the plaintiff's intention to transfer wealth (and knowledge and wrongdoing by the defendant are irrelevant) and a knowledge-based model of trust liability where the focus is on the defendant?

23.8 Constructive trusts and mutual wills

Mutual wills exist when two or more people agree to make their wills a certain way and also promise not to revoke their will should one party predecease the other. Prior to the death of either party, the arrangement is a matter of contract law, and either can withdraw from the arrangement by agreement or by giving notice of withdrawal to the other which is accepted. However, contract law is limited in its capacity to provide a remedy if one party dies leaving the property under their will in accordance with the contract, and then the surviving party makes a new will leaving their property to someone other than the agreed beneficiaries. For example, such beneficiaries may not be parties to the original agreement, and therefore the doctrine of privity of contract will prevent a claim.

By the doctrine of mutual wills, equity may permit third parties, such as agreed beneficiaries, to enforce a constructive trust on property to give effect to the agreement, even if a surviving party has since made a later will or otherwise resiled from the contract for the making of mutual wills.

23.8a *Birmingham v Renfrew* [1937] HCA 52; (1937) 57 CLR 666

Background

A husband and wife made an agreement that the wife would leave the residue of her estate to her husband on the husband's promise that he would leave his property to the wife's relatives. The husband executed a mutual will in similar terms. The wife predeceased her husband and he took under her will. Subsequently, in breach of the agreement, the husband made a new will largely excluding the wife's relatives. After the husband died, the wife's relatives sued the husband's other beneficiaries and the executor of his will, claiming an interest in the estate.

Decision

The High Court held that the wife's relatives held an interest in the property subject to the agreement which, on the husband's death, was enforceable under a constructive trust.

Dixon J

I think the legal result was a contract between husband and wife. The contract bound him … during her lifetime not to revoke his will without notice to her. If she died without altering her will, then he was bound after her death not to revoke his will at all. She on her part afforded the consideration for his promise by making her will. His obligation not to revoke his will during her life without notice to her is to be implied. For I think the express promise should be understood as meaning that if she died leaving her will unrevoked then he would not revoke his. But the agreement really assumes that neither party will alter his or her will without the knowledge of the other. It has long been established that a contract between persons to make corresponding wills gives rise to equitable obligations when one acts on the faith of such an agreement and dies leaving his will unrevoked so that the other takes property under its dispositions. It operates to impose upon the survivor an obligation regarded as specifically enforceable. It is true that he cannot be compelled to make and leave unrevoked a testamentary document and if he dies leaving a last will containing provisions inconsistent with his agreement it is nevertheless valid as a testamentary act. But the doctrines of equity attach the obligation to the property. The effect is … that the survivor becomes a constructive trustee and the terms of the trust are those of the will which he undertook would be his last will. …

There is a third element which appears to me to be inherent in the nature of such a contract or agreement, although I do not think it has been expressly considered. The purpose of an arrangement for corresponding wills must often be … to enable the survivor during his life to deal as absolute owner with the property passing under the will of the party first dying. That is to say, the object of the transaction is to put the survivor in a position to enjoy for his own benefit the full ownership so that, for instance, he may convert it and expend the proceeds if he choose. But when he dies he is to bequeath what is left in the manner agreed upon. It is only by the special doctrines of equity that such a floating obligation, suspended, so to speak, during the lifetime of the survivor can descend upon the assets at his death and crystallize into a trust. No doubt gifts and settlements, *inter vivos,* if calculated to defeat the intention of the compact, could not be made by the survivor and his right of disposition, *inter vivos,* is, therefore, not unqualified. But, substantially, the purpose of the arrangement will often be to allow full enjoyment for the survivor's own benefit and advantage upon condition that at his death the residue shall pass as arranged. …

But I do not see any difficulty in modern equity in attaching to the assets a constructive trust which allowed the survivor to enjoy the property subject to a fiduciary duty which, so to speak, crystallized on his death and disabled him only from voluntary dispositions *inter vivos.* On the contrary … it seems rather to provide a reason for the intervention of equity. The objection that the intended beneficiaries could not enforce a contract is met by the fact that a constructive trust arises from the contract and the fact that testamentary dispositions made upon the faith of it have taken effect. It is the constructive trust and not the contract that they are entitled to enforce.

Notes

(1) In *Barns v Barns* (2003) 214 CLR 169, [85] (Gummow and Hayne JJ), the principles were described as follows:

> **(i)** it is the disposition of the property by the first party under a will in the agreed form and upon the faith of the survivor carrying out the obligation of the contract which attracts the intervention of equity in favour of the survivor;
>
> **(ii)** that intervention is by the imposition of a trust of a particular character;
>
> **(iii)** the subject-matter is 'the property passing [to the survivor] under the will of the party first dying';
>
> **(iv)** that which passes to the survivor is identified after due administration by the legal personal representative whereupon 'the dispositions of the will become operative';
>
> **(v)** there is 'a floating obligation' over that property which has passed to the survivor; it is suspended during the lifetime of the survivor and 'crystallises' into a trust upon the assets of the survivor at death.

(2) Whilst both parties are living, either can withdraw from the contractual arrangement by agreement or by giving notice of withdrawal to the other which is accepted (*Stone v Hoskins* [1905] P 194).

(3) A constructive trust enforceable under the doctrine of mutual wills is subject neither to the requirements of writing under the *Wills Act*, nor, if the subject matter of the trust is land, statutory requirements requiring that no interest in land can be created or disposed of except by writing signed by the party created for disposing of the interest (see *Conveyancing Act 1919* (NSW) s 23C; *Property Law Act 1974* (Qld) s 11; *Law of Property Act 1936* (SA) s 29; *Conveyancing and Law of Property Act 1884* (Tas) s 60; *Property Law Act 1969* (WA) s 34; *Property Law Act 1958* (Vic) s 53(1)(a). The mutual wills themselves must comply with the formal requirements for the creation of wills. See textbook at [23.51].

23.9 Constructive trusts imposed over property transferred under specifically enforceable contracts

Property to be transferred under a specifically enforceable contract may be held on constructive trust by the vendor for the purchaser until the sale has been completed. This will commonly be the case for contracts for the sale of land and may also apply to specifically enforceable contracts of sale of particular and unique personalty where damages for breach will not be an adequate remedy. The application of a constructive trust is said to be an application of the principle that equity regards as done that which ought to be done.

23.9a *Chang v Registrar of Titles* [1976] HCA 1; (1976) 137 CLR 177

Background

The Republic of China (Taiwan) was registered proprietor of land in Melbourne. In December 1972, the appellants, Mr and Mrs Chang, contracted with Taiwan's agents to purchase that property. Later in December 1972, the Australian Government ceased to recognise the Taiwan Government, and began recognising the People's Republic of China as the sole legal government of China. The Changs paid the contract price, and memoranda of transfer were executed in favour of the purchasers. The Registrar of Titles refused to register the transfer. The Changs commenced proceedings in the Supreme Court of Victoria, seeking orders under s 51 of the *Trustee Act 1958* (Vic), which empowers a court to make vesting orders in certain cases where property is vested in a trustee.

Decision

The High Court upheld the trial judge's refusal to make an order under s 51.

Mason J

Section 51 of the *Trustee Act 1958* enables the … Court to make vesting orders … 'where property is vested in a trustee and it appears to the Court to be expedient to make a vesting order' (s 51(2)(o)). By s 3 of the Act it is provided that 'the expressions "trust" and "trustee" extend to implied and constructive trusts'. It has long been established that a vendor of real estate under a valid contract of sale is a trustee of the property sold for the purchaser.

However, there has been controversy as to the time when the trust relationship arises and as to the character of that relationship. Lord Eldon considered that a trust arose on execution of the contract (*Paine v Meller* (1801) 31 ER 1088; *Broome v Monck* (1805) 32 ER 976, at 979–980). Plumer MR thought that until it is known whether the agreement will be performed the vendor 'is not even in the situation of a constructive trustee; he is only a trustee sub modo, and providing nothing happens to prevent it. It may turn out that the title is not good, or the purchaser may be unable to pay' (*Wall v Bright* (1820) 37 ER 456, at 459). Lord Hatherley said that the vendor becomes a trustee for the purchaser when the contract is completed, as by payment of the purchase money (*Shaw v Foster* (1872) LR 5 HL 321). Jessel MR held that a trust sub modo arises on execution of the contract but that the constructive trust comes into existence when title is made out by the vendor or is accepted by the purchaser *(Lysaght v Edwards* (1876) 2 Ch D 499). Sir George Jessel's view was accepted by the Court of Appeal in *Rayner v Preston* (1881) 18 Ch D 1.

It is accepted that the availability of the remedy of specific performance is essential to the existence of the constructive trust which arises from a contract of sale. The difficulty of determining upon a petition for a vesting order under the English *Trustee Act 1850* whether specific performance would be granted led Page Wood VC to hold that a constructive trust must first be declared by decree in a suit before the statutory concept of 'trust' in the *Trustee Act* was satisfied. However, in *In re Cuming* (1869) 5 Ch App 72, Giffard LJ distinguished the contract which remains unperformed on either side (when a precedent decree is necessary) and the contract which has been executed by payment of the purchase money and a formal covenant to surrender (when no such decree is required as a preliminary to the making of the vesting order).

Whether this distinction was correctly taken need not presently be decided. It is enough to say that it has been accepted in decisions in England and Australia that at least when the purchaser has paid the purchase money the vendor becomes a constructive trustee of the property sold and that he is a trustee of property within the meaning of the provisions of the *Trustee Act* relating to vesting orders *(In re Colling* (1886) 32 Ch D 333; *Re Campbell; Ex parte Muir* (1861) SCR (Q) 39; *Weigall v Barber* (1884) 10 VLR (E) 90; *Re Clarke and Solomon's Agreements Trusts* (1905) 5 SR (NSW) 498). It may be safely concluded, then, that the Supreme Court can exercise the power to make a vesting order conferred by s 51 when the vendor of real estate who has been paid the purchase money refuses or declines to execute a transfer or is disabled from so doing.

Jacobs J

Moreover, it is doubtful whether a vendor under a contract of sale can properly be described as a trustee within the meaning of the *Trustee Act* unless settlement has taken place and all that remains to be done is to transfer or convey an outstanding legal estate. It is true that a vendor at the stage of contract where the contract is enforceable by specific performance has at times been described as a trustee: see, e.g. *Shaw v Foster; Lysaght v Edwards;* and if by that no more is meant than that the purchaser is regarded by equity as the beneficial owner of the estate of which the vendor is the legal owner then there is no difficulty in describing the vendor as a trustee. However, if by such a description it is sought to transpose into the law of vendor and purchaser the law governing the rights and duties of trustees, statutory or otherwise, considerable difficulties arise. The present case is an example of the confusion which can arise from giving this description to a party to a contract for the sale of land assumed to be capable of specific performance simply because he has the obligation under the contract to transfer property to the other party on completion of the contract and because equity regards the other as beneficial owner. Where there are rights outstanding on both sides, the description of the vendor as a trustee tends to conceal the essentially contractual relationship which, rather than the relationship of trustee and beneficiary, governs the rights and duties of the respective parties. [Barwick CJ concurred. It was not clear that an order for specific performance would be made against the vendor.]

Notes

(1) The requirements to create a specifically enforceable contract to assign an interest in land (eg, *Conveyancing Act 1919* (NSW) s 54A, or satisfaction of the doctrine of part performance) are discussed in chapter 9.

(2) Consider the position where the vendor in breach of contract sells the land to a third party. What is the position of the initial purchaser in relation to the proceeds of sale?

In *Bunny Industries Ltd v FSW Enterprises Ltd* [1982] Qd R 712, the plaintiff agreed to purchase land from the defendant for $180,000. $1,000 was paid by way of deposit and the balance of purchase moneys to solicitors named in the contract. The defendant subsequently agreed to sell the land to a third party, for a price that was at least $180,000. That sale was completed and the purchaser registered title to the land. The Court found that the plaintiff had an enforceable contract, that the plaintiff was ready, willing and able to perform and that the defendant had wrongly repudiated the contract. Connolly J stated (at 716) that prior to the sale 'the plaintiff was entitled to a decree for specific performance and equity would have intervened to prevent the first defendant conveying the land in breach of the contract and the registration of the transfer'. The Court held that the defendant must account to the purchaser as constructive trustee for the proceeds of sale. Connolly J summarised the principles:

> **(1)** On the execution of the contract the vendor becomes a trustee for the purchaser. He is not however a bare trustee for he has a personal and substantial interest to the extent of the unpaid purchase moneys. He is 'in progress towards' bare trusteeship and finally becomes such when the whole of the purchase moneys are paid and he is bound to convey …
>
> **(2)** The purchaser may devise, alienate and charge his equitable interest so that it is plainly not a mere right in contract.
>
> **(3)** The extent of the equitable interest is measured by the amount of the purchase moneys paid. Thus to the extent of the payments the purchaser acquires a lien exactly as if the vendor had given a mortgage to secure them …
>
> **(4)** Where there is a clear and undisputed contract, the Court will not permit the vendor to transfer the legal estate to a third person and the reason for this was explained … as being because in equity the property was transferred to the purchaser.
>
> **(5)** The incidents of trusteeship exist only if and so far as a Court of Equity would in all the circumstances of the case grant specific performance of the contract.
>
> … [T]he first defendant must be regarded as having dealt with this land in breach of trust and as being therefore accountable to the plaintiff for his dealings with it. This view accords with the decision of Walton J in *Lake v Bayliss* … Once it is understood that the plaintiff on its part must be debited with the balance of purchase moneys the same result is reached in equity as at law.

Questions

(1) Why does Mason J refer to the trust as 'sub modo'? How, if at all, is the trust defeasible?

(2) When does the trust arise? Mason J canvasses the options and holds the trust arises 'at least when the purchaser has paid the purchase money'. See also *Bunny Industries Ltd v FSW Enterprises Ltd* [1982] Qd R 712 referred to in note 2 above.

(3) In what circumstances does Jacobs J doubt that a constructive trust arises?

Background

For a statement of the facts, see [7.4.2a].

Of relevance here is the High Court's discussion of the constructive trust 'analogy' drawn in *Lysaght v Edwards* (1876) 2 Ch D 499.

Decision

Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ

At all events, the analogies drawn over a century ago in *Lysaght* with the trust and the mortgage are no longer accepted. Jacobs J observed in *Chang v Registrar of Titles* (1976) 137 CLR 177 at 190 that:

> [w]here there are rights outstanding on both sides, the description of the vendor as a trustee tends to conceal the essentially contractual relationship which, rather than the relationship of trustee and beneficiary, governs the rights and duties of the respective parties.

Subsequently, in *Kern Corporation Ltd v Walter Reid Trading Pty Ltd* (1987) 163 CLR 164 at 192, Deane J said:

> [I] t is both inaccurate and misleading to speak of the unpaid vendor under an uncompleted contract as a trustee for the purchaser.

In *Stern,* Gaudron J points out, consistently with authority in this Court, that the 'interest' of the purchaser is commensurate with the availability of specific performance. That availability is the very question in issue where there has been a termination by the vendor for failure to complete as required by the essential stipulation. Reliance upon the 'interest' therefore does not assist; it is bedevilled by circularity.

Notes

(1) A contract for the sale of property which is entitled to equitable protection in the sense of being specifically enforceable may later cease to be so. For example, the right to specific performance may be lost by the subsequent conduct of the party in whose favour specific performance might originally have been granted. To this extent, any constructive trust raised to protect the purchaser is fragile. As emphasised by the above extract from *Tanwar,* although made within the general context of a discussion endorsing the notion that a right to specific performance gives rise to an equitable interest, the equitable interest is itself delimited by the right to equitable relief. See also the discussion of *Tanwar* at [7.4.2].

(2) As set out in the following extract from the judgment of Emmett JA (with whom Macfarlan JA and Gleeson JA agreed) in *Golden Mile Property Investments Pty Ltd (in liq) v Cudgegong Australia Pty Ltd* [2015] NSWCA 100; (2015) 89 NSWLR 237, [104]–[105], the purchaser and vendor both have equities for relief, some of which are proprietary and others which are merely personal (footnotes omitted).

> The purchaser's interest comprises four separate rights or 'equities'. First, the purchaser has an interest in the land that is enforceable against third parties and that can take priority over holders of competing interests. Second, the purchaser has an equitable right that the vendor exercise due care to preserve and maintain the land pending completion. Third, the purchaser has an equitable right to the rents and profits received by the vendor between the agreed date for completion and the actual date of completion (but the vendor has that right during the period between the date of contract and the agreed date for completion). Fourth,

the purchaser has an equitable lien for repayment of the purchase price in the event of non-conveyance by the vendor. Of those four rights, the first and last are in rem rights over the land the subject of the contract. The vendor also has four such rights: to receive rents before completion; to retain damages recoverable against others for wrongs to the vendor's land before completion; to receive the purchase money on completion; and, in default, to enforce a lien for the purchase money.

Importantly, whether or not these 'equities' arise, and the extent to which they may be enforced, depends on the time at which the enquiry is made; that is, for example, immediately after formation of the contract, or at a later point when the purchaser is ready, willing and able to tender the purchase price, or at a point after payment of the purchase price. Before completion, the purchaser has an equitable interest in the land that reflects the extent to which equitable remedies are available to protect the purchaser's contractual rights. The fact that the point may not yet have arrived that the purchaser can obtain a decree of specific performance does not mean that the purchaser is not entitled to other equitable remedies: the purchaser could, for example, obtain negative injunctions to enforce any of the four 'equities' referred to above.

Part I

Terminating and varying trusts

24

Termination and variation of trusts

24.1 Introduction

24.2 Statement of the principle

24.3 Limits on its application

24.4 Variation of trusts

24.1 Introduction

Most trust instruments specify a termination, or vesting, date when the trust will come to an end and title to the trust property becomes vested absolutely in the nominated residuary beneficiaries. Termination must occur within the perpetuity period except in the case of trusts governed by South Australian law where no perpetuity rule applies (see textbook at [15.34] for a discussion of perpetuity).

Even before a trust has been terminated, a legally competent beneficiary can invoke the rule in *Saunders v Vautier* (1841) 4 Beav 115; 49 ER 282 to call for the trust assets to which she is absolutely entitled. An adult beneficiary who has full legal capacity and who has an absolute vested interest in the capital and income of a share of the trust property can require the trustees to transfer that share to her, or to some third party at her direction. For example, where a fixed trust is created for B1, B2 and B3, who are all minors, each will be able to claim his or her share of the trust property on attaining 18 years of age. The rule in *Saunders v Vautier* can also be applied collectively by the beneficiaries of some discretionary trusts. If a trust is established for the benefit of such of B1, B2 and B3 as the trustees shall select, the trust can be terminated by the unanimous decision of all three beneficiaries, on attaining 18 years of age, to bring the trust to an end and take a one-third share in the trust property. Termination will also bring the office of trustee to an end. But the rule is inapplicable to a discretionary trust for 'such employees and former employees of the XYZ company, and relatives and dependants of such persons, as my trustees shall select' (cf *McPhail v Doulton* [1971] AC 424 at [14.4b]). This is because, even though the trust is valid, a list of all the beneficiaries entitled to invoke the rule in *Saunders v Vautier* and claim a share of the trust property cannot be drawn up prior to the termination of the trust.

The rule in *Saunders v Vautier* is a rule of law, not a rule of construction, applying even if the trust instrument expressly prohibits distribution of trust property to adult beneficiaries until some event occurs. Its rationale is that adult beneficiaries should be entitled to dispose of their own property as they wish. The rule is well established in Anglo-Australian law, but has been rejected in the United States where the basic principle is that the settlor's wishes, as expressed in the trust instrument, cannot be overridden by the claims of adult beneficiaries, even if they unanimously agree that the trust should be terminated: *Claflin v Claflin,* 20 NE 454 (Mass 1889).

This chapter examines some legal and practical difficulties in applying the rule in *Saunders v Vautier.* A doctrinal question considered by the High Court is whether beneficiaries are absolutely entitled to the trust property when the trustees have an unsatisfied right of indemnity from the trust fund for their expenses incurred in administering the trust: *CPT Custodian Pty Ltd v Commissioner of State Revenue (Vic)* [2005] HCA 53; (2005) 224 CLR 98 (see chapter 19 for analysis of the trustee's right of indemnity). A practical consideration is whether an adult beneficiary entitled to a share of property, such as land or shares in a private company, should be allowed to invoke the rule in *Saunders v Vautier* when removal of her share from the trust will reduce the value of the interests of the remaining beneficiaries: *Beck v Henley* [2014] NSWCA 201; (2014) 11 ASTLR 457 (see [24.3b]).

The chapter concludes with a brief discussion of how the terms of a trust can be varied.

24.2 Statement of the principle

24.2a *Saunders v Vautier* (1841) 4 Beav 115; 49 ER 282

Background

A testamentary trust directed the trustees to hold East India stock, valued at £2,000, on trust for the testator's nephew, Daniel Vautier, and to transfer the stock, together with the accumulated interest and dividends, to Mr Vautier upon attaining the age of 25. When he was 21 (then the age of majority), Vautier petitioned for termination of the trust and for the trust fund to be transferred to him.

Decision

Lord Langdale MR held that Daniel Vautier was entitled to the trust fund even though he was not yet 25 years of age.

Langdale MR

I think that principle has been repeatedly acted upon; and where a legacy is directed to accumulate for a certain period, or where the payment is postponed the legatee, if he has an absolute indefeasible interest in the legacy, is not bound to wait until the expiration of that period, but may require payment the moment he is competent to give a valid discharge.

The decision of the Master of the Rolls was affirmed by Lord Cottenham LC: (1841) Cr & Ph 240; 41 ER 482.

Notes

(1) The principle was applied in *Saunders v Vautier* to a fixed trust for a sole beneficiary. It also applies to trusts where several beneficiaries hold fixed interests in the trust property (*Stephenson v Barclays Bank Trust Co Ltd* [1975] 1 WLR 882) and to those discretionary trusts where all the beneficiaries can be identified (*Re Smith* [1928] Ch 915; *Sir Moses Montefiore Jewish Home v Howell & Co (No 7) Pty Ltd* [1984] 2 NSWLR 406, 411 (Kearney J)).

(2) For analysis of *Saunders v Vautier*, see P Matthews 'The Comparative Importance of the Rule in *Saunders v Vautier*' (2006) 122(2) *Law Quarterly Review* 266. On the American rejection of *Saunders v Vautier*, see JH Langbein, 'Why the Rule in *Saunders v Vautier* is Wrong' in PG Turner (ed), *Equity and Administration* (Cambridge University Press, 2016) 189.

Questions

(1) What is the policy justification for the rule in *Saunders v Vautier?* Do you think the justification is convincing?

(2) Can the application of the rule be avoided by careful drafting? See *Laycock v Ingram* [2008] VSC 113 for an illustration of a trust to which *Saunders v Vautier* was held to be inapplicable.

(3) Consider the application of *Saunders v Vautier* to the following dispositions:

(a) A trust to pay the income from the trust to A for life, remainder to B.

(b) A trust for A and B in equal shares, the trustees having a power to apply the income of the trust for the benefit of C and D.

(c) A trust for such of A, B, C, D and E as my trustees shall select. The trust shall terminate 30 years after its commencement and any undistributed trust property transferred to F.

(d) A trust for such of A, B, C, D and any charity or charities recognised by the Australian Tax Office as my trustees shall select.

(e) A trust to provide a gymnasium for the employees and former employees of the XYZ Company.

(f) A trust consisting of shares in the XYZ Company. The trust instrument provides that the trustees shall accumulate dividends and pay the shares and dividends to A when she shall attain 25 years of age, unless she has suffered some act or process of law (such as bankruptcy) whereby any trust income shall cease to be payable to her. In that eventuality, the shares shall be held on trust for such of A, any children of A, and A's brothers and sisters as the trustees shall select. A is 24 years old. She has no children and one brother and sister. She has never been bankrupt and claims that she is absolutely entitled to the shares and dividends.

24.3 Limits on its application

24.3a *CPT Custodian Pty Ltd v Commissioner of State Revenue (Vic)* [2005] HCA 53; (2005) 224 CLR 98

Background

The case concerned the application of land tax to land held by a trustee of a unit trust. CPT, the trustee, and the manager of the trust were entitled to significant fees payable by the unit-holders out of the trust fund, as well as to reimbursement of its costs, charges and expenses from the fund (see chapter 19 on a trustee's right to recover the costs of administering a trust). The beneficial interest in the fund was divided into units, each unit conferring an equal interest in all the property for the time being held by the trustee but no unit conferred an interest in any particular part of the trust fund. The Commissioner of State Revenue argued that all the unit-holders collectively held the beneficial interest in the land owned by the unit trust and, applying the rule in *Saunders v Vautier,* could terminate the trust and, subject to reimbursing the trustee's costs, divide the land among themselves. They therefore had rights in the land that attracted land tax.

Decision

The High Court held that the unit-holders did not have equitable interests in the land liable to land tax. *Saunders v Vautier* was held to have no application to the particular unit trust. The extract focuses on the High Court's analysis of *Saunders v Vautier* and the reasons why the rule did not apply to the unit trust.

Gleeson CJ, McHugh, Gummow, Callinan and Heydon JJ

Saunders v Vautier is a case which has given its name to a 'rule' not explicitly formulated in the case itself, either by Lord Langdale MR (at first instance) or by Lord Cottenham LC (on appeal). In Anglo-Australian law the rule has been seen to embody a 'consent principle' recently identified by Mummery LJ in *Goulding v James* [1997] 2 All ER 239 at 247 as follows:

> The principle recognises the rights of beneficiaries, who are sui juris and together absolutely entitled to the trust property, to exercise their proprietary rights to overbear and defeat the intention of a testator or settlor to subject property to the continuing trusts, powers and limitations of a will or trust instrument.

A different view was taken long ago by the United States Supreme Court. In *Shelton v King* [1913] USSC 178, the Court repeated what had been said by Miller J in 1875 when speaking for the Supreme Court in *Nichols v Eaton* [1875] USSC 122. He saw no reason in the principles of public policy concerning frauds upon creditors, restraints upon alienation, the prevention of perpetuities and of excessive accumulations, or in the necessary incidents of equitable estates, which supported a rule of the width engrafted upon the law (then comparatively recently) by the English Court of Chancery as a limitation upon effecting the intent of testators and settlors. However that may be, there is force for Anglo-Australian law in the statement that the rule in *Saunders v Vautier* gives the beneficiaries a Hohfeldian 'power' which correlates to a 'liability' on the part of the trustees, rather than a 'right' correlative to a 'duty'. This is because, in the words of Professor JW Harris ('Trust, Power and Duty' (1971) 87 *Law Quarterly Review* 31 at 63):

> [b]y breaking up the trust, the beneficiaries do not compel the trustees to carry out any part of their office as active trustees; on the contrary, they bring that office to an end. (footnote omitted)

Whilst the reasoning of the Court of Appeal respecting the special case of the holder of all issued units depended largely upon the rule in *Saunders v Vautier,* in oral argument in this Court the Commissioner said that, in effect, here the rule was a red herring. The rule was but a corollary of the beneficial ownership for which the Commissioner contended in his earlier submissions; this did not depend upon the exercise of the entitlement to terminate the trust.

The submissions respecting the beneficial ownership by each unit holder have been rejected earlier in these reasons. The trusts exemplified in the Deed recognised (cl 29.4) that all issued units might be in the one beneficial ownership, but the trusts were drawn in terms conferring individual rights attached to each unit. They were not drawn to provide a single right of a cumulative nature so that the whole differed from the sum of the parts. There could be no such single right unless held jointly or in common, but the Deed was not cast in such terms (cf *Gartside v Inland Revenue Commissioners* [1968] AC 553 at 605).

There is a further consideration. The facts of the present cases do not, in any event, answer the modern formulation of the rule in *Saunders v Vautier,* stated as follows in *Thomas on Powers* (1998) at 176:

> Under the rule in *Saunders* v *Vautier,* an adult beneficiary (or a number of adult beneficiaries acting together) who has (or between them have) an absolute, vested and indefeasible interest in the capital and income of property may at any time require the transfer of the property to him (or them) and may terminate any accumulation.

Lightman J said in *Don King Productions Inc v Warren* [2000] Ch 291 at 321 that the rule only applies if, as was not so there, the beneficiaries were entitled to wind up the trust and require the trustee to assign to them the subject-matter of the trust.

Notwithstanding these references to beneficiaries, the repositories of the power to override the terms of a trust by bringing to an end its further administration have been variously identified. For example, it has been asked to whom do the trustees owe their duties of administration? Looking at the testamentary trusts considered in *Glenn v Federal Commissioner of Land Tax,* Isaacs J considered the scope of the duties of the trustees and asked whether the trusts were exclusively for the benefit of the appellants. The

appellants' interests in the residuary estate were subject to the payment of annuities to the widow of the testator for her life and to his unmarried daughters until marriage. Isaacs J concluded (1915) 20 CLR 490 at 504:

> The trustees have prior duties to other legatees having definite interests, and the strict performance of those duties requires the trustees to retain possession of the property, to receive the profits, and to deal with them otherwise than by paying them to the appellants. … It is obvious, therefore, that the principle of *Saunders* v *Vautier* cannot apply, for the trusts are not exclusively for the appellants' benefit.

More recently, in *Sir Moses Montefiore Jewish Home v Howell and Co (No 7) Pty Ltd* [1984] 2 NSWLR 406 at 410–411, Kearney J treated the power to achieve immediate payment of the trust property as reposed in the entire range of persons entitled to call for the due administration of the trust in question.

But that approach to the rule in *Saunders v Vautier* would not meet the case of the Deed considered in this litigation. In the Deed, the Manager covenanted with the Trustee (cl 23.4) to ensure that there were at all times sufficient readily realisable assets of the Trust available for the Trustee to raise the fees to which the Manager and the Trustee were entitled under cl 23.1 and cl 23.2 respectively. These stipulations made the Trustee and the Manager interested in due administration of the trusts of the Deed, in the sense identified by Kearney J in *Moses Montefiore.* Put somewhat differently, the unit holders were not the persons in whose favour alone the trust property might be applied by the trustee of the Deed.

The classic nineteenth century formulation by the English courts of the rule in *Saunders v Vautier* did not give consideration to the significance of the right of the trustee under the general law to reimbursement or exoneration for the discharge of liabilities incurred in administration of the trust. In *Wharton v Masterman* [1895] AC 186, Lord Davey approached the rule in *Saunders v Vautier* from the viewpoint of the law respecting accumulations of income for an excessive period; if no person had any interest in the trust other than the legatee, the legatee might put an end to the accumulation which was exclusively for the benefit of that person and as a result there was no effective or enforceable direction for any accumulation. However, his Lordship's discussion of the authorities does indicate that the rule in *Saunders v Vautier* could not apply if, by reason of the charging of legacies on the fund and accumulations, the persons seeking to put an end to the accumulations were 'only entitled to an undetermined and uncertain surplus (if any) which might be left of the fund after payment of the legacies' [1895] AC 186 at 201.

In the present case, the unsatisfied trustees' right of indemnity was expressed as an actual liability in each of the relevant accounts at each 31 December date and rendered applicable the sense of the above words of Lord Davey. Until satisfaction of rights of reimbursement or exoneration, it was impossible to say what the trust fund in question was *(Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226 at 246).

Note

The rule in *Saunders v Vautier* was formulated in the context of testamentary trusts but its application extends to commercial trusts. G Thomas and A Hudson, *The Law of Trusts* (Oxford University Press, 2010) discuss *CPT Custodian* and other cases in which trusts have been created by commercial contracts, concluding (at [7.11]) that:

> the rule in *Saunders v Vautier* is clearly capable of applying to a unit trust (and any other 'commercial' trust) but whether it actually does so, and how, must depend on the precise terms of the particular arrangement, for example whether the class of unit holders is closed or not, which, in turn, determines the nature of the rights and interests of the particular interest holder.

Another difficult issue, most commonly occurring in a commercial setting, is to determine the application of *Saunders v Vautier* to a trust created by a contract where the trustee has outstanding obligations under the contract: see *Trident General Insurance Co Ltd v McNiece Brothers Pty Ltd* [13.4.3a] and *Don King Productions Inc v Warren* [2000] Ch 291, 321 (where two boxing promoters contractually agreed to hold the benefit of promotion and management contracts entered into between one of the promoters and his boxers on trust for a partnership both promoters had formed). On the one hand, to permit the beneficiary of the contract to terminate the trust and claim the trust property may defeat the intentions of the contracting parties. On the other hand, permitting contractual provisions to exclude or limit the application of *Saunders v Vautier* is inconsistent with the principle that *Saunders v Vautier* is a rule of law and not a rule of construction.

Background

A brother and sister, Ami and Tami, were absolutely and indefeasibly entitled to a share of trust property, including two of the four voting shares in a private company, Zipor. Ami requested the trustee to transfer to him his half of the shares. Tami opposed the transfer. The trustee sought judicial advice on whether he should accede to the request.

Decision

The New South Wales Court of Appeal held that there were no special circumstances preventing the rule in *Saunders v Vautier* from applying and directed the trustee to transfer the requested shares to Ami.

Leeming JA

The 'rule' in *Saunders v Vautier*

First, as the primary judge recognised, the High Court has said that 'rule' in *Saunders v Vautier* is not a rule, and was not in terms formulated either by the Master of the Rolls or the Lord Chancellor in the decision of the former or the rehearing by the latter: *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53 at [43]. The 'rule' pre-dates the decision; it may be found in the first edition of Thomas Lewin's *A Practical Treatise on the Law of Trusts and Trustees* (Maxwell, 1837) at 496. Both *Love v L'Estrange* (1727) 5 Bro PC 59; 2 ER 532 and *Barnes v Rowley* (1797) 3 Ves Jr 305; 30 ER 1024 presuppose that an adult beneficiary could call for settled property contrary to the terms of the trust (in *Love v L'Estrange* the property was to be invested so as to provide an annuity for life; in *Barnes v Rowley* it was to be held until the beneficiary attained the age of 24).

Moreover, the 'rule' is best described as a *power* on the part of the beneficiaries, with a correlative *liability* on the part of the trustees: *CPT* at [44]. The exercise of the power does not involve the performance by the trustees of any part of their office as active trustees; instead, it brings their office to an end. The exercise of this power is a canonical example of, to use Hohfeld's language, effecting a change in a given legal relation: W Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning* (Lawbook Exchange reprint, 2000) pp 50–51.

Secondly, Anglo-Australian law has taken the course of giving primacy to adult beneficiaries who enjoy an absolute vested and indefeasible interest in trust property, such that the power overrides restrictions imposed by testators and settlors in the trust instrument: *CPT* at [43]–[44]. United States trusts law took a different course, influenced by early New York and Michigan statutes; the process by which courts in other States followed those statutes is thoughtfully described in P Matthews, 'The Comparative Importance of the Rule in *Saunders v Vautier*' (2006) 122 *LQR* 266 at 282–287. The different approach in the United States of America reflects a policy choice, expressed in *Scott and Ascher on Trusts* (5th ed, 2008) at §34.1.3 thus: 'How far should a settlor be permitted to control not only the disposition but also the enjoyment of property?' The resultant divergence has practical consequences; for example, it made it vital to determine whether English or Texan law governed the testamentary trust in *Re Barton* [2002] EWHC 264.

The upshot is that it is not to the point to observe, as Tami did, that the trust established by Hedy's will is a trust for sale, with special provisions directed to a sale (including the right of first refusal which contemplates by its existence and by the provision for payment over time without interest that the shares will remain in single ownership). Adult beneficiaries who are absolutely and indefeasibly entitled have power to 'overbear and defeat the intention of a testator or settlor to subject property to the continuing trusts, powers and limitations of a will or trust instrument': *Goulding v James* [1997] 2 All ER 239 at 247, cited in *CPT* at [43].

Thirdly, the power is not unqualified, even where the beneficiaries are unanimous and absolutely and indefeasibly entitled. The exercise of the power may be subject to the trustee's right to reimbursement or exoneration for the discharge of liabilities incurred in the administration of the trust: *CPT* at [50]–[51]. That said, it seems clear that since the trustee's rights to reimbursement and exoneration are a consequence of the trustee being a fiduciary with ownership and control of trust property, the exercise of those rights by the trustee is subject to the trustee's fiduciary duties. Thus, the trustee may not refuse to accede to a *Saunders v Vautier* direction in order to keep the trust in existence for the trustee's own benefit: *Wester v Borland* [2007] EWHC 2484 at [12]–[13]. It likewise seems clear that the trustee's lien over trust assets does not detract from the beneficiaries having power to give a *Saun-*

ders v Vautier direction, although the terms of the trust may require the trustee's interest to be protected: *CPT* at [49]; why should the position be different from trust property subject to a charge or mortgage? These matters are considered in G Thomas and A Hudson, *The Law of Trusts* (2nd ed, Oxford University Press, 2010) pp 165–166. Professor Thomas also states (at 166) that the power may be defeated by an exercise by the trustee of a power of appropriation; it is not necessary to consider this aspect, although mentioned during the course of argument, since that power was not exercised. The only point of present relevance is that the power is not unqualified. This reflects the merely equitable nature of the beneficiaries' interest.

Fourthly, the power of some but not all of the beneficiaries to bring the trust to an end *in part* (and the correlative liability on the part of the trustees for their office to cease to that extent) is also qualified, and to a greater extent than would be the case if they were unanimous. In addition to the foregoing, as Sugerman J said in *Manfred v Maddrell* (1950) 51 SR (NSW) 95 at 97, its exercise is 'governed by practical considerations and, in particular, by considerations of convenience of division and of the risk of prejudice to other beneficiaries'. These two considerations may overlap but are distinct.

It has been traditional to proceed on the basis that where *land* is held on trust, the power on the part of some but not all of the beneficiaries is unavailable. It was said in *In re Marshall* [1914] 1 Ch 192 at 199 that 'it is a matter of notoriety … that an undivided share of real estate never fetches quite its proper proportion of the proceeds of sale of the entire estate' (it is not necessary to consider whether that statement continues to be universally correct or what follows if it is not). The same is true of indivisible *personal* property, such as a racehorse or painting.

Tami's written submissions referred to various examples where a trustee lacked power to direct a trustee to transfer trust property. If two adult beneficiaries are absolutely and indefeasibly entitled to personal property constituting volumes 1–84 of the New South Wales Law Reports (to take one example posed by Tami), one cannot call for a half share. The set is not divisible, even though it comprises an even number of volumes, for there is no way that the set may be divided so as to produce two equal halves. The same is true of the other examples offered by Tami's written submissions: a collection of stud animals or a professional sporting team. A precondition to the exercise of the *Saunders v Vautier* power by a subclass of the adult beneficiaries absolutely and indefeasibly entitled is that the property be divisible. The position is at least analogous (I suspect in fact it is identical) with what was said by Dixon CJ and Fullagar J in *Brady v Stapleton* (1952) 88 CLR 322 at 339: the distinction drawn by equity is whether it is practicable to give effect to the rights of the beneficiary by appropriating a specific severable part of the available property.

Shares are plainly specifically severable. Hence their *name*. 'One share … is the same as another, and share No 1 is not distinguishable from share No 2 in the same way as a grey horse is distinguishable from a black horse': *In re International Contract Co* (1872) 7 Ch App 485 at 487; see the analyses by Lockhart J in *Sydney Futures Exchange Ltd v Australian Stock Exchange Ltd* (1995) 56 FCR 236 at 255–256 and Campbell J in *White v Shortall* [2006] NSWSC 1379 at [193]–[200].

Where personal property which *can* be conveniently and fairly divided is held on trust, courts have long stated that the power of some but not all beneficiaries to bring an end to the trust is qualified by 'special circumstances'. The metes and bounds of 'special circumstances' have never been fully defined. Indeed, as Clauson J said in *Re Sandeman's Will Trusts* [1937] 1 All ER 368 at 372, courts have been 'rather careful never to define in precise terms exactly what would be good ground to the contrary'.

It follows that trustees of divisible personal property faced by a *Saunders v Vautier* direction by some but not all of the adult beneficiaries who enjoy an absolute vested and indefeasible interest must determine whether they are obliged to accede to the direction. In the way that issue has repeatedly been framed that has required a determination by them of whether there are 'special circumstances' such as to disentitle the beneficiaries from the valid exercise of the power.

Fifthly, in such cases, the critical question is whether there is prejudice to those beneficiaries who oppose the *Saunders v Vautier* direction. In all contested cases, at least one absolutely entitled beneficiary will claim there is no relevant prejudice, while another will assert that there is prejudice.

A partial answer to Tami's principal submission is that its factual premise is not made out. Tami tendered a report by a qualified valuer, who was not cross-examined, who expressed views to the effect that parcels of shares in private companies may attract a premium for control. The high points of his report were (emphasis added):

> A shareholder holding between 25.1% (ie more than 25%) and 50% of the voting shares of a private company has some influence over the company as the shareholder is able to block a special resolution being passed by the other shareholder(s). This is sometimes referred to as 'negative control'.
> A purchaser acquiring more than 25% but less than 50% of the voting shares in a private company *may pay a small premium* above the price that would be paid for an interest of 25% or less because the purchaser would obtain 'negative control' of the company.

As Ami said, the opinions were entirely general, unrelated to the particular company Zipor, and speculative. The opinion was, expressly, left at the level of possibility *(may* pay a small premium). No opinion was expressed *at all* in relation to the particular parcels of shares in Zipor. Yet no one could contemplate buying a minority interest in shares in Zipor without being conscious of the years of dispute and litigation dividing the existing shareholders.

Contrary to Tami's submissions, I would not read [110] of the reasons of the primary judge as an acceptance of the proposition that the break-up of the parcel of two 'A' class shares will result in an actual loss of value. His Honour said only that he was prepared to accept expert evidence adduced that 'control premiums for controlling interests (that is more than 50%) in private companies in Australia generally range between 15% and 20% and could be higher depending upon the circumstances.' His Honour's statement was directed to parcels of shares which could secure the passage of an ordinary resolution, and not directed to Zipor at all.

Contrast the quantified prejudice established on the evidence in *Lloyds Bank v Duker* [1987] 1 WLR 1324, where John Mowbray QC, sitting as a Deputy Judge of the High Court, relied on a trustee's duty of impartiality between beneficiaries, so as to prevent a beneficiary entitled to 46/80ths of the estate from directing the transfer of 46/80ths of the shares in a private company. There was evidence (including valuation evidence and evidence of an offer) which was inherently plausible and which enabled the court to find that the value per share of a holding of 46/80ths of the company's ordinary shares was 'markedly higher' than the value per share of a minority parcel. 'The result is that, if Mr Duker takes 574 shares, the value of what he takes will be markedly more than 46/80ths of the aggregate values of his and the other holdings' (at 1328–9; 197). It was held that for that reason the trustee was required to sell all the shares and pay 46/80ths of the proceeds to Mr Duker, rather than transferring the majority parcel to him. The narrowness of that holding is emphasised by the fact that it was expressly based upon the valuation evidence, and indeed the distinguished Deputy Judge accepted (at 1330; 198):

> *Re Sandeman's Will Trusts* and *Re Weiner's Will Trusts* as authorities which ought to be followed at first instance that the general rule is not excluded by the fact that the distribution breaks up a controlling interest, and so reduces the value of the whole.

To return to Zipor, it would be unreal to think that there was any appreciable premium attaching to the two 'A' class shares as a parcel, as opposed to the shares individually. The certainty is that any purchaser would be acquiring a minority interest in a company whose other shareholders have demonstrated a prodigious appetite for litigation. In the absence of any other evidence at all, it was entirely open to the primary judge to conclude that Tami had failed to establish any diminution in value by the splitting of the parcel of two 'A' class shares …

Equity long ago took the step to subject the terms of the trust established by the settlor or testator to the exercise of power by adult beneficiaries who are absolutely and indefeasibly entitled *collectively*. The question which then arose was what was to occur when they were not unanimous but the property could be divided. The answer was to have regard to any prejudice to a beneficiary who opposes an *in specie* distribution. However, not every form of prejudice is sufficient.

To take an extreme case, one of three beneficiaries of a small trust where the trust property comprises listed securities may be prejudiced by a *Saunders v Vautier* direction made by another beneficiary, for it may not be possible to secure the same investment return if the principal is diminished, and the fees charged by the trustee will be borne by two rather than three beneficiaries. Yet no one would suggest that those considerations could defeat an adult beneficiary absolutely and indefeasibly entitled to his or her share of the trust property from calling for it. That is to say, the exercise of power by one but not all beneficiaries may be attended by *actual* prejudice upon the other, yet be insufficient to disentitle the exercise of power by the beneficiary.

Similarly, suppose a parcel of non-voting preference shares is held on trust for a number of adult beneficiaries. To the extent that the rights attaching to those shares comprise, for practical purposes, the right to a preferred dividend and return on capital, it is difficult to see how there could be any prejudice if one beneficiary called for his or her share of the parcel. That would be so even if the parcel were large, and its division meant that no longer would a single shareholder be able to block a special resolution of preference shareholders varying class rights.

On the other hand, if ten particular shares entitle their owner to exclusive occupation of an apartment in a company title building, and the parcel is held on trust for two adult beneficiaries absolutely and indefeasibly entitled, for my part I would find it difficult to see that one beneficiary would be entitled to call for five of the shares, leaving the balance held by the trustee for the other beneficiary. The prejudice is real and immediate, even though both beneficiaries are treated identically. The purpose of that parcel of shares is to confer a right to live in the apartment, and the analogy with trusts of land is very strong.

The point of the foregoing is to emphasise that there are shares and there are shares. Company constitutions are flexible institutions, and it does not follow that principles applicable to one private company will apply to all private companies.

Here, the only prejudice Tami relied on was the loss of a measure of control at an ordinary meeting of Zipor's members. For the reasons identified above, there was no error by the primary judge in finding no quantified loss of value. And the English decisions amount to a uniform line of authority precisely a century old rejecting as sufficient prejudice the mere break up of a parcel of shares which enjoys a measure of control.

Question

Ralph's will leaves Sheepswill Farm, a large grazing property, and his shares in a private company, Sheepswill Pty Ltd, which sells farm produce, to trustees to be held on trust for his twin children, Karen and Justin, absolutely. The children have just turned 18 years of age. Karen wants to continue farming but Justin wants to sell his share of the farm and shareholding in order to move to the city and start up a business. Justin requests the trustees to sell the farm and to transfer his shareholding to him. Advise the trustees.

24.4 Variation of trusts

Saunders v Vautier confers a power on qualified beneficiaries to terminate a trust, but it does not permit the beneficiaries to direct the trustees how to perform their duties or to exercise their powers under an unterminated trust: *Re Brockbank* [1948] Ch 206 where it was held that the beneficiaries could not direct the trustees how to exercise their power to appoint a new trustee. Moreover, a trust can only be varied if all the beneficiaries are adult and agree to terminate the trust and reconstitute it on the terms of the varied trusts. This cannot be accomplished if some beneficiaries lack legal capacity or are unborn. Many trust instruments therefore include a provision enabling the trustees (or a third party, such as a guardian or protector) to vary the terms of the trust. Such a provision enables the trustees to adapt the terms of the trust to meet changes of circumstances, including changes in relevant tax law. Whether any proposed variation can be authorised by the application of the provision is a question of construction of its terms in the context of the overall scheme of the trust: *Mercanti v Mercanti* (2016) 50 WAR 495.

In the absence of an express variation clause, an application may be made to the court for approval of the proposed variation. One possibility is to invoke the statutory power contained in all State and Territory trustee legislation enabling courts to approve transactions which are expedient and which could not otherwise be carried out. The following is the New South Wales provision.

Section 81: Advantageous dealings

(1) Where in the management or administration of any property vested in trustees, any sale, lease, mortgage, surrender, release, or disposition, or any purchase, investment, acquisition, expenditure, or transaction, is in the opinion of the Court expedient, but the same cannot be effected by reason of the absence of any power for that purpose vested in the trustees by the instrument, if any, creating the trust, or by law, the Court:

(a) may by order confer upon the trustees, either generally or in any particular instance, the necessary power for the purpose, on such terms, and subject to such provisions and conditions, including adjustment of the respective rights of the beneficiaries, as the Court may think fit, and

(b) may direct in what manner any money authorised to be expended, and the costs of any transaction, are to be paid or borne as between capital and income.

...

Note

This provision does not confer a general power on courts to approve variations of trust. In *Re Dion Investments Pty Ltd* (2014) 87 NSWLR 753, the Court of Appeal confirmed that the scope of s 81 is limited to the judicial approval of a 'transaction' which would otherwise be unauthorised by the terms of the trust instrument. A variation of the terms of the trust is not a 'transaction' for this purpose. Equivalent provisions are: ACT s 81; NT s 50A; Qld s 94; SA s 59B; Tas s 47; Vic s 63; WA s 89. The Queensland and Western Australian provisions add, as an alternative to 'expediency', the criterion that the proposed transaction 'would be in the best interests of the persons or the majority of persons, beneficially interested under the trust'. See *Re Arthur Brady Family Trust* [2015] 2 Qd R 172, [24]–[26]. The Northern Territory provision omits any reference to 'expediency', but its scope is confined to listed trustee dispositions, and not to 'transactions' generally.

New South Wales, Queensland, Tasmania, Victoria and Western Australia have adopted legislation, based on the English *Variation of Trusts Act 1958*, enabling the court to approve a proposed variation on behalf of persons, such as minors and unborn beneficiaries, who are unable to consent for the purpose of the rule in *Saunders v Vautier*. The following is the Victorian provision.

Section 63A: Power of Court to vary trusts

(1) Where property, whether real or personal, is held on trusts arising, whether before or after the commencement of this Act, under any will settlement or other disposition, the Court may if it thinks fit by order approve on behalf of –

(a) any person having, directly or indirectly, an interest, whether vested or contingent, under the trusts who by reason of minority or other incapacity is incapable of assenting; or

(b) any person (whether ascertained or not) who may become entitled, directly or indirectly, to an interest under the trusts as being at a future date or on the happening of a future event a person of any specified description or a member of any specified class of persons, so however that this paragraph shall not include any person who would be of that description, or a member of that class (as the case may be) if the said date had fallen or the said event had happened at the date of the application to the Court; or

(c) any person unborn; or

(d) any person in respect of any discretionary interest of his under protective trusts where the interest of the principal beneficiary has not failed or determined –

any arrangement (by whomsoever proposed and whether or not there is any other person beneficially interested who is capable of assenting thereto) varying or revoking all or any of the trusts, or enlarging the powers of the trustees or managing or administering any of the property subject to the trusts:

Provided that except by virtue of paragraph (d) of this subsection the Court shall not approve an arrangement on behalf of any person unless the carrying out thereof would be for the benefit of that person.

...

Notes

(1) Equivalent provisions are NSW ss 86A–86C; Qld s 95; *Variation of Trusts Act 1994* (Tas) s 14 (provides that the proposed variation must be 'in the interests of' the person or persons of the beneficiary in question and lists matters that a court must consider); WA s 90 (s 90(2) provides that the arrangement must not be approved if it is detrimental to the beneficiary. Among matters to be considered are 'the welfare and honour of the family to which he belongs'. See *Palmer v McAllister* (1991) 4 WAR 206, 211–12.

(2) A critical question, except where consent is sought in respect of a discretionary interest under a protective trust under *Trustee Act 1958* (Vic) s 63A(1)(d), will be whether the proposed variation is for the benefit of the beneficiary on whose behalf judicial approval has been sought (or, in Western Australia, whether it is for his or her detriment). Difficult 'benefit' issues include assessing whether the tax advantages of the proposed variation outweigh any potential social disadvantages, and the evaluation of non-financial considerations, such as the desirability of avoiding family disputes. On these questions see *Re Weston's Settlement* [1969] 1 Ch 223; *Re Remnant's Settlement Trusts* [1970] Ch 560; *Re Christmas Settlement Trusts* [1986] 1 Qd R 372; *George v Kollias* [2007] VSC 46; *Thomas Hare Investments Ltd v Hare* (2012) 34 VR 656.

South Australia has enacted the following broad discretionary variation provision which is not limited to enabling the court to supply the consent of a beneficiary who could not otherwise invoke the rule in *Saunders v Vautier*.

Section 59C: Power of Court to authorise variations of trust

(1) The Supreme Court may, on the application of a trustee, or of any person who has a vested, future, or contingent interest in property held on trust –

(a) vary or revoke all or any of the trusts; or

(b) where trusts are revoked –

(i) distribute the trust property in such manner as the Court considers just; or

(ii) resettle the trust property upon such trusts as the Court thinks fit; or

(c) enlarge or otherwise vary the powers of the trustee to manage or administer the trust property.

(2) In any proceedings under this section the interests of all actual and potential beneficiaries of the trust must be represented, and the Court may appoint counsel to represent the interests of any class of beneficiaries who are at the date of the proceedings unborn or unascertained.

(3) Before the Court exercises its powers under this section, the Court must be satisfied –

(a) that the application to the court is not substantially motivated by a desire to avoid, or reduce the incidence of tax; and

(b) that the proposed exercise of powers would be in the interests of beneficiaries of the trust and would not result in one class of beneficiaries being unfairly advantaged to the prejudice of some other class; and

(c) that the proposed exercise of powers would not disturb the trust beyond what is necessary to give effect to the reasons justifying the exercise of the powers; and

(d) that the proposed exercise of powers accords as far as reasonably practicable with the spirit of the trust.

(4) An order made by the Supreme Court in the exercise of powers conferred by this section is binding upon all present and future trustees and beneficiaries of the trust.

…

Note

Variations which are 'substantially motivated' by tax minimisation cannot be approved under the *Trustee Act 1936* (SA) s 59C(3)(a). Contrast the position in the *Variation of Trusts Act* jurisdictions where the primary objective of an application may be to minimise tax liability: *Thomas Hare Investments Ltd v Hare* (2012) 34 VR 656.

Question

Should tax minimisation considerations be relevant to a court's exercise of its statutory discretion to vary a trust?