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principles of EQUITY AND TRUSTS

Second Edition

Samantha Hepburn

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For my beautiful children, Emma and Jack –
who are a constant source of inspiration to me

PREFACE

The first edition of this textbook was published in 1997. It was designed as a book whose purpose was to guide students and practitioners through the labyrinth of equity and trusts with a straightforward and structured methodology. The second edition continues this tradition – including a significant discussion on current judicial and legislative developments. The text includes more detailed discussion of important new equity cases: including, for example, analysis of the High Court decisions in *Garcia v NAB*; *Giumelli v Giumelli*; *Bridgewater v Leahy*; and *Cardile v LED Builders* – all of these cases have been clearly outlined, methodically discussed and their consequences examined – with the corresponding materials on undue influence, estoppel, unconscionable dealing and Mareva orders updated and expanded to ensure that these new developments are properly incorporated into the text. This approach has been adopted throughout the entire second edition and has resulted in a significant expansion of materials throughout.

Despite the numerous changes in the second edition, the foundation of the text remains the same: the structure and format is the same as the first edition and so is the overall objective: to provide clear, accessible and comprehensive outlines of conceptually complex and challenging materials encountered in the variety of principles and doctrines associated with the study of equity and trusts.

The law is stated as at May 2001.

Samantha Hepburn
Anglesea, 2001

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PART I

WHAT IS EQUITY?

Part I of this text examines the nature and current operation of equity. When considering the question 'what is equity?', it must be borne in mind that there is no single, definitive answer. The concept of equity has different meanings according to the social, ethical or legal context in which it is examined. Some of the more common interpretations include: symmetry, balance, harmony, morality, justice, fairness, a form of property interest and a recognised and established legal principle. In a legal sense, however, equity is primarily associated with justice. Equity has become a legal paradigm for the implementation of individual justice; equitable justice has both a palpable legal presence and an indefinite legal potential. Equity represents a nascent body of law which has developed to cater for the needs of individual justice as they have arisen in the past, and a system of justice capable of adapting to individual needs in the future. This does not mean that equity has an exclusive province over legal justice. The principles which have evolved under the common law also aim for justice; however, under the common law, justice is attained through more generalised legal norms. The vitality of equity lies in its individuality.

As Aristotle points out:

> The source of the difficulty is that equity, though just, is not legal justice, but a rectification of legal justice. The reason for this is that law is always a general statement, yet there are cases which it is not possible to cover in a general statement ... Hence, while the equitable is just, and is superior to one sort of justice, it is not superior to absolute justice, but only to the error due to its absolute statement. This is the essential nature of the equitable; it is a rectification of law where law is defective because of its generality.[1]

The legal justice that equity represents has become an indispensable part of our civil legal system. Equitable principles have, and will continue to evolve to meet the demands of individual justice where the common law is deficient. This functioning of equity places it in a rather unusual position in the overall structure of our legal system. Equitable justice is detached from common law justice; however, its principles are very much a part of the law. This has tended to encourage uncertainty and distrust of the equitable jurisdiction.

As Professor Newman points out:

> The relationship between law and equity in modern times has never been clearly established, and the nature of equity remains shrouded in mystery.[2]

In this part, the amorphous nature of the equitable jurisdiction and its somewhat nebulous relationship with the common law is examined. It is not until Part II that the character and application of juridical equitable principles that have evolved in this jurisdiction are considered.

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1 *The Nicomathean Ethics*, Book Vx, 5-xi, Rackham, H (trans), 1926.

2 Newman, RA (ed), *Equity in the World's Legal Systems*, 1973, Introduction, p 15.

THE NATURE OF EQUITY

1.1 Equity and justice

The concept of equity has different social and legal interpretations. Its primitive meaning, if traced back to its Latin source *aequum*, is physical equality or evenness. In this purely neutral sense equity refers to a balance or an equilibrium; just as the origin of rightness is straightness, the origin of equity is equality.

This primary understanding of equity is also used in an ethical context. What is equitable has come to represent behavioural neutrality; this in turn is equated with fair and just conduct. A person who has acted equitably will be presumed to have acted justly because 'just conduct' is associated with balanced, proportionate conduct. Conduct which is not balanced and neutral is likely to be considered inequitable; such conduct is, in turn, likely to be described as being either immoral or unethical.[3]

This ethical understanding of equity is of great relevance to our legal system. Whilst in a social context equity represents morally balanced behaviour, in a legal context equity represents what is legally just. Legal morality is encapsulated within the notion of justice. Conduct found to be equitable will generally be found to be just, although legal justice is not the exclusive province of equity. This is well explained by Aristotle.

1.1.1 Aristotle

In Book V Chapter 3(A), Aristotle claims that the 'just' is a species of the proportionate and the unjust violates proportionality. In Book V Chapter 10, Aristotle concludes that equity and justice are effectively the same thing because they are both concerned with balance and proportionality and with what is right and good.

According to Aristotle, however, different forms of legal justice exist: that which is distributive and that which is corrective.[4] In broad terms, distributive justice refers to principles enunciating collective proportionality. The articulation and application of common law principles may be broadly termed 'distributive justice'. On the other hand, collective justice considers the proportionality of conduct in private, individual transactions. Collective justice refers to individual equality and fairness. It is reflected, not in the

3 See Parker, JL (ed), *Salmond on Jurisprudence*, 9th edn, 1937, pp 672–73.

4 See *op cit*, Aristotle, fn 1, book Vii, 10-iii.

creation of generalised principles of proportionality, but in the equalisation of particular instances of injustice. As noted by Aristotle (Book V Chapter 4), collective justice represents 'Justice in Rectification'.

Aristotle felt that the form of justice which 'equity' most represents is collective justice because it rectifies the unfairness flaw from distributive justice. According to Aristotle, equitable justice is superior because it individualises a legal justice. Whilst law is universal, it is not possible to make a universal statement which shall be correct about all things; equity ensures that the law as generally stated is not applied unjustly to individual situations.

As Aristotle notes (Book V Chapter 10):

> When the law speaks universally, and a case arises on it which is not covered by the universal statement, then it is right to ... correct the omission ... Hence the equitable is just, and better than one kind of justice – not better than absolute justice, but better than the error that arises from the absoluteness of the statement. And this is the nature of the equitable: a correction of law where it is defective owing to its universality.

Equitable justice is superior because it is not absolute in nature. Unlike the common law, equity is determined individually rather than collectively; it is therefore able to correct the law by considering particular applications.

The need for this type of ethical dimension to the law is also found in Roman jurisprudence where Domat lays it down as a general principle of the civil law that, if any case should happen which is not regulated by some express or written law, it should have for a law the natural principles of equity, which are the universal law extending to everything.[5]

1.2 Equity as a body of law

The application of equitable justice has gradually resulted in the evolution of tangible, equitable principles which embellish the common law by alleviating the deficiencies of the absolute law. The most common legal understanding of 'equity' today is not as an intangible sense of justice, but rather as a discernible body of law, developed by the early Courts of Chancery and administered by modern Courts of Justice. Equity has become a source of legal principles in much the same way as the common law. The primary difference between common law and equity today lies in the method of implementation. Equitable principles are administered according to processes which have evolved in the courts of equity: equitable discretions, maxims and remedies will only be relevant to the administration and application of equitable principles.

The evolution of equity into a body of law has not, however, destroyed the functioning of equitable justice. Whilst current legal references to equity are usually to the legal principles administered by courts of equity rather than the

5 Randall, AE (ed), *Story on Equity*, 3rd edn, 1920, pp 3–4.

form of corrective justice that equity represents, this is not to suggest that equity is no longer synonymous with corrective justice. The equitable principles which have developed embody this justice and retain the inherent discretionary capacity to adapt to new forms of individual unfairness.

1.3 Equity corrects the law

In its discretionary capacity, equity operates to correct the law, not to overwhelm it. The jurisdictional foundation of equity is, as Aristotle notes, corrective rather than distributive; it prescribes relief against the proscriptive operation of the common law. It is imperative that every rational system of jurisprudence has a place for equity. In every legal system, defects will arise which cannot be cured by a universal principle.

This requirement is summarised in the famous words by St Germain:

> In some cases it is necessary to leave the words of the law, and to follow that which reason and justice requireth, and to that intent equity is ordained, that is to say, to temper and mitigate the rigour of the law.[6]

In the evolution of equitable principles and in the application of existing rules, equity operates to correct all defects arising from the generalised operation of the law. Justice cannot ever be properly achieved without the ability to move from the general to the particular; equity endows the law with this capacity so that what is legally equitable is synonymous with what is singularly just.

1.4 Form and substance

Whilst equitable principles were intended to alleviate the deficiencies of the common law, they still gave effect to the spirit and intent of the law. Equity is not obliged to follow the letter of the law, where the universality of this 'letter' produces injustice; equitable principles follow the 'reason and spirit', so that deficiencies arising from a strictly literal interpretation can be corrected.

Mr Justice Blackstone, in his famous *Commentaries*, alludes to this:

> Equity, in its true and genuine meaning, is the soul and spirit of all law; positive law is construed, and rational law is made by it. In this, equity is synonymous with justice in that, to the true and sound interpretation of the rule.[7]

1.5 Standards of conduct

Equity does not apply defined rules, it evaluates specific conduct; this requires flexibility and discretion. Most equitable principles are based upon

6 'St Germain's doctor', adapted from Plucknett, TFT and Barton, JL (eds), *St Germain's Doctor and Student*,1974, 97, Dialogue 1, Chapter 16.

7 Blackstone's *Commentaries*, Book III, 2001, London: Cavendish Publishing.

discretionary standards of conduct rather than definitive rules; these standards usually stem from the basic precepts of good faith, honesty and generosity, and in this sense are relational in nature.

Equitable standards emanate from fundamental precepts of good faith and fair dealing; courts are required to balance the nature of the alleged unfairness with the circumstances in which it occurred and compare it with existing social, domestic and commercial norms. Inevitably, standards of conduct vary from time to time in accordance with changing societal expectations.

Increasing commercial pressures and expectations and changing family dynamics have meant that equitable standards are constantly being reassessed. For example, in assessing the relational fairness between individuals and large institutions, courts are increasingly taking into account the inequity flowing from lack of information. This is particularly prevalent with large institutions which have the expertise and financial ability to obtain a greater degree of information, and are thereby placed in a superior position to individuals dealing with them. Where large institutions proceed to take advantage of this by failing to fully inform or advise the individual to seek independent advice, equity must consider whether an injustice has occurred and relief should be granted. The question for a court of equity in such a situation is not so much whether there is an information imbalance, but whether the parties have acted fairly in light of the disproportionate circumstances. Equity will apply a behavioural standard based upon what it considers would constitute fair conduct for an institution in such a situation. Relief will only be granted after a full assessment of the circumstances.

1.5.1 Unconscionability

In modern times, 'unconscionability' has become a fundamental cornerstone for the assessment of equitable standards. As one commentator has noted, avoiding unconscionability 'may be the central informing idea of equity'.[8] Modern courts prefer to talk in the language of conscience as it provides a clearer reminder of the ethical origins of equity. Today, 'unconscionability' has become the founding standard for equitable intervention; its categories are expansive and include:

- abusing a position or relationship of trust or confidence;
- exploiting a recognised vulnerability or weakness;
- unfair insistence upon strict legal rights in circumstances where this would be harsh or oppressive; and
- unfair refusal to perform legal obligations.

None of the above categories are mutually exclusive; there is always the possibility for new areas to open up. Each category must be carefully assessed;

8 Hackney, J, *Understanding Equity and Trusts*, 1987, p 17.

unconscionability will only be proven where a clear injustice can be established. While a level of doctrinal uncertainty is inevitable in the application of open-ended concepts, courts are very wary of the dangers of using unconscionability as a 'panacea' for any idiosyncratic perception of unfairness.[9]

1.6 Distrust of equity

Despite the fact that modern equity is identified by well established equitable principles, the equitable jurisdiction has always been shrouded in a degree of suspicion and distrust. This suspicion stems largely from the fact that equitable principles are applied in a discretionary manner to individual situations and the outcome is never absolute and often unexpected. The courts, particularly the early common law courts which were nurtured on doctrinal predictability, found such uncertainty to be contrary to the fundamental objectives of the law and regarded the equitable jurisdiction with a fairly high degree of suspicion. Common lawyers feared the encroachment of the equitable jurisdiction upon established legal doctrine and were generally quite scathing of any development.

The apparent 'ad hoc' operation of equity, particularly in the early times when no established principles had evolved, was a great hindrance to the formal acceptance and recognition of equity as a valid source of law. The claim that the outcome of equity depended 'upon the length of the Chancellor's foot' was not uncommon, and common law courts chose to ignore the 'precarious' and 'evanescent' workings of Chancery as long as they could.

With the systemisation of equity and the introduction of a merged administration, this fear has subsided; it has, however, not disappeared altogether. In a merged system, different reasons for distrusting the equitable jurisdiction are beginning to emerge. As Professor Newman pointed out, in contemporary society, resentment to religious authoritarianism is sharpening and many equitable doctrines are perceived to entrench ecclesiastical dogma. The modern struggle of humanity to emancipate itself from religious dogma and moral monopolies has inevitably led courts to feel uneasy with a system of law ostensibly founded upon moral correctness.[10]

1.7 Equitable relief is discretionary

One of the primary identifying features of the equitable jurisdiction is its discretionary approach to the determination of relief. There are generally seen to be two different levels to this discretion. On the first level, a court of equity

9 See the judgment of Deane J in *Muschinski v Dodds* (1986) on this point.

10 *Op cit*, Newman, fn 2, Introduction, p 18.

has a discretion to determine whether or not the particular circumstances warrant any relief being issued at all; on the second, once it has been determined that some form of relief is appropriate, the court has a discretion to determine the type or measure of relief to be granted.

In exercising this secondary discretion, the court may take into account a wide variety of factors, including: hardship on the defendant; laches (that is, the delay of the plaintiff in bringing the action); the overall conduct of both parties; the adequacy of common law relief; the adequacy of the relief being sought; and the overall consequences of the relief upon both parties. It is important to bear in mind that the discretionary operation of equity is different from the common law, where every plaintiff has a right to relief once a cause of action can be established. In equity, proving that facts come within a recognised principle will not guarantee relief. The court must further assess the alleged injustice to determine that it is truly against the conscience of the court and that relief sought is both justifiable and morally correct.

1.8 Equitable maxims

As the principles of equity began to emerge, a set of generalisations concerning the equity methodology were developed. These generalisations have come to be known as the 'equitable maxims'. These maxims represent the accumulated insight and wisdom of the early courts of equity and are often used as a guide in the application of equitable principles.

1.8.1 Equity will only assist those with clean hands

This maxim refers to the quality of the plaintiff's conduct. When a plaintiff, whose conduct has been improper in a transaction, seeks relief in equity, such relief will generally be refused at the discretion of the court. The 'clean hands' maxim can operate as a defence to an equitable action, but for it to be successful the impropriety complained of must have an immediate and necessary relation to the equitable principle in issue. To establish impropriety, some sort of fraud or improper behaviour on the part of the plaintiff must be proven. The mere breach of a legal duty will be insufficient in this regard. However, a misrepresentation (whether fraudulent or innocent) will generally be sufficient.[11] This maxim is closely associated with the maxim, 'those who seek equity, must do equity'.

1.8.2 Equity follows the law

A consequence of the corrective operation of equity is that it will never overrule or invalidate the common law and will always, where possible,

11 See *Cadman v Horner* (1810); *Viscount Clermont v Tasburgh* (1819).

attempt to follow it. If the common law is defective, equity may provide an alternative cause of action. However, it cannot actually overrule or invalidate an existing legal principle. Equity may prevent a legal right from being asserted where the holder has acted unconscionably or the assertion itself would be unconscientious. However, it does not have the jurisdiction to expressly declare the legal rule to be ineffective. The equitable jurisdiction follows the law and alleviates the deficiencies of the law; it does not overrule it.

1.8.3 Equity is equality

When applying relief, equity will try, as far as possible, to grant relief which is proportionate to the loss suffered or the unfairness involved. Once relief has actually been granted, there will be a presumption that the distribution was equal.

1.8.4 Equity looks to intent rather than form

This maxim reflects one of the basic tenets of equity. When considering the circumstances and law applicable to a particular case, equity will not regard itself as being bound by formality. If equity finds that, by insisting upon a particular form, the substance of the issue is overwhelmed, it will hold such insistence to be inequitable.

For example, in a situation where a trust was intended but has not been expressly created through compliance with the formal requirements, if sufficient evidence of an intention to create a trust can be proven, equity will enforce the intention of the parties despite the absence of any express wording.

1.8.5 Equity deems that to be done which ought to be done

Under this maxim, equity ensures that any transaction or arrangement which has been fairly and honestly agreed upon is properly performed. Naturally, however, if circumstances have arisen to make such performance impossible, this maxim will have no effect. Equity will only enforce performance of an agreement where it is capable of being carried out.

1.8.6 Equity acts in personam

This maxim has great historical significance as it describes the equitable methodology. Equity, as a court of conscience, issues relief to a defendant personally to prevent an identifiable injustice from continuing. Whether the defendant is required to perform a contract which she has refused to perform, or discontinue conduct found to be unconscionable, equity directs its relief against the defendant personally. This approach of equity relates back to the essential functioning of equity as a correction of the universal law; equity acts

in personam so that it can better relieve the defects of an absolute rule. The maxim does not mean that equitable relief will always be personal in nature. The evolution of the constructive trust as a proprietary form of equitable relief provides clear evidence of this.[12]

1.8.7 No relief if damages are adequate

This is a discretionary principle, which is like a maxim. It relates back to the maxim that equity will follow the law. Equitable relief will be declined where such relief is substantially the same as that which is available under the common law. For example, specific performance of a contract will not be available if damages at common law are already available and adequate. The same is applicable to other instances where common law offers relief which is perfectly capable of remedying the particular unfairness. The justification for this lies once again in the fact that equity operates as a corrective jurisdiction: its aim is to remedy the defects of the law, not to interfere in a situation where legal relief is perfectly adequate.

1.9 Conclusion

The intention of this chapter has been to provide a brief overview of the nature and functioning of modern equity. As discussed, modern equity refers to much more than simply proportionality. Today, equity has become a multifaceted concept: in its role as arbitrator of justice, equity represents not only a source of future law but also a body of existing law.[13] It will always be possible for new, equitable principles to develop; the discretionary, individualised nature of equity will ensure its continued evolution. This evolution is vital to our legal system. Human relationships, whether they be commercial, domestic or social in nature, are always changing; it is important for our legal system to keep pace with such changes. The equity jurisdiction, to some degree, functions as a cornerstone for legal progression; it embodies the justice requirements of the past whilst anticipating those of the present and future. As Professor Newman eloquently notes, nearly all modern legal systems demonstrate a basic symmetry in their recognition of 'the fundamental principles of equity, born of the human spirit and attached to the core of a multitude of legal rules that aim to order the complex realities of contemporary existence'.[14]

12 See further discussion on this below, Part IV.

13 See Martin, J (ed), *Hanbury and Maudsley's Modern Equity*, 13th edn, 1989, Chapter 1.

14 *Ibid,* 'An introduction to the world's legal systems', p 14.

CHAPTER 2

THE ORIGIN OF THE EQUITY JURISDICTION

In this chapter, we trace the historical evolution of the equitable jurisdiction. The legal evolution of equity is identified in three major periods: the medieval period; the formative period; and the period of systemisation. The body of law we currently refer to as equity progressed gradually throughout these periods from a broad-based discretion in the very early stages to a well structured administration in the end. The modern equitable jurisdiction is vastly different from its predecessors; the differences are better appreciated through a careful examination of these historical processes.

2.1 The medieval period (c13–15)

The administration of justice in England was originally given to the *Aula Regis*, also known as the 'Great Court' or the 'Council of the King', which ultimately came to be known as the Supreme Court of Judicature. When that court was dispersed at the end of the 13th century, different jurisdictions were created in separate courts These jurisdictions were as follows: Common Pleas; the King's Bench; and the Exchequer. The notion of the 'common' law as a distinct body of law was gradually emerging. However, during this very early period the equitable jurisdiction could not be contrasted with the common law because it had no substantial existence.

As Maitland notes:

> The common law is a phrase borrowed from the canonists who used *jus commune* to denote the general law of the Catholic Church. It described that part of the law which was unenacted, non-statutory and common to the whole of the land, by contrast with statutory provisions and the royal prerogative. It cannot yet be contrasted with equity because, at this point, equity as a juridical body of principles did not exist.[1]

The King had developed what was loosely referred to as a 'Chancery Division' in the 13th century. However, it did not handle actual cases, but merely operated as the King's secretariat department. At the head of the Chancery Division was the Chancellor, who was usually a bishop. The function of the Chancellor was to look after the administrative tasks of the King; the Chancellor was the secretary of all of the King's departments; he performed all of the King's writing and, more importantly, kept the King's seal.

1 Maitland, R, *Equity and the Forms of Action,* 2nd edn, 1936, p 2.

The King's seal was required for all writs bringing an action in one of the courts of law. The Chancellor was not, at this point, a judge, although his work did bring him into a close association with the legal system and the administration of justice. As the Chancellor controlled the King's seal, it was necessary for all legal writs to go to the Chancery to be stamped before commencement. In this way it was the Chancellor who actually initiated legal proceedings.[2]

In most situations, the writs which were issued in the courts of law were based upon well established legal principles. However, in some situations, writs were issued claiming actions that the court had never before considered. In such cases, the Chancery jurisdiction was given a limited power, where the justice of the circumstances demanded it, to recognise the validity of such writs and issue relief. This power stemmed from the Second Statute of Westminster authorising writs *in consimili casu*.[3] This power was not a judicial process because there was no formal adjudication between the two sides; the Chancellor would simply hear the plaintiff's application and, in his discretion, make a determination. Where such writs were issued, they were often only temporarily enforced; courts of law were always capable of quashing these writs if they were found to be contrary to the actual law of the land. Hence, despite the beginnings of a judicial process, the Chancery jurisdiction could still only be properly described as administrative at this stage.

Nevertheless, the administrative functions of the Chancery increased and gradually became more judicially orientated. This was particularly assisted when the Chancery jurisdiction assumed control of the King's residuary power to grant justice in individual cases. Apart from administering the writs, the King also retained a reserve of justice. When no other relief was available, an applicant could present a petition to the King and pray for relief.

The practice of 'praying' for relief became very popular in the latter part of the 13th and early 14th centuries, and most of the 'petitions' were dealt with by the Chancellor. In the examination of such petitions, the Chancellor began to assume a more judicial approach; consideration was given to the alleged injustice, the parameters of the existing law and the necessity for according justice in the particular circumstances. Furthermore, the practice of issuing such petitions was growing. Whilst the great courts of law administered the bulk of the writs, the Chancellor dealt with the increasing number of petitions praying for relief at the behest of the King.[4]

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2 For a more detailed discussion, see Holdsworth, WS, *History of English Law*, 1903, Vol 1; and Randall, AE (ed), *Story on Equity*, 3rd edn, 1920.

3 This statute was issued in 1285. See the excellent discussion on this period by Holdsworth, WS (1931) 47 LQR 334.

4 See Adams, 'The origin of English equity' (1916) 16 Col L Rev 87, and *op cit*, Maitland, fn 1, esp Lecture 1.

The petitions to the Chancellor generally assumed two primary forms. The first, covering the vast majority of writs, were against the King. It was impossible to bring a writ against the King directly because he could not be sued; instead, the individual had to make a 'humble' petition for justice to the Chancellor. The second form was more important for the evolution of equity. In this form of writ, rather than seeking relief against the King, the applicant sought relief at the expense of another person. The petition generally set out the nature of the injustice and the necessity for relief; relief was petitioned for in this way because the applicant was unable to obtain a remedy in the ordinary course of justice, yet believed (in all justice and fairness) that it should be granted. In such a petition, the King (and therefore the Chancellor) were asked 'out of charity and for the love of God' to grant relief and prevent the injustice from continuing.[5]

In both of these types of petitions, the Chancellor had the option of creating a new writ (which was liable to be quashed by a court of law), or ordering the other party to appear and then making a determination on the validity of the claim. The procedure for hearing these petitions (which came to be known as 'bills') was that the Chancellor would order the other party to come before him so that the complaint could be heard. The writ ordering the party to appear became known as a *subpoena*, because it ordered the party to appear 'upon pain of forfeiting a sum of money'. Once the party appeared, the charge was given and the other party had to answer the charge.

The process of hearing a bill in Chancery was to be distinguished from the procedures applicable in the courts of law at the time which informed the defendant the cause of action, and then allowed him or her to answer. By contrast, the *subpoena* ordered the defendant to come before the Chancellor and answer the charges; in this regard, the *subpoena* was similar to the old canon law process invoked for the suppression of heresy.[6]

Eventually, the practice of issuing bills in the Chancery jurisdiction began to grow. The rigidity and inflexibility of the common law meant that the common law writs were increasingly unable to adapt to new situations of unfairness. The hardship that this caused forced more applicants to issue bills for relief in the Chancery jurisdiction. A body of equitable decisions began to accumulate and equity started to assume the task of correcting the deficiencies of the common law. No clear limitations were imposed on the ambit of the equitable petitions during this period, although it was clear that the Chancellor was not to interfere where an adequate remedy was already available in the common law courts.[7]

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5 See the Seldon Society's *Select Cases in Chancery*, Vol 10, pp 1, 364–71, for examples of how the writs were generally worded.

6 See *Ashburner's Principles of Equity*, 2nd edn, 1933, pp 22–26.

7 See especially the discussion by Meagher, RP, Gummow, WMC and Lehane, JRF, *Equity: Doctrines and Remedies*, 3rd edn, 1992, Chapter 1.

2.1.1 Equity and precedent

One of the established characteristics of the early Chancery jurisdiction was that the Chancellors did not consider themselves bound by precedent. This was indicated by the fact that case reports go back no further than 1557. Even during this period the reporting was very light. The absence of precedent can be attributed to a number of factors. First, there was really no need for equity to follow precedent because, acting as a correction of the law, in the early stages it did not actually constitute a body of law itself.[8] Secondly, the Chancellors were still in the process of forming their own practices and procedures for dealing with individual petitions. Rigid adherence to previous determinations would have been contrary to the fundamental nature of equity during this time.

Gradually, however, as the equitable jurisdiction grew and an accumulated body of decisions emerged, the practice of following a previous equitable decision became quite common. This was partly due to the natural desire of the court to establish some consistency in their decision-making, particularly with the growing number of petitions.

The use of precedent in early equity differed markedly, however, from its common law counterpart where, depending upon the status of the particular court involved, the precedent had actual authority. In the early stages of Chancery, the use of precedent was primarily for the purposes of analogy. Quite often, if substantial factual differences existed, previous decisions were ignored altogether. Hence, the use of precedent did not hinder the discretion of the Chancellor; it simply conferred a greater range of considerations. No Chancellor felt bound to reach the same conclusion as had previously resulted. However, comparing and contrasting the previous reasoning was often found to be extremely helpful.

The relevance of precedent increased during the later years as a greater body of cases accumulated. By the 18th and 19th centuries, substantive equitable principles had emerged and, inevitably, previous decisions assumed a far greater significance.

2.2 The formative period (c16–17)

It was not until the 16th century that the Chancellor and his Office of Chancery acquired the characteristics of a court. By the second half of the 15th century, the Chancellor had the power to issue a decree upon his own authority without reference to the King's Council. This gave the equitable jurisdiction greater autonomy and, by the second half of the 16th century, the Court of Chancery had well and truly assumed judicial functions; the determination of petitions was more organised and a judicial foundation was forming.

8 See the excellent discussion of precedent in equity by Croft, C, 'Lord Hardwicke's use of precedent in equity' [1988] Australian Bar Rev 29.

The appointment of ecclesiastical Chancellors was uncommon during this time; it became more usual to appoint a Chancellor who was legally trained. Inevitably, the appointment of legally trained Chancellors produced a more legal and formalised environment. Petitions were determined by Chancellors trained in the law and, therefore, more readily capable of discerning its deficiencies. The creation of a more definite court of Chancery created a sense of unease in the courts of law. Common law judges felt threatened by the accumulation of power in the Chancery Courts and became extremely protective of their jurisdiction.[9]

Particular hostility was displayed by the common law courts concerning the power of Chancery to issue injunctive relief. This controversy was given renewed vigour during the reign of James I when the common law claimed that equity did not or should not have the jurisdiction to issue injunctive relief for or against a judgment at common law. During this period, equity had assumed a practice of issuing what was called a 'common injunction' to prevent a person from proceeding at common law or executing a judgment obtained at common law where it would interfere with an equitable right.[10]

This debate over the validity of common injunctions was largely instigated by Lord Coke and Lord Ellesmere (as Chancellor at the time). In the celebrated case of *The Earl of Oxford*,[11] the King found in favour of the Court of Chancery's right to issue a common injunction. This did not, however, mean that the Court of Chancery asserted any superiority over common law-injunctive relief. Equitable injunctive relief, if granted, was to be directed personally against the parties where it would be inequitable for the common law judgment to be enforced. This decision was a landmark for the Chancery jurisdiction as it prevented common law judgments or rights from overwhelming the operation of the equitable jurisdiction.[12] *The Earl of Oxford's* case gave the equitable jurisdiction a clear legal mandate.

Following this decision, little development occurred in the Court of Chancery up until the appointment of the Earl of Nottingham as Chancellor in 1673. Lord Nottingham was a very learned man who was responsible, over a course of nine years, for establishing a rationalised body of equitable principles and remedies. For this reason, Lord Nottingham is often referred to as the 'father of equity'.

A similar successor, Lord Hardwicke, was appointed in 1736. He presided in the equity jurisdiction for a period of 20 years, during which time he

9 See *op cit,* Maitland, fn 1, Lecture 2; and *op cit,* Meagher, Gummow and Lehane, fn 7, pp 6–7.

10 (1615) 1 Ch Rep 1; (1615) 21 ER 485.

11 See *op cit,* Ashburner, fn 6, pp 10–13.

12 See the list of equitable principles which emerged during this period in *op cit,* Holdsworth, fn 2, Vol 1, p 466. See, also, Kerly, DM, *An Historical Sketch of the Equitable Jurisdiction of the Court of Chancery,* 1890, esp pp 159–60.

developed the foundation introduced by Lord Nottingham. A clear spirit of equity began to develop. Not only did equity emerge as a significant body of law, it also established a more identifiable methodology. Together, Lords Nottingham and Hardwicke transformed equity into a formalised body of law, structured and legalised but still retaining its essential discretionary, corrective character.[13] Under the stern guidance of these two Chancellors, equity became a more identifiable source of law.

As Lord Hardwicke himself wrote:

> The equitable jurisdiction exercised by the Chancellor took its rise from his being the proper officer to whom all applications were made for writs to ground actions at common law and from many cases being brought before him, in which that law would not afford a remedy, and thereby being induced, through necessity or compassion, to extend a discretionary one ... and in the administration of such discretion ... there ought to be some general rules.[14]

2.3 The period of systemisation (c17–19)

The third historical period of equity traces the evolution of the Court of Chancery down to the introduction of the Judicature Acts in 1873. This period includes decisions made by a series of great Chancellors: Lord Nottingham (1673–82); Lord Hardwicke (1736–56); and Lord Eldon (1801–06). It was during this period that equity began more definitely to lose its arbitrary and capricious approach (the *arbitrium boni viri*) that had so clearly characterised its early operation and become a more positive, systemised body of law.

Some of the primary developments that emerged during this period included the creation of the 'use' (the modern equivalent being the trust) – the emergence of an organised body of principles dealing with the implementation of the use and the introduction of the modern rule against perpetuities.

It was during this time that equity first represented a real challenge to the common law, and the possibility of a conflict between legal and equitable principles became more realistic. The emergence of equity as an independent, systemised body of law meant that for the first time it could actually challenge the operation of common law.

Nevertheless, despite the fears expressed by many common law judges, it was very unlikely that equity would ever threaten the operation of the common law; the whole purpose of equity was to work with the common law in order to achieve a more universalised justice. Equity was dependent upon

13 Written in a letter by the Earl of Hardwicke to Henry Home, Lord Kames, 30 June 1759, and taken from Yorke, PC, *The Life and Correspondence of Earl of Hardwicke: Lord High Chancellor of Great Britain*, 1982, Vol 2, p 553.

14 *Op cit*, Maitland, fn 1, Lecture 2, p 19.

common law and was not set up to overwhelm it. As Maitland notes, equity was never self-sufficient; at every point it 'presupposed the existence of the common law'.[15]

If the common law was abolished or destroyed, equity could no longer operate as a correction of the existing law; it would have no foundation. Considered in this light, the possibility of a conflict was improbable. This did not prevent the development of widespread fear and uncertainty about the exact character of the relationship between common law and equity.[16] This was one of the primary incentives for the introduction of the Judicature system in 1873.

15 See, eg, the comments by Hale J in *Roscarrick v Barton* (1672) 1 Ch Cas 217, p 219 (referred to in *op cit*, Ashburner, fn 6, p 12): 'By the growth of equity on equity, the heart of the common law is eaten out.'

16 This statute was issued in 1285. See the excellent discussion on this period in *op cit*, Holdsworth, fn 3.

THE RELATIONSHIP BETWEEN COMMON LAW AND EQUITY

In this chapter, we examine the jurisdictional relationship between common law and the body of principles referred to as equity. This requires a consideration of the essential purpose of equity and its true functioning under the Judicature system. It is important to understand properly the jurisdictional dynamic operating between the common law and the equitable jurisdiction. Equitable principles exist in a number of different areas where the common law operates either inadequately, or not at all. The objective of the equitable jurisdiction has always been to embellish the existing law; this has often meant that equity has had to create principles not formally recognised by the common law or develop remedies to deal with particular common law inadequacies. The relationship between law and equity was intended to be one of mutuality but, as we shall see, this has not always been the case. The introduction of the Judicature system was intended to formalise an administrative union between the two bodies of law. Unfortunately, its application has tended to obscure the true character of the legal/equitable alliance. In modern times, references to jurisdictional interaction, fusion and fusion fallacy have produced a great deal of uncertainty about the actual objectives of the Judicature system and the current status of the relationship between common law and equity.

3.1 The exclusive jurisdiction

In many cases, a claim by a plaintiff (prior to the introduction of the Judicature Act) would only be enforceable in a Court of Chancery. In such cases, when the Court of Chancery granted relief, it was said to be exercising its exclusive jurisdiction. The jurisdiction was exclusive because only Chancery recognised it; the common law did not provide relief for such rights. Examples of the exclusive jurisdiction of equity include the trust jurisdiction and the principles relating to fiduciary relationships generally.

When equity is acting in its exclusive capacity, it is only capable of administering equitable relief; common law relief is inappropriate because the action is exclusively recognised by equity.

Example

If A acts as a fiduciary for B and A breaches that duty, B will be able to bring an action for breach of fiduciary duty in the exclusive jurisdiction of equity. If a breach can be established, B will be entitled to claim equitable relief against A,

which may include: equitable compensation; an account of profits; or the imposition of a constructive trust over property in the possession of the breaching fiduciary. Common law damages would not be available for such an action because common law does not recognise breach of fiduciary obligation as a valid principle, and damages are a legal remedy not generally recognised by the equitable jurisdiction [see, further, below, Chapter 22].

3.2 The concurrent jurisdiction

In some situations, a single set of facts will give rise to both legal and equitable actions. When equity provides the same sort of relief as would have been issued at law, equity is said to be exercising its 'concurrent jurisdiction'. In all concurrent jurisdiction situations, equity is required to determine the validity of the legal claim. In earlier times, this often required an applicant to attend two courts: a court of law for a legal declaration concerning the breach of contract; and an equitable court for the issuing of an equitable remedy. Now, as we shall see, under the Judicature system one court is capable of determining both the legal issues and the equitable rights. The concurrent jurisdiction will arise in any situation where a claim for equitable relief is established and it is proven that the legal relief available is inadequate.

The most common example of equity exercising concurrent jurisdiction occurs where the person holding the legal right has either lost the right to enforce it, or feels that the relief available in law is inadequate for the particular circumstances. A good example of this latter situation arises where a plaintiff seeks specific performance for a breach of contract in equity rather than damages under common law. Another situation may occur where a person seeks rescission of a contract in equity rather than common law.

Example

A enters into a contract with B to purchase a house. A is unable to settle on the settlement date because she cannot obtain the requisite finance. B is told by his lawyer that he has a choice: he can rescind the contract and seek damages for the breach at law; or claim specific performance for the contract in equity. The choice lies with B. If B decides to seek specific performance, equity must determine whether such relief should be awarded. In making this determination, a court of equity must consider whether a legal right exists and whether damages at law are adequate. In earlier times, this would have required B to prove his legal interest in a court of law before seeking equitable relief in a court of Chancery. Today, under the Judicature system, one court can determine both matters.

3.3 The auxiliary jurisdiction

Where the equitable jurisdiction did not have concurrent jurisdiction over a legal right, it could only grant aid in the enforcement of that right; it was unable to provide any actual relief. Where equity aided the enforcement of a

legal right, it was said to be acting in its auxiliary jurisdiction. In cases under the auxiliary jurisdiction, the Court of Chancery did not itself adjudicate upon the validity of the plaintiff's claim; the adjudication was made by the courts of common law, but the assistance of the Court of Chancery was required either before the adjudication, to keep matters in status quo until the rights of the parties could be determined at common law, or after the adjudication in order to confer a more complete remedy to the party who had already obtained common law relief. The jurisdiction in equity was auxiliary to the jurisdiction at common law, because the actual common law adjudication was binding upon equity.

Examples of the operation of the auxiliary jurisdiction include the old common injunction and the doctrine of discovery in equity. The common injunction was an equitable injunction, which was issued to restrain a judgment being obtained in law by a plaintiff when equitable defences were available to the defendant. The jurisdiction to grant the common injunction existed in equity due to the fact that common law refused to recognise equitable rights, titles and defences. A defendant had to plead an equitable defence in the Court of Chancery and, in the process of so doing, have the legal action restrained. In such a situation, the common injunction was issued in the auxiliary jurisdiction of equity. The common injunction has now been abolished by the Judicature Act (see below, 3.5.3).

The doctrine of a discovery is a procedural doctrine whereby the parties to an action disclose to each other all documents in their possession, custody or power which relate to the matter at hand. Like the common injunction, the doctrine of discovery was used to assist the determination of legal rights and had to be applied for in a court of equity. The introduction of a merged administration as well as detailed statutory provisions dealing with the application and operation of discovery has greatly reduced the need for the auxiliary functioning of equity in these areas.

3.4 The Judicature system

3.4.1 Lord Cairns' Act damages and injunctive relief

Just prior to the large scale procedural amendments introduced by the Judicature Act, a small number of statutory developments were enacted in order to assist relations between the courts of equity and the common law. First, the Court of Chancery was given the power to award damages (in addition to, or in substitution for, specific performance or injunctive relief). This power was granted pursuant to s 2 of the Chancery Amendment Act 1858 (commonly referred to as Lord Cairns' Act).

Secondly, ss 79 and 82 of the Common Law Procedure Act 1854, ss 79 and 82, conferred a statutory power upon the courts of law to grant injunctive relief in circumstances where such power had not previously existed. These

two enactments assisted relations between the two jurisdictions substantially, conferring a limited statutory right upon equity to grant damages, and upon the common law to grant injunctive relief, reducing the prospect of an applicant having to apply to two separate courts for relief.

3.4.2 Problems with separate courts

Eventually, however, it was felt that a complete administrative overhaul of both systems was necessary, and discussions concerning the introduction of the Judicature system were initiated. The primary purpose underlying the implementation of the Judicature system was administrative efficiency. There were many practical difficulties associated with the administration of two separate courts, and it was felt that these might be ironed out within a system of merged administration.

Before the Judicature system was introduced, the common law courts were generally unable and unwilling to administer any part of the equitable jurisdiction.[1] This effectively meant that each court professed an understanding of principles and remedies within their own jurisdiction, but refused to examine, apply or administer principles existing in separate jurisdictions.

Inevitably, the segregation between two systems of law produced substantial difficulties (particularly as equity was dependant upon the common law). A common law judge faced with an equitable matter would simply refer the matter to the Court of Chancery rather than confront the equitable principle; it was as if equity did not actually exist for the common law. As *Ashburner's Principles of Equity* notes, 'The courts of law, in the exercise of their jurisdiction, ignored not only the doctrines, but also the very existence of the Court of Chancery'.[2]

A further difficulty was that there was always a danger that an applicant with an equitable matter would mistakenly commence an action in a court exercising common law jurisdiction and have the matter dismissed altogether. The Court of Chancery disclaimed all authority to sit as a court of appeal from the courts of common law, or to exercise any power over their judgments. In order to achieve a final result, in many cases it was necessary for the applicant to bring two separate actions. This process was costly and time-consuming. The connection between principle and remedy became disjointed and unduly technical. Inevitably, these difficulties engendered a great deal of criticism and demands for change.

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1 Whilst the Court of Exchequer did have an equity jurisdiction, in 1841 this ancient jurisdiction was transferred to Chancery, thereby increasing even further the exclusivity of equity. Kerly, DM, *History of Equity*, 1890, p 277.

2 Browne, D (ed), *Ashburner's Principles of Equity*, 2nd edn, 1983, p 11.

3.4.3 The New York reforms

The prospect of creating a single court, with jurisdiction to administer both legal and equitable principles, became increasingly attractive. The proposal was not, however, a novel one. The idea emanated from the process which had been introduced in New York in 1848 whereby law and equity were united in a single court with the same system of procedure. The New York system, like the English system which was eventually introduced, did not advocate the introduction of a doctrinal merger or fusion between actual legal and equitable principles, but rather the introduction of a single court of law and equity. Like the New York code of 1848, the English Judicature Act of 1873 was intended to be primarily procedural in effect. The New York code differed in one major aspect from the English Judicature system; it attempted to maintain the old distinctive methods of trial and remedies within a blended jurisdiction.

The English system did not follow this precedent. Although the reforms introduced by the 1873 Judicature Act drew inspiration from the New York code, the actual legislation was different in form and practice; it ensured that every division of the newly merged jurisdiction administered a single method of procedure, and that every division had the power to administer all the remedies that might be available to a party either in law or in equity. All of the old 'separate' forms of procedure were effectively abolished. A 'statement of claim' was substituted for the 'declaration and bill' in equity, a 'defence' for a plea and answer and a 'reply' for the replication.

3.5 A merged administration

The English Judicature Act of 1873 abolished the old courts so that a High Court of Justice with a Court of Appeal replaced Chancery, Common Pleas, Queen's Bench and Exchequer Courts. This High Court of Justice was divided into five divisions (one court with five separate sections): Chancery, Queen's Bench, Common Pleas, Exchequer and Probate, Divorce, and Admiralty. The divisions of the new court were utterly different from the old independent courts. Business was divided between the courts and every judge of each division was bound to administer whatever rules of law (meaning common law or equity) were applicable in the circumstances. It was no longer possible for a division to refuse a matter because it was legal or equitable in nature; each division had jurisdiction over both areas expressly conferred upon it.

3.5.1 Concurrent administration

Section 24 of the English Judicature Act was the primary provision conferring concurrent legal and equitable jurisdiction upon every division of the new court.

In Australia, the equivalent Acts and concurrency provisions of the English Judicature system are as follows: s 29 of the Supreme Court Act 1986 (Vic);

ss 10 and 11 of the Supreme Court Civil Procedure Act 1932 (Tas); ss 4 and 5 of the Judicature Act 1876 (Qld); ss 24 and 25 of the Supreme Court Act 1935 (WA); ss 17 and 18 of the Supreme Court Act 1935 (SA); ss 25–32 of the Supreme Court Act 1933 (ACT); ss 61–70 of the Supreme Court Act 1979 (NT); ss 57–64 of the Supreme Court Act 1970 (NSW); and the Law Reform (Law and Equity) Act 1972 (NSW).

It is significant to note that in NSW the Judicature system was not introduced until a much later date. From about 1823 until 1972, equity was administered as a body of law distinct from the common law. Supreme Court judges sitting at law had no jurisdiction in equity and *vice versa*. This was not a consequence of two separate courts, but rather two separate sets of procedures. This was eventually abolished with the introduction of the Law Reform (Law and Equity) Act (NSW) in 1972.

3.5.2 Conflict or variance

Naturally enough, it was apparent to the drafters of the system that possible conflicts between law and equity would emerge in a situation where one court was empowered to administer both jurisdictions. The drafters of the Judicature Act foresaw this possibility and attempted to deal with these problems in a number of separate provisions, which are discussed below.

Section 25(11) of the English Judicature Act sets out that, where 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 will prevail.[3]

This provision confers superiority upon equitable principles where any conflict or variance between equity and common law arises. The intended effect of this provision has caused some controversy; it has often been interpreted to suggest that either a conflict exists when it does not, or that legal and equitable doctrines coming under this provision have been doctrinally merged and any remedy can be applied. Both interpretations are inaccurate and unsupported by the express terms of the provision.

In practice the section is rarely used because it is difficult to establish an actual conflict between law and equity. By reading equity and law as consistent bodies of law, there is little room for any assessment of 'conflict or variance'; in this regard, it would seem that the provision has very little scope. A conflict or variance could only occur in those unusual situations where it is possible to choose only one principle whose operation is contrary to other legal principles. This could only arise where two principles cover exactly the

3 Australian Capital Territory Supreme Court Act 1933 (ACT), s 25; Law Reform (Law and Equity) Act 1972 (NSW), s 5; Supreme Court Act 1979 (NT), s 68; Judicature Act 1876 (Qld), s 5(11); Supreme Court Act 1935 (SA), s 28; Supreme Court Civil Procedure Act 1932 (Tas), s 11(10); Supreme Court Act 1986 (Vic), s 29(1); Supreme Court Act 1935 (WA), s 25(12).

same area and it would be impossible to apply both. Very few areas of law would fit into this category.

As noted by Maitland:

> We ought not to think of common law and equity as of two rival systems. Equity was not a self-sufficient system, at every point it presupposed the existence of common law …

In considering the application of the conflict provision he further noted that the relation between common law and equity:

> … was not one of conflict. Equity had come not to destroy the law but to fulfil it. Every jot and every title of the law was to be obeyed, but when all this had been done something might yet be needful, something that equity would require.[4]

Unfortunately, a number of judges have utilised the conflict provision as a foundation for inaccurate assumptions about the continuing jurisdictional relationship between common law and equity, since the introduction of the Judicature system (see 3.7). It is very clear that the drafters of the Judicature Act did not intend, by the express terms of the Act, to do anything more than introduce a procedural merger between law and equity. There was no intention to alter or blend existing legal and equitable principles. The argument that the conflict provision in some way effected a merger or 'fusion' between law and equity is, undoubtedly, a 'fusion fallacy'.[5]

3.5.3 Abolition of the common injunction

The introduction of a merged administration effectively rendered the common injunction unnecessary. The abolition of the common injunction was inevitable with the introduction of a merged system. There was no longer a need for such an injunction in a system which provided for access to both legal and equitable principles in the same jurisdiction. Consequently, s 24(5) of the Judicature Act abolishes the common injunction. The common injunction was replaced by a new jurisdiction giving the court power to grant an injunction in all cases where it was felt to be 'just or convenient'; injunctive relief issued under this provision was capable of being issued upon such terms and conditions as the court thought fit. Section 25(8) of the Judicature Act introduced the new 'just and convenient' injunction.[6]

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4 Maitland, FW, *The Origins of Equity*, 1908, pp 11–12.

5 See Meagher, RP, Gummow, WMC and Lehane, JRF, *Equity Doctrines and Remedies*, 3rd edn, 1992, Chapter 2. The concept of a fusion fallacy is explored in more detail below, 3.7.

6 The equivalent Australian provisions are: Supreme Court Act (1933) (ACT), s 26; Supreme Court Act (NSW) (1970), s 66; Supreme Court Act (1979) (NT), s 69; Judicature Act (1876) (Qld), s 5(8); Supreme Court Act (1935) (SA), s 29; Supreme Court Civil Procedure Act (1932) (Tas), s 11(12); Supreme Court Act (1986) (Vic), s 37; Supreme Court Act (1935) (WA), s 25(9).

The provision to grant injunctive relief whenever 'just or convenient' is far more broad ranging than its predecessor. Being statutory in nature, the new injunction is not classified as legal or equitable in nature and is, apparently, available whenever the courts deem it necessary.[7]

3.6 Overview of the Judicature system

An overview of the provisions of the English Judicature system (with the Australian statutory equivalents) is set out below:

- *The Act introduced a new court which had both a legal and an equitable jurisdiction:* The old Court of Chancery was abolished and one Supreme Court with two divisions was established. This effectively meant that an action with legal and equitable components no longer had to be brought in two separate courts; it could be completely dealt with in the one jurisdiction.
- *The Act introduced a single, consistent method of procedure:* The Judicature system ensured that every division of the new merged jurisdiction administered a single method of procedure. All old forms of procedure were abolished. A 'statement of claim' replaced the declaration and bill in equity; a 'defence' for a plea and answer and a 'reply' for the replication.
- *The Act introduced concurrent jurisdiction over law and equity in all divisions:* s 24 of the Judicature Act (1873) (Eng) (now set out in s 49 of the Supreme Court Act (1981) (Eng)); s 29 of the Supreme Court Act 1986 (Vic); Supreme Court Act 1933 (ACT); Supreme Court Act 1979 (NT); ss 10 and 11 of the Supreme Court Civil Procedure Act 1932 (Tas); ss 4 and 5 of the Judicature Act 1876 (Qld); ss 24 and 25 of the Supreme Court Act 1935 (WA); ss 17 and 18 of the Supreme Court Act 1935 (SA) and ss 57–64 of the Supreme Court Act (NSW) 1970 and the Law Reform (Law and Equity) Act 1972 (NSW).
- *The Act set out that equity would prevail over the common law whenever there was a conflict:* s 25(11) of the Judicature Act (Eng) (now set out in s 49 of the Supreme Court Act (1981) (Eng)). The equivalent Australian provisions are as follows: s 25 of the ACT Supreme Court Act (1933); s 5 of the Law Reform (Law and Equity) Act (1972) (NSW); s 68 of the Supreme Court Act (1979) (NT); s 5(11) of the Judicature Act (1876) (Qld); s 28 of the Supreme Court Act (1935) (SA); s 11(10) of the Supreme Court Civil Procedure Act (1932) (Tas); s 29(1) of the Supreme Court Act (1986) (Vic) ; s 25(12) of the Supreme Court Act (1935) (WA).
- *The Act abolished the common injunction and replaced it with a new jurisdiction giving the court the right to grant an injunction in all cases where the court felt it to be 'just and convenient':* As noted above, the common injunction was necessary where two separate courts existed so that equity could prevent the common law from overwhelming its jurisdiction. It became redundant

7 Injunctive relief is discussed in more detail below, Chapter 20.

in a merged system administering law and equity concurrently. The common injunction was abolished by s 24(5) of the Judicature Act (Eng) (1873) and replaced by the new jurisdiction in s 25(8) of that Act. The modern form can be found in: s 37(1) of the Supreme Court Act (1981) (Eng); s 26 of the Supreme Court Act (1933) (ACT) (Cth); s 66 of the Supreme Court Act (NSW) (1970); s 69 of the Supreme Court Act (1979) (NT); s 5(8) of the Judicature Act (1876) (Qld); s 29 of the Supreme Court Act (1935) (SA); s 11(2) of the Supreme Court Civil Procedure Act (1932) (Tas); s 37 of the Supreme Court Act (1986) (Vic); s 25(9) of the Supreme Court Act (1935) (WA).

Further reading: Perkins, W, 'The English Judicature system' 12 Michigan L Rev 277 (on reserve); *Hansard*, 3rd series, vol 216, especially p 1601.

3.7 Fusion fallacies

There are a number of decisions which have incorrectly interpreted the effect of the Judicature system as substantive rather than procedural in effect. These decisions claim that, in some way, the express provisions of the Acts intended that not only the procedure of administering law and equity be merged, but also the actual doctrines. This merger is often described as a 'fusion' between legal and equitable principles. Decisions in this category usually define the fusion in very broad terms and rarely explain how it has occurred or what express terms in the Judicature system justify it. We have already referred to such decisions as 'fusion fallacies' above. We now consider some of the cases responsible for such inconsistent interpretations of the Judicature Acts.

The first, and best known, case in point is *Walsh v Lonsdale* (1882). In this case, Lonsdale owned a mill and he agreed in writing (but not by deed) to grant a seven year lease of the mill to Walsh at a rent expressed to be payable 'quarterly in arrears'. The lease included a further covenant stating that a year's rent was payable in advance if Lonsdale so demanded. Walsh entered into possession of the mill and paid his rent quarterly in arrears. Subsequently, Lonsdale proceeded to demand a year's rent in advance. Walsh refused to pay and so Lonsdale levied for distress at law.[8] Walsh claimed an injunction against the distress and damages for illegal distress. The issue was whether or not the legal remedy of distress would be available to Lonsdale in light of the fact that the lease was not in the form of a deed and, therefore, not a legal interest according to s 3 of the Real Property Act (Vic) 1845. It was conceded that the agreement was such that a decree of specific performance would have been granted to enforce it.

The Court of Appeal held that the situation was to be assessed 'as if' all of the steps had been taken to make the deed legally enforceable. Jessel MR

8 Distress is an old common law remedy which allowed a landlord to seize chattels owned by a lessee, to hold them until the rent was paid and ultimately to sell them if the rent was not forthcoming.

stated that, since the introduction of the Judicature system, a tenant holding under an agreement for lease of which specific performance would be decreed, stands in the same position as to liability as if the lease had been legally executed.

He felt that, since the Judicature Act, legal and equitable estates were merged:

> There are not two estates as there were formerly, one estate at common law ... and an estate in equity under the agreement. There is only one court and the equity rules prevail in it.[9]

The outcome meant that the common law remedy of distress was available to enforce on equitable leasehold interest because the lease was to be treated as if it was legal in character. Taken literally, however, the judgment of Jessel MR would completely obliterate all distinctions between law and equity and justify this destruction on the ground that the 'conflict' provision in the Judicature Act intended such a result. There is nothing, however, in the express wording of the conflict provision which would justify such a result.[10]

If the opinion of Jessel MR is considered in more practical terms, the decision in *Walsh v Lonsdale* can be interpreted as an attempt to equalise the enforcement of legal and equitable interests rather than merge them completely. Jessel MR uses the conflict provision as the basis for a further assessment of legal and equitable interests post-Judicature Act. Whilst it is clearly a fallacy to claim that legal and equitable interests were intended to be fused through the operation of the conflict provision, it is perfectly acceptable to reassess the continuing relationship between the two interests with reference to the existing provisions of the Judicature system.

There are many further instances where the conflict provision has been used to justify a fusion fallacy. In *Redgrave v Hurd* (1881), Jessel MR again concludes that the conflict provision obliterated the distinction between law and equity. In considering the differences between rescission of a contract at law and in equity, he held that these differences 'have now disappeared by the operation of the Judicature Act which makes the rules of equity prevail',[11] and consequently felt that an award of damages would be available for an innocent representation, traditionally only recognised and enforced in equity.

In *Seager v Copydex* (1967), Lord Denning came to a similar conclusion in holding that damages were available for a breach of confidence action which was exclusively enforceable in the equitable jurisdiction. No clear justification was given for this award, and no express reference to the provisions of the Judicature Act were made, although subsequent interpretations have often

9 *Walsh v Lonsdale* (1882) 21 Ch D 9, p 14.

10 The judgment was expressly disapproved in the later case of *Manchester Brewery v Coombs* [1901] 2 Ch 608.

11 *Walsh v Lonsdale* (1882) 21 Ch D 9, p 12.

alluded to it. There are a number of possible ways in which to interpret such a decision:

- the award of damages was actually intended to be an award of equitable compensation rather than legal damages, although this conclusion is unlikely on the facts (see below, 22.1);
- the award was based upon the provisions of Lord Cairns' Act, which gives equity a limited jurisdiction to award damages in addition to, or in substitution for, specific performance or injunctive relief. It should be noted, of course, that there was no reference to applicability of this legislation within the course of the judgment (see below, 22.2.);
- the award was granted for the same reasons given by Jessel MR in *Walsh v Lonsdale* and *Redgrave v Hurd*, that is, that the conflict provision in the Judicature Act resulted in a merger between common law and equity with equity prevailing;
- the award was granted because Lord Denning MR felt that the time had come to grant the most appropriate remedy applicable to the circumstances, irrespective of the character of the action. This development has nothing to do with the provisions of the Judicature Act but is a consequence of the changing nature of the relationship between common law and equity within the Judicature system. This reasoning assumes a radical change in jurisdictional relations between law and equity and should not be readily inferred.[12]

The alternatives suggested above provide a basic outline for the rationalisation of many 'fusion fallacy' decisions. It is important to remember that not all references to fusion are erroneous. Inevitably, many years of operating under a merged system of administration will bring common law and equity closer together. Decisions which confirm this assimilation and interaction are valid and justifiable. It is only those decisions which make radical changes to the status quo and attempt to justify them under the terms of the Judicature Act which can properly be labelled fallacious. Fusion, or the increasing association between common law and equitable doctrines, is not of itself erroneous.

3.8 Legitimate fusion developments

The fusion introduced by the Judicature system was purely administrative in nature, as it was only intended to merge the courts and court procedure rather than the substantive principles existing within common law and equity. Nevertheless, this does not prevent the conclusion that, within such a

12 See, generally, Tilbury, MJ, *Civil Remedies: Volume One, Principles of Civil Remedies*, 1990, paras 1014–20.

framework, a greater conceptual interaction is likely to occur, encouraging an increased interaction or communication between existing principles, whatever their jurisdictional origin.[13]

Discussions concerning the emergence of doctrinal and remedial interaction between common law and equitable principles have varied in strength and character. Lord Simon of Glaisdale, in *United Scientific Holdings Ltd v Burnley Borough Council* (1978), noted 'how revolutionary was the change made by the Supreme Court of the Judicature Act 1873 and how truly it brought about a fusion of law and equity'. Ashburner noted that the effect of the Judicature Act meant that a person could pursue both legal and equitable remedies in one proceeding, but that the two streams of jurisdiction, 'though they run in the same channel, run side by side and do not mingle their waters'.[14] The response of Lord Diplock to this, in *United Scientific Holdings,* was: 'If Professor Ashburner's fluvial metaphor is to be retained at all, the waters of the confluent streams of law and equity have surely mingled now.'[15] Similarly, in *Aquaculture Corp v NZ Green Mussel Co Ltd* (1990), the New Zealand High Court came to the conclusion that 'for all purposes now material, equity and common law are mingled or merged'.[16]

Such comments tend to be characterised by extremes; either fusion is absolute, or it is nothing at all. However, the modern relationship between common law and equity defies such absolutism. Whilst both jurisdictions are displaying an increasing interest in each other, encouraged by the fact that both are administered in the same court by the same procedures, this interest refers more to the desire for guidance and analogy rather than any categorical doctrinal fusion. Courts are beginning to consider how the two jurisdictions can be rationally co-ordinated rather than indiscriminately merged.

Sir Anthony Mason has noted this increasing 'convergence' between common law and equitable principles, and states:

> Equity and common law are converging and will continue to converge, so that the differences in origin of particular principles should become of decreasing importance ... The recent decade might be regarded as a period of legal transition in which we have been moving from an era of strict law to one which gives greater emphasis to equity and natural law. As Roscoe Pound

13 See, generally, Mason, A (Sir), 'The place of equity and equitable remedies in the contemporary common law world' (1994) 110 LQR 238; and Maxton, JK, 'Intermingling of common law and equity', in Cope, M (ed), *Equity: Issues and Trends,* 1995.

14 Browne, D (ed), *Ashburner's Principles of Equity,* 2nd edn, 1933.

15 *United Scientific Holdings Ltd v Burnley Borough Council* [1978] AC 908, p 924. See, also, p 937 (Viscount Dilhone), pp 944–45 (Lord Simon of Glaisdale), p 949 (Lord Salmon) and p 957 (Lord Fraser of Tullybelton).

16 *Aquaculture Corp v NZ Green Mussel Co Ltd* [1990] 3 NZLR 299, p 301.

> said, the endeavour to make morals and law coincide will be an important future goal.[17]

Unfortunately, the decisions in this area have not clearly identified the legitimacy of this process, preferring, instead, to make vague comments about the so called 'fusion' between common law and equity. One of the most interesting decisions in this regard was that of the New Zealand High Court, in *Aquaculture Corp v NZ Green Mussel Co Ltd* (1990). The case involved a breach of confidence and a subsequent misuse of the confidential information supplied by Aquaculture Corp to a director of the NZ Green Mussel Co Ltd. The trial judge, Pritchard J, found the defendants liable to Aquaculture for a breach of confidence and concluded that, whilst he had no power to award compensatory damages, exemplary damages could be awarded. Aquaculture appealed to the High Court in order to obtain the award of $1.5 million compensatory damages that had been assessed.

The High Court held that compensatory damages were available and that the $1.5 million could be awarded, in substitution for the award at first instance of $100,000 exemplary damages. During the course of the judgment the court concluded that, as equity and law were now merged, a full range of remedies should be available as appropriate, no matter whether they originated in common law, equity or statute.

The following comments were made by the court:

> For all purposes now material, equity and common law are mingled or merged. The practicality of the matter is that in the circumstances of the dealings between the parties the law imposes a duty of confidence. For its breach, a full range of remedies should be available as appropriate, no matter whether they originated in common law, equity or statute.[18]

In a subsequent New Zealand decision, *New Zealand Land Development Co Ltd v Porter* (1991), it was held by Tipping J that there was no longer any value, apart from historical purposes, in seeking to distinguish, or to keep conceptually separate, common law damages and damages in equity, whether under Lord Cairns' Act or otherwise. It was held that the court should 'award such damages as are a proper and fair reflection of what the plaintiff has lost by reason of the failure of the defendant to perform the contract'. Tipping J does not refer to any broad 'fusion' between law and equity generally but considers instead the need to merge legal and equitable damages based upon their similarity.[19]

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17 *Op cit*, Mason, fn 13, pp 258–59. Quote refers to Pound, R, 'The philosophy of law in the nineteenth century', in *The Spirit of the Common Law,* 1921, pp 141–42. See, also, Mason, A, 'The impact of equitable doctrine on the law of contract' (1998) 27 Anglo-Am L Rev 1, p 1, where he notes that common law and equity are 'converging into what will become one coherent body of concepts and principles'.

18 *Aquaculture Corp v NZ Green Mussel Co Ltd* [1990] 3 NZLR 299, p 301.

19 See, generally, Michalik, P, 'The availability of compensatory and exemplary damages in equity: a note on the *Aquaculture* decision' (1991) 21 Victoria University Wellington L Rev 391; Aitken, L, 'Developments in equitable compensation: opportunity or danger?' (1993) 67 ALJ 596.

Fusion developments have also made a very prominent appearance in the doctrine of estoppel. Increasingly, the High Court has shown a preparedness to merge legal and equitable estoppel doctrines rather than perpetuate an archaic and unnecessary distinction between the two.[20] In this area, in particular, it is possible that doctrinal integration is necessary because of the clear overlaps and inconsistencies. The main difficulty has been that the courts have adopted different approaches to the nature, scope and remedial consequences of such a merger. (See the discussion in Chapter 15.)

Another area are of interest lies in the interaction between tortious and fiduciary standards. In *Day v Mead* (1987), the tortious defence of contributory negligence was applied to reduce an award of equitable compensation for a breach of fiduciary duty. Traditionally, compensation in equity could not be mitigated by legal defences.

The 'spirit' of the decision in *Day v Mead* was approved by the New Zealand Court of Appeal in *Mouat v Clark Boyce* (1992). In that case, it was held that a defendant solicitor owed both common law and equitable obligations to his client, Mrs Mouat. Mrs Mouat had sought the advice of the solicitor with regard to a mortgage she was about to enter into with her son. The solicitor acted in the matter for both Mrs Mouat and her son, but did not seek information on the financial state of either of them and did not discuss the matter with the widow in the absence of her son. The son ended up defaulting and Mrs Mouat was called upon to pay the moneys secured by the mortgage. Mrs Mouat sued the solicitor, and the Court of Appeal held that the solicitor owed legal and equitable duties, and the defence of contributory negligence was available to apportion the relief granted.

Sir Robin Cooke P (quoting McLachlin J from *Canson Enterprises Ltd v Boughton* which is discussed below), held:

> Whether the courts refine the equitable tools such as the remedy of compensation, or follow the common law on its own terms, seems not particularly important where the same policy objective is sought.

The decision of *Day v Mead* was endorsed by the important Canadian decision, *Canson Enterprises Ltd v Boughton,* which concerned a similar issue. In that case, the court was unanimous in its decision that there should be a rule in fiduciary law limiting the recovery of losses stemming from a breach of a fiduciary obligation according to their remoteness from the breach. A majority of the court developed the principle of remoteness for fiduciaries in equity according to the approach adopted by common law tortious principles.

La Forest J in the majority concluded that some cross-pollination between common law and equity was desirable. He felt that interaction between common law and equity:

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20 See, especially, *Waltons Stores (Interstate) Ltd v Maher* (1988); *Foran v Wight* (1989); and *Commonwealth v Verwayen* (1990). These decisions are discussed below, Pt II, under estoppel.

> ... allows for direct application of the experience and best features of both law and equity, whether the mode of redress originates in one system or the other.[21]

The minority in *Canson* did not worry about explaining jurisdictional interaction because they ultimately rejected it. They feared that any interaction with the common law would 'overwhelm' the approach of equity. Hence, the minority preferred to develop remoteness principles, from the law of trusts rather than the common law of torts. The concern of McLachlin J in the minority (with whom Lamer CJ and L'Heureux-Dube J agreed) was that to adopt a common law approach to equity,[22] even by way of analogy, 'overlooks the unique foundation and goals of equity'. McLachlin makes the following comments on the interaction between tort and equitable compensation:

> Rather than begin from tort and proceed by changing the tort model to meet the constraints of trust, I prefer to start from trust, using the tort analogy to the extent shared concerns may make it helpful. This said, I readily concede that we may take wisdom where we find it, and accept such insights offered by the law of tort, in particular deceit, as may prove useful. My first concern with proceeding by analogy with tort is that it overlooks the unique foundation and goals of equity. The basis of the fiduciary obligation and the rationale for equitable compensation are distinct from the tort of negligence and contract. In negligence and contract the parties are taken to be independent and equal actors, concerned primarily with their own self-interest. Consequently the law seeks a balance between enforcing obligations by awarding compensation and preserving optimum freedom for those involved in the relationship in question, communal or otherwise. The essence of a fiduciary relationship, by contrast, is that one party pledges herself to act in the best interest of the other. The fiduciary relationship has trust, not self-interest, at its core, and when breach occurs, the balance favours the person wronged. The freedom of the fiduciary is diminished by the nature of the obligation he or she has undertaken – an obligation which 'betokens loyalty, good faith and avoidance of a conflict of duty and self-interest'.[23]

This concern is not without merit. The difficulty associated with any interactive process between common law and equity is that it may overwhelm the fundamental nature of each jurisdiction. This is a particular problem in the relationship between tort and fiduciary.

As noted by JD Heydon:[24]

> It is one thing to mould the tort of negligence by analogy with an equitable rule, or even to contend that the common law rule is the same as the equitable rule independently of any process of latter-day moulding. It is another to contend that once the tort of negligence has been moulded into its new form,

21 *Canson Enterprises*, p 135.

22 *Ibid*, p 143.

23 Lord Browne-Wilkinson in the House of Lords decision of *Target Holdings Ltd v Redferns* (1995) recently approved the minority decision of McLachlin J in *Canson Enterprises*.

24 'The negligent fiduciary' [1995] 3 LQR 1, p 3.

> or discovered as having the same form as the equitable rule, the equitable rule thereby becomes somehow annihilated.

The problem has been further highlighted by the Australian High Court decision of *Breen v Williams* (1996). In that case, during the course of considering whether or not to impose fiduciary obligations upon a doctor/patient relationship, the court examined the problem of superimposing equitable obligations upon pre-existing tortious and contractual obligations.

As noted by J Gummow (p 287):

> [The plaintiff] seeks to impose fiduciary obligations on a class of relationship which has not traditionally been recognised as fiduciary in nature and which would significantly alter the already existing complex of legal doctrines governing the doctor/patient relationship, particularly in the areas of contract and tort. As Sopinka J remarked in *Norberg v Wynrib* (1992), 'Fiduciary duties should not be superimposed on these common law duties simply to improve the nature or extent of the remedy'.

Interaction between common law and equitable principles is an ongoing process – inevitable within a merged administration. The real question today is not whether fusion will occur but, rather, how will it manifest itself? Peter Birks[25] suggests that the integration of law and equity should occur in a coherently structured, uniform manner, with a single remedial regime. Nowhere is the 'integration' of law and equity more obvious than in the assessment of damages. In *Hodgkinson v Simms* (1994), La Forest, L'Heureux-Dube and Gothier JJ, of the Canadian Supreme Court, noted:

> Where the common law has developed a measured and just principle in response to a particular kind of wrong, equity is flexible enough to borrow from the common law. This approach is in accordance with the fusion of law and equity. Courts should strive to treat similar wrongs similarly, regardless of the particular cause or causes of action that may have been pleaded.

The desire to apply a balanced, comparable judicial methodology to legal actions – whatever their jurisdictional background – lies at the heart of the fusion issue and is particularly relevant to the equity jurisdiction, founded as it is on equality and fairness.

One possible method of legitimising all of these developments is to change their method of reference. If we accept that legitimate jurisdictional interaction is currently occurring within a modern Judicature system it simply comes down to appropriately categorising the form of interaction and the methodology being adopted. For example, some types of interaction will potentially produce the need for a doctrinal fusion, others will enhance the character and consistency of separate legal and equitable principles, whilst still others may encourage a reassessment of the relationship between legal and equitable remedies. All of these forms of interaction are valid; they are neither endorsed nor prohibited by the Judicature system, but are rather an inevitable product of the environment it has created.

25 'Equity in the modern law: an exercise in taxonomy' (1996) 26 Western Australia UL Rev.

PART II

EQUITABLE PRINCIPLES

In the second part of the text we move on to consider the range of equitable principles which have evolved in the equitable jurisdiction. Substantive equitable principles include both proprietary and personal claims. Most principles have originated as a result of a perceived deficiency in the common law and have continued to develop and expand despite the fact that, in many cases, the common law deficiency is either irrelevant or redundant. For example, the evolution of the trust was largely a consequence of the stringency of common law rules relating to the devolution of estates and the enforceability of legal contingent remainders. Today, the trust in all of its forms represents one of the most significant and expansive institutions in the equitable jurisdiction.

Equitable principles dealing with the enforcement of personal obligations have also experienced a rapid growth. Transactional fairness is not the exclusive province of the equitable jurisdiction, however it is one area where equity has been in constant demand. The importance of protecting the vulnerable, the trusting and the weak against unscrupulous bargains has encouraged a diffuse range of equitable doctrine; equity will provide relief where it considers that it would be against the conscience of the court to refuse such relief. Fiduciary obligations and confidential relationships provide an equitable safeguard against the possibility of a breach of trust or confidence; the determination that a relationship is fiduciary in nature will not automatically result in equitable relief being granted; it must be proved that fiduciary duty or confidence has been breached. The basis of fiduciary duty is primarily negative in nature: the fiduciary must avoid a conflict of interest. Where a fiduciary makes a gain out of his or her position, equity may hold the fiduciary liable to account for the gain. In this sense, fiduciary obligations are a protective mechanism to encourage loyalty and help prevent fairness from arising. There is no equivalent form of protection under common law. The foundation of the fiduciary obligation has been recently summarised by Gaudron and McHugh JJ in *Breen v Williams* (1996):

> The law of fiduciary duty rests not so much on morality or conscience as on the acceptance of the implications of the biblical injunction that 'no man can serve two masters'. Duty and self-interest, like God and Mammon, make inconsistent calls on the faithful. Equity solves the problem in a practical way by insisting that fiduciaries give undivided loyalty to the persons whom they serve [p 285].

Other principles focus upon actual unfair practices during the process of transacting. Common law has always required full and free consent to a transaction before it is enforceable. In this respect, where one party to a contract entered under duress, the contract was unenforceable.

Traditionally, duress under common law only covered specific categories. This meant that many diverse forms of coercion including the more surreptitious such as emotional and relational influence, were not covered by duress. Equity alleviated this deficiency through the evolution of undue

influence. Today, the expansion of the categories covered by duress at law, and the evolution of the broad doctrine of unconscientious dealing in equity has rendered undue influence somewhat superfluous although it remains firmly entrenched in the equity psyche.

Unconscientious does not focus upon the quality of consent, but the rather, the quality of the stronger party in making the transaction. If it can be proven that one party has exploited a disadvantage or disability held by the other, equity may set aside the bargain. Once again, there is no equivalent common law principle. Unconscientious dealing has been criticised for its undefined scope. However, it has been instrumental in providing relief to deserving parties and is now emulated in a range of Commonwealth and State legislation dealing with consumer and corporate transactional protection.

Attention is also given to the principle of estoppel. Estoppel is a principle which exists in both equity and common law. Essentially, it protects against the unfairness resulting from a denial of the truth of a representation that one party has induced another to rely upon either within a transaction, or in the course of negotiating a transaction. The traditional limitation of the common law to specific forms of representations resulted in equity establishing a flourishing jurisdiction in promissory representations. The validity of maintaining two separate estoppel actions in law and equity, in light of the fineness of the distinction between the two, is currently under review although the methodology of a joinder has not yet been property articulated.

Finally, consideration is given to equitable principles which focus upon the substantive fairness of a transaction. In cases where a contractual breach results in the payment of an excessive monetary amount, over and above whatever damages would have been recoverable for such a breach, or the loss of a specific property interest, equity may either strike down the clause as a penalty or provide relief against forfeiture and enforce the strict terms of the contract. These principles are more controversial because there is no categorical unfairness, both parties have freely entered into the transaction which may even be at arms length. The problem lies with the enforcement of the legal right which forms a part of the transaction, not with the terms of the contract itself. Equity considers excessive recovery to be against public policy and therefore against the conscience of the court and unenforceable.

Part II of the text reveals the diversity of the equity jurisdiction. Its capacity to relieve against circumstances that might be generally described as unconscionable or specifically, as contrary to the conscience of the equity jurisdiction, has been carefully articulated. The development of increasingly flexible and capacious equitable doctrines dealing with the enforcement of transactional fairness has, undoubtedly, ensured the continuing significance of the equitable jurisdiction, despite its increasingly tenuous links with existing common law principles.

THE NATURE OF EQUITABLE PROPRIETARY INTERESTS

4.1 The evolution of equitable interests

Equitable beneficial interests originally evolved as a response to common law limitations. In the first place, the rules relating to contingent legal remainder interests which emerged during the 16th and early 17th centuries were extremely stringent. Any contingent legal remainder interest which did not vest before or at the moment of the determination of the prior estate was invalid, as was any such interest which attempted to cut down the natural determination of any previous estate. There are two primary justifications for these principles: feudal dues were to be collected from the person who was seised of the land, hence it was extremely important that someone always have seisin; furthermore, real actions for the recovery of land only lay with a freeholder having seisin (*Colthurst v Bejushin* (1550)).

Seisin did not exist where a life estate expired prior to a contingent legal remainder vesting. This effectively meant that many legal contingent remainder interests were struck down as invalid under common law. The evolution of equitable beneficial interests under the use and the trust effectively avoided these difficulties because it ensured that the party holding the legal estate always had seisin.

Secondly, during the period prior to the Statute of Wills 1540, under common law the owner of a fee simple could not devise his interest in the land. The land automatically devolved to his eldest son and no other descendants could be provided for, except *inter vivos*. The use or trust overcame this because it allowed property to be transferred to another party for the ultimate benefit of a third party. In such a situation, an *inter vivos* disposition could overwhelm the inheritance laws and still allow the grantor to have use of his estate during his lifetime.

Gradually, due to the problems illustrated above, the equitable 'use' became more popular. It eventually became common to plan estates under what was traditionally referred to as a use and which is now known as a trust, rather than risk the difficulties associated with legal remainder interests or the inheritancy provisions. Hence, the foundation for the enforceability of equitable proprietary interests in the equitable jurisdiction was established.

4.2 The difference between legal and equitable ownership

Equitable interests will exist where they are expressly created, where intention can be inferred from the circumstances or where a trust is imposed by the court to satisfy the demands of fairness. Where an equitable interest exists it

will confer upon the holder beneficial title to the property. This means that the holder owns the property in equity. Ownership in equity confers similar rights to ownership at law. The holder of an equitable beneficial interest has, for example, the right to exclude the rest of the world (apart from the legal owner) from the property and the right to alienate the interest. The interest of the beneficiary is considered proprietary because it consists of the right to compel the trustee to exercise their legal proprietary rights in accordance with the terms of the trust. Hence, the difference between legal and equitable ownership lies in the sphere of enforceability. A legal interest is enforceable under common law according to common law categories of relief and, if land, must fit within the doctrine of estates. On the other hand, an equitable interest is enforceable in the equity jurisdiction, according to equitable categories of relief (*Chan v Cresdon* (1989)).

Unless the legal interest is a future interest, a legal interest holder will generally have the right to possession. On the other hand, the holder of an equitable beneficial interest has no legal right to possession in the sense that he cannot bring a common law action for ejectment. The only rights of the equitable interest holder are those which are enforceable in equity.

In *DKLR Holding Co (No 2) v Commissioner of Stamp Duties* (1980), Hope JA made the following comments:

> As a legal owner, and subject to any disposition of that right, such as would occur upon the granting of a lease, the trustee has at law the right to possession of the land and, unless somebody else is in possession, under him or adversely to him, he also has the legal possession of the land. He may maintain trespass against anyone who infringes that possession, and ejectment against any person who, without his consent, takes possession. At law a beneficiary has no right of possession. He cannot sue the trustee at common law for ejectment ... His right can be enforced only by an order made in the exercise of the equitable jurisdiction of the court.

Furthermore, an equitable interest will not exist until it has been created, whether expressly, impliedly or by the court. A person who owns property absolutely is not considered to own both a legal and an equitable estate in that property. A person is assumed to hold the legal estate; no equitable interest can arise until it has been created. Creation of an equitable interest can, broadly speaking, occur in three different ways. The interest may arise through the creation of an express trust by transfer or by declaration. The interest may arise where an intention to confer an equitable interest can be proven and an equitable interest can be inferred, for example, an equitable lease or a resulting trust. Finally, the interest may be imposed by the courts under a constructive trust where the court feels that it would be against the conscience of the court to deny the existence of an equitable interest.

Until an equitable interest is created, and legal and equitable ownership are separated, the owner is considered to own, at law, the whole undivided property.

As the Privy Council noted in *Commissioner of Stamp Duties (Qld) v Livingston* (1965):

> Where a person owns property ... there is no need to distinguish between the legal and equitable interest in that property.

4.3 Rights attached to equitable interests

As noted, an equitable interest is enforceable in equity and all rights associated with it will be equitable in nature. The holder of an equitable interest will own the property in equity but not under common law. An equitable beneficial interest holder under a fixed interest trust will have both proprietary and personal rights in equity; they will have a proprietary right, enforceable in equity, to the trust property and a personal right, enforceable in equity, to make sure that the trustee holding the legal interest in the property does not abuse his position and looks after the property for the benefit of the beneficiary. The personal right stems from the fact that the trustee owes fiduciary obligations towards the beneficiary.

A beneficiary under a discretionary trust does not have a fixed interest in the property but holds a mere expectancy. Under a discretionary trust the trustee has a discretion to select beneficiaries from a designated class and, up until this selection is made, all that the beneficiary has is a right to be properly considered as a potential beneficiary. Similarly, a beneficiary under an unadministered estate does not have a proprietary interest in any specific asset prior to administration, and simply has a right to have the estate properly administered (*Official Receiver in Bankruptcy v Schultz* (1990)).

CHARACTERISATION OF EQUITABLE PROPRIETARY INTERESTS

The Australian High Court has recognised the ability of a court of equity to uphold and enforce a right as an *in rem* right.[1] For a full equitable proprietary interest to exist, the right should be enforceable against third parties. The mere fact that an equitable right is specifically enforceable, or its breach prevented by injunction, does not necessarily mean that the right is proprietary (*National Provincial Bank Ltd v Ainsworth* (1965)). Nevertheless, as noted by Finkelstein J in *Wily v St George Partnership Banking Ltd* (1999):

> ... where the protection that a court of equity will afford is in respect of a 'thing' that the law regards as property and that protection is available not only against the grantor but against third parties, including assignees or successors, there is much to be said for the view that the right being protected is a proprietary right.

5.1 Expressly created equitable interests

Equitable interests may be expressly created where a holder of property intends to create a trust and complies with all of the requirements for the valid creation of such a trust. A trust may be created by transferring the property to a third party trustee for the benefit of a named beneficiary, or where the settlor declares that he or she holds the property on trust themselves for a named beneficiary.

Where a trust by transfer is intended, the settlor must make sure that legal title to the trust property is properly assigned to the third party trustee. The validity of the assignment will depend upon whether or not the settlor has carried out all of the necessary requirements for transferring the particular form of property involved. If, for example, the property is Torrens title land, the settlor must at least execute a transfer and organise for the certificate of title to be made available, otherwise the assignment to the trustee may not even be enforceable in equity (*Corin v Patton* (1990)).

A settlor must intend to have created an express trust; where a trust by declaration is alleged, it must be proven from the words that a trust was intended. Mere conversation will be insufficient to establish the requisite intent (*Jones v Lock* (1865)). The property to be held on trust and the beneficiaries taking under the trust must be described with sufficient certainty.

1 See, eg, *Brown v Heffer* (1967) 116 CLR 344, where the purchaser's equitable interest arising under the contract of sale was described as proprietary – the interest being commensurate with the purchaser's ability to obtain specific performance of the contract.

The express trust must also comply with relevant formality requirements. In Victoria these requirements are set out in s 53(1) of the Property Law Act (Vic) (1958). In order to be valid, a trust by transfer must be created in writing (s 53(1)(c)) and a trust by declaration must be evidenced in writing (s 53(1)(c)). Section 53(2) exempts resulting, implied and constructive trusts from these provisions. The equitable beneficial interest under an express trust will vest in the beneficiary from the date on which the trust is validly created. (See below, Chapters 27 and 28.)

5.2 Equitable interests inferred from the circumstances

Where equitable interests have not been properly created, but an intention to confer such an interest is apparent from the circumstances, an equitable interest may be inferred. A resulting trust will arise in circumstances where it can be shown that a person has transferred property to another, but actually intended to retain beneficial ownership of the property either completely or in part.

5.2.1 Automatic resulting trust

An automatic trust is a trust that arises automatically in any circumstance where it can be shown that property has been transferred to a third party trustee with the intention of creating an express trust, but the trust either fails or is incomplete. Where a settlor intends to create an express trust by transfer but does not comply with certainty or formality requirements, the trustee will hold the trust property under an automatic resulting trust for the settlor. Where the settlor intends to create an express trust by transfer, but does not deal with all of the property, the surplus property will be held by the trustees under a resulting trust back to the settlor.

For example, where A transfers a fee simple to B and directs him to hold the life estate on trust for C, B will automatically hold the fee simple reversion under a resulting trust for A.

Where a settlor transfers property to a third party trustee on trust for a named beneficiary under a specific purpose and the purpose fails, the trustee will hold the property under a resulting trust back to the settlor (*Barclays Bank v Quistclose Investments Ltd* (1970)). See below, 37.2 for a more detailed summary.

5.2.2 Presumed resulting trust

A resulting trust will be presumed whenever the true purchaser of property is not legally identified. Equity presumes that the legal title holder holds the property under a resulting trust for the true purchaser. The presumed resulting trust may arise where one person has paid the total purchase price or, alternatively, where one person has paid a greater amount of the purchase price than is legally reflected.

Where property is transferred into a third party volunteer's name, in the absence of any evidence suggesting that the settlor intended the third party to take beneficially, the third party will hold the property under a presumed resulting trust. Whilst some States have altered this presumption where a voluntary disposition of land is conferred (s 44 of the Conveyancing Act 1919 (NSW); s 7 of the Property Law Act 1974 (Qld); s 38 of the Property Law Act 1969 (WA)), in Victoria, s 19A(4) of the Property Law Act (1958) expressly sets out that the section will not interfere with, or affect, any presumption of resulting trust.[2]

Where one party has purchased the property, but legal title to the property is held by a third party, in the absence of any evidence suggesting that the settlor intended the third party to take beneficially, the third party will hold the property under a presumed resulting trust. The courts presume that the purchaser intended to benefit himself rather than another, and a resulting trust arises to give effect to this intention (*Calverley v Green* (1984)). Voluntary transfer resulting trusts and purchase money resulting trusts are, essentially, founded upon an intention by the assignor or purchaser to retain ownership rather than any intention to create an actual trust. Hence, traditional problems associated with the creation of express trusts will not apply to resulting trusts. In *Re Vinogradoff* (1935), the court held that a resulting trust could arise even where the trustee was an infant.

Where there are unequal contributions to the purchase of property, in the absence of any evidence that one party intended to benefit the other, equity will deem each party to hold the property in shares proportionate to their contributions. A presumed resulting trust will apply. See below, 37.8.2 for a more detailed discussion.

5.2.3 Rebutting the presumption of a resulting trust

A presumed resulting trust may be rebutted where actual evidence of an intention to benefit a third party is adduced by the purchaser. This could be established where an express agreement can be proven. However, the evidence must be substantial (*Luke v Waite* (1905)). Alternatively, a presumed resulting trust rebutted where a presumption of advancement arises. See below, 37.8.4 for a more detailed discussion.

5.3 Equitable interests imposed by the court: constructive trusts

Unlike other equitable interests we have been considering, the constructive trust is imposed irrespective of the intention of the parties. It is imposed by a

2 Note the discussion by Ford, HAJ and Lee, WA, *Principles of the Law of Trusts,* 2nd edn, 1990, pp 968–69.

court and, therefore, arguably does not come into effect until a court determination, and will be imposed where the court feels such protection is necessary. The essence of the constructive trust is justice and fairness. The trust operates as a protection mechanism; it protects against unconscionable behaviour, whether that behaviour be the denial of another party's beneficial interest or the receipt of property known to be in breach of trust. The constructive trust is, in this sense, both an institution and a form of remedy. See the discussion below, 38.2.

5.3.1 De facto *relationship constructive trusts*

A constructive trust may be imposed whenever a court feels that it would be unconscionable to deny one person an interest in the property because they have made some contribution. This situation arises quite often in *de facto* relationships. It is important to recognise that, these days, many relationships of husband and wife or *de facto* couples are covered by legislative provisions giving the court a wide discretion to deal with the property. Nevertheless, the principles relating to resulting and constructive trusts provide a good foundation for the implementation of the courts' discretion, as well as applying to cases not covered by the legislation.

The *de facto* relationship constructive trust has two foundations: unconscionable denial of a contribution, and common intention. Initially, wherever parties could prove an actual, express or inferred intention for property to be held beneficially, a constructive trust may be imposed (*Hohol v Hohol* (1981) and *Allen v Snyder* (1977)). The common intention had to be proven at the date of purchase and it had to be proven that one party had acted to their detriment in reliance upon the agreement. The cases in this are very similar to proprietary estoppel decisions and were certainly unable to cover a range of considerations. The unconscionable denial constructive trust may be imposed by a court wherever a court feels it would be unconscionable to deny the validity of a person's interest in the property, taking into account that person's direct or indirect financial contributions. The two foundational cases are *Muschinski v Dodds* (1985) and *Baumgertner v Baumgertner* (1987). Both of these cases are discussed in detail below, Chapter 38. See especially 38.4.1.

5.3.2 Contracts for the sale of land

A constructive trust will be imposed wherever one party pays valuable consideration for the purchase of property, the legal title of which is to be transferred in the future. This principle is clearly evident in contracts for the sale of land. Whenever a purchaser enters into a contract for the sale of land and pays a deposit, the vendor will hold the land as constructive trustee for the benefit of the purchaser until the date at which legal title is transferred (*Lysaght*

v Edwards (1876)). The constructive trust is imposed to protect the interests of the purchaser. Even if the vendor does not have legal title at the time of selling the property, equity will bind her conscience and, as soon as the title is vested, a constructive trust will arise (*Booth v Federal Commissioner of Taxation* (1987)).

5.3.3 Unauthorised gain by a fiduciary

A fiduciary who makes an unauthorised gain during the course of exercising his fiduciary duties may not only be liable to compensate for any loss flowing from the breach, he may also hold any gain as constructive trustee for the beneficiary (*Chan v Zacharia* (1984); see below, Chapter 38 for a more detailed discussion of this).

5.3.4 Strangers as constructive trustees: knowing receipt of trust property/knowing assistance or inducement in dishonest and fraudulent design

A third party stranger who receives trust property in breach of trust will not hold the property as a constructive trustee unless she took it with knowledge of the breach, or actively participated in or induced the fraud (*Barnes v Addy* (1874); *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975)). The knowledge which is necessary should be actual, wilful disregard, reckless failure or knowledge which would, in the circumstances, cause a reasonable and honest person to make enquiries. (See below, Chapter 38 for a more detailed discussion, especially 38.4.2–38.4.5.)

5.4 Equitable leasehold interest

Where a lessor intends to create a legal leasehold interest and enters into an enforceable agreement with a lessee, but the legal requirements are not complied with, equity may enforce the agreement. In this situation, it is important to understand that equity is not simply elevating a contractual agreement into a proprietary interest. It must be established that the agreement was a leasehold agreement, and it must be proven that a decree of specific performance would be awarded in equity before the interest will be enforceable in equity. The position is well set out in the classic decision of *Walsh v Lonsdale* (1882). In that case, the court held that a leasehold agreement was enforceable in equity, despite the fact that it was not enforceable at law, having been executed by way of a deed. The facts of the case are set out in some detail above, 3.7.

Jessel MR held that a tenant holding under an agreement for a lease of which specific performance would be decreed, stands in the same position concerning liability as if the lease had been legally executed. The equitable leasehold agreement confers the same rights as a legal leasehold agreement and, consequently, the lessor has a right to seek distress at law.

A *Walsh v Lonsdale* equitable leasehold interest would appear to arise whenever it can be established that there is an 'enforceable' leasehold agreement. Before such an interest can arise, a court must be ready and willing to decree specific performance. The court may decide not to award specific performance (or it may not have jurisdiction, as with courts of summary jurisdiction). It may refuse to issue specific performance where the agreement has been entered into and one of the terms has been breached. If specific performance is not available, then the leasehold interest will not be enforceable in equity.

The application and consequences of the *Walsh v Lonsdale* decision have been further examined in the High Court decision of *Chan v Cresdon Pty Ltd* (1989). In that case, an agreement for a lease was executed under which the respondent agreed to lease certain land in Queensland for five years to Sarcourt Pty Ltd. A form of lease was annexed and a lease in registrable form was simultaneously executed, but not registered under the Real Property Act 1861 (Qld). After default by Sarcourt, the lessor sought to recover from the appellants who were guarantors under the unregistered lease. Under s 43 of the Qld Act, the lease was not effectual to pass any estate or interest until registration.

The High Court held by majority, with Toohey J in dissent, that the appellants were not liable under the guarantee. The appellants had agreed to guarantee the obligations of Sarcourt under the registered lease and, even if it could be shown that specific performance of the lease would be given, that would not be enough to establish the liability of the guarantors. Only a lease at law would achieve this purpose. After discussing *Walsh v Lonsdale,* the court concluded that the willingness to treat the agreement in that case as an equitable interest was dependant upon the fact that equity looks to intent rather than form, and that the agreement was specifically enforceable. Once such an interest is established, it can be regarded as 'legal in effect' only between the landlord and tenant. The guarantors to the lease were entitled to rely upon the fact that they had only intended to guarantee the lessee's obligations under a legal lease, not an equitable lease. Consequently, the 'legal effect' of the equitable lease did not extend to the guarantors. The circumstance that the term under an agreement for lease is about to expire, or, indeed, has expired, is no bar to the jurisdiction of a court of equity to grant relief in the nature of specific performance of that agreement: *S & E Promotions Pty Ltd v Tobin Bros* (1994).

5.5 Equitable interests arising under security transactions

5.5.1 Equitable mortgages

Where a mortgage is entered into and there is no legal conveyance of the secured property to the mortgagee, or there is no registration of the mortgage

as a statutory charge over the property, the mortgage may be enforceable in equity. Where it can be proven that the parties intended to enter into a mortgage agreement and secure property in return for a loan, equity will enforce the rights of the mortgagee.

A mortgage may be equitable in nature because an agreement can be proven and sufficient acts of part performance have been carried out to support that agreement. For example, in *J & H Just Holdings v Bank of New South Wales* (1971), an equitable mortgage arose when a mortgage agreement was entered into and the title deeds to the secured property were deposited with the mortgagee. Merely entering into a contract for a loan, however, will be insufficient to establish an equitable mortgage (*Rogers v Challis* (1859)).

Similarly, a mortgage may be executed over Torrens title land but not submitted for registration, and it will be considered to be equitable in nature. Furthermore, a mortgage may be equitable because the interest being secured is itself equitable. For example, where a beneficiary under a trust mortgages his or her interest, the mortgage will be equitable; or where a second mortgage is taken out over general law land, the mortgage will be equitable.

The interest of an equitable mortgagee is in the nature of a charge. An equitable charge confers a proprietary interest. The rights of the holder of the charge do not include possession, but rather the right to enforce the interest against the property where the terms of the loan contract are not complied with. Where an equitable charge is held by a mortgagee, the right to enforce includes the right to take possession, exercise a power of sale or foreclose upon the property. As noted by Buckley LJ in *Swiss Bank Corp v Lloyds Bank Ltd* (1982), pp 594–95:

> An equitable charge may ... take the form of an equitable mortgage or of an equitable charge not by way of a mortgage. An equitable mortgage is created when the legal owner of the property constituting the security enters into some instrument or does some act which, though insufficient to confer the legal estate or title in the subject matter upon the mortgagee, nevertheless demonstrates a binding intention to create a security in favour of the mortgagee, or, in other words, evidences a contract to do so ... An equitable charge which is not an equitable mortgage is said to be created when the property is expressly or constructively made liable, or is specially appropriate, to the discharge of a debt or some other obligation, and confers on the charge a right of realisation by judicial process ...

5.5.2 Equity of redemption

An equity of redemption will arise automatically in equity whenever a mortgage transaction can be proven. The equity of redemption is an equitable interest, held by the mortgagor, to redeem the secured property once the mortgage debt has been discharged.

The equity of redemption evolved as a proprietary interest in, or about, the 17th century. It was at this stage that a Court of Chancery was prepared to consider the mortgagor's right to redeem as a proprietary, rather than a personal, contractual interest. The equity of redemption arises as soon as the mortgage is entered into, but is only enforceable once the debt is properly discharged. The proprietary equity of redemption need only be enforced by a mortgagor where the debt is discharged and the contractual date for repayment has passed. If the debt is discharged before the contractual date has expired, the mortgagor may rely upon his contractual right to redeem.

The foundation for the emergence of the equity of redemption lies in the fact that, in equity, the courts examine the substance of the transaction rather than its strict common law form. This can be expressed through the old equitable maxim: 'Equity looks to the intent, rather than to the form.' If a dealing is, in truth, a mortgage, regardless of any other wording used to describe it, equity will recognise the intent of the borrower to acquire an interest in the property, only as security for repayment of the loan. Once the loan is repaid the mortgagor has the right to have this interest discharged.

Whenever it can be automatically established that a transaction is, in substance, a mortgage, the mortgagor will acquire an equity of redemption. For example, a conveyance with an option for the vendor to repurchase the property within a given period may, in substance, amount to a mortgage in equity, and the vendor/mortgagor will be permitted to redeem even after the given period has expired, provided the amount secured is repaid.

This will be the situation even if the contract states that time is of the essence and failure to make the repayment on time constitutes a fundamental breach. The onus of proof will rest upon the person attempting to assert that a mortgage exists, and parole evidence will be admissible to show the intention of the parties concerning the substance of the transaction.

A mortgage is usually easily detectable by its form because mortgages normally follow standard precedents. Nevertheless, form is not conclusive because equity will look to the substance of the transaction, although the following factors may be relevant:

- in the case of a sale, the money paid will tend to approach the full value of the property, but a prudent mortgagee is unlikely to lend more than two-thirds of the value;
- if the transferor pays the transferee's costs, he is likely to be a mortgagor;
- if the transferee takes immediate possession, she is likely to be a purchaser.

The equitable jurisdiction will not readily accept any interference in the enforceability of the right to redeem. The equity of redemption is well protected by the equitable jurisdiction, and any actual or attempted 'clogs' on this right will be struck down.

Potential 'clogs' over the equity of redemption include the following:

- where the mortgagee is given the power to extinguish the equity of redemption;
- equity will not permit any device or contrivance to be made a part of the mortgage if its purpose is to prevent or impede redemption. Hence, a mortgagee cannot, as part of the mortgage transaction, take a right or option to purchase the mortgaged property because that would extinguish the right to redeem; the right to purchase should be a separate and independent agreement;
- no oppressive or unconscionable postponement of the right to redeem will be accepted; equity may give relief against provisions in a mortgage which are, generally speaking, oppressive or unconscionable. In deciding this question, the length of time for which the right to redeem is postponed may well be an important consideration. If the provision attempts to restrict the right to redeem to a particular person, it will generally be struck down as an unfair clog on the right (*Salt v Marquise of Northampton* (1892));
- clauses conferring collateral advantages; some mortgages attempt to secure the mortgagee some advantage over and above repayment of the loan with interest. These advantages are generally termed 'collateral advantages' and can be struck down as clogs on the equity of redemption (*Kreglinger v New Patagonia Meat & Cold Storage Co Ltd* (1914)).

5.5.3 Equitable lien

An equitable lien will automatically arise where a debt can be proven and property is specifically identified, or related to, the performance of the agreement. An equitable lien should be distinguished from a possessory lien as it is not necessary for a creditor to have possession of property in order for a lien to arise in equity. To establish an equitable lien or a charge, all that needs to be proven is that it would be unconscientious to allow a debtor to dispose of property without recognising the interests of the creditor. An equitable lien is a right against property which arises automatically by implication of equity to secure the discharge of an actual or potential indebtedness (*Hewitt v Court* (1983)). In such a situation, a court may hold that the creditor has a lien or a charge in the property which may bind *bona fide* purchasers of the property who take with notice. One of the classic examples of an equitable lien is the vendor's lien for the unpaid purchase price under a contract for sale. Once a contract for sale is entered into and a deposit is paid, the vendor becomes constructive trustee of the legal estate for the purchaser; the vendor also acquires an equitable lien for the balance of the purchase price and may retain the legal estate if the balance is not paid.

5.6 Mere equities

A mere equity confers upon its holder a personal right, enforceable in equity, to have specific proprietary interests adjusted. In essence, the mere equity is simply a right to invoke an equitable remedy, However, its proprietary consequences give it some of the flavour of a full equitable interest. The spectrum of equitable rights was discussed in *Snell's Equity*, 29th edn, 1990, Chapter 2, p 23, where four distinct senses of the term 'an equity' were outlined. In the first sense, 'an equity' means an equitable interest in property, that is, some right of ownership enforced by equity but not by the common law. An equity in the second sense – referred to here as a 'mere equity' – is not a right of property and is accordingly contrasted with the equitable interest. Snell defines this right as being usually of a procedural character, ancillary to some right of property, which limits or qualifies the proprietary right. Examples are a right to have a transaction set aside for fraud or undue influence, or to have a document rectified for mistake. The third sense of the term 'equity' is the 'floating equity', and an example is the right which family members have in respect of the unadministered estate of an intestate. In its fourth and widest sense, 'an equity' means nothing more than the right to seek an equitable remedy, whether or not that remedy is sought in aid of a property right.[3]

The nature of the mere equity was discussed in some detail in *Latec Investments Ltd v Hotel Terringal Pty Ltd* (1965). In that case, all three members of the court agreed that the equitable interest created by way of charge by the purchaser from the mortgagee prevailed over the rights of the mortgagor where the mortgagee's sale had been improperly exercised. On the facts of the case, Latec was the registered mortgagee of Torrens title land owned by Terrigal. When Terrigal fell into arrears with the mortgage payments, Latec exercised the mortgagee's power of sale and sold to Southern Hotels, a wholly owned subsidiary of Latec. The court was satisfied that Terrigal had a right to have the sale set aside, a right referred to as an equity of rectification. The equity arose because Latec had shown a lack of good faith by opting for a very high reserve, arranging a very short advertising period for the auction, and by selling to Southern at a price well below the reserve. The difficulty, however, was that, before Terrigal proceeded to have the sale set aside, Southern had created another full equitable charge in favour of MLC Nominees. The conflict arose between the equity of rectification held by the mortgagor, Terrigal, and the subsequent equitable charge held by MLC Nominees.

3 See Skapinker, D, 'Equitable interests, mere equities and personal equities – distinctions with a difference' (1994) 68 ALJ 593, and Neave, M and Weinberg, M, 'The nature and function of equities (Part 1)' (1978–80) 6 Tasmania UL Rev; Megarry, RE, 'Mere equities' (1955) 71 LQR 480; Martin, J (ed), *Hanbury and Maudsley on Modern Equity*, 13th edn, 1989, pp 869–77.

The approach of the members of the court differed. Kitto J distinguished between the mortgagor's equity to have the sale set aside – a 'mere equity' – and the equitable interest (the equity of redemption), which would be held to exist if the equity to have the sale set aside was made good. According to Kitto J, the mortgagor's claim to the equitable interest was dependent for its success upon the setting aside by the court of the mortgagee's sale. This meant that the equitable right held by the mortgagor was different in form and character to a full equitable right. Consequently, Kitto J felt that the usual principle relevant to priority disputes between equitable interests, prior in time if both are equal – *qui prior est tempore potior est jure* – did not apply. In such a situation, if the subsequent equitable interest holder is a *bona fide* purchaser for value without notice of the existence of the prior equity, then the interest is not bound in any way by the prior equity. His Honour made it clear that, 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 earlier interest is unprovable against the third party.

Taylor J differed from Kitto J to an extent, holding that the mortgagor, being entitled to have the sale set aside, already had an equitable interest in the land: it was not correct to say that there was a mere equity unless and until the sale was set aside. But the prior equitable interest of the mortgagor was postponed to the equitable interest of the chargee because the mortgagor required the assistance of a court of equity to remove an impediment to its title, which assistance would be withheld if an equitable interest had already passed to a purchaser for value without notice.

Menzies J agreed with Kitto J that the competition was not between two equitable interests, but between the mortgagor's equity to have the sale set aside and the equitable interest of the chargee. His Honour felt that there was no inconsistency between the notion that a person in the position of the mortgagor had a mere equity in competition with the chargee's equitable interest and the notion that such a person had a devisable interest by virtue of his equity.

Following the reasoning of Kitto and Menzies JJ, a mortgagor holding a right to set aside a sale by reason of a breach of duty holds a form of equitable right. If this right is not classified as proprietary in nature, then it can have dramatic consequences. For example, in *Swanston Mortgage Pty Ltd v Trepan*

Investments Pty Ltd (1994), Brooking J interpreted the judgment of Kitto and Menzies JJ in *Latec* to mean that an equity did not constitute a proprietary interest and, consequently, such a right was not able to be caveated.[4]

The mere equity will bind successors in title in circumstances where a purchaser acquires the property with notice of the existence of the right. Apart from the right to rectify a fraudulent exercise of a mortgagee's power of sale, mere equities have also commonly been argued in cases of acquiescence or estoppel and equities arising from a right to have an improper or incorrect arrangement rectified.

5.6.1 Acquiescence and estoppel

A mere equity may be raised where a person is led to believe that a representation concerning property is correct and intentional and acts to his detriment in this belief. In *Inwards v Baker* (1965), Mr Baker owned six acres of land. His son, Jack, was thinking of buying some land and putting a bungalow on it. His father suggested that, instead of buying land, he put the bungalow on his land. The son, acting upon these words of encouragement, built a bungalow on Mr Baker's land. The son built the bungalow and paid for the bungalow and, although the father provided some assistance, the father was paid back. The son continued to live there and ultimately the father died. Miss Inwards was executrix of the will and the father had left most of the property to her. After a number of years, proceedings were brought by Miss Inwards and her children to remove Jack from his bungalow.

Lord Denning MR held that, if the owner of land requests, or allows, another to expend money on the land, under an expectation created or encouraged by the landlord that he will be able to remain there, that raises an equity in the licensee which will entitle him to stay. The person obtains a licence coupled with an equity which arises from the particular expenditure involved. All that is necessary is proof of a request or encouragement to make the expenditure. If this can be established, the court will not allow the expenditure to be defeated. The equity gives the holder the right to have the

4 Compare the decision of *Swanston Mortgage Pty Ltd v Trepan Investments Pty* Ltd with that in *Re McKean's Caveat* [1988] 1 Qd R 525, where Ryan J held that the registered proprietor of land had a caveatable interest where the mortgagee under a mortgage over the land had improperly exercised its power of sale. This decision was not followed by Brooking J in *Swanston Mortgage*. The decision in *Swanson Mortgage* was recently approved by Warren J in the Victorian Supreme Court: *Law Mortgages Qld Pty Ltd v Thirteenth Corp Ltd* [1999] VSC 360, 28 September, although Kenny JA in the Victorian Supreme Court, in *F & F Holdings Pty Ltd v Ridge Land Pty Ltd* [1998] VSCA 72, 14 October, in *dicta*, expressed a preference for an approach which adopted a rational consideration of the individual circumstances which may give rise to a caveatable interest rather than a blanket restriction on an equity of the type refused in *Swanson Mortgag*e. In *Re An Application: Haupiri Courts Ltd (No 2)* [1969] NZLR 353, p 357, the court noted that a registered proprietor should be entitled to caveat if 'some set of circumstances over an above his status as a registered proprietor arise which affirmatively gave rise to a distinct caveatable interest in the land'.

expectation enforced and effectively to stay on the land as long as he desires. The equity will be binding upon successors in title to the land but cannot be passed on by the holder. The character of the equity in this case was, therefore, akin to a life estate.

A similar type of right arose in *Crabb v Arun District Council* (1976). The facts of that case concerned a road owned by the Arun District Council. Crabb had access to this road and a right of way over it in order to reach another road. Crabb decided to subdivide, which meant that he needed another right of way. Crabb met the council and an agreement was made whereby Crabb believed he was to be granted an additional access point. No written agreement was entered into and no payment was made. The council later refused Crabb entrance to this access point and demanded payment of £3,000.

Lord Denning MR held that an equity was raised by way of proprietary estoppel; His Honour stated that, where a person has, by words or conduct, led another to believe that they will not insist upon their strict legal rights and they know or intend the other to act upon this belief, an equity will be raised in favour of the other. The equity is based upon the terms of the particular agreement. In such a situation, equitable principles would only be satisfied by ensuring that Crabb did have a right of access. The equity effectively gave Crabb a right akin to an easement over the land although, as the right was essentially personal in nature, it was not capable of being alienated.

The idea that an estoppel action may create an equity has been recently confirmed in the Australian High Court in *Commonwealth of Australia v Verwayen* (1990), although there is some difference of opinion as to the relief which may be awarded for such an equity. On the one hand, it has been noted that the most appropriate form of relief may be to compensate for all loss incurred from the plaintiff's reliance upon the truth of the representation (see Mason CJ). On the other hand, it has been noted that the most appropriate relief is to enforce the expectation and acknowledge the plaintiff's right (see Deane J). It will really only be in the latter case that an action in estoppel can be properly considered to fit within the category of mere equity. In *Commonwealth v Clark* (1994), Marks J felt that the appropriate relief necessary to form the basis for an equitable estoppel right is that which is necessary to prevent unconscionable conduct and to do justice between the parties. The degree of relief awarded will vary depending upon the individual circumstances of each case.[5]

5 See, also, *S & E Promotions Pty Ltd v Tobin Brothers Pty Ltd* (1994) 122 ALR 637; and the excellent article by Robertson, A, 'Satisfying the minimum equity: equitable estoppel remedies after *Verwayen*' (1996) 20 Melbourne UL Rev 805, esp pp 829–30. See, also, *Giumelli v Giumelli* (1999) 161 ALR 473.

5.6.2 Equity of rectification

Rectification is a right which is available to correct most instruments which do not accurately reflect the legal relationship existing between the parties; where a person acquires a right, as a result of fraud or misconduct of some description, the right is one which is personal to the individual subject to the fraud or misconduct. This right is only available to a party who is privy to the mutual mistake.

The right was described as a 'personal' equity by Upjohn J in *Smith v Jones* (1954). In *Downie v Lockwood* (1965), however, Smith J in the Supreme Court of Victoria held that, in circumstances where the written lease did not reflect the true agreement, the plaintiff had a right to rectify the lease and this right constituted a full equitable interest. His Honour noted that the equitable interest in land existed because the plaintiff was entitled to specific performance of the lease contract and that, whilst a mere or personal equity would not ordinarily be enforceable upon a subsequent purchaser for value taking an equitable interest, the right held by the plaintiff was more than a mere equity; 'it was an equitable interest upon terms which, because equity would have specifically enforced the true bargain between the parties' and because the possession of the plaintiff gave the subsequent purchaser notice of its existence.

In *Latec Investments Ltd v Hotel Terrigal Pty Ltd* (1965), Taylor J agreed that the right to rectify an instrument constitutes a full equitable interest. However, Kitto J in that decision concluded that such a right only constitutes a mere equity. The right to rectify, however classified, will survive a transfer of any land it is attached to, although where a priority dispute arises the right will generally fail against a full equitable estate unless the subsequent interest holder takes with notice. This rationale is based upon the inherent assumption that the equity to rectify is classified, at least for priority dispute purposes, as a mere equity. Hence, proof that a subsequent purchaser had notice of the existence of the right to rectify is an important element in a priority dispute. In *Tanzone v Westpac* (1999), Windeyer J in the Supreme Court of New South Wales held that an equity of rectification of a lease is a 'mere equity' which will bind a purchaser who takes with notice of the equity, 'perhaps because it is attached to an equitable interest in land'.

EQUITABLE PRIORITY RULES

6.1 Competing equitable interests

The basic principle between competing equitable interests is that, where the equities are equal in their merits and in all other respects, the prior equity will gain priority (*Rice v Rice* (1853)). This principle stems from the discretionary operation of equity; the equitable jurisdiction will examine all of the circumstances under which each equity was created in order to determine their relative strengths; if no improper conduct, or other conduct warranting postponement, can be proven, the court will revert to the primacy of priority in time.

The decision of *Rice v Rice* (1853) warrants some discussion. On the facts of that case, the vendors sold property to the purchaser. The purchaser entered into a contract of sale and paid a purchase price. The vendors automatically acquired an equitable lien for the unpaid purchase price. When the deposit was paid, the vendors executed a conveyance of the land in favour of the purchasers and declared that the whole purchase money had been paid. They then handed over the title documents. The vendors then went out and acquired a mortgage over the title with a mortgagee. The competition was between the vendor's equitable lien for the unpaid purchase price and the mortgagee's equitable interest under the equitable mortgage.

The court held that the conduct of the prior equitable interest holder, in not protecting their interest and in allowing the vendors to hold out to the world that they held uninterrupted legal title, amounted to postponing conduct. The following circumstances were put forwards as significant features in the assessment of the 'equality' of the circumstances:

- the vendors chose to leave part of the purchase money unpaid but still conveyed the entire estate to the purchasers;
- the vendors did not choose to hold on to the title deeds as security for the balance of the unpaid purchase price as they might have done;
- if the vendors had chosen to hold on to the title deeds they would have been secure against any subsequent encumbrance;
- the vendors voluntarily armed the purchaser with the means of dealing with the property as absolute legal owner; and
- the mortgagee was guilty of no negligence. The mortgagees gave good consideration for the mortgage and they obtained a *bona fide* possession of the title.

The conduct of the first interest holders in not protecting themselves, and in conveying title to the purchaser prior to the full purchase price being paid, effectively encouraged and assured the mortgagee that the purchaser's title was absolute and it would be unfair to confer priority in such circumstances.

Mere negligence may not be sufficient, but it is important to consider all of the circumstances and, in particular, how much the conduct of the earlier interest holder has contributed to the creation of the later interest. The importance of a subsequent equitable interest holder acquiring notice of a previous equity was considered by the Victorian Supreme Court in *Moffett v Dillon* (1999). In that case, Brooking J noted that the fact that the *'bona fide* purchaser for value without notice' rule applies only to legal interests does not mean that notice cannot be fatal to a competition between two equitable interests. There is a deeply rooted principle that a person taking with notice of an equitable right takes subject to it as it binds his or her conscience, and this notion 'applies whether the estate or interest taken by the person is legal or equitable' and, according to Brooking J, applies whether the notice is of a full equity or a mere equity. Another important consideration, where the equitable interest is created over Torrens title land, is whether or not the prior equitable interest holder has caveated their interest. The fact that one equitable interest is registered and the other is not will not, in itself, affect the merit analysis (*Moffett v Dillon* (1999)). The caveat system provides effective notice to the rest of the world that a potential interest exists over the property. Failure to caveat can amount to postponing conduct because it effectively amounts to a failure to utilise the protection system set up by the Torrens system for unregistered interests. The principles concerning priority disputes between unregistered interests are well established.

In *Butler v Fairclough* (1917), the High Court concluded that a failure to lodge a caveat amounted to postponing conduct. It was held that, generally, a prior unregistered equitable interest will be postponed if the conduct in failing to execute a proper transfer and to place it on the register is so unreasonable and negligent as to make this prior equity inferior. In the Torrens system, because a system of protecting unregistered interest against subsequent interest exists, a failure to utilise the system will amount to postponing conduct.

The decision was upheld by Bryson J in *Double Bay Newspapers Pty Ltd v AW Holdings Pty Ltd* (1996), where his Honour noted that priority which would otherwise exist according to time may be lost through failure to lodge a caveat in the absence of any other protection. In *Abigail v Lapin* (1934), the Privy Council concluded that the appellant's unregistered equitable mortgage was entitled to priority over the respondents' unregistered interest in the land. The respondents had not retained the title deeds and had effectively armed a third party to go forth as if they were the full legal interest holders. The court also added that the failure of the respondents to lodge a caveat reinforced the 'apparent ownership' of the third party and provided justification for the prior interest being postponed (see, also, *Breskvar v Wall* (1971)).

Nevertheless, simply failing to lodge a caveat may not be sufficient to postpone an earlier unregistered interest if the interest holder takes other steps to protect his interest. One way in which protection might be assured would be for the prior interest holder to retain control of the title deeds. If the prior interest holder has the title deeds they can be assured that no other person can be registered without that holder finding out (because possession of the title deeds would be necessary) and, in such a situation, it may not be necessary to lodge a caveat.

In *J & H Just Holdings Pty Ltd v Bank of NSW* (1971), Josephson was the registered proprietor of residential land in Sydney and executed a mortgage to the defendant bank to secure an overdraft. The bank did not lodge a caveat but did retain the title deeds. Subsequently, Josephson executed a mortgage to J & H Holdings Pty Ltd. This transaction was done quickly and it was not registered in order to save expense. The company did not receive the duplicate certificate of title as the director was satisfied with the explanation that it was held by Josephson's bank. After searching the title the company found no encumbrances. J & H Holdings made no further inquiry to the bank as to the terms upon which it held the certificate of title.

The main issue in the case was essentially whether an equitable mortgagee, who did not lodge a caveat but did obtain possession of the duplicate certificate of title, should be postponed to a subsequent equitable mortgagee who searched the original certificate of title but did not seek production of the duplicate certificate of title.

The High Court held that the holder of an unregistered interest is not under a duty to lodge a caveat; the respondent's possession of the duplicate certificate of title was sufficient to protect its interest and the second unregistered interest holder ought not to have settled without obtaining possession of the duplicate certificate of title. There was no inequitable conduct on the part of the first interest holder. Failure to lodge a caveat should not indicate to a subsequent party that the title was clear, especially when the duplicate certificate of title has not been delivered (see also *Person-to-Person Financial Services Pty Ltd v Sharari* (1984)). In *IAC (Finance) Pty Ltd v Courtenay* (1963), the court held that, where a purchaser has followed usual conveyancing procedure and does not caveat his interest, he should not be held liable for the fraud of the vendor's solicitor.

6.2 Legal and equitable interests

Where a legal interest is in competition with an equitable interest, the legal interest will always take priority where it has been properly and fairly acquired. Legal interests are generally given superior status to equitable interests in a priority dispute and, unless there is some apparent fraud or the holder has notice of the existence of the prior equitable interest when purchasing the property, the legal interest will be paramount whether it is prior in time or otherwise.

It is important to remember that these priority principles have been modified by the introduction of the Deeds Registration system for the registration of general law interests in land and the Torrens system for the registration of Torrens title land interests. Where a person acquires registered priority under the Deeds Registration system, they will take priority whatever the status of the interest. Priority under the Deeds Registration system will only be conferred where the interest is registered *bona fide* for value without any prior interests. Registration under the Deeds Registration system will only confer priority over unregistered but registrable interests or later registered interests. An interest may be registered if it is set out in an instrument. This excludes resulting and constructive trusts from the operation of the Deeds Registration system (see Part 1 of the Property Law Act 1958 (Vic)). Where a person acquires a registered legal interest of Torrens title land, the interest holder obtains what is known as an 'indefeasible title'. This will protect the title holder against all other claims for priority except where they fit within the established statutory and non-statutory exceptions.

6.2.1 Prior legal interest, subsequent equitable interest

The basic principle here is that a legal interest holder will take priority unless the holder has fraudulently contributed to the creation of the subsequent equitable interest, been grossly negligent or entrusted title documents with an agent who has authority to raise money on them. It is only where the legal interest holder has played a significant part in the creation of the subsequent equitable interest that his priority will be postponed.

This is clearly evinced in the classic decision in *Northern Counties of England Fire Insurance Company v Whipp* (1884). In that case, the manager of the plaintiff insurance company borrowed money from the company pursuant to a mortgage arrangement. The insurance company acquired the title deeds to the manager's property and the documents were handed over to the company and placed in the company safe. The manager had one of the keys to the safe because he was the manager of the company. He subsequently opened the safe and handed the title documents over to the defendant as security for a further loan transaction. This second loan transaction had the effect of creating an equitable mortgage in the defendant, Whipp, because the legal interest had already been conveyed to the insurance company. The defendant had no knowledge of the previous legal mortgage which the insurance company had over the fee simple. When the manager became bankrupt, the defendant claimed that the prior legal mortgage was void and ineffective against his subsequent equitable mortgage.

The court held that the issue here related to the circumstances in which a prior legal estate may be postponed by a subsequent equitable interest and the legal estate holder deprived of his interest. Where the legal interest holder allows a subsequent interest to be established by making the title deeds

available, the interest of the legal estate holder can only be postponed through evidence of a clear fraud. If the prior legal interest holder stands by and lets another lend money on his estate without giving any notice of the prior interest, this conduct will be sufficient to amount to a fraud which will postpone the initial interest. Mere carelessness or want of prudence on the part of the prior legal interest holder will not be sufficient to postpone the prior legal interest. It was held on the facts that the carelessness of the company in placing the deeds in a company safe of which the manager had a key did not amount to fraud or gross negligence.

Where a legal interest holder has encouraged a subsequent equitable interest to be created by fraudulently allowing the title deeds to be made available, the subsequent equitable interest created will defeat the prior legal estate. In such a case, it must be established that the prior legal interest holder deceived the new interest holder into believing that no other interest existed over the property in order to obtain a financial benefit. Such conduct will postpone the legal estate whatever the character of the subsequent interest created (*Barry v Heider* (1914)).

6.2.2 Prior equitable interest, subsequent legal interest

The general principle applied where a prior equitable interest competes with a subsequent legal interest is that the legal interest will succeed if the holder is a *bona fide* purchaser for value without notice.

The purchaser must be *bona fide* in the sense that there was no inequitable conduct when acquiring the interest. Valuable consideration must have been given for the interest. A person taking a legal estate as a volunteer will not take priority over a prior equitable interest. Finally, the purchaser must have taken the interest without notice of the existence of the prior equitable interest.

The doctrine of notice incorporates both actual and constructive knowledge. In *Barclays Bank plc v O'Brien*, Lord Browne-Wilkinson, with whom the other members of the House agreed, said (p 195):

> The doctrine of notice lies at the heart of equity. Given that there are two innocent parties, each enjoying rights, the earlier right prevails against the later right if the acquirer of the later right knows of the earlier right (actual notice), or would have discovered it had he taken proper steps (constructive notice). In particular, if the party asserting that he takes free of the earlier rights of another knows of certain facts which put him on inquiry as to the possible existence of the rights of that other and he fails to make such inquiry or take such other steps as are reasonable to verify whether such earlier right does or does not exist, he will have constructive notice of the earlier right and will take subject to it.[1]

1 See, also, *Garcia v NAB* (1998) 155 ALR 614; *Tresize and Others v National Australia Bank* (1994) 122 ALR 185.

Constructive notice is determined by reference to a detailed consideration of each individual case, and courts generally assume a 'common sense' approach. As noted by Winneke P in *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd* (1998):

> Though part of the common law, the process of reasoning that authorises a conclusion to be drawn from a condition of so called wilful blindness really depends on little more than common sense. In some circumstances it may be legitimate to infer that a person's 'wilful shutting of the eyes', or wilfully and recklessly failing to enquire, is evidence that the person had no need to look or to enquire in order to know what would be plainly revealed by the merest glance or the most obvious enquiry ... There is no question of constructive notice or constructive knowledge involved in that inference; it is actual knowledge which is inferred. The equitable doctrine of constructive notice coincides exactly in result in this respect with the common law concept of inferred knowledge; a person who wilfully shuts his eyes, or wilfully and recklessly fails to make such enquiries as an honest and reasonable man would make, might find himself disentitled to rely on lack of actual knowledge.

Constructive notice or knowledge is, however, a doctrine which is centred around land title investigation. The reluctance to extend constructive notice principles beyond this forum was clearly enunciated by Hansen J in *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd* (1998), where his Honour noted that:

> The doctrine of constructive notice has developed in relation to land, where there is a recognised procedure for investigating the title of the transferor. There is no room for the doctrine of notice, in the strict conveyancing sense, in a situation in which it is not the custom and practice to investigate the transferor's title.

If a purchaser actually knows that a prior equitable interest exists, then priority will be postponed. Furthermore, if a purchaser makes enquiries and discovers information which should alert her that a prior equitable interest exists, priority will be postponed. The purchaser must, however, acquire actual or constructive notice prior to purchasing the legal interest. Priority will not be postponed if the legal interest holder acquires notice after purchasing the interest (*Bailey v Barnes* (1894)). As summarised by Millet J in *MacMillen Inc v Bishopsgate Investment Trust plc (No 3)* (1995), 'A *bona fide* purchaser for value who obtains the legal estate without actual or constructive notice is entitled to priority in equity as well as law' (pp 768–69). The priority rules are set out in legislative provisions in each State.

The Victorian equivalent is s 199 of the Property Law Act 1958 (Vic), and is reproduced below.

> A purchaser will not be prejudicially affected by notice unless it: (a) is within his knowledge, or would have come to his knowledge if such inquiries and inspections had been made which ought to have been made; or (b) has come to the knowledge of his solicitor or other agent if such inquiries and inspections were made as ought reasonably have been made.

Once a purchaser has knowledge that a prior equitable interest exists, that knowledge cannot be taken away. This is well illustrated in *Jared v Clements* (1902). In that case, there was a competition between a prior equitable mortgagee and a subsequent legal estate holder. When purchasing the property, the purchasers did have notice of the mortgage because they had searched the file in bankruptcy and discovered it. However, they were fraudulently led to believe that the interest had been discharged prior to the sale by the vendor's solicitor. In fact, no discharge had occurred; the vendor's solicitor had fraudulently forged the discharge and the purchasers acted on it. The issue was whether or not the purchasers could be relieved of their notice because of the deceit which had been committed against them.

The court took a very strict approach and held that, once a person is affected by notice, it cannot be removed, even if she is fraudulently led to believe that the interest has been discharged.

As Byrne J points out:

> The case is a hard one upon the defendant and no less so because, if less diligence had been shown by the gentleman who actually made the search in bankruptcy, the mortgage would probably never have been disclosed, and the purchaser could then have claimed to be a purchaser for value without notice.[2]

Constructive notice will require the purchaser to be aware of all interests which are reasonably apparent from the transaction. This may require the purchaser to check the obligations and clauses of a particular agreement or contract of sale, and to make any further investigations as may be deemed necessary in the circumstances. Once a general inquiry has been made, however, and the accuracy of that inquiry questioned, it would seem that there is no obligation to extend an inquiry any further. In *Smith v Jones* (1954), it was found that there was no general duty to make any further inquiries beyond those which became apparent from the actual transaction. In that case, the purchaser of a farm was aware of a tenancy arrangement and was required to inspect the agreement, but was under no further duty to examine possible rights and actions which may have arisen out of the tenancy arrangement.

The full operation of the *bona fide* principle is apparent from the classic decision of *Pilcher v Rawlins* (1872). In that case, Pilcher held a sum of money on trust and subsequently advanced this money to Rawlins, a solicitor, by way of a mortgage over land, known as Blackacre, which was owned by Rawlins. Pilcher received the legal estate in Blackacre as mortgagee and held the benefit of the mortgage on trust for the beneficiaries. Rawlins held an equity of redemption which would allow him to obtain a reconveyance of the estate once the advance had been repaid.

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2 Note that subsequent courts have approached this principle cautiously: see, for example, *International Alpaca Management Pty Ltd v Ensor* (1995) 133 ALR 561, *per* Beaumont and Carr JJ, and *Robinson Motors Pty Ltd v Fowler* [1982] Qd R 374, esp pp 378–79.

Pursuant to a fraudulent scheme, Pilcher and Rawlins decided to borrow some money from another set of trustees and issued a second 'purported' legal mortgage of Blackacre as security for the loan. The mortgage of the estate was fraudulently prepared by Rawlins because he did not have the legal estate, but he succeeded in convincing the trustees who were lending the money that he did.

Rawlins subsequently discharged the first mortgage to Pilcher and a reconveyance of the legal estate to Rawlins was executed. Rawlins then executed a 'correct' legal mortgage over Blackacre to the trustees. The trustees under the second mortgage were unaware that they had not received the legal interest under the mortgage until after the reconveyance. One of the issues was whether the equitable interest which the beneficiaries under the Pilcher trust held in respect of the first mortgage could prevail against the subsequent legal interest acquired by the trustees pursuant to the second mortgage.

The court held that the issue was essentially which party should have to bear the loss. According to Mellish LJ, the legal interest held by the second mortgagee (the trustees) was acquired *bona fide* for value without notice. The fact that the beneficiaries were defrauded by their trustee did not alter this because, as the court stated: 'If you trust your property to a man who turns out to be a rogue, it stands to reason that you may lose it'. Working from this principle, Mellish LJ held that, where a trustee in breach of trust conveys away a legal estate which he possesses, and that legal estate comes into the possession of a purchaser for valuable consideration without notice, that purchaser can hold the property against the beneficiaries who were defrauded by the conveyance of the trustee.

6.3 Enforceability of mere equities

As discussed above, 5.6, the decision in *Latec Investments Ltd v Hotel Terringal Pty Ltd* (1965) involves some debate as to whether or not an equity to rectify an improper exercise of a power of sale is capable of being classified as a proprietary interest prior to being enforced by a court of equity. If this 'mere equity' does not retain any proprietary characteristics, as was the suggestion by Brooking J in *Swanson Mortgage Pty Ltd v Trepan Investments Pty Ltd* (1994), then it is naturally arguable that there is no priority dispute as such, and, once it is established that a third party has subsequently taken a full equitable proprietary interest, *bona fide* for value and without notice, the mere equity is unenforceable. Certainly, it is clear following the *Latec* decision that the usual priority principle relating to a competition between equitable interests: *qui prior est tempore potior est jure* is inapplicable.

In *Double Bay Newspapers Pty Ltd v AW Holdings Pty Ltd* (1996), Bryson J, in the Supreme Court of New South Wales, concluded that the position was stated with great clarity by Upjohn J (as his Lordship then was) in *Westminster Bank Ltd v Lee* (1956), pp 18–20:

> An equitable mortgagee takes subject to all prior equitable estates or interests in the land, whether he has notice of them or not, but in relation to a mere equity it is otherwise; the defence of purchaser for value without notice may be available by the owner of an equitable estate against the owner of a prior equity.

Bryson J agreed with this approach, confirming that an equity which requires the assistance of a court, if it is to be established at all, does not enter into a competition of priorities with an equitable interest which was obtained for value and without notice of it.

EQUITABLE ASSIGNMENTS

7.1 When is an assignment in equity necessary?

Equitable principles will govern the validity of an assignment where either the law has no application, or the law has not been fully complied with. Where an assignor attempts to assign an equitable interest, unless statutory provisions regulate the assignment requirements, equitable principles will govern the assignment (*Booth v FCT* (1987)). Where an assignor attempts to assign a mere expectancy, it will be invalid at law but may be enforced in equity if valuable consideration is given (*Holroyd v Marshall* (1862)). Where an assignor attempts to assign property which is legally capable of assignment, but all the requirements have not been complied with, equity may enforce the assignment if the assignor has shown sufficient intention, through her acts, that an assignment was intended (*Milroy v Lord* (1862)). A miscellaneous category of rights exist which are not capable of being assigned, either in common law or equity, and these include: rights under a personal contract for services, rights to seek legal action (such as the right to seek damages for a breach of contract) and other rights which would be against public policy to assign.

7.1.1 Where valuable consideration is given

Where an assignment of legal or equitable property is attempted and valuable consideration is given, equity will bind the assignor to the contract. In this situation, the assignor will become constructive trustee of the interest until the interest has been legally assigned. Equity binds the conscience of the assignor and, even if the assignment is invalid at law, it will be enforceable in equity until the legal assignment has been properly effected (*Re Lind* (1915)).

7.1.2 Voluntary assignments

Where a voluntary assignment of legal or equitable property is attempted, equity will enforce the assignment if it can be shown that the donor has done all that he alone can do to effect the assignment. A mere expectancy cannot be voluntarily assigned; an assignment of a mere expectancy will only be enforceable in equity where valuable consideration is given (*Tailby v Official Receiver* (1888)). Where it is established that the legal requirements applicable to the assignment of a particular piece of property have not been complied with, equity will enforce the assignment if the donor can prove that he or she intended to assign the property and has evidenced this intention through their actions.

The test for the enforcement of voluntary assignments in equity has evolved slowly over time. It has a different focus to the equitable enforcement of assignments for valuable consideration. When equity enforces a voluntary assignment of property, it focuses upon the intention of the assignor; when equity enforces an assignment of property for valuable consideration, it focuses upon the conscience of the assignor who has received the consideration. In both cases, if the assignment is ineffective because the legal requirements have not been fully complied with, equity will enforce the assignment by imposing a constructive trust, which will exist up until the point when the legal requirements are satisfied.

7.1.3 Evolution of the equitable principles

The emergence of the equitable rules relating to the enforcement of voluntary assignments has developed over a series of cases. The equitable principles are founded upon two equitable maxims:

- equity will not assist a volunteer; and
- equity will not perfect an imperfect gift.

A volunteer is a person who has taken property without giving any valuable consideration. Equity will not protect the interest of the volunteer until the donor of the property has shown an adequate intention that he meant to pass the property. Equity will not assume an intention to make a gratuitous transfer of property. Hence, in order for a gift to be valid and for the volunteer (donee) to acquire a valid interest, the donee must have done everything necessary for the donor to do to effect a legal transfer of the property to the donee.

The concept of 'everything necessary to be done' will depend upon the method of creating the gift. If the gift is made by way of a direct assignment, consideration must be given to all the legal requirements for assignment. A court will then consider whether or not the acts of the donor evince a sufficient intention to pass the property. If the gift is by way of a trust by declaration, the court must consider whether or not the words of declaration evince a sufficient intention to create a trust. If a donor attempts to make a gift by assignment, either to the person directly or to a trustee, and that assignment is held to be invalid in equity, it cannot be validated as a declaration of trust (*Richards v Delbridge* (1874)).

In assessing the equitable rules, it must be remembered that equity functions as a supplement to the law (both common and statute) and it will only be necessary to examine the equitable approach once it has been determined that the legal requirements have not been satisfied. Whilst equity generally follows the maxim that it will not assist a volunteer, where a clear intention to assign is established and the only impediment lies in the fact that the legal requirements have not been complied with, equity will look to the substance of the transaction rather than its form.

The classic case initiating discussion on the equitable principles is *Milroy v Lord* (1862). In that case, the donor intended to establish a trust of shares for the benefit of his niece. He executed a deed, setting out the terms of the trust, but never executed a document transferring the legal interest in the shares to the trustee. According to the Memorandum of Association of the company in which the donor held the shares, the shares were only able to be transferred upon registration of a transfer executed by the donor. The trustee did, however, hold a power of attorney under which he could have executed a document of transfer on behalf of the donor.

The transfer of the shares was never executed by the donor. There was, however, a gift made of dividends which were paid upon the shares, and this was paid directly to the niece. The issue in the case was whether or not the shares could pass in equity prior to passing validly at law. There had been no legally effective assignment because the Articles of Association require the share transfers to be registered, and this had not occurred. The court ultimately concluded that the transfer of the shares was invalid at law because it had not been registered with the Share Registry; it was also held to be invalid in equity because the donor had not executed the transfer and had not, therefore, evinced a sufficient intention to pass the property.

Turner LJ set out the basic test for the valid assignment of property in equity:

> *The* Milroy v Lord *test*
>
> The donor must do everything which, according to the nature of the property in the settlement, is necessary to be done to render the settlement valid.

Equity will not perfect an imperfect gift where it cannot be shown that the donor has carried out all acts which he or she could possibly perform. The emphasis is upon the physical acts which manifest the intention of the donor. If these acts do not reach a specific threshold, then it cannot be said that the donor has shown a sufficiently clear intention to assign the property, and it will not be enforceable in equity.

It was held to be irrelevant, on the actual facts of *Milroy v Lord*, that the trustee had a power of attorney and could have executed the transfer on behalf of the donor. The reason for this was because, as the test reveals, the focus of equity is entirely upon the acts of the donor. The important point was that the donor had not executed the transfer and had, therefore, not evidenced a sufficient intention to carry out the assignment.

The court also emphasised the fact that an invalid assignment could not operate as a valid declaration of trust. Once one method of acquisition is attempted, the court will focus upon that particular method; the court was not prepared to give effect to the transfer by applying another mode of acquisition, such as a declaration of trust; if this did occur, it would mean that every imperfect gift would be made effectual by being converted into a perfect trust.

The only valid assignment on the facts was the gift of the dividends, which were considered to be an effective gift, both in law and in equity, because all the necessary legal requirements were satisfied and the dividends had been directly transferred over.

The test set out in *Milroy v Lord* was further expanded upon in the subsequent decision of *Re Rose* (1952). The facts of that case involved a purported assignment of company shares which were transferable pursuant to the registration of a share transfer with the Share Registry. The donor executed the share transfer documents in the appropriate form, and proceeded to make the transfer of his shares to his wife and to the company secretary. The donor then handed the transfers to the company secretary, as agent for the wife, and the secretary then lodged the transfers for registration. The donor subsequently died.

The primary issue in the case was when the gift of the shares became complete. It was necessary to determine the date of the gift in order to determine whether the shares were dutiable. The Crown argued that the gift of the shares was not complete until the actual registration of the transfers occurred. Against this, it was argued that the gifts could be effective in equity prior to the registration. If the gift was not complete until registration, then because registration had not occurred, they remained a part of the estate and were, therefore, dutiable. On the other hand, if the shares could pass prior to registration they would not be dutiable.

The Court of Appeal in *Re Rose* ultimately held that the transfer of the shares could be validly effected prior to registration. It was held that, since the donor had done everything necessary (and everything which he alone could do) prior to the registration of the share transfers, the beneficial interest in the shares should pass. Lord Evershed considered the *Milroy v Lord* decision and concluded that, in that case, the reason why the gift was not effective in equity was because the donor had not done everything necessary to be done; he had not executed the transfers. On the facts of *Re Rose*, however, the donor had done all that lay in his power to do, and this was sufficient for equity to enforce the transfer.

> *The* Re Rose *test*
>
> If the donor has done everything necessary to reveal the requisite level of intention to transfer the property, then the assignment will be effective in equity. In a situation where 'everything necessary' involves actions by third parties (such as the act of registration), the donor is only required to carry out those acts which it is within his or her power to carry out.

A final point about *Re Rose* is the relevance of the fact that the registration of the share transfers could have been refused by the directors of the family company in their absolute discretion. The Court of Appeal rejected this possibility as irrelevant to the test because the focus was upon the acts of the donor, not upon the possible acts of a third party.

The decision of *Re Rose* was similar to the judgment of Griffith CJ in the earlier Australia decision of *Anning v Anning* (1907), although the court in *Re Rose* did not refer to it. The facts of *Anning v Anning* involved the attempted assignment of a legal chose in action. Pursuant to statutory requirements, the chose in action could not be legally assigned prior to the assignor setting out the assignment in writing, both parties signing the document and notice being given to the debtor. The issue on the facts was whether the chose in action could pass if the assignor had not given notice to the debtor. The court developed three different tests, summarised as follows:

- *Griffith CJ test* – in order to render a voluntary settlement valid and effective, the settlor must have done everything which, according to the nature of the property comprised in the settlement, was necessary to be done by him to transfer the property and render the settlement binding. This test is now generally accepted as the correct test. It is similar to the test set out in *Re Rose,* and it has subsequently been adopted by a majority in the High Court decision of *Corin v Patton* (1990).
- *Isaacs J test* – Isaacs J felt that, in order to pass property, it was necessary to comply with all the necessary legislative requirements for assignment. If all the legislative requirements had not been complied with, then there could be no valid assignment. Under this approach, it would seem that there could be no assignment in equity until there was an assignment at law, because there could be no assignment until all acts, including acts which could only be carried out by third parties, have been carried out. Under this test, at least as far as choices in action are concerned, it is not possible to assign until all the legal requirements have been complied with. This test has now been disapproved (*Corin v Patton* (1990)).
- *Higgins J test* – this is similar to that of Griffith CJ but differs slightly. Higgins J felt that the assignor must do everything which it is within his or her power to do to divest the gift. This does not necessarily mean everything which is legislatively required to be done, but everything which is within the power of the assignor to do. It is to be distinguished from the test set out by Griffith CJ, which requires everything to be done which the donor alone can do. Higgins J requires the donor to do everything which is within the power of the donor to do. This test is similar to that enunciated by Turner LJ in *Milroy v Lord*, but the High Court now favours the Griffith CJ test (*Corin v Patton* (1990)).

The final determination of the equitable test for the enforcement of voluntary assignments came in the Australian High Court decision of *Corin v Patton* (1990). On the facts of that case, Mrs Patton was registered as a joint proprietor of Torrens title land with her husband. Mrs Patton executed a transfer of her interest in the land in favour of her brother, who accepted and signed the transfer as transferee. This transfer was expressed to be in consideration of her brother executing a deed of trust, under which Mr Corin declared that he held

the half-interest in the land as a tenant in common on trust for Mrs Patton. The whole transaction was carried out in order to sever the joint tenancy existing between Mr and Mrs Patton. One of the issues in the case was whether the transfer to the brother was enforceable prior to registration.

Mrs Patton took no action to procure the production of the certificate of title so as to enable registration of the transfer, and died before the transfer had been registered The certificate of title was held by the State Bank of NSW under an unregistered mortgage and remained with the bank. The Bank of NSW did, however, have a discretion under s 96 of the Conveyancing Act 1919 (NSW) to make the duplicate certificate of title available to the Titles Office where properly requested.

The court held that the assignment was not effective in equity. Mrs Patton had not shown a sufficient intention to pass the property; she had not carried out all of the acts which she alone could do because she had not made the certificate of title available, and the fact that the bank had a statutory discretion to make the title available did not alter this.[1]

In summary then, it appears that the equitable test for enforcing a voluntary assignment of property is strictly applied. It must be proven (*per* majority in *Corin v Patton, Re Rose* and the test of Griffith CJ in *Anning v Anning*) that the donor has done everything which he or she alone can do to effect a transfer of the legal title beyond the recall or intervention of the donor. Satisfaction of this test will depend entirely upon the nature of the property involved and the acts which have been performed. The donor only has to carry out the act she alone can do. If the donor is primarily responsible for carrying out the act, the act must be carried out before equity will enforce the gift. This would seem to apply even if a third party has a discretion to perform the act. In the context of Torrens title land, an assignment is only complete once the donor's direction is acted upon and the certification of title is actually produced: *Motor Auction Pty Ltd v John Joyce Wholesale Cars* (1996).

7.2 Assignment of choses in action

The assignment of choses in action has traditionally been an area where equity has played an important role. This is largely because of the fact that many choses in action are not presently enforceable rights, but rather, future expectancies. Only equity will enforce the assignment of a future expectancy, and it will only be enforced where valuable consideration is given.

1 See, also, *Costin v Costin* [1994] NSW Conv R 55715.

7.2.1 What is a chose in action?

A chose in action is an intangible right against personal property which is enforceable by way of a court action. The foundation of the chose in action is its enforceability. Because the chose is intangible it cannot be enforced by physical possession; it can only be enforced by judicial proceedings.

Choses in action can be legal, equitable or statutory in nature. If the right is enforceable under statute, it will constitute a statutory chose in action. A good example of statutory chose in action is the right to copyright. If the right is enforceable pursuant to a body of principles which have evolved at common law, such as contract or tort, then the chose in action will be legal in nature. A good example of a legal chose in action is a debt or a right to damages arising from a breach of contract or a tortious wrong. Finally, if the right is enforceable pursuant to equitable principles, the chose in action will be equitable. Some examples of equitable choses in action include partnership interests and the right of beneficiaries to enforce the trust against the trustee. The partnership interest is historically considered to be an equitable interest because it is a right or interest enforceable in equity and not at law (*FCT v Everett* (1978)).

A partnership interest is comprised of two different rights: the right to income which the partnership accrues, and the right to assets which the partnership purchases. The rights which make up the partnership are not divisible (*FCT v Everett* (1978)).

A beneficiary under a discretionary trust holds an equitable chose in action to secure the proper administration of the trust. Similarly, a beneficiary under an unadministered estate only has a right to have the estate properly administered. This right is in the nature of an equitable chose in action (*Official Receiver in Bankruptcy v Schultz* (1990)).

7.2.2 Assigning a chose in action at law

Traditionally, the common law considered enforceable legal rights to be unassignable. The assignment of legally enforceable rights were treated as ineffective due to policy considerations which focused upon the need to prevent a proliferation of judicial actions in this area.

As Lord Coke stated in the *Lampet* case (1612):

> The great wisdom and policy of the sages and founders of our law, who have provided that no possibility, right, title nor thing in action, shall be granted or assigned to strangers, for that would be the occasion for multiplying contentious suits.

Gradually, this prohibition was worn down. Assignors used different methods to get around the prohibition, for example, novation or a power of attorney given by the assignor to the assignee to sue the debtor at law in the assignor's name. Eventually, statutory provisions were introduced. The Judicature

system originally introduced a statutory regime for the assignment of choses in action. Most States now have specific statutory requirements for the assignment of choses in action.

In Victoria, s 134 of the Property Law Act 1958 states:

> An 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 thing 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 claim such debt or thing in action, shall be and shall be deemed to have been effectual in law (subject to equities having priority over the right of the assignee) to pass and transfer from the date of such notice:
>
> (a) the legal and other remedies for the same; and
>
> (b) all legal and other remedies for the same; and
>
> (c) the power to give a good discharge for the same without the concurrence of the assignor.

Section 134 will apply to all legal and equitable choses in action. *Dicta* in the decision of *FCT v Everett* interprets the expression 'legal chose in action' in s 134 to read 'lawfully assignable chose in action'. This interpretation is based upon the fact that the section appears to contemplate the assignment by a beneficiary of an equitable chose in action against a trustee. There would be, according to the court, no point in referring to a trustee if the assignment of equitable choses in action were not covered by the section.

Other statutory regimes may also be relevant to the assignment of particular choses in action. For example, shares must comply with the Corporations Law before they can be properly assigned: s 1085 sets out that shares are transferable in the manner provided by the Articles of Association and s 1091 sets out that a proper instrument of transfer must be delivered to the company. A simplified procedure for the transfer of shares in companies listed under the stock exchange is set out in ss 1097–113. The Articles of Association will generally require registration of such transfers.

Where the chose in action arises out of contractual rights, additional contractual obligations for the assignment of such rights may be imposed. For example, a contract for personal services may not be able to be assigned without consent because the contract is closely linked to the personal qualifications of one of the contracting parties. Attention must be given to the terms of the contract and any conditions relating to the assignment of the right, including whether such an assignment is expressly or impliedly prohibited without consent (*Peacocke Land Co v Hamilton Milk Producers* (1963); see, also, Chin, NY, 'Impediments to assignments' (1991) 22 Western Australia UL Rev 123).

If all the legal requirements for the assignment of the chose in action have not been complied with, the assignment may be enforceable in equity.

7.2.3 Assigning a chose in action in equity

The principle enunciated by Griffith CJ in *Anning v Anning* and endorsed by the majority of the High Court in *Corin v Patton* will apply. A donor of a chose in action need only do all of those acts which are only within his power to do. Hence, as set out in *Re Rose*, an assignment of shares will be valid when the donor has properly executed a transfer, even though the transfer has not yet been registered. Notice to the debtor of the assignment does not need to be performed by the donor; anybody could perform it, hence an assignment of a chose in action will be enforceable in equity even if the donor themselves have not informed the debtor (*Anning v Anning, per* Griffith CJ).

7.2.4 The importance of the notice requirement

Whilst it is true to say that notice is not a requirement for the enforceability of a voluntary assignment of a chose in action in equity, the giving of notice is, nevertheless, a beneficial step. In *Mantain Road (No 9) Ltd v Michael Edgley Corp Pty Ltd* (1999), Tipping J, in the New Zealand Court of Appeal, said that it is clear enough from the authorities that notice is not necessary to complete an equitable assignment; however, 'notice to the person liable has consistently been regarded as necessary to give the assignee title to claim the benefit of the chose in action against that person'.

According to the rule in *Dearle v Hall* (1828), priority between successive dealings with a chose in action will be determined according to the order in which the assignees have given notice. This rule constitutes an exception to the general principle that equitable interests take priority in the order in which they are created. If notice is not given in a particular assignment, the assignee may lose priority.[2]

For example, if A assigns a right to money in a bank account to B and then attempts to assign it to C, and C gives the bank notice of the assignment, C's interest will take priority over B's, even though B's interest was prior in time.

The rule in *Dearle v Hall* makes notice an important requirement, although it should be remembered that the form of the notice is broadly interpreted and that the rule only applies to choses in action, not to intangible interests relating to real property.

2 The authority of the rule in *Dearle v Hall* was confirmed in *Weineinkauf GmbH & Co v Arbuthnot Factors Ltd* [1988] 1 WLR 150. See, also, Pfeiffer Weinkellerei, E, 'Priority rules of *Dearle v Hall* restated' [1999] Conv 311.

7.2.5 Mere expectancies

An assignment of a chose in action can only occur at law where there is a presently existing right. If the right is not presently existing, it can only be assigned in equity where valuable consideration is given (*Re Lind* (1915); *Williams v Commissioner of Inland Revenue* (1965)). In light of this, it is important to understand the difference between a presently existing right and a mere expectancy arising in the future. This distinction is not always clear, as is illustrated in the following two decisions.

In *Norman v Federal Commissioner of Taxation* (1963), there was an attempted voluntary assignment to a wife of a right to interest under a loan and dividends from shares which the husband was to receive. The Federal Commissioner of Taxation claimed that the husband had received this income. The issue was whether the assignment to the wife was effective.

The High Court held by majority that the interest under the loan agreement and the right to dividends were mere expectancies and could not be assigned in the absence of consideration. Menzies J felt that the right to interest under a loan which was capable of being repaid without any notice could not constitute an existing right. The right was capable of being destroyed independently of any acts by the assignor and, therefore, could not be regarded as presently existing. Similarly, the court held that the right to the dividends was a mere expectancy which may never arise, because the directors may decide not to declare a dividend and a dividend does not constitute a debt until it has been declared.

On the other hand, in *Shepherd v FCT* (1965), the assignor owed a patent in respect of certain inventions for castors. The assignor had licensed a licensee for a number of years to manufacture the castors on terms that he, as licensor, would receive 5% royalty on the gross sale price of the castors. The assignor assigned the right to royalties. The issue was whether or not the assignment was valid.

The High Court by a majority held that the right to royalties was a presently existing chose in action and could be assigned in the absence of valuable consideration. Whilst it was true that the right to royalties might become divested if the patent was not maintained or if it became void, the court held that the possibility of invalidation did not prevent an enforceable presently existing right to royalties from arising. There was no uncertainty relating to the assignor's contractual right against the licensee.

It would seem that the only way to distinguish the decision in *Shepherd* from that in *Norman* is that, in *Shepherd*, the whole chose in action was assigned and the right to royalties could not be arbitrarily determined by the debtor, whereas in *Norman* only a part of the chose was assigned the right to interest and the right to dividends and these rights could be arbitrarily determined by the acts of the debtor. The fineness of this distinction

emphasises the uncertainty apparent in this area. Nevertheless, if a right is characterised as a mere expectancy, however fine the distinction might be, it cannot be assigned in the absence of valuable consideration.

Rights accruing under an executed bilateral contract may be transferred by way of equitable assignment for value, so as to enable mutual enforcement between the equitable assignee and the other contracting party – provided that the contract is, by its terms, assignable and the performance of the obligations of the other contracting party is not rendered more onerous (*Calaby Pty Ltd v Ampal Pty Ltd* (1990)). It has been suggested that, as the equitable assignee is regarded as the 'entitled' holder of the chose, he is able to sue the debtor on that chose provided that, as a procedural requirement, the assignor is joined to the action: *Three Rivers District Council v Governor and Company of the Bank of England* (1995). The rationale behind this process has been questioned and, in *Calaby Pty Ltd v Ampol Pty Ltd*, Angel J noted that, if the assignment is undisputed, notice is given and the other party to the contract is bound to complete with the assignee and not the assignor, there seems no reason in principle why the assignor should be joined to the action.

CHAPTER 8

FIDUCIARY OBLIGATIONS

8.1 Definition

There is no comprehensive definition of a fiduciary relationship. Indeed, Mason CJ has asserted that the fiduciary is a 'concept in search of a principle' (Finn, PD (ed), *Essays in Equity*, 1985). An influential description is given by Mason J in *Hospital Products Ltd v United States Surgical Corp* (1984):

> A fiduciary is a person who undertakes or agrees to act for, or on behalf of, or in the interests of, another person, in the exercise of power or discretion which will affect the interests of that other person in a legal or practical sense.

In its rudimentary form, a fiduciary relationship represents a protective shield – it protects those parties within a relationship that are deemed needy of such protection without seeking to alter the fundamental objective of the relationship. Hence, in one sense, the fiduciary relationship is a supervisory mechanism: it monitors the functioning of given relationships with the primary aim of blocking prospective equitable breaches, and relieving any that may have already occurred. In the words of La Forest J in *Hodgkinson v Simms* (1994):

> The law of fiduciary duties has always contained within it an element of deterrence. The law can, accordingly, monitor a given relationship that society views as socially useful while avoiding the necessity of formal regulation that may tend to hamper its social utility.

There are many hallmark features which may indicate the existence of a fiduciary status within a relationship. Common features include: the existence of an undertaking such that one party undertakes to act in the interests of another and assumes power over the other; one party entrusting another party with some duty, information, property or some other obligation; one party in a vulnerable and disadvantaged position and being at the 'mercy' of the other party; reliance, mutual reciprocity and confidence between parties to a relationship; and the existence of a discretionary power in one party which may adversely affect the interests or proprietary rights of the other party.

In *Lac Minerals v International Corona Resources* (1989), Sopinka J noted that there are three common characteristics of fiduciary relationships. The first is that the fiduciary has scope for the exercise of some discretion or power; the second is that the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests; and the third is that the beneficiary is peculiarly vulnerable to, or at the mercy of, the fiduciary holding the discretion or power. His Honour noted that it is possible for a fiduciary relationship to be found without the existence of these characteristics

and that the existence of these characteristics will not necessarily mean that a fiduciary relationship exists. However, they provide a useful framework from which to commence a relational analysis.

In *Hodgkinson v Simms* (1994), La Forest J emphasised that the 'fiduciary principle monitors the abuse of loyalty reposed' (pp 173–74). A fiduciary relationship is sometimes constructed by a court from the facts of the case, even where there is no undertaking or apparent vulnerability. Such findings are generally made to entitle a deserving plaintiff to the distinctive equitable remedies for breach of fiduciary obligation: an account of profits and the constructive trust. Other reasons for 'inventing' a fiduciary relationship include enabling the plaintiff to avoid the statute of limitations which does apply to some forms of civil liability. These cases are controversial and are often considered to 'distort' the essential nature of a fiduciary relationship.

Fiduciary relationships arise in all forms of social interaction – whether it be commercial or personal in nature. Whilst courts are often reticent to impose fiduciary obligations upon parties who have entered into arm's length commercial arrangements, it will not present an insuperable objection and, indeed, components of such relationships may be held to be fiduciary whilst others remain unaffected. A similar position exists with respect to personal relationships. In *Breen v Williams* (1996), the High Court of Australia noted that parts of the doctor/patient relationship exhibit fiduciary characteristics. As stated by Gaudron and McHugh JJ, from:

> ... the most mundane consultation with a general practitioner through to the most complicated surgical procedure by a specialist surgeon, a patient is invariably dependent upon the advice and treatment of his or her doctor. Patients also invariably confide intimate personal details about themselves to their doctors. In 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.

See further discussion on *Breen v Williams* below, 8.6.

8.2 Classic fiduciary relationships

Certain relationships have long been regarded as possessing fiduciary characteristics. These relationships include those which oblige one party to act in the best interests of the other, and which penalise improper profit-making by the former. There are some fiduciary relationships which are traditionally recognised but retain flexibility in terms of their scope and the fact that the person 'represented' by the fiduciary has the freedom to decide whether or not the relationship should continue, whereas there are others which are far more restrictive because they arise by operation of law.

The diversity in the regulation of classic fiduciary relationships was carefully enunciated by Handley JJ (with whom Priestley and Stern JA agreed) in *Brunninghausen v Glavanics* (1999). That was a case in which the issue was whether the defendant, the sole effective director of a company and its majority shareholder, owed a fiduciary duty to the plaintiff when the plaintiff sold his shares in the company to the defendant and the defendant's wife.

> Some of the traditional fiduciary relationships, such as partners, principal and agent, solicitor and client, and priest and penitent are created by the more or less free choice of the parties. Subject to contractual restraints, the person to whom fiduciary duties are owed in these relationships is free to terminate them at any time. Other relationships, such as guardian and ward, parent and child, and trustee and beneficiary, arise by operation of law or from the acts of others. The parties in these relationships to whom fiduciary duties are owed did not enter into those relationships voluntarily and are not free to terminate them [p 555].

8.2.1 Joint ventures

Joint ventures are profit-making ventures which are set up between a group of persons who join together to generate a product, the profit of which is capable of being shared amongst the participants. Some joint venturers will be held to be under fiduciary obligations, others will not. It will depend upon the form which the particular joint venture takes and the content of the obligations which the joint venture parties have undertaken. In *United Dominions Corp Ltd v Brian Pty Ltd* (1985), the issue of a fiduciary relationship arising within a joint venture was considered.

On the facts of that case, Brian, UDC and a third company were in a joint venture relationship in a land development project which had been mostly financed by borrowings from UDC. The project realised a substantial profit but UDC claimed to retain all of it. It relied upon what was called a 'collateralisation clause' in a mortgage given by SPL before the execution of the joint venture agreement. The High Court ultimately held that UDC could not rely on the clause when the share of the profits was computed.

Mason, Brennan and Deane JJ held that the most that can be said about whether a joint venture constitutes a fiduciary relationship is that it 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.

Upon the facts here, UDC was effectively a partner with all the other parties as well as being a lender. However, the fact that UDC was also a lender did not absolve it from fiduciary duties. It is not necessary to draw up a formal agreement between the parties to constitute a fiduciary relationship, nor is it necessary to establish any consensual arrangement. A fiduciary relationship will ordinarily exist between prospective partners who have embarked upon a partnership business or venture before any precise terms have been actually drawn up.

Certainly, the mutual trust and confidence which underlies most consensual relationships is likely to be more readily apparent in the case where mutual rights and obligations have been expressly set out, although it may be implied in particular agreements. The High Court ultimately held that the proposed participants in the joint venture owed 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 gaining any collateral advantage in relation to the proposed project, without the informed assent of the other participants. The court held that SPL and UDC were in breach of their duties and UDC was precluded from relying upon the mortgage clause.

The principles to be gleaned from this case can be summarised as follows:

- a single joint venture can attract fiduciary duties;
- the non-existence of a completed partnership/joint venture contract will not preclude the creation of a fiduciary relationship, although the existence of such an agreement makes it easier to see whether the rights raise issues of mutual trust and confidence;
- the partners/joint venturers may be fiduciaries at the stage when they are first embarking upon the project which ultimately is to form the basis for an agreement; and
- a fiduciary relationship imposed at the early pre-agreement stage will require the parties to refrain from obtaining any collateral benefit without the full assent of all of the joint venturers/partners.

8.2.2 Partnerships

Unlike the joint venture, the primary purpose of a partnership is the joinder of persons engaging in a common business undertaking for profit. Partners generally owe fiduciary duties to each other in relation to the conduct of, and the assets owned by, the business. The application of fiduciary obligations in a partnership was considered in *Chan v Zacharia* (1984).

On the facts, both Dr Chan and Dr Zacharia conducted a medical practice in partnership. They held a joint three year lease at the premises where the medical practice was conducted with an option to renew for a further two years, provided notice was given to the lessor not later than three months before the end of the term. During the third year of the term, the partnership was determined and a receiver was appointed to wind up the partnership. The parties could not agree to the joint exercise of the option of renewal. The appellant, Dr Chan, within the option period, sought a renewal for himself and later the lessor granted a lease to him for two years upon the payment of a premium. The High Court considered:

- whether a fiduciary relationship could exist in such a partnership; and
- if so, what the duties were.

On the facts, it was held that a fiduciary relationship did exist and that Dr Chan was bound to account in the winding up of the partnership as a constructive trustee for any benefit he received from the new lease.

Deane J held that, after the dissolution of the partnership, the two doctors held the legal rights under the lease including the option, as trustees, for those entitled to share in the proceeds of the realisation of the partnership assets. They both occupied related but overlapping roles. They were trustees of those legal rights as well as being partners in the partnership of which those rights were an asset.

In both capacities, Dr Chan assumed fiduciary obligations. Each role complemented and reinforced the fiduciary relationship involved in the other. In particular, each role involved the fiduciary obligation to act, in relation to rights under the lease, in the interests of the dissolved partnership (not themselves). The court clearly held that fiduciary relationships can continue despite the fact that the partnership is dissolved.

The real issue in the case was whether Dr Chan was entitled to obtain and retain the benefit of a new lease of the premises for himself. Deane J held that there are basically two essential duties here:

- the duty to avoid a conflict of interest or a significant possibility of such a conflict; and
- the duty to account for any benefit or gain obtained or received by reason of or by use of the fiduciary position.

He held that, whatever way one looks at it, Dr Chan abused his fiduciary position as a trustee and former partner in seeking to obtain an advantage for himself by exercising the option to renew in his own name. He subjected the performance of his fiduciary obligations to the pursuit of his personal interest. As such, he held the lease upon constructive trust.

The approach of Deane J here rests upon the irrefutable presumption that the new lease was obtained by the use of the partner's position as trustee of the previous tenancy. Indeed, it is difficult to argue that there was any other means by which Dr Chan could have obtained the new lease.

Murphy J, dissenting, in that case, felt that exercise of the option was purely a matter of choice, and obtaining a new lease was not a part of the winding up of the partnership. There was no obligation on either party to join in renewing the lease. It was not equitable to impose upon Dr Chan a duty to join in the exercise of the option. He questioned why Dr Chan should be expected to enter a fresh transaction and become a co-tenant for a further term with a person to whom he was antagonistic and who was an adversary in litigation. The acquisition of a further lease was not for the purpose of the partnership business. According to Murphy J, in renewing this lease, Dr Chan did not deal with the partnership property for his own advantage.

Following the majority in this case, it seems clear that partners may owe fiduciary obligations to one another in relation to the conduct of the partnership and in respect of the assets of the partnership. Those obligations will endure beyond any formal dissolution of the partnership to cover any matters involved in its winding up, although, where the partnership is dissolved by the death of one of the partners, the continuing partners do not become trustees for the estate of that former partner over such part of the profits of the business as are attributable to the use of the deceased's share. The relationship between the continuing partners and the estate of their former partner is more in the nature of a debtor and creditor relationship.

8.2.3 Corporations

It is possible for corporations to owe fiduciary duties to third parties with whom they deal. Much will depend upon the circumstances of the transaction. In *Hill v Rose* (1990), Tadgell J held that a company and its controllers owed fiduciary obligations to a third party whom they had induced to invest in the company's business; the fiduciary obligations were breached because the company failed to provide adequate information concerning the financial viability of the business and its ownership.

It is certainly not clear that every arrangement which may lead into a business partnership is fiduciary in nature. Commercial relationships are capable of being fiduciary in nature, but will not always be so. As noted by Mason J in *Hospital Products*, the commerciality of a relationship will not preclude the application of fiduciary duties, although a careful assessment of the circumstances must be carried out. Some of the important considerations in such cases include:

- where the nature of the relationship is contractual and the contractual duties involve trust and confidence, it is possible that the parties will be construed as fiduciaries;
- where the relationship is commercial in nature some care must be taken, although this should not prevent the conclusion that the parties owe fiduciary obligations. If the arrangement is commercial, arm's length and purely addressed at allowing each party to gain profit, a fiduciary relationship is unlikely. Nevertheless, the fact that one party is gaining some benefit from a contract does not necessarily preclude the possibility of a fiduciary relationship if that party is also acting for the benefit of the other party;
- where there is no contract in force, but some oral arrangement and conduct in anticipation of the agreement, a fiduciary agreement can exist; fiduciary duties are not dependant upon the existence of a consensual arrangement. It must be clear from the conduct, however, that the

relationship involves acting for the benefit of others, even if it also involves personal benefit;

- fiduciary duties can exist even if the relationship between the two parties has dissolved. The duties will generally apply to the property which was the subject of the relationship and it should not extend beyond this.

8.2.4 Trustee and beneficiary

A fiduciary relationship will always exist between a trustee and beneficiary and will be strictly enforced. The reason for this lies in the fact that the trustee actually has the legal estate vested in him, making the potential for abuse towards the beneficiary far greater. The stringency with which the courts approach the fiduciary relationship in this context is clearly manifested by the classic decision of *Keech v Sandford* (1726).

That case involved a lease which was held by a trustee upon trust. Upon the expiration of the lease, the trustee sought a renewal of it for the benefit of his beneficiary; this was refused. The trustee then sought and obtained a renewal of the lease for his own benefit. Lord Chancellor King held that the trustee, despite the fact that he was attempting to obtain the option in circumstances where the lessor had refused to renew for the benefit of the beneficiary, could not obtain the benefit of the option to renew under the lease.

The Lord Chancellor had the following comments to make:

> Though I do not say there is a fraud in this case, yet he should rather have let it (the lease) run out than to have the lease to himself. This may seem hard, that the trustee is the only person of all mankind who might not have the lease; but it is very proper that the rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequences of letting trustees have the lease on refusal to renew the *cestui que* use.

The fiduciary obligations of the trustee required him not to seek the lease for himself, and if a trustee does obtain a lease for himself, he will automatically hold it upon constructive trust for the benefit of the beneficiary. The foundation of the rule in *Keech v Sandford* is that it is contrary to public policy to allow a trustee to claim that in obtaining the renewal of the lease he or she is acting in the interests of all persons interested in the old lease. The rule is clearly applicable to trustees, whether the trust is express, resulting or constructive, although it is possible that it may apply with less stringency to other types of fiduciary relationships existing outside the trustee/beneficiary realm.

8.2.5 Principal and agent

An agent will commonly owe a fiduciary duty towards her principal. Nevertheless, it appears to be true that not every agent will be a fiduciary. Gibbs CJ, in *Hospital Products,* clearly stated the view that not every agent is a

fiduciary. Where the agent receives property either for investment, sale or safe custody, then she will also be a trustee of the property. Where, however, an agent merely collects rents or debts upon commission, then unless the agency is of an exceptional character revealing a relationship of particular trust and confidence, fiduciary obligations may not be imposed.

Fiduciary obligations may be imposed where the agent assumes a clear representative capacity. Generally, if the agent is involved in purchasing some property for the principal, or a like transaction, the relationship will have fiduciary duties superimposed upon their existing duties. This is particularly appropriate where the relationship gives the agent intimate knowledge of the plaintiff's difficulties and of the value of the property. The position is well set out in *McKenzie v McDonald* (1927).

The facts of that case involved a plaintiff widow who wanted to sell her farm and purchase a property in Melbourne, and the defendant, who was a real estate agent. The plaintiff had already leased out the farm to a tenant. The plaintiff told the real estate agent of her wishes and she put a price of £4 10s per acre upon the farm. The real estate agent inspected the property and was told by an experienced land valuer in the district that it was worth the price she asked. The real estate agent then wrote to the widow, telling her that he believed the farm would not receive as much, that she was asking too much and the price should be lowered. The agent then proposed that the plaintiff should exchange the farm for his suburban shop and dwelling, which he valued at £2,000; valuing the farm at £4 per acre, he paid her the difference. The plaintiff agreed to the proposal and signed a contract to that effect. It turned out that the shop and dwelling was worth no more than £1,150. The defendant's real estate agent then sold the farm at an increased price to Littlewood, who entered into a mortgage in order to repay the amount. The plaintiff argued, *inter alia*, that the defendant had breached his fiduciary duties towards her.

The High Court held that the defendant owed fiduciary duties in his capacity as a real estate agent. During the course of his judgment, Dixon AJ was careful to point out that not all principal/agent relationships are fiduciary in nature. In this case, the real estate agent assumed the function of advising and assisting the plaintiff in the disposal of her property. As a result of this position, he was furnished with an intimate knowledge of her financial position, her obligations, and her family needs. He advised her upon the wisdom and practicability of raising money by mortgage and acted for her in an effort to do so. He then abused this position by setting out to make as advantageous a bargain for himself as he could. He suppressed the opinion of the experienced land valuer, wrote a misleading and untruthful report, underestimated the value of the shop and grossly overestimated the value of his land. The defendant was, therefore, held to be in breach of his fiduciary obligations and was obliged to pay compensation to the plaintiff. The compensation payable was the difference in price between what was paid by the defendant to the plaintiff and the real value of the farm.

It is now clear that any commission made by an agent in breach of their fiduciary duty is held by the agent as constructive trustee for the benefit of the principal. In *Attorney-General v Reid* (1994), Lord Templeman, following the maxim 'equity deems that to be done which ought to be done', concluded that as soon as the secret commission or bribe is received by the agent, the fiduciary holds it as a constructive trustee; if the property decreases in value the fiduciary must pay the difference between that value and the initial amount. The rationale for this approach is that a fiduciary must account for any benefit or profit he or she receives as a result of their breach and this principle must not be diluted, or it would impede the effectiveness of fiduciary protection. In this respect, the Privy Council disapproved of the decision of the English Court of Appeal in *Lister v Stubbs* (1890).

8.2.6 Solicitor and client

A fiduciary relationship will usually exist between a solicitor and client because of the vulnerable position in which a client is generally placed. The solicitor must act for the sole benefit of the client and has a duty to avoid all conflicts of interest which may arise. The issue in client/solicitor relationships is not so much whether a fiduciary relationship should be imposed, as it is generally assumed, but rather whether the solicitor is in conflict of interest. The fiduciary duties imposed in a solicitor/client relationship, particularly the duty to avoid a conflict of interest, are usually strictly enforced; this is clearly illustrated in *Farrington v Rose, McBride and Partners* (1985).

In that case, the defendants were a firm of solicitors who acted for the plaintiff in a personal injury claim. The plaintiff sought advice from the firm concerning how a damages award they had been paid could be invested. The firm had, as a major client, a large group of land development companies. A solicitor acting on behalf of the firm advised the plaintiff to invest in the property group by granting a mortgage to one of the nominee companies, although he did not disclose that he was acting for the group. Two years later the investment group went into receivership and the plaintiff argued that the solicitor had breached his fiduciary duty. The trial judge rejected this, although it was allowed upon appeal.

Richardson J held that solicitors will generally be under fiduciary obligations to act fairly and openly with their clients. In this situation, there was a question of whether the firm acquired any personal benefit, combined with the issue of whether the firm could perform its duties of loyalty towards two clients. The court held that the firm had breached the conflict rules because it could not properly discharge duties of loyalty to both.

No agent who has accepted an employment from one principal can, in law, accept an engagement inconsistent with his duty to the first principal from a second principal, unless he makes the fullest disclosure to each principal of his

interest and obtains consent. If there is an actual or potential opposition of interests, a breach of duty will arise unless consent is obtained.

8.2.7 Director and company

Director and company is one of the most easily established fiduciary relationships, because a director will generally owe fiduciary duties to the company as a whole. This represents the general rule, although in *Brunninghausen v Glavanics* (1999) Handley JA noted that, while the absence of a direct fiduciary obligation between a director and a shareholder is an aspect of a company's legal personality, exceptions may arise where the relationship between the director and shareholder is very close, and their dealings are direct and endow the director with the capacity to affect 'the interests of the plaintiff in a practical sense'. This is particularly evident where there is a sole director involved in commercial dealings with the shareholder.

A director will not necessarily be involved with the management of the company's business, although if he or she is, the scope of fiduciary obligations needs to be carefully examined. It is possible to be a director of more than one company if a sensible approach is adopted and the director avoids direct conflicts of interest. Consideration of the actual circumstances needs to be taken into account, and it must also be remembered that the Companies Code adds substantially to any equitable duties which may be imposed upon a director. The equitable approach to the assessment of fiduciary obligations owed by directors is examined in *Regal Hastings Ltd v Gulliver* (1942).

On the facts of that case, the directors of Regal Hastings Ltd formed a subsidiary, Hastings Ltd (HAC), in order to purchase two cinemas, and the directors from Regal Hastings were asked to invest in HAC to assist with the purchase. Hastings Ltd acquired the cinemas and, two weeks later, the company was sold, producing a profit on the shares. Regal, under its new management, took proceedings against the ex-directors seeking an account of the profits they had made upon the sale, arguing they were in breach of fiduciary duty because directors cannot make a profit from the company.

The House of Lords held that the ex-directors were liable to Regal for these profits on the ground that they had obtained their shares by reason of their position as directors of Regal and in the course of their office as directors. Viscount Sankey held that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interests of those whom he is bound to protect. The liability arising from the mere fact of a profit, however well intended, cannot escape the risk of being called upon to account.

Whilst this seems harsh, directors investing their own money in a risky capital venture should approach such an investment extremely cautiously, particularly where they make a good profit, to ensure that they are not in breach of fiduciary duties owed towards the company.

In *Whitehouse v Carlton Hotel Pty Ltd* (1987), the High Court dismissed an appeal against a decision from the Court of Appeal in Queensland which held that an allotment of shares by the governing director was not a valid exercise of the powers because it was in breach of his fiduciary obligations as director of the company. The plaintiffs were the recipients of the allotments. There were (quite obviously) long running hostilities within the Whitehouse family.

The essential issue of the case was whether the purported allotment by Mr Whitehouse to his two sons of two B class shares in Carlton Hotel Pty Ltd was a valid exercise of the powers and discretion vested in him by the articles of the company. At the time of the allotment, Mr and Mrs Whitehouse were divorced and the family was divided. The capital of the company was divided into three classes, A, B and C. Only Mr Whitehouse held A class shares, which carried unrestricted voting rights. Mrs Whitehouse held B class shares and the sons held C class shares. The C class shares carried rights to profits and surplus capital but no voting rights. Mr Whitehouse purported to make an allotment of B class shares to the sons so that the daughters would not gain control of the company upon the death of Mrs Whitehouse. The allotment had the effect of creating a new majority.

The court held that directors of a company cannot ordinarily exercise fiduciary power to allot shares for the purpose of defeating the voting power of existing shareholders by creating a new majority; directors should not favour one group of shareholders over another. The only substantial motivating purpose for the allotment of shares in this case was the manipulation of voting power; hence, it constituted a breach of fiduciary duty. The only qualification to this rule is that a voidable allotment made by directors for an impermissible purpose can subsequently be ratified by the directors.

8.2.8 Employer and employee

Employees are often described as owing fiduciary duties to their employers. However, given the fact that the employment relationship is generally regulated by contract, this should be carefully examined. A close consideration of the terms of the employment contract needs to be carried out and, in particular, attention should be given to the character of the employment and the nature and extent of the obligations owed. Where the employee is in a position of trust and responsibility, the employee may be held to be under a fiduciary obligation to carry out those duties properly.

In *Reading v R* (1951), the plaintiff had been employed by the British Army and carried the rank of sergeant. When in Egypt, and whilst still on active service, the plaintiff had agreed to safeguard the journey of lorries, which contained illegal spirits, to particular destinations for a fee. As he always wore military uniform, inspection of the lorries by the police was avoided. The plaintiff received £20,000 for his services. He was subsequently

court-marshalled and sent to prison. After his release he sought the return of the amount seized. His appeal to the House of Lords failed.

The House of Lords held that the Crown was justified in retaining the money on the grounds that it was received in breach of his fiduciary duty to the Crown as his employer. The court held that a fiduciary relationship can exist whenever the plaintiff entrusts to the defendant property, including intangible information, and relies on the defendant to deal with such property for the benefit of the employer.

On the facts, the Crown entrusted to its employees and servants a uniform (and its intangible attributes such as authority, prestige, immunities, status, etc) to be used for the interests of the Crown; the employee owed fiduciary obligations towards the Crown to act in its best interests when wearing this uniform. Any profit received in breach of such duties was to be held under a constructive trust for the Crown.

The above categories provide a brief overview of the more established relationships where fiduciary duties are usually imposed, and the type of obligations which may be owed. Whilst these relationships are perceived to be classic categories, it may be that fiduciary obligations only attach to a particular part of them. Fiduciary obligations may only apply to that part of the relationship which is characterised by mutual trust and confidence; they do not have to regulate the entire relationship. It will depend upon the particular circumstances. Simply because a relationship falls into one of these categories does not automatically mean it will be fiduciary in nature; however, such relationships are generally more amenable to the application of fiduciary duties. This tendency is a consequence of the higher degree of mutuality and reliance apparent in such relationships (*Birtchuell v Equity Trustees, Executors and Agency Co Ltd* (1929), Dixon J).

8.3 Outside classic fiduciary relationships – the *Hospital Products* decision

Fiduciary obligations may also be imposed on parties who are not within the classic categories of relationships. The precise circumstances in which a court will deduce the existence of a fiduciary relationship from the facts of a case are unclear. The leading authority is the High Court decision in *Hospital Products Ltd v United States Surgical Corp* (1984).

In that case, USSC (the plaintiff) was an American company specialising in surgical stapling instruments. Blackman, who had been a product manager of USSC, visited Australia and ascertained that USSC's products had not been patented in Australia. He returned to the USA and persuaded the plaintiff to appoint him sole distributor in Australia for its products. Upon his return to Australia he formed a company, HPI, initially to sell the plaintiff's products, but ultimately to manufacture products closely resembling USSC's and pass

them off as the products of that company. He then reverse engineered the plaintiff's products which HPI sold to the plaintiff's customers. Finally, Blackman terminated the distributorship with USSC and went out into direct competition with that company, both in Australia and in the USA. USSC claimed that Blackman was in breach of fiduciary duties.

The High Court unanimously held HPI with Blackman liable for breach of the terms of the distributorship agreement whereby they agreed that they would use their 'best efforts' to distribute the plaintiff's products. By a majority of four to one, the High Court held than no fiduciary relationship existed between USSC and HPI. The majority (Gibbs CJ, Wilson and Dawson JJ) emphasised the following factors as indicating that no fiduciary relationship existed:

- a strong bias existed against importing equitable fiduciary principles into commercial cases;
- the distributorship agreement was a contract freely entered into by parties negotiating at arm's length and on equal footing. Any gaps in what was a loosely drafted agreement must be presumed to have been deliberately left unfilled by the parties;
- a key factor in the determination of whether a fiduciary relationship exists is if one party undertakes to act on behalf of another and is entrusted with power. HPI undertook to act in its *own* interests, not USSC's, and USSC was not powerless;
- under the agreement, HPI was permitted by the plaintiffs to make a profit and to control the level of sales of the plaintiff's product which would determine the amount of the profit.

Mason J, dissenting, did not accept that fiduciary obligations were incompatible with commercial activity. He found that HPI owed USSC a limited fiduciary obligation to protect the latter's Australian product goodwill. His Honour noted that the obligation to act in the interests of another 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'. This 'limited scope' fiduciary analysis means that a relationship may be partially fiduciary, but that parties are entitled to act in their separate interests in other aspects of the relationship. This type of analysis recognises that relationships should not be examined in polar extremes for the purpose of equitable fiduciary obligations. This is particularly relevant for commercial transactions where corporations hold a range of different responsibilities, and it is sensible to mould the scope of the fiduciary duty to the precise nature of the relationship. Whilst it is clear, in the words of La Forest J from *Hodgkinson v Simms*, that 'commercial interactions between parties at arm's length normally derive their social utility from the pursuit of self-interest', this should not mean that such relationships are holistically exempted from equitable protection.

The dissenting judgment of Deane J agreed with the majority that HPI did not owe fiduciary obligations to USSC. His Honour, however, felt that a constructive trust could still arise, even in the absence of a fiduciary relationship, since HPI could not 'in good conscience' be permitted to retain the benefits it had derived from the breach of the distributorship agreement. Deane J's judgment is controversial, since he holds that the profit disgorgement remedies of the account of profits and constructive trustee available for a simple breach of contract, although he does not clearly articulate the circumstances in which they will be awarded.

8.4 Fiduciary obligations in commercial dealings

Courts are generally reluctant to construe a fiduciary relationship from the circumstances of particular commercial dealings, particularly where there is a profit motive and the parties have dealt with each other at arm's length and *bona fides*. Courts generally state that, if a person enters into an agreement in order to make a profit, it is inappropriate to impose fiduciary obligations which alter the character of the agreement to the extent that all profit is held on trust. This point was clearly emphasised in *Hospital Products,* where Mason J noted the 'understandable reluctance' in subjecting commercial arm's length relationships to fiduciary principles. This is not, of course, to suggest that fiduciary obligations will not be applied to such relationships, but rather, that courts will assume a more cautious approach. The 'commercial dealing' cases which have had fiduciary obligations imposed over some of their dealings fall into the following very general categories:

- cases similar on their facts to a classic fiduciary relationship (see, for example, *United Dominions Corps Ltd v Brian Pty Ltd* (1985)); and
- the provision of professional service by one party to the other where a relationship of special dependence exists.

Banks normally owe only contractual and statutory obligations to their customers. Exceptionally, however, a customer may rely on a bank for professional advice and assistance to a degree which justifies a court holding that the bank owes a duty of loyalty to the customer. In *Commonwealth Bank v Smith* (1991), the appellants were a bank and the local branch manager of that bank in a small country town 150 km north of Adelaide. The appellant bank had, through successive managers of its local branch, been the banker and financial adviser for some 24 years to the respondents, who were long term local residents engaged in farming and various business enterprises. The respondents, the Smiths, sought assistance from the manager, Mr Dungan, in respect of the purchase of a licensed leasehold of one of several hotels in the vicinity of the town, which was a new type of venture for the respondents.

Mr Dungan advised that the purchase was a good one, without disclosing the fact that the valuation received by the bank was significantly lower than the purchase price, and that it was likely that the lessor was bound to grant a further two year extension of the existing hotel lease, whilst telling the Smiths that it was not appropriate to negotiate for a lower price and that they had no real need to consult an accountant. Of particular significance was the fact that Mr Dungan did not advise the Smiths of this fact prior to completion and, in particular, prior to the statutory cooling off period. Mr Dungan advised the Smiths that the vendor was a customer of the bank, and that would affect any confidential information he could give to the Smiths, but he did not give any further information. He discouraged the Smiths from seeking advice from an independent hotel broker and encouraged them to use the solicitor for the vendor. The Smiths relied upon the advice given by the bank, particularly in light of their established history together. The full court of the Federal Court held that the bank manager owed a fiduciary duty towards the Smiths and that duty had been breached.

Davies, Sheppard and Gummow JJ held that Mr Dungan was not merely acting in the interests of the bank, he was also acting as their financial adviser. He was, therefore, under a duty to advise them with due care and skill, and he failed in this duty because the advice he gave about the appropriateness of the transaction was incorrect. The court held that the bank manager had no reasonable basis for coming to his conclusion.

Certainly, to argue that he was in a fiduciary relationship was a novel proposition; however, it was possible. Where a bank gives a customer advice upon financial matters, then in addition to any contractual rights the customer may have, the relationship between the parties may be such as to found either a common law duty of care or a fiduciary duty.

Obviously the bank, as financier, has a manifest personal interest in the matter. The question to consider in each individual case is whether, given the apparent commercial self interest of one party, that party may also be taken to have assumed a fiduciary responsibility towards the other. A bank may be expected to act in its own interests in ensuring the security of its position as lender to its customer, but where it creates in the customer the expectation that it will provide financial advice, it may be held to owe fiduciary duties.

The relationship of stockbroker and client, which is also founded on contract, may also occasionally 'cross the line' into the fiduciary status (*Daly v Sydney Stock Exchange* (1986)). In *Duke Group Ltd (In Liq) v Pilmer* (1999), Doyle CJ, Duggan and Bleby JJ noted that in the case of professional adviser, the nature of the duty will be largely defined by the terms of the retainer and the nature of the client's instructions and that, while fiduciary obligations are not innate to the relationship, the potential exists because the relationship is one of trust, whereby the client reposes confidence in the advice of the adviser and it is not an ordinary arm's length commercial relationship.

In a few cases, fiduciary obligations have been imposed on a party where the criteria for the imposition of fiduciary duties has not been satisfied. These cases defy classification and, whilst they may be correct, it seems likely that they are to be better considered as exceptional oddities:

- In *Sinclair v Brougham* (1914), a building society which carried on an *ultra vires* banking business was held by some members of the House of Lords to owe fiduciary obligations to those who deposited money with the *ultra vires* bank. This decision has, however, been overruled in the House of Lords in *Westdeutsche Landesbank Girozentrale v Council of the London Borough of Islington* (1996).
- In *Chase Manhattan Bank v Israel-British Bank* (1981), the plaintiff bank paid $2 million (US) to the New York branch of the defendant bank, which transacted its main business in London. Due to a clerical error, a further $2 million was paid to the defendant. Soon after the mistake had been discovered, the defendant bank went into liquidation. Goulding J held that the plaintiff retained 'equitable property' in the mistaken payment, entitling it to recover the money ahead of the defendant's general creditors.

In both cases, fiduciary arguments were added in order to defeat the normal priority rules on insolvency. In *Sinclair v Brougham*, the House of Lords empowered the deposition to share rateably with the building society's members in the distribution of the society's assets. In the *Chase Manhattan* decision, plaintiffs were entitled to make a claim to the overpayment, if it could be identified in the defendant's assets, ahead of the insolvent bank's general creditors. Both decisions have been criticised on the ground that they distort the fiduciary concept by imposing the fiduciary status retrospectively, where there was no prior relationship of confidence between the parties. In *Westdeutsche*, Lord Browne-Wilkinson was particularly reluctant to expand fiduciary obligations and, in particular, the imposition of a resulting trust in circumstances where it would produce an unfair priority upon a particular creditor against other creditors claiming under an insolvency. His Honour warned against a 'wholesale importation' of principles into commercial dealings which are 'inconsistent with the certainty and speed which are essential requirements for the orderly conduct of business affairs'.

8.5 Personal relationships

An issue which has received some attention in recent cases is whether personal relationships, as well as financial and professional ones, can be characterised as fiduciary. Where one member of a family assumes responsibility for the money or other property of another member, the degree of trust may be sufficient to create a fiduciary relationship (*Chittick v Maxwell* (1993)). Some Canadian decisions have gone further, however, in holding that parents owe fiduciary duties to children, entitling the children to sue parents

for breach of duty in cases of sexual abuse (*M(K) v M(H)* (1992)). Doctors have also been held to owe patients fiduciary duties of disclosure of medical records (*McInerney v MacDonald* (1992)). *McInerney* was not accepted as good authority in Australia by either the New South Wales Court of Appeal (*Breen v Williams* (1994)), nor by the subsequent High Court appeal *Breen v Williams* (1996). Whilst the court noted that it is possible for the relationship between a doctor to be fiduciary in nature, it is unlikely that the fiduciary duties would extend to a disclosure of medical files. The majority of the Australian High Court concluded that the development of such fiduciary duties was beyond the scope of equity; they expressly disapproved of developments in the Canadian cases in this respect. Hence, whilst Gummow J felt that 'the relationship between practitioner and patient who seeks skilled and confidential advice and treatment is a fiduciary one' (p 305), he concluded that the scope of the duties imposed in such a relationship should be restricted because the Australian approach to fiduciary obligations is less intrusive on the law of negligence and contract than Canada. The status of the Canadian decisions on the fiduciary status of family and other personal relationships remains doubtful.

In *Paramasivan v Flynn* (1998), a case involving alleged sexual assaults of a ward by a male guardian, the Full Federal Court disapproved of the Canadian decisions and concluded that the protection of parental duties was within the purview of tort rather than contract. Miles, Lehane and Weinberg JJ approved of the High Court decision in *Breen v Williams* (1996) and noted that 'Equity, through the principles it has developed about fiduciary duty, protects particular interests which differ from those protected by the law of contract and tort', and felt that fiduciary duties should not be superimposed upon common law duties simply to provide an alternative form of remedy, because it distorts their inherent perspective.

In the US and Canada, original title to native land has often been determined on the basis of the State's fiduciary obligations owed to indigenous people. In *Guerin v The Queen* (1984), Dickson J held that fiduciary duties generally only arise with respect to private law obligations, and public law duties, involving the exercise of discretion, do not typically give rise to fiduciary relations. Nevertheless, his Honour felt that the mere characterisation of one party as 'the Crown' did not mean that it was removed from the scope of the fiduciary principle; the existence of a broad discretionary power in s 18(1) of the Indian Act, conferring a broad discretion upon the Crown to 'deal' with 'surrendered' land, meant that the Crown had an obligation to act in the interests of the Indians and, 'where by statute, agreement, or perhaps by unilateral undertaking, one party has an obligation to act for the benefit of another, and that obligation carries with it a discretionary power, the party thus empowered becomes a fiduciary'.

In *Mabo v The State of Queensland (No 2)* (1992), Toohey J noted that a government may breach a fiduciary duty if it introduces legislation, the effect of which is 'adverse to the interests of native title holders, or if the process does not take account of those interests' (p 160). The fiduciary analysis was not considered by the other judges and was explicitly rejected by the dissenting judge, Dawson J.

Other, non-territorial responsibilities to indigenous people may, however, attract fiduciary obligations. In *Williams v Minister of Aboriginal Land Rights (No 1)* (1994), Kirby P indicated that welfare and maintenance may come within the realm of fiduciary protection and that 'guardian and ward' was an established category of fiduciary protection.[1] In *Williams v Minister of Aboriginal Land Rights* (1999), however, the New South Wales Supreme Court indicated that a relationship between a child ward and the the Aboriginal Welfare Board should not be regarded as fiduciary; Abadee J felt that fiduciary principles only extend to the protection of economic interests, and personal relationships are usually given adequate protection in tort and contract law. Abadee J approved of *Paramasivan v Flynn* (1998) and felt that fiduciary duties are directed towards safeguarding interests of a broader financial nature, and should not be imposed to 'circumvent the non-imposition of a common law duty which is denied, for example, for policy reasons, or to support a claim for relief where no breach of any common law duty of care has been established on the merits'.

In *Cubillo v Commonwealth* (1999), the fiduciary principles were considered in the context of the 'stolen generation' of aboriginal children by O'Loughlin J of the Federal Court. The applicants argued that the Commonwealth owed them fiduciary duties because of 'the vast power of the Commonwealth in relation to its control over Aboriginal people' which 'brought about a total inequality of position' with respect to the Commonwealth and the applicants. The applicants relied on the decision of the High Court in *Bennett v Minister of Community Welfare* (1992), where the plaintiff, a 16 year old boy, was a ward of the State; he was injured at the institution where he was in care while using a saw without a proper guard. He lost four fingers. It was clear that he would have been entitled to recover damages from the defendant and that he would have sought to recover them, if he had known of such entitlement; however, he was incorrectly advised that he had no cause of action and, subsequently, any cause became statute barred. The High Court concluded that the duty owed to the plaintiff was a fiduciary one. In their joint judgment, Mason CJ, Deane and Toohey JJ said:

1 For further reading, see Tan, D, 'The fiduciary as an accordion term: can the Crown play a different tune?' (1995) 69 ALJ 440; Di Marco, L, 'Fiduciary obligations and native title' (1994) 19 Mon LR 868.

> That fiduciary duty was a positive duty to obtain independent legal advice with respect to the possible existence of a cause of action on the part of the appellant arising out of the circumstances in which he sustained an amputation of four fingers of his hand [p 411].

The applicants also relied upon the comments of Kirby P in *Williams v Minister, Aboriginal Land Rights Act* (1994). The Federal Court, however, followed the approach in *Paramasivam v Flynn* and concluded that no cause of action existed because the losses sought to be protected were psychiatric and cultural rather than economic in nature, and because fiduciary principles should not be applied in circumstances where the conduct complained of is within the purview of the common law – and the law of tort was clearly more relevant to the 'stolen generation' arguments. The comments of Miles, Lehane and Weinberg JJ, from *Paramasivam v Flynn*, outlined below, were reiterated by O'Loughlin J in *Cubillo*:

> Here, the conduct complained of is within the purview of the law of tort, which has worked out and elaborated principles according to which various kinds of loss and damage, resulting from intentional or negligent wrongful conduct, is to be compensated. That is not a field on which there is any obvious need for equity to enter and there is no obvious advantage to be gained from equity's entry upon it. And such an extension would, in our view, involve a leap not easily to be justified in terms of conventional legal reasoning [p 219].

The constriction of fiduciary principle to the protection of economic loss is not one which sits well with the fundamental principles of equitable protection – of which fiduciary law is a part. In the words of Aristotle, 'the equitable is just, and better than one kind of justice – not better than absolute justice, but better than the error that arises from the absoluteness of the statement'.[2] The true jurisdictional objective of equity is to supplement the rigours of the common law, and this cannot be properly achieved if equitable principles are ousted in circumstances where the facts come 'within the purview of the law of tort'. It is clear that the mere existence of a contractual relationship will not prevent a fiduciary relationship from arising – although it might regulate it – and the same approach should be taken with tort. The existence of a tortious duty of care should not necessarily oust equity – particularly where the common law remedial focus does not sit properly with the circumstances of the case. Whilst some relationships may not, by their very nature, be amenable to *prescriptive* equitable fiduciary duties, such principles must not be excluded without a thorough examination of their appropriateness. Furthermore, the fact that the loss in a particular case does not come within a judicially conceived notion of 'economic' should not mean that the range and scope of fiduciary protection and remedies are automatically denied. In this regard, and particularly in the context of the 'stolen generation' cases, the words of La Forest, L'Heureux and Gonthier JJ in *Hodgkinson v Simms* (1994) are particularly compelling:

2 Aristotle, *Nicomathean Ethics*, Book V, Chapter 10.

> In seeking to identify the various civil duties that flow from a particular power-dependency relationship, it is wrong to focus only on the degree to which a power or discretion to harm another is somehow 'unilateral'. This concept has neither descriptive nor analytical relevance to many fact-based fiduciary relationships. *Ipso facto*, persons in a 'power-dependency relationship' are vulnerable to harm. Further, the relative 'degree of vulnerability' does not depend on some hypothetical ability to protect one's self from harm, but rather on the nature of the parties' reasonable expectations. A party which expects the other party to a relationship to act in the former's best interests is more vulnerable to an abuse of power than a party which should be expected to know that it should take measures to protect itself [p 166].

8.6 Nature of fiduciary obligations

The precise nature of fiduciary obligations will depend on the relationship in question. Judgments on fiduciary obligations are often prefaced by the dictum of Fletcher Moulton LJ: 'fiduciary relationships range from the trustee to the errand boy'. The duties imposed on errand boys are less onerous, and more specifically related to the nature of the errand, that the equitable obligations of trustees. The most authoritative modern exposition of a fiduciary's duties is contained in the judgment of Dean J in *Chan v Zacharia* (1984).

In that case, Deane J identified two situations giving rise to a duty to account:

- where a fiduciary has obtained a benefit in circumstances where a conflict of interest or significant possibility of conflict existed between the fiduciary's duty and his personal interest in the pursuit or possible receipt of such a benefit; or
- where a fiduciary has obtained a benefit by use or by reason of his position or of his opportunity or knowledge resulting from it. It is not necessary to prove an actual benefit. It is the 'opportunity for benefit', and not necessarily the benefit itself, which attracts equitable intervention.

Equity has imposed draconian standards on fiduciaries in order to discourage disloyalty and to encourage fiduciaries to promote their beneficiaries' interests actively. A fiduciary can be held liable even if he has acted in good faith and has made a profit for the beneficiaries as well as deriving a personal benefit.

In *Boardman v Phipps* (1967), the defendant, a solicitor to a family trust and one of the beneficiaries, was dissatisfied with the performance of a company in which the trust held a substantial minority of the shares. They bought shares in the company so that they and the trust obtained a majority shareholding and reorganised the company, selling off some loss-making activities. In the process, they made profits for themselves as well as for the beneficiaries of the trust. The defendants had kept the beneficiaries and the trustees informed about their actions, with the exception of an elderly, senile trustee who took no part in the management of the trust. After the

reorganisation had been completed, a dissatisfied beneficiary sued the defendants for an account of the profits they had made.

The House of Lords held by a majority of three to two that the defendants must account for the profits they had personally made from the organisation. The majority went on to hold, however, that they should be remunerated on a liberal scale for the work they had done. Two reasons were given by the majority for holding the defendants liable:

- they had used trust property, namely information about the company, in order to make profits for themselves; and
- they had made a profit from their fiduciary positions which had resulted from a potential conflict between the duties they owed to the beneficiaries and their own interest in making profits from the reorganisation.

The minority judgments rejected the proposition that information about the trust constituted trust property. They also considered that there was no real, sensible possibility of a conflict of interest.

Boardman v Phipps is a controversial decision. Later cases have often favoured the minority judgments, especially that of Lord Upjohn, who insisted that equity would intervene only where there was a real possibility of a conflict of interest, and not where the conflict was hypothetical. In *Chan v Zacharia* (1984), Deane J proposed that, notwithstanding decisions such as *Boardman v Phipps*, the liability to account would not arise in circumstances where it would be unconscientious to assert it. The tempering of equity's deterrent approach by notions of conscience has not been directly considered in later Australian cases.

In *Breen v Williams*, the Australian High Court concluded that there was no fiduciary obligation for a doctor to act in the best interests of a patient. On the facts of that case, the court felt that while a doctor is obliged to exercise reasonable care in the administration of his or her professional duties and, in certain cases, to avoid a conflict of interest, fiduciary duties should not be imposed to the extent that they alter the contractual obligations intended by the parties. A duty to act in the best interests of the patient and provide a patient with full access to medical records would 'conflict with the narrower contractual and tortious duties' relevant to this relationship. Whilst a doctor may be obliged to act with good faith and loyalty, the scope of the fiduciary obligation should not extend beyond this. The application of fiduciary obligations to the relationship between a doctor and a patient invariably results in an increased protection for the patient; a doctor is obliged to avoid a conflict of interest and to account for any profit he or she might make. Despite this cogent argument, not all of the court in *Breen v Williams* agreed that fiduciary duties were consistent with the inherent nature of the doctor/patient relationship. Dawson and Toohey JJ were prepared to recognise that fiduciary obligations could co-exist with contract and tort obligations; however, they concluded that fiduciary protection may be unnecessary because the nature of

the obligations imposed are proscriptive rather than prescriptive; consequently, the doctor/patient relationship is more appropriately catered for by the application of a positive duty of care rather than negative equitable fiduciary obligations.

Similarly, Gaudron and McHugh JJ felt that the application of fiduciary duties could not alter the basic contractual nature of the relationship. If the contract did not confer any obligation to act in the best interests of the patient or any corresponding right to access medical files, this right could not be provided via equitable fiduciary obligations because this would change the essential nature of the contract.

Dawson and Toohey JJ, as well as Gaudron and McHugh JJ, noted with disapproval the Canadian developments in this regard. In *McInerney v MacDonald* (1992), La Forest J held that one of the fiduciary qualities of the relationship between a medical practitioner and patient included the obligation to act with utmost good faith and loyalty to a patient and to grant access to the information the doctor uses in administering treatment. Dawson and Toohey JJ concluded that such obligations went too far and effectively 'displaced the role hitherto played by the law of contract and tort by becoming an independent source of positive obligations and creating new forms of civil wrong'.[3] Gaudron and McHugh JJ felt that the Australian approach to fiduciary obligations is less intrusive on the law of negligence and contract than that which has developed in Canada.

As discussed in para 8.5 above, if tortious or contractual relationships require the application of fiduciary principles, then the courts should impose them – particularly where such principles ensure a greater level of protection and a more satisfactory remedial outcome in the event of a breach. Whilst fiduciary principles should not be created so as to alter the basic contractual intention between parties, they can be utilised in a functional manner so as to provide greater encouragement for compliance.

8.7 Proper consent

Fiduciaries will be exonerated from liability if they obtain the fully informed consent for their actions from their beneficiaries, who for this purpose must all be adults and of sound mind. Consent may be implied where the beneficiaries possess full knowledge of the relevant facts and acquiesce in what would otherwise constitute a breach of duty.

In *Queensland Mines v Hudson* (1978), the plaintiff mining company had been interested in developing iron ore mining operations in Tasmania. Hudson, the managing director of the company, was successful in obtaining

3 See also the excellent article by Parkinson, P, 'Fiduciary law and access to medical records: *Breen v Williams*' (1995) 17 Sydney L Rev 442–43.

mining licences from the company. In the event, liquidity problems prevented the plaintiff from opening up the mines. Hudson resigned his position with the company and, with full knowledge of the plaintiff's board, successfully developed the mines. When success was assured, the company sued Hudson for breach of fiduciary duty.

The Privy Council held that, as Hudson had acted with full knowledge of the plaintiff's board, the board must be taken to have consented to his activities. The decision has been criticised on the ground that Hudson's acts should have been authorised or ratified by a general meeting of shareholders. Nevertheless, the decision is authority for the proposition that beneficiaries can exonerate a breach of fiduciary duty by acquiescence, provided that they are in possession of all material facts. It is probable that tacit consent will be more common in the case of a small company, whereas a larger company will usually require a director to obtain consent from the shareholders acting formally in a general meeting: *Hurley v BGH Nominees Pty Ltd* (1984). If a breach of fiduciary duty occurs and a company is established for the purpose of committing a breach – if the breaching trustee is, in effect, the *de facto* mind and will of the company – then the company will be attached with the knowledge of the breach: *Re Rossfield Group Operator Pty Ltd and Morton Holdings* (1981); *Yore Contractors v Halcon Pty Ltd* (1990).

8.7.1 Strict standard for purchase of property

The requirement of fully informed consent is applied strictly in cases where fiduciaries buy property from beneficiaries and sell it to them. Statute apart, contract law does not generally impose a duty of disclosure of material facts. In contrast, equity imposes strict duties of disclosure upon fiduciaries who deal with beneficiaries (*McKenzie v MacDonald* (1927)). Nevertheless, where a fiduciary has acted fairly and given a good price, and consent to the purchase of property ought reasonably to be inferred, the court may apply the fair dealing rule and uphold the purchase (*Holder v Holder* (1968); but note the disapproval of the case in Ford and Lee, *Principles of the Law of Trusts*, 2nd edn, 1990, p 918. See below, 32.8 for a more detailed discussion).

8.8 Remedies for a breach of fiduciary obligation

Equitable remedies will be considered in more detail in Chapters 18–24. It is, however, impossible fully to comprehend the law of fiduciary obligations without some account of the remedies available for breach of obligation. Equity intervenes in a breach of fiduciary duty not so much to recoup the loss suffered as to hold the fiduciary to and vindicate the high duty owed; those in fiduciary relationships labour under a heavy duty to show the righteousness of their actions: *Maguire v Makaronis* (1997). On the facts of *Maguire*, a mortgage was set aside by the High Court because of an undisclosed conflict of interest between

a fiduciary solicitor and their clients. The appellants were solicitors for the respondents and the appellants financed the purchase of a poultry farm by the respondents. The loan to the respondents was secured by a mortgage over property owned by the respondents. After the respondents defaulted on the mortgage repayments, the appellants sought repayment of the moneys secured and instituted proceedings to take possession of the secured property. The respondents then argued breach of fiduciary duty on the grounds of an undisclosed conflict of interest, because the appellants did not disclose the personal interest they had in the mortgage transaction, and this conflicted with the fiduciary obligations to the respondents as their clients. The High Court found that the respondents had not consented to the breach and, consequently, the mortgage should be set aside on condition that the respondents repay the moneys borrowed. The court spent some time considering the impact of the Canadian decision in *Brickenden v London Loan & Savings Co* (1934), where it was held by the Judicial Committee that a breach of fiduciary duty stemming from a non-disclosure of material facts which the represented party was entitled to know prior to entering into the transaction resulted in the breaching fiduciary being liable for all consequential loss. The High Court in *Maguire v Makaronis* considered the stringency of the Brickenden approach; in particular their Honours considered the appropriateness of a rule which appeared to impose a very high burden on breaching fiduciaries, making them potentially liable for loss which was not causally related.

In their joint judgment, Brennan CJ, Gaudron, McHugh and Gummow JJ noted that the policy of the law in upholding a breaching fiduciary to duties owed is very 'strongly manifested' in cases of conflict of interest, and that the reasoning in Brickenden should continue to apply to 'delinquent fiduciaries' although, given the potential remedial severity for fiduciary breaches, courts should not be too ready to classify as fiduciary those relationships which are more within the scope of contract or tort. Kirby J felt that the stringency of the Brickenden principle should be upheld, as it fulfils the equitable aims of ensuring 'the strict loyalty and good faith to beneficiaries'; the 'dutiful enforcement of obligations and deterrence of breaches by fiduciaries of their powers'; and enables a court, 'in fashioning the remedies which it is apt for equity to provide, to consider most, if not all, of the matters which would otherwise be urged as a reason for excluding relief altogether on the ground of alleged absence of a causal connection between the breach and the loss'. Such an approach maintains the breadth of the equitable discretion and secures the principal object of equitable relief for a breaching fiduciary, namely, restitution.

8.8.1 Equitable compensation

A fiduciary who commits a breach of duty which causes damage to the beneficiary is liable to pay compensation for all the losses flowing from the breach of duty. The breach must cause the loss for which recovery is sought

(*Target v Redferns Solicitors* (1995)), but equitable compensation is not otherwise limited by considerations of foreseeability or mitigation (*Re Dawson* (1966); *Commonwealth Bank v Smith* (1991)). Some New Zealand courts have reduced compensation awards by reference to common law and the statutory concept of contributory negligence (*Day v Mead* (1987)), but this may blur the recognised divisions between common law and equity, as well as dilute the deterrent conception of fiduciary liability. Conversely, some Canadian courts have justified awards of exemplary compensation on the basis of the deterred role of fiduciary law (*M(K) v M(H)*) (1992)), but this development has also not been accepted in Australia (see also Chapter 22).

8.8.2 Equitable rescission

An equitable right to a decree of rescission is immediately generated by a preceding breach of fiduciary duty. Where a fiduciary has dealt with the beneficiary, for example, by buying the latter's property, the contract may be rescinded if the fiduciary has not made full disclosure of relevant information to the beneficiary. The usual contractual bars to rescission apply. In particular, where third parties have, in good faith, acquired rights in property under the voidable contract, rescission can no longer be ordered. The beneficiary, however, may obtain compensation for losses incurred or compel the fiduciary to account for any profit made upon the sale of property (*McKenzie v McDonald* (1927); see also the discussion in Chapter 24).

8.8.3 Account of profit

The primary obligations of a fiduciary who has acted in breach is to account to the beneficiary for any profits made in consequence of the breach. The account is a personal remedy, conferring no priority on the plaintiff in the event of the defendant's insolvency. The defendant must have made a quantifiable profit; the remedy cannot be awarded where the plaintiff is complaining of a loss of an opportunity to make a profit. In *Woodman Dwyer* (1995), the High Court held that a victim of a breach of fiduciary duty has a right of election between the account of profits and equitable compensation, subject to the application of equitable defences. This right of election will be important where the plaintiff has suffered a loss and the fiduciary has made an improper profit. Where the fiduciary has made a profit as a result of a breach of duty, a court cannot deprive the plaintiff of the right to take an account (see also Chapter 22).

8.8.4 Constructive trust

A court may hold that property held by the fiduciary, or by a recipient from the fiduciary, not being a good faith purchaser for value without notice, belongs in equity to the plaintiff and shall be held by the fiduciary on

constructive trust for the plaintiff. A constructive trust, unlike an account of profits, is a proprietary remedy conferring priority on the plaintiff over the defendant's general creditors, in the event of the latter's insolvency. A plaintiff cannot elect to take a constructive trust, in contrast to the election to take an account, but must demonstrate equitable title to the property belonging to the fiduciary. The grounds for asserting equitable title are fairly obscure and permit a court to exercise a measure of discretion.

The property which is the subject matter of constructive trust must be clearly defined. In *Hospital Products Ltd v United States Surgical Corp Ltd* (1984), Mason CJ, who held that the defendants owed the plaintiffs fiduciary duties under a distributorship agreement, declined to impose a constructive trust over all the defendant's assets, but limited its operation to the profits made by the defendants when they should have been acting to promote the plaintiff's interests under the agreement.

In *Lac Minerals v International Corona Resources* (1989), a majority of the Canadian Supreme Court held that a breach of fiduciary obligation was not a necessary precondition to the award of a constructive trust, but that other legal or restitutionary imposed claims, including a claim for breach of confidence, could justify the imposition of a remedial constructive trust. This radical decision has not yet been considered by the High Court, although the approach is broadly consistent with Deane J's judgment in the *Hospital Products* case.

Courts have generally been ready to hold that property held in consequence of a breach of duty shall be held on constructive trust for the victim of a breach of fiduciary duty. However, where the fiduciary has received a bribe in the course of carrying out his or her duties, the English Court of Appeal held, in *Lister v Stubbs* (1890), that the fiduciary was liable to account to the beneficiary for the amount of the bribe, but that a constructive trust could not be imposed over the bribe or property acquired with the bribe. This meant that, if the corrupt fiduciary became bankrupt, the beneficiary had to prove, in competition with other unsecured creditors, in order to recover the bribe money. Liability to pay over the bribe or its product was said to be a matter of obligation and not ownership.

The status of *Lister v Stubbs* in Australia is uncertain (compare *Daly v Sydney Stock Exchange* (1986), Gibbs CJ, with *Consul Developments v DPC Estates* (1973), Hardie and Hutley JJ). *Lister v Stubbs* was disapproved by the Privy Council in an appeal from New Zealand in *Attorney-General for Hong Kong v Reid* (1994), where it was held that land purchased from the proceeds of a bribe paid to a corrupt police officer must be held on constructive trust for the Government which employed him. The Privy Council decision has been criticised, both because the plaintiff was awarded a constructive trust over the property to which it had never previously had title, and because the Privy Council did not consider the appropriateness of an account of profits as an

alternative to the constructive trust. In *Soulos v Korkontzilas* (1997), the Supreme Court of Canada held that a constructive trust can be imposed over property purchased in breach of fiduciary duty – even where no profit has been made. McLachlin J held that good conscience was the unifying concept for the constructive trust and that such a 'general' concept was necessary in order to ensure that a range of different circumstances are embraced. McLachlin J noted that:

> [A] judge faced with a claim for constructive trust will have regard not merely to what might seem fair in a general sense, but to other situations where courts have found a constructive trust. The goal is a reasoned, incremental development of the law.

CHAPTER 9

THE PROTECTION IN EQUITY OF CONFIDENTIAL INFORMATION

9.1 Jurisdiction to protect confidential information: the common law

Remedies against those who disclose, or threaten to disclose, confidential information can be obtained both at common law and in equity. At law, an express term in a contract may prohibit the unauthorised disclosure of confidential information. Alternatively, courts may imply a term requiring a party to a contract to keep information secret. Implied terms are commonly found in contracts of employment, but the implication may also be made in other agreements, for example, agency agreements. Many of these contracts will also constitute fiduciary relationships, thereby attracting the remedies for breach of fiduciary duty in the event of improper disclosure by a party subject to an implied term of disclosure (*Ansell Rubber Co Pty Ltd v Allied Rubber Industries Pty Ltd* (1967)).

Confidential information has also been held to be property (*Abernethy v Hutchinson* (1825)), especially for legislative purposes including bankruptcy legislation (*Re Keene* (1922)). Confidential information is described as proprietary, because the degree of protection afforded by equitable doctrines and remedies, and the effect of that protection, make the proprietary analysis appropriate (*Smith Kline (Aust) Ltd v Department of Community Services and Health Alphapharm Pty Ltd* (1993)). The existence of a possible tort of breach of confidence has also attracted academic, if not judicial, consideration.[1]

9.2 Equitable protection of confidential information

Courts of equity provide remedies for an actual or threatened breach of confidence in a number of situations. In the first place, a party may disclose information to another in circumstances where no common law contract exists, but where courts of equity recognise the existence of a confidential relationship.

In *Seager v Copydex* (1967), Lord Denning MR formulated a broad principle of equity, namely that someone 'who has received information in confidence shall not take unfair advantage of it'. This equitable principle most commonly applies to information disclosed in the course of pre-contractual negotiations. The negotiations will often, as in *Seager v Copydex* itself, be conducted between an inventor and an organisation which has expressed an interest in licensing the invention.

1 See North, P, 'Breach of confidence – is there a new tort?' [1972–73] JS PTL 149; Curry, F, *Breach of Confidence,* 1984, pp 46–56.

9.2.1 When will equitable liability be imposed?

The circumstances in which equitable liability for breach of confidence can be imposed were explained by Megarry J in *Coco v AN Clark (Engineers) Ltd* (1969):

- the information must have the necessary quality of confidence; it must not be publicly available. While it need not meet patentable standards of novelty, the information must satisfy at least some minimum criteria of novelty and originality;
- the information must have been communicated in circumstances importing an obligation of confidence; and
- there must be an unauthorised use of that information. It is unclear whether the use must be detrimental to the party communicating it. It has been said that detriment to the plaintiff 'may not always be necessary' (*Attorney-General v Observer Ltd* (1990) *per* Lord Goff). Even if it is required, it need not take the form of economic damage (*Attorney-General (UK) v Heinemann Publishers Australia Pty Ltd* (1987) *per* McHugh JA).

9.3 Confidential relationships

Most obligations of confidence are imposed on parties who are within a pre-existing relationship. It is no easy matter, however, to determine when an equitable relationship of confidence will be recognised. In *Coco v AN Clark Engineers Ltd*, Megarry J suggested that the appropriate test was whether a reasonable person, standing in the shoes of the recipient of the information, would have realised on reasonable grounds that the information was being communicated in confidence. Equity's adoption of the common law's reasonableness criterion was criticised and, in *Deta Nominees Pty Ltd v Viscount Plastic Products Pty Ltd* (1979), Fullager J, who argued that equitable analogies 'so far drawn from the produce of labour' should be preferred. Any text purporting to govern the imposition of equitable relationship of confidence will necessarily be imprecise and risks circularity.

9.3.1 Obligations of confidence where there is no relationship

Exceptionally, an equitable obligation of confidence may be imposed on a party not within a relationship of confidence, who has obtained confidential information by reprehensible means. In *Franklin v Giddins* (1978), the defendant stole budwood from the plaintiff, who grew 'Franklin Early White' nectarines, in order to grow his own nectarines. Dunn J held that the defendant had misappropriated the defendant's 'property' in the nectarines. In *AG v Observer Ltd* (1990), Lord Goff proposed, as illustrious of equitable liability, 'where an obviously confidential document is wafted by an electric fan out of a window into a crowded street, or where an obviously confidential document, such as a

private diary, is dropped in a public place, and is then picked up by a passer-by'. His Honour further noted that an equitable obligation of confidence could arise wherever 'confidants had simply had notice that the information was confidential, combined with the fact that it would be just to prevent them from disclosing it' (p 281).

The informing principle underlying these examples of non-relational liability has never been authoritatively articulated. In *Moorgate Tobacco Co Ltd v Philip Morris Ltd (No 2)* (1984), Deane J located the basis of the action for breach of confidence 'in the notion of an obligation of conscience arising from the circumstances in, or through, which the information was communicated or obtained'. The application of standards of 'conscience' is usually unproblematic where the defendant's conduct is independently criminal or tortious, but in other cases it may be more uncertain, where attempts are made to convert moral notions of privacy into equitable obligations of confidence.

9.4 Types of confidential information

There is, in principle, no restriction on the type of information which courts of equity will protect. It can include secret folklore of aboriginal peoples (*Foster v Mountford* (1977)), personal secrets (*Argyll v Argyll* (1967)), commercially sensitive information (*Thomas Marshall Ltd v Guinte* (1979)), concepts for television programmes (*Talbot v Thames Television* (1980)) and information relating to the business of government (*Commonwealth v John Fairfax and Sons Ltd* (1980)). A plaintiff claiming protection for an idea must be able to show that the idea is capable of practical realisation (*Talbot v Thames Television* (1980)). In the case of government secrets, the onus rests on government to demonstrate that the public interest requires preservation of secrecy; the defendant in these cases is not required to justify disclosure (*Commonwealth v John Fairfax and Sons Ltd* (1980)). The information in respect of which confidentiality is claimed must be clearly identified – confidential information cannot be claimed in general or global terms: *O'Brien v Komesaroff* (1982).

9.5 Information in the public domain

Information which has been published cannot be protected in an action for breach of confidence. Partial disclosure will still entitle the undisclosed part to protection (*Schering Chemicals Ltd v Falkman Ltd* (1982)). Even publication by the confidant will preclude the award of an injunction to prevent future breaches, although the defendant may still be compelled to account for previous breaches (*AG (UK) v Heinemann Publishers Australia Pty Ltd* (1987); *AG v Observer Ltd* (1990)). Factors taken into account in this respect include:

- the extent to which information is known outside the business;
- the extent to which employees are aware of the information;
- secrecy measures taken;

- the value of the information to the business and to its competitors;
- the amount of money spent in getting the information; and
- the ease with which the information could be duplicated: *Ingersall-Rond (Aus) v Industrial Rollformers P/L* (2000), *per* Bergin J.

9.6 Disclosure in the public interest

A confidant will not be liable for disclosing information in breach of confidence where disclosure is in the public interest. Documents may not be inspected, except by authorised legal persons, during discovery if to do so would result in trade secrets being revealed to trade rivals: *Mobil Oil Aust Ltd v Guina Developments Pty Ltd* (1996); *Decor Corp Pty v Australian Housewares* (1998), *per* Sundberg J. In *Corrs Pavey Whiting and Byrne v Collector of Customs* (1987), Gummow J doubted the existence of a discrete public interest defence, preferring to consider such matters under established equitable grounds as the 'unclean hand' doctrine. The defence is, however, well recognised by the courts, even if its scope is somewhat uncertain. In *A v Hayden* (1984), the High Court held that an express contractual stipulation for confidentiality would not be enforced where to do so would obstruct the administration of justice. Disclosures of serious crimes and civil wrongs are permissible, although revelations of negligent conduct obtained by abuse of discovery procedures (*Distiltern v The Times* (1975)) will not justify a breach of confidence. In *Castrol Australia Pty Ltd v Emtech Associates Pty Ltd* (1981), Rath J confined the defence to disclosure of actual or threatened breaches of security, or misdeeds of similar gravity relating to such matters as public interest.[2]

The English version of the defence is construed more broadly, so that disclosure may be justified even though the plaintiff is guilty of no misdeed. A defendant may establish that there is 'just excuse' for disclosure, for example, where the defendant can show that a pop star's lifestyle does not accord with the public image of the star (*Woodward v Hutchins* (1977)). Australian authority suggests that the 'just cause' defence has not so far been accepted. Even in England, Lord Goff has stressed that disclosure to newspapers will not always be justifiable. A more limited disclosure may be required, especially where 'there are a number of avenues for proper complaint' (*AG v Observer* (1990)).

9.7 Liability of third parties

The equitable obligation of confidence applies not only to the original confidant but also to any party who acquires the information and is aware, or becomes aware, that the information was originally communicated in

2 See Pizer, J, 'The public interest exception to the breach of confidence action: are the lights about to change?' (1994) 20 Mon LR 67.

confidence. In *Wheatley v Bell* (1982), Helsham CJ in equity held that third party recipients of confidential information would not avoid liability, on the basis that they were *bona fide* purchasers of the information without notice of the breach. The correct approach was to hold liable all those who knew about the breach of confidence. This can include those who become aware that they have received confidential information as a result of the initiation of legal proceedings. Such persons can be restrained from further disclosure or use of the information after the date of notification. In *Dart Industries v David Brymar & Associates* (1997), Goldberg J held that a court will, in an appropriate case, grant injunctive relief against a third person who acquired confidential information to which he was not entitled, even though that person was unaware of any breach by the person from whom they received the information. Such relief will only be granted where an arguable case has been made out: *JH Fenner Ltd v Gulf Conveyor Systems Ltd* (1998).

9.8 Remedies

9.8.1 Injunction

An injunction may be ordered to restrain disclosure of confidential information or to prevent use of the information in breach of the terms of the initial disclosure. Much of the law of breach of confidence has been developed in applications for interlocutory injunctions. Few cases where interlocutory relief is granted or denied proceed to final trial.

9.8.2 Account of profits

A defendant may be ordered to account for the profits made in consequence of the breach of confidence. The profit to be accounted for will be the net profit made by the defendant (*Peter Pan Manufacturing Corp Ltd v Corsets Silhouette Ltd* (1964)). Restitution of benefits acquired in breach of confidence has been stated to be 'an important section of the law of restitution' (*AG v Observer Ltd* (1990) *per* Lord Goff).

9.8.3 Equitable compensation

Where the plaintiff has suffered loss as a result of the defendant's equitable breach of confidence, it is sometimes asserted that 'damages' are recoverable (*Seager v Copydex (No 1)* (1967); *Aquaculture Corp v New Zealand Mussel Co Ltd* (1990)). These references to damages should arguably be construed to mean that equitable compensation is payable. However, they have, rightly or wrongly, generally been interpreted as references to statutory damages awarded under Lord Cairns' Act or its State equivalents (see, also, Chapters 3 and 22).

9.8.4 Statutory damages

Damages for a breach of confidence have been awarded under the Chancery Amendment Act 1858 (Imp) (Lord Cairns' Act) and equivalent State legislation. It has been argued that damages should only be awarded under this head where a legal wrong has been committed; the damages awarded for an equitable breach of confidence have been said to be the result of a 'beneficial interpretation' of the statute (*AG v Observer Ltd* (1990), *per* Lord Goff).

In *Seager v Copydex* (1969), the English Court of Appeal held that damages should be assessed by analogy with damages for the tort of conversion, based on the value of the secret as between a willing seller and a willing buyer. It is now recognised that this method of quantification is unsuitable in the case of non-technical information, where market values cannot readily be assessed. Other measures may be adopted provided that they fulfil the objective of restoring to the plaintiff the value by which his interest in the information has been depreciated by the defendant's breach of confidence (*Talbot v General Television Corp Pty Ltd* (1980)).

In *Aquaculture Corp v New Zealand Mussel Co Ltd* (1990), the New Zealand Court of Appeal held that exemplary damages could be awarded for breach of confidence. The decision has been severely criticised; it can only be understood in the context of the approach towards the integration of common law and equitable doctrine pursued by the New Zealand courts (see Chapter 3).

9.8.5 Constructive trust

In *Lac Minerals v International Corona Resources* (1989), a majority of the Supreme Court of Canada held that a defendant could be compelled to hold property acquired through misuse of confidential information on constructive trust for the plaintiff. The confidential information itself was not the trust property, but the property obtained through misuse of the information. This is a controversial decision because it is often difficult to determine the identity of the property to which the trust relates. It is uncertain whether this decision will be accepted in Australia. The majority held that the award of a constructive trust did not depend on a prior breach of fiduciary duty. Since there are signs that Australian courts may also be cutting loose from the fiduciary requirement (*Muschinski v Dodds* (1985)), *Lac Minerals v International Corona Resources* may not be inconsistent with developments in Australian law.

9.8.6 Delivery up and destruction

A court of equity may order the delivery up of documents obtained in breach of confidence. A defendant who has manufactured articles by misusing confidential information may be ordered to deliver them up for destruction by a court officer. Alternatively, the defendant may be put under oath to destroy them.

CHAPTER 10

FRAUD IN EQUITY

10.1 The nature of equitable fraud

The prevention of fraud is the basis of much equitable intervention. Early Chancellors treated an allegation of fraud as a justification for assuming jurisdiction.

A couplet attributed to Sir Thomas Moore LC summarised the jurisdiction of the 'Court of Conscience':

> Three things are apt to be kept in conscience: fraud, accident and things of confidence [1 Rolle's Abridgment 374].

The unravelling of fraud was an objective of both common law and equitable jurisdictions. However, equitable fraud was a broader notion than common law, found encompassed by the tort of deceit. In particular, a defendant might be held to be fraudulent in equity even though there was no intent to deceive or recklessness with respect to the making of a statement (contrast *Derry v Peek* (1889) with *Nocton v Lord Ashburton* (1914), Lord Haldane LC).

Traditionally, the jurisdiction which equity assumes in relation to fraud was principally those matters which were not remediable at law. It is difficult to lay down a precise reference to fraud as it is known in the equitable jurisdiction. As Lord Hardwicke has observed, 'fraud is infinite',[1] and in the context of equity, fraud represents a clear reminder of the functioning of Chancery as a court of conscience.

At common law, to establish fraud an actual deceit had to be proven. Deceit will arise where there is an intention to commit a fraud. This concept was extended in *Derry v Peek* (1889), where it was held that deceit (also known as common law fraud) could only be established where there was either an actual intent to deceive, or a reckless indifference to the truth or falsity of the representation.

The equitable approach to fraud extends far beyond intentional or reckless behaviour, and is capable of encompassing a much broader range of principles. As noted in *Story on Equity*, the fraud which equity will protect against properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust or confidence, and are injurious to another, or by which an undue and unconscientious advantage is taken of another. Equity will not only interfere to set aside fraudulent acts already committed, but also if acts have, by fraud, been prevented from being done by

1 See *Lawley v Hooper* (1745); Randall, AE (ed), *Story on Equity*, 3rd edn, 1920, p 80.

the parties, equity will interfere and treat the case exactly as if the acts had been done.[2]

Lord Hardwicke has classified the broad equitable fraud jurisdiction into a number of sub-categories in the classic Chancery decision of *Chesterfield v Janssen* (1750). These categories include the following:

- actual fraud arising from the facts and circumstances of the case;
- fraud which is apparent from the intrinsic nature and subject of the bargain (this fraud arises where the bargain is one which no person would make in her right mind, and no honest and fair person would accept; it would cover principles relating to the award of relief for inequitable and unconscientious bargains);
- fraud which may be presumed from the circumstances and condition of the contractual arrangement (this fraud surpasses the common law because the common law requires fraud to be proven, rather than presumed; equitable fraud will attempt to prevent a person from taking advantage of a weakness or necessity of another because to do so knowingly would be contrary to the conscience of the court);
- fraud which is inferred from the nature of the circumstances of a transaction and which involves deceit towards third parties who are not actually a party to the contractual arrangement.

The ambit of the equitable fraud jurisdiction is clearly exemplified in *Nocton v Lord Ashburton* (1914). The facts of the case involved Nocton, a solicitor, advising his client, Lord Ashburton, to release part of the land which had been subjected to a first mortgage in order to assist building development on the site. Nocton then advanced Lord Ashburton a second mortgage. Lord Ashburton took Nocton's advice, which proved inaccurate because his security interest was effectively diminished. Lord Ashburton subsequently sought to recover loss from Nocton.

An action in tort or contract for negligent advice was refused by the court. The Court of Appeal found that actual fraud existed. The House of Lords overturned this decision and found that there was no actual deceit, but equitable fraud did exist. The court held that Nocton had been in a fiduciary relationship with Lord Ashburton, and the advice that Nocton had given with respect to the second mortgage had created a conflict of interest which constituted a breach of equitable fraud. Consequently, it was held that Nocton owed a duty to indemnify Lord Ashburton against the loss resulting from the defective advice.

During the course of the judgment, the House of Lords took the opportunity to re-examine the essential nature of the equitable fraud jurisdiction.

2 *Op cit*, Randall, fn 1, pp 80–81.

Lord Haldane made the following comments:

> What equitable fraud really means is not moral fraud in the ordinary sense, but a breach of the sort of obligation which is enforced by a court that from the beginning regarded itself as a court of conscience.

Whilst equitable fraud is more far reaching than common law deceit, it is certainly not a weaker variety; as Meagher, Gummow and Lehane point out, equitable fraud 'is just as quick as the common law to detect the unblushing cheat and unmask red-blooded deceit'.[3]

Equitable fraud often overlaps with the common law because, just as the law might find something fraudulent, so to does equity. Nevertheless, equitable fraud has an exclusive jurisdiction in areas where the law is either deficient or non-existent. The well-recognised heads of equity are generally described without reference to the founding jurisdiction of equitable fraud. The notion of fraud should, however, never be forgotten, because it emphasises the flexibility and purpose of equity in preventing actions which are abhorrent to the notion of good conscience. Fraud is today most commonly prevented through the application of specific equitable doctrines which are discussed in other chapters of this book. These doctrines include:

- fiduciary obligation (including liability for breach of trust): see Chapter 8;
- constructive trusts: see Chapter 38;
- the doctrine of undue influence, especially in case of actual undue influence (*Barton v Armstrong* (1976)): see Chapter 13;
- proprietary estoppel: see Chapter 15; and
- misrepresentation, especially with respect to the remedies of rescission and compensation where the misrepresentation was 'innocent' at common law (*Vadasz v Pioneer Concrete* (1995)): see Chapter 12.

The 'rediscovery of conscience' by the High Court in recent years is really, in many cases, the revival of old notions of equitable fraud. Modern courts tend to use the term 'unconscionable' or 'unconscientious'. In *Legione v Hateley* (1983), Mason and Deane JJ (p 444) state that the fundamental principle according to which equity acts is that a party having a legal right shall not be permitted to exercise it in such a way that it amounts to unconscionable conduct. Unconscionability has been identified as a concept in a range of factual scenarios traditionally covered by fraud. These include: exploitation of vulnerability or weakness; abuse of position of trust or confidence; insistence upon rights in circumstances which make it harsh or oppressive; and inequitable denial of legal obligations.[4] The concept of unconscionability is presently confined in its operation by reference to specific doctrines – such as estoppel, penalties and forfeiture and unconscientious exploitation of another

3 *Equity Doctrines and Remedies*, 1992, para 1208.

4 See Parkinson, P, *The Notion of Unconscionability: Laws of Australia*, 2001, p 8.

person's serious disadvantage – all of which are discussed in the following chapters. There is no settled, general or technical meaning for unconscionability, and Mahoney JA in *Antonovic v Volker* (1986), p 165, observed that 'the role of unconscionability is better described than defined'. The most that can be said is that 'unconscionable' should be understood in the sense of referring to what a person ought, in conscience, as between the parties, not be allowed to do. In the words of French J in *Australian Competition and Consumer Commission (ACCC) v CG Berbatis Holdings Pty Ltd* (2000), unconscionability 'offers a standard determined by judicial decision making rather than a rule, albeit it may for the present be subject to limitation in its factual field of operation by the existence of specific doctrines'.[5]

10.2 Manifestation of equitable fraud

Although most equitable interventions on the grounds of fraud have now been subsumed under specific doctrinal heads, some discrete manifestations of equitable relief for fraud remain:

- equity may impose terms on both parties to an action for deceit where the plaintiff's losses may not have fully crystallised at the date of action, or may be hard to qualify (*Demetrios v Gikas Dry Cleaning Industries* (1991));
- a suit may be brought in equity to set aside a judgment obtained by fraud (*Wentworth v Rogers (No 5)* (1986)). The initial judgment need not have been an equitable matter;
- a long standing principle is that equity will not allow a statute to be used as a cloak for fraud. The principle is most often applied where a party relies on the writing requirements of the Statute of Frauds in a fraudulent attempt to defeat the other party's expectations of a proprietary interest (*Last v Rosenfeld* (1972)). The principle is not, however, confined to the Statute of Frauds, and has been used to read the corporate veil erected by companies legislation (*Jones v Lipman* (1962)). The rapid development of estoppel and constructive trust principles in recent years has, however, reduced the practical significance of this equitable principle.

5 For more discussion on the nature and scope of unconscionability, see Zumbo, 'Unconscionability within a commercial setting: an Australian perspective' (1995) 3 TPLJ 183, pp 186–87; Mason, A, 'Contract, good faith and equitable standards in fair dealing' (2000) 116 LQR 66; Finn, P, 'Unconscionable conduct' (1994) 8 JCL 37; Hardingham, I, 'Unconscionable dealing', in Finn, P (ed), *Essays on Equity*, 1985, p 1; Mason, A, 'The impact of equitable doctrine on the law of contract' (1998) 27 Anglo-Am L Rev 1; Dal Pont, G, 'The varying shades of "unconscionable conduct" – same term, different meaning' (1999) 19 Aus Bar Rev 26; Clough, D, 'Trends in the law of unconscionability' (1999) 18 Aus Bar Rev 4; and the general overview of the concept of unconscionability as outlined by French J in *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* (2000) 169 ALR 324.

MISTAKE IN EQUITY

11.1 Nature of 'mistake' in equity

There is no such thing as an integral doctrine of mistake in equity. Instead, miscellaneous grounds of equitable intervention developed, with the availability of relief depending on the nature of the mistake made as well as the precise remedy sought.

In certain circumstances, a mistaken payment could be recovered in equity from the wrongful recipient:

- recipients of wrongful payments made by executors, and perhaps by other fiduciaries, are personally liable to repay the rightful recipients (*Re Diplock's Estate* (1948)). In Queensland and Western Australia, this personal action has been placed on a statutory basis and applies to payments made by executors and trustees (see ss 119, 11 of the Trusts Act 1973 (Qld), ss 65, 131 of the Trustees Act 1962 (WA)); and
- officers of the court are bound in equity to restore money wrongfully paid to them (*Ex p James* (1874)). This rule applies to all officers of court, and is not restricted to officers of a court of equity, even though the rule was originally developed to apply purely to Chancery officials (*Re Carnac* (1885)).

These rules apply to payments made under a mistake of the law, as well as to factually mistaken payments. In the High Court decision of *David Securities Pty Ltd v Commonwealth Bank of Australia* (1992), it was held that an action in restitution for a mistaken payment could apply to a mistake of law as well as a mistake of fact.

11.2 Mistaken payments

In *Chase Manhattan Bank NA v Israel Bank (London) Ltd* (1981), Goulding J held that the recipient of a mistaken payment could create a fiduciary relationship between the payer and payee, entitling the former to trace into the assets of the insolvent payee. The decision has been criticised on the ground that no relationship existed between the parties prior to the payment, and its status in Australia is uncertain.

Where parties set out the terms of an agreement or other transaction in a written instrument which, by mistake, does not embody the true agreement between the parties, equity will allow rectification of the document. There need not be a concluded agreement, but it must be shown that the document does not reflect the common intention of the parties (*Maralinga Pty Ltd v Major Enterprises Pty Ltd* (1973)).

11.3 Refusal to relieve against mistake

A court may refuse to award on the ground of mistake. In *Steel v Warke* (1949), the High Court held that, where the plaintiff had not contributed to the defendant's mistake, specific performance would only be refused where there was 'a hardship amounting to injustice'. In such cases, the contract remains valid and the plaintiff is entitled to common law damages.

The circumstances which entitle a plaintiff to rescind a contract for mistake cannot be stated with certainty. The reasons for the confusion are: first, that both the courts and academic commentators have failed to agree upon a system for the clarification of mistakes; and, secondly, that there is doubt as to whether a line of cases permitting rescission for common mistake will be followed in Australia. It is doubtful if a rational set of equitable rules can be developed on this topic until the common law position is clearly stated.

11.4 Effect of mistake

11.4.1 Unilateral mistake

Where one party is mistaken as to some matter which is fundamental to the nature of the contract, such as the identity of the parties or the nature of the agreement signed, there is no sufficient 'meeting of minds' to create a contract. Accordingly, the contract will be void at law, leaving no room for equitable intervention. Some cases on unilateral mistake have, however, been classified as examples of mutual mistake, where the contract is valid at law and liable to rescission in equity.

11.4.2 Mutual mistake

Mutual mistake occurs where the parties are at cross-purposes as to each other's intentions. The contract may be valid at common law, since the parties may be taken to have objectively agreed. Nevertheless, rescission will usually be ordered in equity if a party has behaved unconscientiously. This will generally occur where the defendant knows facts which should lead him or her to realise that the plaintiff has made a mistake.

In *Taylor v Johnson* (1983), the plaintiff agreed to sell land to the defendant for $15,000. The vendor thought she was selling the land for $15,000 per acre, but the contract did not state this. The purchaser was aware that the vendor was under a misapprehension and took steps to ensure that she did not discover her mistake. A majority of the High Court held that the contract could be rescinded.

The majority formulated the following propositions:

> [A] party who has entered into a written contract under a serious mistake about its contents in relation to a fundamental term will be entitled in equity to

> an order rescinding the contract if the other party is aware that circumstances exist which indicate that the first party is entering the contract under some serious mistake or misapprehension about either the content or subject matter of that term and deliberately sets out to ensure that the first party does not become aware of the existence of his mistake or misapprehension.

In *Taylor v Johnson*, the defendant took deliberate steps to prevent the plaintiff from discovering her mistake. It is unclear whether rescission would be ordered where the defendant is aware of the mistake but takes no steps to conceal the situation, because it is possible that rescission was available in equity as a consequence of the unconscientious behaviour, rather than the mistake itself.

Where there is a simple misunderstanding between the parties not caused by any unconscientious behaviour by the defendant, rescission will be refused.

In *Riverlate Properties Ltd v Paul* (1975), the parties executed a lease which obliged the landlord to carry out exterior and structural repairs of the demised property. The landlord had intended that the tenant should contribute to the cost of such repairs. The tenant was unaware of the landlord's mistake and did not intend to make a contribution.

The English Court of Appeal refused to rectify the lease or to order rescission. The Court stated that 'conscience' did not prevent someone from obtaining a property at bargain price.

11.4.3 Common mistake

Common mistake occurs when both parties are under the same mistaken belief. In *Bell v Lever Bros Ltd* (1932), the House of Lords held that a contract was only void at common law if the mistake was fundamental. In Australia, the High Court, in *McRae v Commonwealth Disposals Commission* (1951), held that, whether the contract was enforceable, giving rise to an obligation to pay damages on breach, or failed because a condition precedent to its existence had not been satisfied, was a question of the construction of the particular contract. On this analysis, the existence of a contract, and the nature of the obligations of the parties, are entirely matters for the common law. The role of the judge is to construe the contract and determine the allocation of risk expressly or impliedly fixed by the parties. In performing this function, the judge is not required to apply any equitable doctrine.

Nevertheless, in a series of decisions commencing with *Sole v Butcher* (1950), Lord Denning asserted a general equitable jurisdiction to rescind contracts for common mistake. The strongest authority relied upon by Lord Denning is *Cooper v Phibbs* (1867).

The plaintiff took a lease of a fishery of a river, together with other real property comprising an estate in Ireland, from his cousins. The plaintiff was told by his uncle that the fishery belonged to him. The uncle had effected

improvements to the fishery. In fact, the fishery belonged to the plaintiff. The plaintiff applied to have the lease delivered up and cancelled.

The House of Lords granted the plaintiff's application subject to the condition that the uncle's daughters be paid for the expenditure the uncle had made on the fishery whilst he was alive. The House assumed that the lease, which was equitable, was void at law. Lord Westbury drew a distinction between a mistake of law, for which relief was not given, and a mistake as to private ownership rights, which could give rise to equitable relief. However, the distinction is immaterial now that the High Court, in *David Securities v Commonwealth Bank,* has eliminated the distinction between mistake of fact and mistake of law.

In view of the approach in *McRae's* case, whereby the consequences of an alleged common mistake are treated as a question of construction of the contract under common law, there would appear to be no special role for equity to play in cases of common mistake under Australian law.

Subsequent English courts have adopted a more flexible approach. In *Associated Japanese Bank (International) Ltd v Credit Du Nord* SA (1988), Steyn J addressed the role of common law and equity where a common mistake under a contract is alleged. On the facts of the case, a contract was entered into whereby the plaintiff (AJB) agreed to purchase some engineering machines from the defendant, which would then be leased back to the defendant. When the defendant failed to keep up the payments under the lease, it was discovered that the machines did not exist and that the entire agreement was a fraud effected by the defendant. The plaintiff claimed the outstanding balance due under the lease. However, the defendant argued that the agreement was dependant upon the implied condition that the machines existed and, consequently, the agreement was void *ab initio* on the grounds of common mistake.

Steyn J held that the agreement was void on the grounds of common law mistake. His Honour held that the non-existence of the subject matter of the principal contract was of fundamental importance to the entire agreement. In the course of his judgment, Steyn J considered the differing approaches to mistake under common law and equity. In relation to the application of mistake in equity, his Honour made the following comments:

> The law has not stood still in relation to mistake in equity. Today, it is clear that mistake in equity is not circumscribed by common law definitions. Where common law mistake has been pleaded, the court must first consider this plea. If the contract is held to be void, no question of mistake in equity arises. But, if the contract is held to be valid, a plea of mistake in equity may still have to be considered …[1]

1 See, also, *William Sindall plc v Cambridgeshire County Council* [1994] 1 WLR 1016; [1994] 3 All ER 932.

His Honour did not explicate the circumstances under which a mistake in equity may be raised, other than to indicate that it may be available as a more flexible alternative to mistake under common law.

In *Clarion Ltd v National Provident Institution* (2000), Rimer J approved of the approach of Steyn J in *Associated Japanese Bank* in giving equity some role in common mistake. However, he sought to restrict its application. Rimer J stated that the jurisdiction of equity did not extend to relieving a party from a contract when the mistake does not go to the subject matter of the contract, but only to its consequences and effect. His Honour made the following comments:

> … even accepting that equity is more sympathetic towards providing relief from mistake than is the common law, its sympathy does not extend to providing relief in cases such as this. The limit of the applicable principles is … that a court of equity may in certain circumstances relieve a party from his contract if he entered into it under a mistaken understanding of its subject matter or terms, provided that such mistake was known by the other party at the time; but that equity's jurisdiction does not extend to relieving a party from his contract when the nature of his mistake went not to subject matter or terms, but only to its commercial consequences and effect.

MISREPRESENTATION

12.1 Consequences of misrepresentation

A misrepresentation of existing fact or law may give rise to various forms of equitable intervention:

- specific performance of a contract may be refused where the plaintiff has made a misrepresentation;
- a contract may be rescinded on account of the defendant's misrepresentation;
- a misrepresentation made by a fiduciary who has contracted to buy a property from the beneficiary will give rise to rescission and, where the beneficiary has suffered loss, to equitable compensation;
- a misrepresentation may create an estoppel within the principles of *Waltons Stores (Interstate) Ltd v Maher* (1988).

12.2 Rescission for misrepresentation

The focus of this chapter is on rescission for misrepresentation. Whilst the common law awards damages and rescission for fraud (*Derry v Peek* (1889)) and damages for negligent misstatement (*Hedley Byrne and Co v Heller and Partners Ltd* (1964)), a contract can be rescinded in equity for innocent misrepresentation. Innocent misrepresentation refers to a misrepresentation made without intention or reckless indifference. Relief for such an action is only available in equity.

In *Redgrave v Hurd* (1881), the plaintiff agreed to sell his house to the defendant, who proposed to take over the plaintiff's legal practice. Upon inquiry, the plaintiff stated that the practice brought in £300 a year, whereas the papers, which the defendant did not examine, showed that it was worth only £200 a year. The defendant took on the practice. Finding that it was worth less than he had been told, he refused to complete the contract to buy the house. The plaintiff sued for specific performance and the defendant counter-claimed to have the contract rescinded, even though no fraud had been alleged against the plaintiff. The court allowed rescission in equity based upon the innocent misrepresentation. The effect of *Redgrave v Hurd* was summarised by Gummow J in *Marks v GIO Australia Holdings Ltd* (1998), where his Honour concluded that the rationale underlying the case could be put in two ways:

> A man is not to be allowed to get a benefit from a statement which he now admits to be false. He is not to be allowed to say, for the purpose of civil jurisdiction, that when he made it he did not know it to be false; he ought to have found that out before he made it. The other way of putting it was this: Even assuming that moral fraud must be shown in order to set aside a contract, you have it where a man, having obtained a beneficial contract by a statement which he now knows to be false, insists upon that contract. To do so is a moral delinquency: no man ought to seek to take advantage of his own false statements.

The misrepresentation must have induced the representee to enter into the contract. Rescission cannot be obtained if the misrepresentation did not cause the representee to enter into the contract (*Smith v Chadwick* (1882)). It is not necessary for the representation to be the sole cause inducing the party to enter into a contract (*Welcher v Steain* (1962)).

The right to rescind is not lost if the representation is incorporated as a term of the contract.

In *Academy of Health and Fitness Pty Ltd v Power* (1973), a contract entitled the defendant to 'the free use at any time of the sauna baths at the Academy's premises'. Before he signed the contract the defendant had been told that the sauna baths would be available at any time. In fact, they were not, as they were sometimes reserved for women only.

Crockett J held that rescission was not precluded by the fact that the statement was incorporated as a term of the contract. More doubtfully, he considered that the right to rescind would be lost where the term incorporated was a condition. The judgment appears to misunderstand the nature of a condition, which entitles the plaintiff to treat the contract as repudiated from rescission which seeks to restore the parties to their original position.

Where a misrepresentation is incorporated as a term of the contract, the representee will be entitled to the usual remedies for breach of contract.

12.3 Cases where rescission has been refused

In Victoria, it has been held that a contract for the sale of goods cannot be rescinded for innocent misrepresentation (*West v Westhoven* (1993)). The rule is based on the false analogy of specific performance of contracts for the sale of goods. Specific performance of such contracts is usually held not to be available. In such cases, however, the specific performance is based upon the presumed adequacy of damages, a factor which is irrelevant where rescission is sought for innocent misrepresentation.

It has also been said that the sale of goods legislation provides for the preservation of common law remedies but not, with some exceptions, for the preservation of equitable remedies. The reference to common law in the legislation, however, should be construed to include equitable as well as common law remedies (*Leason Pty v Princes Farm Pty Ltd* (1983)).

The right to rescind is said to be lost after a contract has been executed, for example, by completion of a conveyance.

In *Seddon v North East Salt Co Ltd* (1905), Joyce J refused to order rescission of a contract to sell shares. The judge thought that the defendant had not made a misrepresentation and stated, *obiter*, the opinion that rescission for innocent misrepresentation could not be ordered after the contract had been executed.

The rule in *Seddon's* case was applied by the majority of the High Court in *Svanosio v McNamara* (1965) to a contract for the sale of land. It has been criticised on the ground that, while execution of a contract may be relevant to the question of whether a plaintiff has slept on his or her rights, it should not by itself be a ground for denying rescission. The remedy is, nevertheless, unlikely to be available after registration of land under Torrens system title.

12.4 The nature of equitable rescission

Rescission is a remedy typically awarded of a contract entered into in consequence of a misrepresentation. A court may order a rescission in equity, on terms, where the plaintiff has received some benefits under the contract.

In *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995), the defendant gave credit to the plaintiff's company in return for a guarantee by the plaintiff relating to 'all moneys that are now, or may at any time, be owing to the defendant'. When sued on the guarantee, the plaintiff successfully argued that the defendant had misrepresented to the plaintiff that he would only be liable for future, and not past, indebtedness of the company.

The High Court ordered rescission of the guarantee insofar as it related to the company's past indebtedness. The plaintiff remained liable, however, in respect of any future indebtedness of the company, since that was the basis on which he had signed the guarantee. In equity, even if the facts preclude precise restitution, rescission may be granted on specific terms in order to achieve substantial restitution.[1] In *Bridgewater v Leahy* (1998), in referring to the *Vadasz* decision, the High Court emphasised the importance of flexibility in equitable rescission and equitable remedies generally. Gaudron, Gummow and Kirby JJ, in the majority, noted that once a court has determined the existence of an equity sufficient to attract relief:

> ... the framing, or as it is often expressed, the moulding, of relief may produce a final result not exactly representing what either side would have wished. However, that is a consequence of the balancing of competing interests to which, in the particular circumstances, weight is to be given [p 126].

1 Cf the approach taken by the High Court in *Maguire v Makaronis* (1997) 144 ALR 729, a breach of fiduciary duty case where *Vadasz v Pioneer Concrete (SA) Pty Ltd* was distinguished.

Where a plaintiff has suffered loss under a rescinded contract, the plaintiff may be able to obtain compensation in addition to rescission. Compensation can be awarded only for losses directly flowing from the misrepresentation, and cannot be awarded where there is some supervening cause, such as the poor business judgment of the plaintiff (*Munchies Management v Belperio* (1988)). See, also, below, 24.1 (especially 24.4.1).

12.5 Relevant legislation

The significance of equitable remedies for misrepresentation has been reduced by the introduction of legislation. Section 52 of the Trade Practices Act 1974 (Cth) prohibits misleading and deceptive conduct by corporations during the course of their business. Section 87 permits setting aside and variation of such contracts in a wider range of circumstances than equity permits. The scope and purpose of this remedial provision was discussed by the High Court in *Marks v GIO Australia Holdings Ltd* (1998). In determining the measure of damages to be awarded for an interest rate misrepresentation coming within the ambit of s 52 of the Trade Practices Act 1974 (Cth), the court concluded that s 87 should not be confined or restricted by contractual, tortious or equitable approaches to the assessment of damages. Relief under s 87 should be tailored to suit the fairness requirements of the individual case without being constrained by particular jurisidictional doctrines, although the courts of common law and equity could provide some valuable guidance in this regard. Gummow J felt that s 87 should be implemented in accordance with the fullest relief equity would allow, although Kirby J, in dissent, felt that 'while the discretion which is enlivened' under s 87 'must be exercised judicially, there is, nevertheless, an unusually wide range of powers extending well beyond those available in courts of the common law or of equity. Judges should not narrow or confine what the parliament has so amply provided'.

Similar provisions have been introduced at the State level in the Fair Trading Act 1985 (Vic). The Misrepresentation Act 1971–72 (SA) reforms, on a piecemeal basis, deficiencies relating to the law of misrepresentation, including the abolition of the rule in the *Seddon* case. Section 7 of the South Australian legislation also confers a statutory right to damages for misrepresentation, unless the defendant had reasonable grounds to believe that the representation was true and could not reasonably have been expected to know that it was untrue.

UNDUE INFLUENCE

13.1 Definition

Like most legal concepts, undue influence cannot be precisely defined; however, it has been helpfully described as follows (*Union Bank of Australia v Whitelaw* (1906)):

> 'Influence', as I understand the term in this connection, is the ascendancy acquired by one person over another. 'Undue influence' is the improper use by the ascendant person of such ascendancy for the benefit of himself or someone else, so that the acts of the person influenced are not, in the fullest sense of the word, his free voluntary acts.

The primary focus of undue influence is the quality of the consent rather than the unconscientious conduct of the stronger party (*Commercial Bank v Amadio* (1983)). The fact that the stronger, ascendant party has good intentions and no ulterior motive is irrelevant if it can be proven that the influence exerted prevented the weaker party from freely consenting to the transaction: *Carey v Norton* (1998).[1]

13.2 Development of undue influence

Equity's doctrine of undue influence was a response to the limited nature of duress at common law, which, until the 18th century, was confined to duress to the person. The doctrine of undue influence enabled transactions, induced by more subtle forms of pressure than those recognised by duress, to be set aside. Now that the law of duress has expanded to encompass, for example, economic duress, and that a wide range of equitable and statutory remedies provide relief for unconscientious conduct, the existence of undue influence as an independent doctrine remains problematic. In recent years, a three-fold classification of undue influence cases has been accepted (*Barclays Bank v O'Brien* (1994)).

13.2.1 Actual undue influence

The first established class is 'actual' undue influence. If a person has obtained a benefit through the use of actual pressure, including violence and the threats of violence, the transactions can be set aside on the ground of actual undue influence and, in this way, common law and equity were integrated.

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1 See Birks, P and Yin, CN, 'On the nature of undue influence', in Beatson and Friedmann (eds), *Good Faith and Contract Law*, 1995, p 57.

In *Farriers' Co-operative Executors and Trustees Ltd v Perks* (1989), a wife transferred her share in a property to her husband following violence and threats of violence. The husband later murdered the wife. Duggan J ordered the transfer to be set aside on the grounds of actual undue influence. During the course of his judgment, his Honour agreed with a suggestion of M Cope in *Duress, Undue Influence and Unconscientious Bargains* (1985), p 124, that cases of duress to the person could properly be classified under the heading of actual influence.

13.2.2 Relationships of presumed influence (category 2A undue influence)

Equity presumed that, by their very nature, certain relationships created a presumption of undue influence as a matter of law. Where it can be proven that there is a relationship of trust and confidence of 'such a nature that it is fair to presume that the wrongdoer abused that relationship in procuring the complainant to enter into the impugned transaction, the court will presume undue influence': *Barclays Bank v O'Brien* (1993). Where a presumed relationship of influence exists, a burden rests on the ascendant party to show that any benefits received from the other party were the consequence of an independent exercise of judgment. The categories of 'presumed influence' relationship are not closed, but include the following:

- parent and child;
- guardian and ward;
- religious adviser and disciple;
- solicitor and client; and
- doctor and patient.

Other relationships have been included from time to time. For example, some expositions of the law of undue influence have stated that the relationship between fiancailles is one of pressured influence (*Johnson v Buttress* (1936)). More recently, this has been doubted (*Zamet v Hyman* (1961)), although in *Louth v Diprose* (1992), Brennan J assumed that this relationship continued to be one of presumed influence.

The relationship of husband and wife is not presumed to be one of undue influence, although it may, depending on the nature of the relationship, come within the category of relationships of 'proven influence'. Similarly, the relationship of trustee and beneficiary, although fiduciary, is not a relationship of presumed undue influence. Fiduciary relationships and relationships of presumed influence should be distinguished. Fiduciary relationships focus upon the possibility of abuse in relationships of mutual trust and confidence and the need for equitable safeguards to be imposed. Not every action of a fiduciary will constitute a breach, whereas relationships of presumed influence assume that all decisions made will be affected by influence unless the presumption is rebutted. In such relationships, abuse of mutual trust and

confidence is assumed; there is no need to prove an actual breach as with fiduciary relationships. The position has been well summarised by La Forest J in the Canadian decision: *Hodgkinson v Simms* (1994), pp 173–74:

> The concepts of unequal bargaining power and undue influence are also often linked to discussions of fiduciary principle … However, whereas undue influence focuses on the sufficiency of consent … the fiduciary principle monitors the abuse of loyalty reposed. Thus, whilst the existence of a fiduciary relationship will often give rise to an opportunity for the fiduciary to gain an advantage through undue influence, it is possible for a fiduciary to gain an advantage for him or herself without having to resort to coercion.

13.2.3 Relationships of proven influence (category 2B undue influence)

A plaintiff may establish that a relationship between him or her and another person was, in fact, a relationship of influence and ascendancy by providing that the relationship was, on the facts, one of trust and confidence; a court may consider the character of both parties and, in particular, their intelligence, understanding of business, infirmities of mind or body, and the overall nature of the friendship. Once the nature of the relationship has been proven, the burden shifts to the stronger party to stress that any benefit conferred by the stronger party was the consequence of an exercise of independent judgment.

The leading authority on relationships of proven influence is the High Court decision in *Johnson v Buttress* (1936). In that case, a 67 year old man who was illiterate and of very low intelligence became, after his wife's death, on close terms with the appellant, who was a distant relative of his wife. Shortly before his death he transferred to her his only substantial asset, his house and the surrounding land. He received no independent advice concerning the effect of these transactions. After his death, his son applied to have the transfer set aside on the ground that it had been executed under undue influence.

The High Court held that a relationship of influence between the son's father and his wife's relative existed and which had not been rebutted. Dixon J explained that the relationship could be directly proven from 'the man's illiteracy, his ignorance of affairs, and his strangeness of disposition'.

In contrast to the law of unconscionable dealings, a gift may be set aside for undue influence even though the ascendant party has not exploited the weaker party. The appellant in *Johnson v Buttress* was not found to have exploited the other party; the transfer was set aside because it was against public policy for the ascendant to transact with the weaker party when there was no evidence of an independent exercise of judgment by the latter.

Many cases of undue influence, including *Johnson Buttress*, are based on an incapacity or disability preventing the weaker party from protecting his or her own interests. But the doctrine can also apply to a person who suffers from no apparent disability apart from a high degree of dependence, in certain matters, on another person.

In *Union Fidelity Trustee of Australia v Gibson* (1971), Miss Dunn, who had considerable business experience, released the defendant from the obligation of having to make repayments under a mortgage he had taken out with her. The defendant had acted as her estate agent and financial adviser for many years. Miss Dunn took no independent advice on the desirability of executing the release. Gillard J held that, whilst Miss Dunn was fully capable of handling financial transactions, she was acting under the influence of the defendant in releasing him from further obligations to repay the mortgage. Gillard J was careful to point out that, where a gift of a substantial sum such as the release of a mortgage is alleged by someone who is not a blood relative, but merely a friend in business activities, the court will treat all alleged transactions suspiciously. The defendant, therefore, was ultimately unable to rebut the presumption that the transaction had occurred by way of undue influence.

13.3 Defences to undue influence

13.3.1 Independent legal advice

The provision of independent legal advice is not the only method of showing that the weaker party exercised independent judgment, but it is the most accurate method. The advice must, however, be fully informed and be directed to the consequences of entering into a transaction, including the wisdom of entering into it, as well as to explaining the legal effect of the transaction.

In *Bester v Perpetual Trustee* (1970), both the plaintiff's parents died before she was 18. She was advised by the trustee company administering her father's estate, and also by her uncle and a solicitor who had married one of her aunts, to settle her interest in her father's estate. A deed of settlement was drawn up which entitled the plaintiff to the income of her father's estate but to none of the capital. The deed of settlement was read over to her at the time of signature by a solicitor who asked her if she had any questions; 20 years later the plaintiff successfully applied to have the settlement set aside on the grounds of undue influence. Street J stated that: 'it was not textual advice upon the engrossment which was of prime importance in this regard, rather it was advice upon the more general topic of whether a settlement should have been entered into at all and, if so, the general nature of the settlement, which in my view ought to have been provided for the plaintiff'. The advice must be clear, properly translated and directed at the particular transaction in issue: *Ribchenkov v Suncorp Metway Ltd* (2000).

13.3.2 Adequacy of consideration

In *Johnson v Buttress*, Dixon J stated that, where a contract is entered into, 'adequacy of consideration becomes a material question'. However, he did not go as far as to hold that the payment of adequate consideration by the

ascendant party was a complete defence. It would seem that proof of adequate consideration being given in a transaction will constitute one, albeit significant, factor in the overall assessment of the circumstances.

13.3.3 Manifest disadvantage

In recent years, the issue of adequacy of consideration has been re-characterised by English courts as one of 'manifest disadvantage'. In *National Westminster Bank v Morgan* (1985), the House of Lords held that a family guarantee, whereby a wife agreed to mortgage the family home to the bank in order to secure additional finance for her husband's business, could not be set aside on the ground of the bank's alleged undue influence because the guarantee was not 'manifestly disadvantageous' to the wife; it secured a financial lifeline for her husband's business which would benefit the wife as well as her husband. Lord Scarman grounded the doctrine of undue influence on the notion of the 'victimisation' of the weaker party by the stronger. This is, however, inconsistent with the 'public policy' rationale identified by Dixon J in *Johnson v Buttress*.

Some State courts have applied the 'manifest disadvantage test' (for example, *Farriers' Co-operative Executors and Trustees Ltd v Perks* (1989)), although others, for example, *Baburin v Baburin (No 2)* (1991), have refused to do so on the ground of its apparent inconsistency with *Johnson v Buttress*.

The House of Lords has now held that the 'manifest disadvantage' test does not apply to cases of actual undue influence (*CIBC Mortgages plc v Pitt* (1994)), and foreshadowed a more general review of the requirement. It is unlikely that 'manifest disadvantage' will be accepted, at any rate as a formal requirement, in the Australian law of undue influence.

13.4 Undue influence and third parties

Where it is established that a transaction is tainted by undue influence, it is voidable against the party who has exercised the influence, as well as third parties who acquire rights under the transaction. The existence of undue influence confers an equity upon the person who has been induced, and this equity is enforceable against third parties in three primary situations: first, where the third party has actual or constructive notice of the exertion of the influence; secondly, where the third party was, in effect, the agent of the person who has exercised the influence; and finally, where the third party has unconscionably precluded a full and proper explanation of a transaction to a wife who has agreed to secure the transaction – this final situation is covered under what is known as the *Yerkey v Jones* principle.

The most common factual situation where a third party acquires rights in an 'undue influence' transaction is where a person is unduly influenced into acting as guarantor for a creditor to ensure the approval of a loan transaction.

When the loan is defaulted and the creditor attempts to enforce the security, if the guarantor can prove that undue influence has been exerted then the creditor may be subject to this equity.

The situations where third parties may be subject to the undue influence 'equity' are discussed below.

13.4.1 Notice

English and New Zealand courts have accepted that an equity may be raised against a third party creditor in circumstances where it can be established that, at the time of executing the transaction, the third party had actual or constructive notice that the transaction had been procured by the exercise of undue influence. The exact nature of the notice required was discussed by the House of Lords in *Barclays Bank v O'Brien* (1993). On the facts of that case, the bank had agreed to increase the overdraft facility to a husband's company in exchange for the execution of a second mortgage over the matrimonial home of the husband and wife. The branch manager of the bank sent the mortgage documentation to a different branch with instructions that both Mr and Mrs O'Brien were to be fully informed of the nature of the documents. These instruction were not followed and, relying upon her husband's assurance that the mortgage was limited to £60,000 and would only last three weeks, Mrs O'Brien signed the mortgage without reading it.

The House of Lords set aside the mortgage, finding that if Mrs O'Brien had received a full and proper explanation it would have countered Mr O'Brien's misrepresentations. Lord Browne-Wilkinson noted that a wife who has been induced to stand as a surety for her husband's debts by his undue influence has 'an equity as against him to set aside that transaction'. Furthermore, his Honour felt that, under the ordinary principles of the equitable jurisdiction, 'her right to set aside that transaction will be enforceable against third parties (for example, against her creditor) if either the husband was acting as the third party's agent or the third party had actual or constructive notice of the facts giving rise to her equity'.

Whilst it was clear, on the facts of *O'Brien*, that the bank did not have any actual notice of undue influence, Lord Browne-Wilkinson felt that a bank would be placed on constructive notice of potential undue influence where the transaction is, on its face, not to the financial advantage of the wife, and there is a substantial risk in transactions of that kind that the husband may have committed a legal or equitable wrong. In such a situation, the bank could only escape liability if it had insisted that the wife attend a separate meeting, unattended by her husband, where she would be informed of the extent of her liability, and warned of the risks she was running and of the importance of obtaining independent legal and financial advice. In order to avoid being fixed with constructive notice, the third party creditor must be reasonably expected to take steps to bring home to the wife the full consequences of the transaction she is about to enter.

Lord Browne-Wilkinson felt that this responsibility was not too onerous a burden upon banks because it largely accorded with good banking practice, the only additional requirement being that the bank ensure that a full explanation is specifically addressed to the wife, and his Honour felt that the requirement of a personal interview did not 'impose such an additional administrative burden as to render the bank's position unworkable'.

Whilst the facts of *O'Brien* deal specifically with a wife, Lord Browne-Wilkinson made it clear that the same principles would apply to all other cases where there is an emotional relationship between cohabitees, and 'legal wives are not the only group which are now exposed to the emotional pressure of cohabitation'. In *Midland Bank plc v Massey* (1995), Steyn J approved of the *O'Brien* decision and applied it to a relationship where the guarantor was a non-cohabiting *de facto* partner; in endorsing the approach of Lord Browne-Wilkinson in *O'Brien*, his Honour made the following comments:

> When speaking of wives Lord Browne-Wilkinson had in mind that in the given circumstances the capacity for self-management of wives is frequently impaired by the emotional ties between the spouses. He stated, however, that the reality was that the determinative factor cannot be a marriage certificate. He observed that the same approach applies equally to heterosexual and homosexual cohabitees. Miss Massey never cohabited with Mr Potts, but she had a stable sexual and emotional relationship with him over many years, and they had two children. Whilst it is an extension of the approach enunciated by Lord Browne-Wilkinson, I have no doubt that, in terms of impairment of Miss Massey's judgmental capacity, this case should be approached as if she was a wife or cohabitee of Mr Potts [p 936].

In *Banco Exterior Internacional SA v Thomas* (1997), however, Sir Richard Scott VC concluded that a bank was not subject to constructive notice of any undue influence between a woman who had guaranteed a loan for the benefit of a close male friend. In that case, his Honour felt that the bank had no business inquiring into the 'personal relationships' or the 'personal motives' of persons wanting to provide financial assistance and that, provided the bank was assured that the guarantor knew what she was doing, no further inquiries were necessary.

In the subsequent decision of *CIBC Mortgages plc v Pitt* (1994), the principles expounded in the *O'Brien* case were held to be inapplicable where a wife joined with her husband to obtain a loan secured by a joint mortgage on the home, ostensibly to raise money for a second holiday home for them both, but, in fact, to enable the husband to speculate on the share market. Mrs Pitt argued that CIBC should be affected with constructive notice of the undue influence equity. The trial judge held that the husband had exercised actual undue influence on the wife to procure her agreement, and that the transaction was manifestly disadvantageous to her, but that, since the husband had not acted as agent of the plaintiff and there had been a joint advance to both husband and wife by way of a loan, rather than the wife

standing as surety for the husband's debt, the wife's claim failed. The appeal to the Court of Appeal was dismissed. The wife then appealed to the House of Lords, which held that, whilst the wife had established actual undue influence by the husband, CIBC was not affected by it because the husband had not acted as the agent of CIBC in any real sense, and CIBC did not have any actual or constructive notice; there was nothing in the nature of this loan application to indicate that it was anything other than a normal advance for the joint benefit of the husband and the wife. The mere fact that there was a risk of there being undue influence because one of the borrowers was the wife was, in itself, not sufficient to put the plaintiff on inquiry. Lord Browne-Wilkinson noted that the distinction between the 'joint advance' case from the case where the wife acts as a 'surety', as occurred in the *O'Brien* case, 'is that, in the latter, there is not only the possibility of undue influence having been exercised but also the increased risk of it having, in fact, been exercised because, at least on its face, the guarantee by a wife of her husband's debts is not for her financial benefit. It is the combination of these two factors that puts the creditor on inquiry'.

In *Barclays Bank v Boulter* (1999), the House of Lords noted that the burden of proof in third party undue influence cases was upon the wife, to show why her husband's actions should render the transaction invalid; this burden would be satisfied where the wife could establish that the bank knew that she and her husband lived together, and that the transaction was not, on its face, financially advantageous to her. Once this was established, the burden then shifted to the bank to show that it had taken reasonable steps to satisfy itself that the consent of the wife had been properly obtained, and that the wife had been fully explained of the nature and consequences of the transaction.

In *Royal Bank of Scotland v Etridge (No 2)* (1998), the Court of Appeal noted that a third party creditor would not be affected with constructive notice if the wife, when entering into the financially disadvantageous transaction, was legally represented. In *Wilkinson v ASB Bank Ltd* (1998), the New Zealand Court of Appeal held that a bank is entitled to assume that the advice of a family solicitor was independent and sound, and that it could not be assumed, just because the solicitor had some involvement with the principal debtor (that is, the person who had exerted the influence), that he or she would be unable to provide independent and balanced legal advice. In *Barclays Bank v Coleman* (2000), Nourse LJ, in the Court of Appeal, noted that a third party creditor would not be affected with constructive notice if adequate and independent legal advice was given to the wife. His Honour felt that such advice could come from either a solicitor or a legal executive, because 'what is required is independent legal advice, by which is meant advice independent of the mortgagee. Advice given by a legal executive is legal advice and, provided that it is independent and given with the authority of his principal, there is no sound reason for holding it to be inadequate'. His Honour felt that this conclusion accorded with the current realities of a solicitor's practice.

13.4.2 Agency

A third party may also be subject to the 'undue influence' equity in circumstances where it is clear that the person exerting the influence was acting as the agent of the third party. The *O'Brien* decision made it very clear that agency will taint a third party with undue influence; however, the agency principles should not be distorted in order to hold a third party creditor liable when, in truth, the real blame lies with the party who has exerted the influence. The House of Lords rejected the agency argument on the facts of the *O'Brien* decision. The rationale underlying the third party agency principle was succinctly outlined by Dillon LJ in *Kings North Trust Ltd v Bell* (1986), p 123:

> ... if a creditor, or potential creditor, of a husband desires to obtain, by way of security for a husband's indebtedness, a guarantee from his wife, or a charge on property of his wife, and if the creditor entrusts to the husband himself the task of obtaining the execution of the relevant document by the wife, then the creditor can be in no better position than the husband himself, and the creditor cannot enforce the guarantee or security against the wife if it is established that the execution of the document by the wife was procured by undue influence by the husband, and the wife had no independent advice.

This principle accords with the approach of the general law of principal and agent in relation to fraudulent misrepresentations made by an agent in carrying out the specific instructions of his principal.

13.4.3 The Australian position: the Yerkey v Jones principle

The final situation where a third party creditor may be subject to the equity created by proof of undue influence against a party to the loan transaction is where the facts come within what is known as the 'special wives' equity, emanating from the decision of the Australian High Court by Dixon J in *Yerkey v Jones* (1939).[2] The *Yerkey* principle, as enunciated by Dixon J, may be stated as follows: if a married woman's consent to become a surety for her husband's debt is procured by the husband and, without understanding its effect in essential respects, she executes an instrument of suretyship which the creditor accepts without dealing directly with her personally, the wife has a *prima facie* right to have it set aside.[3]

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2 For academic discussion on the 'special wives' equity, see Otto, D, 'A barren future? Equity's conscience and women's inequality' (1992) 18 Melbourne UL Rev 808; Fehlberg, B, 'The husband, the bank, the wife and her signature' (1994) 57 MLR 467; Howell, N, 'Sexually transmitted debt: a feminist analysis of laws regulating guarantors and co-borrowers' (1994) 4 Aus Feminist LJ 93; Fehlberg, B, 'The husband, the bank, the wife and her signature – the sequel' (1996) 59 MLR 675; Duggan, AJ, 'Till debt us do part: a note on *NAB v Garcia*' (1997) 19 Sydney L Rev 220; Pascoe, B, 'Wives, business debts and guarantees' (1997) 9 Bond L Rev 58; Fehlberg, B, 'Women in "family" companies: English and Australian experiences' (1997) 15 Company and Securities LJ 348.

3 See, also, the judgment of Cussen J in *Bank of Victoria v Mueller* [1925] VLR 642.

The *Yerkey* principle has two elements. First, where the consent of the wife to the surety transaction is procured through actual undue influence by the husband, the wife will be entitled to set aside the instrument against the creditor, unless the creditor can prove that the wife received independent legal advice. There is no need to prove that the creditor knew the particular circumstances surrounding the actual influence; proof that the creditor received constructive knowledge of the marriage relationship will be sufficient.

Secondly, in the absence of actual undue influence, the second limb of the *Yerkey* principle will arise where, if the wife fails to fully appreciate the effect of the surety transaction, the wife may set aside the transaction against the creditor unless the creditor took steps to inform the wife about the transaction and reasonably believed that the wife knew what she was entering into. It is not necessary for the creditor to prove that the wife was independently advised, as long as the creditor is reasonably satisfied as to the wife's comprehension of the transaction. In this situation, the *Yerkey* principle presumes the existence of undue influence in circumstances where the woman is a wife and where she has entered into a surety transaction, the terms of which have not been properly explained to her by the creditor.

The second element of the *Yerkey* principle has been the subject of much judicial and academic discussion and debate, primarily because of the assumptions it makes about the wife within a marital relationship.[4] The 'special wives' equity is founded upon the belief that a wife in a marriage relationship is in a relationship of presumed influence, and is, therefore, unable to make an informed decision when asked to consent to surety transactions. Dixon J expressly noted that courts of equity should not be blind to the opportunities that a husband may have of obtaining, and unfairly using, influence over his wife, and that wives will quite often place complete dependence upon their husbands, particularly with respect to financial decisions, his Honour stating: '... courts of equity examine every transaction between husband and wife with an anxious watchfulness and caution, and dread of undue influence.'[5] In light of this, Dixon J felt that such a relationship could not be divested of an 'equitable presumption of an invalidating tendency'.[6]

This principle is unique to Australia, having been specifically rejected recently in England,[7] New Zealand,[8] and never being fully adopted in

4 *Op cit*, Fehlberg (1994), fn 2.

5 Randall, AE (ed), *Story on Equity*, quoted by Dixon J in *Yerkey v Jones* (1939) 63 CLR 649.

6 *Ibid*, p 675.

7 *Barclays Bank plc v O'Brien* [1994] 1 AC 180 (HL).

8 In its latest case, *Wilkinson v ASB Bank* (1998) 6 NZBLC 102, p 427, the Court of Appeal adopted a modified *O'Brien* approach.

Canada.[9] In *O'Brien*, the House of Lords concluded that there was no need for a 'special wives' equity because adequate protection could be afforded under ordinary equitable principles.[10] In *O'Brien*, Lord Browne-Wilkinson argued that the *Yerkey* principle was based upon unsure foundations, developed in an artificial way, and failed to reflect the current requirements and certainties of modern society.[11] The English approach, as set out in *O'Brien* and discussed above, relies upon ordinary undue influence principles, only providing an exception where a third party creditor knew of the marriage or close emotional relationship and failed to reasonably satisfy itself that the wife understood the nature of the transaction.[12]

The validity of the *Yerkey* principle has now been confirmed by the Australian High Court in *Garcia v National Australia Bank* (1998), where the majority approved of the *Yerkey* principle. The *Garcia* decision examines the relational focus of the 'special wives' equity and confirms its continuing relevance to the modern law of undue influence in Australia, despite clear changes in societal mores and gender perceptions since the *Yerkey* decision was handed down. The majority in *Garcia* make it clear that the level of trust that a wife places in her husband with respect to financial transactions has not really changed over time, and that wives are just as needy of protection today as they were in 1939 when *Yerkey* was handed down. Nevertheless, the *Garcia* decision takes a slightly different perspective to the judgment of Dixon J in *Yerkey*. The majority in *Garcia* emphasise the relational foundation of the 'special wives' equity to a greater degree, and this focus tends to give the decision an added legitimacy, making it appear more flexible and more in line with modern sensibilities.[13]

On the facts of *Garcia*, the appellant, Mrs Garcia and her husband, Mr Fabio Garcia, executed a mortgage over their home in favour of the Commercial Banking Company of Sydney Ltd. The terms of the mortgage set out that the mortgage secured all moneys loaned to the mortgagors under the mortgage, as well as moneys loaned to the mortgagors under future guarantees they may enter into. The mortgage was initially entered into to secure a $5000 loan to the husband for use in his business, that of buying and

9 There is no uniform Canadian approach; it is only in British Columbia that the *Yerkey* principle has been followed. See *E & R Distributors v Atlas Drywall Ltd* (1980) 118 DLR (3d) 339, which has subsequently been qualified in *North West Life Assurance Co of Canada v Shannon Heights Developments Ltd* (1987) 12 BCLR (2d) 346, p 349. The other provinces have rejected or ignored *Yerkey;* see, eg, *Bank of Montreal v Featherstone* (1989) 58 DLR (4th) 567 (Ont CA); R*oyal Bank of Canada v Poisson* (1977) 103 DLR (3d) 735.

10 See, also, *CIBC Mortgages plc v Pitt* [1994] 1 AC 201; *Royal Bank of Scotland v Etridge and Others* [1998] 4 All ER 705 (CA), following *O'Brien*.

11 *Barclays Bank plc v O'Brien* [1994] 1 AC 180 (HL).

12 *Ibid*, pp 198–99.

13 See Haigh, R and Hepburn, S, 'The bank manager always rings twice: stereotyping in equity after *Garcia*' (2000) 26 Mon LR 275.

selling gold through a company known as 'Citizens Gold Bullion Exchange Pty Ltd', and was subsequently used as security for a personal loan to Mrs Garcia and her husband.

Mrs Garcia worked part time as a physiotherapist, and in 1979 set up her own practice. She was a competent, professional woman and exhibited a fairly sophisticated business knowledge. Despite this, she deferred many decisions outside of her own business to her husband, Fabio. Fabio had complete control of the domestic and business finances. Over a two year period, between 1985–87, Mrs Garcia signed four guarantees in favour of the bank for debts owed by her husband's company, Citizens Gold Bullion Exchange Pty Ltd. In particular, Mrs Garcia signed a guarantee in November, 1987, for an amount of $270,000 plus interest, costs and charges. The trial judge found that Mrs Garcia understood the nature of the instrument at the time of signing the guarantee, and she knew it was to secure the overdraft of Citizens Gold Bullion Exchange Pty Ltd. Nevertheless, the trial judge found that Mrs Garcia did not understand that the guarantee was secured by the previous mortgage she had entered into in August, 1979. Mr and Mrs Garcia subsequently divorced, and Mrs Garcia commenced proceedings in the Supreme Court of New South Wales seeking a declaration that the mortgage and guarantees she had given were void on the grounds of undue influence. The trial judge found in favour of Mrs Garcia, under the *Yerkey* principle, and set aside the mortgage. The bank then appealed to the New South Wales Court of Appeal and the appeal was allowed. Sheller JA held that it was not bound to follow *Yerkey v Jones* as it represented a principle which was outdated and should no longer be applied in New South Wales. His Honour concluded that cases of this nature were better dealt with under the unconscionable dealing principle as enunciated by the High Court in *Commercial Bank of Australia Ltd v Amadio* (1983).

Mrs Garcia then appealed to the High Court. The High Court unanimously upheld the appeal, holding that the guarantee entered into by Mrs Garcia in November, 1987, could not be enforced by the bank. In reaching this decision, Gaudron, McHugh, Gummow and Hayne JJ jointly concluded that the *Yerkey* principle applied to the facts and that the November, 1987, guarantee could not be enforced against Mrs Garcia as the bank was affected by the 'misconduct' of the husband. Their Honours carefully examined the *Yerkey* principle and concluded that the principles enunciated by Dixon J did not reflect an outdated view of the role of women in society, but rather were particular applications of accepted equitable principles that remained relevant in modern society. Their Honours felt that the perceived progression of women in Australian society since 1939 did not actually mean that Australian women are no longer in need of protection. As noted in their judgment:

> ... 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.[14]

Whilst it was clear that the majority restricted their adaptation of the *Yerkey* principle to the particular facts, that is, a relationship involving a married woman, they did indicate the possibility of the Yerkey principle being extended to apply to 'long term and publicly declared relationships short of marriage between members of the same or of opposite sex'.[15]

There are four crucial elements to the *Yerkey* principle as enunciated by the majority in *Garcia*. These elements are as follows:

- the surety did not understand the purport and effect of the transaction;
- the transaction was voluntary (in the sense that the surety obtained no gain from the contract, the performance of which was guaranteed);
- the lender is to be taken to have understood that the surety may repose trust and confidence in the partner in matters of business and, therefore, to have understood that the partner may not fully and accurately explain the purport and effect of the transaction to his wife; and
- the lender did not itself take steps to explain the transaction to the wife or to find out if a stranger had explained it to her.[16] This final element will be satisfied if it is clear that the surety has received competent, independent and disinterested advice. This includes advice from a properly qualified solicitor which clearly explains the nature, terms and consequence of the transaction to the surety. If the third party creditor reasonably believes that such advice has been given, and the solicitor provides a statutory declaration to this effect, it is reasonable for a third party creditor to rely on this: *Ribchenkov v Suncorp Metway Ltd* (2000).

In adopting this approach, the majority expressly rejected the English approach outlined by Lord Browne-Wilkinson in *Barclays Bank plc v O'Brien*, which is dependent upon actual or constructive notice to the creditors. Their Honours noted that, whilst notice may be relevant to a priority dispute between competing interests in property, it was irrelevant to the special wives equity and 'may well distract from the underlying principle'.[17]

Their Honours also disagreed with Sheller JA, who, in the Court of Appeal, found that the *Yerkey* principle was not a component of the unconscionable dealing principle set out in *Commercial Bank of Australia v Amadio* (1983). The majority gave three specific reasons for rejecting the joinder of undue influence with unconscionable dealing: first, there is no clear

14 *Garcia v NAB* (1998) 194 CLR 395, p 399.

15 *Ibid*, p 399.

16 *Ibid*, pp 402–03.

17 *Ibid*, p 404.

indication of the desire to subsume the special wives equity in the *Amadio* decision itself; secondly, the *Amadio* decision did not intend to mark out the boundaries of the whole field of unconscionable conduct;[18] and, finally, the unconscionable dealing principle outlined in the *Amadio* decision is very different from the *Yerkey* principle because *Yerkey* does not depend upon proof that the third party creditor had received actual or constructive notice of inequitable behaviour, and this is a clear requirement in *Amadio.*

Kirby J agreed with the majority, and held that the November 1987 guarantee was not enforceable against Mrs Garcia; however, he did not apply the *Yerkey* principle but, rather, a 're-formulation' of the principles adopted by the English courts in *Barclays Bank plc v O'Brien* (1994). His Honour rejected the application of *Yerkey* on six primary grounds. He criticised the *Yerkey* principle on a number of broad policy grounds: that it was historically anachronistic; that it perpetuated a discriminatory stereotype; that marriage is not, *per se*, a suspect category; and that the principle promoted unacceptable discrimination.

In rejecting the *Yerkey* principle, Kirby J preferred to adopt an approach which was akin to the *O'Brien* decision. He stated (p 641):

> It is my view that the principle should be stated thus: Where a person has entered into an obligation to stand as surety for the debts of another, and the credit provider knows, or ought to know, that there is a relationship involving emotional dependence on the part of the surety towards the debtor: (1) the surety obligation will be valid and enforceable by the credit provider unless the suretyship was procured by the undue influence, misrepresentation, or other legal wrong of the principal debtor; (2) if there has been undue influence, misrepresentation or other legal wrong by the principal debtor, unless the credit provider has taken reasonable steps to satisfy itself that the surety entered into the obligation freely and in knowledge of the true facts, the credit provider will be unable to enforce the surety obligation, because it will be fixed with notice of the surety's right to set aside the transaction; (3) unless there are special exceptional circumstances, or the risks are large, a credit provider will have taken such reasonable steps to avoid being fixed with constructive notice if it warns the surety (at a meeting not attended by the principal debtor) of the amount of the surety's potential liability, of the risks involved to the surety's own interests, and advises the surety to take independent legal advice. Out of respect for economic freedom, the duty of the credit provider will be limited to taking reasonable steps only.

Callinan J also concluded that the November 1987 guarantee could not be enforced against Mrs Garcia, although he reached this conclusion through an application of the 'old' *Yerkey* principle, and rejected the principle enunciated by the English Courts in *O'Brien*.

18 Reference was made to the comments of Mason J in *Amadio* at p 461, where he specifically notes that 'it is impossible to describe definitively all the situations in which relief will be granted on the ground of unconscionable conduct'.

The majority judgment in *Garcia* reformulates the *Yerkey* principle, to a certain extent, as it rationalises its relational and emotional foundation of the rule, focusing on the fact that the problem lies not in a lack of comprehension on the part of the wife, but rather, the unquestioning faith and confidence that is a common feature in close emotional relationships. Underlying the majority decision in *Garcia* is an acknowledgment of the continuing discrepancy between the perception of modern gender roles in relationships and the reality. Modern society may embrace, as an ideal, equality between the sexes and notions of balance and mutuality in a marriage and in the financial decisions made within a marriage; however, in reality, a substantial number of wives do not independently assess the suitability of financial transactions they enter into for the benefit of their husband. The desire to change this situation does not necessary mean that it has occurred and courts of equity must necessarily take into account the realities of the current day in order to ensure that individual justice is properly implemented.[19]

13.5 Remedies

The principle remedy for undue influence is rescission; rescission may be granted unconditionally, or on terms where the weaker party has received a benefit, or the ascended party has, in good faith, changed his or her position (*Cheese v Thomas* (1994)). In *Bridgewater v Leahy* (1998), the High Court noted that, depending upon the particular circumstances of the case, the 'equity' may be satisfied by orders having the effect of setting aside no more than 'so much of a disposition as prevents the moving party obtaining an unwarranted benefit at the expense of the other'.

There is some Canadian authority for awarding equitable compensation in cases of undue influence, for example, *Dusik v Newton* (1985), where the plaintiff was awarded equitable compensation for loss suffered as a result of a transaction into which he had been pressured to enter, whereby he sold his shares in a company for a fraction of their real value. Nevertheless, so far this decision has not been followed in Australia.

19 See in particular the comments by Lord Browne-Wilkinson in *Barclays Bank plc v O'Brien* [1994] 1 AC 180, p 188, where his Honour notes: 'Society's recognition of the equality of the sexes has led to a rejection of the concept that the wife is subservient to the husband in the management of the family's finances ... yet ... the number of recent cases in this field shows that in practice many wives are still subjected to, and yield to, undue influence by their husbands.'

CHAPTER 14

UNCONSCIENTIOUS DEALINGS

14.1 Origins

Courts of equity have long claimed a jurisdiction to set aside unconscientious and improvident dealings. Until recently, however, there was no coherent doctrine relating to unconscientious transactions. Instead, equity intervened in an ad hoc way to set aside exploitative agreements. For example, improvident dealings by solicitors with their pay or prize money attracted equitable intervention in the 18th century. The best known examples of these isolated categories of intervention were 'catching bargains' or 'dispositions of reversionary interests by expectant heirs'.

Holders of reversionary interests who enjoyed little present income would often raise money by mortgaging their reversionary interests at usurious rates of interest. Courts of equity would set aside the unconscientious agreements and substitute commercially realistic interest rates (*Earl of Aylesford v Morris* (1873)). Such cases provided a blatant exception to the principle that the law does not examine the adequacy of consideration. In reaction to the potential of these cases on 'catching bargains' to undermine contractual certainty, legislation re-enacted in every State provided that agreements were not to be set aside on account of inadequacy of consideration alone, for example, s 175 of the Property Law Act 1958 (Vic).

14.2 Modern synthesis

In time, the principle was refocused to examine, in broader terms, the conscience of the defendant. The principle came to be known as 'unconscientious dealing', a particular form of equitable doctrine based upon a situation where one party to a transaction unconscientiously takes advantage of a known disability held by the other. It is still accepted that this principle has 'no settled technical meaning' and, being a principle based essentially upon standards of behaviour, can engender great diversity in judicial decision making.[1] In modern courts, the framework of unconscientious dealing is often circumscribed in form, scope and application in order to provide a greater judicial legitimacy. This trend has been noted by judicial and academic commentators. In *Australian Competition and Consumer Commission v Berbatis Holdings Pty Ltd* (2000), French J stated:

1 See especially Dal Pont, G, 'The varying shades of "unconscionable conduct" – same term, different meaning' (1999) 19 Aus Bar Rev 26.

> ... the question of whether someone has acted unconscionably does not roam at large. Randomly asking whether people have behaved 'unconscionably' would be quite a meaningless exercise. Instead, such a question is asked only after certain specific requirements have been met.[2]

Rick Bigwood, in 'Conscience and the liberal conception of contract: observing basic distinctions part 1',[3] considers the rationale for this trend:

> The deployment of particularised doctrines in respect of matters of conscience is critical to the maintenance of certainty and predictability in this area of law, in particular by avoiding decline into a generalised ground for the courts doing whatever they deem to be 'fair'. Thus, appeals are not generally made directly to 'conscience' in order to resolve particular disputes between litigants, but rather the inquiry is channelled, and hence disciplined, through specific rules and criteria that express the unconscionability idea, and, in turn, serve the desirable purpose of compelling judges to focus the issues and to give precise reasons for their decisions based in conscience.

The refurbished doctrine of unconscientious dealing is not, however, set in stone; its basic concepts are flexible or dangerously elastic, depending on one's point of view. Furthermore, the unconscientious dealing principle now works in tandem with modern consumer legislation, imbuing the statute with the 'unwritten law'.[4] The principal contribution of legislative proscription of unconscientious transactions has been to introduce a wider and more case-specific array of remedies than is available to courts of equity.[5]

14.3 Elements of the modern doctrine of unconscientious dealing

The principal ingredients of the modern doctrine of unconscientious dealings are as follows.

14.3.1 Exploitation of a disability: the difference between undue influence and unconscientious dealing

The plaintiff must establish that she suffered from a special disability or disadvantage. The term is derived from the judgments of Mason and Dean JJ in *Commercial Bank v Amadio* (1983), and is intended to distinguish differences in bargaining power from more serious impediments to transacting.

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2 See Dietrich, D, *Restitution: A New Perspective*, 1998, p 48.

3 [2000] 16 J Contract Law 25.

4 For a full discussion on the relationship between s 51AA of the Trade Practices Act (Cth) 1974 and general equitable principles, see the judgment of French J in *Australian Competition and Consumer Commission v Berbatis Holdings Pty Ltd* [2000] 169 ALR 324.

5 For a discussion on the scope of legislative remedies, see *Marks v GIO Australia Holdings Ltd* (1998) 158 ALR 333.

In *Commercial Bank v Amadio*, a builder who was indebted to the bank and who exceeded all overdraft limits set from time to time, negotiated an extension to his overdraft. The bank wanted to keep the builder in business, since its own subsidiary was engaged in a joint venture with him. It selectively dishonoured cheques whose payment exceeded agreed overdraft limits. The bank asked the builder to provide security for the overdraft. He arranged for his parents to provide security on their own properties. The parents were migrants with a poor command of English, and were unaware of their son's business difficulties. They thought they were signing a mortgage limited to $50,000 and to six months in duration; it was, in fact, an unlimited guarantee. The document was brought to their home by the local branch manager and signed in his presence. He failed to explain the nature of the transaction to them, erroneously believing that the son had already provided an explanation.

In the High Court, Dawson J, dissenting, set aside the guarantee on the ground that it had been procured by the bank's unconscientious behaviour.

The parents were held subject to a 'special disability or disadvantage'. This was based on a multi-factored analysis which included not only the parent's poor command of English, but also the bank's concealment of the nature of their business relationship with the son. As the bank was in a superior position to the parents, due to its greater knowledge of the transaction, it could be argued that one of the apparent disabilities of the parents was their lack of knowledge. The dissenting judgment of Dawson J drew attention to the fact that the parents had considerable business experience, in spite of their poor English and ignorance of their son's financial situation. Deane J emphasised that the focus of unconscientious dealing was on the conduct of the stronger party, rather than the quality of the consent of the weaker party. Consequently, his Honour concluded that inadequacy of consideration was not, in itself, an indication of the presence of unconscientious dealing. Of particular concern for Deane J was the fact that the parents were under a significant misapprehension as to the nature of the transaction, and this lack of knowledge was known, or ought to have been known, by the bank, and under such circumstances going ahead with the transaction was unconscionable. In this situation, the focus of the case was upon the exploitation, or taking advantage, by the bank of the lack of knowledge of the Amadios. From this, it can be extrapolated that the 'special disability' of the Amadios was a lack of awareness, or an information shortfall which put the bank into a much stronger bargaining position and made the Amadios vulnerable to abuse. In *Begbie v State Bank of New South Wales* (1994), Drummond J noted that the question of whether a 'special disability' exists is determined by 'an objective comparison of the relative positions of the respective parties and of their ability to protect their own interests' (p 41-896).

In this respect, unconscientious dealing is to be contrasted with undue influence. As noted by Deane J in *Amadio* (p 474):

> 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.

Undue influence exists where one party has not truly consented to enter into a transaction because the will of that party has been overborne. As noted by Deane J, undue influence 'looks to the quality of the consent or assent of the weaker party, whereas unconscionable dealings looks to the conduct of the stronger party in seeking to obtain or retain an advantage in circumstances where it would be against conscience to do so' (pp 474–75). Unconscionable conduct on the part of the defendant is an integral part of the doctrine of unconscionability, but is not essential to undue influence.[6]

In *Bridgewater v Leahy* (1998), the majority judgment (Gaudron, Gummow and Kirby JJ) noted that, sometimes, both undue influence and unconscionable dealing may apply in one case, as both doctrines are a 'species of that genus of equitable intervention to refuse enforcement of, or to set aside, transactions which, if allowed to stand, would offend equity and good conscience'; however, there remain significant conceptual and practical distinctions between each doctrine'.

The 'significant conceptual and practical distinctions' that their Honours were concerned with have been outlined by Deane J in *Amadio* (above). This is not to suggest that a rationalisation of the two principles may not, eventually, occur, particularly given the fact that a single set of facts will often raise both doctrines and, in such cases, the law can appear cluttered and inefficient. This concern is a significant issue for equitable principles and, as noted by M Halliwell, owing to 'over-categorisation and over-classification, without recourse to the basic tenets of equitable intervention, the law has suffered from being unduly fettered'.[7]

14.3.2 Subjectivity of special disability

The judgments in *Amadio* illustrate the subjectivity inherent in the assessment of special disability. It is inevitable that different judges will emphasise the different qualities and limitations of the plaintiffs. Moreover, what is relevant is not a person's characteristics in the abstract, but the characteristics in the context of the transaction in question.

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6 See, also, *Bridgewater v Leahy* (1998) 158 ALR 66; *Credit Lyonnais Bank Nederland NV v Burch* [1997] 1 All ER 141, p151, *per* Nourse LJ; Capper, D, 'Undue influence and unconscionability: a rationalisation' (1998) 114 LQR 479; Birks, P and Chin, NY, 'On the nature of undue influence', in Beatson, J and Friedmann, F (eds), *Good Faith and Fault in Contract Law,* 1995.

7 Halliwell, M, *Equity and Good Conscience in a Contemporary Context*, 1997, p 70. See, also, *ibid*, Capper.

The application of the requirement of 'special disability or disadvantage' will often be controversial. Recent decisions have drawn upon the flexibility of the concept to a somewhat extreme degree.

In *Louth v Diprose* (1992), the plaintiff, a solicitor, became emotionally attached to the defendant, who was recently divorced. His love was unrequited. When the defendant moved to Adelaide, the plaintiff followed her there. He gave her gifts and paid bills. He bought the house in which she was living and had it transferred to her name, apparently after she had told him that she had an accommodation crisis. Three years later, when he finally realised that the defendant had no affection for him, he applied to have the home returned to him and the transaction set aside.

King CJ, of the South Australian Supreme Court, held that it would be unconscientious for the defendant to retain the home. The plaintiff's 'special disability' was his emotional dependence on the defendant, placed in the context of the defendant having 'manufactured' an emotional crisis.

This finding was upheld by the High Court, Toohey J dissenting. The majority was content to rely on the principle that the findings of fact, and the assessment of witness by the trial judge, should not be interfered with on appeal. Brennan J analogised from 18th century cases on undue influence, which had held that the relationship of fiancailles was one of presumed influence, to reinforce the holding that emotional dependence could constitute a 'special disability'. Toohey J undertook a careful review of the facts to show that different conclusions could be drawn from the evidence.

He concluded that a more balanced assessment of the relationship needed to be conducted, and in this regard the rejection of Louth's evidence by the trial judge was questioned. Toohey J also examined the 'loaded' language of the trial judge in making references to the 'unrequited love' of Diprose, or the 'pathetic devotion' and 'utter infatuation' of Diprose, and how Louth was 'feeding the flames of the respondent's passion'. He felt that such colourful language tended to display an unbalanced picture of the relationship between Louth and Diprose. Ultimately, according to Toohey J, whilst the relationship may have been unusual, it did not necessarily display attributes of emotional dependency, and it should not be within the power of judges to set aside bargains simply because they appear to be unusual. Furthermore, Toohey J felt that Diprose was in a perfectly adequate position to protect himself. Even if emotional dependency did constitute a special disability, it was difficult to hold that Louth had unconscientiously taken advantage of it when Diprose was a financially independent solicitor.

The decision of the majority in the High Court has been criticised because of the subjective evaluation intrinsic in an assessment of emotional dependency. It is very difficult to establish whether or not one person is emotionally 'infatuated' with another, and to further allege that such dependency constitutes a special disability sufficient to ground an action in

unconscientious dealing. The mere purchase of large gifts does not necessarily connote dependency; it may simply be evidence of persuasion or hope as to how a relationship may evolve. Nevertheless, the decision in *Louth v Diprose* illustrates the reluctance of appellate courts to overturn the findings of trial judges in cases concerning unconscientious dealings (see also Sarmas, L, 'Story-telling and the law: *Louth v Diprose*' [1995] 1 MULR 1; and Hepburn, S, 'Equity and infatuation' (1993) Alternative LJ 32). Subsequent cases have endorsed the validity of emotional dependence as a form of 'special disability'. In *Gregg v Tasmanian Trustees* (1997), the Federal Court noted that 'the importance of *Louth*' lies in the 'recognition that emotional dependence, or subjection to emotional influence, is a relevant disadvantage which might constitute a ground to set aside a transaction as unconscionable in reliance on *Amadio*'. In *Garcia v NAB* (1998), the High Court specifically note that the range and type of disability able to form the basis of an action in unconscionable dealing are limitless, and in this respect quote from Sir Anthony Mason, who stated: '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.'[8]

In *Garcia v NAB* (1998), the High Court made it clear that emotional considerations are particularly significant for the equitable jurisdiction. Whilst the *Garcia* decision focuses upon the *Yerkey* principle and its continued application to married women, it is clear from the judgment that the court was convinced that abuse of the trust and confidence that can be reposed in an intimate relationship must be carefully monitored, although the court was not prepared to move outside the confines of the 'emotions' experienced by a married wife.[9]

In *Bridgewater v Leahy* (1998), the High Court concluded that it would be unconscionable for a nephew to retain the benefit of an improvident transaction by asserting the forgiveness of the whole of the debt which would otherwise be owing. The facts of the case involved a transaction between the deceased, Mr Bill York, and his nephew, Neil York, whereby the nephew obtained farming property from the deceased for $150,000 when its market value at the time was about $700,000. In July 1988, Neil bought interests in land from Mr York over which Neil and his brothers had conducted farming operations. At the time of the sale, Mr York also entered into a deed of forgiveness of debt whereby Mr York forgave Neil $546,811 of the amount owing under the contracts of sale. In effect, Neil only paid $150,000 for the land. It was clear from the evidence that Neil had proposed the transaction to Mr York, knowing of his strong emotional affection for him, and Mr York entered into the transaction knowing exactly what he was doing, his motive

8 'The impact of equitable doctrine on the law of contract' (1998) 27 Anglo-Am L Rev 1, p 8.

9 See, generally, Phan, A and Tjio, P, 'From mythical equities to substantive doctrines – *Yerkey* in the shadow of notice and unconscionability' (1999) 14 JCL 72, esp pp 88–89.

being to ensure that the properties continued to be part of an integrated farming enterprise under reliable and experienced management. Mr York was examined by a doctor, who concluded that he was of sound mind and capable of making decisions about his personal affairs. Mr York received legal advice concerning the transaction from the same solicitor who acted for Neil. The effect of this transaction was to significantly reduce the estate of Mr York, and his daughters sought to have it set aside on the ground of unconscionability.

The High Court (Gaudron, Gummow and Kirby JJ, with Gleeson CJ and Callinan J dissenting) held that Neil had taken advantage of his position in order to obtain a benefit through a grossly improvident transaction on the part of Mr York. It was, therefore, unconscionable for Neil to retain the benefit of this improvident transaction. The majority made it clear that equitable principles may be invoked to set aside a gift where a donor is perfectly competent to understand and intend what he or she did or said.[10] Their Honours went on to illustrate the emotional attachment and dependency arising out of this relationship:

> Bill's goal to preserve his rural interests intact, and his perception that Neil was the candidate to provide reliable and experienced management thereof, were significant elements in his emotional attachment to and dependency upon Neil ... The equity to set aside the deed may be enlivened not only by the active pursuit of the benefit it conferred, but by the passive acceptance of that benefit [p 121].

Their Honours felt that it would be an 'oversimplification' to say that because the respondent acted as he did with his eyes open, and with a full understanding of what he was doing, he was not in a position of disadvantage, and, therefore, not a victim of unconscionable conduct (p 116). Under the circumstances, particularly in light of the fact that Neil had initiated the transaction and followed it through, aware of the strong bond that Bill had for him, the majority concluded that it was unconscionable for Neil to retain the benefit of the improvident transaction. The deed of forgiveness was set aside, with due allowance given to Neil and his wife, such as would have been the wishes of Bill.

The 'special disability' of Mr York is not expressly highlighted by the majority determination; however, it is impliedly accepted that the disability is one related to emotional dependency. Other factors are briefly discussed: Bill's age (84), his physical debility, and his 'probable mental decline (ordinarily associated with such advancing years)', are all mentioned. Nevertheless, at the time of making the transaction, and indeed throughout the entire 'transaction' period, Mr York was found to be of sound mind and physical condition. It is certainly difficult to categorise 'age' or an 'emotional fondness' for a relative as amounting to a 'special disability' in the form of emotional dependence without the involvement of a high level of subjective presumption. Indeed, the

10 See *Huguenin v Baseley* (1807) 14 Ves Jun 273, pp 299–300; (1807) 33 ER 526, p 536, *per* Lord Eldon LC.

majority seem to assume the existence of a 'special disability' from the 'classic' contract in equity facts: an elderly man, emotionally attached to his nephew, agreeing to a grossly imprudent transaction. In this respect, this decision bears some resemblance to *Louth,* as the court is satisfied with a rather dubious 'special disability' analysis stemming from an assumed emotional dependence in order to address what is perceived as an 'exploitative' transaction.

The exploitative behaviour emphasised by the majority in *Bridgewater* is passive, yet, according to the majority, clearly 'unconscionable'. Analysis of this exploitative behaviour forms the foundation of the majority judgment; emphasis is given to the sustained acceptance by the nephew of a transaction providing excessive benefit; the failure by the nephew to advise his uncle to obtain adequate 'independent' legal advice; and the initiation of the transaction at a point when the uncle was elderly and quite probably emotionally vulnerable, particularly with regard to the future interests of his adored nephew and the farming future of the land.

By contrast, Gleeson CJ and Callinan J, in the minority, clearly consider the question: 'Was there a "special disability"?' Their Honours are of the opinion that absence of legal advice, age, infirmity and other conditions can have factual relevance in the determination of a 'special disability'; however, they do not, in themselves, constitute a special disability and as the facts denied the existence of a special disability, it was not possible to argue that Neil was guilty of unconscientious conduct.

The decision in *Bridgewater* further highlights the inherent subjectivity of the unconscientious dealing doctrine; the failure of courts to judiciously adhere to a rationalised assessment of the three tiered test: (1) unconscionable (2) exploitation of a (3) special disability, and the significance that individual judicial perception and assumption has in such cases, all of which only serve to illustrate a disturbing trend. As noted by Dal Pont:

> Though couched in terms of unconscionability, the upshot of the decision appears to be the transaction was set aside because the outcome stemming from it was unfair. It is difficult to find any evidence of conduct on behalf of the nephew which comes close to meriting the description 'unconscionable'. One wonders whether the majority would have decided any differently had the idea for the transaction come solely from the deceased. If so, what the court is saying is that sowing the seed in the mind of another person as to what he or she could do with his or her property can, of itself, amount to exploitation, even though the course which the transferor chooses to adopt also serves his or her ends; a remarkable conclusion.[11]

14.3.3 Knowledge of the disability

The defendant must know of the plaintiff's disability or disadvantage. In *Commercial Bank v Amadio* (1983), Mason J explained that knowledge meant

11 *Op cit,* Dal Pont, fn 1, p 42.

'actual knowledge', or circumstances where the defendant 'is aware of the possibility that such a situation may exist, or is aware of facts that would raise that possibility in the mind of any reasonable person'. This means that the circumstances must be such that actual or constructive knowledge can be proven as it is difficult to argue that the superior, ascendant party has unconscientiously exploited a disability if they were unaware of it.

Knowledge, in this context, is essential to the proof of unconscionable dealing. Hence, if one party continues with a transaction, unaware that the other party is labouring under a form of 'special disability', under the circumstances the conduct of that party may be regarded as reasonable. For example, in *Ribchenkov v Suncorp-Metway Ltd* (2000), Spender J, in the Federal Court, concluded that it was reasonable for a bank to go ahead with a transaction, despite the fact that the other party did not appreciate the full nature of the transaction, because the bank was unaware that the other party had this information imbalance, believing that the person had been appropriately advised by an independent legal adviser and appropriate language interpreter. In such circumstances, the court found that it was not unconscionable for the bank to rely upon the statutory declaration given over by the solicitor. Furthermore, the knowledge which the superior party must have is knowledge of the existence of a recognised disability and, as noted by Spender J in *Ribchenkov,* just because the bank knows of the existence of financial difficulty does not mean that it is aware of the exact nature of a disability. In this respect, consideration must be given to what would be reasonable in the individual circumstances of the case.

A bank which leaves it to a debtor to prove a guarantee will be tainted by any unconscientious conduct practised by the debtor in order to secure the guarantee, even if the bank has no direct knowledge of the conduct (*Borg-Warner (Aust) Ltd v Switzerland General Insurance Co Ltd* (1989)).

14.3.4 Exploitation

The rules relating to unconscientious dealings are intended to provide relief where a stronger party exploits or victimises a weaker party. In this respect, the doctrine can be contrasted with the doctrine of undue influence, for which exploitation is not a prerequisite. Some judgments, especially the majority judgments in *Louth v Diprose*, appear to place the onus on the plaintiff to show that he or she was exploited or manipulated by the defendant. The judgment of Deane J in *Amadio* on the one hand, and *Louth v Diprose* on the other, requires the plaintiff to establish special disability and knowledge, the burden then passing to the defendant to show that he or she did not exploit the plaintiff's disadvantage.

It is important to remember that the exploitation must be of the recognised 'special disability'. In some decisions, the recognition of exploitative behaviour tends to overwhelm any examination of a 'special disability'; this is

discussed in the *Bridgewater* decision above (14.3.2). Whilst special disability lends itself to subjective analysis, the same can be said of the 'exploitation' requirement. For example, in the *Bridgewater* decision, the majority emphasised the fact that exploitation can be 'passive'. On the facts of that case, the unconscionable conduct of the nephew was found to lie in the failure of the nephew to act in light of the excessively generous transaction and the failure of the uncle to obtain 'independent' legal advice; in the circumstances, the presumption of exploitation was accepted despite clear evidence that the uncle wanted the transaction to go ahead, was of a sound mind when entering into it, and that it accorded with aims and desires of the uncle. This type of approach tends to accord with the 'substantive' unconscionability cases, whereby the focus of the principle lies more on the awareness of an unfair outcome, rather than any identifiable unfair conduct.

14.4 Defences

Where a plaintiff has established a *prima facie* case of unconscientious dealing, the defendant may show that no unfair advantage was taken of the plaintiff.

14.4.1 Adequacy of consideration

Adequacy of consideration is not a complete defence to an application to set aside a transaction on the grounds of unconscientious dealings, although it will provide strong evidence that the plaintiff was not exploited. In *Bridgewater v Leahy* (1998), the excessive inadequacy of the consideration ($150,000 for land valued in excess of $700,000) was a very strong factor in the determination of unconscionable conduct by the majority. Gaudron, Gummow and Kirby JJ noted many times that the inactivity of the nephew, in light of the inadequate consideration, was a 'significant element' in the overall finding of unconscientious conduct.

In *Blomley v Ryan* (1956), the respondent was elderly and his mental and physical powers had been much impaired by his addiction to rum. He contracted to sell his grazing property to the appellant. The negotiations were primarily conducted by the appellant's father and an agent who plied the respondent with rum. The property, valued at £33,450, was sold for £25,000 on terms which entitled the purchaser to a mortgage back to the vendor at 1% below the bank rate.

The High Court, Kitto J dissenting, set aside the contract of sale. Fullagar J stated that adequacy of consideration was important in cases of this type, but not necessarily decisive. In this case, the respondent had not received adequate consideration for the property. Even if full market consideration has been paid, it is arguable that a contract might, nonetheless, be set aside where the property is of sentimental or other non-economic value to the vendor.

Adequacy of consideration may be immaterial in guarantee cases, where the bank will provide adequate consideration, in the form of a loan or an overdraft to the debtor, which will be of no direct benefit to the guarantor.

14.4.2 Independent legal advice

The provision of fully informed legal advice will constitute a defence to an application to set aside a transaction alleged to be unconscientious. As Mason J stated in the *Amadio* case, the fact that the weaker party obtained informed legal advice may be a more complete defence in case of unconscientious dealings than in undue influence cases (see also *Australia and New Zealand Banking Group Ltd v Barry* (1992)). This stems from the fact that the emphasis of unconscientious dealing is upon the overall conduct of the superior party. In *Bridgewater v Leahy* (1998), Gaudron, Gummow and Kirby JJ observed the difference between undue influence and unconscionable dealing (p 100):

> Where the complaint is of unconscionable dealing, the point is rather different. As Manning J put it in *Re Levey ex p Official Assignee* (1894) 15 NSWR (B & P) 30 36, 'the court does not allow any person to take advantage of any known weakness of the vendor' and the court asks whether that party had 'the opportunity' of professional advice as to 'the effect of what he [was] doing'. This denial of the opportunity to have 'the assistance of a disinterested legal adviser' … rather than speculation as to what might have followed had it been pursued, is an element in the unconscientious conduct in respect of which equity intervenes to deny the entitlement of the disponee to retain the property in question, unless the disponee shows the disposition to have been 'fair, just and reasonable'.

Hence, if it can be established that the superior party was *aware* of the fact that independent legal advice had not been obtained, or that the advice was not independent, and still proceeded with the transaction, this may form the basis of unconscionable conduct. Nevertheless, this does not mean that the superior party can only raise this defence where the advice given did, in fact, provide the weaker party with a disinterested and comprehensive appraisal of the transaction. In some cases, even though the advice may have been incomplete or inadequate, the conduct of the superior party may not be impugned. The emphasis in unconscionable conduct is upon the knowledge and conduct of the stronger party; hence, it will be enough if that party reasonably believed that proper, independent legal advice had been obtained by the weaker party. On the facts of *Bridgewater,* the nephew was clearly aware that the legal advice given was not independent, as the solicitor had also acted for the nephew, and this was a significant factor in the overall determination of the existence of unconscionable behaviour. Nevertheless, in *Ribchenkov v Suncorp-Metway Ltd* (2000), Spender J concluded that a bank was entitled to rely upon a statutory declaration given by a solicitor asserting that properly interpreted legal advice had been given to the guarantor, even though it turned out to be otherwise.

Spender J approved of the comments by Hoffman LJ in *Bank of Baroda v Rayarel* (1995) (p 386):

> If a prospective surety deals with a bank through a solicitor, the bank is entitled to assume that the solicitor has given her appropriate advice. If there is a possibility of a conflict of interest between the surety and the other parties whom the solicitor is also advising, the bank is entitled to assume that the solicitor will have told her that she was entitled to take independent advice. The bank's legal department is not obliged to commit the professional discourtesy of communicating directly with the solicitor's client and tendering such advice itself. Nor is it obliged to inform the solicitor of his professional duties.

Each case must be assessed on its individual circumstances; however, it is clear that where the circumstances reveal that the stronger party is in receipt of a properly executed statutory declaration, setting out that proper and independent legal advice has been given, and the stronger party has no knowledge of any facts indicating otherwise, the conduct of the stronger party may not be impugned and the defence may be established.

14.5 Remedies

14.5.1 Rescission

Where it has been established that the defendant acted unconscientiously, the usual remedy is rescission of the agreement which has been procured by the unconscientious conduct. Rescission may be ordered unconditionally or on terms. In *Commercial Bank v Amadio*, Deane J considered whether a conditional order of rescission, enforcing the security to the extent that the parents believed it to be enforceable, should be awarded, but ultimately made an unconditional order of rescission. In *Bridgewater v Leahy* (1998), the order of rescission was complete, with an allowance given to ensure that equality was done and that the intentions of the deceased uncle were given some regard.

14.5.2 Refusal of specific performance

A court may refuse to order specific performance of an agreement tainted by unconscientious behaviour. Where the agreement is not also rescinded, the plaintiff will be entitled to common law damages despite the presence of unconscientious conduct.

14.5.3 Constructive trust

In *Louth v Diprose*, King CJ, at first instance, ordered the defendant to hold the home she had unconscientiously obtained on trust for the plaintiff. The full court saw difficulty in compelling the defendant to hold a property on trust for the plaintiff when he had never initially owned the property. It substituted

an order that the defendant should repay the plaintiff the purchase price of the house, together with other costs attributed to the purchase. The jurisdictional source of the repayment order was not explained. The High Court did not discuss these remedies, being content simply to confirm the trial judge's order.

14.6 Relevant legislation

An innovation of the last 15 years has been the enactment of legislation by both the federal government and States proscribing unconscientious conduct. Statutory unconscionability is best known under Pt IVA of the Trade Practices Act 1974 (Cth), but it also exists in the Australian Consumer Credit Code and in a variety of State Acts.[12] Unlike the equitable doctrine, the legislation provides relief for substantive unconscionability; in other words, inadequacy of consideration (*West v AGC (Advances) Ltd* (1985)). A wider range of statutory remedies is available where a contravention has occurred.

At the federal level, s 51AB of the Trade Practices Act 1974 (Cth) provides that:

> A corporation shall not, in trade or commerce, in connection with the supply of goods or services to a person, engage in conduct that is, in all the circumstances, unconscionable.

The provision provides relief in respect of unconscientious conduct committed by corporations in the course of consumer transactions. Although its enactment was influenced by the High Court decision in *Commercial Bank v Amadio*, it is doubtful whether the bank's behaviour in that case amounts to a contravention of s 51AB.

Accordingly, in 1992 s 51AA(1) was added. This delphically worded section provides that:

> A corporation must not, in trade or commerce, engage in conduct that is unconscionable within the unwritten law, from time to time, of the States and territories.

'Unwritten law' may include not only the doctrine of unconscientious dealings, but also other doctrines founded in notions of conscience such as undue influence and economic duress. The reference in s 51AA(1) to 'the unwritten law, from time to time, of the States and Territories' denotes the non-statutory law as developed by the courts of common law and equity. It was accepted as one body of law. Part IVA of the Trade Practices Act was further amended in 1998 by the introduction of s 51AC(1), which provides:

> ... a corporation must not, in trade or commerce, in connection with:
>
> (a) the supply or possible supply of goods or services to a person (other than a listed public company); or

12 The Australian Consumer Credit Code operates in all State jurisdictions. See, also, the Contracts Review Act 1980 (NSW), s 4; the Industrial Relations Act 1997 (NSW), s 105; and the Workplace Relations Act 1997 (Qld), s 290(1).

> (b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company); engage in conduct that is, in all the circumstances, unconscionable.

The same wording is repeated in s 51AC(2), using the word 'person' instead of 'corporation'. The concept of unconscionable conduct is not defined, but in s 51AC(3) various factors are set out to which the court may have regard when considering whether there has been a contravention.

In *Australian Competition and Consumer Commission v Berbatis Holdings Pty Ltd* (2000), French J argued that the concept of unconscionability existed at two levels in the unwritten law: a generic level, informing the fundamental principle according to which equity acts; and the specific level, where the usage of unconscionability is limited to specific doctrines. French J notes that the explanatory memorandum to the legislation suggests that it is the 'specific' sense that was intended, as defined by reference to *Blomley v Ryan* and *Commercial Bank of Australia v Amadio*.[13] This reference does not, however, fully describe the application of the second level of unconscionability, as it may be applied not only to the disposition of property and the assumption of contractual obligations, but also to equitable estoppel and the harsh and oppressive exercise of rights attracting relief from penalties and forfeitures. In *Olex Focas Pty Ltd v Skodaexport Co Ltd* (1998), Batt J noted that s 51AA had the scope to encompass all doctrines having 'unconscionable conduct' as their basis, although care must be taken in expanding the application of this provision too far as it may subsume the other provisions completely.

French J, in *Berabatis,* felt that there was no reason to suppose that the unconscionable conduct prohibited by ss 51AB and 51AC is limited by reference to specific equitable doctrines. The factors to which the court may have regard for the purpose of determining whether there has been a contravention of those sections include undue influence and duress, as well as a range of other matters. In *Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Pty Ltd* (1999), Finkelstein J said (p 43-016): 'I take as the measure of unconscionability, conduct that might be described as unfair.' Ultimately, French J, in *Berbatis,* concluded that :

> ... each of s 51AB and s 51AC prescribes a standard rather than a rule. The boundaries of its application are normative rather than logical. There is a qualitative difference between their operation and that of the prohibition on misleading or deceptive conduct imposed by s 52 of the Act, even allowing for normative controls on the application of that section within its logical boundary. The categories of unconscionable conduct, for the purposes of ss 51AB and 51AC, will never be closed, albeit the circumstances of the application of the standard prescribed in each of them is confined by the language of each section [p 330].

13 See, also, *HECEC Australia Pty Ltd v Hydro-Electric Corp* (1999) PR 46-196.

Hence, his Honour felt that the description embodied in the word 'unconscionable' in s 51AA refers to the 'normative characterisation of conduct by a judge having jurisdiction in the relevant class of case'. On this basis, the rules governing the relevant application of the term 'unconscionable conduct' are judge made rules that can change from time to time. The statutory recasting of the equitable rules enables courts to take advantage of the wide array of remedies contained in Pt VI of the Act, which are generally unconcerned with doctrinal and jurisdictional constraints.

CHAPTER 15

ESTOPPEL

15.1 Definition

Estoppel is a doctrine which is designed to protect a reliant party from the detriment which may flow where another party denies the truth of an assumption or expectation which they have encouraged the reliant party to believe. Estoppel doctrines are recognised under both common law and equity and whilst, traditionally, estoppel has served an evidentiary function, these days equitable estoppel is recognised as having a substantive operation in some circumstances. Classically, there are three classes of estoppel: estoppel by record, estoppel by writing and estoppel *in pais* (conduct). Common law recognises estoppel in writing and by record, and a limited form of estoppel in pais. Equity only recognises estoppel in pais where it is not already recognised by the common law. The rationale of equitable estoppel is to prevent 'persons from being victimised by other people', and, as in other areas of equitable doctrine, the basic rationale underlying equitable estoppel is the prevention of conduct which is unconscionable; in estoppel that will 'commonly involve the use of, or insistence upon, legal entitlement to take advantage of another's special vulnerability or misadventure ... in a way that is unreasonable and oppressive to an extent that affronts ordinary minimum standards of fair dealing'.[1]

15.2 Common law estoppel

Common law estoppel prevents a party from departing from an assumption of fact where that party's creation of the assumption has caused another party to adopt or accept it for the purpose of their legal relations (*Grundt v Great Boulder Gold Mines Pty Ltd* (1937)). In *Jorden v Money* (1854), a majority of the House of Lords held that an estoppel could not be based on a representation of existing fact, but must be based on a statement of existing fact.[2]

15.3 Equitable promissory estoppel

Equitable estoppel by representation (promissory estoppel) prevents a party from denying the truth of a promissory representation.

Equitable estoppel was rejuvenated in *Central London Property Trust Pty v High Trees House Ltd* (1947). In that decision, Denning J held that *Jorden v*

1 *Commonwealth v Verwayen* (1990) 170 CLR 394, p 440, *per* Deane J.

2 See, also, *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387, p 458, *per* Gaudron J.

Money applied only to common law estoppel, and that equitable promissory estoppel could apply to representations as to future conduct in order to prevent the enforcement of a legal right.

A more expansive version of equitable estoppel was fashioned, with some divergent approaches, by the High Court in *Waltons Stores (Interstate) Ltd v Maher* (1988), where some judges concluded that the equitable doctrine of estoppel could, in fact, operate as an independent head of civil obligation. On this view, a party whose conduct creates an assumption which is relied upon by another party to his detriment, will not be permitted to depart from the assumption where it would be unconscionable to do so. This decision is considered in detail below, 15.6.1. Equitable estoppel may form the basis of a cause of action. However, the mere failure to fulfil a promise is not, *per se*, unconscionable. As noted by Mason CJ in *Commonwealth v Verwayen* (1990), 'the breaking of a promise, without more, is morally reprehensible, but not unconscionable in the sense that equity will necessarily prevent its occurrence, or remedy the consequent loss'. In *Giumelli v Guimelli* (1999), the High Court emphasised that equitable estoppel must be distinguished from the enforcement of contractual promises because equitable intervention is not based upon a legally binding agreement, but rather the conduct of the plaintiff in acting upon the expectation to which it gives rise. The court in *Giumelli* further noted that the enforcement of a promise via equitable estoppel does not undermine the doctrine of consideration under common law because of the broad nature of equitable discretion, and the fact that the relief awarded will often be based upon reliance rather than expectation loss.[3]

15.4 Proprietary estoppel

A party who relies to her detriment upon an assumption created by another party, in the belief that she will be granted an interest in property, may be awarded by a court of equity, in its discretion, a remedy appropriate to the circumstances of the case. The remedy may fulfil the reasonable expectations of the plaintiff, or it may recompense the plaintiff in some other way. A distinction may once have been drawn between estoppel by encouragement and estoppel by representation, but it is doubtful if the distinction is meaningful today, and it is now customary to discuss both types of estoppel under the rubric of proprietary estoppel.

3 The High Court in *Giumelli* approved of the comments of Dawson J in *Verwayen*, p 394, where his Honour noted that 'the discretionary nature of 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'.

15.5 Estoppel *in pais*

Reference is sometimes made in judgments to an estoppel '*in pais*'. The term does not have a fixed meaning. An estoppel *in pais* originally connoted an estoppel which arose from conduct, including a representation, rather than an estoppel arising from a formal document, such as estoppel by deed or by a determination of the court. Recently, however, the term has been used as a synonym for a common law estoppel, based on an assumption of existing fact. A more useful and expressive distinction lies between estoppel by conduct, covering all the estoppel described above, and evidentiary estoppel, the generic name for estoppel founded on deeds or court judgments.

15.6 Fusion of estoppel

Despite the jurisdictional segregation between common law and equitable estoppels, the basis of all estoppels is essentially an unconscientious departure from an assumption. It is natural, and somewhat inevitable, that schemes to harmonise the principal categories of the doctrine have readily attracted support, especially since the High Court's recognition, in *Waltons Stores (Interstate) Ltd v Maher,* that estoppel can be a source of legal obligation.

15.6.1 Judicial development of fusion

In *Waltons v Maher* (1988), the appellants wanted to take a lease of property owned by the respondents. The respondents agreed to demolish an old building on the site and construct a new building suitable for the appellants' commercial purposes. The essential terms of the lease had been settled, although the lease itself had not been signed. Waltons' solicitors intimated that their client had accepted certain amendments to the lease which the respondents had proposed, but that if Waltons raised any late objections the respondents would be informed the next day. Having heard nothing from the appellants or their solicitors, the respondents demolished the old building and completed 40% of the new building. Waltons had, meanwhile, decided that it did not want to take a lease of the new building, and refused to sign the counterpart of the deed of lease which it had been sent. Waltons did not inform the Mahers of their true intention until one month after receiving actual notice that the Mahers had gone ahead with the demolition.

The High Court held that no binding contract for a lease had been formed, but that the appellant was estopped from denying that it was bound by the agreement. Mason CJ, Wilson and Brennan JJ ruled that the company had, by its conduct, induced the respondents to act on the assumption that a contract would be signed. Deane and Gaudron JJ found that the company had caused the respondents to act on the assumption that a contract for a lease had been

signed. The High Court held that there was no logical reason for maintaining the separation between promissory and proprietary estoppel.

In the words of Brennan J:

> If it be unconscionable for an owner of property in certain circumstances to fail to fulfil a non-contractual promise that he will convey an interest in the property to another, is there any reason in principle why it is not unconscionable in similar circumstances for a person to fail to fulfil a non-contractual promise that he will confer a non-proprietary legal right to another?

No consensus has emerged, however, on the question of whether common law and promissory estoppel are, or should be, merged. The leading proponents of unified estoppel have been Mason CJ and Deane J, but they are by no means agreed as to the form that a doctrinal integration should assume.

Mason CJ accepted the distinction between common law and equitable estoppel in *Waltons Stores (Interstate) Ltd v Maher*, but in his judgments in *Foran v Wright* (1989) and *Commonwealth v Verwayen* (1990), he favoured 'one overarching doctrine of estoppel rather than a series of independent rules'. The overarching doctrine is intended to be an independent source of obligation. The court will not, however, as it does in contract cases, attempt to satisfy the reasonable expectations of the parties; the relief granted must be proportionate to the detriment suffered.

Deane J also refrained from taking the decisive step of amalgamating common law and equitable estoppel in *Waltons Stores (Interstate) v Maher.* In *Foran v Wright* and *Commonwealth v Verwayen*, however, he elaborated a doctrine of estoppel by conduct which would subserve both common law and equitable estoppel. Deane J's version of estoppel by conduct does not constitute an independent cause of action; the doctrine substantially retains its evidential character. The 'assumed state of affairs' created by estoppel may be relied upon in some other cause of action, for example, in an action to enforce a contract or to assert a property interest, in order to obtain a remedy or defeat a claim. In effect, legal and equitable forms of estoppel would form a merged defence. Deane J felt that integration of estoppel was important because of the similarity in doctrinal objective; both actions aimed to prevent the unconscionable denial of a representation upon which a representee has been induced to rely. The distinction between representations of fact and representations of future was artificial.

As Deane J also notes in *Commonwealth v Verwayen*:

> Once it is accepted that the general doctrine of estoppel by conduct extends to representations about future facts (including conduct), and that the operation of promissory estoppel in equity conforms with the operation of estoppel by conduct in law and equity, there is no reason, in principle, for refusing to accept promissory estoppel as but an emanation of the general doctrine of estoppel by conduct. In pre-Judicature Act times when, to the 'discredit of our jurisprudence', cases could arise in which courts of law and equity applied

> different rules of right and wrong to the same subject matter, the confinement of a developing doctrine to one or other of law and equity may well have been unavoidable. It is not so, however, in a modern system where the law represents the fusion and interaction of both disciples and is administered by courts of both law and equity.

15.6.2 Merits of fusion

A certified doctrine of estoppel would enjoy several advantages over the present 'double headed' doctrine of common law and equitable estoppel:

- it would eliminate the distinction between representation of present fact and statement as to future intention. The distinction is often elusive, as the disagreement between the members of the High Court as to the nature of the representation in *Waltons v Maher* illustrates;
- it ought to assist in breaking down the jurisdictional boundaries between common law and equitable remedies, paving the way towards a more rational structure of private law remedies.

Nevertheless, there is, as yet, no general agreement as to how a unified doctrine of estoppel would operate, and such a doctrine cannot be said to be part of Australian law today.

As Kirby J stated in *Lorimer v State Bank of New South Wales* (1991):

> Were I free to do so, I would unhesitatingly follow the single substantive doctrine espoused by Deane J and more lately embraced by other members of the High Court. Whether justified by legal history or not, the single doctrine is conceptually simpler and easier of practical application.

In *Australian Securities Commission v Marlborough Gold Mines Ltd* (1993), Gaudron J approved of equitable estoppel of the 'kind upheld in *Verwayen*'. In *Guimelli*, the High Court noted that it was not an occasion to consider whether the various estoppels are to be brought under a 'single overarching doctrine', although specific mention was given to such an approach.

15.7 The ingredients of estoppel

In *Waltons Stores (Interstate) Ltd v Maher*, Brennan J listed six requirements which had to be satisfied before an estoppel, common law or equitable, could be recognised.

15.7.1 Assumptions of a legal relationship

It must be proven that the plaintiff assumed a particular legal relationship either did exist or would exist in the future between the plaintiff and the defendant, and in the latter case it must be shown that the defendant would not be free to withdraw from the expected relationship.

An assumption can be created by a positive representation, a failure to disclose one's real intentions, or through conduct which induces a party to act to his detriment. In *Waltons Stores (Interstate) Ltd v Maher,* the assumption was created by silence. Waltons' failure to disclose that it was interested in the Mahers' property induced the latter to proceed with the agreed demolition and rebuilding. The assumption created may relate to a representation of a present state of affairs or it may concern the future intentions of the party creating the assumption, and it may concern a question of law or a question of fact (*Commonwealth v Verwayen* (1990), Mason CJ).

15.7.2 Inducement

It must be proven that the defendant unconscionably induced the plaintiff to rely upon or adopt the assumption or expectation. Brennan J's formulation assumes that it will have been the defendant who induced the plaintiff to act to his detriment. There is an exception, however, where the plaintiff claims a property interest based upon estoppel principles. The defendant will sometimes be a successor in title with actual or constructive notice of a predecessor's inducement over the plaintiff (*Silovi Pty Ltd v Barbaro* (1988)).

15.7.3 Reliance

The plaintiff must prove that he or she has acted, or abstained from acting, in reliance on the assumption or expectation. Brennan J's formulation does not expressly state that the acts of reliance must be reasonable, but courts have, in practice, imported a reasonableness standard into this requirement (*Standard Chartered Bank Australia Ltd v Bank of China* (1991)).

A plaintiff may rely on an assumption by taking no action. Alternatively, reliance may be apparent through positive steps which the plaintiff undertakes. It must be established that the plaintiff has undertaken this course of conduct or inactivity as a result of the assumption created by the defendant. As a practical matter, it will usually be harder for a plaintiff to show that failure to act was a consequence of another's unconscientious behaviour; a defendant may plausibly argue that the plaintiff's inertia was caused by some extraneous factor unrelated to the assumption.

The High Court decision of *Foran v Wright* (1989) illustrates the obstacles apparent when attempting to establish reliance by omission. On the facts of that case, a special condition in a contract for the sale of land required the vendors to obtain registration of a right of way before completion. Two days before the agreed date of completion, the vendors' solicitor told the purchasers' solicitor that the vendors would not be able to settle on the contracted date because the right of way had not been registered. Two days after the date when the contract should have been completed, the purchasers gave the vendors a notice of rescission and sought the retention of their

deposit. The trial judge found that the purchasers would not have had the funds to enable them to complete on the due date in any event.

The High Court, Mason CJ dissenting, held that the purchasers' notice of rescission was valid and that they were entitled to the return of their deposit. Three judges considered whether the statement by the vendors' solicitor created an estoppel. Deane and Dawson JJ held that an estoppel had been created; the purchasers had relied on the statement by not trying to raise the necessary finances to purchase the property on the agreed settlement date. Mason CJ disagreed; he found that the defendants' impecuniosity meant that they were never in a position to buy the property. The statements of the vendors' solicitors had not altered the basic fact that the plaintiffs could not afford to purchase the property. Accordingly, he felt that the reliance requirement had not been properly established.

What constitutes reasonable reliance varies according to the circumstances of the transaction. Courts are reluctant to enforce estoppels in a commercial context, especially where the parties have failed to agree upon the material terms of an intended contract. An estoppel is not a substitute for a commercial agreement. Where material terms have not been settled, it will generally be unreasonable for a party to rely upon incomplete contractual negotiations.

In *Austel Pty Ltd v Franklins Selfserve Pty Ltd* (1989), a property developer and proprietor of a supermarket negotiated for the lease of space in a suburban property during the course of its construction. Letters of intent were exchanged stating that negotiations were subject to the later execution of a formal agreement. Following lengthy discussions the supermarket proprietors agreed to take more space, but no rent had been agreed for the extra space. The supermarket had been built to Franklins' specifications; they ordered special equipment and fittings and took steps to terminate their lease of premises in a nearby shopping centre. When the property developers rented the additional space to another company, Franklins sued them in estoppel.

A majority of the New South Wales Court of Appeal held that it was unreasonable for the supermarket proprietors to rely on the property developers' actions when no agreement had been reached on the rent payable for the additional space.

Kirby P declared:

> [C]ourts should, in any view, be wary lest they distort the relationships of substantial, well advised corporations in commercial transactions by subjecting them to the overly tender consciences of judges.

15.7.4 Causation

A party who raises an estoppel need not have relied solely on the assumption created by the other party's unconscientious conduct; it is enough that the assumption was one factor relied on by the party claiming the benefit of the estoppel (*Austral Standard Cables Pty Ltd v Walker Nominees Pty Ltd* (1992)).

15.7.5 Knowledge

It should be proven that the defendant knew that the plaintiff would act in reliance on the assumption, or intended it so. The requirement of knowledge has been little discussed in the High Court judgments, in contrast with the knowledge required in other areas of equity, such as the roles of unconscientious dealings, undue influence or the constructive trust imposed under the principle of *Barnes v Addy*. Since liability in estoppel is based on the defendant's unconscientious behaviour, it is likely that a court will, where necessary, hold that a defendant must be presumed to have intended the consequences of her actions, even if the defendant did not have actual knowledge or foresight. In *Waltons v Maher,* Waltons acquired actual knowledge that the demolition was going ahead and still remained silent as to their true intentions for another month.

15.7.6 Detriment

The plaintiff's action or inaction must occasion detriment if the assumption or expectation is not fulfilled. Modern Australian restatements of estoppel have consistently emphasised the need for some sort of detriment in estoppel actions. Financial expenditure clearly constitutes a detriment. Other examples of detriment include mental distress and worry, as well as the general inconvenience of ordering one's affairs on the faith of an assumption which turns out to be erroneous (*Commonwealth Bank of Australia v Verwayen* (1990)).

A particular problem is to identify the date for assessing the alleged detriment. It is generally stated that the relevant time is when one party attempts to act in a manner contrary to the assumption induced. This type of assessment, however, can lead a court into complex hypothetical inquiries since, at that date, the assumption has not been departed from, and the full extent of the detriment, if any, will only be known if the court permits the defendant to depart from the assumption created by that conduct.

The difficulties are illustrated by the decision of the High Court in *Commonwealth of Australia v Verwayen* (1990). On the facts of that case, the plaintiff was injured when the HMAS Voyager and HMAS Melbourne collided while engaged in combat exercises. Verwayen did not issue a statement of claim until 1984 because it was, for a time, widely believed that for public policy reasons a member of the armed forces could not recover damages for the negligence of another member of the armed forces. The Commonwealth admitted the allegations made in the statement of claim, except that it did not admit that the plaintiff had suffered damage as a result of the collision. In solicitors' correspondence the Commonwealth stated that it would not rely on the Statute of Limitations as a defence, and that the existence of a duty of care would not be disputed. Later, following a policy review, the Commonwealth decided to raise both these defences.

The High Court held, by a majority of four to three, that the Commonwealth would not be permitted to plead these defences. Two judges, Toohey and Gaudron JJ, held in the plaintiff's favour on the basis of the doctrine of waiver. Two other judges, Deane and Dawson JJ, decided that the Commonwealth was estopped from relying on the defences. They considered that, on the facts as pleaded, the detriment arose from the fact that the plaintiff had 'subjected himself to the stress and anxiety and inconvenience which were inevitably involved in the pursuit of the proceedings'. Consequently, the Commonwealth was precluded from raising the defences and the expectations of Verwayen were enforced.

The three other judges, Mason CJ, Brennan and McHugh JJ, who found that the detriment had not been made out on the facts as pleaded, considered it to be 'sheer speculation' to suggest that the Commonwealth's actions had caused a deterioration in the plaintiff's psychological condition.

The disagreement between Deane and Dawson JJ on the one hand, and the dissenting judges on the other, largely turned on the willingness of the former to infer that detriment exceeding out-of-pocket expenses could be incurred as a natural consequence of the Commonwealth's change of policy. Mason CJ stated that the remedy for estoppel should be fashioned by detriment 'in the narrow sense'; in other words, the detriment which a plaintiff has suffered as a result of relying upon the correctness of the assumption.

The judgments in *Commonwealth v Verwayen* illustrate the difficulties in defining detriment for the purposes of estoppel, and how judges differ in their willingness to infer detriment from the facts adduced at the date of the trial. In *Commonwealth v Clark* (1994), a case arising out of the same facts as those in *Commonwealth v Verwayen*, both Marks J and Ormiston J took a broad approach to the determination of detriment. Ormiston J felt that detriment could include: money actually spent on costs; decisions relating to the entering into of substantial liabilities in order to embark upon major litigation; the stress involved; the need to recount unpleasant experiences; and the exacerbation of a psychological condition were all held to be relevant. They favoured the approaches of Deane and Dawson JJ in *Commonwealth v Verwayen*, concluding that detriment should not be considered narrowly; attention should be given to both actual and potential detriment in an estoppel case. This approach is also in accordance with the recent High Court determination in *Giumelli* which clearly endorsed a broad approach to the assessment and protection of detriment: see below, 15.8.2.

Detriment need not have a quantifiable economic value. In *Foran v Wright* (1989), Deane J held that the detriment consisted of the loss by the purchasers under a contract of sale of land of a 'real chance' that they would be able to buy the land, even though the evidence revealed that the purchasers would probably not have been able to raise the contract price.

15.7.7 The defendant's failure to act

It must be established that the defendant has failed to act to avoid that detriment, whether that means that the defendant has not fulfilled the assumption or expectation or otherwise. The defendant's failure to act to prevent the plaintiff relying, to his detriment, on the assumption completes the plaintiff's cause of action.

15.8 Remedies

The recognition of estoppel as a cause of action has focused attention upon the forms of relief which may be awarded to a successful plaintiff. In this respect, consideration must be given to the differences between proprietary and promissory estoppel.

15.8.1 Proprietary estoppel

Prior to the decision in *Waltons Stores*, the only estoppel that enjoyed a discrete system of remedies was proprietary estoppel. In the property cases, the courts satisfied the estoppel by awarding a wide range of remedies which could include the enforcement of the plaintiff's expectations created by the defendant's conduct (*Pascoe v Turner* (1979)). Other remedies include the award of a licence of indefinite duration (*Plimmer v Wellington Corp* (1884)), a lien for money expended on land *(Unity Joint Stock Banking Association v King* (1858)) and compensation for wasted expenditure (*Raffaele v Raffaele* (1962)).

15.8.2 Promissory estoppel

Promissory estoppel also enjoys a flexible remedy structure. The court will not, however, routinely enforce the plaintiff's expectations; the enforcement of expectations was described by Deane J in *Commonwealth v Verwayen* (1990) as representing 'the outer circuits' of relief. Mason CJ has stressed the need for relief to reflect a proportionality with the detriment which it is the purpose of estoppel to avoid (*Commonwealth v Verwayen* (1990)). A failure to relate the remedy to the detriment alleged by the plaintiff would result in estoppel developing as an alternative, and rival, mechanism of promise enforcement to that already existing under contract law.[4]

In *Giumelli,* the High Court held that it would not award specific relief of a proprietary title, despite the fact that the estoppel representations centred around the conferral of such title, because to do so would go beyond what was required for conscientious conduct, and therefore exceed the reversal of detriment. On the facts of the case, Robert Giumelli had allegedly received a

4 See, also, Robertson, A, 'Satisfying the minimum equity: equitable estoppel remedies after *Verwayen*' (1996) 20 Melbourne UL Rev 805.

number of promises from his parents concerning his ownership of a property of 10 acres known as the Dwellingup property. In particular, the promise by the parents was that Robert should build a house on the Dwellingup property and they would give him ownership of a subdivided portion, including the orchard, if he remained working on the property and did not accept an offer of work from his father-in-law. Robert built the house in reliance of this promise and continued to work on the land. Robert then married someone his parents disapproved of and they told him to choose between the property or his wife; he chose to marry his new wife. He subsequently brought an action in estoppel against his parents. The trial judge found in favour of Robert and concluded that the appropriate relief was a monetary payment which would place him in the position he would have been in if he owned the house which he built and the land on which it was situated. The Full Court of the Supreme Court of Western Australia allowed the appeal by Robert, and held that his parents held the whole of the property under a constructive trust for the benefit of Robert.

His parents then argued that the conferral of proprietary title upon their son went beyond the reversal of detriment and this was contrary to the *Verwayen* determination. The High Court rejected this appraisal of the *Verwayen* decision and, in fact, felt that the judgments supported a broader view of relief. Their Honours specifically noted that all judgments revealed discretion in the award of relief, and that the relief awarded should be sufficient to satisfy the detriment and to alleviate the inequity involved. In particular, the High Court (Gleeson CJ, McHugh, Gummow, Kirby and Callinan JJ) concluded that the tenor of the judgments in *Verwayen* indicated that relief for equitable estoppel remains discretionary, based upon what is required to avoid detriment in a particular case, and whilst the primary operation is to preclude departure from the representation, other forms of relief may be awarded where making good the assumption would be inequitably harsh.

On the facts, the High Court concluded that despite the discretionary ability to award proprietary relief in the form of a constructive trust, such an award was inappropriate because consideration had to be taken of income Mr Giumelli had received from the family partnership and improvements effected upon the land by other members of the Giumelli family. Inevitably, this meant that a money sum, rather than the conveyance of title, was the appropriate order of relief on the facts.

The High Court held that the promise led to an estoppel because the detriment suffered by Robert was in the nature of a failure to obtain a promised benefit, that is, the loss of the property which he worked to improve. Defining detriment in this way results in equity protecting the 'expectation' loss of Robert.[5] The court in *Giumelli* specifically felt that they

5 See *op cit*, Robertson, fn 4, where it is noted that, in the five years following *Verwayen*, every reported case resulted in the courts granting relief which fulfilled the applicant's expectations. See, also, Edelman, J, 'Remedial certainty or remedial discretion in estoppel after *Giumelli*?' (1999) 15 J Contract Law 32.

were not 'curtailed' by the 'reliance loss' approach assumed in *Verwayen*. It has been suggested that the decision in *Giumelli* heralds a new methodology in the assessment and protection of detriment under equitable estoppel; as noted by J Edelman:

> By defining detriment in a way that will result in expectation relief and accepting the trend of Australian relief in this manner it is doubtful that an estoppel, used as a cause of action, will ever result in anything less than an expectation loss.

CHAPTER 16

PENALTIES

16.1 What constitutes a penalty?

The rules relating to equitable relief against penalties are designed to prevent the victim of a breach of contract from being overcompensated for the consequences of the breach. Despite the fact that a contract may have been properly consented to, one of the terms of the contract may be struck down if it is to be properly regarded as a penalty clause. A penalty clause can be loosely defined as a clause in a contract, stipulating a sum payable on breach which does not represent a genuine pre-estimate of the damages actually flowing from the breach. Such a clause will be held to be unenforceable in equity, and the victims will be confined to damages for the actual loss which flows from the party's default.

16.2 History

The equitable rules concerning penalties developed from the relief given, in the late 15th century, against penal bonds in covenants, whereby clauses in covenants specified particular sums which would become payable if a contracting party, for example, a borrower under a contract of loan, failed to make a repayment by the due date. The Chancery jurisdiction has generally regarded such payments as being against the conscience of the court, and jurisdiction to award relief against oppressive contracts has always been recognised. There are other justifications for the provision of relief against penalties. Equity will not condone a person using her legal rights to take advantage of another's misfortune. Where a penalty provision is designed to secure the performance of the contract, as long as equity provides adequate relief, it may give effect to the intentions of the parties without condoning the penalty.

The foundation of the equitable jurisdiction is highlighted by Lord Simon of Glaisdale in *Shiloh Spinners v Harding* (1973):

> ... I would therefore myself hold that equity has an unlimited and unfettered jurisdiction to provide relief against contractual forfeitures and penalties. What have sometimes been regarded as fetters to the jurisdiction are, in my view, more properly to be seen as considerations which the court will weigh in deciding how to exercise an unfettered jurisdiction. Prominent but not exclusive among such considerations is the desirability that contractual promises should be observed and contractual rights respected, and even more, the undesirability of the law appearing to condone flagrant and contemptuous disregard of obligations. Other such considerations are how far it is reasonable

> to require a party who is, *prima facie,* entitled to invoke a penalty or forfeiture clause to accept alternative relief, and how far vindication of contractual rights would be grossly excessive and harsh, having regard to the damage done to the promisee and the moral culpability of the promisor. It is these internal considerations which may limit the cases where courts of equity will relieve against forfeiture rather than any external confinements on the jurisdiction.

16.3 Statute

In recent times, statutory provisions have been enacted in order to provide relief against penalty clauses in certain types of contract, for example, hire purchase contracts (see the Hire Purchase Act 1959 (Vic) and the Credit Act 1984 (Vic)). The equitable doctrine continues, however, to apply to a number of chattel hire and hire purchase transactions not covered by consumer prosecution legislation.

16.4 Elements of a penalty

16.4.1 Breach of contract

A penalty is a payment which becomes payable upon a breach of contract having occurred, or when a contract is terminated following a breach. The equitable rules are inapplicable where a party to a contract is required to make a payment as a condition of the contract, and not upon default. This rule is controversial.

In *AMEV-UDC Finance Ltd v Austin* (1986), Deane J, in a dissenting judgment, strenuously argued that:

> The restriction of equitable relief or common law unenforceability to the case where it is possible to identify a technical breach of contract on the party claiming relief or unenforceability would, in my view, be contrary to historical fact, general principle and basic common sense.

Careful attention should be given to the nature of the clause. If the substantial purpose of the clause is to confer a benefit upon a debtor where particular terms have been complied with, and to revert back to the primary contractual obligations in the event of non-compliance, the clause is likely to constitute an indulgence clause rather than a penalty. If a sum of money is payable by way of instalments, and it is provided that, in the event of one instalment not being punctually paid, the whole sum shall immediately become payable, the acceleration of payment does not constitute a penalty. There is no penalty where it is agreed to charge a certain rate of interest on condition that, if payment is made punctually, the rate will be reduced.

16.4.2 The role of conscience

Where a breach of contract has been committed, a clause prescribing the amount payable by the contract breaker will be construed as a penalty if it is extravagant, or unconscionable, in amount in comparison with the greatest possible loss that could have occurred following the breach. A determination that a presumably freely-negotiated term of a contract is unconscionable clearly interferes with freedom of contract. Courts are naturally reluctant to strike down express terms purely on the ground that they are unconscientious, unless a clear penalty can be established. The High Court has considered the role of conscience in the doctrine of penalties in a trilogy of cases involving acceleration clauses in hire purchase contracts.

In *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983), the respondents leased a prime mover to the appellants for 36 months. The appellants had no right to purchase the vehicle. The agreement provided that the entire rent was payable by the lessee, but that the lessor could not seek full payment if the lessee paid monthly instalments punctually. However, the agreement also provided that in the event of default, the lessor was entitled to claim the unpaid balance of the rent. The lessor could also repossess the property and, whilst the lessor was obliged to re-sell the vehicle, the amount (whether it be the disposable value or the appraisal value) was not deductible from the amount payable by the lessee. The 'appraisal value' was the estimated market value of the vehicle at the end of the 36 month term. The lessees defaulted under the lease after only two months. The lessor re-sold the prime mover for more than the appraisal value. The High Court held that the lessor's contractual right to recover the unpaid instalments constituted a penalty.

Deane J stressed that the determination as to whether a clause constituted a penalty or an enforceable liquidated damages clause was a question of substance:

> The parties to an agreement may have subjectively intended to make a pre-estimate of damages in the event of breach. If, however, that pre-estimate is either extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach or, judged at the time of making the contract, is unreasonable in the burden which it imposes in the circumstances which have arisen, it is a penalty regardless of the intention of the parties in making it.

On the facts, the court felt that the amount payable under the clause exceeded the greatest possible loss which the lessor could suffer as a result of default in payment of instalments. Where the lessee is bound to account for the remainder of the instalments, and the lessor is entitled to repossess and sell the property and not account to the lessee for the proceeds of the sale, the clause will be a penalty. The court held that it was only fair for the lessor to account to the lessee for the proceeds of the sale, even if it does exceed the appraisal value.

16.4.3 Recovery where a clause does constitute a penalty

Where a clause is held to be unenforceable on the ground that it constitutes a penalty, the innocent party will be entitled to recover all losses naturally flowing from the breach, but not damages for loss of bargain. In *AMEV-UDC Finance Ltd v Austin* (1986), Mason and Wilson JJ noted that recovery is not of actual loss but, rather, the 'excessive' clause being struck down and unenforceable beyond the 'appropriate' sum; see, also, *Jobson v Johnson* (1989).

In *Amev Finance Ltd v Artes Studios Thoroughbreds Pty Ltd* (1989), the New South Wales Court of Appeal (*per* Clarke JA, with Kirby P and McHugh agreeing) felt that a clause which entitled AMEV, on default, to a payment amounting to unpaid rent, expenses and the value of the racehorses leased out did constitute a penalty. Their Honours noted that this amount exceeded what would have been available under common law and did not reflect a genuine pre-estimation of damages. During their judgment, their Honours pointed out that a penalty will exist if the amount payable is not reasonably comparable with the actual damage occasioned by the early termination. The foundation of a penal provision is a lack of proportionality between actual loss and the monetary clause, and it is this assessment which is the significant one rather than the nature of the breach occasioning the termination. As their Honours noted:

> Once it is accepted that the parties are free to agree that upon the occurrence of one or more of a number of specified breaches, a party is entitled to terminate the contract and that they are at liberty to agree on an amount of compensation payable … then the fact that the right was capable of being exercised upon the occurrence of a trivial, as opposed to a serious, breach of contract would seem to have little significance on the determination whether an agreed sum payable on termination is a genuine pre-estimation.

16.4.4 What constitutes a fair pre-estimate of damages

Acceleration clauses will be enforceable where a lessee in default is entitled to a rebate to reflect the value to the lessor of earlier payments of the unpaid instalments (*IAC (Leasing) Ltd v Humphrey* (1972)). In *Esanda Finance Corp Ltd v Plessing* (1989), a purchaser was in breach of a hire purchase agreement for a prime mover. The 'recoverable amount' to which the owner was entitled in the event of default was calculated by reference to a formula which allowed the hirer to recover the balance of the unpaid instalments; the prime mover would then be repossessed and account would be made for its wholesale value. The hirer could also claim associated storage expense and repossession costs.

It was argued to be a penalty on a number of grounds. In the first place, it was argued that because the clause did not deal with the prospect of a surplus upon a resale, it constituted a penalty. Furthermore, it was argued that the agreement only gave credit for the wholesale rather than the retail value of the

prime mover, and it took no account of the duty to mitigate loss. Finally, provision was made for loss of bargain damages in the event of any breach entitling the owner to terminate the contract and not only repudiatory breaches.

The High Court held that the clause did not amount to a penalty. Wilson and Toohey JJ rejected the notion that an agreement sum will constitute a penalty simply because there is a possibility that it may exceed the amount of damages which would be available under common law for such a breach. The agreed sum would only be unenforceable as a penalty if it was clearly disproportionate to the damage likely to be suffered as a result of the breach. The fact that the clause failed to deal with the possibility that the prime mover may, upon resale, gain a better price than the wholesale value did not mean that the clause was a penalty. Furthermore, the court felt that loss of bargain damages were capable of being legitimately incorporated into a penalty clause, even if the clause became operable on a non-repudiatory breach. Whilst Brennan J found that this might cause some 'incongruity' with the common law position, the whole focus was upon how genuine the pre-estimation of damages was. Strict contractual analogies were inappropriate in this regard.[1] The equitable conception here is one of balance: the equitable jurisdiction presumes that a clause conferring disproportionate benefits could not have been freely agreed to if both parties were truly in a position to consider the consequences, and that enforcement of such a clause is, in the circumstances, unconscientious.[2]

16.4.5 Date for determining whether a provision is a penalty

The court will consider whether a term constitutes a penalty at the time the contract is entered into. If, at that time, genuine uncertainty exists concerning the greatest amount of damage a breach may cause, a claim disputing payment on breach is unlikely to be held to be unenforceable as a penalty (*PC Developments Pty Ltd v Revell* (1991)). However, if parties make a genuine attempt to pre-estimate damages for a future breach and the estimation is found to be too high, provided it is not excessive, a court is unlikely to strike the clause down as a penalty.

1 See, also, *Bridge Wholesale Acceptance Corp (Aust) Ltd v Regal Pty Ltd* (1992) ASC 56.

2 See Lanyon, E, 'Equality and the doctrine of penalties' (1996) 9 J Contract Law 2.

CHAPTER 17

FORFEITURE

17.1 What is the equitable doctrine of relief against forfeiture?

The aim of the equitable doctrine of relief against forfeiture is identical to the doctrine of relief against penalties; it prevents over-compensation of an innocent party where the other party has committed a breach of an agreement. But, whereas the rule against penalties renders payments of money unenforceable where they exceed the level of reasonable compensation, the rules against forfeiture prevent an owner of property from recovering title or possession to property where to do so would confer an unfair advantage on the owner. In the words of Mason and Deane JJ, in *Legione v Hateley* (1983):

> A penalty, as its name suggests, is in the nature of a punishment for non-observance of a contractual stipulation; it consists of the imposition of an additional or different liability upon breach of the contractual stipulation ... On the other hand, forfeiture involves the loss or determination of an estate or interest in property or a proprietary right.

Forfeiture can operate by way of a specific clause in a contract or pursuant to common law entitlement. Where one party has breached a contract, and the breach entitles the other to terminate or rescind the contract, forfeiting any proprietary right which may have been conferred, relief against forfeiture may be considered. Relief will only be issued where it can be established that the strict enforcement of contractual or common law rights is, in the circumstances, unconscionable. Unconscionability, in this context, can be raised in a number of different ways, including cases where a fraud or inequity is clear from the process of reaching an agreement (procedural unconscionability); or cases where inequity arises as a result of the enforcement of the contract (substantive unconscionability) because the strict enforcement of legal rights confers an unjust enrichment on one party when the breach could have been resolved without the exercise of such rights. Procedural unconscionability focuses upon the fairness of the procedure, whilst substantive unconscionability considers the unfairness in the outcome.

An important consideration in a court's determination as to whether to award relief against forfeiture is the nature of the breach. Where a breach is trivial, relief against forfeiture may be issued if the forfeiture is a consequence of the exercise of a specific termination clause in a contract. Generally, equity will grant relief on the grounds that the retention of the property is, in the circumstances, unconscionable. Where a breach is serious, and enforcement of common law rights is harsh, excessive and unconscionable, a court may issue relief against forfeiture in exceptional circumstances.

17.2 History

The earliest cases of equitable relief in this area concerned breaches by tenants of covenants in leases and the consequent attempts by lessors to forfeit the lease. The breach might consist of a failure to pay rent, or the failure by the tenant to perform some other covenant. It was, at one time, considered that only the former breach could attract equitable relief, but since the House of Lords decision on *Shiloh Spinners Ltd v Harding* (1973), it has been accepted that equitable relief may be granted in respect of non-money covenants. The landlord and tenant cases were central to the development of the equitable doctrine of relief against forfeiture, but in this area statute has now superseded the equitable doctrine. For example, s 146(2) of the Property Law Act 1958 (Vic) substitutes a statutory jurisdiction to grant relief. Nevertheless, the equitable principles for granting relief remain relevant for the exercise of the statutory jurisdiction.

The equitable rules continue to apply to purported forfeitures of other property interests; for example, they apply in many States to forfeiture of interests acquired pursuant to contracts for the sale of land, especially deferred payment contracts or rental purchase agreements.

17.3 The role of conscience

In *Legione v Hateley* (1983), the High Court placed the equitable rules in the context of the general equitable policy of preventing the commission of unconscionable conduct. A contract for the sale of land entitled the purchasers to put down $6,000 on 14 July 1975, and to enter into possession, the balance of $35,000 being payable on 1 July 1979. This was stated to be the essence of the contract. The purchasers erected a house on the land, although the contract did not entitle them to do so. They subsequently failed to pay the balance of the purchase price on 1 July 1979. The vendors served a notice on the purchasers to complete, which was due to expire on 10 August. On 6 August the purchasers were informed, by a secretary of the vendor's solicitors, that it would not matter if the settlement money was paid a week after the expiration of the notice. The purchasers tendered the settlement moneys four days after the expiry of the notice. The vendors refused to complete.

A majority of the High Court, Brennan J dissenting, remitted the question of relief to the Victorian Supreme Court. The majority judges characterised the equitable rules as a manifestation of the general equitable rules against unconscionable conduct.

In the words of Mason and Deane JJ:

> A party having a legal right should not be permitted to exercise it in such a way that the exercise amounts to unconscionable conduct.

The judgments in *Legione v Hateley* were unclear as to whether unconscionable conduct was confined to wrongful unconscionable behaviour, such as the

secretary's misrepresentation in that case, or whether the court could range over broader questions, such as the substantive fairness of the contract.

17.4 Ambiguous nature of the conscience approach

The High Court's failure to explicate the meaning of unconscionable conduct in *Legione v Hateley* was the principal cause of the considerable diversity of High Court judgments in *Stern v McArthur* (1988). A contract for the sale of land provided for the payment of the balance of the purchase price by monthly instalments over a period of 14 years after the contract was signed. The purchasers were not entitled to go into possession until the balance of the purchase price had been paid. The whole of the purchase price became payable upon the purchaser's failure to pay one instalment. In spite of the express prohibition, the purchaser went into possession and built a house on the land. Eight years later the purchaser defaulted in the payment of a number of instalments, although the arrears were later paid off. The vendors sought to rescind the contract while allowing the purchasers credit for the value of their improvements.

The High Court held, by a majority of three to two, that the purchasers were entitled to relief against a forfeiture. Deane and Dawson JJ did not directly apply a conscience approach. By analogy with the enforcement of an equity of redemption and of the protection of mortgagors in the law of mortgages, they held that an instalment purchaser who paid all arrears of instalments, interest and costs was entitled, as of right, to relief in equity.

Gaudron J based relief on the conscience approach. In her view, a court should take into account not only any alleged wrongdoing, but also the potential impact of forfeiture on the parties.

In the dissenting judgments, Mason CJ and Brennan J would have limited relief to cases of proven wrongdoing by the vendor. In the absence of any misconduct, such as the misrepresentation in *Legione v Hateley*, there were no grounds for providing relief against forfeiture in equity in favour of the purchaser. According to Mason CJ, to extend relief against forfeiture to a situation where no exceptional circumstances of unconscionability existed would eviscerate unconscionability of all its meaning. Similarly, Brennan J warned that unconscionability should not operate as a charter for the judicial reformation of contracts. The two felt that there was nothing in the vendors' conduct which equity would regard as unconscionable, except possibly the time allowed in their notice to complete. However, no objection was taken to this.

17.5 Unsettled state of the law

Following *Stern v McArthur*, the law relating to equitable Australian relief against forfeiture remains unsettled and incoherent. The failure of the Australian High Court to define more precisely the types of unconscientious behaviour which ground equitable relief is the principal cause of such incoherence.

The Privy Council, in *Union Eagle Ltd v Golden Achivement Ltd* (1997), considered the scope of the equitable jurisdiction to relieve against forfeiture. On the facts of that case, a purchaser bought a home unit under a contract of sale. The purchaser paid a 10% deposit under the contract, and then failed to pay the balance of the purchase price on time. The contract stipulated that time was of the essence. In fact, the purchaser was able to complete the contract and hand over the balance of the purchase price 10 minutes after the time prescribed in the contract. The deposit paid by the purchaser was forfeited. The Privy Council rejected the purchaser's claim for relief against the forfeiture of the deposit, emphasising the importance of contractual certainty in business transactions. Lord Hoffman noted (pp 218–19):

> The principle that equity will restrain the enforcement of legal rights when it would be unconscionable to insist upon them has an attractive breadth. But the reasons why the courts have rejected such generalisations are founded not merely upon authority but also upon practical considerations of business. These are, in summary, that in many forms of transaction it is of great importance that if something happens for which the contract has made express provision, the parties should know with certainty that the terms of the contract will be enforced. The existence of an undefined discretion to refuse to enforce the contract on the ground that this would be 'unconscionable' is sufficient to create uncertainty. Even if it is most unlikely that a discretion to grant relief will be exercised, its mere existence enables litigation to be employed as a negotiating tactic. The realities of commercial life are that this may cause injustice which cannot be fully compensated by the ultimate decision in the case.

In considering the decision of the Australian High Court in *Stern v McArthur*, the Privy Council in *Union Eagle* noted that the difference of opinion in *Stern* was based upon divergent views as to whether the transaction was, in substance, a mortgage, and not a difference that related to the scope of the jurisdiction to relieve against forfeiture. The Privy Council concluded that the decision in *Stern* was not of relevance to the facts of *Union Eagle* as there was no question of the transaction amounting to a mortgage, and there was no evidence of any procedural unconscionability; the question whether the strict enforcement of contractual rights resulted in substantive unconscionability against the purchaser was not explored.

17.6 Legislative developments

In some States, legislation prohibits or regulates instalments contracts for the sale of land. In South Australia, such contracts are unenforceable (s 89(1) of the Land Agents, Brokers and Valuers Act 1973). In Victoria, s 4 of the Sale of Land Act 1962 entitles a purchaser who is not in default to call for a conveyance of land subject to the execution of a mortgage back to the vendor to secure any purchase moneys outstanding.

17.7 Scope of the equitable rules

Although *Legione v Hateley* and *Stern v McArthur* both concerned contracts for the sale of land, the principles enunciated by the High Court are not confined to cases of forfeiture of real property. The conscience approach, for all its ambiguities, extends to all forms of property, both corporeal and incorporeal (*Federal Airports Corp v Makucha Developments Ltd* (1993)). Recent English decisions, in contrast, have circumscribed the operation of the doctrine to exclude from equitable relief certain types of commercial contract creating choses in action, such as charter parties (*Scandinavian Trading Tanker Co AB v Petrolera Ecuatoriana* (1983)) and trademark licence agreements (*Sport International Vussum BV v Inter-Footwear Ltd* (1984)).

Furthermore, the Privy Council held, in *Workers Trust and Merchant Bank Ltd v Dojap Investments Ltd* (1993), that a reasonable deposit paid under a contract is a guarantee of performance and security, and its forfeiture upon breach will not attract equitable intervention.[1]

1 See, also, *Linggi Plantations Ltd v Jagatheesan* [1972] 1 MLJ 89.

PART III

EQUITABLE RELIEF

This part of the text considers the different forms of equitable remedies which have evolved in the equitable jurisdiction. Unlike common law remedies, equitable remedies are directed at preventing or remedying the individual unfairness: in this sense, they are directed at the individual rather than constituting a generalised award. Furthermore, equitable remedies are intrinsically discretionary. Just because an applicant can prove a breach of equitable obligation or principle does not necessarily mean that relief will be granted; all will depend on the nature of the action and the individual determination of the course.

Generally, equitable relief will only be awarded for a breach of equitable obligation. However, where relief under common law is inadequate, equitable relief may be granted. The forms of equitable relief are diverse and include orders, decrees and declarations having the effect of compelling parties to perform legal or equitable obligations, prohibiting conduct, determining legal or equitable rights, issuing some form of pecuniary relief for loss incurred, or gain made in breach of an equitable obligation and, in circumstances where it is warranted and the property is traceable, imposing a constructive trust over specified property.

The forms of equitable relief examined in this part include:

- the decree of specific performance to compel the performance of an enforceable agreement;
- injunctive relief issued to compel or prohibit inequitable conduct from continuing or being carried out;
- pecuniary relief, including equitable compensation, for loss suffered as a result of a breach of equitable obligation, an account made of profit for gains made in consequence of a breach of equitable obligation, and the limited jurisdiction to award statutory damages as an additional or alternative remedy to a decree of specific performance or injunctive relief; and
- the ability of a court of equity to issue rescission for breach of a contract where rescission is not available at law, or issue declaratory relief setting out the legal status of the parties to an action.

The most important factors in an award of equitable relief are the discretionary considerations. Each chapter considers the discretionary factors relevant to the individual form of relief. However, some of the most important ones include: where the remedy is in aid of a legal right, it must be proved that the relief at law is inadequate; the conduct of the applicant seeking relief must be carefully examined, including the length of time taken, any inequitable conduct committed by the applicant, any contribution made by the applicant to loss incurred; the effect of the relief on the respondent and, in particular, the hardship or financial loss such relief may cause, and the availability of other forms of relief. Naturally, as each form of remedy is different, slightly different factors will be relevant; for example, a decree of

specific performance can only be issued where an enforceable contract can be established and the parties are ready and willing to proceed, and injunctive relief prohibiting the removal of assets from the jurisdiction pending the determination of litigation can only be issued where the assets are identifiable and are within the jurisdiction. Furthermore, it is possible for equitable defences, including laches, acquiescence, set-off, estoppel or waiver to be raised to either mitigate or preclude the form of relief requested.

The aim of this part is to comprehensively examine the form, application and methodology of equitable remedies, and to consider this in the context of the continuing jurisdictional relationship existing between common law and equity. This part represents the final section on the general equitable jurisdiction.

CHAPTER 18

THE NATURE OF EQUITABLE REMEDIES

18.1 What is equitable relief?

In a modern court of equity, the application of relief is dependant upon a range of discretionary factors. Not only must an applicant prove that the particular form of relief is available and appropriate on the facts, but traditionally, a court of equity also has to establish that any available common law relief is inadequate. Such a wide-ranging analysis ensures that the form of relief is appropriate and necessary for the particular circumstances of each case.

Today, equitable remedies cover a kaleidoscope of pecuniary, proprietary and personal forms of relief. In particular, the emergence of the constructive trust as a remedy-driven device has added a new dimension to the equity jurisdiction. Where the circumstances reveal that a defendant has limited financial resources, making a pecuniary award inappropriate, a plaintiff may seek to establish a constructive trust. Proprietary relief can only be granted where the action relates to a particular piece of property which is still identifiable in the hands of the defendant. Once this is established, all that needs to be proven is that the unfairness of the action warrants the imposition of such a trust. This is a particularly useful device for equitable actions, as it ensures recovery of the property in issue, and personal forms of relief such as the injunction, an account of profits, or equitable compensation may be issued as additional forms of relief where the facts require it.

One of the most important developments affecting the application of modern equitable relief is the fusion debate.[1] The relationship between common law and equity is such that equitable rights can, traditionally, only be enforced by equitable remedies. Fusion, or what may be more accurately referred to as jurisdictional intermingling, is beginning to change this. For example, the New Zealand High Court, in *Aquaculture Corp v NZ Green Mussel Co Ltd* (1990), issued an award of compensatory damages for a breach of confidence action based upon the argument that common law and equity were now fused (see above, 3.8).

In that case, the court felt that there was no need to be constrained by jurisdictional dogma where the fairness of the circumstances warrant a particular form of remedy. If this be the case, it may no longer be relevant to determine whether damages are inadequate because the focus will no longer be jurisdictional.

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1 Refer to the discussion in Chapter 3.

This opinion was reconfirmed by the New Zealand High Court in *Mouat v Clarke Boyce* (1992), where Cooke P again concluded:

> … that common law and equity are mingled, and that the court has available the full range of remedies ...

These views have not been confined to the New Zealand courts. In Canada, La Forest J, in *Canson Enterprises Ltd v Boughton and Co* (1992), felt that legal and equitable remedies should be more interactive, particularly where a breach of fiduciary obligation has occurred. His Honour felt that legal and equitable remedies could be interactive where they both follow similar policy objectives; however, he did not go so far as to suggest that all jurisdictional constraints to the application of remedies be removed.

These are all extremely important issues for a court of equity to determine and need to be properly addressed. The possibility of what may be broadly labelled 'remedial fusion' will not only increase the choices available for a particular applicant, it will also encourage a greater consistency between legal and equitable forms of relief. Jurisdictional interaction has affected not only the availability of relief, but also the way in which it is applied. For example, in *Day v Mead* (1987), it was held that equitable compensation should be reduced through the application of the common law defence of contributory negligence (see 3.8).

All these developments have inevitably reduced the purity of the equitable jurisdiction. The supplication of common law remedies and concepts into the equity arena has produced a paradigmatic shift in focus for equitable remedies. The traditional preoccupation with considerations such as the adequacy of common law remedies and the jurisdictional character of the action are being abandoned in favour of a more generalised inquiry, centred around the primary question: 'What is the most appropriate remedy to grant in the circumstances?' This type of inquiry is well suited to a discretionary analysis. Remedial fusion or integration is consistent with the general trend towards what has been described in Chapter 3 as 'legitimate fusion', and what Professor Birks has referred to as a 'shared taxonomy between common law and equity'. As Birks notes:

> Different language and different angles of approach impede the identification of competition and contradiction between law and equity. The hidden dangers would be much easier to spot if all lawyers shared the same taxonomy of law …[2]

Professor Birks has further stated that progress will only occur when judges are willing to 'draw on common law and equitable remedies without over-scrupulous regard for historically determined boundary walls'.[3]

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2 Birks, P, 'Equity in the modern law' (1996) 2 Western Aus UL Rev 1.

3 Birks, P, 'Restitution: dynamics of the modern law' (1993) 46 CLP 157, p 177. See, also, Mason, A, 'The impact of equitable doctrine on the law of contract' (1998) 27 Anglo-Am L Rev.

As yet, an integrated 'taxonomy' for common law and equity has only been sporadically assessed; nevertheless, the movement continues and its eventual acceptance will have a dramatic impact upon the entire methodology of equitable remedies.

18.2 Equitable remedy versus equitable right

The law of remedies is concerned with the means of redressing or preventing infringements of rights. Any discussion of remedial law generally assumes that a right has been, or is about to be, infringed and that the requirements of procedural law have already been satisfied. The law essentially declares that, where there is a right, be that right legal, equitable or statutory in nature, there will generally be a remedy.

There are several ways of classifying judicial remedies. Some remedies are on the person (*in personam*), and others are on the property (*in rem*). Equitable remedies are usually specific and directed at the person in order to prevent a particular unfairness from continuing. For example, specific performance is granted against an individual, ordering that person to comply with contractual obligations. This stems from the old equitable maxim that equity operates *in personam*.

The *in personam* maxim has, however, become somewhat inadequate since the evolution of proprietary remedies in equity. A constructive trust is imposed against property held by a particular individual; it transforms the defendant into a trustee of the property for the benefit of the plaintiff, which has the effect of conferring an equitable beneficial interest upon the plaintiff and imposing personal equitable obligations upon the defendant. This type of remedy has both personal and proprietary aspects.

Proprietary remedies are generally referred to as equitable rights rather than remedies. This classification is not necessarily incorrect; when courts find in favour of a constructive trust, they are not simply imposing an appropriate remedy, although the perspective is remedial; they are creating an equitable beneficial interest in favour of the plaintiff. In this way, it can be seen that the constructive trust has a dual character; it can be described as both a right and a remedy (see further discussion on this in Chapter 38).

18.3 Discretionary application of equitable relief

It is traditionally perceived that the equitable jurisdiction has a discretionary operation, and this is particularly evident in the application of remedy. Judges implementing the equitable jurisdiction may select an equitable remedy that best suits the individual facts, and determine whether and how it is to apply. This is not to suggest that judges implementing equitable remedies have complete autonomy, and the 'rhetoric' of discretion does not mean that the discretion conferred upon a judge in determining equitable relief is not

guided.[4] All forms of equitable relief have particular jurisdictional requirements which must be met before they are available, and these 'rules' monitor the application of judicial discretion.

There are two different levels of equitable discretion which come into operation in the application of equitable relief. In the first place, the court has a discretion to determine whether to award any relief at all. In making this assessment, a court will consider the overall circumstances of the case and a substantive equitable or legal right requiring the protection of equitable relief must be established. At this stage, the court is required to make a determination on whether or not equity should protect the particular unfairness. Unlike the common law, equity does not automatically assume that a right warrants the application of a remedy. If the plaintiff has taken too long to bring the action, or if the plaintiff is not *bona fides* and has acted inequitably (whether the behaviour relates to the particular action or otherwise), or if the plaintiff has taken with notice of other rights, equity may simply refuse to grant a remedy.

Furthermore, if relief is available in both equity and common law, the court has traditionally been required to determine whether or not common law relief is adequate. If adequate relief is provided under the common law, there is really no need to grant equitable relief. This relates back to the established understanding of the relationship between common law and equity; the whole purpose of equity is to embellish the deficiencies of the common law and not to override them. The availability and adequacy of common law relief has always been a very important consideration in the determination of equitable relief, although this is changing. The reasons for this, broadly speaking, are twofold. In the first place, as stated above, the fundamental nature of the remedial inquiry is changing. Courts are beginning to focus upon the suitability of a remedy irrespective of its jurisdictional origins. Secondly, courts have shown an increasing flexibility in their examination of whether common law relief is 'adequate' in the circumstances.

Example

X seeks a decree of specific performance of a contract for the sale of land where the vendor is in breach. Damages are already available under common law. X claims that damages are not appropriate in the circumstances because the property is in a rare location and X will be unable to find another in such a position. In such a situation the court, in its discretion (provided the contract is capable of being enforced), will usually grant a decree of specific performance

4 See, generally, Wright, D, '*Giumelli*, estoppel and the new law of remedies' [1999] CLJ 476. Cf Edelman, JJ, 'Remedial certainty or remedial discretion in estoppel after *Giumelli*' (1999) 15 JCL 179; Finn, P, 'Equitable doctrine and discretion in remedies', in Cornish, WL *et al* (eds), *Restitution: Past, Present and Future – Essays in Honour of Gareth Jones*, 1998, p 251; Wright, DM, *The Remedial Constructive Trust*, 1998; Wright, D, 'The statutory trust, the remedial constructive trust and remedial flexibility' (1999) 14 JCL 221.

> rather than an award of damages. The mere fact that damages are available does not necessarily mean that they are the most appropriate remedy, and the courts are increasingly giving the definition of 'adequate' a broad interpretation.

Once equity determines that some form of equitable relief is available under the circumstances, a secondary discretion needs to be exercised, that is, which form of relief should be granted. This analysis requires a close examination of the circumstances and the range of remedies available: personal or proprietary; pecuniary or non-pecuniary. Before reaching any firm conclusion in this regard, a court of equity must make sure that the jurisdictional requirements for the application of the remedy are established on the facts. For example, specific enforcement cannot be granted where performance of a contract is impossible.

Similarly, a constructive trust cannot be imposed where there is no identifiable property. Furthermore, where the parties in issue are found to be in a pre-existing fiduciary relationship, a court will be more likely to impose a constructive trust. This stems from the fact that obligations of trust and confidence have already been reposed in the fiduciary with respect to the particular property. If those obligations are breached and the property is dealt with in a way which is adverse to the interests of the represented party, a court will usually conclude that the fiduciary holds the property on constructive trust.

Where no fiduciary obligation exists, a constructive trust will generally only be imposed if, at the discretion of the court, such a remedy is sufficiently necessary to prevent the equitable fraud from continuing. Where there has been some unjust enrichment, or where it would be equitable fraud to deny that an individual has an interest in property, it may be held that the defendant holds the property under a constructive trust for the plaintiff.

Where personal relief is sought, the plaintiff must satisfy the court that such relief is available on the facts. This will depend upon the type of relief sought. For example, if an account of profits is sought, it must be proven that the defendant has actually made an inequitable profit. Where equitable compensation is claimed, it must be proven that an identifiable loss has resulted from the inequitable conduct. Specific performance will only be available where the parties are ready and willing to perform the contractual obligations, and injunctive relief is only relevant where there is an actual or threatened danger of the wrong complained of occurring again. The secondary discretion focuses upon the appropriate model of relief in the circumstances, rather than the threshold issue of whether relief should be granted at all.

SPECIFIC PERFORMANCE

By definition, specific performance is an order of the court compelling a party to a contract to perform his or her obligations according to the terms of the contract. Specific performance of a contract will usually be sought where one party wants the contractual relationship to continue despite the other party being in breach of the contractual obligations. It is a remedy compelling the performance of a pre-existing legal obligation where such enforcement is fair, reasonable and, most importantly, possible. In order for specific performance to be granted, it must be clearly shown that the contract is capable of being performed and that the parties are ready, willing and able to go ahead with the contractual obligations they undertook. Specific performance is a personal remedy because it is directed at the individual party who has breached the legal obligations. Traditionally, courts have been reluctant to issue a decree of specific performance where it can be proven that an award of damages would be adequate.

19.1 The definition of specific performance

Specific performance is an equitable remedy whereby a court will compel a defendant to perform legally enforceable obligations under a contract. The remedy is a discretionary one and is only available when certain prerequisites are satisfied. The 'specific performance' refers to the actual execution of the contract according to its stipulations and terms. Equity directs the party in default to do the very thing which he or she has contracted to do.

Australian courts have drawn a distinction between two different types of specific performance which may be ordered. The first has a more limited application, referring to the situation where a court issues an order compelling a party to an executory contract to execute some document or do some act which will put the parties in the position, relative to each other, in which, by the preliminary agreement, they were intended to be placed.

This limited approach to specific performance is described by Dixon J in *JC Williamson Ltd v Lukey and Mulholland* (1931) in the following manner:

> Specific performance, in the proper sense, is a remedy to compel the execution *in specie* of a contract which requires some definite thing to be done before the transaction is complete and the parties' rights are settled and defined in the manner intended.

The second type of specific performance is broader and may be more generally referred to as 'specific relief analogous to specific performance'. This type of relief will arise where a court orders a party to an executed contract to perform obligations due under that contract, according to its terms. In this situation, the decree has a broader effect because it results in the enforcement of the entire, completed contract rather than individual contractual obligations. A reference to specific performance will generally cover both the limited and the broader notions of specific performance.

Whether the enforcement be limited or broad in nature, specific performance is a part of the general equitable jurisdiction. If the defendant comes within the jurisdiction of the court and can be compelled to perform her obligations personally, then a court will generally issue a decree of specific performance. The significance of the distinction between the different forms of specific performance has been the subject of much debate in recent years.[1] Ultimately, however, whether the relief is in the form of an order compelling the performance of obligations under an executory or an executed contract, the substance of the relief is the same.

19.2 Specific performance – a personal remedy

A decree of specific performance is a personal remedy, enforceable against an individual defendant. It will be issued against a defendant personally to prevent the unfairness flowing from non-compliance with contractual obligations. When a court issues a decree of specific performance it is acting *in personam*, because it is directing a particular individual to comply personally with contractual obligations.

It is imperative that the defendant, against whom specific performance is being decreed, be within the jurisdiction of the court and be capable of personally carrying out the contractual obligations. Where the defendant is a person over whom the courts have no jurisdiction, there can be no relief. It is not necessary for the actual contract to be within the jurisdiction of the court. The focus of specific performance is upon the enforcement of personal contractual obligations owed by the defendant, hence it does not matter where those contractual obligations arose. The only thing with which the court is concerned is the location of the person required to perform the contractual obligations. It follows from this that a contract outside of the court's jurisdiction may be enforced against a defendant within the jurisdiction; the remedies for a breach of contract are clearly governed by the *lex fori* where the action is brought.

1 See Heydon, Gummow and Austin, in Meagher, RP, Gummow, WMC and Lehane, JRF, *Equity: Doctrines and Remedies*, 3rd edn, 1992, paras 2001–04; Spry, ICF, *Equitable Remedies*, 4th edn, 1990, pp 50–51.

19.3 The jurisdictional requirements for an award of specific performance

19.3.1 Enforceable contract

Generally, a decree of specific performance will only be issued when an enforceable, subsisting contract is proven. If the contract is not enforceable, a decree will usually not be issued. In issuing a decree of specific performance, equity is operating in its auxiliary jurisdiction; it is not adjudicating upon the validity of the plaintiff's claim, but is assisting in its enforcement. There are, however, some situations where proceedings for specific performance may be brought in order to establish whether or not the particular contract in issue is enforceable. Equity will not reject such applications because, under the judicature system, a separate proceeding establishing the enforceability of the contract is no longer essential: see *Cowell v Rosehill Racecourse Co Ltd* (1937), Dixon J (pp 632–33). See, also, the discussion in Chapter 3.

Even where a contract is not legally enforceable, a purported agreement which has been acted upon may be enforceable under estoppel or part performance principles in equity. In such a situation, a decree of specific performance may be issued to prevent the unfair denial of the agreement.

19.3.2 Valuable consideration

It must be established that an applicant for the award of specific performance has provided valuable consideration. The mere fact that an agreement has been made under seal does not mean that valuable consideration has been conferred. Some proof of the conferral of valuable consideration must be given. Specific performance will not be available to enforce a mere promise; the failure to perform a mere promise is not regarded as sufficiently inequitable to warrant such a decree.

Generally, equity has adopted the same approach to consideration as that developed by the common law in this regard. There are, however, a few exceptions to this; equity has recognised a few anomalous forms of consideration not accepted by the common law. First, an agreement made in contemplation and consideration of marriage, or made after marriage in the pursuance of an ante-nuptial covenant, may be enforced in equity. Both the spouses and the issue of the marriage may enforce the agreement. However, the next of kin may not. Secondly, agreements which are extensions of contracts which have originally been entered into for valuable consideration may be specifically enforced. Hence, an option to purchase land in a contract is specifically enforceable, provided that valuable consideration has been given for the original grant. In such a situation, the option is enforceable because it forms a part of the original contract pursuant to which valuable consideration was given.

Both common law and equity take the view that it is the presence of valuable consideration, rather than the actual amount, which is important. Provided that something of value has been given, specific performance of the contract will not be denied. The value may well be less than expected or, indeed, completely unsuitable, but this in itself will not prevent specific performance from being granted. It may, however, be a relevant discretionary consideration for a court of equity.

19.3.3 Breach of contract

A claim for specific performance will only succeed if it can be established that there has been either an actual or an anticipatory breach of the terms of the contract. The court must then determine whether or not the defendant, in breaching the contract, has evidenced an intention not to be bound by the terms of the contract. This must be determined according to individual circumstances. It is not necessary to prove that the particular breach was fundamental, provided the contract is capable of being enforced. Specific performance may be awarded where a breach of contract has occurred, although no cause of action for damages has accrued. The basis of the jurisdiction does not lie in the character of the breach, but in the inequity arising from the fact that a breach has occurred.

19.3.4 Inadequacy of damages

Equity will not grant specific performance if an award of damages at common law will provide sufficient compensation for the plaintiff. This stems from the old maxim 'equity follows the law'. Modern courts do not tend to adhere to this principle as stringently as their predecessors because of the changing relationship between common law and equity. Nevertheless, a general inquiry as to the availability of an award of damages and the suitability of such an award is usually carried out. The first matter to consider will be whether damages are, in fact, available. In *Co-Operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* (1998), the House of Lords noted that part of the 'rationalisation' of the modern decree of specific performance included an assurance that 'common law remedies' were inadequate. Where a breach of contract can be established, the right to damages will be automatic. When assessing the suitability of damages, such factors as the needs of the plaintiff and the financial viability of the defendant will be taken into account as a matter of course. Circumstances in which damages are inadequate or inappropriate are numerous and varied in content. In each situation, the proper question to ask is whether the plaintiff would be just as satisfied with an award of damages as he would with a decree of specific performance. It is important to distinguish between those situations where damages are not available and those where damages are unsuitable.

Example where damages are not available

Where a contract is only enforceable in equity because it has not complied with the formality requirements at law, specific performance will generally be decreed; damages at law would not be available as the agreement is only enforceable in equity. In equity, if an agreement has been partly performed and the defendant has carried out some of the obligations under a contract in reliance on the promise of the defendant, it is inequitable to allow the defendant to defeat the plaintiff's claim by pleading the absence of writing. Equity will not allow the formality of writing to be made an instrument of fraud, and consequently a decree of specific performance may be issued. In this situation, damages would not be available because the transaction is only recognised in equity.

Example where damages are available but not suitable

Where the defendant is insolvent, or has a doubtful solvency, and has committed a breach of contract, damages may be available but unsuitable because there is little chance of such damages being obtained. Naturally, when considering this issue, a court of equity should take into account the fact that issuing a decree of specific performance may effectively result in one creditor being given an unfair preference over other creditors.

In *Dougan v Ley* (1946), the defendant contracted to sell his taxi-cab licence to the plaintiff. Due to restrictive legislation, there were very few taxi-cab licences in New South Wales; this made the contract extremely valuable to the plaintiff. The defendant refused to go ahead with the contract and the plaintiff sought specific performance of the contract.

The High Court held that a decree of specific performance should be issued. Due to the valuable nature of the taxi-cab licence and its relative scarcity, specific performance was a preferable remedy to damages despite the fact that damages were available on the facts.

Courts are beginning to consider a wide variety of factors when examining the adequacy of damages, including changing commercial circumstances and the increasing complications associated with the proper valuation of damages. In *ANZ Executors and Trustees Ltd v Humes Ltd* (1990), the Supreme Court of Victoria came to the conclusion that damages would not be an adequate remedy for breach of a contract to sell notes which were convertible into shares. On the facts, the sale of the notes had a special value because the purchaser wanted to acquire as many shares as possible in the corporation during that year to gain tax advantages for its takeover. It would be extremely difficult to measure this value so as to calculate damages. The court concluded that damages were inadequate because of the complexity associated with the valuation of the notes, and felt that the plaintiff would not be placed in as good a position by an award of damages as it would if it obtained a decree of specific performance.

Damages may also be inappropriate when circumstances reveal that multiple contractual breaches have occurred, requiring successive actions. If the substance of the plaintiff's action is to prevent the breaches from continuing, specific performance may be more appropriate than damages. Specific performance is a single decree, and in such cases may be more appropriate than continuing awards of damages. Damages will be inadequate unless they are at least of such an amount that the plaintiff can adequately compensate the breach and any loss accruing to third parties. If such compensation cannot be achieved, a court of equity may prefer a decree of specific performance.

In some situations, it may become apparent that the plaintiff will actually be in a worse position if damages are awarded. For example, if the plaintiff brings an action seeking relief against forfeiture of an interest acquired under the contract, the best way to prevent the forfeiture is to issue an award of specific performance. An award of damages may provide monetary compensation for the contractual breach, but it will effectively endorse the forfeiture.

A breach of a contract to provide a benefit to a third party will generally be specifically enforceable when an award of damages would result in the third party losing the contractual benefit (*Coulls v Bagot's Executor and Trustee Co Ltd* (1967); see, also, *Beswick v Beswick* (1968)).

19.3.5 Type of contract

The availability of specific performance may also depend upon the particular type of contract involved. In some contracts, specific performance will be awarded almost as a matter of course. In others, it will only be awarded in special circumstances. The essential issue is the subject matter of the agreement. One area where specific performance is often awarded is contracts for the sale of land. A court of equity will almost always issue a decree of specific performance of a contract for the sale of land, in the absence of other discretionary considerations working against it.

In *Turner v Bladin* (1951), the High Court made the following comments concerning the availability of specific performance of a contract for the sale of land:

> Where a contract of sale is of such a kind that the purchaser can sue for specific performance, the vendor can also sue for specific performance although the claim is merely to recover a sum of money, and he can do so although at the date of the writ the contract has been fully performed except for the payment of the purchase money or some part thereof.[2]

2 *Turner v Bladin* (1951) 82 CLR 463, p 470.

On the other hand, parties to a contract for the sale of a chattel will generally be limited to a remedy in damages, particularly if the chattel involved is of an ordinary, domestic or commercial nature and is easily replaced.

In *Adderley v Dixon* (1924), Sir John Leach stated that:

> ... a court of equity will not, generally, decree performance of a contract for the sale of stock or goods, not because of their personal nature, but because damages at law, calculated upon the market price of the stock or goods, are as complete a remedy to the purchaser as the delivery of the stock or goods contracted for; in as much as, with the damages, he may purchase the same quantity of the like stock or goods.[3]

The reason why contracts for the sale of land are generally enforceable is because each piece of land is considered to be unique; an award of damages is usually inappropriate because monetary relief cannot replace the actual form of the land and is not an equivalent substitute. It may also be the case that damages cannot adequately compensate a purchaser for the time-consuming process of seeking out and purchasing another comparable property.

Specific performance of a contract for the sale of land will generally be awarded whatever the nature of the estate or interest. An agreement to sell an interest under a tenancy in common, the sale of a leasehold interest, and a contract for sale under a mortgagee's power, may all be specifically enforced. A contract for the sale of land may be specifically enforced even if the land is subject to the approval of subdivision. Leases of a very short duration are unlikely to be specifically enforced, although leases for yearly tenancies have been specifically enforced.

Contracts for the sale of chattels will only be enforceable once it is clearly shown that damages are inadequate. In most situations, the court will not decree specific performance with regard to personal chattels because the remedy at law will be sufficient. This will not always be the case, and there are many circumstances where an award of damages will not put the plaintiff into as favourable a position as a decree of specific performance. This has been well illustrated in regard to contracts for the sale of shares or stock. A contract for the sale of shares may be enforced if the shares are not readily available in the market. However, if it is possible for anyone to purchase the shares, a plaintiff will generally be left to a remedy in damages. It is not necessary to establish that the chattels are absolutely unavailable in the market; it will be sufficient if it can be shown that the plaintiff would either have some difficulty in obtaining them, or that the price may be greater (*ANZ Executors and Trustees Ltd v Humes Ltd* (1990)).

3 See, also, *op cit*, Spry, fn 1, p 62.

19.4 Discretionary considerations for the award of specific performance

19.4.1 Readiness and willingness of the plaintiff

The plaintiff who seeks to enforce a contract must be ready and willing to perform the contractual obligations in order for the court to enforce it. Ready and willingness refers to the assessment, at the time when the proposed relief is sought, of the ability of the plaintiff to perform her obligations. The assessment is a discretionary one. This requirement is often referred to as the doctrine of mutuality; both parties to a contract must be mutually capable of performing their respective obligations.

Obviously, the existence of past breaches, the possibility of future breaches and the character of the breach will all be relevant considerations. Under common law, where a plaintiff either wilfully refuses, or is incapable of performing, an essential term under the contract, it may give rise to an anticipatory breach. In this situation, there is no contractual right which equity can enforce, although the defendant has a legal right to repudiate the contract. However, where a contract is presently existing and the obligations attaching to it do not come into existence until a future date, consideration must be given as to whether the parties are ready and willing to perform at the time when the contractual obligations come into existence. It is not necessary to prove that the parties are ready and willing to perform all of the terms in the contract. It must be established, however, that the parties are willing to perform the essential terms of the contract. A lack of readiness and willingness can only be properly established once it is absolutely clear that the plaintiff cannot perform her contractual obligations.

For example, in *Foran v Wight* (1989), Brennan, Deane and Dawson JJ concluded that specific performance could be granted for an anticipatory contractual breach. On the facts, the vendors had intimated to the purchasers that settlement would not be going ahead. The purchasers, despite being in financial difficulty, still had a real chance of obtaining finance for the full purchase price. For that reason the purchasers were able to demonstrate their potential readiness and willingness to complete the contract.

The court did, however, hold that in some circumstances even if the parties can prove readiness and willingness to complete the contract, a decree of specific performance may still be refused:

> Even if the parties do prove that they are ready and willing to perform their contractual obligations, if it can be shown that constant court supervision would be required to maintain this state of affairs, specific performance will generally be denied. Specific performance cannot realistically be granted where there is a continual prospect of a contractual breach occurring.

Mason CJ, in dissent, held that the requirement of readiness and willingness had not been established on the facts. He felt that the requirement related to

both the cause of action and the remedy; a plaintiff seeking specific performance as a result of a breach of contract must first establish that he is ready and willing to perform his contractual obligations. Once this is established, a decree of specific performance may be awarded. According to Mason CJ, as the plaintiffs were not ready and willing to perform the contractual obligations at the time of the intimation by the vendors that settlement would not go ahead, the defendant's conduct did not constitute a breach of contract. The rules of court often dispense with the actual need to aver the requirement of readiness and willingness in the statement of claim. It has been held that the absence of such a plea is not inevitably fatal to the plaintiff's claim for specific performance.[4]

19.4.2 Contracts for personal services

Contracts for personal services will generally not be enforced. The reason for this is twofold. First, it is felt that enforcement of personal service contracts may involve hardship or inconvenience to particular defendants. Secondly, general policy considerations make it undesirable to force individuals to maintain particular personal relationships; this is so even though the parties may have earlier agreed to do so. The court takes the opinion that the circumstances and attitudes of the parties may have changed since the agreement was first entered into, and the court should not interfere. Furthermore, the enforcement of such contracts may result in repeated contractual breaches and require continual court supervision. Ordinarily, in such situations, it is felt that the proper course is to confine the parties to damages (see *Johnson v Shrewsbury and Birmingham Rly Co* (1953)).

19.4.3 Contractual difficulties

At the discretion of the court, specific performance will generally not be granted where the performance of the contract is either impossible or futile. A contract may be impossible to perform for a variety of reasons; for example, a condition precedent may not have been complied with. In such a situation, an order for specific performance should be conditional because, until the condition is complied with, the actual contractual obligation does not arise. Where a condition subsequent exists and is yet to be complied with, the court may make an award of specific performance which is only to operate once the condition has been satisfied.

Impossibility may arise due to altered circumstances. For example, in a situation where a defendant owing contractual obligations is no longer within the jurisdiction, it may be impossible to enforce such obligations, and specific performance will not usually be awarded. Impossibility should be

4 See *Bahr v Nicolay (No 2)* (1988), p 640, *per* Wilson and Toohey JJ; and *McDonald v McMullen* (1908).

distinguished from futility. Unlike impossibility, which refers to the inability of a defendant to carry out contractual obligations, futility refers to the uselessness of obtaining relief in the nature of specific performance.

Specific performance may be refused if it would be futile to enforce the contract, even though such performance is theoretically possible. Futility may be established where it can be proven that the defendant would be able to get out of the contractual obligations in some alternative manner, even if the contract were enforced. For example, where a lease contract expires before the court date, it would be futile to award specific performance. Brevity of the contract will not necessarily preclude an award of specific performance; it will depend upon what relief the court feels is the most appropriate in the circumstances.

Specific performance may also be refused where performance of the contract is illegal. It is a well established principle that specific performance of a contract will not be available unless the plaintiff can show that the contract is valid and legally enforceable at the time when the actual relief is sought. Obviously, equity will not enforce a contract if it is invalid at law. Determining whether a contract is illegal will be a matter of construction and will depend upon all of the circumstances. Illegality does not only refer to statutory infringements; if the defendant can show that there is no legally enforceable contract because, for example, there was no valid offer or acceptance to the contract, then the contract will be unenforceable.

A court will generally refuse to issue a decree of specific performance where the continued supervision of the court is necessary in order to ensure fulfilment of the contract (*JC Williamson Ltd v Lukey and Mulholland* (1931)). This was reinforced by the House of Lords in *Co-Operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* (1998), where Lord Hoffman noted that it is 'undesirable that a court should face the possibility of having to give an indefinite series of such rulings in order to ensure the execution of the order'. On the facts of that case, a decree of specific performance was refused to a plaintiff who sought specific enforcement of a retail lease. The House of Lords refused the relief, noting that such a decree can prolong the problem and this can be wasteful and expensive for both parties, whereas an award of damages provides closure for both parties.

19.4.4 Unfairness

Specific performance may be refused where the plaintiff has acted unfairly in enforcing the contract. Unfairness covers a wide range of factors, including: whether the plaintiff was in a position of advantage; whether the plaintiff had greater information available to him; whether the plaintiff was aware that the defendant lacked requisite knowledge about the consequences of the contract; and whether the plaintiff took advantage of any special disability held by the defendant.

Whether or not unfairness exists will depend upon an assessment of all the relevant circumstances. Where the facts do not clearly raise an equitable action, it is still possible for the court, in its absolute discretion, to refuse an award of specific performance on the basis of unfairness. Where a contract is particularly favourable to the plaintiff, or involves some sort of hardship to the defendant, and was entered into where the defendant does not have a complete understanding of the nature and consequences of the contract (or there is reasonable doubt of this), specific performance may be refused (see *Vivers v Tuck* (1963)).

The strongest situation barring the award of specific performance will occur where the plaintiff has knowingly contributed to the particular error in question. Where there is no actual knowledge of the error on the part of the plaintiff, specific performance will generally only be refused if it can be shown that the defendant would suffer a disproportionate hardship. Inadequacy or excess of consideration, *per se*, will not generally constitute a sufficient unfairness for a court to refuse specific performance. A court usually assumes that the amount of consideration is a private matter of negotiation which the parties are, *prima facie*, able to determine for themselves.

19.4.5 Hardship

Specific performance may be refused on the ground that it would cause hardship either to the defendant or to third parties. A refusal to award specific performance on the ground of hardship is very similar to the ground dealing with unfairness. Strictly speaking, however, the distinction between unfairness and hardship is one of perspective. Questions relating to unfairness are determined primarily by reference to the behaviour of the plaintiff, and questions of hardship are determined by reference to the consequences of the award upon the defendant or third parties.

Where it is alleged that specific performance should be refused on the ground of hardship, the defendant must establish that the detriment suffered will exceed that of the plaintiff if the award is refused. This is a question of balance. Attention should be given to the terms of the contract, the amount of consideration, and any alteration in circumstances which have occurred since the contract was entered into. The mere fact that circumstances have changed, making the contract less attractive to the defendant, will not be sufficient to establish hardship. It must be proven that specific enforcement of the contract would be oppressive to the defendant (see *Ready Construction Pty Ltd v Jenno* (1984) and *Doust v Hubbard* (1964)).

Hardship may be established where the award of specific performance would cause financial hardship to the defendant. Financial hardship will not be established just because the defendant is having trouble coming up with the purchase price. If the defendant has voluntarily entered into the contract and accepted the purchase price, then it will not constitute an unfair hardship

upon the defendant to enforce the contract. Where the consideration is excessive or the defendant, after making adequate attempts, is unable to obtain finance, the court may be prepared to hold that specific performance should be refused. Specific performance will not, however, be refused where the financial hardship is a direct result of the conduct of the defendant. For example, where the defendant has delayed obtaining requisite finance and, consequently, has to accept finance at a higher rate of interest, specific performance will not be refused.

Hardship is not restricted to financial considerations. A court may also refuse to grant specific performance on the grounds of non-financial hardship caused to the defendant. For example, specific performance may be refused where the award would give rise to difficult family litigation, where it would cause prejudice to beneficiaries under a trust, or where it would be contrary to public policy to award specific performance. It is also possible for hardship suffered by a third party to preclude the award of specific performance (see *Wroth v Tyler* (1974); *Colyton Investments Pty Ltd v McSorley* (1962); and *Hope v Walter* (1900)).

19.4.6 Uncertainty

Specific performance may be refused on the ground of contractual uncertainty. A court of equity will not award specific performance of a contract which is uncertain. Where it is difficult for a court to determine what must be done by the parties and what constitutes sufficient performance, a court will not award specific performance due to the burden it places upon the court and the hardship it may cause to the defendant (*Rampant v Jones* (1987)).

Difficult and ambiguous language in the actual terms of the contract will not constitute a bar to specific performance if the court can possibly construe and define the terms (*Tooth v Fleming* (1959)). However, where the exact meaning of a contract is open to doubt the court will generally refuse to enforce the contract. A contract may be uncertain for a variety of reasons. The actual meaning of the terms may be unclear or there may be ambiguity surrounding the nature of the contract as a whole. This can particularly occur where the agreement is oral in nature. In a situation where uncertainty arises because there is some variation between an actual oral agreement and the terms set out in a written agreement, specific performance will not usually be awarded.

19.5 Specific performance as additional or alternative relief

A plaintiff who has elected to sue for specific performance of a contract will not be precluded from later rescinding the contract and claiming damages. The enforcement of a contract in equity will not necessarily affect the availability of common law rights to a plaintiff. A plaintiff who has obtained an order for specific performance may, at a later stage, rescind the contract and

seek damages in equity. In this situation, however, leave of court will generally be required.

Even where the plaintiff has sought an award of specific performance under a current action, it is possible for the plaintiff to repudiate the contract and make an alternative claim for damages. A plaintiff may be entitled to damages where the court has made an order for the specific performance of a contract by the defendant, but circumstances later arise which are such as to make it inequitable that the order should be enforced (see *McKenna v Richey* (1950)). Damages in this situation will be awarded instead of the specific performance award.

On the other hand, damages may be awarded in addition to, or in substitution for, an order of specific performance. These damages are based upon the statutory provisions originally set out under the Chancery Amendment Act 1858 (UK) 19 and 22 Vic c 27 s 2, otherwise known as Lord Cairns' Act, and its State equivalents (see Chapter 22). In order for such damages to be awarded, it must first be established that the court has jurisdiction to make an award of specific performance. All that needs to be established are the jurisdictional requirements for an award of specific performance; discretionary considerations which may preclude a specific performance decree will not bar statutory damages (see *Norton v Angus* (1926)).

In some situations, injunctive relief may be available as an ancillary to an award of specific performance. For example, in a situation where an order for specific performance is sought, a plaintiff may claim injunctive relief to prevent a defendant from asserting legal rights before the specific performance claim is determined. Injunctive relief in these circumstances will generally only be granted where the plaintiff enters into an undertaking to observe the terms of the contract as its stands, and to pay damages if the enforcement of the award is refused.

CHAPTER 20

INJUNCTIONS

Unlike specific performance, injunctive relief usually takes the form of a court order compelling a party to refrain from doing a particular act. Injunctive relief is an inherent, equitable remedy, and is most commonly used to restrain breaches of equitable obligations or to assist in the enforcement of legal obligations. The form that an issued injunction takes will vary according to the circumstances; it can be interlocutory or final and can relate to legal rights as well as property interests. Injunctive relief will be subjected to the same kind of discretionary considerations as those examined in Chapter 19, including the fairness of the plaintiff, the effect upon the defendant, and the need for protection, clarification and certainty.

20.1 What is an injunction?

In essence, an injunction is an order issued to assist, clarify or determine legal proceedings. The power to grant injunctions stems from the inherent jurisdiction of the court of equity to grant equitable relief, and exists in two separate senses: the exclusive jurisdiction and the auxiliary jurisdiction. Under the exclusive jurisdiction, an injunction is awarded purely to assist the enforcement of an equitable obligation. Under the auxiliary jurisdiction, an injunction will be awarded to assist the enforcement of legal rights where it is determined that damages would be an inadequate remedy.

Injunctive relief will only be available when there is no adequate remedy at law and the plaintiff's rights have been infringed. Injunctive relief traditionally stemmed from the inherent power of the Courts of Chancery. A court of equity could grant injunctive relief, in its auxiliary jurisdiction, to protect against apprehended or continuing breaches of legal right. In its exclusive jurisdiction, a court of equity could grant injunctive relief to protect against any actual or continuing breach of equitable obligation.

The power to grant injunctive relief was conferred upon the common law by ss 79–81 of the Common Law Procedure Act 1854 (UK).[1] Under this power, the common law had the ability to grant injunctive relief to protect against a continuing legal wrong. The power did not enable the common law to impose an injunction against an apprehended legal wrong and, hence, did not confer a power on the common law to impose *quia timet* injunctions.[2] These problems

1 These provisions were copied in the Common Law Procedure Act 1857 (NSW).

2 See Meagher, RP, Gummow, WMC and Lehane, JRF, *Equity Doctrines and Remedies*, 1992, para 2,111.

have been resolved since the introduction of the Judicature system. As discussed in Chapter 3, under this system one court may administer both common law and equitable relief. Section 25(8) of the UK Judicature Act (and its equivalent Australian provisions)[3] conferred upon the newly merged administration the right to grant injunctive relief whenever 'just and convenient'. There has been some debate as to whether or not this provision alters powers formerly exercisable by the Common Law and Chancery Courts, or merely codifies the existing powers.[4] Whatever the conclusion, however, the fact remains that the traditional forms of injunctive relief have developed significantly within a merged jurisdiction.

Traditionally, it was necessary to prove that the plaintiff's proprietary rights had been infringed,[5] but today, infringement of any recognised legal or equitable right appears to be sufficient. In *National Australia Bank Ltd v Bond Brewing Holdings Ltd* (1991), Murphy J concluded that injunctive relief could be granted even though the action did not 'constitute a breach or infringement of any recognisable right in equity which might have entitled the appellants to monetary compensation'. Furthermore, the Mareva injunction and the Anton Piller order have significantly extended the traditional form of interlocutory injunctions by applying them to the assets of a defendant. Despite the apparent lack of jurisdiction for such injunctions, the courts have repeatedly approved of their validity where they are necessary to effect justice between the parties.[6]

A variety of different forms of injunctive relief have evolved within a merged jurisdiction. A brief examination of each follows.

20.2 Different types of injunctive relief

20.2.1 Common injunction

Prior to the introduction of the Judicature Acts, the common injunction was regularly used by courts of equity to prevent common law actions overwhelming equitable defences. As discussed above, Chapter 3, there was no longer a need for such relief following the introduction of a merged administration under the Judicature system. The Judicature system introduced reforms which now allow all divisions of a merged court to grant injunctive relief, whenever justice requires it.

3 Discussed above, Chapter 3.

4 See, *op cit*, Meagher, Gummow and Lehane, fn 2, para 2,113.

5 See *Cowell v Rosehill Racecourse Co Ltd* (1937).

6 The High Court has now endorsed the validity of these injunctions in *Jackson v Sterling Industries Ltd* (1987).

20.2.2 Mandatory injunction

An injunction will basically be either mandatory or prohibitive in nature. This means that it will either direct an individual to carry out, or restrain from carrying out, a certain act. The whole purpose of injunctive relief is to issue a direction; the direction may be aimed at the defendant personally or at property held by the defendant.

A mandatory injunction is a positive injunction; it is a positive order of the court compelling a party to perform (rather than restrain from performing) a particular act. There are two forms of mandatory injunctions: orders which are similar to a decree of specific performance in that they compel performance of legal obligations; and orders which are restorative in nature because they compel a defendant to undo the effects of a particular act committed in breach of a statutory provision or a contractual obligation. In order for a mandatory injunction to be issued, it must be proven that a clear probability of grave damage will occur to the applicant if such an injunction were not granted, and that, under such circumstances, damages would be inadequate. A mandatory injunction will not be available against a public authority or any body which is statutorily empowered.

In *Redland Bricks Ltd v Morris* (1970), the House of Lords held that mandatory injunctive relief would only be granted where the plaintiff could establish that serious damage would result without it. In making this assessment, the cost to the defendant of the work required must be balanced against the anticipated possible damage to be suffered by the plaintiff. The conduct of the defendant is relevant; if the defendant has acted without regard to the plaintiff's right, or has attempted to evade the jurisdiction of the court, a mandatory injunction may be issued even if the order is out of proportion to the damage done. On the other hand, if the defendant has acted reasonably, a more balanced assessment as to the appropriateness of such an order must be carried out.

Mandatory injunctions which compel the performance of contractual obligations must, as with the decree of specific performance, prove that the other party is ready, willing and able to perform the contract. In *Telstra Corp Ltd v First Netcom Pty Ltd* (1997), Telstra Corporation supplied telecommunication services to First Netcom. A dispute arose between the parties and First Netcom refused to pay the disputed accounts. Consequently, Telstra gave notice of its intention to discontinue the provision of the services, and to send a letter to First Netcom customers advising them of the termination of the supply of services and that they would need to choose a new telecommunications carrier. First, Netcom sought an injunction restraining Telstra from terminating the contract and from sending the letter to its customers. At first instance, it was held that the balance of convenience lay in granting the injunction as, otherwise, First Netcom was likely to go out of business. Telstra sought leave to appeal against that judgment, and argued

that First Netcom was not entitled to a mandatory injunction because it was not ready, willing and able to perform its side of the bargain. The Federal Court allowed the appeal in part, holding that First Netcom was not entitled to a mandatory injunction compelling Telstra to perform contractual obligations because it was not clear that First Netcom was financially able to continue with the contract, and the company had made no offer to pay for outstanding accounts. Lockart, Beaumont and Hill JJ noted that:

> ... where a person seeks an injunction to restrain the termination of an ongoing agreement, with the consequence that the party so enjoined is forced to continue to deal against his or her will, the party seeking the injunction will, *prima facie*, be required to pay to the party enjoined any moneys owing between them or, if there is dispute as to whether moneys are owing, to pay the amount in dispute into court, in addition to the normal as to damages.

Nevertheless, the court did uphold the mandatory injunction restraining Telstra from sending a letter to First Netcom customers informing them of the contractual termination, noting that such a letter was unnecessary and beyond the purpose of the agreement.

A mandatory injunction is also available under s 80(1) of the Trade Practices Act 1974 (Cth). In *Truth About Motorways Pty Ltd v Macquaries Infrastructure Investment Management Ltd* (2000), the court noted that the Federal Court could grant injunctive relief where, in the opinion of the court, it is desirable to do so (s 80(2)), and that the regime established by s 80 'differs in several respects from that applying to injunctions as traditionally understood. In particular, negative and mandatory injunctions may be granted whether or not it appears to the court that there is a continuing threat or an imminent danger of substantial damage and whether or not there has been a previous contravention'.

20.2.3 Prohibitory injunction: injunction to enforce a negative covenant

A common type of prohibitory injunction is the injunction issued to enforce a negative stipulation. Where a contract is entered into and, by the terms of the agreement, it is set out that one party will not perform a particular act, an injunction may be issued to enforce this stipulation. In *Ampol Petroleum Ltd v Mutton* (1952), the New South Wales Supreme Court (in Equity) held that an injunction was available to prevent the defendant breaching a contractual stipulation. The stipulation set out that the defendant was not to cease operating as a service station or sub-let the premises without the prior consent of the plaintiff. On the facts, it was held that a prohibitive injunction was the most appropriate remedy because it corresponded with what the parties had already agreed to. McLelland J held that where parties, for valuable consideration and with their eyes wide open, contract that a particular thing shall not be done, a court of equity may award an injunction to say what the parties have already said in the contract. The principle will apply even if the

contract is not completely capable of being enforced; it will apply to both express and implied contractual terms which are negative in nature.

Injunctive relief enforcing a negative stipulation in a contract for personal services will not always be available. In *Lumley v Wagner* (1852), an injunction was awarded to enforce a negative stipulation preventing a singer from singing at any other theatre for the three month duration of her contract. Stamp J, in *Page One Records Ltd v Britton* (1967), distinguished the decision in *Lumley* and refused to award an injunction enforcing a negative stipulation which prevented the pop group The Troggs from terminating contracts under which they had employed a manager for five years and a publisher for three. Stamp J held that the contract was for personal services and was not capable of being specifically enforced and, therefore, injunctive relief should be refused. The decision in *Lumley* was distinguished because it was held that, on the facts, the obligation of the plaintiff was to pay the singer money, and that this was more readily capable of being enforced than the obligations of trust and confidence imposed upon the manager and publisher.

20.2.4 Ex parte/inter partes *injunctions*

Where an injunction is granted to one party in the absence of another or to an interested person who is not a party, the injunction will be *ex parte*. These injunctions should be distinguished from *inter partes* injunctions, which are granted after both parties have been heard. An applicant for an *ex parte* injunction must make full disclosure of the material facts and issues involved; the court has a discretion to determine whether such relief is necessary taking into account the urgency of the situation and the circumstances of both parties. Such injunctive relief will only operate against a defendant for a limited period of time prior to litigation being instituted. Most *ex parte* injunctions are interim orders, whereby an applicant is seeking to preserve the status quo up until a full interlocutory injunction can be heard. Hence, an *ex parte* application for an interim injunction will usually exist for a specified period, up to the hearing of the interlocutory injunction. An undertaking for damages should usually be given by the plaintiff to ensure that any loss suffered by the defendant will be compensated for (see *National Australia Bank Ltd v Bond Brewing Holdings Ltd* (1991)).

20.2.5 Quia timet *injunctions*

Quia timet injunctions are injunctions against apprehended (as opposed to actual) wrongs. These injunctions are issued in order to prevent a wrong from being carried out, rather than to prohibit a wrong from continuing. *Quia timet* injunctions can be interlocutory, final, *ex parte*, *inter parte*, mandatory or prohibitory in nature. The defining characteristic of these injunctions lies in their timing; they are issued prior to any actual interference, on evidence that

an applicant's interests are in impending danger. Before a *quia timet* injunction will be issued, the defendant must demonstrate clearly that the wrongful behaviour carried out by the defendant is about to be exercised against the applicant or the applicant's interests. A causative link must be established. This requires the applicant to prove the reasonableness of such an apprehension; the mere fear of the possibility of danger will be insufficient to warrant the issue of such injunctive relief.[7]

In *Magic Menu Systems Pty Ltd v AFA Facilitation Pty Ltd* (1997), Lockart, Cooper and Kiefel JJ, in the Federal Court, noted that there is no fixed or absolute standard of proof which is to be required before injunctions *quia timet*, to prevent apprehended damage, might issue. However, their Honours felt that, if no damage has occurred by the time the matter comes on for hearing, it makes it very difficult to establish, as a matter of evidence, that there is a sufficient risk of a future injury to justify the immediate grant of injunctive relief.[8]

20.2.6 Interlocutory injunctions

An interlocutory injunction is an order used to preserve the status quo between parties involved in litigation, pending the final determination of the case. An interlocutory injunction must be sought before all the evidence has been presented and the issues raised in court; this means that the interlocutory injunction may be granted to an applicant without the benefit of a full hearing. An interlocutory injunction may be issued *ex parte* or *inter partes*, and it may be mandatory or prohibitory in nature.

The main difficulty associated with the granting of interlocutory injunctions lies in the fact that the applicant may turn out to have no legal right upon which such an injunction may be based; relief is conferred on the assumption that an enforceable right exists. However, this may turn out to be incorrect once a final determination has been reached.

There are two basic requirements which must be established before a court will grant an interlocutory injunction. The first is that there must be a serious question to be tried. This means that an applicant must prove that a significant legal question has arisen and needs to be determined, and that the applicant has a serious and not merely superficial interest in this matter. The second requirement is that the interlocutory injunction be granted after a determination of the balance of convenience. This brings the equitable discretion into operation. A court must engage in the rather difficult task of weighing up the associated risks and benefits of granting interlocutory relief.

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7 See *Commonwealth v Progress Advertising and Press Agency Co Pty Ltd* (1910).

8 *Hooper v Rogers* [1975] 1 Ch 43; *Copyright Agency Ltd v Haines* [1982] 1 NSWLR 182; (1982) 40 ALR 264.

In performing this balancing process, a court will generally take into account the availability of alternative relief. A court must consider whether, upon succeeding in the determination, a plaintiff would be more adequately compensated by an award of damages rather than injunctive relief. This is not an easy assessment, because it is difficult to determine the appropriate form of remedy for a right which does not yet exist. If it can be proven that the applicant is under a risk of irreparable damage to his or her interests, then injunctive relief will generally be regarded as more appropriate than damages. Nevertheless, the situation is somewhat unclear, particularly where both injunctive relief and damages are available; it is often too difficult to make an accurate judgment on these matters at such an early stage in proceedings.

One way of reducing this problem is to incorporate the 'adequacy of damages' assessment into the overall 'balance of convenience' assessment. In *Beecham Group Ltd v Bristol Laboratories Pty Ltd* (1968), the High Court pointed out that the approach to be taken is whether the inconvenience or injury which a plaintiff may suffer if the injunction were refused outweighs the injury which may be suffered by the defendant if the injunction were granted, and it is proven to be granted incorrectly. The adequacy of damages is one of the considerations to be taken into account in this balancing process.[9]

As with the award of specific performance, assessing the adequacy of damages when awarding injunctive relief is becoming an increasingly flexible process. Courts are starting with the question: what is the most suitable and just form of relief? The adequacy of damages is only one factor to take into account in this regard.[10] If the circumstances prove that injunctive relief is likely to be the most appropriate form of relief, capable of preventing further harm or damage, it should be granted. The need for lengthy explanations concerning adequacy of damage and irreparable injury is diminishing.

Wherever an interlocutory injunction is sought, a court will generally require the applicant to enter into an undertaking to reimburse the defendant for any damages arising from an improper order. The undertaking functions as a protection mechanism for the defendant, in the event that the injunction turns out to be wrongful and injurious. It also operates as a filtering process; applicants seriously concerned about their interests will be more likely to enter into an undertaking as to damages, protecting the court against improper and ill-considered applications.

9 Cf the decision in *American Cyanamid Co v Ethicon Ltd* (1975), where the House of Lords held that determining the adequacy of damages was a jurisdictional requirement to the relief being granted.

10 See *Mayfair Trading Co Pty Ltd v Dreyer* (1958), *per* Dixon CJ; *State Transport Authority v Apex Quarries Ltd* (1988); Gerwitz, J, 'Remedies and resistance' (1983) 92 Yale LJ 585; Tilbury, M, *Civil Remedies*, 1990, Vol 1, para 6,054; Hammond, G, *Remedies: Issues and Perspectives*, 1991.

The fact that an applicant has not entered into an undertaking for damages will not necessarily preclude a court from granting interlocutory relief.[11] An undertaking as to damages remains a discretionary consideration. Nevertheless, it is an important consideration, particularly in situations where there is some risk that injunctive relief will cause damage to the defendant's interests. If an applicant does not enter into an undertaking for damages and the injunctive relief turns out to be incorrect and injurious, the court has no power to award damages for the harm suffered by the defendant.[12] Damages can only be awarded where an undertaking is entered into because, in such a situation, the applicant has agreed to damages as a condition to interlocutory relief being awarded. Where an undertaking is not obtained there is no such agreement, and an applicant cannot be blamed for what is ultimately the court's decision to confer such relief.

Other discretionary factors relevant to the award of an interlocutory injunction include: public interest in granting interlocutory relief; the effect of such relief upon third party interests; and the character of the injunction being sought. A court will be very cautious in granting interlocutory 'mandatory' relief. Whilst, traditionally, the test for such injunctions was a 'high degree of assurance', this test has been subject to some reassessment. In *Films Rover International Ltd v Cannon Film Sales Ltd* (1986), Hoffman J pointed out that the danger with interlocutory 'mandatory' injunctions is the risk that the court will make an incorrect decision and grant an injunction to a party which fails to establish a right at the trial. In order to reduce this possibility, it is important that a court, in issuing such relief, follows this rule: if it appears to the court that, exceptionally, the case is one in which withholding an interlocutory mandatory injunction would, in fact, carry a greater risk of injustice than granting it, even though the court does not feel a high degree of assurance about the plaintiff's chances of establishing his or her right, the injunction should be issued.

20.2.7 Interim injunction

The interim injunction is a form of interlocutory injunction. As interlocutory injunctions, they are granted before the court has heard all of the evidence and made any determination on the matter. The interim injunctions serve the same purpose as interlocutory injunctions. However, they may last for a different duration. The interlocutory injunction will only last until the date of the hearing; the interim injunction will last until the date specified in the application. The date specified may be the date of the hearing or it may be some future date.

11 See *National Australia Bank v Bond Brewing Holdings Ltd* (1991).

12 *Ibid, per* Murphy J.

In *Patrick Stevedores Operations v Maritime Union of Australia* (1998), the High Court reviewed the judicial discretion to award interlocutory relief in the context of industrial disputes. On the facts, the workers at the Patrick Group feared that it intended to dismiss its unionised workforce and replace it with non-union labour. On 6 April 1998, the Maritime Union obtained interlocutory injunctions restraining the Patrick Group from dismissing its employees. On 8 April 1998, the Patrick Group advised the Federal Court that administrators had been appointed to the employers and that the administrators intended to dismiss the employees. The Maritime Union then alleged that the applicants had breached s 298K of the Workplace Relations Act 1996 (Cth) and that there had been a conspiracy to dismiss the union workforce in breach of the Act. Orders were sought that the employees be retained to do the work they had done up to 7 April 1998. The final orders sought by the Maritime Union included orders to undo the reorganisation of the Patrick Group and return the stevedoring businesses and assets to the employers.

The Federal Court found that there was a serious question to be tried: that the various companies in the Patrick Group were in breach of s 298K of the Act and that the balance of convenience lay in granting interlocutory orders preserving the position that existed prior to 7 April 1998. Orders were, therefore, made against the employers and operators restraining them from giving effect to the purported termination of the unionised workforce. An appeal to the Full Court of the Federal Court by the Patrick Group was dismissed. The Patrick Group then sought leave to appeal to the High Court. The High Court allowed the appeal in part, holding, *per* Brennan CJ, McHugh, Gummow, Kirby and Hayne JJ, Callinan J dissenting, that once jurisdiction conferred under s 23 of the Federal Court of Australia Act 1976 (Cth) is invoked, the court has power to make such interlocutory orders as it thinks appropriate, and orders may be made against persons other than the person who has engaged in the conduct. Hence, the Federal Court had the power to issue interlocutory relief preventing irredeemable prejudice or damage to the employees pending the trial of the action. The central difficulty with the orders made by the Federal Court was that they inappropriately interfered with the discretions of the administrators. The orders were, therefore, modified so as to be without prejudice to the powers of the administrators during the period in which the employers were under administration. During the course of their judgment, the majority noted that courts of equity must not only consider the rights of the plaintiffs, but also the rights of third parties, and that a court will not 'ordinarily' grant interlocutory injunctive relief where it causes hardship or disadvantage to third persons or to the public generally.

20.2.8 Mareva order

A Mareva order is a form of interlocutory injunction which is issued with the specific aim of preserving assets so that the integrity of the court process can

be protected. Generally, creditors cannot stop debtors from dealing with the assets, even pending litigation, and the Mareva order is best regarded as a special exception to this principle, made against the defendant personally to restrain that person from dealing with any assets under their control and, in particular, prevent them from removing those assets from the reach of the plaintiff, so as to render a judgment pointless. The remedy was initially directed against foreign defendants with assets within the jurisdiction; however, it now has a more general application as noted by Deane J, in *Jackson v Sterling Industries Ltd* (1987), p 623:

> … it should now be accepted in this country that a Mareva order can be granted … if the circumstances are such that there is a danger of the defendant's absconding, a danger of the assets being removed out of the jurisdiction or disposed of within the jurisdiction, or otherwise dealt with so that there is a danger that the plaintiff, if he gets judgment, will not be able to get it satisfied.

The order was first propounded by Lord Denning MR, presiding over the court in *Nippon Yusen Kaisha v Karageorgis* (1975), and takes its name from the subsequent decision of that court in *Mareva Compania Naviera SA v International Bulk Carriers SA (The Mareva)* (1980).

Given the significant effect that a Mareva order has upon the assets of a defendant, it is not granted lightly and consideration should be given to other less extensive forms of interlocutory relief as a possible alternative; where it is found that a Mareva order should be issued, the order can be flexibly applied; a Mareva order can be issued at whatever stage of court proceedings best suits the individual case. In *Pelechowski v Registrar, Court of Appeal* (1999), the High Court noted that the common law world now clearly accepts a jurisdiction to issue Mareva-type orders preserving or protecting assets even after judgment in an action has been given.

In order to obtain a Mareva order, the plaintiff must satisfy the court that the plaintiff has a vested and accrued cause of action against the defendant, that no other more suitable interlocutory remedy is available, that a danger exists of a successful judgment for the plaintiff being thwarted by the defendant absconding or removing assets from the jurisdiction, and that the balance of convenience favours the granting of relief. In assessing the balance of convenience, the court will consider whether the potential damage to the plaintiff of being unable to satisfy a successful judgment outweighs the inconvenience to the defendant of the Mareva order: *Pearce v Waterhouse* (1986), p 607, *per* Vincent J.

A particularly important consideration is the issue of whether third parties, unconcerned with the case proceedings, can have their assets restrained by a Mareva injunction. In *Cardile v LED Builders Pty Ltd* (1999), the High Court concluded that a Mareva order may be issued against a third party who is not a party to court proceedings in order to protect the integrity of those proceedings. However, courts must exercise a 'high degree of caution'

when deciding whether to make such an order, and it should not be properly granted without an undertaking as to damages.

In Australia, the power to grant a Mareva order arises from both statute and the inherent function of the court. The fundamental source of jurisdiction for the Mareva order is the court's inherent jurisdiction to prevent abuse of its own process. In this respect, the Mareva order is now accepted as an 'established part of the armoury of a court of law and equity to prevent the abuse or frustration of its process'.[13] The Federal Court's power to grant a Mareva order derives from s 23 of the Federal Court of Australia Act 1976 (Cth), which allows the court to make 'orders of such kinds, including interlocutory orders, and to issue or direct the issue of writs of such kinds, as the Court thinks appropriate'. Similar statutory powers exist in most States.[14]

20.2.9 Anton Piller order

An Anton Piller order is an *ex parte*, interlocutory injunction compelling the defendant to allow the plaintiff to inspect its property and premises. This type of injunction is similar to the Mareva injunction, except that it is positive in nature and aims to enforce a property inspection rather than preventing a defendant from dealing with property. The injunction arose from the decision of the English Court of Appeal in *Anton Piller KG v Manufacturing Processes Ltd* (1976). Anton Piller orders are extremely useful where the character or amount of property is a matter in issue. Such an order will have the effect of safeguarding documentary evidence which is relevant to a particular determination (*Bankers Trust Co v Shapira* (1980)), or determining whether or not property is identifiable and in existence.

Despite the utility of the Anton Piller order, particularly where it is issued along with the Mareva injunction, courts must exercise caution when ordering these injunctions. Both injunctions are directed against property and both are interlocutory in nature. These factors greatly enhance the possibility of an abuse. A court may effectively freeze the assets of one individual whilst conferring full disclosure and access to those assets upon another, who may prove not to have any legal right at all. Naturally, the desire to prevent this type of situation arising has meant that courts will generally be very cautious in granting an order. In *Long v Specifier Publications Pty Ltd* (1998), Powell JA, in the New South Wales Court of Appeal, reviewed the nature, scope and purpose of the order, stating that, essentially:

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13 *Jackson v Sterling Industries Ltd* (1987) 162 CLR 612, which was subsequently approved by the Australian High Court in *Pelechowski v Registrar* (1999) 73 ALJR 687.

14 Supreme Court Act 1933 (ACT), s 34; Supreme Court Act 1970 (NSW), s 23. The District Court of New South Wales has jurisdiction under the District Court Act 1973 (NSW), s 46; Supreme Court Act 1979 (NT), s 69; Judicature Act 1876 (Qld), s 5(8); Supreme Court Act 1935 (SA), s 29(1); Supreme Court Civil Procedure Act 1932 (Tas), s 11(12); and Supreme Court Act 1986 (Vic), s 37(3).

> ... the Anton Piller order is an order that the defendant to whom, or to which, it is directed, should permit the persons specified in the order to enter upon his, or its premises, and to inspect, take copies of, and to remove, specified material, or classes of material, indicating, where appropriate, documents, articles or other forms of property. It is an extraordinary remedy designed to obtain, and to preserve, vital evidence pending the final determination of the plaintiff's claim in the proceedings, in a case in which it can be shown that there is a high risk that, if forewarned, the defendant, would destroy, or hide, the evidence or cause it to be removed from the jurisdiction of the court. For this reason, such orders are invariably made *ex parte.*

Powell JA went on to suggest that, in order to ensure adequate safeguards in the implementation of Anton Piller orders, judges should hold that the order be supervised by an experienced solicitor not working for the plaintiff, and that the solicitor should prepare a written report outlining the events that occurred when the order was executed, and that this report should be presented to both parties.

DECLARATIONS

21.1 The nature of declaratory relief

A declaration is a conclusive statement by a court of equity concerning the rights of a party or parties in a particular case. A declaration is not an order or a direction to any party personally, but rather a general proclamation of the existing legal status of the parties. Historically, the equity jurisdiction always had the power to grant declaratory relief in support of a legal right. It was not until the introduction of the Judicature Acts, however, that a more generalised right to declaratory relief was introduced. Today, the right to grant declaratory relief is entirely founded upon statute.[1]

21.2 The power to grant declaratory relief

Today, courts are prepared to issue declaratory relief wherever a clear necessity can be proven. A declaration does not alter the rights between the parties; it merely states them. The parties are then left to organise these rights. The procedure is extremely appropriate for complex actions where there is some confusion as to the exact nature of the rights between the parties. In an increasingly complex commercial environment, declarations have become a very useful device, and the only real limitation is the discretion of the court itself.[2] Declarations are particularly useful in actions against the Crown. The non-coercive character of the declaration means that it can readily pronounce legal issues *inter partes* without interfering with Crown rights and privileges.[3]

The sort of discretionary factors which a court will take into account include: a determination of whether or not a person has a real interest in the particular case; the legality of the issue involved; the practical need for a determination on the issue; the complexity of the matter at hand; and the availability of another, more convenient manner of determination.[4] In *Forster v Jododex* (1972), the High Court held that declaratory relief was available on the facts, even though the plaintiff could also avail itself of the provisions of the Mining Act 1906 (NSW), which conferred power on the Warden of Mining to

1 See Supreme Court Act 1935 (WA), s 25(6); Supreme Court Act 1986 (Vic), s 36; Rules of the Supreme Court (Tas) Ord 28 r 5; Supreme Court Rules (Qld) Ord 4 r 5; Supreme Court Act 1935 (SA), s 31; Supreme Court Act 1979 (NT), s 18; Supreme Court Act 1970 (NSW), s 75; Supreme Court Rules (ACT) Ord 29; Federal Court of Australia Act 1976 (Cth), s 21; High Court Rules (Cth) Ord 26 r 19.

2 See the comments of Gibbs J in *Forster v Jododex Australia Pty Ltd* (1972).

3 See *FAI Insurance v Winneke* (1982).

4 See *Ainsworth v Criminal Justice Commission* (1992).

deal with any disputes. The court felt that, as a matter of legislative interpretation, the Act did not intend to oust the rights of the court in granting declaratory relief over these disputes. Furthermore, where the issues involve important questions of construction, declaratory relief can be very important.

21.3 Limitations upon the award of declaratory relief

The only situation where declaratory relief will be truly excluded is where the legislation intended to confer exclusive rights of determination upon a specialised body. Apart from these situations, the court has a very broad discretion.

A court may have the power to issue declaratory relief, but decide to refuse it where a plaintiff has no real interest in the legal outcome of the matter. Usually, this means a plaintiff must prove that some sort of business, financial or property right will be affected before declaratory relief will be granted (see *Australian Conservation Foundation Inc v Commonwealth* (1980), where the High Court held that a more flexible test will apply, and the plaintiff must prove a special interest in the outcome, over and above a mere emotional or intellectual interest). However, the matter will ultimately be at the discretion of the court.

Furthermore, a declaration will only be granted where it will be of some practical value. A court will not go to the trouble of making a detailed determination on a matter where the issue has no relevance, or it has become of no relevance. A court will not issue declaratory relief where the declaration relates to a hypothetical, theoretical or academic question: *Hommersley Iron Pty Ltd v National Competition Council* (1999). As the remedy is discretionary, considerations including the conduct of the plaintiff and the overall fairness of the circumstances may be taken into account by the court.[5] It should be remembered, however, that the power to award declaratory relief is now based in statute, and whilst it originated in equity, traditional equitable defences will now simply form a part of the court's overall statutory discretion. Nevertheless, the jurisdiction of a superior court to grant declaratory relief is only excluded by clear and express language; in *Philips Electronics NV v Remington Products Australia Pty Ltd* (1997), the court held that it did have jurisdiction to grant declaratory relief, under the Trade Marks Act 1995 (Cth), that a pending trademark was not registrable, although it will rarely exercise such jurisdiction.[6]

5 See *Salmar Holdings Pty Ltd v Hornsby Shire Council* (1971).

6 See, also, *Telstra Corp Ltd v Australian Telecommunications Authority* (1995) 133 ALR 417.

CHAPTER 22

PECUNIARY RELIEF IN EQUITY

Damages are, strictly speaking, a common law remedy, and equity has no inherent jurisdiction to grant such relief. Nevertheless, the equitable jurisdiction does have the power to issue pecuniary awards. These awards vary in form, but include: equitable compensation, Lord Cairns' Act (statutory) damages, and an account of profits. The type of award issued will depend upon the circumstances and the nature of the obligation in issue.

Pecuniary relief in equity, for example, is traditionally directed at redressing the particular unfairness raised; for example, equitable compensation seeks to place the parties in the position they occupied prior to the inequitable conduct having occurred, and an account of profit allows an applicant to disgorge the profit arising from the breach of equitable obligation. Lord Cairns' Act damages are a statutory award. Prior to any damages award being granted, it must be proven that the award is either in addition to, or in substitution for, injunctive relief or specific performance. Proof of the availability of equitable relief must be established before any damages award can be issued.

As already noted, the dividing line between legal and equitable remedies is becoming increasingly blurred. With the developing interaction between legal and equitable principles, the strict demarcation between legal and equitable remedies is diminishing. This is particularly evident in the increasingly interactive association between damages under common law and equitable compensation. Traditionally, as a purely equitable remedy, common law principles and approaches were irrelevant to equitable compensation. Today, however, courts are increasingly drawing guidance and analogy from common law principles in the application of equitable compensation. There are a number of possible reasons for this.

In the first place, there is a general movement away from a strict adherence to jurisdictional form. If a particular approach seems to fit well with the development of a right or remedy, the courts are increasingly reluctant to dismiss it purely on jurisdictional grounds.

Secondly, the emergence of fusion-based discussions has encouraged courts to analyse doctrinal and remedial developments in a less constrained fashion. Jurisdictional interaction and communication is becoming a more accepted feature within contemporary courts, encouraging a reassessment of doctrinal and remedial principles. This is particularly evident in the recent

phenomenon of courts applying common law damages methodology and assessment to equitable compensation awards (see below, 22.1.3, for a further discussion).

22.1 Equitable compensation

A court of equity has an inherent jurisdiction to issue an award of compensation for a breach of equitable obligation. Compensation is usually issued for loss caused by a breaching trustee or other fiduciary (*Nocton v Lord Ashburton* (1914)). The primary object of equitable compensation is to place the party in the position in which he would have been had the breach not occurred. Compensation originated from the liability of a trustee to 'make good' all losses to the trust estate; in this regard, compensation aims for restitution.

22.1.1 Equitable compensation is absolute

The approach taken by courts to the assessment of equitable compensation is set out in *Re Dawson* (1966). On the facts of that case, Percy Dawson was one of the trustees and a beneficiary of his father's estate. Dawson improperly paid over trust moneys, in New Zealand pounds, from a trust fund to an agent who absconded with it. At this time, New Zealand and Australian pounds were in parity. According to fiduciary principles, Dawson was under a duty to make good the loss; however, he did not. After Dawson died, the other trustees purported to withhold from Dawson's share of his father's estate, an amount sufficient to cover the loss plus interest. It was held that equitable compensation was payable. At the date of the trial, the New Zealand pound was worth more than the Australian pound. The primary issue in the case was whether or not damages could be assessed at the date of the trial, so that the currency increases could be taken into account.

Street J held that the obligation to compensate for loss in equity is a personal obligation and its extent is not to be limited by common law principles governing remoteness of damage. If a fiduciary has been guilty of loss, their obligation to effect restitution is an absolute one. If they have already been guilty of negligence, they must be responsible for any loss in any way to that property. In equity, as opposed to common law, the form of relief is couched in terms appropriate to require the defaulting trustee to restore to the estate the assets of which he deprived it. This will naturally include increases in market values between the date of breach and the date of recoupment. Hence, the obligation is a continuing one and ordinarily, if the assets are for some reason not restored, it will fall for quantification at the date when recoupment is to be effected, and not before. On the facts of this case, that meant that the defendant was entitled to require the plaintiff to make good £4,700 which, at the time of the case, was worth £5,829.

The broad ambit of the equitable remedy was alluded to by Rogers J in *Catt v Marac Australia Ltd* (1986), where he found that the 'reach of this beneficial equitable remedy is not restricted' purely to situations where there has been a rescission of the transaction and a subsequent loss can be shown. It has an extremely broad application, and may cover both pecuniary and non-pecuniary losses. For example, a court of equity may decide that an applicant will be better compensated by a mandatory order compelling the defendant to transfer an asset, rather than requiring an actual sum of money to be paid.

Despite the breadth of the equitable compensation award, it will generally not cover the plaintiff's expectation loss. The reason for this is that loss of expectation is considered to be too far removed from the actual breach. In *Wav v McDonald* (1992), it was held that compensation for a breach of fiduciary duty flowing from non-disclosure of material facts did not include speculation as to what course would have been taken if disclosure had occurred. In *Commonwealth v Verwayen* (1990), Mason CJ concluded that a compensatory reward was available to enforce a substantive estoppel action; however, it would be restricted to loss suffered as a direct result of relying upon the assumption. Deane J, on the other hand, felt that the usual remedy for estoppel would be to hold the party to the representation and thereby issue compensation based upon the expectation raised.[1]

22.1.2 The scope of equitable compensation

Equitable compensation will usually be awarded against a breaching fiduciary. Outside of these situations, compensation will only be awarded where equitable fraud can be clearly proven. Compensation may be available in an estoppel action; however, there is divergence of opinion as to its scope and effect (see above discussion). Equitable compensation is also subject to the broad discretion of the court so that factors including conscience, fairness, hardship, laches and acquiescence can all be taken into consideration when issuing the award.

The availability of equitable compensation for a breach of fiduciary obligation is clearly illustrated in *McKenzie v McDonald* (1927). On the facts of that case (see also Chapter 8), it was held that an estate agent was in breach of his fiduciary duties and equitable compensation was payable. Rescission was impossible because the defendant had already sold the farm to third parties. The defendant, in effect, had paid £2,250 for the farm, a sum which was too great when the true value was taken into account. The court ordered the defendant to pay the plaintiff compensation for the undervaluation of the farm; compensation was awarded on the difference between the market value of the farm at the time of purchase by the third party and the lower price paid

1 See *Commonwealth v Verwayen* (1990), pp 413, 441–42. The opinion of Deane J has been approved by Marks J, in *Commonwealth of Australia v Clark* (1994).

by the defendant. The court also ordered the plaintiff to pay compensation for the overvaluation of the suburban shop and dwelling.

22.1.3 The distinction between equitable compensation and common law damages

The distinction between compensation in equity and damages at law is said to be based upon the fact that the obligation to restore the loss in equity is absolute; the full amount of the deprivation must be restored irrespective of whether or not there have been increases in market value between the date of the breach and the date of recoupment. Under common law, damages will be awarded where a breach of a legal right can be proven. However, the award is not as absolute as equity; causation, remoteness of damage, foreseeability of loss, and other mitigating factors will all be relevant to common law and may result in a more reduced award. In this sense, unlike the traditional approach of equity, the common law award is not as categorical (*Hill v Rose* (1990)).

Both common law and equity have 'compensatory' aims in awarding relief. However, the focus in each is slightly different. The compensatory objective is stricter in equity because the emphasis is exclusively upon restoring all the loss flowing from the breach of obligation. The approach of the common law is not as strict or personal; an award of damages at common law aims to compensate for loss, but only that loss which directly flows from the legal breach.

These traditional distinctions are, however, diminishing. Professor Tilbury notes that the time has come where 'any general distinctions between compensation and damages can only be justified by reference to the discretionary nature of equitable relief'.[2] This argument has some weight, considering the fact that common law mitigating factors are becoming increasingly influential in the assessment of equitable compensation.

Ian Davidson makes the following comments:[3]

> The greater flexibility now available with damages at law, especially the increased willingness of courts not to apply the general rule of assessing damages at the date of breach, will make it more likely that restitution in equity (equitable compensation) will give the same result as damages.

This interaction between common law damages and equitable compensation has been explored in a number of decisions, the most recent being the House of Lords in *Target Holdings Ltd v Redferns* (1995). In delivering the leading judgment, Lord Browne-Wilkinson held that the rules concerning causation and quantification of loss differ in form between common law and equity, but the essential principles underlying both systems are the same.

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2 Tilbury, M, *Civil Remedies*, 1990, para 3249.

3 'The equitable remedy of compensation' (1982) 13 MULR 349.

The facts of the case involved an appeal by a firm of solicitors against a finding that they were liable for the full amount of loss flowing from conduct relating to mortgage moneys which their client, a finance company, had paid to them. The House of Lords, in upholding the appeal, held, *inter alia*, that the finance company had not shown that it was entitled to any compensation as it had obtained exactly what it would have acquired had no breach of trust occurred, that is, a valid security for the sum advanced.

Lord Browne-Wilkinson made the following comments:

> 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 the 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 as to causation and the quantification of loss differ, at least ostensibly, from those applicable to common law. But the principles underlying both systems are the same.[4]

His Honour felt that equity should be expanded by a 'common sense' approach to loss assessment rather than the precise adoption of the common law methodology.[5] In order to achieve the compensation equity truly intended, only a loss which has, in fact, been suffered by the beneficiaries and which, using hindsight and common sense, can be seen to have been caused by the breach, should be recoverable. An equitable compensation award made under this approach will, at least in substance, be very similar to a common law award.

In *Day v Mead* (1987), the New Zealand Court of Appeal reduced an award of equitable compensation by applying the common law defence of contributory negligence. Cooke P held that the difference between common law damages and equitable compensation is often without distinction, and the discretionary approach of equity enables it to incorporate contributory negligence considerations, particularly as law and equity are now interacting[6] (see also above, Chapter 3).

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4 *Op cit,* Davidson, fn 3, p 359.

5 *Op cit,* Davidson, fn 3, pp 364–65.

6 See, also, *Mouat v Clark Boyce* (1992); *New Zealand Land Development Co Ltd v Porter* (1991). See, especially, *Duke Group Ltd (In Liq) v Pilmer* (1999) 17 ACLC 1329, p 1475, where the Full Court of the South Australian Supreme Court noted that a consideration of 'contributory behaviour' is 'consistent with the application of appropriate discretionary principles which equity embraces in the awarding of compensation'.

The relevance of remoteness principles to an award of equitable compensation was discussed by the Canadian Supreme Court in *Canson Enterprises Ltd v Boughton* (1991) (see also 3.8). On the facts of that case, the defendant solicitor was held to be in breach of his fiduciary duties because he failed to disclose to the plaintiff purchaser a secret profit which had been made by an intermediate vendor.

La Forest J held that equity should not be rigidly applied:

> Its doctrines must be attuned to different circumstances. Quite obviously, not all fiduciary obligations are the same. It would be wholly inappropriate to interpret equitable doctrines so technically as to displace common law rules that achieve substantial justice in areas of common concern thereby leading to harsh and inequitable results.

Accordingly, he felt that remoteness of damage was a relevant consideration for equitable compensation. McLachlin J, in dissent, however, felt that foreseeability of loss is not a concern in the assessment of equitable compensation. Equitable compensation should not be mitigated by common law principles such as causation or foreseeability, although losses flowing from clearly unreasonable behaviour should be accounted for.[7] In *Everist v McEvedy* (1996), the New Zealand High Court concluded that the current position in New Zealand is that to succeed in a claim for equitable compensation arising out of a breach of fiduciary duty, the plaintiff must establish three things: first, that the defendant owed the plaintiff a fiduciary duty; secondly, that the defendant was in breach of that duty; and, thirdly, that the plaintiff has suffered a loss arising out of a transaction or circumstance to which the breach was material.

In *Maguire v Makaronis* (1997), the High Court of Australia approved the Canadian decision of *Brickenden v London Loan & Savings Co* (1934), which held that breaching fiduciaries should be liable for all consequential loss resulting from the breach, irrespective of causation issues. In a joint judgment, Brennan CJ, Gaudron, McHugh and Gummow JJ upheld the underlying policy of the *Brickenden* principle in order to ensure that the fiduciary standard was not diluted. The court stated that, following the *Brickenden* principle, it must be established that the loss is in some way 'connected' to the breach, and that compensation will not be available if the loss would have occurred anyway. In affirming the validity of the *Brickenden* principle, the Australian High Court has reinforced the equitable foundation of compensation for loss flowing from a breach of fiduciary duty, thereby ensuring that it retains a distinctively equitable character, particularly when compared to common law damages.[8]

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7 Lord Browne-Wilkinson, on behalf of the majority in *Target v Redferns* (1995), approved of the dissent by McLachlin J in *Canson Enterprises*.

8 See Heydon, 'Causal relationships between a fiduciary's default and the principal's loss' (1994) 110 LQR 328. See, also, the discussion of *Maguire v Makaronis*, above, 8.8 of this text.

English courts have not followed this approach. In *Swindle v Harrison* (1997), the English Court of Appeal rejected the *Brickenden* principle and noted that, whilst equitable compensation was not damages, 'it is still necessary for the defendant to show that the loss suffered has been caused by the relevant breach of fiduciary duty. Liability is not unlimited. There is no equitable by-pass of the need to establish causation' (pp 733–35).

22.2 Equitable Lord Cairns' Act damages

22.2.1 The requirements of the award

Since 1858, equity has had a limited statutory right to grant 'such damages as the court shall direct' in addition to, or in substitution for, specific performance or injunctive relief; this was expressly set out in s 2 of the Chancery Amendment Act 1858 (Imp) (Lord Cairns' Act) currently embodied in s 38 of the Supreme Court Act 1986 (Vic).[9]

This provision reads as follows:

> 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, an injunction or specific performance.

The Act endows equity with an additional statutory power to issue an award of damages. An award of statutory equitable damages can only be made 'in addition to, or in substitution for, an injunction or specific performance'. Proving the availability of such relief in the first instance is a jurisdictional requirement. Statutory damages are then awarded, either as a more preferable remedy or as an additional one.

The need to prove the availability of specific performance or injunctive relief has proven a severe limitation to the application of statutory damages, although it is not necessary to prove categorically that equitable relief will be granted. As long as the basic jurisdictional right to the equitable remedies can be established, there is no need to further prove that the remedies would not have been excluded at the discretion of the court (*Ferguson v Wilson* (1866), Cairns LJ).

22.2.2 The scope of equitable damages

Equitable damages under Lord Cairns' Act will generally be assessed in the same manner as those available under common law. There are, however, a number of variations. In the first place, as with equitable compensation, equitable damages are subject to the general equitable discretion which has allowed relief to be assessed at the date of the action. This is particularly true where the equitable

9 In NSW, it is set out in the Supreme Court Act (1970), s 68, and most other States have equivalent provisions.

damages are intended as a substitute for equitable relief (*Wroth v Tyler* (1974)). There are no general rules on this, however, as the matter will depend upon the individual circumstances of each case (*Johnson v Agnew* (1980)).

There is also some doubt as to whether 'Lord Cairns' damages' can be granted for the breach of a purely equitable right. It is possible that the reference to 'wrongful acts' refers to purely common law acts such as nuisance or breach of a contract for the sale of land.[10] It is, however, difficult to justify such a limitation. If the purpose of the section was to supplement the remedial jurisdiction of equity, it seems rather incongruous that the provision should be restricted to legal wrongs, as common law damages are already available for the enforcement of legal rights. It seems logical that statutory damages should apply to obligations recognised exclusively in equity and common law. The fact that equitable compensation is also available for the enforcement rights does not justify an arbitrary jurisdictional restraint upon a broad statutory power.

Unlike the common law, equitable damages can be awarded for a threatened injury. This will occur where damages are sought in addition to, or in substitution for, *quia timet*, injunctive relief.

According to Viscount Findlay, in *Leeds v Industrial Co-operative Society Ltd v Slack* (1924), equitable damages should be available as a substitute for a *quia timet* injunction:

> ... the power to give damages *in lieu* of an injunction must, in all reason, import the power to give an equivalent for what is lost by the refusal of the injunction; for this purpose compensation only for what has passed would be futile.

22.2.3 Equity's inherent jurisdiction to award damages

It has been suggested by Dr Spry that the Lord Cairns' Act did not actually introduce a new equitable remedy, but rather codified a jurisdiction which already existed.[11] According to Dr Spry, equity always had a general and inherent power to grant damages. The early Chancery Courts were reluctant to grant monetary awards, but this was more a consequence of policy and practice, and the desire to prevent any confrontation with the courts of law on the matter, than from a lack of jurisdiction. In the opinion of Dr Spry, damages were more likely to be awarded under the common law because it had the appropriate procedures for the measurement and quantification of such awards; however, this did not mean that equity did not have the jurisdiction.[12]

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10 See the opinion of Meagher, RP, Gummow, WMC and Lehane, JRF, *Equity and Remedies*, 3rd edn, 1992, para 2321.

11 Spry, I, 'Plaintiffs' undertakings and equity's power to award damages' (1990) 65 ALJ 658–59.

12 For a discussion about the inherent jurisdiction to award damages in equity outside of Lord Cairns' Act, see *Grant v Dawkins* (1973), where Goff J left the issue undecided.

Whether or not equity has an inherent jurisdiction to award damages (in addition to equitable compensation and account) is unclear. There were many early equity cases which did refer to the award of damages, although their true meaning is uncertain. For example, in *Phelps v Prothero* (1855), Turner LJ concluded that 'it was competent to this court to have ascertained the damages'. The monetary award actually made, however, may not necessarily have been a consequence of equity's inherent right to award damages. There is the possibility that Turner J was actually referring to equitable compensation. Furthermore, many early cases used the term 'damages' to describe the jurisdiction of the Chancellor to grant an account, whereas today an account is more generally regarded as a claim for profits or for money had and received.

22.2.4 The availability of equitable relief

The jurisdictional requirement for Lord Cairns' Act damages will be satisfied once it is clearly established at the commencement of the action that either specific performance or injunctive relief is available. This was discussed in *King v Poggioli* (1923). On the facts of that case, the vendor contracted to sell a rural property to the purchaser, with completion to take place upon a particular day. The vendor refused to deliver possession on that day. The purchaser was unable to obtain sufficient pasturage and consequently some of his cattle died of starvation. The purchaser sought specific performance of the contract and damages in addition. He wanted damages to be deduced from the purchase price under the contract. He asserted in his statement of claim that he was ready and willing to complete the contract from the date expressly fixed for completion, but only if the deduction in the purchase price was allowed.

In the High Court, Starke J held that before equitable damages are granted it must be shown that the plaintiff has performed, or has been ready and willing to perform, the terms of the contract. On the facts, the purchaser was not ready and willing to perform because he could not pay the agreed purchase price; he could only pay the reduced purchase price. As a result of this, Lord Cairns' Act damages were refused. In *Jaggard v Sawyer* (1995), Millet LJ, in the English Court of Appeal, stated that the power to award damages under Lord Cairns' Act arises whenever the court has jurisdiction to entertain an application for an injunction or specific performance and this question must be determined at the date of the writ; the question of whether a court has jurisdiction to grant injunctive relief or specific performance must be determined at the date of the hearing. His Honour felt that, once a judge decides that damages should be awarded instead of an injunction or specific performance, the measure of damages should take into account the future as well as the past, thereby amounting to what the plaintiff could reasonably have expected to receive for past and future breaches. Lord Cairns' Act damages will generally be assessed in the same way as common law damages except for the fact that they remain, in essence, discretionary, and they are not restricted to an assessment at the date of the breach.

Equitable damages will clearly be of assistance in cases where specific performance is available for the entire contract. It is unclear, however, whether it would be possible to enforce specific performance over certain provisions of a contract, which are enforceable, and award damages over the rest.

It is difficult to establish any precise principles concerning when the courts will act to award damages *in lieu* of specific relief, although the following list provides a good working basis:

- if the injury to the plaintiff's legal rights is small;
- if the injury is one which is capable of being estimated in money;
- if the injury is one which can adequately be compensated by a small money payment;
- if the injury is one in which it would be oppressive to the defendant to grant an injunction or issue a decree of specific performance.

It should be remembered that the damages awarded under the Act are not assessed as equitable compensation. Hence, common law principles relating to the assessment of damages are applicable, even though the quantum might vary. In the decision of *Johnson v Agnew* (1980), it was held that there was no warrant to award Lord Cairns' Act damages any differently from common law damages, and that, while the date of breach would be the usual time at which such damages should be assessed, the court had the power to fix such other dates as may be appropriate.

Lord Cairns' Act damages will be available in the auxiliary jurisdiction in addition to, or *in lieu* of, specific performance or injunctive relief for a legal right. They may also be available in the exclusive jurisdiction if it can be proven that injunctive relief would be available to enforce the equitable obligation. The need for such damages will generally not be as great in these cases because of the availability of equitable compensation.

22.3 Account of profits

Equity may order a party to account for any profit received as a result of a breach of equitable duty. The remedy of account is only available in equity. If a court can show that a breach of equitable obligations has occurred, any profit which has resulted from this breach may be accounted for. The primary objective of the account in equity is the prevention of the defendant's unjust enrichment (*Dart Industries Inc v Decor Corp Pty Ltd* (1993) *per* Mason CJ, Deane, Dawson and Toohey JJ). Court rules have also been introduced in Australia to regulate the operation of the account.[13]

13 High Court Rules (Cth) Ord 15 r 34; Federal Court Rules (Cth) Ord 39; Supreme Court Rules (Tas) Ord 3 r 17; Supreme Court Rules (Vic) Ord 52 r 78; Supreme Court Rules (WA) Ord 45 r 61; Supreme Court Rules (SA) Ord 7 rr 71, 85; Supreme Court Rules (Qld) Ord 19 r 37; Supreme Court Rules (NSW) Pts 48–49; Supreme Court Rules (NT) Ord 52; Supreme Court Rules (ACT) Ord 4 r 36.

The equitable remedy of account stems from the ancient Chancery jurisdiction of the court to call both parties to 'account' for the particular injustice alleged. It is a pecuniary remedy focusing upon the profits received from the conduct. Before an account for profit can be issued, it must be established that some profit has resulted from the breach. If this cannot be proven, then clearly no profit can be disgorged. An account may be issued in the exclusive jurisdiction for a breach of equitable obligation, or in aid of a common law right in the auxiliary jurisdiction.[14]

The Australian High Court, in *Scott v Scott* (1963), approved the general principle that a trustee in breach of an equitable obligation must account for all profit made. If the party in breach of the equitable obligation has acted honestly, they may receive a proportion of the profit in accordance with the level of skill and expertise which they have put into obtaining the profit.[15] This stems from the fact that the account in equity is a discretionary award, aimed at achieving fairness. The defendant will generally be entitled to the costs which have been incurred in earning the profit. Only those costs which are solely referable or directly attributable to the earning of the profit will, however, be recoverable (*Dart Industries Inc v Decor Corp Pty Ltd* (1990)). In *Warman International Ltd v Duyer* (1995), the High Court of Australia noted that a fiduciary will, ordinarily, be ordered to render an account for only that profit which has been made within the scope and ambit of his duty – with some regard to the skill, efforts, property and resources given by the fiduciary himself. Whether due allowance is given to the efforts of the fiduciary or not will be a matter of fact in each case, and it is up to the defendant to establish that it is inequitable to order an account for the full profits.

Where both equitable compensation and an account are available, an applicant must elect one remedy or the other so that the danger of double recovery is avoided. Equitable compensation cannot be sought for one part of a period and an account of profits for the other. The reason for this lies in the differing perspective of each remedy; equitable compensation restores the loss flowing from a breach, whereas an account disgorges all gain.

In *Colbeam Palmer Ltd v Stock Affiliates Pty Ltd* (1970), Windeyer J explained this difference:

> The two computations obviously yield different results, for a plaintiff's loss is not to be measured by the defendant's gain, nor a defendant's gain by the plaintiff's loss. Either may be greater, or less than, the other.

14 See *Colbeam Palmer Ltd v Stock Affiliates Pty Ltd* (1970), where an account was granted for a passing off action under common law.

15 See, also, the court rules on this (except in Victoria): High Court Rules (Cth) Ord 34 r 9; Federal Court Rules Ord 39 r 7; Supreme Court Rules (WA) Ord 45 r 8; Supreme Court Rules (Tas) Ord 35 r 10; Supreme Court Rules (SA) Ord 7 r 71; Supreme Court Rules (Qld) Ord 67 r 25; Supreme Court Rules (NT) Ord 52 r 6; Supreme Court Rules (NSW) Pt 48 r 7; Supreme Court Rules (ACT) Ord 36 r 10.

An account of profits is most commonly awarded for a breach of fiduciary duty. Where the breach is committed by a trustee, all gain must be accounted for.[16] Where the breach is committed by a non-fiduciary, only those profits made with knowledge by the defendant that the plaintiff's rights were infringed will be recoverable (*Colbeam Palmer Ltd v Stock Affiliates Pty Ltd* (1970)).

16 This stems from the rigid approach to trustee duties set out in *Keech v Sandford* (1726).

TRACING

23.1 What is tracing?

Tracing is a right or claim available to a beneficiary of a trust or to anyone to whom a fiduciary obligation is owed; it allows a claimant to follow property into the hands of third parties who have received it, or trace it into whatever different form it has taken by way of exchange or otherwise. So long as property can be traced, it is capable of remaining the property of a trust. Hence, tracing is simply the process of allowing a primary beneficiary to follow misused trust property through various subsequent owners in order to regain it (*Re Diplock* (1948)).

The need to trace property will generally arise in the equitable jurisdiction when a trustee converts trust property to her own use. Nevertheless, tracing may also arise under common law proceedings. Tracing is neither a remedy nor a claim but, rather, a process. It is the process by which the plaintiff traces what has happened to his property and justifies his claim, showing that the defendant's unjust enrichment was at his expense. The plaintiff must also overcome defences: a challenge to the tracing claim, a priority dispute or, following the House of Lords decision in *Lipkin Gormon v Karpnale Ltd* (1991), the defence of innocent change of position. See, generally, *Boscawen v Bajwa* (1995).

23.2 Tracing under common law

Under common law, property may be traced where an illegal action can be established. Tracing pursuant to common law actions has arisen under two primary categories: detinue, and money had and received. Where such actions can be established, the existence or otherwise of a trust relationship is unimportant. In some situations, where equity and the common law concurrently recognise rights, tracing may be available under both jurisdictions. In both cases, a legal or equitable right must be established. The equitable right to tracing will not be available under the auxiliary jurisdiction in support of a purely legal action (*Re Diplock* (1948)).

Tracing under detinue will depend upon the discretion of the court. Once an action in detinue is established, the court has a statutory discretion, pursuant to s 78 of the Common Law Procedure Act 1854 (Imp), to order the return of the chattel. An important consideration for the court in exercising this consideration will be whether or not damages are inadequate. Tracing may also arise pursuant to an order under the common law action of money had and received.

Under common law, property may be traced despite the fact that it is no longer identifiable in the hands of the wrongdoer, or that it has passed on to a *bona fide* third party purchaser. It would seem, however, that property cannot be traced under common law if it has been placed into a fund and mixed with other funds so that it is unidentifiable (*Taylor v Plumer* (1815)). The foundation of this rule appears to stem from the fact that, under common law, the action is based upon the wrongful conduct, rather than the precise identification of the property which is the subject of the wrongful conduct.

This apparent stringency of the common law has been clearly described by the Court of Appeal in *Re Diplock* (1948):

> The common law approached [the rule of tracing] in a strictly materialistic way. It could only appreciate what might be called the 'physical' identity of one thing with another. It could treat a person's money as identifiable so long as it had not become mixed with other money. It could treat as identifiable with the money other kinds of property acquired by means of it, provided that there was no admixture of other money. It is noticeable that, in this latter case, the common law did not base itself on any known theory of tracing such as that adopted in equity ... Equity adopted a more metaphysical approach. It found no difficulty in regarding a composite fund as an amalgam constituted by the mixture of two or more funds, each of which could be regarded as having, for certain purposes, a continued separate existence. Putting it another way, equity regarded the amalgam as capable, in proper circumstances, of being resolved into its component parts.

Nevertheless, with the development of specific rules enabling equity to trace property into mixed funds, the common law restrictions may be revised. The increasing interaction and harmonisation occurring between the legal and equitable jurisdiction, may eventually result in common law practices being influenced by equitable tracing procedures. This possibility was alluded to by Atkin LJ, in *Banque Belge Pour L'Etranger v Hambrouch* (1921):

> I see no reason why the means of ascertainment so provided should not now be available both for common law and equity proceedings. If, following the principles laid down in *Re Hallet's Estate* [discussed below], it can be ascertained either that the money in the bank, or the commodity which it has bought, is 'the product of, or substitute for, the original thing' then it still follows 'the nature of the thing itself'. On these principles it would follow that, as the money paid into the bank can be identified as the product of the original money, the plaintiffs have the common law right to claim it, and can sue for money had and received.

The Australian courts have not, however, accepted this proposition to date (*Puma Australia Pty Ltd v Sportsman's Australia Ltd* (1994)).

23.3 Tracing principles in equity

The general principle in equity is that a beneficiary may recover misused trust property wherever it is capable of being traced, even where it has gone into

the hands of a third party, provided that third party is not a *bona fide* purchaser for value without notice. The equity jurisdiction assumed, as the court in *Re Diplock* described it, a metaphysical approach to tracing. The property which is traced does not have to be the exact property which was misused in the first place. It will be sufficient if a link between the original property and the traceable property can be established. In this regard, equity pre-supposes the continued existence of the property either as a separate fund or as a latent part of a mixed fund. The basic requirements for tracing property in equity are proof of the existence of a breach of fiduciary obligation (it is unclear whether tracing in equity is limited to fiduciary relationships), and proof that the property which is sought is still identifiable.

23.3.1 The need for a pre-existing fiduciary relationship

There is a view that, in equity, tracing can only arise where some pre-existing fiduciary relationship can be proven (*Re Diplock's Estate* (1948)). The basis for this would appear to be that, where such relationships exist, equity has the power to protect and enforce property rights which are the subject of the relationship. Nevertheless, some cases and academic commentary have suggested that it is not always necessary to prove such a relationship.

In *Chase Manhattan Bank v Israel-British Bank* (1981), a banker mistakenly overpaid the Israel-British Bank a large sum of money. It was held that the banker was entitled to trace the amount of the overpayment and impose a constructive trust, despite the fact that no pre-existing fiduciary relationship existed. Goulding J held that a payment under a factual mistake was enough to confer upon the applicant an equitable right to property, and therefore a right to trace.[1] See also the discussion on this case in Chapter 8.

A similar conclusion was reached in *Sinclair v Brougham* (1914). On the facts of that case, a building society was wound up. For 60 years it had taken deposits from members and non-members, but in the latter case the dealings were *ultra vires*. Once the general creditors had been paid off, the issue was whether or not the non-members were entitled to retrieve their money. The House of Lords held that the balance of the moneys should be distributed equally to members and non-members. With respect to the non-members, it was held that they were able to trace their money. Lord Haldane implied that tracing was a necessary part of the auxiliary jurisdiction in equity or could arise without a pre-existing fiduciary relationship being established. Lord Parker claimed that a fiduciary relationship did, in fact, exist between the directors and the non-members through the finding of a resulting trust. Lord Dunedin felt that the equitable principle of tracing should apply wherever a

1 *Chase Manhattan* was approved by Tuckey J in *Bank Tejarat v Hong Kong & Shanghai Banking Corp* [1995] 1 Lloyd's Rep 239, but disapproved by Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, pp 714–15.

person has, without legal title, acquired some benefit through the use of another's property. As with the judgment of Goulding J in *Chase Manhattan*, the determination of Lord Dunedin appears to allow equitable tracing wherever an unjust enrichment can be established. The judgment of Lord Dunedin on this issue was, however, expressly overruled by the Court of Appeal in *Re Diplock.*

Recent cases have suggested that property owners who have been defrauded of their property interests by false and fraudulent misrepresentations may, despite the absence of a fiduciary relationship, be able to trace their property into the hands of third parties (*Bankers Trust Ltd v Shapira* (1980); *El Ajou v Dollar Holdings plc* (1993)).

Many of these issues are related to the law of restitution and to the more general question of whether recovery should be based upon unjust enrichment alone. Whilst the difficulty may be resolved where a court is prepared to impose a constructive trust, restitution academics have suggested that this is an artificial approach to an unreasonable limitation (see Birks, P, *Introduction to Restitution,* 1985; and Goff and Jones, *Law of Restitution,* 3rd edn, 1986).

In *Westdeutsche Landesbank Girozentrale v Council of the London Borough of Islington* (handed down 22 May 1996), a majority of the House of Lords overruled the decision in *Sinclair v Brougham*. The main issue in the case was whether or not the bank had any right to trace moneys paid to the Council under an *ultra vires* transaction known as an 'interest rate swap'. The House of Lords unanimously held that the bank was unable to trace the money into the hands of the council and proprietary relief was inapplicable. All members of the House, apart from Lord Goff, agreed that *Sinclair v Brougham* should be overruled. According to Lord Browne-Wilkinson, the decision in *Sinclair* was seriously flawed and could really only apply where there were no competing claims from creditors. To allow the bank a right in equity to trace the moneys to the local authorities would confer an unfair advantage upon the plaintiff at the expense of all other persons who may have an interest in the property and it could not be justified, particularly under the rubric of a resulting trust, although Lord Browne-Wilkinson was prepared to accept that the remedial constructive trust may be a more appropriate device (see, also, the discussion of *Westdeutsche Landesbank,* paras 26.4, 37.2.4 and 38.3).[2]

23.3.2 Tracing principles under constructive trusts

The equitable principles of tracing are applicable to pre-existing equitable obligations as well constructive trusts which are imposed by the court. If there is no identifiable property, a constructive trust cannot be imposed. If a

2 The decision of Lord Browne-Wilkinson in *Westdeutsche Landesbank* was approved in *Bank of America v Arnell* (1999) unreported, 28 July.

constructive trust is imposed, an important question lies in the issue of when the equitable interest arises. If the interest arises at the date of the dealing, equitable tracing principles may allow a previously unsecured creditor to defeat a subsequent secured creditor; however, the validity of this approach is subject to some debate (see, generally, the discussion in Chapter 38).

In the opinion of Glover J in *Commercial Equity Fiduciary Relationships* (1995):

> The better view may be that interests under constructive trusts arise independently of court orders. A claimed beneficial interest in the property is, from the beginning, in the person who has been wronged. No suit in equity is needed to create it. Constructive trusts are 'construed', not 'constructed' at trial.

Traditionally, the court has shown some reluctance in conferring a preference upon a single creditor for policy reasons. In some cases, such reasoning has prevented the court from imposing a constructive trust at all (*Lister v Stubbs* (1890)). This approach seems too absolute. More recently, courts appear to be reassessing the date when constructive trust interests may arise. In insolvency situations, constructive trusts imposed as a measure of justice and fairness after a particular dealing have been held to arise when the court construes them, thereby preventing security interests from being unfairly displaced and the imposition of unfair preferences upon creditors. This approach is broadly consistent with the House of Lords' decision in *Westdeutsche* (*Re Goldcorp Exchange Ltd* (1994)).

23.4 Dealing with and mixing trust property

Simply because a trustee may mix trust property with his own property or that of a third party, does not necessarily mean that the property cannot be traced. As long as the property is still identifiable, the fact that it has been combined with other property will, at least in equity, not prevent it from being traced.

This has been clearly established in *Re Hallet's Estate* (1889). In that case, a solicitor, to whom two parcels of bonds had been entrusted by different parties, sold them and deposited the proceeds in his own account. The solicitor subsequently died insolvent, and both parties sought to trace into his account. The Court of Appeal allowed both claimants a charge over the account for the proceeds of sale of the bonds. Sir George Jessel MR discussed the issue in some depth:

> … 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 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 [p 709].

23.4.1 Where the trustee wrongfully takes property and/or makes a purchase

Where a trustee or fiduciary wrongfully takes property entrusted to him, the equitable owner has a right to trace the identifiable property into the hands of the trustee or fiduciary. Where the property has been used to purchase other property, the equitable owner has the right take the property purchased, or to hold that property as security for the amount of trust money which has been paid out.

23.4.2 Where the trustee has mixed money in a bank account with his own money

Where a trustee has mixed money with his own money, the first money that is deemed to be withdrawn is that held by the trustee. This is because equity assumes that the trustee has acted honestly and reasonably and has withdrawn his own money first. Nevertheless, the rules of tracing still require the money of the beneficiary to be identifiable. In this regard, the lowest intermediate balance rule applies; under this rule, the beneficiary will be restricted to the lowest intermediate balance standing to the credit of the particular account, after the date of mixing the moneys but before the date of the claim. Effectively, then, if the trustee makes a subsequent deposit, the beneficiary cannot trace into that deposit. The rule makes particular sense where the trustee has other creditors, because the creditors may wish to claim the deposit and the trustee cannot make a settlement to favour the beneficiaries over the creditors: the Bankruptcy Act 1966 (Cth). In *Law Society of Upper Canada v Toronto-Dominion Bank* (1999), Blair J discussed the 'lowest intermediate balance' rule, noting that it:

> ... seeks to recognise that at some point in time, because of earlier misappropriations, an earlier beneficiary's money has unquestionably left the fund and, therefore, cannot physically still be in the fund. Accordingly, it cannot be 'traced' to any subsequent versions of the fund that have been swollen by the contributions of others ...[3]

3 (1999) 169 DLR (4th) 353, p 362. See Smith, L, 'Tracing in bank accounts: the lowest intermediate balance rule on trial' (2000) 33 Canada Business LJ 75.

23.4.3 Where the trustee has mixed money and made a purchase

Where a trustee has mixed money of his own with that of the equitable owner and bought property, the equitable owner cannot simply elect to take the purchased property, as would be the case where there was no mix. The reason for this lies in the fact that the property was not purchased with trust money purely and simply, but, rather, with a mixed fund. In such a case, the applicant is entitled to a charge on the property purchased for the amount of the trust money which has been laid out on the purchase.

23.5 Mixing multiple trust funds

Where a trustee holds multiple trust funds, the beneficiaries of these funds may have their funds mixed. Equity will allow beneficiaries to trace their trust fund according to their individual contributions, where they have been mixed, provided they remain identifiable (the *pari passu* principle). Where some of the funds have been spent, the balance is not equally divided amongst the beneficiaries. The rule, which is commonly referred to as the rule from *Clayton's* case, applies, and essentially states that the first funds placed into the account are the first to be taken out.

According to *Clayton's* case (*Devaynes v Noble* (1816)), the right of an equitable owner to trace into a mixed fund will depend upon what happens to that fund after the trust moneys are paid into it. If the trustee continues to draw on the account and exhausts it, the trust funds will be gone. It will not matter that the trustee later pays in further funds. As noted above, the lowest intermediate balance rule applies. If there are funds remaining, the 'first in first out' rule sets out that the first to lose their right to trace will be the ones who had money deposited first.

For example, X is a trustee of A fund and B fund. X, in breach of fiduciary obligations, withdraws $10,000 from A fund and deposits it into his bank account. X then, in breach of fiduciary obligations, withdraws $10,000 from B fund and deposits it into his bank account. X had no money in his account himself. X then takes out $15,000 from his bank account and spends it gambling. Under the *Clayton's* rule, this means that all of A's $10,000 has been spent and half of B's.

The rule can be avoided where there is a specific agreement between the bank and the customer (*Barclays Bank Ltd v Quistclose Investments Ltd* (1970)). Furthermore, the rule will only apply to continuing accounts and to the balance at the end of the day, not to dealings which have been carried out on the same day (*The Mecca* (1897)).

Application of the *Clayton's* rule is probably more appropriate for difficult cases where the account is complex and a number of different moneys have been paid in. The rule has, however, been criticised because it is seen as more of a banking principle than an equitable principle: see, generally, McConville,

Tracing and the Rule in Clayton's Case, 1963. Where the account is only in existence for a short time and the transactions are not too involved, a *pari passu* distribution may be more in accordance with fundamental equitable principles. In *Barlow Clowes International Ltd (In Liq) v Vaughan* (1992), the English Court of Appeal unanimously concluded that the *pari passu* is, apart from highly exceptional circumstances, the 'more logical method' of dealing with mixed funds. The practical difficulties associated with ascertaining contributions from various funds and their associated transactions was the original rationale for the rule in the *Clayton's* case, although, given the detailed computerised nature of bank transactions today, this rationale may well be outdated.[4]

23.6 Tracing property into the hands of third parties

A *bona fide* purchaser for value, without notice of the existence of a prior interest, will take the trust property free from the claims of the beneficiaries. In this context, therefore, it is important to distinguish between a *bona fide* purchaser of the property and a mere volunteer. Where third parties receive property in circumstances short of a *bona fide* purchase, they may be liable as constructive trustees. In *Re Diplock's Estate* (1948), the court noted that a volunteer is not entitled to set up his claim adversely against the claim of a person having an equitable interest in the land and, therefore, 'in the case of a mixed fund of money, the volunteer must give such recognition as equity considers him in conscience (as a volunteer) bound to give in the interest of the equitable owner of the money'.

On the facts of that case, a testator who died in 1936 devised his entire residuary estate 'for such charitable institutions or benevolent object or objects as his executors should in their absolute discretion think fit'. The executors distributed over £210,000 to 229 charitable institutions over the next three years. In 1944, the House of Lords held the bequest to be invalid. The next of kin sought to trace the funds into the various institutions and the court held that they were able to do so, holding that the *bona fide* purchaser principle did not apply because the charities were volunteers. The following principles concerning recovery against third party volunteers were laid down:

- where trust property is transferred to a volunteer who takes with notice, and there is no question of mixing, then the volunteer will hold the property on trust for the rightful beneficiaries;
- money spent by the charities on altering or improving buildings could not be traced. The basis for this lay in the fact that it was not clear that such improvements would add value to the property; they may in fact reduce its value;

4 See *Keefe v Law Society of New South Wales* (1998) 44 NSWLR 451.

- money spent to pay off unsecured debts was unrecoverable. The debt had been extinguished and it could not be recovered under tracing principles, hence, it would seem that if property is purchased on credit that property will not be recoverable;
- money used to pay off secured debts owed by the charities could not be traced. The applicant could not be subrogated to the position of the secured creditor because that would create a new charge and endorse a sale of property which was contributed to by the charity;
- the rule in *Clayton's* applied to a mixed bank account;
- war stock purchased by one of the charities was capable of being apportioned;
- if an asset is purchased with mixed funds and increases in value, the beneficiary will not be entitled to any proportionate share in that increase in value. In this respect, careful consideration needs to be given to renovations or improvements made upon real property.

If the trust property has passed on from a volunteer or a person who took with notice, to a *bona fide* purchaser for value without notice, the property will not be recoverable (*Brady v Stapleton* (1952)). Furthermore, a third party who is a volunteer may raise the defence of change of position, where he can prove that he has changed his position as a result of receiving the trust property (*Moses v Macferlan* (1760)).

MINOR FORMS OF EQUITABLE RELIEF

24.1 Rescission

The remedy of rescission is available in both common law and equity. Where it is issued it allows a party to a contract to have that contract set aside, 'rescinded', so that the party will be returned to the position prior to the contract coming into effect.

24.2 Rescission at common law

Under common law, the right to rescind a contract will only arise where there has been a fundamental breach of the contract, the contract was induced by fraudulent misrepresentation or duress, or the remedy is available under statutory provisions, for example, s 4(2) of the Goods Act 1958 (Vic). Furthermore, rescission will only be granted where precise restitution is possible; as a jurisdictional requirement, the applicant must establish that when the contract is set aside the parties will be in exactly the same position as they were prior to the contract being entered into (*Clarke v Dickson* (1858)).

24.3 Rescission in the exclusive and auxiliary jurisdiction of equity

Equity has a far wider jurisdiction to rescind a contract than that which is available under the common law. Equity can operate in both its auxiliary and its exclusive jurisdiction in awarding rescission. If the action is based upon a breach of contract and rescission is not available at law, equity may award rescission in its auxiliary jurisdiction. If the action is exclusively recognised in the equitable jurisdiction, rescission may be awarded in the exclusive jurisdiction of equity.

24.4 Precise and substantial restitution

Both legal and equitable rescission will only be granted where it is possible to return the parties to the position they were in prior to the contract being entered into. This is because the effect of a rescission order is to set aside the contract *ab initio*. Common law takes a strict approach and requires absolute restitution, '*restitutio in integrum*', because it does not have the means of making appropriate adjustments between the parties to achieve this result. Hence, if the position of the parties has substantially changed since entering into the contract, rescission will be refused under common law because of the limited

common law powers (*Alati v Kruger* (1955)). However, it is not necessary for precise restitution to be established before rescission will be granted in equity.

This was clearly established by the High Court decision of *Alati v Kruger* (1955). On the facts of that case, Kruger purchased a fruit business from Alati believing that the business earned a particular amount per week. It turned out that Alati had fraudulently misrepresented the average weekly takings to Kruger. Kruger sought to have the contract rescinded. The business was conducted upon a leased premises. However, the landlord had agreed to re-assign the lease back to Alati should rescission be granted.

The High Court held that Kruger could rescind the contract. Even though precise restitution was not possible, in equity rescission was available where the parties could be substantially restored to the position they were in prior to entering the contract.

Dixon CJ, Webb, Kitto and Taylor JJ made the following comments:

> 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*.

Equity takes a more flexible approach because of its discretionary capacity; it is often able to mould a rescission order to achieve substantially the same effect as precise restitution. The primary focus of equity is to achieve practical justice between the parties, with the objective being compensatory in nature (*Spence v Crawford* (1939)).

24.4.1 The meaning of practical justice

What constitutes practical and substantial restitution will vary according to individual cases. In some situations, practical justice may be achieved where the rescission award is issued along with associated orders, whilst in others it may be achieved by awarding a partial rescission. The decision of the High Court, in *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995), provides a good example of the flexibility of equitable awards. In that case, the appellant, Vadasz, was the director of Vadipile Pty Ltd, which entered into a contract with the respondent company, Pioneer Concrete (SA) Pty Ltd, for the supply of ready mix concrete. Due to cash flow difficulties, Vadipile could not pay Pioneer for concrete that had been supplied. By July 1992, Vadipile owed Pioneer over $210,000. It was then arranged that Vadipile would repay the debt by monthly instalments. Vadasz then agreed to enter into a personal guarantee because, without it, future supplies of concrete would have ceased. Vadasz did not read the contract before signing it. Further difficulties were

encountered, and Pioneer then sued Vadasz under the personal guarantee for the full amount owing (past and future debts). The trial judge found that Vadasz had signed the guarantee on the basis that it only covered future debts. The misrepresentation as to the nature of the guarantee entitled Vadasz to equitable rescission.

The trial judge found that the contract could be rescinded to the extent that it covered past debts. Vadasz appealed to the Full Court and then the High Court, arguing that he was entitled to have the guarantee completely set aside. Deane, Dawson, Toohey, Gaudron and McHugh JJ noted that rescission would not have been available under common law because precise restitution was not possible, and, as such, they were left in the realm of equity.

In considering the application of the equitable jurisdiction, the following comments were made:

> 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.

On the facts, it was held that complete rescission of the contract was not possible because Vadasz did not offer to submit to terms or conditions which would ensure that Pioneer was paid. In equity, rescission aims at achieving practical justice between the parties. If, on the facts, it was apparent that Vadasz would not have entered into the contract at all if he was aware of the true position, the guarantee could be set aside in its entirety. However, the court held that, in the circumstances, Vadasz had intended to guarantee future debts because he wanted to make sure that the goods continued to be supplied. Under the maxim 'he who seeks equity must do equity', the court held that only a partial rescission was available in equity; such an order accorded the practical justice requirements of the circumstances.

In *Bridgewater v Leahy* (1998), the High Court approved of the partial rescission in *Vadasz* and noted that, once a court has determined upon the existence of a necessary equity to attract relief, the framing or, as it is often expressed, the moulding of relief is a consequence of a balancing process, considering the competing interests. On the facts of that case, the court concluded that it would not be consistent with equity and good conscience to order a full rescission of the transaction and that, in the circumstances, an allowance should be given to the defendant in recognition of their efforts and the overall intention of the testator to provide some benefit to the defendant. See the detailed discussion of this case above, 14.4.2.

24.5 Equitable grounds for rescission

Rescission may be awarded in equity where a party has been induced to enter into a contract pursuant to a fraudulent or innocent misrepresentation (*Alati v Kruger* (1955); *Root v Bradley* (1960)). Rescission may also be available where a contract is proven to have been entered into under undue influence, where a common mistake can be proven or where the contract is unconscionable (*Solle v Butcher* (1950); *Louth v Diprose* (1992)).

Legislation in all States sets out that rescission shall be available for contracts for the sale of goods pursuant to the rules of the common law.[1] At the time when the legislation was introduced, the rules relating to equitable rescission for innocent misrepresentation had not evolved, so there has been some doubt as to whether or not the legislation intended to incorporate equitable rescission for such cases. Earlier decisions indicated that the legislative provisions were probably restricted to rescission principles under common law (*Root v Bradley* (1960)). More recent authority suggests that the principles relating to equitable rescission may be more appropriate for sale of goods legislation (*Leason Pty Ltd v Princes Farm Pty Ltd* (1983); *Goldsmith v Roger* (1962)).

24.6 Restraints upon rescission

Rescission for innocent misrepresentation will generally not be granted where the contract is executed (*Seddon v North Eastern Salt Company* (1905)). In *Svanosio v McNamara* (1956), the Australia High Court endorsed the decision of *Seddon* and refused to award rescission of a completed contract for the sale of land. It is not clear how far this prohibition extends, particularly where the contract is not an executed contract for the sale of land. The rule does not apply to contracts for the sale of goods (see ss 100(1) and 111(1) of the Goods Act 1958 (Vic), and the discussion above).

Other restraints upon the availability of rescission in equity include the usual discretionary considerations: hardship on the other party, delay and the conduct of the applicant. Where an applicant elects to affirm a contract, the contract cannot, at a later stage, be rescinded unless a new ground for rescission can be proven (*Coastal Estates Pty Ltd v Melevende* (1965)).

24.7 Rectification

A right to rectify an instrument is a right which is enforceable in equity whenever the true agreement between the parties is not properly reflected

1 Sale of Goods Act 1895 (WA), s 59(2); Sale of Goods Act 1958 (Vic), s 4(2); Sale of Goods Act 1896 (Tas), s 5(2); Sale of Goods Act 1895 (SA), s 59(2); Sale of Goods Act 1896 (Qld), s 61(2); Sale of Goods Act 1972 (NT), s 4(2); Sale of Goods Act 1923 (NSW), s 4(2); Sale of Goods Act 1954 (ACT), s 62(1).

(*Maralinga Pty Ltd v Major Enterprises Pty Ltd* (1973)). Rectification will be available where the written instrument is intended to reflect the entire, completed agreement. If the instrument does not reflect the completed and final intention of the parties to the agreement, no right to rectify may arise (*Slee v Warke* (1952)).

The usual equitable discretionary considerations apply in considering whether or not to rectify an instrument. If the remedy is adequate at law, or if the rectification of the agreement will prejudice the interests of a *bona fide* third party, it will not be granted. The right to rectification will only arise where the instrument reveals a clear mistake; if the instrument is capable, upon a proper construction, of reflecting the true intentions of the parties, rectification will generally be unnecessary. Rectification will be available for contracts and voluntary agreements (*Re Butlin's Settlement Trusts* (1976)).

Rectification will not be available in equity where it goes against the common intention of the parties. In the absence of a completed agreement reflecting the intention of the parties, other clear evidence should be adduced.

As Lord Chelmsford LC stated in *Fowler v Fowler* (1859), the applicant must establish that:

> The alleged intention to which he desires [the instrument] to be made continued concurrently in the minds of all the parties down to the time of its execution, and also must be able to show exactly and precisely the form to which the deed ought to be brought.

In *Maralinga Pty Ltd v Major Enterprises Pty Ltd* (1973), a land auctioneer stated before the sale that the vendor required a three year mortgage for the balance of the price. However, the written contract stated that cash should be given upon the completion of the sale. The vendor sought rectification of the agreement. The High Court rejected the application on the ground that the mistake was unilateral rather than common. The applicant could not prove that both parties intended to incorporate the mortgage term into the contract; on the facts, the court held that the purchaser knew of the mistake and executed the contract under this knowledge, thereby intending to keep the finance agreement separate from the written agreement. There was no clear evidence concerning the mutual intention of the parties as to the terms of the written agreement and as a result rectification was not available.

Hence, it would seem that the parties must prove a united, mutual intention as to the terms of the agreement, right up to the moment of executing the formal instrument. This intention need not be expressly manifested. However, it should be objectively apparent, and it must be established that the instrument differs clearly from this intention (see *Australasian Performing Right Association Ltd v Austarama Television Pty Ltd* (1972); and Bromley, *Rectification in Equity,* 1971).

In some situations, rectification may be available for a unilateral mistake; the right may arise where one party has knowledge of a written mistake in their favour and does not attempt to correct it. In such a situation, the court has held that the party should not be able to rely upon the fact that the mistake is unilateral, rather than common, to prevent rectification occurring (*Commission for the New Towns v Cooper (Great Britain) Ltd* (1995)).

The sort of mistakes for which rectification may apply include mistakes of fact and law, for example, an incorrect price, an incorrect land description, an incorrect description of a payment period, or even an incorrect interpretation as to law (*Re Butlin's Settlement Trusts* (1976)). Equity does not, however, have jurisdiction to alter wills (*Harter v Harter* (1873)) nor articles of association of a company (*Scott v Frank F Scott (London) Ltd* (1940)).

24.8 Appointment of receivers

Equity has an inherent power to appoint a receiver to enforce an equitable security or to protect and preserve property in which the applicant has a beneficial interest. Usually, an application will be made by a creditor, or a person beneficially interested in property, to have a receiver appointed in order to protect and maintain the secured property. Once appointed, a receiver is entitled to take possession of, and recover property for, the benefit of the applicant; a manager may also be appointed to manage or conduct any business in which the property is employed.

The appointment of a receiver and manager is not a remedy which is exclusive to the equitable jurisdiction. Parties to an agreement may appoint a receiver and manager over property in which they are interested where express provision is set out in the agreement. Security interest holders may insert a clause in the agreement setting out that, upon any default of payment, the security interest holder shall have a right to appoint a receiver.

The power of a court to appoint a receiver was originally set out in s 45 of the Judicature Act 1925 (Eng). Each State has now enacted legislative equivalents, and in Victoria it is set out in s 62(2) of the Supreme Court Act 1986 (Vic). Where a receiver is appointed privately, it will generally be the case that he or she will attempt to restore the property to a level of financial stability; whereas, where a receiver is appointed by a court, she is only expected to function as a caretaker for the property.

24.8.1 Court appointment

Where a receiver is appointed by the court she will be an officer of the court (*Re Flowers and Co* (1897)). A court-appointed receiver can only exercise such power as the court chooses, in its discretion, to confer. Usually, the court will confer a broad discretion upon the receiver but ensure that careful review and control of the receiver's actions is maintained. Where a receiver is appointed

without the consent of the defendant, and at the expense of the defendant's possession, the receiver should exercise caution in the manner in which he manages the property (*National Australia Bank Ltd v Bond Brewing Holdings* (1991)). Indeed, discretionary considerations of convenience and hardship may affect a court's decision to award a receiver in the first place.

Where a receiver is appointed in an interlocutory capacity, a court will generally require the applicant to consent to an undertaking for damages (*National Australia Bank Ltd v Bond Brewing Holdings* (1991)). Usually, a court will appoint a receiver where an applicant, who may be a person with a legal, equitable or proprietary right in the matter, can prove that the appointment of an independent party to protect and preserve the property is the most appropriate form of relief. Mere proof of the existence of a debt will generally be insufficient to warrant the appointment of a receiver. However, where it can be proven that a creditor has a right to be paid out of identified property, and the only remedy which can adequately protect and preserve the property is the appointment of a receiver, a court may exercise its jurisdiction. Usually, a court will not appoint a receiver for an *ex parte* application unless a very strong case can be proven (*National Australia Bank Ltd v Bond Brewing Holdings* (1991)). The reason for this lies in the fact that the defendant has no opportunity to make a case in his defence.

Where a court appoints a receiver, the appointment will not necessarily result in a complete cessation of all business. If a court appoints a receiver with the intention of continuing business as usual, then the receiver should ensure that the business is, as far as possible, uninterrupted and contracts are not terminated. The level of disruption generated by the appointment of a receiver will very much depend upon the individual terms of the appointment (*Re Newdigate Colliery Ltd* (1912)).

The most common cases in which a court may appoint a receiver include: the winding up of a partnership where the partners cannot agree or one partner is guilty of misconduct (*Mitchell v Simons* (1862)), and default under a legal mortgage, in aid of a Mareva injunction, on the application of a debenture holder or unsecured creditor of a company. In light of the fact that most written agreements contain clauses for the private appointment of receivers, and corporations law itself has extensive provisions dealing with the appointment of receivers, the exercise of the court jurisdiction is relatively infrequent.

24.8.2 Private appointments

Most commonly today, receivers are appointed pursuant to contractual provisions in security agreements such as mortgage or debenture documents. The duty of a privately appointed receiver is to manage the property with the aim of obtaining repayment of the outstanding debt. In exercising this function, the receiver should act with due care and diligence. Where such an

appointment is made, the receiver will generally be appointed as the agent of the debtor/mortgagor rather than that of the security interest holder. This agency relationship will generally arise automatically under the terms of the security interest, and it will arise whether the debtor/mortgagor agrees or not. Usually, the security agreement will set out that the debtor/mortgagor will be liable to pay all costs incurred by the receiver (*Federal Commissioner of Taxation v Card* (1963)).

The primary reason for the establishment of an agency relationship between the receiver and the mortgagor/debtor is to ensure that the security interest holder is exempted from all possible liability for acts performed by the receiver they have appointed (*Gaskell v Gosling* (1896)). It should be remembered that, despite the fact that such receivers are appointed as agents of the debtor/mortgagor, the primary duty of the receiver remains the realisation of the debt on behalf of the mortgagee. This makes the agency relationship between the receiver and the mortgagor/debtor somewhat unusual, because the receiver is an agent for one party but acting in the interests of another. This anomalous form of agency is imposed only upon privately appointed receivers according to the express terms of the agreement; all of the rights and duties of such a receiver flow from the express terms of the instrument (*Re B Johnson and Co (Builders) Pty Ltd* (1955)).

The conduct of privately appointed receivers over the property of corporations is also governed by corporations law. Part 5.2 of the Corporations Law sets out statutory provisions regulating the conduct of receivers. Section 420 is a particularly significant provision in this regard, as it confers upon a receiver broad powers of management. Under this provision the receiver has the power, *inter alia*, to borrow money on the security of the property and, more generally, to carry on the business of the corporation. Further provisions impose stringent reporting and accounting requirements upon the receiver, and these requirements are supervised by both the court and the Australian Securities Commission.

24.9 Equitable defences

24.9.1 Acquiescence and laches

As the award of equitable relief is discretionary, courts have a clear jurisdiction to refuse an application where circumstances exist making the award inequitable. Such circumstances may be raised by a defendant as a defence to an equitable cause of action. One of the most common equitable defences which may be raised by a defendant is that the plaintiff took too long to bring the action. This defence of delay is referred to generally as 'laches'. Mere delay will, in itself, be ineffective to establish a proper defence. It must be proven that bringing the action in light of the delay would be inequitable. There are a number of ways in which delay may cause inequity. For example,

the delay may be evidence of an acquiescence on the part of the plaintiff (*Cash v Clark* (1882)). Alternatively, the delay may have been of such an extent that allowing a cause of action to go ahead would cause severe hardship to the defendant or to third parties who have become involved (*Fysh v Page* (1956)), or confer an unfair advantage on the plaintiff. It is not necessary to prove acquiescence to successfully establish the defence of delay because laches is broader than acquiescence.

Courts will give consideration to the length of the delay, the justification for the delay and the extent to which the circumstances have altered as a result of the delay. To establish the defence a court must reach the conclusion that the delay is virtually tantamount to a waiver of legal rights, and that it would be unreasonable for relief to be awarded to a plaintiff who, by his conduct and neglect, has failed to initiate proceedings (*Hourigan v Trustees Executors and Agency Co Ltd* (1934)).

Naturally, in determining whether to apply this defence, the length of time involved will be an important consideration. There are no hard and fast rules on this as each case will depend upon its own individual facts. Generally, however, courts will assume that the time begins from the moment when the plaintiff became aware of a possible right to relief, and the longer the plaintiff leaves it, the worse the position will be (*Baburin v Baburin (No 2)* (1991)).

In a situation where the delay has resulted in third parties becoming involved, a court will consider the degree of prejudice which such parties may face. For example, in *Boyns v Lackey* (1958), the plaintiffs acquired mining rights from the defendants and refused to exercise them for a period of approximately two years because of the associated risks. Towards the end of this period, third parties acquired mining rights from the defendants and proceeded to make substantial developments and carry out mining operations in the area. The plaintiffs subsequently attempted to assert their mining rights and brought an action for specific performance.

Hardie J held that the plaintiffs had taken too long to bring the action, and it would be unfair to allow such an action to be brought where third parties had acquired rights and made substantial investments in the area during the period of the delay.

In particular, reference was made to the decision of *Ernest v Vivian* (1863), where Kindersley VC said:

> Whatever remedy he [the plaintiff] may have at law, he can have none here, because it is not equitable to allow him to wait till it is ascertained that the persons in possession have succeeded or may have been ruined, and if the subject result in profit, to ask to put that in his pocket; if in loss, to repudiate the loss. It is not necessary, even if possible, to prove whether he acted from premeditated design or carelessness.

Acquiescence can also operate as a defence. Acquiescence refers to a situation where a plaintiff refrains from exercising a right to which the plaintiff is aware

she is entitled, thereby resulting in the conclusion that the plaintiff has accepted the defendant's position. Mere failure to enforce an equitable right will be insufficient to establish the defence; it must be proven that, by such failure, the plaintiff has, albeit indirectly, assented to the continuation of the *status quo* (*Cashman v 7 North Golden Gate Gold Mining Co* (1897)). Acquiescence can only be established where it can be proven that the plaintiff knows of her equitable rights. Knowledge may be expressly or constructively acquired. Once knowledge is acquired, it will be a question of how long the plaintiff has taken to bring the action in light of this knowledge. Considering the broad nature of the defence of acquiescence, significant overlap exists between estoppel, consent, waiver, election and the defence of delay.

Despite such overlap, there are definite distinctions between each area, as noted by Deane J in *Orr v Ford* (1989):

> Strictly used, acquiescence indicates the contemporaneous and informed acceptance or standing by which is treated by equity as 'assent' to what would otherwise be an infringement of rights ... The word is commonly used to refer ... (i) to a representation by silence of a type which may found in estoppel by conduct ... or (ii) to acceptance of a past wrongful act in circumstances which give rise to an active waiver of rights or a release of liability ... or (iii) to an election to abandon or not enforce rights. A plaintiff may, however, lose his right to relief by an 'inferior' species of acquiescence which does not amount to assent, waiver or election or give rise to an estoppel. In these cases, acquiescence may be used in at least one of three ways. First, it is sometimes used as an indefinite overlapping component of a catch-all phrase also incorporating 'laches' ... Secondly, acquiescence is used as a true alternative to 'laches' to divide the field between inaction in the face of the 'assertion of adverse rights' and inaction in prosecuting rights ...

Unlike laches, but like estoppel and waiver, the defence of acquiescence focuses primarily upon the perception encouraged by the plaintiff in the mind of the defendant that equitable rights will not be enforced. On the other hand, the defence of laches focuses upon the inequitable length of time that it has taken for the plaintiff to enforce such rights. In both situations, courts will take into account factors emphasising the inequity of enforcement. Factors such as hardship, unfair conferral of a benefit upon the plaintiff and prejudice to third parties are relevant to both defences, despite the difference in focus.

Where the defences of laches or acquiescence can be established, they will generally operate to bar the award of equitable relief, whatever form that relief might take. The defence of laches cannot, however, operate to defeat a plaintiff from enforcing an express trust unless it can be proven that the delay is 'gross' (*Orr v Ford* (1989)).

24.9.2 Statutory limitation periods

The limitation periods existing under statute, prohibiting a plaintiff from commencing an action after a specified period of time, will generally not apply to the equitable jurisdiction. The equitable jurisdiction developed the defence of laches to deal with the issue, and statutory limitation periods will usually be restricted to common law actions. The only substantial exception to this principle lies with equitable interests in land, because they are bound by the same periods of limitation as those which apply to legal interests in land: s 11(1) of the Limitations of Actions Act 1958 (Vic) and its State equivalents.

The defence of laches in the equitable jurisdiction will operate so that, even if an action might be statute barred under the legislative provisions, if the delay cannot be proven to be inequitable the action may be allowed. A court of equity will not, however, allow a plaintiff to circumvent the operation of the statute by simply claiming relief in equity. If the claim in equity is analogous to a common law claim, then a court of equity may adopt the same limitation period as that existing under common law. However, this determination will depend upon a discretionary analysis of the facts in each case (*Smith v Clay* (1767)).

24.9.3 Waiver and estoppel

Where a plaintiff waives his legal or equitable rights, it will constitute a valid defence both at law and in equity. Waiver may arise where a plaintiff expressly releases his equitable rights and where an estoppel action can be established. In equity, a release may be proven where the plaintiff enters into a voluntary agreement for valuable consideration, or where a clear intention to release equitable rights can be proven. Waiver will not be inferred unless the circumstances provide clear evidence of such an intention. In *Commonwealth v Verwayen* (1990), Toohey and Gaudron JJ felt that the Commonwealth of Australia had waived its right to plead the Limitations Act defence and other tortious defences. They were careful to point out that waiver arose because the Commonwealth knew of its legal rights and did not plead the defence in its initial statement of claim. Under such circumstances, it could be inferred that the Commonwealth had intended to waive its legal rights and this waiver precluded it from amending its statement of claim to include the limitation defence later in the proceedings.

The doctrine of estoppel has also been used as a defence in equity where it can be proven that the defendant has acted to her detriment in reliance upon a representation which the plaintiff unconscionably induced the defendant to believe, and which is subsequently denied to the detriment of the plaintiff (*Commonwealth v Verwayen* (1990) *per* Mason CJ, Brennan, Deane and Dawson JJ). As the decision in *Commonwealth v Verwayen* indicates, estoppel and waiver may arise under the same facts. It is, however, unclear whether estoppel will

continue to function purely as a defence. Deane J in *Commonwealth v Verwayen* felt that, whilst estoppel operates as a defence, it may form a substantive right where its elements are relevant to a separate cause of action. Both Mason CJ and Brennan J went further than this, to suggest that the potential fusions between different forms of estoppel may now justify the operation of estoppel as a substantive cause of action in its own right (see the discussion at 15.7.6).

24.9.4 Set-off

A defendant may claim a right to set-off a debt owing by the plaintiff to him in the enforcement of an equitable right. A set-off operates to reduce or extinguish the relief awarded to the plaintiff, and it can only operate where the relief is pecuniary in nature. If an enforceable debt cannot be proven, set-off will be unavailable (*J & S Holdings Pty Ltd v NRMA Insurance Ltd* (1982)).

Set-off in equity follows and expands upon the principles set out under common law. At common law, the rules relating to set-off were introduced under the Statutes of Set-Off: Insolvent Debtors Relief Act 1728 (Imp) and Set-off Act 1735 (Imp). These Acts allowed mutual debts which were incurred between the plaintiff and defendant out of the same legal right, to be set-off where a liquidate sum was claimed. Where the debts were not mutual or were equitable in nature, common law set-off would not apply.

Set-off in equity will arise where the defendant can prove an enforceable debt, whether that be legal or equitable in nature and whether it arose out of the same right or otherwise. The essence of the equitable jurisdiction is proof of an enforceable debt with such proof raising equitable grounds for protecting the defendant against the demands of the plaintiff (*Rawson v Samuel* (1841)). It must be established that the claims are closely connected to the subject matter of the plaintiff's claim so as to make the claim inequitable. In this sense, it must be established that the existence of the enforceable debt impeaches the title of the plaintiff (*Rawson v Samuel* (1841)). An excellent example of what would be sufficient to constitute closely connected claims lies in the decision of *General Credits (Finance) Pty Ltd v Stoyakovich* (1975), where it was held that a defendant mortgagor, being sued for the balance owing under the mortgage, was entitled to an equitable set-off stemming from the fact that the mortgagee sold the property at an undervalue. In that decision, the court held that the right of the defendant was closely connected to the plaintiff's action, making it inequitable for a court to award relief without regard to the defendants rights (see, also, *AWA Ltd v Exicom Australia* (1990)).

The right to set-off in equity may be expressly or impliedly excluded by the parties. In interpreting an exclusion clause, the court will consider the intentions of the parties; in the absence of clear words of exclusion, courts will generally lean against such a construction (*Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd* (1974)).

PART IV

TRUSTS

The final part of the text is completely devoted to a detailed examination of one the foremost emanations of the equitable jurisdiction, the trust. The importance of the trust in the modern legal world cannot be overstated. Its essential characteristic, the separation between legal and equitable interest, has been used for a multitudinous array of purposes. Family trusts have been created, utilising the device as a means of achieving future benefit for young children, or as a means of splitting income to obtain tax advantages. Employers and employees alike have embraced the trust as a means of establishing superannuation and pension funds for the future benefit of employees. Trading companies have applied the trust as a means of co-ordinating business functions and maximising tax advantages. Investors have used the unit trust as an alternative to investment within a share portfolio, as it confers equitable protection upon the unit holders and is often perceived to have a greater investment potential. Courts have utilised the trust as a remedial device for according justice within certain prescribed instances including: fair and equal distribution of property between *de facto* partners, protection against a defaulting trustee, the knowing receipt of trust property by a third party and certain contractual arrangements entered into for the express benefit of a third party. Where the trust is being imposed by the court, rather than created by the settlor, different policy considerations will be relevant. Courts are paying increasing attention to the consequences surrounding the application of constructive trusts, including the type of unfairness warranting the application of a proprietary interest and the impact that such an interest may have upon the competing claims of other interested parties.

There are three primary areas of consideration for the law of trusts. The first relates to creation: did the settlor intend to create a trust relationship and separate legal and equitable title? Have all the requisite requirements for the creation of an express trust by transfer or declaration been complied with, including formalities and compliance with the three certainties? Or alternatively, is the trust within one of the recognised categories of resulting or constructive trust? Secondly, once it is determined that a trust relationship exists, what are the duties and rights of the trustee? It has already been seen that the trust relationship is fiduciary in nature, but additional trustee duties have evolved in equity to protect a beneficiary against the possibility of abuse, including strict rules relating to the dealing with and investment of trust property, the receipt of profit, the standard of care imposed upon trustees, and the disclosure of trust documents. Often the equitable duties are embellished by express clauses within the trust deed or through statutory provisions in the trustee legislation. Despite having stringent duties imposed upon them, trustees also have certain rights conferred upon them. All trustees are entitled, under both equity and statute, to a full indemnity for all expenses properly incurred in the administration of the trust which is enforceable against both the trust fund and the beneficiaries personally.

The final area of examination is the rights and obligations of the beneficiaries. As beneficiaries hold an equitable proprietary interest in the trust property, all beneficiaries who are absolutely entitled and of full age and capacity may wind up the trust, request access to trust documents, remove defaulting or negligent trustees, seek compensation for loss incurred as a result of any breach committed by a trustee, or seek to have an improper exercise of discretion by a trustee set aside. One of the most important aspects of the trust lies in the differentiation between the ownership of the trustee and that of the beneficiary. The trustee owns the legal estate which gives him control and possession of the property; the beneficiary holds the equitable interest which gives her an enforceable equitable right to the property but no actual possession. The rights and duties of the beneficiary are based upon the dual character of the interest held by the beneficiary; the beneficiary needs to be protected against the possibility of the trustee abusing the possession and control which is vested in him on the one hand, but also needs to be held liable for all proper expenses and fees incurred in managing the property because she has ultimate ownership. The following chapters examine each of these three primary areas of trust law in some detail.

Ultimately, the trust is probably the most common encounter that individuals have with the equity jurisdiction and it represents the pinnacle of equitable jurisprudence. In the words of Maitland, 'of all the exploits of equity, the largest and the most important is the invention and development of the trust … it seems to us almost essential to civilisation'.

WHAT IS A TRUST?

25.1 The evolution of the use

The modern form of the trust evolved from an early device known as the 'use'. The 'use' would arise where legal ownership was transferred to one party for the use of another. The Chancery jurisdiction would enforce the obligation of the legal holder to 'use' the property for the benefit of the other party. The other party was held to 'own' the property in equity, and Chancery would impose equitable obligations upon the legal interest holder to ensure that the 'use' was upheld. This process represented the rudimentary basis for the institution which became known as the trust.

The use evolved in the Chancery jurisdiction for a number of reasons. In the first place, it served to remedy the stringent rules relating to legal contingent remainders – future estates which vested when the contingency took effect. Due to the strict requirements relating to seisin under the common law, a contingent remainder interest would be invalid if it did not vest at the expiration of the life estate. The use avoided these difficulties because the legal interest could be held by one party (the feoffee to uses) for the benefit of another party (the *cestui que* use) for as long as the person creating the use (the feoffor) set out. The *cestui que* use automatically acquired an enforceable, equitable, beneficial interest in the property, and would acquire the legal interest once the contingency was satisfied and the use vested. The problem of a potential lack of seisin was not relevant to the Chancery jurisdiction, so the *cestui que* use never suffered the problem of having the interest invalidated.

Furthermore, and perhaps even more significantly, under common law the old inheritancy principles effectively precluded the holder of a fee simple from devising the property to anyone other than his eldest son or heir apparent. The holder of a legal estate could not devise it to any other descendants and he could not disinherit his heir. This situation continued until the Statute of Wills (Imp) 1540, which entitled legal interests to be devised. The use helped resolve inheritancy difficulties, because the grantor could pass the property over to the 'feoffee to uses' during his life, on the proviso that the 'feoffee to uses' would allow the grantor to remain on the property until his death, and after his death the property was to be held to the use of a designated third party (who did not have to be the eldest son or heir apparent).

Finally, the Statutes of Mortmain 1279 and 1290 prohibited the transfer of legal estates to religious institutions, because such institutions, being unable to die or reach the age of majority, were able to avoid paying feudal dues. The prohibitions set out in the Statutes of Mortmain were effectively avoided by

the use, because the estate could be transferred to a 'feoffee to uses' for the use of a religious order without offending the statutory provisions.

The 'use' and, later on, the trust, could be enforced wherever an intention to split ownership between two parties, by transferring property to one party with associated personal obligations to look after the property for the use of the other party, could be discerned.

Example

If land was given to A upon A's undertaking to hold the land for the 'use and benefit of B', it was unfair for A to claim complete legal ownership of the land and ignore the claims of B. B has no common law claim over the land. A has full legal title to the land and is able to exercise all of the rights which ownership at law provides. However, B can enforce A to his undertaking in equity. The Chancellor would enforce the use to compel A to use the land for the exclusive use and benefit of B, because otherwise it would be acting against the conscience of the agreement. The Chancellor could not say that B was the owner at law. However, the benefit of the land passed to B was enforceable in equity. Eventually, the Chancellor would enforce B's rights not only against A but against all other persons taking the land from A. Once the Chancellor recognised the enforceability of B's rights, it was not long before it could be said that A was the owner in law and B was the owner in equity.

25.2 The Statute of Uses

The Statute of Uses, which was passed in 1535, greatly reduced the enforceability of the use. The purpose of the statute was to prevent tax (revenue) avoidance by legal title holders where they passed the property on to a 'feoffee to uses'. After the introduction of the Statute of Uses, the *cestui qui* use was to be treated as if he was the legal title holder; equitable ownership was effectively equated with legal ownership for the purpose of collecting revenue. Despite the broad-reaching changes introduced under the Statute of Uses, the functioning of the use was not entirely destroyed.

The first point to note is that not all uses were affected by the legislation. Where the property involved was not freehold land, the statute did not transform the *cestui qui* use into a legal title holder. Furthermore, where the 'feoffee to uses' had active rather than passive duties, the legislation did not affect the use. Finally, and most importantly for trust law, the statute did not affect the enforcement of what came to be known as the 'second' use.

Example

A 'second' use would arise in the following situation: A grants property to a feoffee in use for the use of B, for and unto the use of C. In such a situation the first use went to B and the second to C. The first use would come under the Statute of Uses and would make A and B the equivalent at law. The second use to C would not come under the Statute, so that C could remain the *cestui qui* use, and hold an enforceable interest in equity.

Courts of Chancery were not prepared to enforce the 'second' use and bypass the effect of the Statute of Uses for a long time. It was not until the mid-17th century that the Chancellor began recognising the validity of such uses, and this probably resulted from the fact that revenue could no longer be raised from feudal tenures. Eventually, the words 'unto and to the use of' became the standard conveyancing practice. The second use gradually came to be known as the 'trust', and the fundamental dichotomy between common law and equitable ownership, which was introduced by the 'use', now forms the backbone of the modern trust institution.

25.3 The nature of a trust

An exact definition of the trust is difficult and usually descriptive, rather than substantive, in nature. Essentially, the trust is an equitable relationship arising where the creator (settlor) confers an enforceable equitable interest in a person or a charitable institution (who may be called the beneficiary or the charitable purpose) in property (known as the trust property), against the legal owner of that property (known as the trustee). The primary elements of the trust can be summarised as follows:

- The trustee must have ownership and possession of the trust property conferred in her. The trust property must be a recognised property interest which is in existence, is identifiable and which has been clearly and accurately described in the trust. This is not to say that the trust property must be a legal interest; equitable interests are quite capable of forming the subject matter of a trust; all that is required is for the trustee to have ownership of that property, whatever type it might be, vested in her.
- The trustee owes equitable fiduciary obligations to the beneficiary. Equity will enforce these obligations strictly. If the trustee breaches these duties, the beneficiary may seek equitable relief for all loss flowing from such a breach. The equitable obligations of the trustee do not extend beyond the trust property.
- The beneficiary must be clearly and accurately described in the trust. Once a valid trust is recognised, the beneficiary acquires an equitable beneficial interest in the trust property. This interest is a property interest akin to a legal interest. However, it is only recognised and enforceable in the equitable jurisdiction. If a purpose rather than a beneficiary is set out, the trust will only be enforceable if the purpose is charitable.
- A trust can only exist where legal and equitable title have been separated. It must be shown that the trustee holds the trust property as owner in a legal capacity for the benefit of a beneficiary who holds the trust property in an equitable capacity. The trustee and the beneficiary must be separate persons or exist in separate capacities. Without this legal and equitable separation, a trust cannot exist.

One of the most significant consequences following the creation of a trust is the emergence of an enforceable, equitable, beneficial interest. Where a valid trust is created, ownership of the trust property is fragmented on the basis of jurisdiction; not only is the trust property owned at law, it is also owned in equity. Wherever a trust is validly created, a beneficial interest will arise. This has been held to be the case, even where the trust functions as an investment device and the beneficiary holds an interest in an oscillating fund such as a unit trust. In *Costa and Duppe Properties Pty Ltd v Duppe* (1986), the nature of an interest under a unit trust was examined. On the facts of the case, the trust deed set out that the beneficial interest in the trust should be vested in the unit holders, and that each unit would entitle the holder to a beneficial interest, but would not entitle the holder to any particular security or investment in the trust fund. Furthermore, a unit holder would not be entitled to transfer the property comprised in the trust fund unless it was in accordance with the trust deed.

It was held by Brooking J (as a single judgment of the Supreme Court) that the unit holder/beneficiary had a proprietary interest in all the property and, therefore, in each asset of the trust, despite the possible duration of the trust, the wide powers of management, and the possibility that the trust may lose all or a part of its capital through unsuccessful investment or speculation.

25.4 The role of the settlor

Once a trust is validly created, certain legal consequences will automatically follow. Upon creation, the settlor (the person creating the trust) will generally have no further legal rights over the property. The settlor has no right to interfere with the trust unless the settlor is also the trustee (as would be the case where the settlor makes an oral declaration of trust). Unless the settlor specifically reserves contractual rights, he or she will have no further rights over the property once it is legally transferred over to the trustee.

Traditionally, no contractual relationship has existed between the settlor and the trustee. According to Maitland, (*Lectures on Equity,* 2nd edn, 1936, p 30), the absence of a contract stemmed from that fact that trusts are only recognised in the exclusive jurisdiction of equity, and Chancery would not enforce a contract. Furthermore, if the relationship between settlor and trustee was contractual, no trust could arise until the trustee had accepted the position. This approach would be inconsistent with the equitable presumption that an express trust arises as soon as a settlor manifests a sufficiently clear intention to create it. This position is well set out in the decision of *Mallot v Wilson* (1903). On the facts of that case, a settlor made a voluntary conveyance of land to a third party in 1866 to hold the land on trust for his wife for life, and then to his children. When the third party learned of the conveyance, he disclaimed the trusteeship by deed. The settlor then purported to cancel the trust by deed. In 1889, the settlor attempted to convey the same land to other

people. After the settlor and his wife died, a person claimed on behalf of the settlor's only child that they were entitled to the land as a beneficiary under the earlier 1866 conveyance.

It was held by Byrne J that a trust could exist before the trustee's office was accepted. Once the land was transferred the trust was effective; if the trustee disclaimed the office, the legal title to the land would re-vest in the settlor and the settlor would then hold the property on trust for the beneficiaries. Byrne J felt that this consequence should be justified where a trust was expressly intended by the settlor and a beneficiary had been clearly set out. The mere fact that the designated trustee refuses the position should not, in itself, destroy the intention of the settlor to set up a valid express trust.

A settlor may retain legal rights in a trust where the settlor expressly reserves the power to revoke, add to or vary the trust. Beneficiaries under a revocable trust have vested interests in trust property, which are liable to become divested where the settlor exercises the contractual right to revoke. In Australia, however, settlors seldom reserve the power to revoke trusts due to s 102 of the Income Tax Assessment Act 1936 (Cth), which effectively makes the settlor liable for tax upon a beneficial interest in the property where the settlor contractually reserves a power to revoke the trust.

25.5 The role of the trustee

Once the trust is properly created and the trustee is appointed, the trustee will be responsible for looking after the trust property on behalf of the beneficiary. The trustee owes fiduciary obligations towards the beneficiary, and must make sure that he abides by these obligations when dealing with the trust property. In all dealings with the trust property, the trustee should make sure that he is acting in the best interests of the beneficiary, and that he has avoided any conflict between personal interest and the interests of the beneficiary. The duties and obligations of the trustee will automatically arise upon the creation of a valid trust. The full range and character of these duties are explored in detail in Chapter 32**.**

25.6 Classification of trusts

Trusts can be divided into three primary categories: those that are expressly created; those where an intention can be inferred from the facts; and those that are imposed by the courts on the basis of fairness. As equity is a flexible, discretionary jurisdiction, it does not confine itself to the administration of deliberate, categorical trusts; it is prepared to enforce trusts 'inferred' from the circumstances, or imposed where it would be unconscionable to deny the existence of an equitable beneficial interest. Trusts can be classified according to the following categories.

25.6.1 Express trust

The express trust arises when the settlor expresses a clear intention to establish a trust and complies with all of the relevant formalities and procedures for properly creating the trust. The express trust can only exist when the settlor expressly intends it. There are two types of express trust: the express trust by transfer; and the express trust by declaration. An express trust by transfer will arise where the settlor expresses an intention to create a trust by transferring trust property to a third party trustee for the benefit of a named beneficiary.

On the other hand, a declaration of trust will arise where the settlor declares herself to be trustee of the trust property for the benefit of a named beneficiary. Under an express trust by transfer, the settlor must legally transfer the trust property into the name of the trustee, and all the legal requirements for a valid transfer of the property must be complied with. However, a declaration of trust will arise where the requisite intention to transform an owner into a trustee of property can be established. Obviously, as the property is already vested in the owner, there is no need for a transfer. However, the owner must sufficiently prove, through words or conduct, his intent to declare a trust.

Where an express trust exists, the settlor must clearly identify the trustee, the trust property and the beneficiaries. If the trust is vague or unclear on any of these issues, the trust will not be enforceable.

25.6.2 Resulting trust

A resulting trust will arise where an intention to create an express trust can be found but the settlor has not carried out the requisite acts for the valid enforcement of such a trust. There are two primary categories of resulting trust: the automatic resulting trust and the presumed resulting trust. The automatic resulting trust arises where an express trust was intended, but has failed for some reason. For example, where property is transferred into the name of a trustee and the settlor sets out that the beneficiary is to hold a life interest in the trust property, but does not set out what is to happen after this, a resulting trust may arise over the future reversion so that the trustee holds it under a resulting trust back for the benefit of the settlor (see the discussion at 5.2.1 and 37.2).

The presumed resulting trust will arise where the intention to create an express trust is inferred and the presumption is not rebutted. The most common situation where such a presumption may arise is where one party has paid the full purchase price, or a contribution of the purchase price, without having this payment reflected on the legal title. In such a situation, the court will generally presume that the legal title holder retains the title on resulting trust to the extent of the contribution. Presumptive resulting trusts are based upon inferred intention from the circumstances but may be rebutted by proof of an intention to advance a benefit (see 5.2.2 and 37.2).

25.6.3 Constructive trust

A constructive trust is imposed by a court in circumstances where it would be against the conscience of the court to deny the existence of a beneficial interest. As noted in Chapters 5 and 38, constructive trusts will apply irrespective of intention. The constructive trust has both an institutional and a remedial perspective because, once established, it resembles the institutional features of a trust. However, it cannot arise until a court, exercising a primarily remedial focus, determines that it should apply on the facts. It should, however, be noted that the constructive trust has retained its institutional characteristics in Australia despite movements in Canada and, to a limited extent, the UK, towards an acceptance of a broader remedial constructive trust doctrine. In *Kensington v Liggett* (1994), the House of Lords concluded that the remedial constructive trust could prove to be a 'valuable instrument of justice' and, on appeal, the Privy Council in *Re Goldcorp Exchange* (1995) noted that the law relating to the creation of equitable proprietary interests is still in a state of development. In *Westdeutsche Landesbank Girozentrale v Council of London Borough of Islington* (1996), Lord Browne-Wilkinson noted that the remedial constructive trust would probably be a more appropriate restitutionary device for the protection of proprietary interests than the resulting trust (see the discussion at 38.2 for a more detailed examination of the remedial constructive trust doctrine).

The categories of institutional constructive trust are not closed, although in Australia a constructive trust will not be imposed upon idiosyncratic notions of fairness (*Muschinski v Dodds* (1985)). Unlike the position in Canada, an unjust enrichment will not, *per se*, constitute a sufficient ground for the imposition of a constructive trust. Neither the resulting or constructive trust are required to comply with statutory formalities as to form. This exemption is statutorily set out in all States. In Victoria, the relevant provision is s 53(2) of the Property Law Act 1958 (Vic) (see Chapter 38 for a more detailed examination of constructive trusts).

25.7 Commercial, domestic and social uses of the trust

As noted in the overview, in a modern world the trust has a diverse range of uses and functions. Unlike its early history, where the main purpose of the trust was to assist in the continuation of family estates, the modern trust has branched out into a large variety of areas including: superannuation, family planning, commercial investment, tax planning and corporate ventures. To fully understand the breadth and scope of the trust today, it is important to appreciate the variety of differing functions it is used for. A brief overview of some of the more common uses of express trusts in society today is set out below.

25.7.1 Superannuation and pension funds

The popularity of superannuation and pension funds has escalated rapidly over the last 20 years or so, and this is due largely to the tax concessions which have been granted for employers contributing to such schemes. Superannuation schemes can vary markedly, but the most common form is the contributory scheme which provides a defined benefit for its members. This type of scheme establishes a body of trustees (who are usually employees and members of the board of the employer) who hold a fund on trust for the provision of benefits for members upon their respective retirement. The benefits are specified as a proportion of the employees' final salary. The employees' annual contributions are fixed as a percentage of salary. The employer also makes contributions. These contributions are dependant upon actuarial forecasts. As the final benefit provided to members will depend upon a number of future circumstances such as salary rises, redundancies, retirement of the employer and future income and capital performance of the fund investments, the employer must pay the sum which the actuary certifies will make the fund 'actuarially solvent'.

The trust is the most obvious structure for such 'retirement' schemes. As such schemes must be kept separate from other assets held by the employer, the trust ensures that trust funds are held separately by a specified body of trustees. These trustees are regulated by equitable and statutory obligations when dealing or investing these funds, and such rules help to prevent any potential abuse by the trustees in managing the fund.

Despite the advantages of the trust to superannuation and pension schemes, superannuation trusts do contain some marked differences to the traditional trust structure. This has often meant that the benefits flowing from the trust structure are abused within superannuation and pension schemes. In most superannuation schemes, the beneficiaries are employees and are, therefore, obliged to enter into the scheme. Unlike the traditional trustee/beneficiary relationship, an employment contract generally exists between employer and employee, and this can add further tensions to the equitable relationship. A superannuation fund is variable, and an employer has a continuing financial interest in it as the employer has to constantly meet the actuarial cost. This is clearly different from the traditional trust structure, where there is no common law relationship between the trustee and the beneficiary and the trustee does not have a financial interest in the trust property.

The trustees of a superannuation fund are usually employees and the employer is generally given the power to appoint and remove trustees. Naturally, with the threat of possible dismissal, the integrity of trustees may be threatened. Furthermore, most superannuation schemes contain a power to amend the rules. Employers may place pressure upon employee trustees to amend the rules in their favour if, for example, they wish to obtain any

surplus in the fund or alter the powers of investment.[1] In such a situation, it is possible that employers may amend the rules to confer benefits upon employee trustees in exchange for accepting employer demands. Naturally, this type of situation is contrary to the underlying aims of the traditional trust. Nevertheless, despite the existence of such difficulties, superannuation and pension trust schemes are extremely popular and represent one of the most common form of trust existing in society today.

25.7.2 Public unit trusts

The unit trust was established as an alternative form of investment to share portfolios. Under a public unit trust, unit holders invest in units so that they hold a portion of a business which is conducted by the manager of the trust on their behalf. Public unit trusts are significant investment vehicles. A unit trust is a fixed (rather than a discretionary) trust and all of the beneficiaries are referred to as unit holders. A trustee of a unit trust has less discretion than a traditional trustee. The unit trust trustee has the primary duty of acquiring the money (in the form of subscription fees) which constitutes the trust fund and acting as custodian of the fund and supervisor of the manager. The unit trust has a manager as well as a trustee. The manager is appointed to administer the trust fund and carry out the investments on behalf of the unit holders. The fund will generally be legally vested in the trustee; however, the trustee will usually be obliged to give effect to the 'lawful' decisions of the manager in administering the fund. Where a manager breaches his fiduciary obligations in investing the trust fund, there is authority to suggest that the mere inaction by a trustee will not constitute a breach of trust (see the English decision of *Galmerrau Securities Ltd v National Westminster Bank* (1993), Harman J; see, also, the detailed discussion on investment duties in Australia at 32.2).

Each unit holder retains a property interest in the fund (*Costa and Duppe Properties Pty Ltd v Duppe* (1986)). The units purchased by a unit holder are intended to be akin to shares. However, some limitations have been imposed upon unit-holders which do not apply to traditional beneficiaries: no unit-holder can require the trust property to be transferred to them, and no unit-holder can interfere with or question the decisions of the manager and trustee in dealing with the fund. On the other hand, unit holders will only be liable for the subscription price of each unit: the trustee or manager cannot seek an indemnity from the unit holder. Furthermore, the manager is obliged to redeem units held by a unit holder where this is so required.

As unit trusts are considered to be akin to corporations, the legislation regulating such trusts is not the Trustee Act (Vic) 1958, but rather corporations

1 See, generally, *Lock v Westpac* (1991). Note that some of these difficulties have now been dealt with in the Superannuation Industry Supervision Act (Vic) 1993.

law.[2] When taxation law favours unit trust investments as against corporate shares, there is significant advantage in purchasing units, particularly in light of the fact that unit holders, like beneficiaries, are considered to actually own a portion of the trust fund and this ownership is rigidly protected by equity.

25.7.3 Family planning

Trusts have become instrumental devices in family planning arrangements. Not only have constructive trusts entered the realm of *de facto* relationships and provided protection for partners contributing to major property purchases, wills and express *inter vivos* trusts are continually used to plan inheritance and property division.

Discretionary trusts are also being increasingly favoured in family situations. Discretionary trusts provide tax incentives. Unlike traditional fixed interest trusts, a beneficiary under a discretionary trust is considered to have no present entitlement under the trust until the trustee makes a determination to apply income in their favour. Such trusts may allow income to be split amongst the different members of a family. Most family trusts are established for the benefit of a family group and the trustee will usually be one or more of the family members; alternatively, the trustee may be a company set up by the family with particular members as directors and/or shareholders. Where a family trust is discretionary, the trustee may distribute income amongst each of the family members. These type of arrangements can be particularly useful in a family where only one member works and the children are older so that they can receive income.

The tax benefit of discretionary family trusts can be quite advantageous. For example, if a discretionary trust is set up as a 'trading trust' in order to run the family business, family members may be set out as 'potential beneficiaries' under a discretionary trust. When income is distributed to the beneficiaries it will be split among the family members, thereby attracting a lower marginal tax rate.

2 See the Corporations Act 1989 (Cth), Chapter 7.

A COMPARISON BETWEEN TRUSTS AND OTHER LEGAL RELATIONSHIPS

A trust is similar to a range of legal relationships. Hence, it is important to determine that a settlor intended to create a trust. In order to do this, it is important to appreciate the differences between trusts and other analogous relationships. If a settlor does not expressly set out that he or she intended to create a trust, any number of interrelated legal relationships may arise. A brief overview of the legal relationships usually associated with the trust follows.

26.1 Trust and fiduciary relationships

Where a trust is created or established, the trustee will automatically acquire fiduciary obligations towards the beneficiary; this is a consequence of the special relationship of trust and confidence between a trustee and beneficiary and the need to protect the beneficiary against the possibility of abuse by the trustee. It is important to understand, however, that not every fiduciary relationship will constitute a trust. Fiduciary relationships may be imposed wherever a relationship of trust and confidence exists, and there remains the possibility that one party will take advantage of that trust and confidence. Such a relationship naturally arises where a trust is created, but it can also arise in other circumstances. Where a person is a fiduciary without being a trustee, only personal equitable obligations will be created.

For example, a director of a company stands in a fiduciary relation to the company, but not to the company's creditors or shareholders. The director of a company is not a trustee for the company. The director must not place herself in a position where her own interests would conflict with those of the company's. The director cannot obtain any personal advantage from the company. These obligations are fiduciary in nature; no equitable beneficial interest is created where the obligation is purely fiduciary in nature.

Where a trust relationship is created, however, the trustee will have the same obligations as the company director, but the person to whom they are owed retains not only personal rights to enforce fiduciary obligations but also a beneficial proprietary interest in the property which is the subject of the trust. The overlap between fiduciary and trustee obligations needs to be appreciated but not confused. To assume automatically that all fiduciaries constitute trustees is incorrect, and it would create a great deal of confusion and uncertainty. A mere fiduciary will not necessarily have trust property vested in them, nor will beneficiaries be clearly determined. Fiduciary relationships are personal, equitable obligations which are imposed in a range of relationships of which the trustee/beneficiary relationship is merely one.

26.2 Trust and bailment

A bailment is to be distinguished from a trust relationship in that it only confers possessory title to property, rather than proprietary rights, upon a bailee. A bailment will not, in itself, create a trust. If the property is expressly conferred to a bailee for the benefit of third parties, then a trust in favour of the third parties may arise. However, the mere transfer of possession is, in itself, insufficient. A bailment confers possession of property to a third party for certain defined purposes; common law will enforce a breach of the terms of bailment or an action for detinue of the property, but unless the terms of the bailment specifically create a trust, no equitable relief will be available.

The distinction between trust and bailment is well evidenced in the dealings that a trustee and bailee may have with third parties. A trustee may pass the property on to an innocent third party purchaser. A bailee cannot pass any proprietary title on because a bailee only holds a possessory title. Furthermore, a bailment relationship can only arise with respect to personal property, whereas a trust relationship can be created over real or personal property.

26.3 Trust and agency

The distinction between a trust relationship and an agency relationship lies in the fact that a trustee holds a vested property interest whereas the agent does not; an agent will usually only have possession of the property on behalf of his principal, rather than actual title. An agent may (although not always) owe fiduciary obligations towards the principal, and so will have similarities with the trustee in this regard, although fiduciary obligations imposed in a trust relationship will generally be more rigorous than those applicable to an agency relationship (*Keech v Sandford* (1726)).

The distinction between the trust relationship and the agency relationship is also well highlighted through their dealings with third parties. An agent who deals with third parties will rarely be liable to those parties because she is acting on behalf of the principal, provided the dealing is within the scope of her powers. A trustee, however, will always be liable to third parties for debts incurred in the course of running the trust unless she expressly exempts personal liability. Once the trustee pays out for expenses associated with the proper management of the trust, she may be indemnified from the trust fund, or, if that is deficient, the beneficiaries personally.

26.4 Trust and contract

A contract is not a trust because it creates personal, common law obligations between the contracting parties; a contract does not, *per se*, create proprietary interests or impose fiduciary obligations. In *Associated Alloys Pty Ltd v ACN*

001 452 106 Pty Ltd (2000), the High Court noted that 'the origins and nature of contract and trust are, of course, quite different. There is, however, no dichotomy between the two. The contracted relationship provides one of the most common bases for the establishment or implication and for the definition of a trust' (p 575). Contractual obligations are enforceable under common law, whilst obligations arising under a trust are enforceable in the equitable jurisdiction. Under the doctrine of privity in contract law, third parties to the contract cannot enforce contractual terms. However, under a trust, a third party beneficiary holds an equitable interest in the trust property and is entitled to enforce the terms of the trust.

In some situations, a contract can result in the imposition of fiduciary obligations and even a trust relationship; it will depend upon the intention of the parties. For example, if a person paying over money intends the recipient to hold that money for the benefit of a third party, then the money will vest in the recipient, who may then be under an equitable obligation to look after the money for the benefit of the third party. Equity may impose a trust, so that the contracting party is bound in equity to look after the money, and the third party acquires an equitable proprietary interest in the money. Alternatively, if the person paying over the property allows the person receiving the property to use the money as their own, and to be under an obligation to repay the money at a future date with no specific obligation towards a third party, it is likely that a contractual rather than a trust relationship will arise.

If, for example, A agrees to pay B a sum of money with the common intention that B should invest the money for a period of one year, and at the end of the year should return the money to A together with a half share of the profits earned by the investment, B may hold the money on trust for A, or B may hold the money under a loan contract with A. In determining whether the relationship is one of trust or contract, consideration must be given to the intention of the parties and an examination of the express terms and the nature and circumstances of the case is necessary. If a trust is created in the example, then A will be able to trace his money into B's hands or into any property B may have purchased with that money. If a debt contract exists, A will be limited to common law contractual remedies for the recovery of the money.

The functional distinction between trust and contract was directly raised in the decision of *Barclays Bank Ltd v Quistclose Investments Ltd* (1970). On the facts of that case, a loan contract was held to constitute a trust relationship because of its particular characteristics. Rolls Razor Pty Ltd had declared a dividend to its shareholders but lacked the necessary liquid funds to make the payments. As the declaration of dividends constituted a debt, it was necessary for the payments to be made. Rolls Razor Ltd then borrowed money from Quistclose Investments Ltd in order to pay the dividends. The arrangement between Quistclose and Rolls Razor was that the borrowed money was only to be used to pay dividends, and it was placed into a separate account with Barclays Bank for this purpose. Rolls Razor went bankrupt before any

dividends could be paid. Barclays wanted to use the funds in the separate account to set off debts it was owed by Rolls Razor. Quistclose argued that it could not do this because the loan contract created a trust and the moneys were held by the bank with notice of this trust. Quistclose argued that the loan moneys had been paid for a specific purpose and, until this specific purpose was performed, the moneys were to be held under an express trust. Once the purpose of the loan was fulfiled and the dividends were paid, the relationship would revert to a normal loan contract. If the purpose could not be performed, however, and the express trust failed, it was argued that the money should be held under a resulting trust back to Quistclose. The bank was affected by this trust because it received the deposit of the money with notice that it was to be paid for a specific purpose.

The House of Lords held in favour of Quistclose Investments. Lord Wilberforce considered the interplay between contractual rights under common law and rights arising from trust principles in equity. He felt that, where the primary purpose for the loan could not be carried out, a secondary purpose could be implied and equity would impose a trust to protect this secondary purpose. The flexible interplay between common law and equity helped the court give true effect to the intentions of the parties. The ultimate conclusion favoured the lender because, as a beneficiary under a trust, Quistclose could recover the loan money in full despite the bankruptcy of Rolls Razor. If the company had remained solvent and the dividends had been paid, Quistclose would only have been able to recover the money pursuant to its rights arising under the debt contract.

The decision in *Quistclose* raised a number of important issues concerning the creation of trust and its relationship with contract. The decision may be summarised as follows:

- A loan contract for a specific purpose may result in the creation of an express trust where the lender makes it apparent that the loaned money is only to be used in a particular manner. The trust will exist until the purpose is carried out. The borrower will act as trustee for this purpose and the beneficiaries will be the subject of the purpose; on the facts of *Quistclose*, this meant that the shareholders of Rolls Razor were the beneficiaries.[1] Where the borrower places the money in a bank account and the bank has notice of the specific purpose for which the money is to be used, the bank holds those moneys as constructive trustee.
- Once the purpose of the loan has been performed, the relationship between the lender and borrower will revert to that of contract. If the purpose is not carried out, for whatever reason, a secondary purpose may be imputed to the lender. If the lender intended the money to be returned

1 Note that the loan contract in *Quistclose* favoured specifically identifiable beneficiaries, namely, the shareholders. If the purpose does not identify the beneficiaries the trust may be unenforceable for not complying with certainty requirements.

> in circumstances where the specific purpose for which it was lent cannot be carried out, a secondary trust may be inferred. This secondary trust would operate as a resulting trust. The secondary resulting trust will only arise where it can be proven to be either expressly or impliedly incorporated into the initial contractual agreement.

The decision in *Quistclose* was supported by the English decision of *Re Kayford Ltd* (1975), where moneys received for the future supply of goods were paid into a special account. It was determined that such moneys were to be held upon trust for the benefit of the customers and would only pass to the company once the goods were supplied. Hence, when the company went into liquidation, the moneys were not treated as a part of the general assets and were held on trust for the benefit of the clients who had paid them in.

The decision in *Quistclose* was approved by O'Loughlin J, in the Federal Court of Australia, in *Peter Cox Investments Pty Ltd v International Air Transport Association* (1999); his Honour noted the 'in depth analysis' of the *Quistclose* decision by Gummow J in *Re Australian Elizabethan Theatre Trust; Lord v Commonwealth Bank of Australia* (1991), where Gummow J emphasised that the question as to the existence of any express trust will always have to be answered by reference to intention, and the relevant intention is to be inferred from the language employed by the parties in question. O'Loughlin J concluded that *Quistclose* stands as authority for the proposition that an apparent debtor-creditor relationship can incorporate a trust relationship when such a trust relationship accords with the mutual intentions of the parties, and that this approach represents good law in Australia.[2]

In both *Quistclose* and *Re Kayford* the contract involved was specifically designed to benefit a third party. Third party contracts are more amenable to the application of trust principles than ordinary two party transactions. This is because the third party has no recourse to contractual rights as a result of the doctrine of privity and equity regards the trust as a protective device. Where a trust is imposed, the third party will automatically acquire enforceable equitable proprietary rights. This is not to suggest that a third party contract will automatically invoke the equitable jurisdiction; it must be proven that the parties intended to confer equitable ownership upon the beneficiary and equitable obligations upon the contracting party (*Bahr v Nicolay (No 2)* (1988)).

In some third party contracts, courts have preferred to extend the doctrine of privity rather than artificially impose trust obligations. In *Trident v McNiece* (1987), it was held that a third party to an insurance contract could sue on a policy of liability insurance provided he was specified or referred to within that contract. The majority of the High Court (Mason CJ, Wilson and Toohey

2 See, also, *Walsh Bay Developments Pty Ltd v FCT* (1995) 130 ALR 415, p 425; and *Re Emanuel (No 14) Pty Ltd (In Liq); Macks v Blacklaw & Shadforth Pty Ltd* (1997) 147 ALR 281, p 290, in support of that proposition.

JJ) held that when an insurer issues a liability insurance policy identifying the assured in terms that evidence an intention on the part of the insurer and assured that the policy will also cover third parties dealing with the assured, and third parties have acted in reliance of such an agreement, the third parties may sue the insurer on the policy despite the lack of privity. Whilst the decision in *Trident* has broadened the application of contractual principles, trust obligations may still be a preferable option as they confer a proprietary rather than a personal right of action (*Bahr v Nicolay (No 2)* (1988)).

Courts have been more reluctant to impose trust obligations over other types of contract unless clearly warranted in the circumstances. For example, in the decision of *Lister v Stubbs* (1890), the court refused to impose a constructive trust over money received by an employer through secret bribes during the course of his employment. The court felt that imposing a trust relationship would confer an unfair advantage upon one creditor against others in bankruptcy proceedings, and there was nothing to justify such priority on the facts. The debt contract arose between an employee and an employer, and there was no issue of the money being paid over to benefit a third party; the employee was held to be contractually liable to return large sums of money he had received as secret commissions during his employment, but there were no special circumstances, apart from fraud, warranting the transformation of the contract into a trust obligation. The decision in *Lister v Stubbs* has, however, been academically criticised (Meagher RP, Gummow WMC and Lehane JRF, *Equity Doctrines and Remedies*, 3rd edn, 1992, para 545) and judicially disapproved (*Attorney-General (Hong Kong) v Reid* (1994)). See also 8.8.4 for a discussion on the decision of *Lister v Stubbs*.

The House of Lords has, however, imposed trust obligations in circumstances where contractual rights were unenforceable, although the wisdom of such an approach has been recently reassessed. In *Sinclair v Brougham* (1914), the House of Lords held that contracts which were entered into without any prior knowledge that they were *ultra vires* could create trust obligations. On the facts, it was held that contracts entered into by depositors when depositing money with a building society were *ultra vires*. The unenforceability of the contract meant that the depositors were unable to recover their money pursuant to contractual actions. The patent unfairness of this led the court to conclude that the building society held the deposited amounts under trust obligations. Viscount Haldane and Lord Atkinson felt that a resulting trust arose once the contracts were proven to be *ultra vires* and unenforceable. Lord Parker held that the building society actually received the money under an express trust, and the depositors could trace their beneficial interest in the money even if the contract was unenforceable.

In the recent House of Lords decision, *Westdeutsche Landesbank Girozentrale v Council of the London Borough of Islington* (1996), the ambit of *Sinclair v Brougham* was reconsidered. In that decision, the court was careful not to

'illegitimately distort' (Lord Goff) equitable trust principles. Lord Goff ultimately restricted the application of *Sinclair v Brougham* to its facts, preferring to provide relief to the bank seeking the restitutionary claim through the application of compound interest. Lord Browne-Wilkinson rejected the application of an express or resulting trust to void contracts for a number of reasons. Primarily, he felt that it would accord unjust priority upon the lender and may adversely affect third parties not coming within the *bona fide* purchaser for value principle.

As Lord Browne-Wilkinson notes:

> I can see no moral or legal justification for giving such priority to the right of [lender] to obtain restitution over third parties who have themselves not been enriched, in any real sense, at [the lender's] expense, and indeed have had no dealings with [the lender]. [The lender] paid over his money and transferred property under a supposedly valid contract. If the contract had been valid he would have had purely personal rights against [borrower]. Why should he be better off because the contract is void?

Care must be taken in considering whether or not failed or ineffective contractual arrangements should create valid and enforceable trust obligations. The trust has proprietary implications which extend beyond immediate remedial needs and can adversely affect the priority status of third party interest holders. The trust should not be superimposed upon a contractual relationship without careful consideration and a clear delineation of the special circumstances justifying its application. To do otherwise would distort the legitimate distinction between trust and contract and the jurisdictional boundaries of common law and equity.

26.5 Trust, charge and conditional gift

A trust can be distinguished from an equitable charge and a conditional gift as a trust creates personal and proprietary rights which are enforceable in equity. An equitable charge merely confers a proprietary right on the holder of specific property without the additional imposition of any personal equitable obligations; a conditional gift results in a donee acquiring a gift with a condition attached which, if not complied with, may preclude the gift from vesting or alternatively entitle the donor to divest the gift. In a situation where it is unclear exactly what the settlor intended, a court may decide that either the charge or the conditional gift represents a more accurate reflection of the donee's intent than a trust. This is particularly the case where it is clear from the facts that the donee did not intend to impose onerous equitable obligations.

For example, a settlor executes a deed of settlement which states: 'I give all of my land to my wife provided she hold my personal belongings for the benefit of my children.' A number of possible legal relations may be interpreted from this disposition:

- The words could amount to a gift to the wife free of any further legal obligations (although the words may impose a moral obligation upon the wife). Under such an interpretation, the children would not have any legally enforceable rights.
- The words might create a gift to the wife over the land, but a trust with respect to the personal property. Under such an interpretation, the children would receive an equitable beneficial interest in the personal belongings of the settlor and could enforce trustee obligations against the wife.
- The words may result in a gift of the land and the imposition of a charge in favour of the children over the personal property; under such an interpretation, the children would acquire an enforceable equitable interest in the personal belongings, but would not be able to enforce personal equitable obligations against the wife.
- The words might result in the wife receiving a conditional gift of the land. Under such an interpretation, if the condition was a condition precedent, the wife would only receive the land where she could prove that she held the personal belongings of the settlor for the benefit of the children. It is more likely, however, that the words would be interpreted as a condition subsequent so that the land would vest in the wife, but may be divested if the wife failed to hold the personal belongings for the benefit of the children. In this situation, the children would not have any legally enforceable obligation but the wife would have a vested interest in complying with the condition.

A charge is very similar to a trust, in that it creates proprietary rights. However, it differs in the sense that the rights imposed are purely proprietary; a charge does not impose any fiduciary obligations against a specific individual and the holder of a charge is only capable of enforcing the interest against the property itself. A conditional gift is similar to a trust in the sense that it imposes an obligation upon the donee of property. However, a conditional gift differs from a trust in a number of substantive ways. In the first place, the donee does not hold the property for the benefit of another party so that no equitable proprietary right arises in a third party. A gift involves the conferral of the entire interest over to the donee, whereas a trust results in the separation of legal and equitable title for the ultimate benefit of a third party. Secondly, if the donee does not comply with the condition, the consequence will be that the gift will either fail to vest or become liable to be divested. By contrast, if a trustee does not comply with her equitable obligations towards the third party beneficiary, she may be liable in equity for a breach of trust.

CREATING A TRUST: THE CERTAINTY RULES

27.1 Creating a trust

An express private trust must satisfy certain well established criteria if it is to be valid and enforceable. A trust, like a contract, must conform to prescribed minimum standards of certainty if it is to be a source of legal rights and obligations. If it is unclear exactly who has the right to enforce the trust and to whom the trustee owes equitable obligations, a court will refuse to uphold the trust. The first, and most important, requirement for the creation of an express trust is that the settlor displays a clear and unequivocal intention to create a trust rather than some other, similar legal or equitable relationship (see Chapter 26).

If no intention to create a trust can be proven, or an uncertainty as to intention exists, an express trust cannot arise; a court will not impose both personal and proprietary equitable rights unless a clear intention to construct such rights can be ascertained from the express words of the settlor. Secondly, the actual wording of the trust must be clear and accurate. There must be clarity as to what property constitutes the trust property and who the beneficiaries of the trust are. An express trust cannot exist if there is uncertainty in either of these issues: it must be clear what property is owned by the beneficiary and it must be clear who has the right to enforce the trust.

Finally, an express trust can only be valid if it complies with the correct statutory, common law and equitable procedures set up for the creation of express trusts. This chapter examines the certainty requirements for the creation of express trusts. The following chapter considers the formality requirements applicable to the creation of express trusts and the consequences of failing to comply with such requirements.

The certainty rules for express trusts can be summarised into three primary categories:

- certainty of intention;
- certainty of subject matter; and
- certainty of objects.

27.2 Certainty of intention

A clear intention to create a trust, and not merely some other general intention to confer some form of benefit, must be proven on the part of the settlor before an express trust will be upheld. The word ‘trust’ need not be used in the

specific disposition. However, it must be proven that the settlor intended to separate legal and equitable ownership, so that one party (the trustee) becomes obliged to hold the trust property for benefit of another (the beneficiary) (*Re Armstrong* (1960)).

The execution of a well drafted trust deed will generally remove any doubt as to the certainty of intention to create a trust. Nevertheless, trust deeds are not always executed (particularly where the trust is created by oral declaration), and genuine doubt may exist as to whether a trust has been created even where documentary evidence does exist.

27.2.1 Bank accounts

A common situation where clear evidence of a trust is sometimes lacking is that of bank accounts opened by one party to benefit another. The court in such a case must examine not only the name and nature of the account, but also the circumstances surrounding the setting up of the account.

In *Re Armstrong* (1960), George Armstrong sought the advice of his bank manager about investing money for his two sons. The bank manager advised him to place the money on a two year, fixed deposit term with the bank. The father followed this advice, and the receipts acknowledging the setting up of the accounts read 'George Armstrong in Re William John Armstrong' and 'George Armstrong in Re Bernard Armstrong'. The father's intention was that he should enjoy the interest during his lifetime, but that his sons should be entitled to the capital upon maturity or upon his earlier death.

Herring CJ held that George Armstrong had created a trust of the capital, and felt that, whilst the exact words 'trust' or 'trustee' were not used, what he said showed a clear intention that he intended to hold the capital of the investment upon trust for his sons. The trust relationship was the most appropriate relationship on these facts, particularly considering the nature of the investment involved. As the fixed deposit contained successive interests in both the capital and the income, and the father wished to maintain his right to the income, the only way to divide the rights was through the imposition of a trust. In *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000), the Australian High Court reiterated that a trust may be created despite the absence of an express obligation to keep trust moneys separate. On the facts of that case, the appellant sold steel to the respondent and the invoices contained a clause that 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.

The respondent had not paid the appellant the full amount owing under the invoices, but had used the supplied steel for a variety of steel products. The respondent then went into liquidation. The court, at first instance, held that the clause on the invoice created a charge which was void against the liquidator because it failed to comply with Corporations law. The findings were upheld on appeal. The appeal to the High Court argued that the clause created a trust binding the respondent with respect to certain future-acquired property.

The High Court, *per* Gaudron, McHugh, Gummow and Hayne JJ (Kirby J dissenting), held that where the existence of a trust is explicit, the absence of an express obligation to keep trust moneys separate does not deny the trust. In the circumstances of this case, the terms of the invoices clearly and expressly stipulated the existence of a trust and thereby embodied the parties' intentions that a trust had been made out; there was no need for the expression 'trust' to be utilised in order for the clear intentions of the parties to the contract to be apparent. As noted by the High Court:

> Here the parties have in terms expressed their intention, and said that the property shall not pass till the full purchase-money is paid. I know of no reason to prevent that being a perfectly lawful agreement. If that was really the intention of the parties, I know of no rule or principle of law which prevents its being given effect to. I quite agree that if, although the parties have inserted a provision to that effect, they have shown in other parts of the agreement, by the language they have used or the provisions they have made, that they intended the property to pass, you must look at the transaction as a whole; and it might be necessary to hold that the property has passed, although the parties have said that their intention was that it should not, because they have provided that it shall.

Their Honours felt that it was no objection to the effective creation of a trust that the property to be subjected to the trust was identified to be a proportion of the proceeds received by the buyer, referable to moneys due and owing, but unpaid by the buyer to the seller, from time to time.

27.2.2 Subjective intention

The High Court has held that the best test for determining certainty of intention is subjective. In *Commissioner of Stamp Duties (Queensland) v Joliffe* (1920), Joliffe paid £900 into an account in the Queensland Savings Bank in the name of 'Mrs Hannah Joliffe – Edwin Alfred Joliffe, trustee'. After the death of Hannah, his wife, he drew money from the account and appropriated it for his own use. Queensland legislation provided that no person should have more than one account at the State bank, but permitted the operation of trust accounts. The Commissioner of Taxation subsequently assessed Joliffe to duty on the amount held in the account as a part of Joliffe's income. Joliffe argued that, in spite of the express reference to a trust in the name of the account, he had never intended to open a trust account for his wife.

A majority of the High Court held that no trust had been created. Knox CJ and Gavan Duffy J stated that, since the trial judge had accepted Joliffe's evidence that he had no 'real intention' to create a trust, the court could not go behind that evidence. The strong dissenting judgment of Isaacs J argued that certainty of intention should be assessed objectively. To permit Joliffe to assert that he had not set up a trust would be to allow the statutory restrictions on the holding of more than one account to be circumvented. Isaacs J set out three primary reasons for rejecting oral evidence in these cases:

- once an effective declaration of trust is made it constitutes a vesting of property in the beneficiary; this vesting cannot be affected by subsequent evidence to the contrary;[1]
- under the parole evidence rule, oral evidence cannot contradict a written document;[2]
- public policy considerations require the trust to be upheld. No person should be able to protect himself from the consequences of his own acts, intentional and deliberate, including the natural conclusions to be drawn from them, by afterwards declaring a secret intention to default or break the law.

The decision in *Commissioner of Stamp Duties (Qld) v Joliffe* has generally applied to the creation of express trusts in bank account situations (*Kauter v Hilton* (1953)). However, it is possible that the general principles enunciated may be restricted in cases where public policy requires it. In *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000), the High Court approved *Joliffe* and *Kauter* and concluded that all the 'relevant circumstances' must be examined in deciding whether a trust exists.

27.2.3 Commercial agreements

An intention to create a trust may be construed from the terms of a commercial agreement, even where those terms make no express reference to the creation of a trust. This occurred in *Barclays Bank Ltd v Quistclose Investments Ltd* (1970), where the House of Lords held that a 'specific purpose' loan resulted in the lender holding the money pursuant to an express trust until the purpose was carried out (see 26.4). In such situations, courts may infer an intention to create an express trust from the particular terms of the agreement. As discussed earlier (see 26.4), such trusts should only arise where a clear intention to impose the protection mechanism of the trust can be

1 See, also, Maitland, *Equity Lectures*, 2nd edn, 1936, p 79, where he states: 'If I convey to A upon trust and declare a trust, A cannot produce evidence that I did not mean to make him trustee.'

2 The parole evidence rule will only apply where there is an instrument which has been used in which the word 'trust' appears, and, furthermore, it will only apply to completed instruments.

established from the terms of the agreement, or where it would be unconscionable to deny the existence of a trust (*Re EVTR* (1987); *General Communications Ltd v Development Finance Corp of New Zealand Ltd* (1990)).

In *Bahr v Nicolay (No 2)* (1988), the Bahrs entered into a contract to sell their land to Nicolay. One of the terms of the agreement was that Nicolay agreed to lease the land back to the Bahrs for a period of three years and, when the lease expired, the Bahrs were entitled to repurchase the property. Nicolay then sold the land to the Thompsons. Under the contract of sale, the Thompsons expressly acknowledged the right of the Bahrs to repurchase the property. Once the Thompsons became the registered proprietors of the land, they refused to acknowledge the Bahrs' right to repurchase. The High Court held, *inter alia*, that the contract of sale to the Thompsons and the express agreement by the Thompsons to abide by the right of the Bahrs to repurchase created a trust in favour of the Bahrs.

Mason CJ and Dawson J held that the contract created an express trust in favour of the Bahrs, commenting that:

> Contract scarcely seems to give sufficient effect to what the parties had in mind. A trust relationship is a more accurate and appropriate reflection of the parties' intention.

Brennan, Wilson and Toohey JJ agreed that a trust had been created, but felt that it was a constructive trust arising out of the fairness of the circumstances rather than an express trust.

Brennan J made the following comments:

> A purchaser who has undertaken – whether by contract or by collateral undertaking – to hold his title subject to a third party's right to purchase, remains bound by his undertaking after registration of his transfer. If he should repudiate the third party's right to purchase, equity imposes a constructive trust, so that the registered proprietor holds his title on trust for the third party to the extent of the third party's interest.

According to Brennan J, the trust arose in order to ensure that the parties complied with the contractual stipulation. This conclusion stems from the application of general fairness principles enforceable in the equitable jurisdiction and it is not a product of any express intention evidenced by the parties within the contract itself (see, generally, Burns, F, 'The Quistclose trust: intention and the express private trust' (1992) 18 Mon LR 147).

27.3 Declarations of trust

An express trust by declaration can only be enforced where it can be clearly proven that the words of the settlor intended to create a trust. Sometimes this is unclear. Whilst it is not necessary for a settlor to refer expressly to the word

trust, the words must indicate an intention to separate out legal and equitable ownership. Words uttered in idle conversation, without any accompanying acts evidencing the seriousness of their intention, will generally provide insufficient evidence of an intention to create a trust (*Jones v Lock* (1865)).

In *Paul v Constance* (1977), Mr Constance and Mrs Paul lived together as husband and wife. Constance had received a compensation payment as a result of an injury at work. Both Constance and Paul went to see the bank manager in order to deposit the amount and, after informing the bank manager that they were not married, Constance told the bank manager that the money was to be placed in his name, but he gave written authority for Paul to access the account. Thereafter, small joint deposits of bingo winnings were placed in the account and withdrawals were divided. When Constance died, Paul claimed against his estate that half the money was held for her benefit under an oral declaration of trust.

The Court of Appeal held that Constance had intended to create an oral declaration of trust. The court stressed the fact that no particular form of words was necessary to prove a declaration of trust if, on the whole, it could be established that a trust relationship was intended. In this regard, words and conduct carried out over a period of time may be taken into consideration. On the facts of the case, the history of the relationship between Constance and Paul, the fact that he repeatedly stated during their relationship 'This money is as much mine as it is yours', as well as the joint deposits made into the bank account and the interview with the bank manager, were all considered to amount to an intention on the part of Constance to declare himself trustee of the money for himself and Paul jointly: see also the discussion at 28.1.1 on this issue.

27.4 Certainty of subject matter

Once an intention to create a trust has been established, consideration must be given to the certainty of subject matter. One of the primary questions to consider in this regard is whether or not the subject matter of the trust is sufficiently identifiable. A trust cannot exist if there is either no trust property or the trust property is not identifiable. It has been held that a trust of 'the bulk of my estate' fails to define the subject matter of a trust with sufficient certainty (*Palmer v Simmunds* (1854)). In deciding whether trust property is certain, the court will apply the equitable maxim, 'that which is not certain is capable of being rendered certain'. In *Re Golay* (1965), a trust to provide a reasonable income for a named beneficiary was held to satisfy the requirement of certainty of subject matter. The court felt that the reference to 'reasonable income' was intended to impose an objective yardstick which a court would be readily able to determine. In *Hunter v Moss* (1994), the English Court of Appeal considered whether a trust 'over 5% of the issued capital of the company' exhibited certainty of subject matter because there was no

indication as to which specific shares the purported beneficiary was to have. Dillon LJ concluded that the trust did exhibit certainty of subject matter and that, provided the nature and amount of shares being held under trust were clear, the trust would be valid.

27.4.1 Future property

It is not possible to create a trust which has, as its subject matter, property that does not yet exist.

As Windeyer J stated in *Norman v FCT* (1963):

> 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 then be his to give.

Courts have, however, found it difficult to distinguish between purported dispositions of future property which are void, and dispositions of present property which will be enjoyed in the future, which are valid and enforceable. The rules relating to future property were largely developed in the context of the law of assignments, but they are also applicable to determine whether a trust of present property exists (see, generally, Chapter 7).

In *Williams v Commissioner of Inland Revenue* (1965), the appellant purported to assign by deed 'the first £500 of the net income which would accrue' from a trust of which he was a beneficiary. The New Zealand Court of Appeal held that the assignment was ineffective. North P and Turner J held that it could not be clearly proven, at the date of the assignment, that the sums mentioned would ever come into existence, either in whole or in part. The artificiality of the distinction between present and future property was conceded by the court; if the appellant had purported to assign or create a trust of, say, a quarter of his share in the trust, rather than 'the first £500', then such a disposition would have been effective.

27.5 Certainty of objects

27.5.1 The beneficiary principle

The objects, or beneficiary, of any intended express trust must be sufficiently identifiable from the terms of the trust. If no beneficiaries are set out, or if they are not set out with sufficient certainty, the trust will fail. If the trust is set up to benefit a purpose rather than a specific beneficiary, unless the purpose is charitable, and therefore capable of being enforced by the Attorney General, the trust will be unenforceable.

The underlying rationale of the beneficiary principle is that, without someone to enforce the trust, there would be no one to ensure that the trustee properly performs her equitable obligations. The beneficiary principle was

enunciated in the old Chancery case, *Morice v Bishop of Durham* (1805). In that case, a residuary bequeath to the Bishop of Durham set out that the Bishop was entitled 'to pay the debts and legacies and to dispose of the ultimate residue of the estate to such objects of benevolence and liberality as the Bishop, in his own discretion, shall most approve of'. The Bishop was appointed as the sole executor of this will. The Bishop wished to perform the trust, but the next of kin filed a bill to have the residuary bequest declared void, and this was successful.

It was held by Sir William Grant MR that, as the residuary bequest was a purpose trust, the purpose had to be charitable for it to be enforceable. The reason for this was because a purpose trust did not have any identifiable beneficiaries who could enforce it, and the court could only control and administer the purpose if it was charitable in nature. If there is no one to enforce the trust, it cannot truly constitute a trust; there must be somebody in whose favour the court can decree performance. After examining the purpose the court held that it was not charitable in nature.

A trust will not fail merely because the actual persons who will benefit from the trust are not known at the time of its creation; it will be sufficient if the terms of the trust set out a sufficiently clear criteria to identify a potential class of beneficiaries. The beneficiary principle does not require immediate certainty, particularly where the trust is discretionary in nature. However, in such cases a sufficiently clear selection criteria must be set out.

The beneficiary principle is applied strictly. In some circumstances, it may be argued that the rigidity of this approach is inconsistent with the aims of the equitable jurisdiction. It has been argued that a better approach may be to uphold a private express trust despite it having a broad, indeterminate category of beneficiaries, until a serious, practical problem of policing performance of the trustee's duties arises, and it would be inappropriate for the court itself to undertake the execution of the trust.[3]

The law relating to certainty of objects awaits authoritative classification in Australia, but for the moment it is necessary to distinguish between the following different types of trust for the purposes of determining which 'certainty rule' should apply. Hence, before examining the certainty of object rules, the difference between a trust where the objects are fixed and a trust where the trustee has a power to choose who the objects may be, must be examined.

27.5.2 Fixed interest and discretionary trusts

Express trusts can be divided into two primary categories: traditional fixed interest trusts and discretionary trusts. Discretionary trusts are further divided

3 See Heydon, JD, Gummow, WMC and Austin, RP, *Cases and Materials on Equity and Trusts*, 4th edn, 1993, para 2,512.

into two categories: those containing trust powers and those containing bare powers. The difference between each trust relates to the powers conferred upon the trustees. A trustee who has a discretion to select beneficiaries naturally has broader powers than a trustee under a trust where the beneficiaries have already been selected.

Beneficiaries under fixed interest and discretionary trusts have differing rights. A fixed interest beneficiary holds an automatic beneficial interest in the trust property because the interests are fixed and the settlor has already selected the objects who are to benefit from the trust. A beneficiary under a discretionary trust, however, only has a right to have the trust administered *bona fide* and in accordance with the trustee's fiduciary duties. The fact that the fixed interest trust has 'fixed' beneficiaries will naturally mean that the certainty of object rules will differ from those applicable to discretionary trusts containing a range or class of potential beneficiaries. As the rules differ, it is important to appreciate the distinction.

Example

A appoints B as trustee of Greenacre for the benefit of X, Y and Z. The trust will constitute a fixed interest trust as the settlor has not conferred a discretion of any kind upon the trustee and X, Y and Z are fixed beneficiaries under the trust. Alternatively, where A appoints B as trustee of Greenacre 'with power to appoint the property to X, Y or Z as he chooses', a discretionary trust arises. B has a discretion to determine who, out of the class of X, Y and Z, he should appoint to. Up until appointment, X, Y and Z do not hold any equitable proprietary interest in Greenacre; they merely hold the right to be properly considered as potential beneficiaries and this right constitutes an equitable choice in action.

27.5.3 Discretionary trusts

A discretionary trust can only arise where the settlor confers a discretion upon the trustee to select who, out of a designated class of beneficiaries, is to receive a benefit and how much that benefit will be. The essence of the discretionary trust lies in the fact that the interests of the beneficiaries have not been fixed. In a situation where the beneficiaries are fixed, however, the trustees have a discretion to determine the method in which the fund shall be applied, the trust will be fixed rather than discretionary in nature (*Re Smith* (1928)).

The presence of discretion in a trust is, to some extent, anomalous, because the very essence of the trust connotes duty and obligation, whereas discretion implies freedom and choice. Nevertheless, it is often the case that a settlor chooses to set up a trust and confer upon the trustee control in the determination of who should benefit under the trust. There are many different reasons for this; an important one lies in taxation. The discretionary trust confers flexibility upon the trustee to allocate the trust fund amongst the beneficiaries (especially in a family trust) in order to minimise tax liability.

27.5.4 Types of powers

Further consideration must be given to the nature of the power conferred upon a trustee under a discretionary trust. Powers are categorised according to the range of objects they contain. There are three primary types:

- *Special power* – a special power under a discretionary trust will arise where the settlor sets out a limited range of objects from which the trustee may choose. The range of objects is usually classified according to a common characteristic. For example, a power to choose amongst any member of the Geelong Football Club or a power to choose amongst any member of the Melbourne Theatre Co will constitute a special power. Where a settlor confers a special power upon a trustee, the trustee must select the beneficiaries from within the specified class.
- *General power* – this type of power is unlimited. Where a trustee holds a general power, he or she is given the power to appoint anyone they think fit, including themselves. Where a general, unlimited power is conferred on a person who is not a trustee, it is tantamount to ownership. However, where a general, unlimited power is conferred upon a trustee, the usual equitable obligations will apply, precluding the trustee from making a profit or gaining an advantage. Unlike a bare power, a trust is imperative; the trustee must exercise the discretion. If the general power is not exercised during the lifetime of the trustee, the property will not pass into the estate of the trustee; it will revert to the settlor (*Trustee Executors and Agency Co Ltd v Margottini* (1960)).
- *Hybrid (intermediate) power* – this type of power is a mix of the above categories. A trustee holding a hybrid or intermediate power has the right to appoint to anyone within a special or general class, except for a defined category of persons (*Horan v James* (1982)). The excluded category of persons should not be so large as to effectively transform the remainder into a special class; it will usually constitute a small or defined range of persons (*Perpetual Executor and Trustee Association of Australia Ltd v Adams* (1975)).

A trustee who has either a general or a hybrid power conferred upon him will be permitted to exercise the power without the automatic presumption that the trust is invalid for uncertainty. The validity of such powers was discussed in *Re Park* (1932). A testator gave his residuary estate to his trustee on trust to pay the income to any person 'other than herself or persons or charitable institution or institutions, and in such shares and proportions as his sister should from time to time during her lifetime direct in writing, and from and after her decease in trust for the '"Imperial Merchant Service Guild" for the benefit of their stress fund absolutely'.

Clauson J held that the trust conferred a hybrid power and that the conferral of such a power did not automatically invalidate the trust. Whilst he felt that a power must not be too vague for the court to enforce and must set

its 'metes and bounds', a hybrid power satisfies this requirement because the trustee is, at least, aware to whom the property should not be appointed.[4]

27.5.5 Trust powers and bare powers

A trust power should be distinguished from a bare power. A trust power imposes imperative equitable obligations upon a trustee, whereas a bare power confers an absolute discretion upon the donee (who may or may not be a trustee). A trustee who has a trust power conferred pursuant to a discretionary trust will have a discretion to determine how the power should be exercised. However, unlike the donee of a bare power, the power must be exercised; it is enforceable in equity (*Re Gulbenkian's Settlement* (1970)). Furthermore, the objects of a trust power hold an enforceable right to be properly considered as potential beneficiaries. This right constitutes an equitable chose in action. The objects of a bare power hold no such equitable right. Their interest can, at best, be described as a future expectancy that the power may be exercised in their favour; they have no right to compel the donee of the power to consider their interests.

27.5.6 Fiduciary powers

A trustee under a discretionary trust may hold either a bare power or a trust power. In both cases, the trustee must exercise it in accordance with equitable fiduciary obligations. For this reason, a further distinction between fiduciary and non-fiduciary powers must be drawn. Non-fiduciary powers will be held by donees who do not owe any fiduciary obligations. All powers held by trustees will be fiduciary. Fiduciary obligations do not alter the essential nature of the power; such duties tend to set out what a fiduciary should abstain from doing rather than imposing positive obligations.[5] The primary distinction between a fiduciary and a non-fiduciary power is that a fiduciary power must be exercised in good faith, without fraud or capriciousness (*Re Manisty's Settlement* (1974)). Such equitable obligations are inapplicable to non-fiduciary powers.

In the decision of *Mettoy Pension Trustees Ltd v Evans* (1991), Warner J sets out four primary categories of 'fiduciary powers' which are summarised below:

- *Bare power conferred to a trustee* – there is no duty to make an appointment and, if the power is exercised, there is a discretion to determine to whom to appoint. The trustee owes fiduciary duties to the potential objects. The donee becomes a trustee of the power itself. This means that the trustee

4 It should be noted, however, that in Australia, hybrid powers may infringe the rule against delegation of testamentary power: *Tatham v Huxtable* (1950); *Horan v James* (1982). See further in this chapter for a discussion on principles relating to the non-delegation of testamentary power.

5 See Glover, J, *Commercial Equity Fiduciary Relationships*, 1995, pp 135–36.

owes fiduciary duties towards the potential objects of the power. Such duties include: the duty to consider as and when may be appropriate to exercise the power; whether the power should be exercised; and, if it is exercised, how it should be exercised. There is, however, no duty to make an appointment because the power conferred is a bare power. The fiduciary obligations owed in the exercise of this form of power may be vested in a trustee or in other persons; for example, managers within a unit trust owe fiduciary obligations in the exercise of their powers.

- *Bare power with an implied or express gift over in default of appointment held by a trustee* – there is no duty to make an appointment and, if the power is exercised, there is a discretion to determine whom to appoint. The trustee is not obliged to exercise the power in favour of the primary objects, but he must in default. The fiduciary duty which the trustee owes is a duty not to commit a fraud or a wrong which will affect the takers on default of appointment (see above for a discussion on the nature and application of implied and express gifts over in default of appointment).
- *Bare power conferred to a trustee with a duty to form a judgment as to the existence of particular circumstances* – there is no duty to make an appointment and, if the power is exercised, there is a discretion to determine whom to appoint. There is a fiduciary duty to determine whether or not certain circumstances exist before the power may be exercised.
- *Trust power conferred to a trustee* – the trustees are under a duty to make an appointment and have a discretion as to whom they may appoint. The trustee owes fiduciary obligations to exercise the power properly, and there is a trust for the objects which the court will carry into effect if the donee fails to perform this duty.

27.5.7 Construction of the trust

Three important considerations must be directed to any individual disposition prior to the application of the object certainty rules. In the first place, attention must be given as to whether the disposition constitutes a trust or a bare power. If the donee of the power is not a trustee, or the disposition does not in itself create a trust, no trust relationship will exist and the certainty principles will be irrelevant. Secondly, if a trust exists, consideration must be given as to whether or not the trust is fixed or discretionary. If a power to determine the objects is conferred upon the trustee, the trust will be discretionary rather than fixed.

Once it is concluded that a discretionary trust exists, the final determination is the nature of the discretion. Is the trustee under a duty to make an appointment, and therefore in possession of a trust power, or does the trustee have absolute freedom (subject to his or her fiduciary obligations) as to whether the discretion should be exercised at all, therefore holding only a

bare power?[6] There are a number of reasons why a settlor may wish to confer a bare power of appointment upon a trustee. A settlor may wish to make the disposition more adaptable to changing legal and social circumstances. If the trustee has a broad discretion, future changes in taxation laws or the financial circumstances of possible objects may be taken into account. If, for example, one potential object becomes bankrupt whilst another becomes more financially stable, a trustee with a discretionary power will be able to determine how (and if) an appointment should be made in light of changing circumstances. For example, a superannuation trust may confer a power on the trustees to award discretionary benefits to relatives and dependants of retirees, the retirees themselves being the beneficiaries of the trust, in circumstances where it is deemed necessary and appropriate.

Determining the above questions will be a matter of construction in each case, and the court will search for the true intentions of the disponer. In this regard, consideration must be given to the express words contained in the disposition (*Re Weekes' Settlement* (1897)). If the words evince an intention to confer an absolute discretion upon a donee of the power, a bare power may be construed, and it will then be necessary to determine whether the donee is a trustee. Alternatively, if the language of the disposition imposes a clear duty to make a distribution, conferring only a discretion as to how it may be exercised, a trust power may arise (*Re Leek (Deceased)* (1967)). Another important factor in determining the nature of the discretionary trust is the presence of an express or implied gift over in default of appointment.

27.5.8 Express and implied gifts over in default

In any situation where a power is conferred upon a trustee, the disponer may plan, in advance, who will or may receive the property in default of the power being exercised. A particular disposition may expressly set out how property is to be distributed if the trustee refuses to exercise a power or, if no express provision is made, a court may, in certain circumstances, imply a gift over in default.

Takers under an express gift in default of appointment will hold an interest which is defeasible upon the exercise of the power. If the power is exercised, takers in default will lose any interest they might have had; takers in default are considered to have an interest which is vested from the outset but capable of becoming divested. An express gift over in default may be fixed or discretionary in nature. Once it is established that the trustee has not exercised

6 It should be noted that, where a trust power and bare power are held by trustees, they may also be described as 'exhaustive' and 'non-exhaustive' discretionary trusts. An exhaustive discretionary trust literally confers a duty upon the trustee to distribute or exhaust the whole of the trust fund, with a discretion as to how; whereas a non-exhaustive discretionary trust confers an absolute discretion upon the trustees to choose whether or not to exhaust the trust fund.

the primary power, the interests of the takers in default will automatically vest. Alternatively, where the trustee has a power to choose who to appoint upon default of the primary power, the interest of the takers in default will not vest until the trustee makes the appointment.

An implied gift over in default may arise automatically by operation of law or through a valid implication of the gift based upon the presumed intentions of the disponer (*Re Weekes' Settlement* (1897)). An implied gift over in default by operation of law may arise where a discretionary trust is created and it contains an automatic resulting trust in favour of the settlor (*Re Sayer* (1957)). Alternatively, a gift over in default may be implied where it can be proven that the disponer intended to benefit ascertainable objects in default of appointment under the primary power. Such an implication could only arise where the objects or class of objects were sufficiently identifiable from the express terms of the disposition (*Re Weekes' Settlement* (1897)).

Example

S gives T a broad discretion to appoint the trust fund to any member of S's immediate family. If S has only four members in his immediate family it may be possible to imply an intention that, in default appointment by T, the four members of the family will receive an equal distribution of the property. If S has a very large and diverse group in his immediate family, it may work against such an implication because it would be hard to prove that S would have intended a very small, equal division amongst such a large group.

An implied gift over in default will generally be fixed in nature and will be distributed to each party equally, as tenants in common. Wherever a gift over in default exists in a trust, whether express or implied, the court will always construe the primary power to appoint as a bare power. When a default provision is detected it provides sufficient intention that the settlor could not have intended the trustee to be under any obligation to exercise the primary power.

27.5.9 Certainty rule for fixed interest trusts

Where a fixed interest trust exists, the objects must be identified with sufficient clarity to satisfy what is known as the 'list certainty' rule. Under this rule, a fixed interest trust will only be valid if the beneficiaries taking under the trust are set out with sufficient clarity for a court to be able to draw up a complete list (*Inland Revenue Commissioners v Broadway Cottages Trust* (1950)).

The rationale of the list certainty rule is that, if all of the beneficiaries cannot be listed, then a trustee will be unaware for whom he may be acting, and a court will be unaware who holds and can enforce the equitable beneficial interest in the trust. If the trust is semantically unclear from the wording in the trust, the disposition will be invalid.

Example

A settlor transfers property to 'A on trust for the benefit of the settlors' friends'. This is a fixed interest trust because there is no discretion in the determination of the objects. As a fixed interest trust it is likely that it would be invalid, for it does not satisfy the list certainty requirement: the term 'friends' is semantically unclear.[7]

The mere fact that it may be practically difficult to discover all the beneficiaries under a fixed interest trust will not necessarily mean that list certainty is not satisfied. Evidential uncertainty will not invalidate a fixed interest trust (*McPhail v Doulton* (1971) *per* Lord Wilberforce). Furthermore, it is not necessary for all of the objects of a fixed interest trust to be specifically identifiable at the date when the trust comes into effect, provided it is clear who the objects will be. Hence, a fixed interest trust for unborn children may be properly established (*Routledge v Dorril* (1794)).

27.5.10 Certainty rules for discretionary trusts

The certainty rules for discretionary trusts differ from those applicable to fixed interest trusts. The main reason for this is that, under a discretionary trust, the beneficiaries are not yet determined and the trustee has a discretion to make a selection. Bearing this in mind, the only certainty requirement for such trusts will be a clear and concise description of the class of potential beneficiaries. The test has come to be known as 'criterion certainty'. A discretionary trust must satisfy the criterion certainty test; this test is applicable whether the trustee holds a bare power or a trust power.

The nature of the criterion certainty test was considered in *Re Gulbenkian's Settlement* (1968). In that case, the issue was whether the trust set up by Mr Gulbenkian was valid. Mr Gulbenkian conferred on his trustees the power to appoint as beneficiaries 'all or any one or more or wife, children or remoter issue for the time being in existence whether minors or adults and any person or persons in whose house or apartments or in whose company care or control Gulbenkian may from time to time be residing or employed'.

Lord Upjohn came to the conclusion that, in such a discretionary trust, the trustees must be able to say with certainty who comes within the range of beneficiaries and who is without. The criterion certainty test was adopted. The criterion must be clear and comprehensible. Any semantic uncertainty would invalidate the trust. The rationale given by the court for stringently enforcing the criterion certainty test was, at least in the case of a bare power, the protection of the takers in default. A strict criterion certainty test would allow courts to watch over any determinations made by the trustee and thereby protect takers in default from an improper exercise of power.[8]

7 Whilst this conclusion is consistent with the reasoning in *Re Gulbenkian's Settlement* (1970), cf the decision in *Re Barlow's Will Trusts* (1979).

8 See *Re Gulbenkian's Settlement* (1970), *per* Lord Upjohn.

The decision of *Re Baden's Deed Trusts (No 2)* (1973) provides a good example of the application of the criterion certainty test. The doubtful words in the trust instrument were held to be 'dependants' and 'relatives'.

Sachs LJ held that relatives are all those persons from whom it is possible to trace legal descent from a common ancestor. The widest meaning for relative did not produce uncertainty and it was satisfactory as a criterion for a discretionary trust. Dependant was held to mean a 'dependant' for the ordinary necessities of life for a person of the applicant's class and position. Dependant was also held to satisfy criterion certainty.

Megaw LJ agreed with Sachs LJ. He felt that the test was satisfied if it could be said that a substantial number of applicants were relatives and were therefore within the class. This judgment can, however, be criticised, as it seems to shift away from the purpose of the criterion certainty test which is to determine with certainty whether anyone is within the class (not just a substantial number of applicants).

Stamp LJ had no difficulty with dependants because he felt it had a clear criterion, but did have problems with 'relatives'. He felt that, if it was construed as referring to all descendants of a common ancestor it would not satisfy criterion certainty, whereas if it was construed as 'nearest blood relations', it would satisfy the test. He concluded that relatives would only satisfy the test if the narrow construction of its meaning were adopted.

The criterion certainty test has not yet been authoritatively adopted in Australia. However, it has been approved in a number of decisions. In *Horan v James* (1982), power to appoint to anyone other than the testator's wife and two sons in a will was held to satisfy the criterion certainty test, but was struck down on the ground that it constituted an improper delegation of testamentary power (see 27.6). In *McCraken v Attorney General for Victoria* (1995), however, it was held that a direction in a will to divide certain pecuniary legacies 'between such Christian organisations and societies in such a manner as my said trustee shall in his absolute discretion think fit' was too indefinite to satisfy the criterion certainty test.

27.5.11 Differences in the application of criterion certainty to trust powers and bare powers

The criterion certainty test applies to all discretionary trusts, whether the trustee holds a trust power or a bare power. Nevertheless, for a trust power to be valid, it has been held that it must be further proven that the class which is set out is administratively workable (*McPhail v Doulton* (1971), *per* Lord Wilberforce). This second requirement stems from the imperative nature of a trust power. As the trustee is under a duty to make an appointment it is important to not only identify the class, but also to ensure that it is comprehensible: in the words of Lord Wilberforce, 'if the class of objects is so

hopelessly wide so as to not constitute a class and to be administratively unworkable', the trust will be invalid.

On the facts of *McPhail v Doulton*, the trust clause provided, in summary, that the trustees were to apply the net income of the fund for the benefit of 'any of the officers and employees or ex-officers or ex-employees of the company (the respondent company: Matthew, Hall and Co Ltd) or to any relatives or dependants of such persons in such amounts at such times and on such conditions as they think fit'.

Lord Wilberforce concluded that the disposition constituted a trust power because of the imperative wording. He went on to hold that criterion certainty should apply to such trusts because of their similarity with bare powers; the fact that a trustee has an obligation to exercise the discretion under a trust power does not justify the application of a completely different certainty test. In this regard, he rejected the application of the list certainty rule to trust powers, holding that there was no need to know exactly who was within the class under such a trust, provided the court could sufficiently identify the settlor's intentions.

Nevertheless, Lord Wilberforce did carefully consider the differences between bare and trust powers. He noted that trustees holding trust powers are required to give a wider and more comprehensive examination of the range of beneficiaries than those holding bare powers, because of the fact that they are under a duty to appoint. Accordingly, he felt that while criterion certainty was the appropriate test, the criterion applied to trust powers should be proven to be 'administratively workable'. The example given by his Honour of what would constitute an administratively 'unworkable' class was 'all the residents of Greater London'. He felt that, whilst such criterion might be clear, its breadth and ambiguous scope made it practically unenforceable.

The exact meaning of Lord Wilberforce's comments has been the subject of much interpretation. It is not clear whether Lord Wilberforce was merely referring to evidential uncertainty, or something more. Possible interpretations include the following:

- *Standing* – administrative workability means that the trust power must have criterion which is sufficient to form it into a loose class, so that members of the class have standing to enforce the duty. The loose class needs to be defined by a common characteristic shared by members of the class, and cannot be so wide as to constitute a general or intermediate power.[9]

9 Cf this approach with the determination of Clauson J in *Re Park* (1932), that a hybrid power could be validly contained in a trust. See, also, the *dicta* of Megarry VC in *Re Hay's Settlement Trusts* (1981), who felt that a hybrid power in trust would not necessarily be so wide as to negate any sensible interpretation by the trustees. Cf the opinion of Buckley LJ in *Blausten v Inland Revenue Commissioner* (1972).

- *Enforceable in a court* – administrative workability means that the trust power must have criterion which is justiciable. If a court has to enforce the duty, the court must have some objective, justiciable criterion upon which to exercise the duty.
- *The capricious test* – a trust power will be administratively unworkable in a trust power if it results in the trustee exercising her powers capriciously and with no sensible direction from the trust. If a trustee can apply her mind to the width of the field and the size of the problem, the power will not be exercised capriciously (*Re Manisty's Settlement* (1974)).

None of the above suggestions necessarily provide the correct test; they simply outline the possibilities. The test of whether a trust is administratively unworkable remains open to interpretation. For further reading on this point, see Grbich, 'Awakening the conceptually moribund trust' (1974) 37 MULR 643; and Hardingham LJ, '*Re Manisty's Settlement*: the continuing saga of certainty of object of discretionary trusts' (1975) 49 ALJ 7.

In *McCracken v Attorney General for Victoria* (1995), a will provided for one-half of the residuary estate to be divided, with certain exceptions, 'between such Christian organisations and societies in such manner as my said trustee shall in his absolute discretion think fit'. The executor sought a determination whether the gift was a valid testamentary disposition. Phillips J concluded that the discretionary trust failed to comply with both list certainty and criterion certainty. His Honour approved of the test enunciated in *McPhail v Doulton*, noting that the decision made a significant change to English law and that it remains the appropriate test to be applied today. On the facts of the case, his Honour noted that the breadth of the description 'Christian', without any further explanation or identification, meant that potentially a huge variety of organisations could be included and that, given such a position, 'it is quite possible that the proper conclusion is that, while plainly not lending itself to complete enumeration, the description adopted by the testatrix in this case is so hopelessly wide as not to form "anything like a class", with the result that the trust cannot be executed'. In other words, this might be a case which falls within Lord Wilberforce's qualification on the operation of the general rule adopted in *McPhail*.

27.6 Non-delegation of testamentary power

This special rule only applies to express trusts in the form of a will.[10] The rule prevents a testator from delegating the power to dispose of the estate. If a power conferred in a will results in the trustee rather than the testator making a determination as to the disposition of the trust property, it will be invalid under the non-delegation rule. The non-delegation rule does not invalidate all

10 Note that in Qld and Victoria the rule against delegation has been abolished by statute: Wills Act 1997 (Vic), s 48; Succession Act 1981 (Qld), s 46.

powers conferred in a will. In Australia, it has been held that only hybrid, intermediate powers offend the rule.

In *Tatham v Huxtable* (1950), a will authorised the executor to distribute any balance of real or personal property from the estate to the beneficiaries of the will, or to others not provided for, who, in the opinion of the executor, have rendered service meriting consideration by the testator. A majority of the High Court (Fullager and Kitto JJ in the majority, Latham CJ dissenting) held that this clause was invalid as it offended the non-delegation principle.

Fullager J considered the validity of special, general and hybrid powers contained in wills. He felt that the conferral of a general power to a trustee was equivalent to the conferral of ownership, and therefore could not be regarded as a delegation of testamentary power. A special power was also to be regarded as valid because the provision of a specific class provided evidence that the testator had exercised some choice in the ultimate selection.

Fullager J concluded that the only type of power which could contravene the non-delegation principle was the hybrid, intermediate power. Nevertheless, he felt that, if a valid default clause existed, whether express or implied, the disposition would be valid. Kitto J agreed in principle with the determination of Fullager J.

The application of the non-delegation principle to hybrid powers is controversial. The principle appears to have a wider ambit in Australia than in other common law jurisdictions, where testamentary hybrid powers are routinely upheld. In view of the modern tendency to liberalise the certainty rules, and thereby to enable trusts and fiduciary powers to fulfil a wider range of commercial and social objectives, analysis by the High Court of the modern scope and purpose of the non-delegation principle appears to be necessary.

The non-delegation principle was further applied by the High Court, in *Lutheran Church of Australia SA District Inc v Farmers' Co-op Executors and Trustees Ltd* (1970), to a bare power to appoint to a single object. In that case, a will provided that the trustee would have the discretionary power to transfer any mortgages, property or shares in specified companies to the Lutheran Church Mission for building homes for aged blind pensioners. The issue was whether or not the clause was valid. At first instance, the South Australian Supreme Court held that it was invalid. On appeal to the High Court, McTiernan and Menzies JJ held that the clause was invalid whilst Barwick CJ and Windeyer J held that the power was valid. The High Court being evenly divided, the decision of the Supreme Court of South Australia was affirmed and it was held to be invalid.

McTiernan and Menzies JJ felt that the power offended the non-delegation principle and was, therefore, invalid. They held that a discretion to appoint or not to appoint to a single specified group did not fit within either the general or special powers, and the mission did not constitute a charity. As there was

no express or implied gift over in default, their Honours felt that the trust should fail.

On the other hand, Windeyer J held that the strictness of the non-delegation rule should be accommodated to, and qualified by, the well-established right of a testator to confer a power upon his executor. The power in this case was clearly not a power given to an executor to choose whomever he wanted; it was a power to decide whether or not to appoint to a selected organisation. Windeyer J felt that this type of selection clearly proved the testator had exercised choice; the only difference was that he had given the ultimate determination of whether the gift should go ahead to the trustee. According to Windeyer J, this type of power should not offend the non-delegation principle. As an additional point, he noted that whilst there was no express gift over in default on the facts, it was possible to validate the gift through the implication of a valid default clause.

The decision of McTiernan and Menzies JJ in *Lutheran Church* tends to encourage some arbitrary conclusions. According to their Honours, it seems possible that a testamentary power exercisable in favour of A or B would be valid because it would constitute a special power, and yet a power exercisable in favour of A alone would be invalid; furthermore, a testamentary power exercisable in favour of A, with an express gift over in default to B, would be valid, while a testamentary power exercisable to A with an implied gift over in default to A would be invalid (see also *Horan v James* (1982); *Public Trustee v Vadjani* (1988)).

CREATING A TRUST: FORMALITIES, AND CONSEQUENCES OF A FAILURE TO COMPLY WITH THEM

Every valid express trust must, in addition to satisfying the certainty rules discussed in Chapter 27, and not being void for public policy reasons (see Chapter 31), meet two other requirements:

- the trust must be properly declared; and
- the trust property must be properly vested in the trustee or trustees.

28.1 Declaration

The requirement that a trust must be properly declared is, for the most part, no more than a restatement of the requirement of certainty of intention. A trust will be properly declared where a clearly manifested, irrevocable intention to create a trust can be established.

By the mid-19th century, courts of equity had adopted a strict approach to the requirement of declaration. It was said to be a 'cruel sort of kindness' to construe a trust out of loose words (*Lambe v Eames* (1871)). Courts were particularly suspicious of attempts to construct valid trusts out of gifts which were invalid because the donor had failed to comply with statutory formalities. In *Jones v Lock* (1865), a father produced a cheque for £900 and said to his baby in the presence of the baby's nurse: 'Look you here, I give this to baby.' The father died before an endorsement in favour of the child had been made. The House of Lords held that the father's 'baby talk' did not constitute a declaration of trust in the child's favour because the father had not, by his words alone, manifested a sufficiently clear intention to declare a trust (see also para 27.3).

28.1.1 Relaxation of evidence required for declaration

The principle that courts will not constitute a valid trust where the formalities for making a gift have not been observed remains firmly established; a departure from this principle would result in the atrophy of common law and statutory provisions for the disposition of interests in property. Nevertheless, there have been signs in recent cases of a blurring of the distinction between a gift and a trust.

This is clearly apparent in the decision of *Paul v Constance* (1971) (see also the discussion of this case in para 27.3). In that case, the English Court of Appeal concluded that Constance had declared a trust for his *de facto* partner over money that was placed in a bank account, on the basis of an overall assessment of conduct and conversations entered into between the two. Scarron LJ held that 'the unsophisticated character' of Constance, and the

nature of the relationship between himself and Mrs Paul, justified a finding that a trust had been declared.

The court's admirable determination to ensure that Paul received the money she had been promised meant that some complex issues of trust creation were either ignored or oversimplified. Scarron LJ did not explain why the arrangement between Constance and Paul created a trust rather than a gift. Moreover, it is unclear exactly when the trust in this case was created. It was unnecessary on the facts of *Paul v Constance* to pinpoint the moment of creation of the trust, but in other cases the identification of the precise moment of trust creation will be of greater significance, especially where the beneficiary's interest is involved in a priority dispute with other interests affecting the property. The decision in *Paul v Constance* demonstrates the drawbacks of well-meaning attempts to relax the strict evidential requirements for a declaration of trust.

28.1.2 Formalities for a declaration of trust

In most cases, a settlor declaring a trust is not required to satisfy any formalities. The exception is a declaration of a trust over land where State legislation, based on the Statute of Frauds 1677 (Imp), lays down specific writing requirements.

Section 53(1)(b) of the Property Law Act 1958 (Vic) provides that:

> A declaration of trust respecting any land or any interest therein must be manifested and proved by some writing and signed by some person who is able to declare such trust or by his will.

Equivalent provisions have been enacted in the property legislation of all other States and territories.[1] The requirement sets out that a declaration of trust need only be 'manifested and proved by some writing'. This means that the trust itself does not have to be in writing. When seeking to enforce the trust, however, the declaration must be evidenced in writing. In *Gardner v Rowe* (1828), a lease was granted to a lessee who, afterwards, went bankrupt. After the bankruptcy, the lessee executed a deed stating that his name had been used in the lease as trustee for a third party. The deed set out that the declaration of trust over the lease, which had occurred prior to the bankruptcy, was valid. The creditors claimed the trust was invalid and the lease was a part of the estate. The court held that the declaration of trust was valid even though it was only executed after the bankruptcy had occurred. The deed was sufficient to satisfy the formality requirements for a declaration

1 The equivalent State provisions are: Property Law Act 1969 (WA), s 34(1)(b); Conveyancing and Law of Property Act 1884 (Tas), s 60(2)(b); Law of Property Act 1936 (SA), s 29(1)(b); Property Law Act 1974 (Qld), s 11(b); Conveyancing Act 1919 (NSW), s 23c(1)(b); Imperial Acts (Substituted Provisions) Act 1986 (ACT), Sched 2, Pt 11, cl 1(1)(b). The Statute of Frauds 1677 (UK), 29 chas II c 3 s 7, is applicable in the Northern Territory.

of trust, namely that the trust be 'manifested and proved by some writing'. It was not necessary for the trust to be created in writing on the date that it was declared as long as some written evidence of the trust was available for the court at the point of enforcement.

The overlap between formality provisions requiring the creation of the trust in writing and those merely requiring the manifestation of the trust in writing has been the subject of some judicial discussion (*Adamson v Hayes* (1973)). Recent authority favours the separate application of formality requirements for declarations of trust. In *Department of Social Security v James* (1990), the respondent, James, purchased a unit in order to accommodate her 35 year old invalid daughter. The unit was very close to the home of James. James subsequently applied for an invalid pension. In her application for the pension, James stated that the title to the unit was retained in her own name for her daughter's protection and that, under her will, the unit was to pass on to the daughter. The value of the unit was included in James' property valuation for the Social Security Department. On review, the AAT found that, at the time of acquiring the unit, James had declared an intention to hold the unit on trust for her daughter and granddaughter; documents and oral evidence were taken into account in reaching this conclusion.

The formality issue was whether or not such a declaration could be valid if it had not been created in writing. This required a consideration of whether s 34(b) of the Property Law Act (1969) (WA) would apply independently of the other overlapping provisions in s 34(a) and (c), both of which required the trust to be created in writing. Lee J found that there had been an irrevocable intention to declare a trust for the daughter for life with remainder to the granddaughter. The fact that it was not created in writing did not matter because (b) applied, and the trust only needed to be 'manifested and proved' by some writing. Upon a proper construction, Lee J held that there is no requirement that a declaration of a trust in land is to be treated as a special class of equitable interest only capable of being created in writing, and then to be manifested and proved by writing at some later stage. If the overlap between the formality provisions was such that all declarations were required to be in writing, then (b) would be 'either an odd exception or otiose'.

The requirements for 'manifesting and proving' a trust in writing 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 creating the writing is not material. It may come into existence at any time after the trust has been declared.

28.2 Vesting

The second requirement for creating a valid trust is that the trust property must be properly vested in the trustees. In analysing the vesting requirement, a distinction must be drawn between two types of trust creation:

- *self declaration* – a settlor declares himself trustee of property for the benefit of another. Where the settlor/trustee already has title to the trust property and declares himself to be a trustee over it, the requirement that the property be vested in the trustee is superfluous. In such cases, the only formality requirements will be those discussed above (see 28.1.2); and
- *third party declaration* – where the settlor appoints some other person(s) as trustee(s), the vesting requirement must be satisfied. According to this requirement, the trust property must be properly vested in the trustee(s).

28.2.1 Assignment formalities

Property will be vested in the trustee if the appropriate formalities for conferring title on the trustee have been properly observed. The nature of the formalities will vary with the character of the trust property involved. Property may vest at law where all of the legal requirements for vesting are satisfied, or in equity where the settlor satisfies the equitable tests (see 29.2.1 and Chapter 7).

28.2.2 Statute of Frauds

The Statute of Frauds and its Australian equivalents prescribes formalities for the transfer of interests in land and of equitable interests in any property. It may apply to transfers to trustees as to other transferees.

The relevant Victorian provisions are ss 53 (1)(a) and (c) of the Property Law Act 1958 (s 53(1)(b) relating to the declaration of trusts of land has been discussed above):

> 53(1) – subject to the provisions hereinafter contained with respect to the creation of interests in land by parole:
>
> (a) no interest in land can be created or disposed of except by writing signed by the persons creating or converting the source, or by his agent therewith lawfully authorising in writing, or by will, or by operation of law; ...
>
> (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 therewith lawfully authorised in writing or by will.[2]

Section 53(1)(c) requires all dispositions of subsisting equitable interests to be in writing. Unlike s 53(1)(a) and (b), s 53(1)(c) is not restricted to interests in land; it applies to all dispositions of subsisting equitable interests, whether they

2 The equivalent State provisions are: Property Law Act 1969 (WA), s 34(1)(a), (c); Conveyancing and Law of Property Act 1884 (Tas), s 60(2)(a), (c); Law of Property Act 1936 (SA), s 29(1)(a), (c); Property Law Act 1974 (Qld), s 11(a), (c); Conveyancing Act 1919 (NSW), s 23c(1)(a), (c); Imperial Acts (Substituted Provisions) Act 1986 (ACT), Sched 2, Pt 11, cl 1(1)(a), (c). The Statute of Frauds 1677 (UK), 29 chas II c 3 s 7, is applicable in the Northern Territory.

relate to real or personal property. In *Adamson v Hayes* (1973), Menzies J felt that, despite the absence of an express restriction, s 53(1)(c) should only apply to 'land' interests because s 53(1) expressly states that all of the provisions are to apply to 'interests created in land by parole'. The rest of the court did not interpret s 53(1)(c) in this manner. Gibbs J expressly disagreed with Menzies J on this point, feeling that there was no justification within the provision for such a restriction. In *PT Ltd v Maradona Pty Ltd (No 2)* (1992), Giles J agreed that headings may be used as an aide to the construction of individual statutory provisions, but that such a restriction could not have been intended under the provisions of s 53. His Honour concluded that 'there was no compelling reason to require writing for the disposition of an equitable interest in land and not for the disposition of an equitable interest in personality'.

It has been held by the House of Lords that the word 'disposition' in s 53(1)(c) should be construed with its natural meaning. Although it is not altogether clear what this 'natural meaning' is, it is wider than the term 'grants and assignments' used in the original Statute of Frauds. Hence, a direction given by a beneficiary (B1) to the trustee (T) to hold the trust property or trust for a new beneficiary (B2) will constitute a disposition of an equitable interest within s 53(1)(c) (*Grey v IRC* (1980)).

In *Grey v IRC*, a settlor, in 1949, made five settlements, one in favour of each of his five grandchildren, and in 1950 he made a sixth settlement on his existing and possible future grandchildren. The appellants were the trustees of these grants. On 1 February 1955, he transferred to the appellants, as his nominees, 18,000 ordinary shares in a company. On 18 February 1955, the settlor orally and irrevocably directed the appellants thenceforth to hold the shares transferred to them on 1 February in five blocks of 3,000 for each settlement executed in 1949 and 1950. Under such a direction, the settlor intended to exclude himself entirely from all future right, title and benefit to, or in, the shares. On 25 March 1955, the settlor and the appellants executed six declarations of trust. All of the declarations recited the settlor's oral directions of 18 February 1955. All six declarations of trust were assessed to stamp duty on the settlor. The IRC argued that the transactions were invalid because they had not complied with formality requirements. Statutory requirements necessitated all dispositions of subsisting equitable interests to be created in writing at the time of the disposition.

It was held by the House of Lords that the directions given by the settlor to his trustees on 18 February 1955 amounted to a disposition, and consequently the trust had to be created in writing to be valid and enforceable.

Viscount Simonds held that the natural meaning of disposition included a direction given to the trustee:

> The word 'disposition' is apt to include an act by an owner of property, the legal effect of which is that he ceases to be the owner of that property.

It has been suggested that, in England, s 53 reforms rather than merely consolidates the Statute of Frauds, whereas in Australia, s 53 and its statutory equivalents should be construed as consolidating and re-enacting the Statute of Frauds (*Abjornson v Urban Newspapers Pty Ltd* (1989)). Acceptance of this argument would mean that the word 'disposition' would be interpreted narrowly to mean 'grant and assignment' of an equitable interest; under such an interpretation, a disposition would not necessarily include a direction by beneficiaries to trustees to transfer property. In *Comptroller of Stamps v Howard Smith* (1936), however, the Australian High Court interpreted disposition broadly. The facts of the case were concerned with whether or not a document under hand amounted to an equitable assignment. The Comptroller of Stamps claimed that it was an instrument liable to stamp duty. This claim could not succeed unless, under the document, equitable interests were made over to the various persons and bodies intended to benefit.

The document was a letter to the manager of a trustee company. The company was both the attorney under power and the trustee of the will of Smith's late wife. Under the will, Smith received the whole of his wife's residuary estate. The letter was sent to the trustees before probate of the will was administered.

The letter read as follows:

> Upon the issue of probate of the will of my late wife ... I have to request to you, as executors and trustees of her will and as my attorney under power, to pay out of my interest ... either in shares or in money at your discretion, to the persons and institutions mentioned hereunder.

The primary question which the court raised was whether the document amounted to a mere authorisation, or whether it constituted a disposition of Smith's subsisting equitable interest under the will. Dixon J held that it was not the intention of the donor to impart an interest to any of the intended donees by the terms of the letter. The intention was simply to request that the proposed donees consider a potential distribution of the trust property in the manner set out. The language of the letter was not imperative and, furthermore, the letter was addressed to the manager both in his capacity as Smith's power of attorney and his trustee.

Dixon J went on to summarise three primary transactions which would constitute equitable dispositions within the meaning of s 53(1)(c):

- a declaration of trust over a subsisting equitable interest;
- an assignment of a subsisting equitable interest; and
- a direction to a trustee to hold a beneficial interest on trust for another party.

Section 53(1)(c) will be complied with where the disposition is effected in writing. It has, however, been held by the House of Lords that, where a legal interest in property has been transferred to (say) a trustee, and the correct

formalities for a legal transfer have been followed, separate writing within s 53(1)(c) is not required to convey the equitable interest simultaneously to the trustee (*Vandervell v IRC* (1967)). It will be a question of interpretation as to whether a transfer of a legal estate was intended to transfer the equitable interest, or whether only a bare legal interest was to pass to the transferee (*DKLR Holding Co (No 2) v Commissioner of Stamp Duties* (1982), Mason J).

Section 53(1)(a) requires all legal or equitable interests in land, which are created or disposed of, to be in writing. It is broader than s 53(1)(c) in the sense that it applies to legal or equitable interests, and to both the creation of such interests and/or the disposition. Nevertheless, unlike s 53(1)(c), s 53(1)(a) is expressly limited to interests in land.[3]

28.2.3 Relationship between the subsections

One of the most complex aspects of s 53(1) is the relationship between the various paragraphs of the subsection to each other. Section 53(1)(a) is broad enough on its face to cover any disposition in land, including some which fall within other paragraphs. In *Adamson v Hayes* (1973), which concerned an option to buy land, the High Court failed to resolve the problem of the interrelationship of the paragraphs.

On the facts, A, H and F owned mineral claims on Crown land within Western Australia. The rights were statutory rights respecting land. These rights were held on trust for A, H and F in differing shares. A, H and F held beneficial interests in the mineral claims. An oral agreement was made to the effect that A, H and F would pool together all their interests; after the pooling they would hold differing percentages. A, H and F made new declarations of trust to achieve a different proportionality in the beneficial interests. The effect of the pooling arrangement was that A came out with 56% of the mineral claims and H and F came out with 44%; A also granted options to H and F to enable them, or a nominated company of H and F, to purchase A's interest at a future date. H and F later nominated a company to exercise the option to acquire the interests of A. A refused, however, to convey the interests. The issue was whether the pooling option arrangement was enforceable.

At first instance, the Supreme Court issued a decree of specific performance to H. A then appealed to the High Court. The High Court upheld the appeal and reversed the decision in the Supreme Court. By a majority of judges (Menzies, Walsh, Gibbs and Stephen JJ, with Barwick CJ dissenting) it was held that the pooling agreement was intended to take immediate effect

3 Note, also, that Menzies J in *Adamson v Hayes* (1973) interpreted s 53(1)(a) as being restricted to legal interests alone, leaving s 53(1)(c) to apply to equitable interests. Walsh and Gibbs JJ did not agree with this, and expressed the view that (a) should apply both to legal and equitable interests because, otherwise, the requirements of s 53(1)(a) for the creation of legal interests would directly conflict with the requirements set out in s 52(1). See, also, *Parker and Parker v Ledsham* (1986).

and to operate as a disposition and/or creation of new interests. Furthermore, mineral claims were held to come in the definition of land within the provisions of the Western Australian Property Law Act. The failure to show any writing was fatal to the agreement, making it unenforceable.

In dissent, Barwick CJ held that the pooling arrangements did not involve any change in legal or equitable interests because there was, on the facts, no intention to vary the equitable ownership until an extra partner was found to form a partnership with H and F.

Each judge in the majority examined the application and relationship between the provisions of s 53. The judgments are individually summarised below:

- *Menzies J* – in determining the applicability of s 53, held (as noted above) that (a) was confined to the application of legal interests only, giving (b) and (c) an independent operation. As the pooling arrangement concerned subsisting equitable interests, (a) was inapplicable.

  He also held (as noted above) that (c) was limited to interests in land, despite the absence of words expressly limiting subsection (c) to land. He justified this limitation by noting that the heading to s 53 stated that the provision was to apply to 'land interests'.

  In considering whether the pooling arrangement was a disposition or a creation of land, his Honour concluded that it resulted in the substitution of new trusts for old and, therefore, the pooling arrangement constituted a creation of a new interest. Menzies J felt that what had been created was a declaration of trust, rather than a disposition of subsisting interests, because it replaced old trusts with new trusts and had the effect of altering percentage rights.

  In conclusion, he felt that, as mineral claims constituted land interests, either (b) or (c) were applicable to the facts and, because (c) would have required the pooling arrangement to be in writing, the oral agreement was unenforceable.

- *Walsh J* – concluded that the rights in the mineral claims were proprietary rights in land rather than merely contractual rights, because they affected land and, as such, came within the definition of land under the Property Law Act provisions.

  He felt that (a) should apply on the facts because the pooling agreement was both a creation and a disposition, and came directly under the application of (a) which required the agreement to be in writing. He expressly disagreed with Menzies J as to the ambit of (a), concluding that it was applicable both to legal and equitable interests. In reaching this determination, he considered the application of s 33 of the Property Law Act 1969 (WA) (the equivalent of s 52(1) of the Property Law Act 1958 (Vic)). Section 52(1) sets out that a legal interest can only be created by way

of a deed. He concluded that, if (a) was only intended to apply to legal interests, it would directly contradict the operation of s 52(1).

- *Gibbs J* – felt that the mineral claims constituted 'interests in land' and agreed with Walsh J about the application of (a).

  Disagreeing with Menzies J, he felt that (c) was not restricted to land. He furthermore concluded that the pooling agreement was not a disposition and that (c) was inapplicable on this basis. He felt that the pooling agreement created new interests which were not previously available and, therefore, there was no disposition because the newly proportioned equitable interests did not exist until after the pooling agreement had created them. As such, the pooling agreement was a creation, and possibly a declaration of, trust, rather than a disposition. Consequently, either (a) or (b) was applicable and, as (a) overlapped completely with (b), the agreement needed to be in writing to be enforceable (see *Department of Social Security v James* (1990), and 28.1.2).

  His Honour held that the option rights should be considered separately from the pooling arrangement. He concluded that the option rights did not amount to a declaration because they were contracts to create a future rather than an immediate interest. He felt that (a) was more appropriate to the option agreement because it referred to all forms of 'creations' and was not restricted to 'declarations', and, therefore, the option agreement had to be created in writing to be enforceable.

- *Stephen J* – held that the pooling arrangement constituted a declaration of trust because it sought to declare new trusts over each mineral claim, therefore (a) and (b) could apply.

  He held that the pooling arrangement could also constitute a disposition because it resulted in the disposal of pre-existing equitable interests. This meant that (a), (b) or (c) could apply, but that (a) was probably the most appropriate provision because it specifically referred to both the creation and disposition of interests in land. Consequently, the pooling arrangement needed to be in writing to be enforceable.

The uncertainty revealed in the judgments as to the relationship between these paragraphs and the fundamental disagreement between Menzies J, who construed both s 53(1)(a) and (c) narrowly, and Gibbs J who adopted a wider, more literal reading of these paragraphs, indicates a need for further High Court clarification in this area.

28.3 Exceptions to the formality requirements

Section 53(2) of the Property Law Act 1958 (Vic) and its State equivalents provides that s 53 shall not affect the creation or operation of resulting, implied or constructive trusts. This means that any trust which is either inferred or implied by the court, rather than being expressly created by a

settlor, is exempted from the application of the statutory formality requirements. Dispositions of existing equitable interests under these trusts may, however, be required to satisfy the writing requirement of s 53(1)(c) (*Oughtred v Inland Revenue Commissioners* (1960)).

A number of other transactions related to the creation of express trusts may also be exempted from the application of the statutory formality requirements where they fit within established exceptions. The first exception is the doctrine of part performance; if a purported beneficiary of a trust has acted so as to change his position on the faith that a trust exists, the beneficiary can prove the trust.[4]

Secondly, a legal owner against whom an oral trust is alleged may be prevented from denying the trust under the equitable principle that the statute is not to be used to cloak a fraud. What constitutes fraud for the purposes of the legislation has been discussed in *Wratten v Hunter* (1978). In that case, a father conveyed land to his son by transfer and later died. After the funeral, the son said 'I promise to live in the home and care for the home and property for us all'. After the son died, his sister and brother-in-law sought a declaration that they and her other brothers and sisters had an interest in the land arising out of the promise. They argued that the promise constituted a declaration of trust and was valid and enforceable against the beneficiary under the son's will. The issue was whether the declaration could be enforced despite the fact that the declaration was neither created nor evidenced in writing.

The court held that the statutory formalities should not be used to cloak a fraud and deny the existence of a beneficial interest where such an interest has been intentionally created. Such concealment would be contrary to the fundamental purpose of the Statute of Frauds. A fraud will arise where the owner of land makes an oral declaration, or attempts to execute a trust by transfer to a third party which fails, and then later seeks to use the statutory formality provisions to deny ever having performed such acts. In such cases, a court will not allow the statutory formality provisions to cloak a fraud. The fraud exception has no application to a situation where a declaration is made and is required to be created or proven in writing. It is not fraud for a court to require writing. Fraud does not mean that equity will relieve against a public statute of general policy in cases admitted to fall within it. Fraud can only be raised where a settlor attempts to deny the existence of past actions and uses the statute to assist in this concealment. On the facts of *Wratten*, the court held that as there was no attempt to conceal the declaration, the question of fraud could not be raised.

4 Property Law Act 1958 (Vic), s 55(d); Property Law Act 1969 (WA), s 36(d); Conveyancing and Law of Property Act 1884 (Tas), s 60(5)(d); Law of Property Act 1936 (SA), s 31(d); Property Law Act 1974 (Qld), s 6(d); Conveyancing Act 1919 (NSW), s 23E(d); Imperial Acts (Substituted Provisions) Act 1986 (ACT), Chapter 2 Pt 11, cl 3(e).

The issue of statutory fraud and the unconscionable use of statutory formality provisions was further examined in *Collin v Holden* (1989). In that case, the facts involved settlement of a property dispute. The counsel for both parties signed the settlement agreement but the parties did not. The applicant then consented to an adjournment of property proceedings. The defendant subsequently refused to comply with the agreement and relied upon s 126 of the Instruments Act which required the agreement to be signed by the parties involved.

The court held that the defendant could not rely upon s 126 of the Instruments Act to deny his acquiescence in the agreement. An equity was created in the plaintiff because the defendant, by his conduct and that of his legal advisers, induced the plaintiff to seek an adjournment and to consent to an order for it on the faith of the representation made by the defendant that he would not rely upon his statutory rights. To allow the insistence upon a statutory right in such a situation would be unconscionable, and a court of equity would not countenance an unconscionable insistence upon a statutory right.

28.4 Failure to comply with writing requirements

If a settlor fails to comply with the Statute of Frauds or other prescribed statutory writing requirements, unless one of the exceptions can be raised, the trust will generally be invalid. This stems from the old equitable maxim: 'equity will not perfect an imperfect gift'. If, however, the settlor has done everything which is necessary for him or her to do to transfer title to the trustee, the trust may be enforceable in equity; equity will transform the settlor into a constructive trustee of the property until all the legal requirements have been complied with. The trust will not be enforceable under common law until all the legal requirements pertaining to the creation of the trust have been satisfied and the property is legally vested in the trustee (the requirements for a valid assignment of trust property are considered in Chapter 29, and relate back to the general discussion in Chapter 7).

CHAPTER 29

INCOMPLETELY CONSTITUTED TRUSTS

In order for an express trust to be properly created, all of the formality and assignment requirements must be completed. Where such requirements have not been completed, it is still possible for equity to recognise a valid trust. Where a settlor proves that he or she has done everything which they alone can do, equity may enforce the trust even though it is incomplete at law.

29.1 Express trust by transfer

An express trust by transfer cannot validly arise until the trust property is properly assigned over to the trustee. The legal requirements for the assignment of trust property will depend upon the nature of the property.

If, for example, the property is land, the property will not be legally assigned until the transfer has been registered at the Land Titles Office. If the property is personal in nature, it will not be legally assigned until the execution of a deed of assignment or the actual delivery of the goods. The legal title to shares in a company are transferable in the manner provided by the articles of association. Usually, the articles will provide that a member may transfer shares by instrument in writing which is to be executed by both the transferor and the transferee; the transferor will remain the owner of the shares transferred until the transfer is registered and the name of the transferee is entered in the register of members. Interests in land can be assigned at law only by a deed of conveyance executed by the party transferring.

In a situation where all the legal requirements for a valid transfer of trust property have not been complied with, the transfer may still be enforceable in equity. Equity may enforce a transfer to an intended trustee in situations where the equitable principles relating to assignment are satisfied. The equitable principles are based upon two fundamental maxims: 'equity follows the law', and 'equity looks to intent rather than the form'. The ability of equity to enforce an uncompleted trust was clearly endorsed in the following decisions: *Milroy v Lord* (1862); *Re Rose* (1952); and *Anning v Anning* (1907), especially the judgment of Griffith CJ (see Chapter 7, particularly 7.1.3).

Once it is established that the settlor has done everything which he alone can do, equity will salvage an incomplete express trust by imposing a constructive trust until all of the legal requirements have been complied with. Once a settlor has done everything which he alone can do, and the court is satisfied of this, he will automatically become a constructive trustee of the trust property for the benefit of the intended trustee. The constructive trust is imposed as an interim protection device until the express trust is properly

created. When the legal requirements for the assignment have been complied with and the trust property vests in the intended trustee, the beneficiary set out under the express trust will acquire a beneficial title.

Example

A wants to transfer land over to B on trust for C. A executes a transfer of land to B and makes the Certificate of Title available, but the transfer is not yet registered. At this stage, A has done everything which he alone can do to effect the property transfer. Up until registration and the legal assignment of the land, equity will protect the assignment by imposing a constructive trust. In this situation, A (the settlor) will hold his legal title as constructive trustee for B (the intended trustee). B therefore acquires an equitable interest in the trust property which is enforceable against A. At this point, C will have no interest in the land because the interests are split between A and B. Once the title is legally transferred and registered into the name of B, A's interest will automatically expire, the constructive trust will cease and C will acquire an enforceable equitable beneficial interest in the land.

The enforcement of an incomplete trust by transfer in equity does not overwhelm the relevant common law and statutory formality and assignment requirements. Where a settlor, through her conduct, has manifested a clear intention to create such a trust, it would be against the conscience of the court to deny its existence. Whilst the intended trust cannot properly arise until the legal and statutory requirements have been complied with, equity protects the intention of the settlor once it is properly manifested. Allowing a settlor to use the statutory formality and assignment requirements in a manner which is inconsistent with her clearly manifested intentions would constitute a fraud, which the equity jurisdiction will not countenance (see 28.3).

29.2 Assignment requirements for different forms of property

At law, the settlor must do all that is required to transfer legally the particular property over to the trustee. In equity, the settlor must do all the acts which are within his capacity to do for the transfer to be enforced. In both situations, this requires a clear understanding of the legal requirements for the assignment of property. A brief summary of the legal and equitable assignment requirements for different forms of property follows. See also the discussion in Chapter 7.

29.2.1 Land

- *At law* – a transfer of Torrens title land must be properly executed and the duplicate certificate of title must be made available.

  The transfer must be delivered to the Land Titles Office, and the trustee must be registered as the new registered owner on the original and duplicate certificates of title. For old title land, the parties must properly execute a deed of conveyance.

- *In equity* – the settlor must have properly executed a transfer of Torrens title land, and must either make the duplicate Certificate of Title available, or give appropriate authority for a third party to make it available. For old title land, the parties must properly execute a deed of conveyance.

29.2.2 Chattels personal

- *At law* – chattels will be legally transferred once actual or constructive delivery has occurred. A deed of assignment must be executed by the settlor to the trustee conferring a right to delivery and control of the property (constructive delivery). Alternatively, if no deed of assignment is executed, the settlor may actually deliver the possession and control of the goods.
- *In equity* – a transfer of chattels personal will be enforceable in equity where a deed of assignment is executed or actual or constructive delivery has occurred. In this situation, the requirements at law match the requirements in equity; in order for the settlor to do everything which is within her capacity to do, she must either execute a deed or deliver the goods.

29.2.3 Choses in action

- *At law* – both s 134 of the Property Law Act (Vic) 1958 and general law provisions set out the statutory requirements for the valid assignment of a chose in action. These can be summarised as follows:
  (a) an intention to assign the chose rather than merely authorise the person against whom the right is enforceable to deal with the interest (*Comptroller of Stamps v Howard Smith* (1936));
  (b) the assignment must be absolute and the whole right (not component parts of the right) must be assigned (*FCT v Everett* (1978));
  (c) the assignment must be in writing, signed by the assignor (in the case of a trust by transfer, this will be the settlor) (s 134 of the Property Law Act 1958 (Vic) and its State equivalents);[1]
  (d) express notice in writing must be given to the debtor/person against whom the right is enforceable. Section 134 does not set out who has to give notice so it may be given by anyone provided it is accurate.
- *In equity* – all of the above requirements must be satisfied. However, notice need not be given because it has been held that it is not necessary for the assignor to give notice for an assignment to be effective in equity (*Anning v Anning* (1907); for a more detailed discussion, see para 7.2).

1 All jurisdictions except the Northern Territory have provisions: Property Law Act 1969 (WA), s 20; Law of Property Act 1936 (SA), s 15; Property Law Act 1974 (Qld), ss 99, 200; Conveyancing and Law of Property Act 1884 (Tas), s 86; Conveyancing Act 1919 (NSW), s 12; Law of Property (Miscellaneous Provisions) Act 1958 (ACT), s 3.

29.2.4 Shares

One of the most common types of chose in action is the share. When shares are transferred over to a third party trustee, the above requirements must be satisfied but, in addition, the requirements set out in the Corporations Law and the articles of association of the company must also be complied with. The most common corporate requirements for the transfer of shares are as follows:

- a transfer of the shares in writing, signed by the transferor, with notice to the corporation of the transfer;
- the transferor should make the share certificates available to the transferee;
- the transfer and the share certificates should then be handed over to the share registry so that the transfer can be registered in the name of the new transferee.

For a transfer of shares to be valid at law, all of the above requirements must be complied with. For a transfer of shares to be valid in equity, the settlor need only do everything which he alone is capable of doing. This would generally mean issuing a share transfer and making the share certificate available to the trustee.

29.3 Express trust by declaration

Where a settlor declares herself trustee, there will be no need for her to comply with assignment requirements because the trust property will already be vested. In such a situation, the trust will be completed once a clear intention to declare a trust can be proven (see 27.3 and 28.1). An incomplete trust by transfer cannot be validated as a completed trust by declaration (*Milroy v Lord* (1862)). The justification for this is that, where a settlor attempts to create a trust in one form and it is incomplete (both at law and in equity), it cannot be validated by claiming that it is properly completed in a different form; this would result in a distortion of the settlor's original intentions.

29.4 Promises to create a trust

Where an agreement for a trust exists for valid consideration, the agreement may be enforced in equity even if the trust is incomplete. Such agreements will generally arise where trust property is to be acquired at a future date. They may, however, be created in different ways. First, where a settlor agrees, for valuable consideration, to hold property which he will acquire at a future date upon trust for a third party, as soon as that property is acquired by the promisor, he will hold it pursuant to a constructive trust for the benefit of the third party (*Holroyd v Marshall* (1862)). Secondly, where a settlor agrees, for valuable consideration, to assign property to a trustee at a future date, the settlor will hold the property under a constructive trust for the benefit of the

intended trustee as soon as it comes into existence (*Tailby v Official Receiver* (1888); see, also, 7.2.5).

An important issue in this regard is what constitutes valuable consideration. Consideration may be something of value which is given, a relationship of value which exists between the parties, or something which is forborne. Where one party forbears to sue upon an existing cause of action, it may constitute valuable consideration (*Lee v Lee* (1876)). Marriage has also been held to constitute valuable consideration; a promise made in support of a marriage settlement will constitute good consideration (*Pullan v Koe* (1913)). Similarly, a promise made in contemplation of a future marriage or within an existing marriage will be treated as having been made with good consideration (*Re Cook's Settlement Trust* (1965)). The only parties who may sue for specific performance of the promise will be the parties to the marriage and their children.

29.5 Exceptions to the general rules

There are a couple of anomalous situations where a gift may be enforceable despite being incomplete in both law and equity. The first relates to the rule in *Strong v Bird* (1874). This rule sets out that where one party expresses a clear intention to make a gift of personal property over to a third party, and this intention continues up until the death of the intending donor without the gift having been properly executed, and the third party is appointed executor of the intending donor's will, the third party will become entitled to the property as against the beneficiaries under the will (see, also, *Cope v Keene* (1968) *per* Kitto J).

The second situation where a gift may be enforceable, despite being incomplete, arises where a gift is made in contemplation of death (*donatio mortis causa*). Under this principle, where a gift is made in contemplation of death, with the unequivocal intention of the donor that it will become effective upon his or her death, the gift may vest in the donee upon the death of the donor despite not having been completely executed (*Cosnahan v Grice* (1862)). Where this rule comes into effect, the property will not come within the operation of any will which may be in existence. For further discussion, see Chapter 30.

CHAPTER 30

TRUSTS AND TESTAMENTARY DISPOSITIONS

30.1 Requirements for a valid will

Trusts may be created by will as well as by an '*inter vivos*' disposition. All States prescribe formalities for the execution of a valid will. Typically, (see, for example, s 7 of the Wills Act 1958 (Vic)) they require the will to be in writing, signed by the testator or some other person in his presence or at his direction, the signature being at the foot of the will and two or more witnesses being present and having sighted the testator's signature. Legislation in New South Wales, South Australia, Queensland and Western Australia has conferred on the Supreme Court in these States the power to relax these requirements if there is no reasonable doubt the testator intended the document in question to be his will.[1]

Any failure to comply with these formalities will generally result in the invalidity of the will, including any trust which it purported to create. Nevertheless, insistence on strict legal obligations creates a tension between the need to observe the statutory formalities for the creation of such trusts and sympathy for those who fail to comply.

Non-compliance with the formalities for the valid creation of wills can occur where the parties are ignorant of the statute or wanted to avoid the publicity associated with the signing of a public document. The case for enforcement is strongest where failure to observe statutory formalities is the outcome of a party's reasonable reliance on a promise or undertaking given by another party. In this chapter, we examine two related situations in which courts of equity enforce the reasonable expectations of parties who fail, wholly or in part, to dispose of their property on their death by a properly attested will. In each case, equity does not ignore or override the legislation, but fastens obligations onto the legatee under a valid will. These obligations are referred to as the secret (or semi-secret) trust and the mutual will.

30.2 What is a secret and a semi-secret trust?

A fully secret trust is an obligation imposed on a legatee to whom property has been left absolutely under a will, or who has received property under intestacy, but who has undertaken to hold the property for some other person

1 Wills Act 1970 (WA), s 34; Wills Amendment Act 1987 (WA), ss 4, 9; Succession Act 1981 (Qld), s 9(a); Wills Act 1936 (SA), s 12(2); Wills Act 1992 (Tas), s 26; Wills and Probate Administration Act 1898 (NSW), s 18A; Wills Act 1938 (NT), s 12(2); Wills Act 1968 (ACT), s 11A.

or persons or to hold the property according to the term of the undertaking. A court of equity will permit the legatee to take the property, but will fasten an obligation on the legatee to carry out the terms of the undertaking.

A fully secret trust is imposed where the existence and the terms of the trust are not disclosed on the face of the will. A semi-secret trust is imposed where the existence of the trust is disclosed on the face of the will but the terms are not disclosed; it is an obligation imposed on a legatee to whom property has been left under a will declaring that she is to take the property 'on trust' or 'for the purposes communicated by me', or similar words indicating that the legatee is not absolutely entitled to the property. A court of equity will require the legatee to carry out the terms of the undertaking which the legatee has given to the testator.

30.3 Requirements for the valid enforcement of secret and semi-secret trusts

The essential requirements of both fully and semi-secret trusts are as follows.

30.3.1 Obligation

An obligation must be imposed on the legatee to deal with property for the benefit of another. The essence of a secret trust is obligation, and the failure to fully establish an obligation is fatal to any attempt to prove a secret trust. So, in *McCormick v Grogan* (1869), a testator who handed to his intended legatee a list of individuals he would have liked to benefit, but who left it entirely to the legatee's good judgment as to how his estate was to be distributed, was held not to have created a secret trust. In *Jankowski v Pelek Estate* (1996), Husband JA noted (p 730):

> ... where the testator has communicated the intention that the legacy should be held in trust for others, where the objects of the trust are known to the legatee and the legatee agrees to act as trustee ... the trust will be enforced ... in order to avoid a fraud on the part of the legatee ...

See, also, *Brown v Pourau* (1995).

30.3.2 Acceptance of the obligation

The obligation must have been accepted by the legatee, either expressly or by acquiescence. A legatee who is ignorant of the testator's intentions as to the disposal of his property cannot be a secret trustee (*Wallgraver v Tebbs* (1855)). A fully secret trust obligation can be accepted at any time before the death of the testator (*Re Boyes* (1884)). In England, however, it has been held that a semi-secret trust obligation must have been communicated and accepted prior to the execution of the will. In *Re Keen* (1937), money was left to two individuals 'to be held upon trust and disposed of by them among such person, persons

or charities as may be notified by me to them'. The testator later executed a codicil and, after its execution, handed a sealed envelope to his intended trustees containing the name of his beneficiary. The English Court of Appeal held that the attempt to create a semi-secret trust failed. The communication and acceptance of obligations must take place prior to, or contemporaneously with, the execution of the will, and must be referred to in the will as a prior or contemporaneous act.

The decision has been criticised on the ground that a will is a revocable instrument until the death of the testator, and there seems to be no good reason to posit legal validity on the date of a revocable legal document. The decision has not been followed in other jurisdictions. This requirement was rejected by Young J in *Ledgerwood v Perpetual Trustee Co Ltd* (1997), who felt that a secret trust could still arise even if the communication occurred *after* the will was executed.

30.3.3 Joint tenancy and tenancy in common

Where property is left to two or more legatees as joint tenants or tenants in common, the rules were summarised, with a noticeable lack of conviction, by Farwell J in *Re Stead* (1900):

- where property is left to A and B as tenants in common, and A but not B accepts the trust obligation, only A is bound by the trust;
- where property is left to A and B as joint tenants and A has undertaken, before the making of the will, to hold the property on trust, thereby inducing the making of the will, both A and B are bound by the trust, even if B is ignorant of the obligation; and
- where property is left to A and B as joint tenants and A has undertaken, after the making of the will, to hold the property on trust, A but not B is bound by the trust.

30.4 Remedy

In most cases, the terms of a full or semi-secret trust will require the legatee to convey property to the beneficiary absolutely. The trust remedy is flexible, however, and may require the legatee to settle property. In *Ottaway v Normans* (1972), the testator in his will left his house to his housekeeper, Eva. Eva agreed to leave the property in her own will to the testator's son. After the testator's death, however, she was befriended by Mr and Mrs Norman. She left the home to them and not to the testator's son. Brighton J held that the testator had created a secret trust under which Eva was entitled to enjoy the property for her life but was obliged to devise it to the testator's son.

The decision in *Ottaway v Normans* is inconsistent with the principles underlying secret trusts, insofar as the legatees under the second will, Mr and

Mrs Norman, were bound by the terms of Eva's obligation even though they had accepted no obligations themselves. Nevertheless, the decision illustrates the flexibility of equity in adapting relief to reflect the nature of the representation made by the legatee under the first will.

30.5 Proof

It is more common for a secret trust to fail the stringent evidential requirements rather than the legal requirements for creation. In *Voges v Mouaghan* (1955), Dixon CJ stated that the elements of a secret trust must be established to the reasonable satisfaction of the court. In *Brown v Pourau* (1995), the testatrix orally expressed her wish, on a number of occasions, to leave her property home to her family as a Maori communal home. By her will, however, she left the home absolutely to her eldest daughter. The will was challenged by family members, who alleged that the daughter held the property under a secret trust for the benefit of the wider family. In rejecting the claim to a secret trust, Hammond J concluded that the evidence was in no more than a state of equilibrium, and that such a balance was insufficient, even on the civil standard of proof, to establish a secret trust.

30.6 The rationale underlying secret and semi-secret trusts

The basis of equitable intervention in cases of secret and semi-secret trusts has been much canvassed in academic literature and, to a lesser extent, in the cases. The House of Lords expressly held, in *McCormick v Grogan* (1869), that equity could intervene and impose a secret or semi-secret trust over a validly created will in order to prevent a fraud being perpetrated. Fraud, in the sense of one party improperly obtaining a personal advantage, does not satisfactorily explain why semi-secret trusts are enforced. Nevertheless, protection against fraud remains the foundation of equitable intervention in this area; as Viscount Sumner noted, in *Blackwell v Blackwell* (1929), the enforcement of a semi-secret trust was required to prevent fraud:

> A court of conscience finds a man in the position of an absolute legal owner of a sum of money bequeathed to him under a valid will and, ... for the prevention of fraud, equity fastens upon the legatee a trust ... which otherwise would be inoperative.

30.7 Secret trust as a remedial constructive trust

Recent theorists on the secret trust have abandoned the trust's basis in fraud, treating it, instead, as an application of the remedial constructive trust. In *Brown v Pourau* (1995), Hammond J asserted that it should no longer be necessary to have resort to the old 'fraud' explanation to justify the imposition of an obligation upon the legatee.

The court supported the intended trust by applying a remedial constructive trust to the legatee. The applicability of this *dictum* to the Australian secret trust jurisdiction will first depend upon whether courts are prepared to accept that secret trusts are better regarded as constructive, rather than express, trusts, and to accept that the constructive trust may be applied in a purely remedial manner.

30.8 Mutual wills

Mutual wills are are made by two or more persons, and are drawn in substantially identical terms. There must be an agreement, which may be implied, by each party not to revoke the will without the consent of the other. If the survivor purports to dispose of the property otherwise than in accordance with the terms of the mutual wills, his personal representatives will be compelled to hold the property on constructive trust for those entitled under the wills (*Bigg v Queensland Trustees Ltd* (1990)).

A typical example of mutual wills occurs when a husband and wife make wills leaving their property to each other, with a promise in each will that the survivor should leave the property to their children. The basis on which mutual wills are enforced was considered by the High Court in *Birmingham v Renfrew* (1937). A husband and wife executed wills leaving their respective estates to each other, with a provision that the survivor should leave the estate to named persons who were collateral relatives of the wife. The husband survived the wife but changed his will so that, on his death, the property passed to his relatives and not to his wife's. The High Court held that the net estate should pass in accordance with his earlier will.

Dixon J held that intervention in cases of mutual wills is based upon the equitable jurisdiction for the prevention of fraud. In this respect, the rationale is, as Dixon J recognised, identical to the traditional rationale for the enforcement of secret trusts. Recent authorities have, however, grounded enforcement of mutual wills on the prevention of unjust enrichment (*Re Newey (Deceased)* (1994)). This appears, however, to be inconsistent with the rationale laid down in *Birmingham v Renfrew*.

Like secret trusts, mutual wills may not properly belong to the law of trusts at all. Viewed in conventional trust terms, the requirement of certainty of subject matter will often not be satisfied since the property subject to the eventual constructive trust may not be ascertainable at the time of the execution of the wills. This aspect was foreseen by Dixon J, in *Birmingham v Renfrew,* who characterised the equitable doctrine as 'a floating obligation, suspended, so to speak, during the lifetime of the survivor which descends upon the assets at his death and crystallises into a trust'. Such a 'floating obligation' may be conceptually closer to a general fiduciary obligation than to the formal structure of a trust.

CHAPTER 31

ILLEGAL TRUSTS

31.1 Trusts which are contrary to public policy

A trust which arises in circumstances involving an illegality, or which is perceived to be contrary to acceptable societal standards, will not be enforceable in equity. Equity will not enforce a trust, even if it is properly created, where that trust has the effect of performing or encouraging an illegality. The rationale for this is quite clear. Equity is a jurisdiction centred around justice and fairness, and it would be against the conscience of a court of equity to enforce a trust in circumstances where it has the effect of promoting immoral or illegal behaviour. A number of equitable maxims may be drawn upon in this regard, including: 'equity will only protect those that come with clean hands'; and 'a person who seeks equity must do equity'.

There are a number of different types of illegality or immorality which may invalidate a trust. The primary source will be statutory illegality. Where a trust is set up in order to avoid statutory provisions, equity may hold the trust to be invalid. A trust which offends fundamental moral tenets, which a court holds to be against current community values, may be invalidated on the ground that it is against public policy. Public policy is a difficult concept to define; it is an 'unruly horse' that changes according to social, commercial and legislative trends.[1] Trusts which contain illegal purposes will be unenforceable (see below). Trusts which contain clauses restricting the right of an interest holder to alienate her interest will also be unenforceable.

The rationale for invalidating such trusts is that restrictions upon the right to alienate are repugnant to the essential character of property rights (*Re Dugdale; Dugdale v Dugdale* (1888); *Hall v Busst* (1960)). Trusts which offend the rule against perpetuities may also offend the doctrine of repugnancy and be contrary to public policy (see *Cadell v Palmer* (1833); and the legislative developments in this area).[2] Trusts which interfere with the sanctity of marriage will also be unenforceable. For example, trusts which are conditional upon marriage or which attempt to restrict potential marriage partners will be contrary to public policy (*Morley v Rennoldson* (1843); *Jenny v Turner* (1880)). Similarly, trusts which encourage one party to dissolve a marriage may be

1 *Trustees of Church Property of the Diocese of Newcastle v Ebbeck* (1960) *per* Windeyer J.

2 Perpetuities and Accumulation Act 1968 (Vic); Perpetuities and Accumulations Act 1992 (Tas), s 6; Perpetuities Act 1984 (NSW), s 8; Property Law Act 1969 (WA), s 101; Property Law Act 1974 (Qld), s 209; Perpetuities and Accumulations Act 1985 (ACT), s 8. The general law still applies in South Australia and the Northern Territory.

contrary to public policy (*Re Caborne* (1943); cf *Ramsay v Trustees Executors and Agency Co Ltd* (1948); *Seidler v Shelthorpe* (1982)).

31.2 Trusts which promote illegal purposes

At common law, the maxim *ex turpi causa non oritur actio*[3] has meant that the courts will not allow a plaintiff to bring an action to enforce a transaction involving an illegal purpose. According to this maxim, neither party to an illegal contract is capable of enforcing it or recovering damages for its non-performance, even where they have been innocent or ignorant of the existence of the illegality. Whilst this may seem harsh on the plaintiff, the court takes the view that it should not lend its aid to a person who founds his cause of action upon an immoral or illegal act. Inevitably, the strict application of this policy favours the defendant. Nevertheless, the rule is not intended to confer advantage on any particular litigant, but rather to ensure more generally that illegal actions are discouraged.[4]

Whilst the *ex turpi causa* principle evolved under common law, it has also been applied to the enforcement of trusts, although the manner and extent of its application to the equitable jurisdiction is still the subject of some debate.[5] An illegal purpose will only apply to invalidate a transaction where illegality exists, and is actually carried out at the time when the trust is established. The mere intention to commit an illegal purpose will not render an assignment unenforceable if the illegality is not actually performed (*Symes v Hughes* (1870) *per* Lord Romilly MR).

31.2.1 The Bowmaker *rule*

Under common law, the illegality rule is somewhat modified by the fact that property interests under illegal transactions can pass if the plaintiff can establish title to such interests without relying upon the illegality. This approach has become known as the '*Bowmaker* rule'.[6] The exact basis of the *Bowmaker* rule is not entirely clear and has been the subject of some discussion.[7] It is often difficult to work out how far the illegality extends into a particular action, and whether this extension prohibits the enforcement of the whole transaction or merely a part of it. Hugh Stowe has pointed out that the

3 An action does not arise from a base cause; ie, an illegal contract is void.

4 *Holman v Johnson* (1775) *per* Lord Mansfield CJ.

5 See *Ayerst v Jenkins* (1873) *per* Lord Selborne LC; also, *Symes v Hughes*; *Taylor v Bowers*; *Payne v McDonald*; and, in Australia, *The Perpetual Executors and Trustees Association of Australia Ltd* (1917). Note, also, that this is an area where a potential 'fusion' between legal and equitable approaches may occur: see Martin, J, 'Fusion, fallacy and confusion: a comparative study' [1994] 13 Conv.

6 So called because it evolved from the case *Bowmakers Ltd v Barnet Instruments* (1945).

7 See, especially, Coote, 'Another look at *Bowmakers v Barnet Instruments*' (1972) 35 MLR 38.

rule can result in two separate interpretations to illegality which he calls the 'contractual enforcement' interpretation and the 'evidential' interpretation.[8] Under the contractual enforcement interpretation, the contract will only be struck down if it results in the overall enforcement of an illegal contractual obligation. Under the evidential interpretation, any case which incorporates an illegal act as a part of the pleadings will be struck down. Both interpretations are within the ambit of the *Bowmaker* rule, and no strict guidelines exist to identify exactly what circumstances constitute such a reliance, although recent cases have attempted some refinement.[9]

The application of the *Bowmaker* rule to the enforcement of illegal trusts has caused some debate. It is unclear whether such a rigid rule is even necessary in equity considering the fact that a court of equity may, in its discretion, permit or refuse an 'illegality' application, depending upon the circumstances of the case and the overall conduct of the plaintiff.[10] A court of equity would generally be reticent to adopt rules which have the effect of circumscribing the breadth of their discretion. In this sense, the *Bowmaker* rule may be more suited to the common law process.

The common law approach to illegality is often criticised for its lack of flexibility and its failure to consider policy issues. This has prompted courts to consider the adoption of a broader 'public conscience' analysis to the matter.[11] A public conscience approach would involve the courts balancing out the adverse consequences of granting relief where the plaintiff has behaved illegally, against the adverse consequences of refusing it where the plaintiff seeks to enforce a legal right.[12] The balancing process would encourage an assessment of such issues as the nature and seriousness of the illegality, the relationship between the illegality and the particular transaction, and the overall advantage in allowing the illegality to preclude the enforcement of legal or equitable rights.

In *Tinsley v Milligan* (1994), the co-owners of a property, Tinsley and Milligan, jointly contributed to its purchase. The house was registered only in the name of Tinsley so that Milligan would be able to fraudulently claim welfare payments by misrepresenting to the social security department that

8 'The unruly horse has bolted: *Tinsley v Milligan*' (1994) 57 MLR 441.

9 See, in particular, the Australian High Court decision of *Nelson v Nelson* (1995).

10 See *Muckleston v Brown* (1801), which was quoted by Lord Goff in his dissenting judgment in the House of Lords decision of *Tinsley v Milligan* (1994).

11 The Court of Appeal, in *Tinsley v Milligan* (1992), discussed this development, in particular the judgment of Nicholls LJ, with reference to *Hardy v Motor Insurers' Bureau* (1964) where Diplock LJ stated that the court will not enforce a right which would otherwise be enforceable if the right arises out of an act committed by the person asserting the right which is regarded by the court as sufficiently anti-social to justify the court's refusing to enforce that right. Other cases rejecting the rigidity of the *ex turpi causa* rule include: *Pitts v Hunt* (1991); *Howard v Shirlstar Container Transport* (1990); and *Saunders v Edwards* (1987).

12 See the excellent article by Gelhorn, 'Contract and public policy' (1935) 35 Columbia L Rev 679; and, *ibid*, Stowe, p 442.

she did not own her own home. The fraudulently obtained welfare was then used for the joint expenses of both Tinsley and Milligan. In 1988, Milligan confessed her fraud to the authorities. The relationship between Tinsley and Milligan subsequently broke down and Tinsley commenced proceedings to assert complete ownership of the house. Milligan counterclaimed and sought a declaration to the extent that Tinsley held the property under a resulting trust for both of them in equal shares. The issue was whether or not the illegality of the transaction prevented Milligan from counterclaiming a resulting trust. A majority of the Court of Appeal (and the House of Lords) ultimately held that the resulting trust set up over the illegally obtained property was not invalid, and the property interest was capable of passing.

Nicholls LJ and Lloyd LJ (Ralph Gibson LJ dissenting) in the Court of Appeal held that, on the facts of the case, the illegality should not result in the defendant obtaining a full title to the property, because this was unfair and out of proportion to the acts committed. Nicholls LJ held that the *ex turpi* principle at common law should accord with the so called 'public conscience test'. Under this test, the court should perform a balancing act between the advantages and disadvantages of granting relief, even though the 'ultimate decision may call for a value judgment'.[13]

His Honour then turned to the issue of equity. Counsel for the plaintiff had contended in this case that issues of public conscience were irrelevant in equity because a simpler maxim applied: 'he who seeks equitable relief must come with clean hands'. Accordingly, the plaintiff argued that in equity there was no scope for balancing; once it was determined that the party seeking equity did not have clean hands, the court must simply refuse assistance and let the estate lie where it falls.[14]

Nicholls LJ noted the 'formidable' authority backing up this argument. He concluded, however, that it would be a poor and harsh law to apply such a rule inflexibly in equity as it would:

> ... accord ill with the underlying considerations of public policy the court is seeking to discern and apply in this field. It would draw a rigid line, in cases such as the present, whereby the erstwhile property owner was forever and utterly precluded from recovering his property as soon as one fraudulent claim had been made.[15]

His Honour felt that inflexible principles do not sit well with the equitable jurisdiction, as it is concerned with a broader and more discretionary approach to justice. He ultimately felt that some rationalisation between the approach of the common law and that of equity was necessary in this area.

13 *Tinsley v Milligan* (1994) Court of Appeal decision, p 398.

14 See *Muckleston v Brown* (1775–1802) *per* Lord Eldon; *Curtis v Perry* (1802); *Gascoigne v Gascoigne* (1918); *Re Emery's Investments' Trust, Emery v Emery* (1959); *Chettiar v Chettiar* (1962); *Tinker v Tinker* (1970); and *Cantor v Cox* (1975).

15 *Tinsley v Milligan* (1994), p 401.

If the discretionary approach of equity was applied strictly and all persons failing the 'clean hands' standard were refused relief in equity, it would produce the illogical result of the equitable jurisdiction being narrower and more rigid than the common law.

This would not only be harsh and out of step with the underlying public policy rationale, it would also mean that equity was taking a less flexible attitude to illegality than the common law:

> It cannot be that, by contrast [to the common law], equity acts less perceptively and has a more restricted vision than the common law. It cannot be that equity, rooted in giving relief against unconscionable conduct, shuts its eyes and applies a rigid rule, when the common law acts with its eyes wide open to all the circumstances. The equitable maxim 'he who comes to equity must come with clean hands' is to be applied no less flexibly than its common law counterparts.[16]

A majority of the Court of Appeal thus held that the rationale underlying the *Bowmaker* rule, mitigated by a new 'public conscience' assessment, was the most appropriate way to deal with illegal transactions both under common law and in equity.

Lloyd LJ agreed in substance with Nicholls LJ, and felt that if the common law adopted a more flexible approach, then so should equity:

> If the common law can steer a middle course ... between seeming to encourage illegality or immorality on the one hand, and refusing all relief on the other, then so can equity. If the common law can discriminate, so can equity ... When one looks at the overall equities, the balance comes down strongly in favour of the defendant. I do not think that the clean hands maxim should prevent us from giving effect to that balance.[17]

Ralph Gibson LJ, in dissent, claimed that there should be no modification of the *ex turpi causa* principle to accord with a public conscience approach under common law, because the court could only truly deter illegality if it assumed a strict approach to illegality issues.

The House of Lords, although finding in favour of the defendant, unanimously rejected the public conscience test upheld by the Court of Appeal and took a different approach in examining the relationship between common law and equity in this area. The majority of the House of Lords, Lord Jauncey, Lord Lowry and Lord Browne-Wilkinson (Lord Keith and Lord Goff dissenting), went back to the traditional, strict approach of the *ex turpi causa* test and the *Bowmaker* rule, whereby an illegal transaction could be enforced, but only if the plaintiff could establish title without relying upon any illegality.[18]

16 *Tinsley v Milligan* (1994), p 401.

17 *Ibid*, p 416.

18 *Tinsley v Milligan* [1994] 1 AC 340 (HL).

The House of Lords concluded that this strict approach should apply to both common law and equitable transactions.

In the leading judgment, Lord Browne-Wilkinson held that there should not be separate rules relating to the enforceability of proprietary interests in law and in equity, where those interests are acquired under an illegal transaction; he made the following comments:

> More than 100 years has elapsed since the administration of law and equity became fused. The reality of the matter is that, in 1993, English law has one single law of property made up of legal and equitable interests. Although, for historical reasons, legal and equitable estates have differing incidents, the person owning either type of estate has a right of property, a right *in rem*, not merely a right *in personam*. If the law is that a party is entitled to enforce a property right acquired under an illegal transaction, in my judgment the same rule ought to apply to any property right so acquired, whether such right is legal or equitable.[19]

The test adopted by Lord Browne-Wilkinson for both legal and equitable estates acquired pursuant to an illegal purpose was a strict one; the broader public conscience approach suggested by the Court of Appeal was rejected. Under the strict approach, a plaintiff would be entitled to recover if she was not forced to plead or rely on the illegality. The *Bowmaker* rule was approved, although its exact breadth and structure were not considered. On the facts of the case, Lord Browne-Wilkinson held that it was only necessary to prove that sufficient contributions had been made towards the property for an equitable action based upon resulting trust to be brought. The issue of how and why the house was purchased was irrelevant to the claim and, therefore, under the *Bowmaker* rule the equitable interest could be enforced.

Lord Goff agreed with the majority of the House of Lords in rejecting the public conscience approach and adopting the strict approach to illegality with respect to legal interests in property. He dissented, however, with the majority in applying this test to transactions involving an equitable interest. He felt that the appropriate approach in equity was based upon a discretionary assessment of whether or not the plaintiff came with clean hands. According to Lord Goff, the matter should remain a part of the broad discretion of the equitable jurisdiction. He felt that, in equity, a broader and more flexible account of the individual circumstances was vital. For example, a particular case may seriously contravene the boundaries of equitable fraud but, nevertheless, overcome the *Bowmaker* rule, resulting in the enforcement of an action which is clearly against the conscience of the court. Such a contravention would not be tolerated in other areas of equitable jurisdiction, and there is no good reason why it should be, just because it falls within the area of illegal purpose.[20]

19 *Tinsley v Milligan* (HL), p 371.

20 *Ibid*, p 362.

31.2.2 Illegal purposes and presumptions of advancement

Where a resulting trust automatically arises, there will generally be no need for a plaintiff to rely upon an illegal purpose to establish an interest, and in such situations a plaintiff will have little difficulty in proving an equitable interest. This was the position of the plaintiff in *Tinsley v Milligan*.[21] Where a presumption of advancement exists, however, a plaintiff will generally be unable to rebut the presumption without relying upon, or leading evidence of, an underlying illegal purpose. Under the *Bowmaker* rule, this effectively precludes a plaintiff from enforcing an equitable interest under a resulting trust. In the recent decision of *Nelson v Nelson* (1995), the Australian High Court has reconsidered the suitability of the *Bowmaker* principle in such situations, and rejected the approach of the majority of the House of Lords in *Tinsley v Milligan*. The development of Australian and UK decisions in this area can be contrasted.

In *Nelson v Nelson,* the mother of two children paid for a property but transferred it into the names of her two children in order to ensure that she would qualify for a defence service loan on a subsequent property she was purchasing. Such a loan would not have been available had she already held property in her name. It was found that Mrs Nelson had no intention of conferring any beneficial interest in the property to her children, and transferred it into their names purely to ensure that she would be able to obtain the defence subsidy. It was also held that, due to the closeness of the relationship, when Mrs Nelson transferred the property into the names of her children a presumption of advancement arose; in order for Mrs Nelson to successfully claim her equitable right to the property under the resulting trust, she had to rebut this presumption. The difficulty was, she could not do so without revealing an illegal purpose, and this was precluded under the *Bowmaker* rule. The New South Wales Court of Appeal followed this principle, and would not condone the mother using an illegal purpose to subsequently rebut the presumption of advancement.

The High Court came to a different conclusion. Deane, Dawson, Toohey, McHugh and Gummow JJ all found in favour of the mother. In a joint judgment, Deane and Gummow JJ rejected the approach of the majority of the House of Lords in *Tinsley v Milligan,* and raised two factors of paramount significance. The first related to the nature of the illegality. Their Honours noted that where the illegality stems from statute, but is not directly prohibited, a court must examine the underlying policy of the Act. The court must consider whether or not the alleged illegality truly contravenes the policy of the Act, and if so, whether or not the purpose of the Act is sufficiently served through the imposition of its own penalties. If the latter is the case, equitable relief rebutting the presumption of advancement should not be denied, because this was never the intention of the legislature.

21 See, also, *Blackburn v YV Properties* (1980).

The second factor considered was the nature of the equitable jurisdiction. Deane and Gummow JJ felt that it would be contrary to the range and flexibility of equitable relief to impose absolute principles concerning the assessment of illegal transactions.

Their Honours noted that:

> ... 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 anybody to ask it'.[22]

Their Honours also noted that previous decisions which have been cited as authority for the absolute prohibition of illegal transactions in equity[23] are best considered as individual responses to particular statutory regimes, rather than authority for any general propositions. They emphasised the importance of ensuring a discretionary approach to public policy issues in equity with broad references to Story,[24] Ashburner[25] and Pomeroy,[26] and the recognition that it would be unusual for equity to adopt a formalistic approach that had the effect of allowing a resulting trust where no presumption existed, but not allowing it where it did.

In conclusion, Deane and Gummow JJ held that, on the facts, the purpose of the Act was to provide public moneys for selected individuals who did not already own property in order to facilitate the purchase of housing. In light of the factors stressed above, they found that the policy of the Act had been contravened, but that the contravention was sufficiently served by the penalties it imposed. Denying Mrs Nelson the right to enforce a resulting trust would not further the objects of the legislation, and would unnecessarily restrict the equitable jurisdiction.

Both Toohey and McHugh JJ adopted similar approaches to Gummow and Deane JJ. Toohey J emphasised the importance of considering the public policy underlying the statute. According to Toohey J, there was no rule of public policy that Mrs Nelson be refused relief. The whole purpose of the act was to prevent the unfair enrichment of one person at the expense of another; it did not extend to precluding the enforcement of a properly established resulting trust. Toohey J expressly approved of the 'public-conscience' approach adopted by the Court of Appeal in *Tinsley* in this regard, because he

22 [1994] 1 AC 340, p 371.

23 The two decisions specifically referred to were: *Cottington v Fletcher* (1740); *Muckleston v Brown* (1801).

24 Bigelow (ed), *Equity Jurisprudence,* 13th edn, 1908, Vol 1, Chapter 7, paras 298, 301.

25 *Ashburner's Principles of Equity,* 2nd edn, 1933, p 472.

26 *Pomeroy's Equity Jurisprudence,* 5th edn, Vol 3, para 941.

felt that it most accurately reflected the balancing approach that must be adopted when considering the statutory provisions.

McHugh J adopted an approach to illegality strictly based upon the statute. His Honour felt that a legal or equitable right should not be refused unless the statute discloses an intention that this should occur, or the statute does not disclose an intention to cover the field and the refusal is consistent with the policy and objects of the act, and is not disproportionate to the seriousness of the unlawful behaviour.

Dawson J came to the same conclusion, but adopted a different approach. He disapproved of the decision by the House of Lords in *Tinsley v Milligan*. Whilst he agreed that disconformity between common law and equity in the rules relating to illegality is undesirable, he felt that the conclusion of the majority in *Tinsley* only served to advance an illogical distinction:

> The different result is entirely fortuitous being dependent upon the relationship between the parties, and is wholly unjustifiable upon any policy ground. That the transfer of property by a husband to his wife for an illegal purpose, and not intended as a gift, should not give rise to a resulting trust, whereas a similar transfer of property by a man to his *de facto* wife for a similar illegal purpose should do so ... cannot in my view have any basis in principle.[27]

According to Dawson J, the appropriate principle to apply in equity is the 'clean hands' maxim, as it has a wider application; even if the *Bowmaker* principle did apply, it would not automatically invalidate a plaintiff's action. Dawson J felt that a party seeking to rebut a presumption of advancement through proof of an illegal purpose does not automatically rely upon the illegality. The illegality may help to prove the donor's state of mind, but it will not form the foundation of the action.[28] In *Esso Australia Resources Ltd v Federal Commissioner of Taxation* (1998), the High Court noted that the 'equity of the statute' doctrine built on and extended the operation of the statute into areas not covered by its terms, and approved of the decision in *Nelson v Nelson.* However, by contrast, the court felt that the analogical use of statutes in the evolution of the common law does not give the statute any operation beyond its terms, and that it is, rather, a way of ensuring that common law developments are consistent with the social changes reflected in legislative developments. See, also, *Nonferral (NSW) Pty Ltd v Taufia* (1998), where the

27 See *Nelson v Nelson,* p 166.

28 It should be noted that authority, to the effect that there was no presumption of advancement between a mother and child, had not been repudiated at the date of the decision. However, it had been questioned in *Brown v Brown* (1993). The judgment of Dawson J questions the arbitrariness in distinguishing between different types of relationships in applying the presumption; it also questions the arbitrariness in enforcing a resulting trust with an illegal purpose where no presumption exists, but not doing so where a presumption does arise. It seems that the inevitability of such artificial distinctions led Dawson J to prefer the more flexible and discretionary 'clean hands' approach to enforcement.

Supreme Court of New South Wales applied the tests set out in *Nelson v Nelson*.

While the UK has not followed this approach, the courts are increasingly prepared to allow evidence to rebut a presumption of advancement where the illegal purpose has not actually been implemented (*Tribe v Tribe* (1995)). The difficulty with this approach is that it will often be very hard to prove that a party has actually 'recanted' or 'virtually refrained'[29] from carrying out an illegal purpose; furthermore, such an approach retains the arbitrary distinction between resulting trusts where a presumption arises and those where one does not.

31.2.3 Types of illegal purpose

There are many different types of purpose which may be classified as illegal, and between them there is considerable difference. For example, putting property into the name of another in order to:

- obtain an unentitled amount from a social security fund (*Tinsley v Milligan*);
- evade tax or misrepresent creditors (*Tribe v Tribe*);
- obtain a loan to which one is disentitled (*Nelson v Nelson*); and
- misrepresent financial status in a matrimonial cause.

The above represent only a very small portion of the range of illegal purposes that can arise. Some will be illegal because they are contrary to express statutory provisions; others will be illegal because of the intention to mislead or deceive the other party, thereby constituting legal or equitable fraud. In light of the developments in the application of illegal purposes (noted above), it would seem that merely proving the existence of an illegal purpose is insufficient. At least in Australia, for an illegal purpose to preclude the enforcement of a trust, the following pre-requisites must be established:

- that the illegal purpose has, in fact, been performed;
- that equitable interest under the trust can only be established upon proof of an illegal purpose;
- that the illegal purpose is of such a nature that it should not be relied upon to prove an equitable interest. Considerations which should be taken into account in this assessment include: the relationship between the parties; the character of the illegality; the knowledge of each party that the purpose was illegal; the consequences for both parties if relief is refused; and, if a statute is involved, the policy and sanctions it prescribes and the legitimacy of imposing a double penalty.

29 See the comments of Dixon CJ in *Martin v Martin* (1959).

31.3 Statutory illegality

Whether a trust is invalid on the grounds of statutory illegality will depend upon the character of the trust and the individual interpretation of the statute. The statute may extinguish the trust completely or, alternatively, make the trust void or voidable against particular persons. In order to determine the effect of the statute, close attention should be given to the character of the individual statutory provisions. It is beyond the scope of this book to consider comprehensively all of statutory provisions which may have the effect of invalidating a trust. Nevertheless, a brief overview of the statutory provisions dealing with trusts set up to evade income tax, and trusts set up to avoid creditors claims upon a bankruptcy, follows.

31.3.1 Income tax evasion

An express trust may be set up specifically in order to evade taxation. New taxation laws covering these type of situations are extremely broad and will invalidate any scheme entered into with the primary intention of acquiring a tax benefit; a scheme will include a trust arrangement.

The Income Tax Assessment Act 1936 (Cth) will render any trust entered into for the primary purpose of evading income tax liability as void against the Federal Commissioner of Taxation. Section 260 of the Act renders void all arrangements, agreements or contracts entered into on, or prior to, 27 May 1981 which have the effect of altering, relieving defeating, evading or avoiding tax liability. This section has been held to apply only where it can be proven that the primary explanation for the arrangement was the reduction of tax. If the express trust has been set up for other commercial or domestic reasons apart from tax reduction, s 260 will be inapplicable (*Peate v Federal Commissioner of Taxation* (1967)). Part IVA of the Income Tax Assessment Act 1936 (Cth) has also been introduced in this regard, and confers a general power upon the Federal Commissioner of Taxation to cancel any tax benefit acquired from a scheme where it can be objectively established that the dominant purpose for entering the scheme was to acquire a tax benefit. The breadth of the provision makes it clear that express trusts, entered into purely in order to achieve some form of tax benefit, may come within the terms of part IVA and, thereby, have that tax benefit cancelled. Importantly, pursuant to s 177F, the Commissioner has a wide discretion to determine how, or to what extent, the tax benefit will be cancelled.

It should be remembered that statutory illegality will only invalidate a trust to the extent that an individual statute determines. Section 260 and Part IVA of the Income Tax Assessment Act do not invalidate the trust *per se*; they merely render the trust invalid against the Federal Commissioner of Taxation and cancel any corresponding taxation benefit.

31.3.2 Trusts set up to evade creditors

An express trust which is set up purely in order to avoid the claims of creditors may attract the provisions of the Bankruptcy Act 1966 (Cth). The relevant provision in this regard is s 120, which sets out that a settlement of property will be invalid against a trustee in bankruptcy if the settlor becomes bankrupt within two years of making the settlement. Section 120(1) will not apply if the settlement was made in consideration of a marriage, provided the marriage existed before the settlement, if the settlement was made in good faith for a *bona fide* purchaser for valuable consideration, or if the settlement was made to a spouse or child of a marriage as a matter or right pursuant to the marriage. Section 120(2) sets out that a property settlement (except for those excluded in s 120(1)) will be void against a trustee in bankruptcy if the settlor becomes bankrupt within five years, unless the parties can prove that the settlor was, at the time of making the settlement, able to pay all of his or her debts without using the property contained in the settlement, and that the settlor's interest in the property passed upon execution of the settlement.

Furthermore, s 121(1) sets out that any disposition of property which is entered into with the intent of defrauding creditors may, if the disposer subsequently becomes bankrupt, be void against the trustee in bankruptcy unless the disponee can prove that he or she acted in good faith, and gave valuable consideration. This section tends to catch trust relationships, because traditionally, and this is particularly the case in family trusts, a trustee acts voluntarily and is thereby unable to raise the defence (*Official Trustee v Mitchell* (1992)). Similar provisions exist in Corporations Law for a bankrupt company. Under s 565(1) of the Corporations Law any settlement entered into by a corporation prior to 23 June 1993, which would be void if it had been made by a natural person in the event of a bankruptcy, will also be void against the liquidator of a company. Part 5.7B of the Corporations Law governs property settlements entered into after 23 June 1993.

CHAPTER 32

TRUSTEE'S DUTIES

Having considered the requirements for a valid creation of a trust, in this chapter we move on to examine the duties and obligations of a trustee under a valid and enforceable trust. The trustee owes fiduciary obligations towards the beneficiary in the administration of the trust (see Chapter 8, especially 8.3). Certain clearly established duties have arisen from the fiduciary character of the relationship. These duties are strictly enforced by courts in order to protect the beneficiary against any potential abuse by a trustee. In considering whether conduct by a trustee constitutes a breach of trust, attention must be given not only to the equitable duties, but also to the terms of the trust deed, the application of any statutory provisions, and whether or not the beneficiaries have, on the facts, consented to the conduct.

32.1 Duty to avoid a conflict of interest and account for any profit

One of the fundamental fiduciary obligations owed by a trustee is to avoid a conflict of interest and, if such a conflict arises, to account for any profit which may have been made. This duty was clearly enunciated in *Keech v Sandford* (1726), where Lord King LC held that a trustee was precluded from applying for a renewal of a lease for the benefit of a child beneficiary because of the potential for abuse (see 8.2.4 for a discussion of the case).

This stringency of the principle in trust relationships was confirmed in *Chan v Zacharia* (1984), where the High Court held that a partner who had exercised an option to renew a lease previously existing in joint names in his own name, was bound to account in the winding up of the partnership as a constructive trustee for any benefit he received. The precise nature of the duty owed by the partner as constructive trustee was set out by Deane J, who stated that all persons under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain which:

- has been obtained or received in circumstances where a conflict or significant possibility of conflict existed between fiduciary duty and personal interest in the pursuit of such benefit or gain;
- 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 such benefit or gain; and
- was obtained or received by use or by reason of his fiduciary position, or of opportunity or knowledge resulting from it. Any such gain must be held by the fiduciary for the benefit of the beneficiary.

Deane J concluded that the rule in *Keech v Sandford* created an irrebuttable presumption that any rights obtained by a trustee over trust property involved a conflict of interest, whereas a rebuttable presumption existed for other forms of fiduciary relationships (see 8.2.2 for further discussion).

Further evidence of the stringency of the trustee's duties in avoiding any conflict of interest and accounting for any profit made, lies in the fact that the trustee is not able to be remunerated for his services. In *Williams v Barton* (1927), the defendant was a trustee who was also employed as a clerk by a firm of stockbrokers. His salary consisted of half the commission earned by the firm on business introduced by him. The defendant recommended his firm to value the testator's securities. The firm's charges were paid out of the testator's estate and the defendant received half as his salary. The defendant took no part in the valuation or in fixing the fees to be charged. The court held that the remuneration for the services was only received by the defendant as a result of his trusteeship. The profit would not have been made but for his position as trustee and he was, therefore, bound to treat it as part of the estate of the testator.

Russell J felt that the peculiar nature of the employment contract made the trustee in this case fall into a direct conflict of interest. If it is proven that the trusteeship has been used to obtain a gain or benefit, then the trustee will be liable to compensation or to hold the gain upon constructive trust. If it can be proven that the gain was unrelated to the trusteeship, the trustee will not be liable to account for it (see also *Robinson v Pett* (1734)).

32.2 Duty to act with reasonable prudence

During the continuance of the trust, the trustee must manage the trust property vested within him properly and adequately. The trustee must obey the terms of the trust and must use reasonable prudence in exercising any powers which have been conferred. The duty to act with reasonable prudence was set out in *Speight v Gaunt* (1883). The facts of the case involved an appeal from a decision finding the defendant, Mr Gaunt, who was a trustee, liable to pay an amount of $15,000, which was lost as a result of the failure of a stockbroker employed by him to make investments on behalf of the trust. The issue was whether the trustee was liable for the amount and whether he had breached his duty to act with reasonable prudence.

Jessel MR held that the duty of the trustee here was to conduct the business of the trust in the same manner as an 'ordinary prudent man of business' would conduct his own. The trustee was under no higher standard of care than was reasonable and usual in the circumstances. It was held that the usual precautions taken by men of business, when making an investment on the stock exchange through a stockbroker, is to select a stockbroker in good credit and in a good position having regard to the sum to be invested, and direct him to make the investment. The court held that the trustee made a

proper selection of a broker and had taken all reasonable precautions. The money was lost through the default of the broker and the trustee could not be held liable.

The standard of care was extended in *Re Whiteley* (1886), where Lindley LJ added that the duty of a trustee in exercising a power to invest the trust fund is not to take such care as only a prudent man would take if he had himself to consider, but 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.

Even if the trustee is not a man of business and has no knowledge or experience concerning investments, he will still be expected to act according to prudence by employing skilled agents and seeking advice from experts or directions from the court. The duty of a trustee is an equitable duty; it does not constitute a common law duty of care (*Wickstead v Browne* (1992)). This duty of care is now specifically set out in s 6(b) of the Trustee and Trustee Companies (Amendment) Act 1995 (Vic); equivalent legislative provisions also exist in South Australia. Pursuant to s 6(b), if the trustee is not a professional trustee, he must exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons.

The manner in which a trustee performs the duties will, of course, also depend upon the terms of the trust. The fundamental duty of the trustee to obey the terms of the trust will override all other duties; the trustee must abide by the terms of the trust even if he considers that it is not in the best interests of the trust. In such a situation, the trustee should seek the consent of the beneficiaries to vary the terms of the trust (see Chapter 34).

The duty to act with reasonable prudence is particularly important where the trustee is given a power to invest the trust fund. The trustee must exercise prudence and care in deciding which investments to make and when to make them. The standard of care expected will vary according to the skill and expertise of the trustee. If the trustee is a friend or associate of the settlor, without a great knowledge of the world of business, then the standard of care to be applied will be the ordinary prudent business person who is morally bound to make investments for someone else.

On the other hand, if the trustee holds himself out as a professional in the business of acting as a trustee, he will be expected to carry out a higher standard of care. This is statutorily endorsed in Victoria pursuant to s 6(a) of the Trustee and Trustee Companies (Amendment) Act 1995 (Vic), which states that, where the trustee's profession or business includes acting as a trustee or investing money on behalf of other persons, the trustee must exercise the skill, care and diligence that a prudent person engaged in that profession or business would exercise in managing the affairs of other persons.

This application of this standard is well demonstrated in the decision of *Bartlett v Barclays Bank (No 1)* (1980). In that case, a trust was set up with the

trust property being shares in a property purchasing company. The trustee of the shares was, initially, Barclays Bank, which subsequently set up a trust corporation. Barclays Bank held 99.8% of the shares in the company. After a number of years, the board of directors for the property company changed dramatically; it no longer contained any member of the beneficiaries or any representative of Barclays Bank or the trustee corporation. The board then announced that the policy of investment in property would be changed to that of speculative development in property; the objects clause in the trust instrument was altered to allow for this. The board of directors told the trustee bank that the reason for changing the investment policy was in order to assist the public issue of the property company shares, and that this would raise the finance needed to pay death duties. An investment company was incorporated as a vehicle for purchasing freeholds and leaseholds. All this occurred without the knowledge or approval of Barclays Bank or the trustee corporation.

The primary investment for the company was known as the 'Old Bailey' project. This investment occurred without the prior knowledge or approval of the trustee, and an agreement was entered into to provide half the finance for the acquisition and development of the site. Investment in this scheme was not, however, crucial to the trust fund. Furthermore, planning consent for the site had not yet been obtained, although purchases for the site continued. The board had a chance to dispose of its interest in the Old Bailey project for little or no loss at an early stage, but it decided not to do this and continued to finance the scheme. This opportunity was also unknown to Barclays Bank and the trustee corporation. With the end of the property boom in 1974, the Old Bailey scheme subsequently made a big loss. The plaintiff beneficiaries claimed that the trustee was liable to make good to the trust fund all loss accruing by reason of it having breached its duty of care as a professional trustee in not keeping abreast of the investments being entered into by the property purchasing company.

It was held by Brightman LJ that, where a trustee, such as a trust corporation like the bank, held itself out as having the skill and expertise to carry on the specialised business of trust management, the trustee's standard of care must be higher than the 'ordinary prudent man of business' standard. A professional trustee should not have relied upon information given at the annual general meeting alone; it should have required the board to inform and consult it so that it could intervene, if necessary, to safeguard the interests of the beneficiaries. The fact that the trustee here held itself out as a specialist, with trained trust officers and managers, with ready access to financial information and professional advice, meant that it held itself out as having a higher standard of care. Hence, it was prudent for such a trustee to be properly informed. If the trustee had carried out this duty it could have intervened to prevent the board from entering into, and continuing with, the hazardous speculation of the Old Bailey project; early intervention by the bank might have forced the board to sell for little or no loss when it had the opportunity.

The court held that the trustees had breached their duty of care and were required to make good the loss. They were entitled, however, to set off the loss of the Old Bailey project against profit made in another, separate investment. The court held that such a set-off would not always be possible; it could only arise if the second transaction in which the profit was made arose out of the same investment policy. The compensation awarded was assessed at the date of the sale of the share holdings, and would not take into account any tax liability of individual beneficiaries. The proper rate of interest, in the absence of special circumstances for the non-receipt of trust funds, was that allowed from time to time on the short term investment market. Interest on costs was not allowed. In *Australian Securities Commission v AS Nominees Ltd* (1995), the Federal Court re-examined the standard of care required for trustees when exercising investment powers. Finn J reiterated the comments of Clarke and Sheller JA in *Daniels v Anderson* (1995), who observed that:

> While the duty of a trustee is to exercise a degree of restraint and conservatism in investment judgments, the duty of a director may be to display entrepreneurial flair and accept commercial risks to produce a sufficient return on the capital invested [p 658].

Finn J went on to note that today, the different risks between those persons who invest their assets in companies on the one hand and on trusts in the other; where the trustee is itself a company the requirements of care and caution are in no way diminished; 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. In this context, the duties of trusteeship of the company can give form and direction to the common law statutory duties of care and diligence imposed on directors, where the directors themselves have caused their company's breach of trust, and on the duty of care of directors generally.[1]

Finn J further noted that the classic standard of trustee care and caution is of a general application and does not differentiate between types of trustee. His Honour felt, however, that this standard was settled during a period when trust corporations were not used for the trading and investment purposes that are the commonplace today and that, in consideration of cases like *Bartlett v Barclays Bank*, there should now be a higher standard expected from corporate or professional trustees holding themselves out as having a special skill or experience and inviting public reliance upon such skill and knowledge than that which is expected from ordinary prudent business persons. See, also, *Wilkinson v Feldworth Financial Services Pty Ltd* (1998).

1 See, also, *Daniels v Anderson* (1995) 16 ACSR 607; *Permanent Building Society v Wheeler* (1994) 14 ACSR 109; Superannuation Industry (Supervision) Act 1993 (Cth), s 52(8), (9).

32.3 Duty to act in the interests of the beneficiaries

A trustee is bound to act in the best interests of the beneficiaries; this duty emanates from the fact that the trustee is appointed as custodian of the trust property. Whenever a trustee makes a decision on behalf of the trust, she must make sure that the decision is in the interests of the beneficiaries. This requires a consideration of the nature and range of beneficiaries involved. In Victoria, s 7(2)(a) of the Trustee and Trustee Companies (Amendment) Act 1995 (Vic) specifically requires a trustee to exercise her powers in the best interests of all present and future beneficiaries of the trust.[2] Most commonly, the financial interests of the beneficiaries will be considered to be paramount. In certain circumstances, however, other broader considerations may be relevant. For example, if the beneficiaries hold an established religious or social belief, a decision which is contrary to this may not be in the best interests of the beneficiaries, even if it is a sensible financial decision and, whilst the *prima facie* purposes of the trust are best served by seeking to obtain maximum financial return, commercial prudence may be overwhelmed (*Harries v Church Commissioners for England* (1992), p 1246, *per* Nicholls VC).

It may be the case that the trustee is caught between the express terms of the trust instrument and the social and economic well-being of the beneficiaries. Whilst modern trust instruments usually combine both duty and discretion, in the absence of a discretion it may be necessary to consider whether the duties of the trustee remain in the best interests of the beneficiaries. If the trustee considers an express trust duty to be contrary to the interests of the beneficiary, she will generally not be in breach if she does not exercise it. On the other hand, neither will a breach occur if the trustee does exercise it because, in such a situation, the trustee is only complying with the mandate of the trust deed.

Where a trustee has a discretion, the trustee is required to exercise her judgment in a way which shows she has considered the best interests of the beneficiaries. If the trustee has acted honestly and mistakenly believed the decision to be in the best interests of the beneficiaries, she may be exonerated. Section 67 of the Trustee Act 1958 (Vic)[3] allows a trustee to be relieved from personal liability where 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 directions of the court in the matter in which she committed the breach. This section operates as a general defence. The trustee, however, must have acted with reasonable prudence and care, and must not have acted dishonestly. If this cannot be established, the provision

2 Equivalent statutory amendments have been introduced in South Australia.

3 The equivalent provisions in other States are: Trustees Act 1962 (WA), s 75; Trustee Act 1925 (NSW), s 85; Trusts Act 1973 (Qld), s 76; Trustee Act 1936 (SA), s 56; Trustee Act 1898 (Tas), s 50; Trustee Act 1893 (NT), s 49A; Trustee Act 1925 (ACT), s 85.

will not apply (*National Trustees Co of Australasia Ltd v General Finance Co of Australasia Ltd* (1905)).

If the trustee wants to make sure that the decision is appropriate and will not constitute a breach, s 63 of the Trustee Act 1958 (Vic) gives the court the power to authorise particular dealings with trust property in the management or administration of property or any sale, lease, mortgage, surrender, release or other disposition, or any purchase, investment, acquisition, expenditure or other transaction.[4]

The question of what constitutes the best interests of the beneficiaries was considered in *Cowan v Scargill* (1985). In that case, a pension scheme for mineworkers was established. The pension was set up as a trust for the benefit of all industrial employees of the National Coal Board on their retirement or injury, and for payments to their widows and children. There were 10 trustees of the scheme: five were appointed by the board and five by the mineworkers' union. The trustees had wide powers of investment under the scheme, which entitled them to invest overseas and in energy industries other than coal. In 1982, the five union-appointed trustees refused to approve an investment plan unless it was amended to exclude any increase in overseas investment, to withdraw from existing overseas investment and to prohibit any investment in energy industries which were in direct competition with coal. The union trustees were following union policy to invest in the British coal industry. The other five trustees appointed by the board applied to the court for directions and claimed that the union trustees were in breach of their fiduciary duties of loyalty towards the beneficiaries of the fund.

It was held by Megarry VC that the trustees of the pension fund were subject to the overriding duty of trustees to act in the best interests of the beneficiaries, particularly with a pension scheme where the beneficiaries had actually contributed to the fund. The court concluded that a broad diversification policy was preferable to a narrow one. Trustees of a pension fund could not refuse, for social or political reasons, to make a particular investment if, to make that investment, would be in the best interests of the beneficiaries. On the facts, it was felt that the financial benefit of the beneficiaries was paramount over other non-financial interests. The investment policy excluding foreign investment was held to be against the best interests of the beneficiaries, because most of them were retired from the coal industry and some, for example, widows, had never actually been involved in the industry. A policy which excluded overseas investment and made investment in the British coal industry an imperative would not favour diversification and would, therefore, not be in the best financial interests of the beneficiaries. Any possible economic benefit from investment in the British

4 The equivalent provisions in other States are: Trustees Act 1962 (WA), s 89; Trustee Act 1925 (NSW), s 81; Trusts Act 1973 (Qld), s 94; Trustee Act 1936 (SA), s 59b; Trustee Act 1898 (Tas), s 47; Trustee Act 1893 (NT), s 50A; Trustee Act 1925 (ACT), s 81.

coal industry alone was considered to be too remote from the actual status of the beneficiaries, as they were either retired or widows of miners who no longer depended upon the continuing existence of the coal industry. The five union trustees were, therefore, held to be in breach of their duties.

Sometimes the best interests of the beneficiaries can mean that the trustees must go against their own social beliefs (as in *Cowan*) or they must act dishonourably. In *Buttle v Saunders* (1950), the trustees made a bargain which was not legally enforceable; it was held that the trustees were bound to act in the best interests of the beneficiaries, even if that meant acting dishonourably, by considering and exploring a better offer they had received.

32.4 Duty to act impartially

A trustee must not favour one beneficiary or class of beneficiaries against another; all trustees owe a duty of impartiality towards the beneficiaries (*Tanti v Carlson* (1948)). The trustee must attempt to act fairly with regard to all the interests of the beneficiaries. In Victoria, s 7(2)(c) of the Trustee and Trustee Companies (Amendment) Act 1995 specifically sets out that the trustee is under a duty to act impartially towards beneficiaries and between differing classes of beneficiaries. This duty can be very difficult where the beneficiaries hold differing interests; for example, if one beneficiary holds a life estate whilst another holds the remainder, the trustee must act fairly towards both by ensuring that proper, secure investment strategies are maintained, so that the life estate holder receives a reasonable income without damaging the capital for the remainder interest holder (see *Bouch v Sproule* (1887)).

A trustee must not enter into any agreement either to exclude or sustain a preference or distribution towards beneficiaries, because to do so would be evidence of impartiality and the trustee would be held to be in breach (*Clark v Dillon* (1925)). Where a trustee is found to have acted impartially, the trustee may be discharged by the court, or possibly ordered to pay compensation for any loss flowing from the breach.

32.5 Duty to keep trust funds separate

A trustee must ensure that the trust property is kept separate from the trustee's own property or from third party property. This means that the trust fund must remain exclusive. For example, a trust bank account must be kept separate from other, personal bank accounts which the trustee may have. A trustee must not mix trust funds with his own funds and must not set up any title with third parties which is adverse to that of the beneficiaries (*Newsome v Flowers* (1861)).

32.6 Duty to act gratuitously

The general rule is that a trustee cannot receive any profit or remuneration out of the trust estate.[5] If the trustee accepts the position, then it is assumed that the trustee will act gratuitously; this will be the case even if the trustee is a solicitor or a member of a firm of solicitors acting for the beneficiaries. This strict principle stems from the stringent fiduciary obligations attached to the trustee position as set out in *Keech v Sandford* (1726) (see 32.1 and the decision of *Williams v Barton*).

There are, however, three exceptions to this general rule. A trustee may be remunerated where the trust instrument expressly sets out that remuneration may be granted. The trustee's right to remuneration under the express clause is not contractual; it is a derivation of the settlor's power to direct how her property may be dealt with. A trustee should not insert in the trust instrument a charging clause for himself unless the settlor expressly instructs him to do so, otherwise the clause may be disallowed. Remuneration may also be charged where there is a valid and enforceable agreement between the trustee and beneficiaries, and where it is approved by the court. The decision in *Re Hill* (1924) illustrates a further situation where remuneration may be granted. In that case, the plaintiff was a solicitor and a trustee. The firm in which the plaintiff worked consisted of himself and two other members. The plaintiff introduced the beneficiaries to the firm and another member carried out legal work on their behalf. The issue was whether or not the firm could charge for the work because the plaintiff/trustee was a partner. In fact, the plaintiff was really a salaried employee and a partner in form. This meant that he would not receive any of the costs for the work done on behalf of the beneficiaries; he would receive his salary as usual and the other 'equity' partners would share the profits.

Maugham LJ held that there was a further exception to the general rule that a trustee cannot be paid. This occurred where a trustee/solicitor who was a partner made a clear agreement that he was not to receive any profit from any work carried out on behalf of the beneficiaries. On the facts, however, it was held that the exception did not apply because there was no clear agreement to exclude profits, and it was possible that the firm would have to rely upon profits to pay the salaries. A good example of the wording of an express contract to exclude remuneration is set out in *Re Mundy* (1938).

The clause read as follows:

> No fees, commission or other remuneration earned by either partner ... in the capacity of trustee of a settlement shall be deemed to be partnership earnings or partnership profits, but if one partner acts as solicitor for the other in relation to such remuneration he shall be entitled to receive from the other, and

5 See statutory provisions: Trustee Act 1962 (WA), s 98; Trustee Act 1958 (Vic), s 77; Administration and Probate Act 1919 (SA), s 70(1); Trustee Act 1898 (Tas), s 58; Trusts Act 1973 (Qld), s 101.

> to retain to his own, use such legal charges as would be payable by any other client for similar services.

This clause was considered sufficient to allow remuneration to be paid to the firm which had carried out the work, despite the fact that the trustee was a partner there.

32.7 Duty to invest in authorised securities

A trustee will only have a duty to invest where authorised to do so. Authorisation may come from three sources: the trust instrument; statute; or the court. If the trustee does not have express authorisation to deal with the trust fund from one of these sources, the trustee will have no power to make investments on behalf of the trust. In Victoria, the primary source of obligation is the trust deed; this is statutorily endorsed in s 6(2) of the Trustee and Trustee Companies (Amendment) Act 1995 (Vic), which states that a trustee must exercise a power of investment in accordance with any provision of the trust instrument that is binding on the trustee, and comply with any stated requirements for consent or approval for the entering into of such investments. Authorisation to invest is usually set out in the trust deed. Even where there is no express direction in the trust deed, a trustee of a large trust fund will be under a duty to act in the best interests of the beneficiaries, and this would usually require the investment of the fund in order to produce income (*Cowan v Scargill* (1985)). The definition of 'investment' has been construed narrowly; it will not include the mere acquisition or purchase of property. It must be shown that the purchase was entered into in order to produce some income or profit (*Will of Sheriff* (1971)). According to s 9(4) of the Trustee and Trustee Companies (Amendment) Act 1995 (Vic), any acceptance or subscription for securities referred to within the section will constitute the exercise of a power of investment. In *Condell v Moore* (1998), Girvon J noted that the word 'security' referred generally to investments and included a power to buy land.

If the trust instrument includes a power to invest, the trustee will have the power to deal with the trust fund, although all dealings should be within the scope of the power. Where the trust deed does not set out any particular investment guidelines, the trustee may develop an investment strategy; this is particularly important where the trust fund is extensive.

If the trust deed does not authorise investment, s 5(1) of the Trustee and Trustee Companies (Amendment) Act 1995 (Vic) confers a general power upon a trustee to invest trust property in any investment the trustee thinks fit, provided it is not prohibited by the trust deed. In Victoria, s 5 replaces the old statutory investment lists. The broad investment power introduced by the Act is regulated by a range of discretionary considerations which a trustee should take into account.

Section 8(1)(a)–(o) sets out, *inter alia*, matters that a trustee may take into account when exercising a general power of investment. They include a consideration of: the purpose of the trust; the needs and circumstances of the beneficiaries; the desirability of diversifying trust investments; the nature of any risk associated with trust investments; the need to maintain the real value of the capital or income of the trust; the risk of capital or income loss or depreciation; the likely income return and its timing; the length of the investment; the probable duration of the trust; the liquidity and marketability of the proposed investment during, and on termination of, the investment; the value of the trust estate; the tax liability of the investment; the likelihood of inflation affecting the valuation of the investment; the costs of entering into the investment; and the results of any review taken of existing investments. Section 9 sets out a further range of powers concerning investment in securities.

Sections 6 and 7 set out a range of different duties which a trustee must take into account, in the absence of any contrary provision in the trust instrument, when exercising a power of investment. Pursuant to s 6(3), subject to any contrary provisions in the trust instrument, the trustee must, at least once a year, review the performance (individually and as a whole) of trust investments. Section 7(2)(b) imposes a duty not to invest trust funds in speculative investments. Section 7(2)(d) imposes a duty to take advice concerning the method of investing trust funds. Statutory lists are still retained in most of the other States.[6]

The final method by which a trustee may seek authorisation for investing trust property is through seeking court approval. If a trustee with a wide investment power wants to be absolutely certain that an investment is authorised, he may apply to have it authorised by the court, thereby preventing the subsequent allegation of a breach.[7]

32.7.1 Modern portfolio theory

An important consideration in the exercise of trustees investment power lies in the issue of investment diversification. Should a trustee be considered to be acting prudently and in the best interests of the beneficiary when investing only in secure, low return investments? Modern developments in investment theory tend to suggest this may not be the case. Certainly, the legislative developments in the Victorian Trustee and Trustee Companies (Amendment) Act 1995 seem to be endorsing a more diversified approach to investment.

6 The equivalent provisions in other States are: Trustees Act 1962 (WA), ss 15A(1), 16; Trustee Act 1925 (NSW), ss 14–14E; Trusts Act 1973 (Qld), s 21; Trustee Act 1898 (Tas), s 5; Trustee Act 1893 (NT), s 4; Trustee Act 1925 (ACT), s 14.

7 Trustee Act 1958 (Vic), s 63; Trustees Act 1962 (WA), s 89; Trustee Act 1925 (NSW), s 81; Trusts Act 1973 (Qld), s 94 ; Trustee Act 1936 (SA), s 59B; Trustee Act 1898 (Tas), s 47; Trustee Act 1893 (NT), s 50A; Trustee Act 1925 (ACT), s 81.

Section 8(1)(b) specifically sets out investment diversification as a consideration in the exercise of a trustee's power of investment. Nevertheless, traditionally the courts have tended to equate investment prudence with secure, individual investments (see Finn and Zeigler, 'Prudence and fiduciary obligations in the investment of trust funds' (1987) 61 ALJ 329).

The main difficulty has been the entrenched notion that, to be prudent, each investment must be examined on its own merits rather than in the context of the overall portfolio. The 'modern portfolio theory' (MPT) rejects this approach. Under this theory, investment is based upon two concepts: expected return and risk. The MPT examines the expected rate or return for the portfolio and the total variability of the portfolio return. The theory was devised by Harry Markowitz in the US in the 1960s, with the emphasis being an examination of the entire portfolio rather than single investments.[8] A single investment which, by itself, may seem risky and speculative, may be balanced by a subsequent secure investment. Under the MPT, consideration must be given to the nature of the investment and the expected return compared with the overall risk, how long the investment is for, and when the beneficiaries are to receive their benefits. The MPT is particularly appropriate for large trust funds containing the dual objects of risk and cost minimisation. A highly diversified portfolio ensures that beneficiaries retain the benefits of secure investments as well as higher returns.

The MPT theory was discussed in *Nestlé v National Westminster Bank* (1988). The case concerned an alleged breach of trust arising from the way in which the bank carried out its investments. It was held by Hoffman J, at first instance, that a judgment on the fairness of the choices made by the trustee must have regard to the considerations that the investment will carry current expectations of their future income yield and capital appreciation, and these expectations will be reflected in their current market price, but there is always a greater or lesser risk that the outcome will deviate from those expectations. He felt that it would be inappropriate to apply a mechanical principle here. The Nestlé fund failed by a considerable margin to match the index of ordinary shareholders over its 64 year life. The bank was criticised for lack of balance, lack of diversification and the retention of risky investments in Chinese bonds. Nevertheless, the court ultimately held that the bank had acted conscientiously, fairly and carefully throughout the administration of the trust fund.

During the course of his judgment, Hoffman J pointed out that the trustee's duty of investment should be flexible in order to adapt to a contemporary understanding of markets and investments. He felt that modern trustees are entitled to be judged by the current portfolio approach

8 See Gordon, JN, 'The puzzling survival of the constrained prudent man rule' (1987) 62 NUYLR 52; Lee, WA, 'The investment of pension funds', in Finn, P (ed), *Equity and Commercial Relationships*, 1986, Chapter 11.

rather than individual risk assessments; investments which may seem too risky in isolation, and therefore in breach of trust, may be justified when held in conjunction with other investments.[9] In the Court of Appeal, Leggatt LJ concluded that the importance of preserving the capital of a trust fund will, however, usually be preferable to securing high returns.[10]

The position following the *Nestlé* decision remains unclear. The legislative developments in Victoria, under the Trustee and Trustee Companies (Amendment) Act 1995, emphasise the importance of avoiding rigid, limiting rules in this area, and the range of discretionary considerations set out in s 8(1)(a)–(o) endorse a more flexible and expansive approach to the determination of what constitutes a prudent exercise of a power to invest in any given circumstance. There is no absolute rule requiring the court to scrutinise investment activity solely on a security by security basis. Nor does the law prevent the court from charging a trustee who breaches his standard of care by failing to diversify the investments; what emerges is a more adaptable legislative approach which may or may not favour MPT on any given set of circumstances. Such developments provide the courts with a better foundation for an examination of the overall suitability of contemporary investment practice in particular trust funds (see, also, Worthington, S, 'Public unit trusts: principles, policy and reform of the trustee and manager roles' (1991) 15 NSWULJ 256).

32.8 Duty not to purchase trust property

Connected with the duty to avoid a conflict of interest and to account for any gain is the duty of the trustee not to purchase any trust property. There are two rules applicable to this duty. The first is that the trustee is absolutely prohibited from purchasing the trust property unless expressly authorised to do so by the settlor, the beneficiaries or the court.

The general prohibition on purchasing trust property is justified on the grounds of fairness; it would be very difficult for a trustee to act in the best interests of the beneficiaries when purchasing property for his own benefit. In *Chan v Zacharia* (1984), Deane J felt that, wherever the trustee acquires trust property, there is an irrebuttable presumption that it has been obtained by reason of the position of advantage occupied by the trustee, which can only be defended by proof of consent or authorisation. Whenever the trustee purchases trust property, he or she holds it in the capacity of constructive trustee for the beneficiaries.

9 See Butler ,AS, 'Modern portfolio theory and investment powers of trustees: the New Zealand experience' (1995) 7 Bond L Rev 119; Dal Pont, G, 'Conflicting signals for the trustees' duty to invest' (1996) 24 ABLR 101.

10 [1994] 1 All ER 118, p 142.

The second rule, which has emerged from the English Court of Appeal decision in *Holder v Holder* (1968), is that a trustee may purchase the trust property with the fully informed consent of all the beneficiaries for a fair price. This second rule is commonly referred to as the 'fair dealing' rule. On the facts of *Holder,* a testator devised his property, which consisted of two farms, on trust equally for his widow, eight daughters and two sons, appointing the widow, a daughter and a son as executors. The son who was appointed executor already held a joint tenancy in one of the farms and worked the rest of the land for an annual payment. Subsequently, the executors opened up an executor's account and paid out nine cheques to meet small liabilities of the estate. After this had occurred, the son decided to renounce his executorship by deed so that he could purchase the farms. The son then purchased the farms at a fair price at auction, and no objection was made by any of the executors or beneficiaries at the time of the sale. Subsequently, however, another son, who was a beneficiary to the farms, objected to the purchase on the grounds that the purchaser was debarred from acquiring the farms as he was a trustee.

At first instance, Cross J held that the farms should not have been purchased and that the beneficiaries had not acquiesced in the sale because they were unaware of their rights to have the sale set aside. The case went on appeal.

Harman LJ held that the very special circumstances of the case provided an exception to the normal rule against trustees purchasing trust property. According to Harman LJ, the reason for the prohibition was that a man cannot be both vendor and purchaser. It was held, however, on the facts that the son who purchased the farms had never held this position. He had taken no part in the valuation; all the family knew he was a buyer rather than a seller, and he never assumed the formal duties of an executor. Having only signed a small number of cheques before renouncing the trusteeship, he never interfered with the administration of the trust estate and he managed the farms as a tenant rather than an executor. Hence, the son acquired no special knowledge as executor, and what he knew was as tenant of the farms. It was therefore held that the son was not in breach in purchasing the farms.

Danckwerts LJ came to the same conclusion as Harman LJ, adding that the sale was arm's length, without fraud, and that the son was the obvious purchaser, as he was able to offer the best price. Danckwerts J even went so far as to suggest that, even if the son had remained an executor, he may have purchased the property. This last point is controversial, as it would appear to refute directly the supremacy of the self-dealing principle. Under general principles, however, a trustee will be unable to purchase trust property even if he has retired from the position as trustee. If such a purchase does occur it will be voidable at the option of the court (*Tito v Waddell (No 2)* (1977)). Furthermore, the court must consider whether the trustee has acted improperly by retiring in order to purchase the property, and whether or not he has gained an unfair advantage in the purchase.

The decision marks a clear departure from the apparent stringency of the trustee principle, and has not been categorically approved in Australia. It may well be that the future courts restrict the decision to its particular facts (*Re Thompson's Settlement* (1985)). Some of the important aspects of the decision were emphasised by the court were:

- everyone, including the solicitors, assumed the son was able to purchase the property;
- the beneficiaries never looked to the son for protection of their interests, and they all considered him to be a purchaser; and
- the price the son paid for the farms was a fair one.

32.9 Duty to keep proper accounts

The trustee is under a duty to keep and render to the beneficiaries a full and candid record of all the trust accounts (*Springett v Dashwood* (1860)). Trust accounts should accurately reflect the current status of the trust fund and, even if the trustee is not skilled in accounts, she is under a duty to hire someone to assist. If a trustee is appointed to a number of trust funds, the trustee must ensure that each trust account is kept separately so that the duties can be administered individually. The keeping of up to date trust accounts is extremely important, because they provide information to beneficiaries as to the state of the trust fund and the propriety of the trustee in managing that fund.

The accounts which are kept should reveal all receipts of purchases and details of payments made in the day to day management of the trust. Accounts should be kept, even at the termination of the trust, as they may be required if an allegation of impropriety is made because they constitute *prima facie* evidence of the activities of the trustee (*Gray v Haig* (1854)).

The trustee is required to make such accounts available to the beneficiaries; the beneficiaries have an equitable right to view the accounts, albeit at their own expense, and any refusal to make the accounts available will constitute a breach of trust (*Re Simersall* (1992)). Documents coming within the definition of 'accounts' include receipts, credit notes, investment documents and balance sheets.[11]

32.10 Duty to allow beneficiaries access to trust documents

Trustees must make available to beneficiaries all documents relating to the trust; beneficiaries have an equitable interest in all documents, not just account documents, which relate to the administration of the trust. Hence, all

11 See, generally, Ford and Lee, *Principles of the Law of Trusts*, 2nd edn, 1990, pp 417–30.

documents classified as 'trust documents' may be disclosed to beneficiaries upon request, unless a satisfactory reason can be given for their non-disclosure (*Re Fairburn* (1967)). Furthermore, the trustees are under a duty to ensure that the beneficiaries have sufficient access to trust documents (*Re Whitehouse* (1982)). It has also been held that trustees must explain to each beneficiary, of full age and capacity, his or her rights under the trust, even where they have not specifically requested such information (*Hawkesley v May* (1956)).

The application of the duty to disclose all trust documents has caused some particular problems in discretionary trusts. Where a trustee under a discretionary trust holds a power to determine who the objects of the trust will be, information and documents used by the trustee in the exercise of this discretion has generally been held to be unavailable to beneficiaries. A number of reasons have been postulated for this. In the first place, it is argued that such information does not come within the ambit of 'trust documents'; furthermore, even if such information could be classified as trust documents, courts have generally refused to grant access because it is felt that documents relating to the exercise of a trustee discretion should properly be exempt from the general rules.

The different approaches have been canvassed in *Re Londonderry's Settlement* (1965). The case involved a discretionary trust where the trustees had the power to appoint shares of capital to a specified class. The defendant was a member of the class of potential beneficiaries which the trustees were required to consider. After the trustees had made a number of appointments, including some in favour of the defendant, and the capital of the trust was exhausted, the defendant requested the trustees to supply her with copies of the following documents:

- the minutes of the meetings with the trustees;
- agenda and other documents prepared for the trustees' consideration when exercising their discretion; and
- correspondence relating to the administration or execution of the trust passing between the trustees and their solicitors and the trustees and the beneficiaries.

The trustees took the view that, in the interests of the family as a whole, they ought not to disclose the documents unless they were under a clear duty to do so.

Harman LJ felt that two conflicting principles were raised in this case. First, trustees exercising a discretion are not generally bound to disclose to their beneficiaries the reasons for coming to their decision. If these reasons are voluntarily given, then their soundness may be examined by the court. Secondly, documents which come into the possession of the trustees for the purposes of the trust, and which are classified as trust documents, are the property of the beneficiaries and the beneficiaries have a right to inspect them. Harman LJ felt that, ultimately, the right of the trustees, when exercising a

discretion not to reveal their reasons, should prevail against the beneficiaries' right to trust documents. This was because the communications passing between individual trustees and appointors are documents in which the beneficiaries have no proprietary right.

Danckwerts LJ held that the letters written by individual beneficiaries to the trustees should not be classified as trust documents. Even if they could be classified as such, they should not be disclosed, because the trouble such documents may cause would outweigh the advantages. Such a disclosure would interfere with the confidential role the trustees have been requested to assume, as they would be continually under the threat of investigation.

Salmond LJ held that disclosure of documents under a family trust should not be granted where it has the potential to cause bitterness. The position would be different if the beneficiaries were alleging that the trustees had acted fraudulently and were seeking documents to prove this. In the latter situation, the court may award discovery of such documents. No allegation of *male fides* had, however, been raised in this case. During the course of his judgment, Salmond LJ set out the characteristics which he felt described the category of documents known as 'trust documents'. In *Hartigan Nominees Pty Ltd v Rydge* (1992), the New South Wales Court of Appeal found that the agenda and minutes of trustee meetings and their correspondence – including correspondence between themselves and beneficiaries – did not amount to 'trust documents':

- trust documents are documents which have come into possession of the trustees during the course of them acting as such;
- trust documents contain information about the trust which the beneficiaries are entitled to know. The beneficiaries should not be entitled to documents relating to the exercise of the trustees' discretion where it would cause bitterness amongst the beneficiaries or undermine the confidential role assumed by the trustees;
- the beneficiaries hold a proprietary interest in the documents flowing from their equitable beneficial interest in the trust property.

Examples of documents which would generally be held to be trust documents include:

- title deeds to trust property;
- mortgage deeds where trust moneys are invested;
- books of accounts and records; and
- counsel's opinion as to the effect of the trust.

Examples of documents which would not generally be held to be trust documents, and, therefore, not able to be inspected, are:

- minutes of meetings held by trustees under a discretionary trust;
- agendas prepared for trustees' meetings under a discretionary trust;

- written suggestions by trustees as to what to do concerning the exercise of discretion;
- written inquiries by trustees as to the circumstances of potential beneficiaries; and
- correspondence between trustees and beneficiaries under a discretionary trust.

The right of beneficiaries to inspect trust documents is proprietary; whilst the beneficiaries do not own the documents legally, they hold an equitable right to possession which is tantamount to a property right. In *Re Simersall; Blackwell v Bray* (1992), a trustee corporation went into bankruptcy and applied, under s 77A of the Bankruptcy Act 1966 (Cth), for production of an accountant's trust account records of an associated entity company which was a beneficiary under the trust. The issue was whether or not the beneficiary company held a proprietary interest in the records. If so, s 77A(2) of the bankruptcy legislation would require them to be produced.

It was held by Gummow J that the right of inspection is proprietary in character. His Honour held that the trustee retained legal title to the records while he remained trustee, but that the beneficiary was entitled to inspect the documents and to receive relevant information about them. The right of the beneficiary is an equitable right to call for immediate delivery of the documents into the permanent possession of the beneficiary. The court held that documents held by a body having the right to permanent possession would constitute a property right sufficient for the purposes of s 77A(2) of the Bankruptcy Act 1966 (Cth).

32.11 Defences to a breach of duty

A trustee may be exonerated from a breach of duty if he can prove that he acted properly and reasonably in the circumstances. Section 67 of the Trustee Act (Vic) 1958 allows a court to excuse a trustee who has committed a breach of trust, if that trustee has acted honestly and reasonably and ought fairly to be excused.[12]

What constitutes honest and reasonable behaviour is a question of fact, and must be determined with regard to all the circumstances of the case; there are no general rules or principles. The trustee has the onus of proving that he has acted honestly and reasonably. This will usually be established where the trustee can prove he acted in accordance with the welfare of the trust and the beneficiaries (*Cotton v Dempster* (1918)). Where the trustee has committed a fraud or misappropriated trust funds, however, the defence will not apply.

12 The equivalent provisions in other States are as follows: Trustees Act 1962 (WA), s 75; Trustee Act 1925 (NSW), s 85; Trusts Act 1973 (Qld), s 76; Trustee Act 1936 (SA), s 56; Trustee Act 1898 (Tas), s 50; Trustee Act 1893 (NT), s 49A; Trustee Act 1925 (ACT), s 85.

The fact that a trustee has sought professional advice on a matter will not automatically raise the defence; consideration must be given to the reasonableness and honesty of the trustee in relying upon that advice. A trustee seeking advice should ensure that the adviser is competent and impartial, and that the issue is within her field of expertise (*Re Stuart* (1897)). Where a trustee has received court permission for particular conduct, however, the defence will generally arise. Where a trustee has acted negligently, the defence will usually be unavailable because the trustee cannot be said to have acted reasonably.

In determining whether or not a trustee has acted honestly and reasonably, a court will examine all the circumstances of a breach, including the terms of the trust instrument, the intention of the trustee (if it can be proven), the conduct of the trustee and what constitutes the best interests of the trust. Even where it can be proven that a trustee has acted reasonably and honestly, the trustee may not be excused if it would be unfair or prejudicial upon the beneficiaries or the creditors. This is particularly true where the breach has been committed by a professional trustee with a higher standard of care (*National Trustees Co of Australasia Ltd v General Finance Co of Australasia Ltd* (1905)).

In some cases, the very nature of the breach prevents the defence from being raised. For example, in *Bartlett v Barclays Bank Ltd* (1980), Brightman J held that the bank had not acted reasonably in allowing a speculative, unprotected investment to go ahead, and it would not be fair to excuse the bank at the expense of the beneficiaries (see 32.2 for a more detailed discussion of the facts of *Bartlett v Barclays Bank Ltd*). The defence was never intended to provide protection for careless, inefficient behaviour (*Patridge v Equity Trustees Executors and Agency Co Ltd* (1947)).

The mere fact that a trustee has given the beneficiaries an opportunity to object to conduct amounting to a breach will not necessarily mean that the defence is made out. In *Spellson v George* (1987), it was held that a trustee is not entitled to avoid liability for a breach of trust simply by giving the beneficiaries an election to either object or acquiesce in the breach. The facts of that case involved an alleged breach in the appointment of a new trustee. The trustee was George Investments Pty Ltd; when the company retired as trustee, Lady Renee George was appointed sole trustee in its place. George Investments Pty Ltd argued that the beneficiaries had consented to this replacement through their silence and inactivity, despite receiving knowledge of the material facts. The beneficiaries claimed that the trustees were in breach. The trustees claimed, *inter alia*, that they had acted honestly and reasonably, and this precluded them from being liable because the beneficiaries had not expressly objected. Handley JA held that the beneficiaries cannot be taken to have consented to a breach until they have full knowledge of the facts. Even when full knowledge is acquired, the beneficiaries are entitled to keep their options open until unequivocally called upon to act. Where a trustee can prove that a beneficiary freely acquiesced, encouraged or consented to a

breach of trust, having full knowledge of all the relevant information, a valid defence may be raised.

CHAPTER 33

TRUSTEE'S POWERS

33.1 Fiduciary powers

A trustee may be endowed with duties and powers. A duty is a mandatory obligation arising from the fiduciary status of the trustee or the terms of the trust deed. Alternatively, a power is a right which the trustee may choose to perform. A trustee is generally not bound to exercise a power, but will be obliged to give good consideration as to whether or not it should be exercised. A power must be conferred by the trust deed; a discretion will usually only arise where it has been specifically conferred. Examples of powers commonly conferred include: a power to invest the trust fund; a power to sell or purchase trust property; a power to issue maintenance or an advancement to a beneficiary who is not full age and capacity;[1] a power to vary investments; a power to carry on a trust business; and, under a discretionary trust, a power to appoint beneficiaries from a particular class. Powers existing in this latter category may be special, hybrid (intermediate) or general (see Chapter 27, especially 27.5.3–6).

A beneficiary must accept the decision of a trustee exercising a power, provided the power has been properly exercised. The beneficiaries do not have the right to order the trustee to perform the power, but they have the right to ensure that the power is properly considered and exercised. This right constitutes an equitable chose in action. There are three situations where beneficiaries may seek to have a trustee's exercise of power set aside:

- where the trustee gives no consideration to the exercise of the discretion at all;
- where the trustee exercises the discretion based upon some improper motive;
- where the trustee exercises the discretion as a matter of course (that is, rubber-stamping).

In any of the above situations, the beneficiaries will have the right to seek court intervention. The fiduciary nature of the trustee's position has meant that any powers the trustee holds will be coupled with duties of good faith and honesty in the exercise of the discretion. Equity will make sure the trustee does not abuse the power and that it is exercised with consideration and due

1 All states except Tasmania confer a statutory power to apply trust income for maintenance, education, advancement or benefit of beneficiaries: Trustee Act 1958 (Vic), s 37; Trustees Act 1962 (WA), s 58; Trustee Act 1925 (NSW), s 48; Trusts Act 1973 (Qld), s 61; Trustee Act 1936 (SA), s 33; Trustee Act 1893 (NT), s 24; Trustee Act 1925 (ACT), s 43(6)–(8).

regard for the beneficiaries (*Karger v Paul* (1984)). The trustee does not have the power to make a decision based upon improper motives because, as a fiduciary, the trustee must act in good faith for the benefit of the beneficiaries. This was clearly established by Jessel MR in *Tempest v Lord Camoys* (1866).

33.1.1 Real and genuine consideration

Real and genuine consideration requires the trustee to give a full and detailed examination as to how a particular power should be exercised, if at all. If the trustee follows the opinion of another party blindly, then she cannot be regarded as having exercised real and genuine consideration, and the court may set the decision aside. In *Turner v Turner* (1984), the settlor established a trust for the benefit of his wife and children and other issue or spouse. He then appointed his father and sister-in-law as trustees, although neither of them had any experience or understanding of trusts. The trustees were given a discretionary power to appoint to all or any of the beneficiaries. The trustees then exercised this power of appointment in favour of the settlor's four children upon reaching 21 years of age. Following the instructions of the settlor, the trustees revoked one appointment, then reconveyed it at a later stage. Throughout the course of the trust, the trustees failed to appreciate fully the nature of the trust or their powers and duties within it. They left the decision-making to the settlor and did not appreciate that they had a discretion to act themselves. The trustees applied to the court to determine which, if any, of the appointments was valid.

Mervyn Davies J held that when exercising their power of appointment, the trustees were under a duty to consider its appropriateness. Since, on each occasion, they had not known that they had a discretion and had not read or understood what they were signing, but had merely signed when requested by the settlor, the trustees were in breach and all appointments would be set aside by the court.

If the trustee takes into account a purpose which, in light of the nature and circumstances, is considered to be improper, the court may set the decision aside. In *Klug v Klug* (1918), two trustees were given the power to raise the capital of a trust fund and to apply it for the benefit of the testator's daughter in such a manner as they thought fit. The daughter requested the trustees to provide her with financial assistance to help her pay the legacy duty on her settled share. One trustee was willing to apply the funds in favour of the daughter, but the other trustee was unwilling to do so because the beneficiary, her daughter, had married without her consent.

It was held that the second trustee was acting improperly by failing to give consent for personal reasons, and had, therefore, exercised the discretion for an improper purpose, in bad faith. As a result, it was the duty of the court to interfere and direct that a sum be paid out of the fund on behalf of the daughter.

Mere carelessness or an honest mistake will not constitute bad faith; it must be shown that the trustee intended to defraud the beneficiaries, took into account a purpose which, in the circumstances, was improper, or simply failed to give any attention to the exercise of the discretion at all. In *Karger v Paul* (1984), a settlor appointed her husband, Smith, and her solicitor, Paul, to act as trustees of a discretionary trust. The trustees had the discretion to pay or transfer the whole or part of the fund to the husband during his lifetime. Upon the death of her husband, the trustees had a duty to pay to the settlor's cousin, Karger, the residue of her estate.

After the settlor died, Smith asked Paul to transfer the estate capital to him as he needed it to continue to operate the business. Paul told Smith that the will did not operate as a direct transfer to him, and that the trustees had a discretion as to the amount which could be transferred. Paul then questioned Smith as to the financial circumstances of Karger. Smith assured Paul that Karger was financially sound. Acting on this advice, Paul exercised his discretion in favour of Smith and appointed the entire estate to him. Karger learned, at a later stage, that she had been divested of her entire interest under the will, and brought proceedings against Paul and the executrix of Smith, arguing that the discretion had been improperly exercised and that the trustees had not given the discretion real and genuine consideration.

McGarvie J held that a court could not interfere if the discretion was exercised with good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred. It was only where bad faith or a lack of real and genuine consideration could be proven that a court could intervene. He felt that the onus of proving bad faith lies on the person seeking to have the discretion set aside. Honest and blundering carelessness do not, of themselves, amount to bad faith. On the facts, he felt that natural justice considerations, giving Karger a right to respond, were not a requirement for the proper exercise of the discretion; insufficiency of inquiry did not constitute a ground upon which the exercise of discretion could be impugned. The fact that Smith acted upon the general knowledge of the circumstances did not mean that he or Paul had not given real and genuine consideration to the exercise of the discretion. The trustees did not hold themselves out as professionals, and they had acted honestly in the full belief that the decision was appropriate and in accordance with the expectations of the settlor (see, also, *Wilson v Law Debenture Trust Corp plc* (1995); and ss 6–8 of the Trustee and Trustee Companies (Amendment) Act 1995 (Vic) on the exercise of fiduciary powers).

33.1.2 Superannuation and pension funds

Where a trustee is unfairly prejudiced or influenced in the exercise of a discretion, it may constitute a lack of real and genuine consideration. This has become a particularly significant consideration in large trusts such as pension

and superannuation funds. In such cases, the trustees of the fund are, quite often, also employees who may feel obliged to follow the interests of their employers, particularly where the discretion involves large amounts of money, and these factors may detract from their ability to give real and genuine consideration to the matter.

This issue was directly raised in *Lock v Westpac Banking Corp* (1991). In that case, the plaintiff was a member of the Westpac Banking Corp staff superannuation scheme; he brought an action against the trustees of the scheme on the grounds that the purported amendments to the trust deed, to allow a $300 million surplus in the fund to be returned to the bank, were invalid, having been exercised for an improper purpose. It was alleged that the trustees, who were employees of the bank, were influenced by their desire to maintain industrial relations with the bank and its staff rather than considering the interests of the beneficiaries. It was alleged that the trustees did not give real and genuine consideration to the exercise of their discretion, because they were influenced by the bank.

The court held that a consideration of the employer's interests was valid where decisions were being made which affected the pension fund. While the trustees had a duty to act in the interests of the members, they were entitled to take into account the employer's interests because the employer was a contributor to the fund. It was held that the amendment to the trust deed, allowing the surplus to be returned to the bank, did not overtly favour the employers against the members of the fund, because such a decision would ultimately serve to improve the benefits of the existing members.

CHAPTER 34

TRUSTEE AND BENEFICIARY RIGHTS

34.1 The trustee's right to an indemnity

In most trusts (with the unit trust as an exception), the trustee, as legal interest holder, will naturally be required to manage the trust. This can be an onerous task, particularly where the trust property comprises numerous investments and a large trust fund. In meeting the day to day responsibilities of running the trust, the trustee will inevitably encounter many expenses. Depending upon the character of the trust, the trustee may have a number of alternatives in meeting these expenses: they may be met by the trust fund directly; or the trustee, as legal interest holder, may pay the expenses on behalf of the trust for the ultimate benefit of the beneficiaries.

If the trustee incurs debts or expenses in the proper administration of the trust fund, he will have an equitable right to be indemnified for the amount expended. This right stems from the fact that the trustee holds the property for the benefit of the beneficiary; any expense paid for the management or upkeep of the trust property is ultimately in the interest of the beneficiary and, therefore, it is only fair that the trustee should be reimbursed.

The trustee's right of indemnity is recognised as an enforceable equitable interest as well as being set out in s 36(4) of the Trustee Act (Vic) 1958.[1]

> Section 36(4) entitles a trustee to:
>
> ... reimburse himself, or pay or discharge out of the trust property, all expenses incurred in or about the execution of his trusts or powers. [2]

In equity, a properly incurred expense will give the trustee an equitable right to be indemnified, which exists in the form of a charge or a lien against the trust fund, and a personal right against the beneficiaries. The equitable charge or lien held by the trustee will entitle the trustee to bring an action against all trust assets in the proper and authorised possession of the trustee (*Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (Qld)* (1984)). A trustee's equitable charge or lien to be indemnified will operate in the same way as any other equitable charge; it can only be defeated by a *bona fide* purchaser for value, and it will confer priority upon the trustee in the event of the trust

1 The equivalent provisions in the other States are: Trustees Act 1962 (WA), s 71; Trustee Act 1925 (NSW), s 59(4); Trusts Act 1973 (Qld), s 72; Trustee Act 1936 (SA), s 35(2); Trustee Act 1898 (Tas), s 27(2); Trustee Act 1893 (NT), s 26; Trustee Act 1925 (ACT), s 59(4).

2 See, also, the Trustee and Trustee Companies (Amendment) Act 1995 (Vic), ss 7(4) and 8(2)(b) on the right of the trustee to indemnify himself out of the trust fund for costs incurred in exercising the duty to seek investment advice.

becoming insolvent. The trustee's right of indemnity is primarily exercisable against the trust fund, provided there are sufficient funds to cover the indemnity; only when the trust fund is depleted will a trustee have a right to seek indemnity against the beneficiaries personally (*Hardoon v Belilios* (1901)).

Only expenses which have been properly incurred by the trustee may be indemnified. These expenses will include those authorised by the trust deed, those incurred in the proper exercise of a power, and those incurred in good faith in the proper administration of the trust. Provided the trustee has acted reasonably and with due diligence in the exercise of her duties, a trustee may even recover moneys paid out pursuant to an action for damages (*Re Raybould* (1900)). In *Chief Commissioner of Stamp Duties v Buckle* (1998), the High Court of Australia examined the nature of the trustee's right of indemnity. The court approved of the decision in *Octavo Investments Pty Ltd v Knight* (1979), where it was held that the assets held by the trustee are subject to their application to reimburse or exonerate the trustee, and the beneficiaries are confined to those assets which are available after the liabilities have been discharged. The High Court, in *Buckle,* went on to add:

> 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.

In *Dimos v Dikeakos Nominees Pty Ltd* (1996), the Federal Court noted that the proprietary basis of the trustee's right of indemnity meant that it did not automatically expire once the trusteeship ceased. Jenkinson J held that, as a matter of principle, a right of indemnity must continue after the trusteeship has terminated because it is a proprietary interest which is not dependant upon the continued existence of the trusteeship and the continued possession of the trust property.[3]

34.1.1 Trustee's indemnity and breach of trust

A trustee will only be able to claim a right of indemnity if the expense has been incurred whilst the trustee was carrying out proper duties and functions. If the trustees have incurred the expense in breach of their duties, they will generally be unable to claim for any indemnity until they have first made good any loss caused to the trust estate. Where the breach is not related to the actual transaction in which the expense was incurred, but resulted from some previous transaction which has not been compensated for, the court has argued that the trustee's right of indemnity should not be excluded.

3 See, also, *Coates v McInerney* (1992) 6 ACSR 748.

In *Re Staff Benefits Pty Ltd* (1979), a trustee company was set up as a manager of an investment fund under which contributions were made by investors pursuant to an agreement. The agreement set out that the company would be indemnified against all liabilities incurred by it in the execution of its duties. It also allowed the company to borrow money to facilitate the management of the fund. The trustee company had also employed another party to make investment decisions for it. It had no authority to make such an appointment. Eventually, when money became short, the trustee company borrowed money to meet the claims of the depositors and investors, but it proved to be insufficient.

Needham J held that the depositors, as creditors, were entitled to be subrogated to the rights of the company, as trustee, to an indemnity against its liability to them out of the trust fund. The breach of the trustee company in employing the other party had not caused a loss, and was unrelated to the transaction in which the indemnity was sought; hence, it was held that the indemnity (and, therefore, the subrogation) was not excluded. The justification for such an approach lies in the need to provide more adequate protection to creditors dealing with trustees.

Needham J states:

> The indemnity principle is subject to any equities subsisting between the trustee and the beneficiary. Where the trustee is in default, and is not entitled to an indemnity without making good the default, the creditors are in a similar position. In my opinion, it is not every breach of trust which will debar the trustee from indemnity; the breach must be shown to be related to the subject matter of the indemnity.

These *dicta* comments indicate that the mere existence of a breach will not automatically prohibit the enforcement of the trustee's indemnity. Whilst the loss must be compensated for before any indemnity can be enforced (see Brooking J in *RWG Management Ltd v CCA (Vic)* (1985)), if the breach is unrelated to the transaction and, as on the facts of *Re Staff Benefits*, has caused no actual loss, the indemnity will not be excluded. Such a result favours creditors who seek to be subrogated through the trustee's indemnity. The exact meaning of 'unrelated' is unclear, although, if it can be proven that the breach was prior in time and of a character completely different to the transaction for which an indemnity is sought, it would probably constitute an unrelated breach.

34.1.2 Exclusion of the right to indemnity

In some situations, the trust deed attempts to exclude the trustee's right of indemnity. In Victoria, s 2(3) of the Trustee Act (1958) suggests that the right of indemnity may be excluded where expressly set out in the trust deed.[4] This

4 This is also the case in the Trustees Act 1962 (WA), s 5(3), and the Trustee Act 1898 (Tas), s 64.

issue has caused some debate, as it has been suggested that the right of indemnity against the trust estate cannot be excluded because it is an inherent right of the trustee.

In *RWG Management Ltd v CCA (Vic)* (1985), Brooking J felt that there was nothing to prevent the trust from expressly excluding the indemnity, although he noted the previous authority which argued against this on the basis that the right operated as a natural incident of the office of trustee, and was an intrinsic part of the trustee's rights as legal interest holder for the benefit of another.

In *Worral v Harford* (1802), Lord Eldon stated:

> It is in the nature of the office of a trustee, whether expressed in the instrument or not, that the trust property shall reimburse him all the charges and expenses incurred in the execution of the trust. That is implied in every trust.

The fundamental importance of the right to be indemnified was subsequently reaffirmed in *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (Qld)* (1984), where McPherson J held that a trustee's right to be indemnified against the trust fund could not be excluded by the terms of the trust instrument, although the right to seek an indemnity against the beneficiaries personally could be. Nevertheless, this case can be seen in light of the Queensland legislation which entrenches the right to be indemnified. Legislation in other States, including Victoria, does not have the same effect.

Generally, a trustee would not accept office without the right to be indemnified for all properly incurred expenses. In modern times, however, trustees are increasingly prepared to accept office without an indemnity in order to prevent creditors claiming a right of subrogation.[5] If the trustee enters into a contract with a creditor without telling the creditor that the right of indemnity has been excluded, and the creditor does not check, then the creditor is in a dangerous position. If the trustee does not pay the amount owing (or has excluded personal liability), the right of indemnity will not be available. Corporations law has relieved this unfairness to a certain extent. Pursuant to cl 233 of the Corporations Act 1989 (Cth), a trustee-corporation not entitled to an indemnity from the trust fund will have its directors (at the time liability was incurred) jointly and severally liable to discharge the amount owing to the creditor.

34.1.3 Trustee's indemnity against the beneficiary personally

If the trust fund is deficient, the trustees may seek indemnity from the beneficiaries personally. The rationale for this is that the right of indemnity should not be totally dependant upon the trust fund. As the beneficiaries gain the advantage of equitable ownership, they should be expected to pay for the

5 See, generally, Ford and Lee, *Principles of the Law of Trusts*, 1996, para 14060.

proper management of the property. Beneficial title confers both the advantages and disadvantages of ownership. If the trust fund cannot fully indemnify the trustee, there is no reason why the beneficiaries should not have to pay, for it is they who are gaining the ultimate benefit.

The case which clearly established the right of the trustee to be indemnified against the beneficiaries personally was *Hardoon v Belilios* (1901). In that case, the plaintiff held 50 shares in the Bank of China, Japan and the Straits Ltd. The plaintiff acquired these shares as a clerk for a share-broker. The shares were placed in the name of the clerk. The share-brokers paid the allotment money and the clerk held the shares on behalf of the share-broker; the plaintiff was not a beneficiary. The employer share-brokers then sold the equitable interest to the defendant. The plaintiff, as trustee of the shares, paid the dividends over to the defendant. When calls were made upon the shareholders for payment as a result of the bank going into liquidation, the plaintiff paid the amount and then sought to recover against the defendants personally. There was no established trust fund against which the plaintiff could be indemnified, so he sued the defendant personally for the amount.

It was held by Lord Lindley that this relationship created a trust relationship, and that the beneficiaries of the trust were required to pay the amounts incurred.

> Lord Lindley made the following comments:
>
> The plainest principles of justice require that the *cestui que* trust (beneficiary), who gets all the benefit of the property, should bear its burden unless he can show some good reason why his trustee should bear them himself. The obligation is equitable ... where the beneficiary is a person, *sui juis*, the right of the trustee to 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.

The only qualifications to the personal obligations of beneficiaries are that beneficiaries who are tenants for life, infants or in other special circumstances, may be excluded. Where a trust exists with such beneficiaries, it is assumed that the trustee has accepted the role, knowing that he will be unable to obtain a personal indemnity. The rationale for excluding such beneficiaries appears to be based upon the fact that infants and remaindermen do not yet enjoy the advantages of ownership and, therefore, it is unfair that they should have to endure the hardships it can bring. Furthermore, there is no danger of such beneficiaries winding up or terminating the trust by calling for the legal title, as they are not entitled to do so. Similarly, potential beneficiaries under a discretionary trust cannot be liable, because they have no beneficial interest in the trust until they have actually been selected by the trustee.

Generally, the trustee must first exhaust the trust fund before indemnity is sought against the beneficiaries personally. It is not, however, absolutely necessary to exhaust the trust property before seeking a personal indemnity,

particularly where the trust fund cannot be readily converted to cash, or such a conversion would take a substantial period of time.[6]

34.1.4 Personal liability where there are several beneficiaries

The *Hardoon v Belilios* principle dealt with a single beneficiary who was absolutely entitled and *sui juis*. The position is different where there are a number of beneficiaries. This was discussed in *JW Broomhead v JW Broomhead* (1985). In that case, the trustee of a unit trust incurred expenses whilst carrying on a building business for the benefit of the unit trust holders. The unit trust subsequently went into liquidation and the trustee sought a personal indemnity from the unit trust holders. The unit holders were JW Broomhead (42%), Baroy Industries plc (10%), Accordo Industries Plc (in liquidation) (24%) and Graham and Lynette Wood (24%) (Graham held his 12% entitlement upon sub-trust for the infant children).

It was held by McGarvie J that the trustee's right of personal indemnity extends beyond the well-established case of a single beneficiary, as in *Hardoon v Belilios*, and will apply to a situation where there are multiple beneficiaries, all of whom are of full age and capacity and absolutely entitled. To be absolutely entitled, the beneficiaries must have a vested rather than a contingent interest. On the facts, McGarvie J held that it was not necessary for each unit holder to have the same amount of units in order to hold an absolute interest. Even where a beneficiary has less than an absolute interest, if that beneficiary personally requests the trustee to assume the office, then that request will result in the beneficiary becoming personally liable. If the beneficiaries have validly disclaimed their interest before the liability accrued, any personal right of indemnity the trustee has against the beneficiaries will be destroyed. Sub-beneficiaries under a sub-trust can also be liable if they are absolutely entitled, and of full age and capacity at the date when the liability was incurred.

Where several beneficiaries are liable to indemnify the trustee, they do so proportionately to their shares. In *Broomhead*, liability was proportional to the amount of units held by each unit holder. If one beneficiary is insolvent and unable to contribute the proper proportion, the others will not have their proportion increased. They may, however, be liable where they are partners, on the basis that the partnership ensured that each partner was liable to indemnify the trustee for the full amount, and each had an interest in the whole of the property rather than a separate proportional interest.

There is some controversy over whether to be liable, all the beneficiaries must be *sui juis* or whether, in a situation where some are of full age and capacity and some are not, those who are may be proportionately liable.

6 See, generally, *op cit*, Ford and Lee, fn 5, pp 641–43.

According to McGarvie J, in *Broomhead*, all beneficiaries must be of full age and capacity before any can be liable to be indemnified by the trustee.

By comparison, Ford and Hardingham, in their article 'Trading trusts: rights and liabilities of beneficiaries', (from Finn, PD (ed), *Equity and Commercial Relationships*, 1987, p 80) state:

> One may query whether it is necessary to insist that all beneficiaries be *sui juis*. Certainly, if a beneficiary is not *sui juis*, the general rule will not apply to him. But does it follow that other *sui juis* beneficiaries should thus be exculpated from liability?

These comments are persuasive. It seems somewhat illogical to exclude *sui juis* beneficiaries from liability merely because other beneficiaries exist who are not *sui juis*. The decision in *Broomhead* is yet to be followed in other Australian courts.

34.1.5 Liability where a beneficiary assigns the interest or excludes the right

A beneficiary who decides to assign away his or her beneficial interest upon discovering that money is owed to the trustee will remain liable to indemnify the trustee (*Mathews v Ruggles-Brise* (1911)). This principle is consistent with the rule that a beneficiary enjoys the advantages as well as the disadvantages of ownership. Whilst a trustee cannot refuse to allow a beneficiary the right to assign her interest, equity can ensure that the personal right is not destroyed. The assignor will remain personally liable for the expenses incurred provided they have been incurred prior to the assignment. All expenses incurred after an assignment will be enforceable against the new assignee (*Mathews v Ruggles-Brise* (1911)). A trustee in bankruptcy who has taken over the interest of a beneficiary will, however, never be personally liable to the trustee because he is appointed as a representative of the court.

The issue as to whether the right of indemnity against the beneficiary can be excluded was examined in *McLean v Burns Philp Trustee Co Pty Ltd* (1985), where Young J considered the impact of a clause in a unit trust which read as follows:

> Neither the trustee nor the manager shall have any claim of any nature against any unit holder for any liabilities incurred in connection with any investment or in respect of any action taken by either of them hereunder.

It was held that this clause operated to deny the trustees any rights against the beneficiaries personally. Young J set out that he would not allow such clauses to be used as a cloak for fraud, but beyond this felt that it was possible for personal liability to be expressly excluded in a trust deed, particularly unit trusts, as they are primarily set up as investment vehicles.

34.1.6 Creditor's rights of subrogation

Where an unsecured creditor, dealing with a trustee during the proper course of administering the trust, is not paid, that creditor has a number of options. What course the creditor takes will primarily depend upon where the money lies. If the money is in the trust fund, the creditor may be subrogated through the trustee's right of indemnity and claim against the trust fund for the debt incurred. Alternatively, if there is no money in the trust fund, the creditor may sue the trustee personally, provided the trustee has not excluded her personal liability.

The creditor's right of subrogation is derivative. A creditor dealing with the trustee has exactly the same rights as the trustee against the trust fund. The creditor will not be subrogated against the trust fund unless it can be clearly proven that no funds can be obtained from the trustee personally, and that the trustee's right of indemnity against the trust fund has not been excluded, either expressly or because the transaction was entered into in breach of the trustee's obligations. In *Octavo Investments Pty Ltd v Knight* (1979), it was held that a creditor's right of subrogation may be established in two stages: by first proving the debt against the trustee, and then claiming subrogation through the indemnity. This two-tiered approach can be achieved in a single action. Hence, an unsecured creditor is not to be considered as having an equitable interest in the trust fund until the debt is proven and the right to subrogation established. To hold otherwise would elevate unsecured creditors to a secured status and impact upon priority disputes.[7]

The creditor's right of subrogation exists primarily against the trust estate. It will not necessarily arise against the beneficiaries personally. The personal obligation is primarily enforceable between the trustee and the beneficiary. Whilst it may be argued that the rationale in *Hardoon v Belilios* could be applied to trust creditors, the fact remains that such creditors are not in exactly the same position as the trustee. A trust creditor does not assume the same responsibilities and fiduciary obligations as a trustee. Furthermore, it has never been the practice of the Courts of Chancery to enforce such claims. As noted by Ford and Lee, the right to be subrogated from the trust estate stems from the equitable practice of enforcing a claim when supervising the distribution of a trust fund; by so doing, a Court of Chancery precluded the creditor from pursuing a legal contractual remedy under common law.[8]

34.1.7 Trustee's personal liability

Where a creditor cannot claim a right of subrogation or has such a right excluded, he is left with his common law contractual rights. Where a trustee

7 (1990) pp 641–43.

8 *Op cit*, Ford and Lee, fn 6, para 14080.

has entered into a transaction personally, that trustee will be personally liable to the creditor. In some situations, however, a trustee may enter into a transaction excluding his personal liability. A trustee's personal liability will be excluded where the trustee expressly sets out that he is entering the arrangement in the capacity of 'trustee' rather than in a personal capacity. In *Helvetic Investment Corp Pty Ltd v John Knight* (1982), the trustee contracted with a creditor as 'The John Knight Family Trust: JC Knight Trustee'. In that case, Yeldham J held that the trustee had intended, by these words, to exclude personal liability.

The question in each case will be one of construction. In determining whether a trustee intended to exclude personal liability, consideration must be given to the nature of the contract, the capacity and duties of the parties, the precise words used and the overall intention of the parties (see, also, *Corozo Pty Ltd v Total Australia Ltd* (1988)).

34.2 Right to contribution from co-trustees

In a situation where a trust has numerous trustees, the decision of the trustees must be unanimous. A court can and will only intervene if lack of unanimity causes inactivity which proves to be detrimental to the trust, and inhibits its proper administration. Where there are a number of trustees and one trustee is in breach, the general principle is that all the trustees will be unanimously liable for the loss (*Chillingworth v Chambers* (1896)). If one trustee makes good the loss, that trustee will be able to claim contribution from her co-trustees. As equity considers all trustees to be unanimously responsible for a breach of trust, the natural result is that they should all be equally responsible. The right of one trustee to seek contribution from another trustee is a right enforced by the equitable jurisdiction in order to ensure that the responsibility for a breach of trust is equally distributed.

There are, however, a number of instances where the general principle of unanimous contribution does not apply. Where a trustee has acted fraudulently and a co-trustee has not been a party to the fraud, the co-trustee will not be liable to contribute to the loss (*Bahin v Hughes* (1886)). Where one trustee has caused the loss and another co-trustee has fairly and reasonably relied upon the expertise of that trustee, the co-trustee will not be liable for contribution. This exception may particularly arise where one trustee is a professional, such as a solicitor, and the co-trustee is not. Where one trustee makes use of the trust property for his or her own benefit and does not obtain the full consent from the other trustees, any loss flowing from such use must be borne by the trustee alone. Finally, a trustee will be fully liable for any loss in any situation where it is clear that one trustee has taken advantage of her position without the knowledge of the co-trustees (*Wentworth v Tompson* (1859); see, also, *Goodwin v Duggon* (1996)).

34.3 Right to seek directions from court

Where a trustee is unsure as to what action should or should not be taken, or whether or not a particular transaction constitutes a breach of trust, the trustee has the right to seek the advice or opinion of the court. In Victoria, this right is conferred upon trustees pursuant to the general rules of procedure in Civil Proceedings 1986 (Vic), rr 54.02–03.[9] These provisions allow the trustee to seek court advice concerning any matter of which he is unsure; this may include: the scope of any investment power which may be conferred; the ability to vary the trust deed; the determination of the nature of any discretion which may be conferred; advice concerning the dealings and administration of the trust fund; and the approval for any transaction which involves the trust property.

A trustee seeking court advice should provide the court with all the relevant information, including any other expert advice that may have been received. When a court gives advice it is directed at individual trust situations, and should not be relied upon as a general statement of law or a final determination of matters at hand. It would be sensible for a trustee to seek court direction where he is uncertain about the exact nature and scope of his powers under the trust deed, and wishes to enter into a transaction without committing a breach. Such consultation is not, however, obligatory. It should be remembered that court advice is only intended as a useful guide for future conduct. The court in *Marley v Mutual Security Merchant Bank and Trust Co Ltd* (1991) noted that, when giving a direction, a court is essentially determining what ought to be done in the best interests of the trust estate.

34.4 Right to retire

A trustee has a right to retire where such a right is provided for in the trust deed. A trustee may retire pursuant to statutory provisions which set out that retirement may occur where she has obtained the relevant consent of the remaining trustees, or, in the absence of consent, where at least two trustees or a trust corporation remain.[10]

Alternatively, a trustee may retire where she has acquired the consent of all the beneficiaries who are *sui juis* or the consent of the court. Courts may allow retirement where the trustee can prove incapacity, illness, inexperience or unsuitability. Whether the court grants consent will be a question of fact (*Werner v Boehm* (1890)).

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9 In all other jurisdictions except Tasmania and the Northern Territory the power is conferred under the trustee legislation: Trustees Act 1962 (WA), s 92; Trustee Act 1936 (SA), s 91; Trustee Act 1925 (NSW), s 63; Trusts Act 1973 (Qld), s 96; Trustee Act 1925 (ACT), s 63.

10 Trustees Act 1962 (WA), s 9; Trustee Act 1925 (NSW), s 8; Trusts Act 1973 (Qld), s 14; Trustee Act 1936 (SA), s 15; Trustee Act 1898 (Tas), s 14; Trustee Act 1893 (NT), s 12; Trustee Act 1925 (ACT), s 8; Trustee Act 1958 (Vic), s 44.

34.5 Beneficiary's right to extinguish the trust: the *Saunders v Vautier* principle

A beneficiary who is *sui juis* and absolutely entitled to a vested interest has the right to direct the trustee to transfer the legal title to the trust property into his name and thereby extinguish the trust. This rule is firmly established by the decision in *Saunders v Vautier* (1841). In that case, the testator bequeathed to his trustees all his east Indian stock existing upon his death, along with any accrued interest, to Daniel Vautier upon his reaching the age of 25 years old. The testator died and Daniel, at 21 years old, requested that the fund be transferred to him. The court held that Daniel was able to recover the stock and extinguish the trust as he was of full age and capacity. Lord Langdale MR concluded that, even though the legacy was postponed until Daniel reached 25 years old, as a *sui juis* legatee with an absolute interest, Daniel was not bound to wait until the expiration of that period, but could require payment the moment he was competent to give a valid discharge.

This principle will apply not only where there is one *sui juis* absolutely entitled beneficiary, but also where there are several such beneficiaries who all unanimously agree to extinguish the trust. The principle may also apply to objects under a discretionary trust (*Sir Moses Montefiore Jewish Home v Howell and Co (No 7) Pty Ltd* (1984)).

Where there are several beneficiaries, each will receive a proportionate share. Difficulties may, however, arise in transferring the property over; in such circumstances, distribution of trust property can only occur where it does not prejudice the property in any way. In *Re Marshall* (1914), the testator bequeathed his residuary real and personal estate, including a large number of shares in a limited company, to trustees upon trust. He gave the trustees a power to postpone the conversion of the whole or any part of his residuary estate, in their absolute discretion, for as long as they should deem fit. Several of the trustees were directors of the company and had large holdings in it. It was agreed by the trustees that keeping these shares together would give them a great deal of influence in the company, so they decided, pursuant to their express power, to postpone the transfer of shares in the company. A son and two grandsons, who were absolutely entitled under the will as beneficiaries, applied to have their proportion of the shares transferred to them; the trustees sought the advice of the court.

It was held by Cozens-Hardy MR that, as the company was a public company and the trustees had not shown any reason as to why it was necessary or desirable for the interests of the beneficiaries as a whole to retain all the shares, the power to postpone conferral of shares after the testator's death was only intended to operate for a reasonable time and the right of the absolute owners to a transfer of their shares was held to prevail over the trustee's discretion.

In reaching this conclusion, he made the following comments:

> The right of a person, who is entitled indefeasibly in possession to an aliquot share of property, to have that share transferred to him, is one which is plainly established by law.

The only qualification applicable to this rule is that the trust property in which the proportionate share is held must itself be inherently divisible. The difficulty with real property is that it is not readily divisible; an 'undivided share' of real property will never be worth as much as the entire property, and transferring such a portion may ultimately be detrimental to the overall value of the trust property. Even property which is ostensibly divisible in nature may not be divided up if special circumstances exist showing that division to be undesirable. This principle will also apply to private shares and possibly even mortgage debts.

As Cozens-Hardy MR further noted:

> The court has long ago said it is not right, because it is a matter of notoriety of which the court will take judicial notice, that an undivided share of real estate never fetches quite its proper proportion of the proceeds of sale of the entire estate; therefore, to allow an undivided share to be elected to be taken as real estate by one of the beneficiaries would be detrimental to the other beneficiaries.

The trial judge, Warrington J, further added that a share division may place the other beneficial holders in a different position, because it may prevent them from controlling the market and thereby affect the market price. On appeal, however, this argument was rejected and a division was approved (see also *Lloyds Bank v Duker* (1987)).

The elementary principles concerning a beneficiary's right to terminate may be summarised as follows (see *Stephenson v Barclays Bank* (1975) *per* Walton J):

- where the beneficiary or beneficiaries are *sui juis* and unanimous, they are entitled to direct the trustee to terminate the trust and distribute the trust property;
- beneficiaries who are absolutely entitled can direct the trustees to transfer the fund to a nominated appointee;
- beneficiaries may terminate the trust. They are, however, not entitled to direct the trustees on how to invest the trust fund if the trustees have a discretion conferred upon them. Furthermore, if the beneficiaries decide to terminate the trust, they are no longer entitled to the services of the trustees; once the trustees have discharged the fund their obligations will be extinguished;
- the rights of the beneficiaries will always be subject to the lawful right of the trustees to be fully indemnified against costs incurred in the proper administration of the trust fund.

34.6 Beneficiary's right to remove the trustee

There are a number of ways in which a trustee may be removed: pursuant to an express power in the trust deed; pursuant to the statutory provisions; or pursuant to the inherent equitable jurisdiction of the court. A beneficiary does not have a direct equitable right to bring an action to remove a trustee, although the beneficiary may nominate a person to remove or replace a trustee on their behalf, where it can be shown that it is in their best interests. In determining whether a removal is for the interests of the beneficiary, a court has a broad discretion. However, the mere fact that a trustee is in breach will not necessarily result in a court concluding that removal of that trustee is necessary (*Re Whitehouse* (1982)). If a continuing hostility or dispute between trustees or between beneficiary and trustee can be established, which is proven to be interfering with the proper administration of the trust, a court would be likely to hold that removal is in the interests of the beneficiary.

34.6.1 Statutory rights of removal

Under s 41 of the Trustee Act (Vic) 1958, where a trustee dies, remains continuously out of the State for more than one year, refuses to act as trustee, seeks to be discharged as trustee, is unfit or incapable of acting, is an infant or a corporation that has ceased business, the trustee may be removed and replaced.[11]

Removal or replacement under this section must also be in the best interests of the beneficiary, taking into account the qualifications, capacity and experience of the trustee, the ability of the remaining trustees and the needs and requirements of the beneficiary. If the beneficiary is unhappy with the way in which the statutory power has been exercised, he may challenge it.

Section 48 of the Trustee Act (Vic) 1958 confers a general power of appointment upon the court to appoint new trustees whenever it is 'expedient', either in substitution or addition to existing trustees.

11 The equivalent provisions in the other States are: Trustees Act 1962 (WA), s 77; Trustee Act 1925 (NSW), ss 6, 70; Trusts Act 1973 (Qld), s 80; Trustee Act 1936 (SA), s 36; Trustee Act 1898 (Tas), s 32; Trustee Act 1893 (NT), s 27; Trustee Act 1925 (ACT), ss 6, 70.

VARIATION OF TRUST

There are many situations where it may become apparent that a trust deed needs to be varied or updated. This may become important where the changing needs of the beneficiaries require the deed to be amended. It may be necessary to alter the existing investment powers held by a trustee to accord with developing investment practices; to accord with updates in taxation legislation, or to update trustee powers under superannuation and pension trusts.

35.1 Court's inherent power to vary the trust

A court of equity does not have an inherent general power to vary the terms of a trust deed. Whilst there are a number of specific instances where a court may approve of a variation, it cannot be said that a court has any generalised power, because this would effectively condone the arbitrary alteration of powers expressly set up by the settlor. Endorsing a generalised power to vary the terms of the trust deed may also produce a conflict between the rights of the beneficiaries and the aims of new legislative enactments (*Chapman v Chapman* (1954)). Instances where a court may, in its inherent jurisdiction, approve of a variation include: where a beneficiary makes an application to vary a deed of trust to alter the nature of an infant's property interests; to pay maintenance out of accumulated income; to endorse a transaction with trust property in order to ensure the survival of the trust, or to carry into effect a compromise for future beneficiaries (*Chapman v Chapman* (1954)).

Whilst the court has displayed a reluctance to expand its inherent power too greatly, it is possible that courts may take a more flexible approach where a clear need can be established. In *Re New* (1901), Romer LJ talked about the need for variation where circumstances arise which were not 'foreseen or anticipated' by the settlor, and alteration is considered to be in the best interests of the trust as a whole. These comments would tend to indicate the potential for judicial recognition of a greater range of circumstances justifying variation, despite the fact that decisions to date have remained circumspect (see also *Tickle v Tickle* (1987)).

35.2 Statutory power to vary where it is expedient

Courts in all jurisdictions now have the power to vary the terms of a trust deed where it is expedient, because of the absence of an express provision in

the trust deed.[1] The expediency provisions will only apply to variations relating to the management and administration of the trust. Variation has been held to refer to an arrangement designed to alter the existing terms of a trust deed, but not a scheme to completely replace the existing trust (*Re Ball's Settlement Trust* (1968)). A court will, therefore, have no statutory jurisdiction with respect to a trustee who has no active duties (a bare trustee). Furthermore, a court will have no power to alter the existing interests of a beneficiary as this is considered to be outside the meaning of 'management or administration' (*Perpetual Trustee Co Ltd v Godsall* (1979)).

It is not necessary for a court to take into account the settlors intention in determining whether to approve an arrangement proposed for the variation of a trust. In *Goulding v James* (1997), Sir Ralph Gibson in the English Court of Appeal noted that, where there is an application for approval under the Variation of Trusts Act 1958, 'it is not clear to me why evidence of the intention of the testator can be of any relevance whatever if it does no more than explain why the testator gave the interests set out in the will and the nature and degree of feeling with which such provisions were selected'. Sometimes a settlor's intention can be relevant purely in order to determine the overall purpose of the trust settlement, and this in turn can be of assistance in having an application to vary approved – however, as noted by Mummery LJ in *Goulding v James*, trustees seeking to have such an application approved should take great care to ensure that the settlor's intentions are 'cogent' and 'relevant' to the nature of the variation scheme proposed.

The meaning of 'expediency' has been taken to include variations which would improve the interests of the beneficiaries, the administration of the trust and the ability of trustees in managing the financial and business responsibilities of the trust (*Riddle v Riddle* (1952)). For example, in *Lock v Westpac* (1991), an amendment to a superannuation deed entitling trustees to return a large surplus to an employer bank was held to be valid. A variation will generally be considered expedient where it can be proven to be in the best interests of the beneficiaries (*Perpetual Trustee Co Ltd v Godsall* (1979)). In Western Australia and Queensland, the best interests of the beneficiaries is specified as an alternative ground to expediency for the judicial endorsement of a variation.

The main purpose of the expediency provisions is to provide a means for variation where the trust deed fails to do so. Where express provision for variation is set out in the trust deed, the statutory provision cannot operate. This will be the case even in situations where an express provision is of a limited nature and the beneficiaries seek broader powers of variation; the court does not have the power to overwhelm the express intentions of the settlor (*Riddle v Riddle* (1952)). In both Western Australia and Tasmania, the

1 Trustees Act 1962 (WA), s 89; Trusts Act 1973 (Qld), s 95; Trustee Act 1936 (SA), s 59c; Variation of Trusts Act 1994 (Tas), ss 13, 14; Trustee Act 1958 (Vic), s 63A.

legislation expressly sets out that the court does have the power to vary a trust deed, notwithstanding anything to the contrary contained within the trust deed.

35.3 Statutory power to vary the interests of an infant, an incapacitated person, an unborn child or a future beneficiary

A further statutory power exists, in various States, to vary the terms of a trust instrument where it is held to be in the interests of an infant, an incapacitated person and an unborn child.[2] The purpose of the legislation is to provide an avenue for change for those persons unable to achieve a variation in their own right. The meaning of incapacitated includes not only those persons who are physically or mentally incapable of assenting to a variation, but also those persons who are incapacitated by reason of the nature of their interest, for example, a beneficiary who holds a contingent interest that will expire if a particular form of variation is sought. Furthermore, provision exists to vary the terms of the trust in the interests of unborn children, as well as those who may become entitled to an interest under the trust at a future date, or upon the occurrence of a future event.

The court is restricted by the statute to vary, revoke or enlarge the powers of the trustee in managing or administering the trust. In Victoria, Tasmania and Queensland, the legislation expressly sets out that a variation can only be approved by a court where it is established that it is in the interests of the beneficiaries. Courts have adopted a broad approach in assessing the beneficiaries' interests, which includes a consideration of the financial, social, educational and family interests of beneficiaries (*Re Weston's Settlement* (1969)). Simply because a variation may be in the best financial interests of the beneficiaries does not necessarily mean that it will be approved. In *Re Christmas's Settlement* (1986), McPherson J held that a variation to a trust resulting in the payment of a significant amount of money to infant beneficiaries was, in itself, insufficient to constitute a benefit, as the variation had to be for the overall welfare of the children.

Not all States require the court to establish benefit. In Western Australia, the legislation is negative in effect; it sets out that the court cannot approve a variation if it is considered to be to the detriment of the beneficiaries. This test is less onerous than the benefit test as, provided no detriment can be proven, the variation may be upheld. If detriment can be shown to exist, it must be proven that the advantages to the variation outweigh the disadvantages (*Palmer v McAllister* (1991)). The Western Australian legislation also confers a further power upon the court to vary from time to time any payment being

2 Trustees Act 1962 (WA), s 90; Trusts Act 1973 (Qld), s 95; Trustee Act 1936 (SA), s 59c; Variation of Trusts Act 1994 (Tas), ss 13, 14; Trustee Act 1958 (Vic), s 63A.

made to any beneficiary, provided the court is of the opinion that the variation would be just and equitable. Judicial intervention under this ground would only be justified where it can be proven that an increase or decrease in the amount being paid is justified, taking into account the altered circumstances of the beneficiary; if this cannot be proven the court will generally refuse to interfere with the expressed intentions of the settlor (*Chipper v Perpetual Executors Trustee and Agency Co (WA) Ltd* (1973)).

The legislation in South Australia allows a court to approve a variation, upon the application of any person with a vested, future or contingent interest in the trust property, as long as it is proven that the variation is in the interests of the beneficiaries, does not unfairly prejudice a single group, does not unduly interfere with the administration of the trust, and accords, as far as reasonably practicable, with the spirit and purpose of the trust.

35.4 Effect of a variation

Once the court has approved a scheme for the variation of a trust instrument, the variation will be valid and enforceable and, as the court is acting on behalf of the beneficiaries, is to be treated as if it was made by the beneficiaries themselves (*Re Holmden's Settlement Trusts* (1968)). In some cases, an arrangement to vary a trust may constitute a disposition of an equitable interest and, therefore, needs to comply with the formality requirements set out in s 53(1) of the Property Law Act 1958 (Vic) and the State equivalents (see Chapter 28 for a further discussion). In order to adequately ensure the validity of the scheme, the beneficiaries themselves, or their representatives, should put the scheme in writing and execute it.

TRUSTS FOR CHARITABLE PURPOSES

Gifts for charitable purposes have enjoyed special advantages under the law since medieval times, and much of the modern law of charitable trusts is explicable only in terms of the complex historical development of the subject. A trust is not the only method of carrying out a charitable purpose; incorporated and unincorporated associations provide alternative frameworks. Nevertheless, the trust is an established mechanism for pursuing charitable activity. Charitable trusts are subject to the same requirements and have the same characteristics as private trusts. They differ in one primary aspect: a charitable trust exists to benefit a purpose, whereas a private trust exists for the benefit of specified beneficiaries (*Morice v Bishop of Durham* (1804)).

36.1 Privileges of charitable trusts

36.1.1 Certainty of objects

The rules relating to certainty of objects do not apply to charitable trusts. With a few exceptions, private trusts must be set up for the benefit of identifiable human beneficiaries. Charitable trusts, on the other hand, are created for approved public purposes, not for individual beneficiaries. The purposes must be exclusively charitable purposes, and fit within the established definition of charitable in order to be enforced. Despite the stringency of this principle, statute does permit the enforcement of the charitable parts of a mixed charitable and non-charitable gift (see, for example, s 37(1) of the Conveyancing Act 1919 (NSW) and the discussion on this further in the chapter).

36.1.2 Perpetuity period

Gifts for charitable purposes must vest within the perpetuity period (at common law, a life and 21 years, or, under the statutory period, a term of years not exceeding 80 years). Once the vesting rules for perpetuity have been satisfied, there is no restriction on the duration of a charitable trust. A private trust, on the other hand, cannot endure beyond the perpetuity period, because it must vest in an individual (see, also, *Oesterlin v Sands* (1969)).

36.1.3 Cy-près *doctrine*

Unlike private trusts, charitable trusts are amenable to the *cy-près* doctrine. If an express trust cannot be carried out, or if a surplus remains after the trust

has been executed, that surplus will pass to the settlor pursuant to a resulting trust. If, however, a charitable purpose cannot be carried out, the *cy-près* doctrine allows the court to direct the property to be applied to the nearest and most suitable analogous purpose (see the discussion on the *cy-près* doctrine further in this chapter).

36.1.4 Enforcement proceedings

The terms of an express trust can be enforced by the beneficiaries, or by new trustees suing previous trustees who have acted in breach, for a restoration of the trust property. The Attorney General, both Commonwealth and State, enjoys special standing, by way of a relator action, to sue for breach of a charitable trust (*Morice v Bishop of Durham* (1804); *Wylde v Attorney-General (NSW)* (1948)).

36.1.5 Taxation advantages

Gifts for charitable purposes also enjoy substantial tax advantages, particularly with respect to income tax and rating relief. Modern legislation, however, typically confers tax advantages on a wider range of objects rather than exclusively charitable purposes. Moreover, not all charitable objects enjoy tax relief. Some legislation restricts relief to 'public benevolent' charities, and it is also usual to limit fiscal privileges to charitable activity carried out in Australia (see, for example, ss 23(e), 78 of the Income Tax Assessment Act 1936 (Cth)).

The link between charitable status and fiscal immunity is controversial. In *Dingle v Turner* (1972), Lord Cross argued that, in a case in which the arguments for and against charitable status were finely balanced, it was relevant for a court to consider whether the objects deserved to attract tax advantages. The majority of the House of Lords, however, disassociated itself from these remarks, and they have not received support in later cases.

36.2 The meaning of charity

Charity is a legal term of art; it should not be understood in a lay or popular sense of the word and is confined to an established set of legal criteria.

36.2.1 Preamble to the Statute of Elizabeth

The starting point for inquiring into the legal meaning of charity is the Preamble to the Statute of Charitable Uses 1601 (Imp). The Preamble set out a list of charitable objects which fell within the scope of the reforming legislation. This miscellany of charitable purposes included gifts 'for the relief of aged, impotent, poor people ... schools of learning, free schools, and scholars in universities'. It was not, however, a comprehensive list: trusts for religious purposes, an established category in 1601, were not mentioned in the

Preamble. Courts, therefore, accepted purposes expressly mentioned in the Preamble as charitable, as well as holding that a purpose analogous to one mentioned in the Preamble, or within its 'spirit and intendment', could be held to be charitable.[1]

36.2.2 Pemsel's *case*

In *Commissioners for Special Purposes of Income Tax v Pemsel* (1891), Lord MacNaghten reduced the multiplicity of instances of charitable trust to four primary categories:

- 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.

The fourth category is not to be construed literally and broadly. It is a compendious term embracing all legally recognised gifts for charitable purposes not falling under any of the other three heads. This four tiered classification remains the principal legal categorisation for charitable purposes today.

36.2.3 Alternative approaches

From time to time, it has been suggested that courts should break out of the strait jacket of the Preamble. Lord Wilberforce argued, in *Re Resch's Will Trusts* (1969) and *Scottish Burial Reform and Cremation Society v Glasgow Corp* (1968), that judges, rather than referring to the Preamble, should consider directly whether particular purposes are accepted as being for the benefit of the community; whether the purpose fits within the express categories of the Preamble or its 'spirit and intendment' should be irrelevant in the overall assessment. The Australian High Court has, however, declined to depart from the traditional approach and continues to construct the definition from the historical Preamble (*Royal National Agricultural and Industrial Association v Chester* (1974); and *Incorporated Council of Law Reporting of the State of Queensland v Federal Commissioner of Taxation* (1971)). Whilst it is true that the Preamble categories are broad ranging, considering the multitude of changes that society is constantly experiencing it may be far more appropriate to interpret the definition of charity through a more flexible and adaptable construction of community benefit rather than restrict it to a classification that is centuries old (see Tokeley, 'A new definition for charity?' (1991) 21 VUWLR 41).

1 See Bromley, 'Contemporary philanthropy – is the legal concept of charity any longer adequate?', in Waters, D (ed), *Equity, Fiduciaries and Trusts*, 1993, Chapter 4.

36.3 Education

Trusts falling under the head of education must be:

- for the advancement of education; and
- for the public benefit.

In spite of some judicial wavering, education has been construed generously. In *Re Shaw* (1957), a trust proposed by George Bernard Shaw in his will to promote a 40 letter alphabet was held not to be charitable. Harman J considered that an element of teaching was essential to the validity of a trust for educational purposes. Today, such a requirement is recognised as being unduly restrictive; it would render invalid gifts to promote research where no element of teaching was involved, and a strained and artificial construction of education would be produced. Trusts to promote research have been upheld as charitable (*Taylor v Taylor* (1910)). In *Re Hopkins Will Trusts* (1965), Wilberforce J explained that research is of educational value to the researcher and is generally directed to lead to something which will pass into the store of educational material, so as to improve the sum of communicable knowledge in an area which may need and require further study.

36.3.1 The arts

The holistic approach which courts have taken in defining education has justified the upholding of trusts to promote the arts. In this area, however, courts may find themselves called upon to exercise value judgments as to artistic merit. For example, in *Re Pinion* (1965), the testator's attempt to set up a museum of his furniture and works of art was struck down; his art was described by the court as 'atrociously bad' and far from being educational. Nevertheless, the case is exceptional; disagreements about artistic value are normally resolved in favour of the artist, writer or musician in question (*Re Deluis* (1957)).

36.3.2 Sport

Trusts to promote sport will be upheld as trusts for the advancement of education where the sport is linked to a school or university, or is stated generally to be for the benefit of those attending educational institutions (*IRC v McMullen* (1986)). Trusts to promote sport or recreation outside an educational context will not, however, be charitable in nature.

In Queensland, South Australia and Western Australia statutory provisions allow certain sport and recreational gifts to be classified as charitable, although it must still be established that such gifts are for the public benefit (s 5 of the Charitable Trusts Act 1962 (WA); s 69c of the Trustee Act 1936–84 (SA); s 103 of the Trusts Act 1973–81 (Qld); see also 36.7).

36.3.3 The public benefit requirement in education

A valid trust for the advancement of education must also be proven to be for the public benefit. The public benefit requirement has been construed in education cases to mean that there must be no link, whether by way of family, employment or organisation, between all the beneficiaries, and the purpose itself must benefit a sufficiently large portion of the community. In *Oppenheim Tobacco Securities Trust Co Ltd* (1951), trustees were directed to apply income 'in providing for, or assisting in providing for, the education of children of employees or former employees of British-American Tobacco Co Ltd'. There were over 110,000 employees. The House of Lords held, by a majority of four to one, that the trust was not for the public benefit. Lord Simonds defined public benefits in terms of two requirements:

- the possible beneficiaries 'must not be numerically negligible'; and
- the beneficiaries must not link to each other by a relationship to a common person or organisation.

In *Oppenheim*, the fatality was that the beneficiaries were linked through a common employer held by their parents; hence, the trust was held to be invalid as the common factor was purely personal, depriving the class of its required 'public' character.

36.3.4 Recognition of 'no personal nexus' test in Australia

The 'no personal nexus' test was approved by the High Court in *Thompson v FCT* (1959). In that case, a testator left his property to certain schools that were restricted to children of Bethlehem of the Masonic Order in New South Wales. Membership of the Order occurred through an election by existing members. The High Court held, by a majority of three to two, that the gift did not qualify for exemption from estate duty on the ground that it was 'for public educational purposes'. Dixon CJ considered that the parents' contractual link, as members of the unincorporated association of the order, meant that the public benefit test was not satisfied.

The 'no personal nexus' test has been criticised on the ground that it lays down a formal test for determining whether a trust is for the public benefit. It is possible that a trust for the education of children of residents of Broken Hill would be valid, whereas a trust for the education of employers of BHP would not, and this seems illogical. The cogency of this criticism depends, to a considerable extent, on whether courts will examine the facts underlying a particular gift for charitable purposes and determine whether, in reality, a nexus or common link exists between the beneficiaries (see also *Public Trustee v Young* (1980)).

36.4 Religion

Trusts for religious purposes will be charitable if they are:

- for the advancement of religion; and
- for the public benefit.

Courts of equity at one time construed religion in a strictly theistic sense, so that belief in particular was a precondition of charitable status. This approach excluded monotheistic religions as well as ethical organisations (*Re South Place Ethical Society* (1980)). In *Church of the New Faith v Commissioner of Pay-roll Tax (Victoria)* (1983), the High Court held that the definition of religion should not be confined to theistic religions. The court was divided as to the approach to be adopted towards the definition of religion. Mason ACJ and Brennan J identified two criteria of religion:

- belief in a supernatural being, thing or principle; and
- acceptance of canons of conduct in order to give effect to that belief.

Canons of conduct which offend against ordinary law will not be recognised as a religion. Applying these criteria, the court held that a trust to establish a church following the writings of the scientologist Ronald Hubbard was charitable.

36.4.1 Exclusively charitable

A trust for religious purposes must, subject to legislation to be discussed later, exclusively promote charitable objects. It will be invalid if religious and secular purposes are inextricably interwoven. In *Roman Catholic Archbishop of Melbourne v Lawlor* (1934), the High Court was equally divided on the question of whether a gift 'to establish a Catholic daily newspaper' was exclusively charitable. The decision of the Victorian Full Court that the gift was not charitable, because the newspaper would convey a wide range of news and opinions which would not be restricted to matters of faith or worship, was upheld on appeal.

36.4.2 Public benefit in religion

A trust for religious purposes must satisfy the public benefit requirement, although the meaning of public benefit in the context of religion is not altogether clear. In *Dingle v Turner* (1972), Lord Cross suggested *in obiter dicta* that the 'no personal nexus' test was inapplicable provided the purposes of the trust were clearly spiritual.

It has, however, been held that a public benefit must be established as a matter of proof and cannot rest on the beliefs of adherents to the religion. In *Gilmour v Coats* (1949), the House of Lords held that a gift to a purely contemplative order of Catholic Carmelite nuns, who devoted their lives to

solitary prayer, contemplation and penance, was not a valid gift for charitable purposes since the belief of the faithful that the prayers of the nuns advanced spiritual welfare did not, in itself, satisfy the criterion of public benefit. Lord Simonds noted that a benefit such as that which may be derived from the example of pious lives was so 'indirect, remote and imponderable' that it could not possibly constitute a public benefit.

The decision is a stark demonstration of the law's insistence on proof, which is, in many instances, directly inconsistent with the foundation of religious belief in faith. While the need to establish direct public benefit complicates charitable giving to contemplative religious orders, it has not been difficult for most religious orders to establish temporal benefit (*Re Banfield* (1968); *Neville Estates Madden* (1962)). It has been doubted whether *Gilmour v Coats* is good law in Australia, as it has been held that trusts for intercessory purposes may be upheld on the basis that they enhance the quality of life of those who find peace of mind in prayer (*Crowther v Brophy* (1992)).

36.5 Relief of poverty

Trusts for the relief of poverty have long been recognised as charitable. The requirement of public benefit has only a limited application to this head of charity, as it is generally assumed that a trust for the benefit of the poor will also constitute a public benefit (*Re Scarisbrick* (1951)).

Courts construe poverty in the sense of relative destitution; it is not to be equated with absolute destitution. In *Downing v Federal Commissioner of Taxation* (1971), property was left for the purpose of 'the amelioration of the condition of dependants of any member or ex-members of Her Majesty's naval, military or air forces, or the naval, military or air forces of the Commonwealth'. The High Court held that the donor had made an effective gift for the relief of poverty. Walsh J observed that the term 'poverty' referred to 'persons who, although they may not be in abject poverty, are subject to some degree of financial necessity'. In *Re Segelman (Deceased)* (1995), Chadwick J held that a trust to benefit members of a class which was not, *per se*, poor – but who may need financial assistance from time to time – did fall on the 'charitable' side of the line.

36.5.1 Public benefit

A trust for the relief of poverty will not be upheld as being for the public benefit if the beneficiaries are named individuals. On the other hand, trusts for the relief of the seller's poor relations have been recognised (*Re Scarisbrick* (1951)). The family link between the beneficiaries does not invalidate these trusts. The 'poor relations' cases were upheld by the House of Lords in *Dingle v Turner* (1972). In that case, the testator left his residuary estate to trustees to pay pensions to poor employees of a family company. The House of Lords

upheld the gift, though all the potential beneficiaries were defined in terms of employment by a common employer. The 'no personal nexus' approach of the *Oppenheim* case was rejected in the context of trusts for the relief of poverty.

36.6 Trusts for other purposes beneficial to the community

The fourth head of charity adumbrated by Lord MacNaghten in *Pemsel's* case is the residual category of trusts 'for other purposes beneficial to the community'. In determining whether a trust secures admission to this category the approach is, as described above, to consider whether the trust can be said to be within the 'spirit and intendment of' the Preamble.

Gifts upheld under the heading defy convenient summary. The enhancement of community life has been held to be charitable. So, for example, gifts for the 'improvement of the city of Ballarat' (*Re Boanes* (1930)), and for the 'provision of a concert hall for the city of Launceston' (*Monds v Stackhouse* (1948)) have been upheld. More generally, a trust for the benefit of the community in Australia will be charitable (*CSD (NSW) v Way* (1951)).

Trusts to hospitals or to promote health will also be valid under this head, although some will also be upheld on the basis of the relief of poverty. In *Le Cras v Perpetual Trustee Co Ltd* (1969), a gift to the Sisters of Charity to be applied for the general purposes of St Vincent's Private Hospital was held by the Privy Council to be charitable. The fact that the hospital charged fees was not inconsistent with charitable status, provided that the income so derived was applied for the purposes of the hospital.

Trusts for the welfare of animals will also be upheld, although the perspective of the courts has been to consider animal welfare as an aspect of human sensibility. So, a trust to provide a refuge for animals where they would have no contact with human beings was struck down on the grounds of an absence of public benefit (*Re Grove-Grady* (1929)). In *Murdoch v Attorney-General (Tas)* (1992), Zeeman J held that a trust for the 'benefit of animals generally' was not charitable because a gift benefiting animals is not, *per se*, of benefit to the community. Similarly, trusts to protect native fauna have been held invalid where the public was not permitted access to the area covered by the proposed trust (*Re Green* (1970)).

Trusts for sporting or recreational purposes will be upheld as educational where these activities are carried out in association with an educational institution. Where trusts for sporting purposes are not connected with education, they may still be validated under the fourth heading. It has been held, however, that sporting trusts will not be recognised as charitable where the social aspects of the sport predominate over the aim of improving the condition in life of those who play it (*IRC v Baddeley* (1955)). The distinction between the charitable and social aspects of recreation is elusive, and some States have enacted legislation to ensure that such trusts are upheld (s 5 of the

Charitable Trusts Act 1962 (WA); s 69c of the Trustee Act 1936–84 (SA); s 103 of the Trusts Act 1973–81 (Qld)).

36.7 Foreign charitable purposes

A trust may be recognised as charitable even if it is intended that the trust shall take effect outside Australia. In *Lander v Whitbread* (1982), Holland J upheld a gift on trust 'for the Government of the State of Israel for the advancement of education in that State'. The Government of Israel indicated its willingness to carry out the terms of the trust. The absence of direct benefit to the local community was held to be irrelevant to the validity of the gift, provided the trust came within one of the recognised legal categories of charity and evidenced public benefit to the foreign community. Charitable trusts with a foreign element may not, however, enjoy the fiscal advantages of charitable status, and securing the enforcement of the trust may also present practical problems.

36.8 Trusts for political purposes

A trust which would otherwise be charitable will be denied charitable status if it attempts to carry out a political purpose. Trusts to promote political parties, or the philosophies of political parties, will obviously infringe the political trust doctrine, although legislation confers tax advantages on political parties similar to those enjoyed in charity. Trusts to promote changes in the law will also be held to be political, unless the objective of changing the law is ancillary to the predominant charitable object (*National Anti-Vivisection Society v IRC* (1948)).

Trusts to campaign for changes in the law in other countries have also been struck down, even though, as in the case of Amnesty International, the purpose is to abolish torture (*McGovern v Attorney-General* (1982)). Trusts for associations where the primary purpose is to achieve a change in the law will also constitute invalid political purpose trusts (*Re Cripps* (1941)).

36.9 Mixed charitable and non-charitable objects

Courts of equity only accorded charitable status to trusts which were exclusively charitable. The inclusion of a non-charitable purpose in what would otherwise be a trust for charitable objects was sufficient to invalidate the gift. Equity recognised a limited doctrine of severance, where the non-charitable parts could be separated from the charitable position by drawing a line through the former. In Australia, equitable severance has been superseded by far more comprehensive statutory reforms which enable many more gifts to be partly sustained.

36.9.1 Statutory reform

Typical of the legislation is s 131 of the Property Law Act 1958 (Vic):[2]

> (1) No trust shall be held to be invalid by reason that some non-charitable and invalid purposes as well as some charitable purpose is or could be deemed to be included in any of the purposes to or for which an application of the trust funds or any part thereof is by such trust directed or allowed.
>
> (2) Any such trust shall be construed and give effect to in the same manner in all respects as if no application of the trust funds or any part thereof to or for any such non-charitable and invalid purpose had been or could be deemed to have been directed or allowed.

The principal points which have emerged from the legislation are as follows:

- Section 131, or its equivalent in other States, can be invoked to sever charitable from non-charitable purposes which are separately expressed. In *Re Bond* (1929), a gift 'to the blind and their children' was severed to exclude the legally uncharitable reference to 'children'.
- Section 131 can be used to validate a gift which employs a composite phase embracing both charitable and non-charitable purposes. The gift will then be enforced purely for the charitable purposes. In *Leahy v Attorney-General for NSW* (1959), a trust 'for such order of nuns of the Catholic Church or the Christian Brothers as my executors and trustees shall select' which, without s 131 (or its equivalents) would have been invalidated by the application of *Gilmour v Coats* (see 36.5.2), was upheld on the basis that the gift could be applied for a non-contemplative order.
- Section 131 can, however, only be applied for this purpose if the charitable portion is capable of being detached from the non-charitable portion. Legislative severance was held by the High Court to be inapplicable in *Roman Catholic Archbishop of Melbourne v Lawlor* (1934), because a trust to promote a Catholic newspaper was, *per se*, incapable of being enforced in an exclusively charitable manner.
- Statutory severance can only be invoked where the gift expresses some charitable intent. In *Re Hollole* (1945), the legislation could not save a gift of property 'to be disposed by the testator as he may deem best'. There was no indication that the testator had a charitable motive in making the gift.

36.10 The *cy-près* doctrine

The *cy-près* doctrine enables a court to authorise an alteration to the purposes of a trust in order to produce a valid charitable trust. In applying the doctrine, the court should apply the trust property for a purpose as near as possible (*cy-*

2 Trustee Act 1962 (WA), s 102; Property Law Act 1958 (Vic), s 131; Variation of Trusts Act 1994 (Tas), s 4(2); Trustee Act 1936 (SA), s 69a; Trusts Act 1973 (Qld), s 104.

près) to that stipulated by the settlor in the initial gift. The rationale of the *cy-près* doctrine is that the settlor's primary intention was to give to charity and not for some private purpose, and this intent should be upheld.

A distinction should be drawn for the purpose of the doctrine between:

- initial impossibility, where it is impracticable or impossible from the outset to carry out the terms of the trust; and
- supervening impossibility, where the gift takes effect according to its terms, but it later becomes impossible or impracticable to enforce the trust according to its terms.

36.10.1 Initial impossibility

Where a gift for charitable purposes fails at inception, the gift can be applied *cy-près* provided the original gift exhibits a general charitable intent. This means that the settlor must have shown an intention to give to charity, and this intention supersedes the intention to give for the particular purpose specified in the original disposition. Since the High Court decision, in *Attorney-General for New South Wales v Perpetual Trustee* (1940), Australian courts have generally been astute in construing a general charitable intent out of specific gifts. On the facts of that case, the testator left a farm and nearly 40,000 acres of land for the establishment of 'a training farm for orphan Australian lads'. In the opinion of a pastoral inspector and valuer, it was not practicable to use the property for that purpose. The High Court held, by a majority, that the testatrix had shown a general intent to settle her property for charitable purposes, and this charitable motive was not limited to the specific gift she had made. The primary judgment of Dixon and Evatt JJ made it clear that the general charitable intent required no more than a purpose wider than the execution of a specific plan. A finding of a general charitable intent allowed the court to apply the property *cy-près* and, thereby, render valid a scheme selected by the court.

36.10.2 Charity appeals

Although courts lean in favour of finding a general charitable intent, the practical problems of ascertaining such an intent, when a large number of donors subscribe to an appeal, have sometimes inhibited courts from applying subscription money *cy-près* when the original purpose cannot be carried out, for example, where insufficient money was raised to fulfil the purpose (*Beggs v Kirkpatrick* (1961)). Some States have passed legislation which empowers courts to apply subscription money *cy-près* after advertisements have been published inviting donors to reclaim money (see s 3 of the Charities Act 1978 (Vic)).

36.10.3 Supervening impossibility

When property has been validly dedicated to charitable purposes, there is no need for a court to search for a general charitable intent if it later becomes impractical to apply the property to those purposes. Courts of equity once took a stringent approach to the definition of impossibility for the purposes of the supervening impossibility doctrine. Later cases established, however, that property could be applied *cy-près* if it had become impracticable to carry out the terms of the original trust. Courts have felt that it would not be in the public interest to allow a trust to remain moribund, particularly where a charitable intent can be established (*Re Dominion Students Hall Trust* (1947)).

The requirements for supervising impossibility have been further diluted by legislation in some States which empowers a court to apply *cy-près* where the original purpose has ceased to provide a suitable and effective method of using the property available by virtue of the gift, regard being had to the spirit of the gift.[3]

36.11 Trusts for non-charitable purposes

Where a purpose does not fit within the definition of a charity and cannot be assisted by severance or the *cy-près* doctrine, the trust will be invalid, as it offends against the beneficiary principle (*Morice v Bishop of Durham* (1804)). In some instances, a non-charitable purpose trust may be socially useful, and invalidation on the basis of the beneficiary principle can seem quite artificial. The primary justification for the beneficiary principle is that, without identifiable beneficiaries or a legally recognised charitable purpose, there would be no one to enforce the trust. This type of argument is quite weak when it is considered that the Attorney General rarely initiates relator actions to enforce charitable trusts anyway. Why should enforceability depend upon the mere fact that the Attorney General has power to enforce a charitable purpose trust only? Professor Ford has argued that the cogency of the beneficiary principle is weakened when account is taken of the fact that object trusts can also involve difficulties in enforcement, particularly where the trust involves the administration of a large fund (see Ford, HAJ, 'Dispositions for purposes', from Finn, PD, *Essays in Equity*, 1985).

Where a non-charitable purpose trust exists, rather than overwhelm the beneficiary principle, courts have developed a number of different ways to validate the disposition. It may be argued that the disposition does not, in fact, constitute a trust, but rather the conferral of an authorisation to another person to transfer property to a specified purpose or third party should they

3 Charities Act 1978 (Vic), s 2; Charitable Trusts Act 1962 (WA), s 7; Variation of Trusts Act 1994 (Tas), s 5; Trustee Act 1936 (SA), s 69b; Trusts Act 1973 (Qld), s 101; Charitable Trusts Act 1993 (NSW), ss 9–11.

so desire (*Comptroller of Stamps v Howard Smith* (1936)). Alternatively, it may be argued that what appears, on the face of it, to constitute a purpose trust is, in fact, a trust for individual beneficiaries. One of the classic areas where courts are prepared to hold that a purpose trust, in fact, constitutes a trust for individual beneficiaries is where a gift is conferred to an unincorporated association. The reason for this lies in the special character of such associations.

36.11.1 Unincorporated associations

A group of persons who associate together for a common purpose, such as a religious association, a sporting club or a trade union, will not constitute a separate legal entity unless corporate status has been conferred upon the association. The fact that the association does not have a separate legal status means that, when a gift is given to it, it is possible to read the gift as a trust for the benefit of the existing members of the association, and thereby validate the gift rather than a trust for the non-charitable purpose that the association represents (*Leahy v Attorney-General for NSW* (1959)).

Gifts to unincorporated associations will not automatically be read as gifts to the existing members of the association; consideration has to be given to the wording of the trust and the nature of the trust property as well as the character, purpose and size of the association. In *Leahy v Attorney-General,* a testator devised a grazing property to trustees 'upon trust for such order of nuns of the Catholic Church or the Christian Brothers as my said executors and trustees shall select'. It was held that the purpose was non-charitable, so it was argued that the trust was, in fact, a trust for the benefit of the existing members of the order. The High Court upheld this argument, although it was rejected on appeal to the Privy Council. Viscount Simmonds argued that the trust was expressly set out to be for 'an order' of nuns rather than the nuns individually. Furthermore, the breadth of the order meant that, if every member was to be treated as a beneficiary, very little benefit would be conferred. As Viscount Simmonds noted: 'It is not easy to believe that the testator intended an immediate beneficial legacy to such a body of beneficiaries.' Finally, it was argued that the nature of the property itself, grazing land, was not amenable to such a broad division.

It is important to distinguish between gifts which actually state the purpose for which property is to be used, and those which do not. Where the former is conferred upon an unincorporated association, it will rarely be construed as a gift to each individual member; in stating the exact purpose for which the property is to be used, the settlor has clearly negated any intention to confer it to members individually.

Where a trust for the individual members of an unincorporated association can be construed, it will *prima facie* constitute a gift to the current members of the association as joint tenants. In *Bacon v Pianta* (1966), the testator gave all of

his estate to the 'Communist Party of Australia for its sole use and benefit'. It was held by the High Court that it would be artificial to conclude that the bequest was a gift to existing members of the association, in light of the high degree of fluctuation in the numbers of members, the wording of the bequest, and the fact that the members were unable to put an end to the association in order to distribute the property amongst themselves anyway. This latter point will not be an issue where the gift can be construed as a gift to the existing members of an association, subject to the rules of the association, because, in such a case, the gift will simply augment the existing funds of the association (*Re Goodson* (1971); see also s 63(1) of the Succession Act 1981 (Qld)).

36.11.2 Where the purpose directly or indirectly benefits identifiable beneficiaries

A non-charitable purpose trust may also be validated where it can be proven that the purpose directly benefits an identifiable beneficiary or group of beneficiaries (*Re Denley's Trust Deed* (1969)). On the facts of *Re Denley's Trust Deed*, property was left for the maintenance of a sports ground for the employees of a company. Goff J held that, whilst this appears to constitute a non-charitable purpose trust, because the purpose provided a direct benefit to the employees of the company, it could be validated. On the other hand, in *Re Astor's Settlement Trusts* (1952), a trust to apply the income from shares held in the *Observer* newspaper, for the purposes of improving understanding between nations, preserving and promoting the integrity of newspapers and protecting the monopolisation of newspapers, was held to be invalid because the purposes were non-charitable and did not directly benefit the beneficiaries, as they were too broad and indefinite. It is unlikely that the *Re Denley* approach will be adopted in Australia, given the fairly restricted approach taken to the unincorporated association cases. Furthermore, it seems somewhat illogical to argue that a purpose trust which specifically identifies those who will benefit should be validated against one that does not. If reform is to occur, it would be more appropriate to undertake a complete reassessment of the objectives underlying the beneficiary principle as a whole.

CHAPTER 37

RESULTING TRUSTS

37.1 Nature of a resulting trust

A resulting trust is one which arises in circumstances where an express trust has been created, or should have been created, but is incomplete. The incomplete status can arise in a number of situations. Where a settlor attempts to create an express trust, but fails to completely exhaust the trust property in favour of the beneficiaries, a resulting trust may arise over the surplus property in favour of the settlor. Alternatively, where one party transfers property into the name of another but does not intend the transferee to receive a full beneficial interest in the property, a resulting trust may arise in favour of the transferor. In both these situations, the resulting trust arises either automatically or presumptively. The common feature of all resulting trusts lies in the fact that the beneficial interest has been incompletely disposed of. The trust mechanism is a protective device against the unjust enrichment of trustees or other recipients. The resulting trust confers the same rights and obligations as an express trust, with the primary distinction being that it arises without being expressly created and is not subject to the same formality requirements as express trusts. It differs from the constructive trust in that its creation is not a construction of the court but, rather, an automatic or presumptive result from the actual circumstances.

37.2 Resulting trusts arising automatically from failed express trusts

37.2.1 Where the trust property is not completely exhausted

Where an express trust by transfer is created in favour of specified beneficiaries, and the trust property is not completely exhausted, a resulting trust will generally arise in favour of the settlor (see *Longley v Longley* (1871); *Re Vandervell's Trusts (No 2)* (1974)). For example, where a settlor transfers a piece of land upon trust to A, and confers a life estate upon the beneficiaries in the land, A will hold the fee simple reversion under a resulting trust for the benefit of the settlor. A resulting trust arises because equity is not prepared to confer an unjust enrichment upon the trustee, particularly where there is no evidence that the settlor ever intended such a result, and yet the courts are reluctant to encourage 'ownerless' property.[1]

1 See, generally, Ford and Lee, *Principles of the Law of Trusts*, 2nd edn, 1990, pp 958–59.

37.2.2 Where the express trust is invalid or unenforceable

Where an express trust by transfer fails because it is either void or unenforceable, a trustee who has had trust property transferred to her will hold that property pursuant to a resulting trust back to the settlor. This may occur where the trust is illegal (see, for example, *Tinsley v Milligan* (1993)), or where the certainty or formality requirements have not been complied with (see the discussion generally in Chapter 28). In these situations, it is clear that the settlor intended to create an express trust by transfer, and has transferred the property to the trustee to achieve this purpose. Due to the invalidity or unenforceability of the trust, however, this intention has been thwarted. In such a situation it would be unfair to allow the recipient trustee to be unjustly enriched and to hold the property subject to no equitable obligation, so courts have held that the trustee automatically holds the property under a resulting trust for the benefit of the original settlor.

37.2.3 Quistclose *resulting trust*

Where an express trust is set up with the aim of achieving a particular purpose and the purpose fails, a resulting trust may arise back to the settlor. In *Barclays Bank Ltd v Quistclose Investments Ltd* (1970), the court held that a loan, conferred for a specific purpose, created an express trust for that purpose and, when the purpose failed, the lenders were protected by the imposition of a resulting trust over the funds. This type of resulting trust differs in form from the previous categories because it arises where the purpose for which the express trust is created fails. The court in *Quistclose* was careful to point out that a primary and a secondary purpose could be inferred from the loan agreement: the primary purpose being that the loan moneys were to be held under an express trust until the purpose for which the loan had been granted was satisfied; and the secondary purpose being that, if the purpose for which the loan moneys were granted was not satisfied, the moneys were to be held under a resulting trust back to the lender (see also *Re EVTR* (1987); *General Communications Ltd v Development Finance Corp of New Zealand Ltd* (1990); see the discussion in 27.2.3).

37.2.4 Resulting trust arising from an ultra vires *contract*

A resulting trust has been held to arise where money is paid pursuant to an *ultra vires* contract. In *Sinclair v Brougham* (1914), the House of Lords held that a building society which had received money deposits pursuant to *ultra vires* contracts held the money under a resulting trust for the benefit of the depositors. Viscount Haldane and Lord Atkinson held that, as the contractual remedy was precluded, proprietary rights in the form of a resulting trust should be available. The decision in *Sinclair v Brougham* has, however, been overruled by the subsequent House of Lords' decision in *Westdeutsche*

Landesbank Girozentrale v Council of the London Borough of Islington (1996), which held that the resulting trust was an inappropriate mechanism to apply to *ultra vires* contracts. In one of the leading judgments, Lord Browne-Wilkinson argued that the resulting trust could not be justified because it would adversely affect the rights of creditors where the recipient of the monies became insolvent. Enforcing a resulting trust in such circumstances would be tantamount to conferring an unwarranted priority, and would interfere with established commercial practices. He warned against the 'wholesale importation into commercial law of equitable principles inconsistent with the certainty and speed which are essential requirements for the orderly conduct of business affairs'.

He discussed the two primary circumstances where resulting trusts could arise: where there was an implied intention arising from either an incomplete express trust; or a transfer in the name of another where the transferor never intended the other to retain full beneficial ownership. On the facts of the case, an *ultra vires* payment by the bank to a local authority did not constitute an express trust in the first place, so a resulting trust could not arise under the first method. Furthermore, a resulting trust could not arise presumptively from the transfer as the money was always intended to become the absolute property of the local authority. Lord Browne-Wilkinson rejected recent restitutionary arguments suggesting that the resulting trust be used as a device to preclude unjust enrichment wherever money is paid under a mistake, or is paid on a condition which is not subsequently satisfied. Ultimately, the unfairness that would result to creditors in an insolvency situation, and the artificial constructions it would place upon the commercial law of resulting trusts, prevented any such extension, although Lord Browne-Wilkinson did recognise the possible application of a remedial constructive trust to such cases (for a discussion on the restitutionary implications of resulting trusts, see Birks, P, 'Restitution and resulting trusts', in Goldstein (ed), *Equity: Contemporary Legal Developments*, 1992; and Swadling, W, 'A new role for resulting trusts?', 16 Legal Studies 133. See also Chapter 5, 23.3.1 and 26.4).

37.2.5 Failed charitable purpose trust

Where an express trust is set up for a particular charitable purpose and the charitable purpose becomes impossible to carry into effect, the court may apply the *cy-près* doctrine rather than raising a resulting trust (see 36.11). Where a charitable purpose is impossible to carry into effect and a general charitable intent cannot be established, the property is generally held to vest in the Crown as *bona vacantia* (*Re West Sussex Constabulary's Widows, Children and Benevolent Fund Trusts* (1971)).

37.2.6 Failed express trusts with alternate constructions

Where an express trust by transfer has been imposed upon an absolute gift, and that trust fails, the absolute gift may take effect as an alternate construction. Hence, if A intends to confer a benefit to B under a will, and confers certain powers or provisions upon the executor in administering the interest of B so that a trust is also set up, if the trust becomes invalid or unenforceable, B will still receive the benefit; it will not result back to the settlor (*Lassence v Tierney* (1849)). In such a case, the resulting trust cannot arise because the absolute gift precludes a finding that the settlor intended such a trust to arise. Similarly, where it can be proven that unexhausted trust property was intended to be retained by the trustee recipient, a resulting trust cannot arise.[2]

37.3 Resulting trusts presumed from a transfer

37.3.1 Transfer of property for no valuable consideration

Where one person pays for property and transfers it into the name of another who has given no valuable consideration, the transferee will hold the property pursuant to a resulting trust for the benefit of the purchaser. This type of resulting trust is known as a 'voluntary transfer resulting trust'; it arises because equity presumes, in the absence of a contrary intention, that the person who paid for the property owns the property (*Muschinski v Dodds* (1986)). These resulting trusts are, however, only presumptive, and it is possible to rebut their application by proving an intention to benefit the transferor or through proof of a presumption of advancement. In some States, legislation expressly sets out that a presumed resulting trust will not arise unless the transferor demonstrates an intention to preclude the transferee from holding the beneficial interest.[3]

Where personal property is transferred into the name of another who has given no valuable consideration, the presumption of a resulting trust can only arise where the property is capable of producing income or holds some quantifiable value (*Re Vinogradoff* (1935)).

37.3.2 Transfer of property with partial contribution

Where a purchaser transfers property into the name of another who makes a partial contribution to the purchase price, the transferee will hold the

2 See, generally, *op cit*, Ford and Lee, fn 1, pp 960–61.

3 Property Law Act 1969 (WA), ss 38–39; Property Law Act 1958 (Vic), s 19A(3); Property Law Act 1974 (Qld), s 7; Conveyancing Act 1919 (NSW), s 44; Conveyancing Act 1919 (ACT), s 44. In Victoria, pursuant to the Property Law Act 1958 (Vic), s 19A(4), the legislation expressly sets out that the section is not intended to limit or affect any principles relating to the implication of resulting trusts.

purchaser's share under a presumed resulting trust. This type of resulting trust is known as a 'purchase money resulting trust'; it arises because equity presumes, in the absence of a contrary intention, that the person who contributed to part of the purchase price owns the property to the extent of that contribution (*Calverley v Green* (1984)). In *Calverley v Green,* a couple lived in a *de facto* relationship and decided to purchase property in their joint names. The mortgagee of the purchase required both parties to sign the mortgage before finance would be approved. The man provided $9,250 in cash for the purchase, and the remaining $18,000 was to be paid by the bank and secured by the mortgage. Both parties were registered on the title. For the following five years, the man paid the mortgage instalments whilst the woman paid for general household expenses. When the relationship broke down, the woman wanted trustees appointed to hold the house on statutory trust for sale according to her co-ownership rights. The man cross-claimed that the woman held her interest on trust for him.

The High Court held that a presumed resulting trust applied. The resulting trust was restricted to the amounts each party paid at the purchase date which was the date when the house was bought. Gibbs CJ felt that entering into a mortgage liability can constitute a contribution to purchase price because of the liability it imposes. Hence, in conclusion, the court found that the woman was not entitled to a half share in the property although she was entitled to her contribution, which was proportionate to her liability under the mortgage. Effectively, the woman acquired approximately a one-third interest in the property and held the remaining interest under a resulting trust for the man.

Importantly, the contributions made by each party after the initial purchase price were irrelevant to the application of a purchase price resulting trust. The fact that the man paid the mortgage repayments was irrelevant to the application of the resulting trust, because the interests of the parties are determined at the date of the purchase (*Vedejs v Public Trustee* (1985)). Today, the case would be better dealt with through the imposition of a constructive trust. The constructive trust is not restricted by a strict determination of the time of purchase price; it considers all contributions, both financial and non-financial, which have been made by each party. Nevertheless, unlike the presumed resulting trust, it must actually be imposed by the court where it would be considered unconscionable to deny an interest.

A contribution to the purchase price is to be determined at the date of purchasing the property and not afterwards; consequently, mortgage repayments made after the property has been purchased will not constitute a contribution to the purchase price. On the other hand, entering into a mortgage and assuming liability under the mortgage debt will constitute a contribution to the purchase price (*Calverley v Green* (1984)). This should be contrasted to the English position, where mortgage payments are considered to constitute a contribution to the purchase price (*Re Densham* (1975)). Despite

the apparent rigidity of the Australian approach, it is suggested that it is more in line with the fundamental operation of resulting trusts; restricting relevant contributions to those made at the date of purchase is important because it is this exact point when the resulting trust arises.

As contributions to the purchase price must be assessed at the date of purchase, the character of contributions will generally be financial in nature. Non-financial contributions, such as housekeeping or renovations, will generally be irrelevant to purchase money-resulting trusts because they are performed after the date of the purchase (*Pettitt v Pettitt* (1970)).

In both voluntary transfer and purchase money-resulting trusts, the objective is to withhold the conferral of a beneficial interest upon a transferee, therefore, a transferee is capable of assuming the role of a trustee, even where he or she lacks the capacity to do so (*Re Vinogradoff* (1935)). The presumption of a purchase money resulting trust may be rebutted. In *Muschinski v Dodds* (1986), the High Court concluded that a presumed resulting trust cannot prevail over the actual intentions of the parties as established by the overall evidence.

37.3.3 Rebutting the presumption

Voluntary transfer and purchase money-resulting trusts are presumptive and, therefore, may be rebutted wherever an intention to benefit the transferee can be established. Evidence may be adduced to by the transferee to prove that the transferor intended to confer absolute beneficial title, but only where such evidence has been committed prior to, or at the time of, the purchase (*Charles Marshall Pty Ltd v Grimsley* (1956)). Such evidence could be express, or could be inferred from the nature of the relationship between the parties. Usually, express evidence as to the intentions of the parties is not available, and the court will be required to infer the intentions of each party based upon the individual circumstances of the case. Particular attention is given to the words and conduct of the parties, as well as the nature of the relationship between them.

If it can be proven that the transferor intended either to lend or to give the property to the transferee, a resulting trust cannot arise (*Muschinski v Dodds* (1986)). In some cases, the resulting trust may be partially rebutted due to it being proven that the transferor intended to confer a limited estate upon the transferee and retain beneficial title in the remainder. For example, where A purchases and transfers property into the name of B, intending B to hold the property for life, B will hold a life estate and the reversion will be held by B under a resulting trust for A (*Russell v Scott* (1936)).

37.3.4 Presumption of advancement

Where the transferor and transferee have a close relationship to the extent that the transferor feels under a natural obligation to provide for the transferee, the

presumed resulting trust may be rebutted by the presumption of advancement. In such a case, it is presumed that the transferor intended to make a beneficial advancement to the transferor.

A presumption of advancement will only arise in certain special relationships, which have traditionally been restricted in a gendered, stereotypical manner to cases such as a transfer from a husband to his wife or from a father to his child (*Dullow v Dullow* (1985)), but not from the wife to her husband or from the wife to her child (*March v March* (1945)). The artificiality of these restrictions has become increasingly apparent as courts begin to recognise the changing character of relationships and the need to avoid rigid stereotypes. As Kirby P notes in *Brown v Brown* (1993), gendered restrictions to the application of the presumption of advancement have no rational grounding in a contemporary society.

He states that he would:

> ... have no hesitation in supporting the principle that the presumption of advancement, if it is still to be applied, must be applied equally to gifts by mothers and wives as by fathers and husbands.

These comments were approved by the High Court in *Nelson v Nelson* (1995), where a presumption of advancement was held to arise between a mother and her two children. Dawson J in that case pointed out that the Family Law Act 1975 (Cth) specifically sets out that both parents have the primary duty to maintain the child (ss 66A(2)(b) and 66B(1)), and that this reflects a changed responsibility as between parents and the maintenance of their children.

He notes:

> In modern society, there is no reason to suppose that the probability of a parent intending to transfer a beneficial interest in property to a child is any the more or less in the case of a mother than in the case of a father.

See, also, *Gillies v Keogh* (1989) where Richardson J (at p 347) commented that, whatever route is taken for the resolution of property conflicts in relationships:

> … it is crucial that the conduct of those concerned are assessed against contemporary standards and recognising that individual expectations within relationships must be affected by changing attitudes in society.

If the presumption of advancement is founded on the premise that particular relationships, by their very nature, display a greater propensity for advancement, surely the categories should not, logically, be restricted according to gender. Such an approach is illogical and outdated. Indeed, it may be suggested that any presumption as to the status of a particular relationship is inappropriate in a society where relationships themselves are multifarious and eclectic in nature. The notion that a moral obligation to look after the interests of another should be automatically presumed in particular types of relationships, is both outdated and anachronistic. Whilst a presumed

resulting trust may clearly be inappropriate in some instances, rather than formulating artificial presumptions of advancement, the better approach may be to endorse the validity of a voluntary or purchase money transfer and make no presumptions either way, thereby allowing the parties to prove their true intentions individually (see also 25.6.2).

CHAPTER 38

CONSTRUCTIVE TRUSTS

38.1 Nature of a constructive trust

A constructive trust is a remedial device used by the court to prevent a person from unconscionably or inequitably retaining control over property; the constructive trust will be imposed where a court finds that the circumstances warrant the imposition of proprietary relief. Unlike the express and resulting trust, the constructive trust is primarily remedial in focus. Whilst it creates a proprietary right, this creation is not the result of any positive, creative intention on the part of the settlor, but rather the result of a court order. As Waters has noted, the constructive trust is 'a convenient and available language medium for describing equity's manner of redressing a wrong' (Waters, DWM, *The Constructive Trust,* 1964, pp 13–14; see, also, Dodds, 'The new constructive trust: an analysis of its nature and scope' (1987–88) 16 MULR 484).

38.2 Remedy/institutional dichotomy

The constructive trust is a substantive institution, in the sense that it creates property interests and is governed by the institutional characteristics of other trusts, as well as constituting a purely remedial equitable doctrine.[1] This essential dichotomy, whilst conceptually at cross-purposes, captures the essence of the constructive trust. The remedial objective of the constructive trust in righting a wrong describes the fundamental purpose of the trust. This is not, however, to deny its substantive characteristics.

The constructive trust is substantive in two senses. First, it is a species of trust and displays all the outward features of a trust. It has a trustee and a beneficiary, trust property, and creates equitable obligations. Hence, the constructive trust is from the same genus as the resulting and express trust, the principal difference being the mode of creation.

Secondly, it arises by operation of law where a court decrees that the circumstances justifying its implementation exist. The court does not create the trust as such but, rather, enforces it as a pre-existing institution where the circumstances warranting its creation can be proven to exist (see Millett, P, 'Equity: the road ahead' (1995) 9 Trust Law International 35).

1 The remedial/institutional dichotomy originated in 1920 from Pound, R, in 'The progress of the law of equity' (1920) 33 Harv L Rev 420.

In Canada, the Supreme Court has expressly adopted the remedial conception of the constructive trust (*Pettkus v Becker* (1980)). This means that the constructive trust constitutes one of a range of differing personal and proprietary forms of relief. Liberating the trust in this way confers greater flexibility; where unconscionable or inequitable behaviour is established, the constructive trust may be imposed if it is the most appropriate form of relief. By contrast, the characterisation of the trust as a substantive institution means that its application can only properly arise where the facts fit within pre-established constructive trust categories. In England and Australia, the prevailing view seems to be that the constructive trust is an institutional conception (see Millett, P, 'Equity: the road ahead' (1995) 9 Trust Law International 35).[2]

In *Muschinski v Dodds* (1985), Deane J does not favour one approach over the other but, rather, concludes that the constructive trust is a 'remedial institution'. He felt that the constructive trust emerged as a remedial device but has attained an institutional status. The constructive trust has reached the stage where it contains dual characteristics; it alleviates against a perceived wrong, but exists prior to a court determination because of the fact that it is raised by the inequitable conduct. Hence, according to Deane J, there is 'no true dichotomy'. Despite the emphasis upon the institutional characteristics of the trust, he went on to point out that, in some cases, courts may mould the form of the trust to suit the particular needs of the case. This meant that the trust could be declared to operate from the date of the inequitable conduct or, where necessary, from the date of the court order or some other specified date.

In the determination of *Muschinski v Dodds*, the court held that the equitable interest under the constructive trust arose when the inequitable conduct occurred, prior to the date of the court order. This, effectively, meant that the interest was liable to be defeated by later claims over the property, and the increase in the value of the property that had occurred between the separation and the date of the hearing was denied. The residual discretion advocated by Deane J, in applying the terms of relief, confers a discretion which may, in particular circumstances, create perceived inequities which would be avoided by a firmer adherence to the institutional basis of the constructive trust (see, also, *Green v Green* (1989)).[3]

In *Re Sabri ex p Brien v ANZ* (1996), the Family Court considered the 'superficial plausibility' of the remedial/institutional dichotomy, noting that any perceived dichotomy between the two notions tends to prove ephemeral

2 Note, however, the comments by Glover J in *Commercial Equity, Fiduciary Relationships*, 1995, p 221, where he notes that the constructive trust 'is really just an efficacious way of compelling the defendant to surrender property'.

3 For an excellent examination of this whole area, see O'Connor, P, 'Happy partners or strange bedfellows: the blending of remedial and institutional features in the evolving constructive trust' (1996) 120 Melbourne UL Rev 735.

upon closer examination, because the acknowledgment of the institutional character of the constructive trust does not involve a denial of its continued flexibility as a remedy. The court concluded that, in this country, 'the constructive trust has not outgrown its formative stages as an equitable remedy, and should still be seen as constituting an *in personam* remedy attaching to property, which may be moulded and adjusted to give effect to the application and interplay of equitable principles in the circumstances of the particular case'. The primacy of the constructive trust as an equitable remedy does not mean that it represents a medium for the indulgence of idiosyncratic notions of fairness and justice, because it is only available when clearly warranted by equitable principles and sound legal reasoning and, where available, may be moulded to suit the needs of the particular circumstances. Hence, it remains possible for a court, where equity so requires, to treat an interest arising under a constructive trust as dating from a time prior to the court proceedings.

38.3 In what circumstances will the constructive trust arise?

A constructive trust will arise wherever unconscionable or inequitable conduct justifying its application can be proven. Where a person has unconscionably asserted a beneficial interest in property, that person may be held accountable in equity as a constructive trustee. As the constructive trust remains a substantive institution in Australia and England, it must still fit within one of the established categories. These categories are discussed below. Whether the constructive trust arises in the context of a *de facto* relationship, a third party knowingly receiving trust property or knowingly assisting in trust property being defrauded, the foundation for implying the trust is unconscionable conduct. A court will determine what constitutes unconscionability according to the individual circumstances of the case; according to Deane J, in *Muschinski v Dodds* (1985), the assessment of unconscionability is not to be used as a 'medium for the indulgence of idiosyncratic notions of fairness and justice', and it can only be established by legitimate processes of legal reasoning. This seems to beg the question. Inevitably, courts indulge in the assessment of policy considerations when determining what behaviour constitutes unconscionable conduct and, invariably, these considerations are idiosyncratic. Circumstances which appear unfair to one judge may retain their legitimacy with another; the whole process is dependant upon judicial perspective.

Australia and England have not yet adopted unjust enrichment as a foundation for the constructive trust, although it appears to be increasingly incorporated into the rubric of unconscionability (see, for example, the judgment of Deane and Dawson JJ in *Sterne v McArthur* (1988); *Powell v Thompson* (1991); and the comments by Glover J in *Commercial Equity: Fiduciary Relationships,* 1995, pp 226–27). In *Westdeutsche Landesbank Girozentrale v*

Council of the London Borough of Islington (1996), Lord Browne-Wilkinson noted that, if and when the remedial constructive trust is introduced, it may be applied to a defendant who knowingly retains property of which the plaintiff has been unjustly deprived. Nevertheless, at this stage it is only in Canada that the constructive trust has been described as the 'particular remedy for unjust enrichment' (*Pettkus v Becker* (1980)). See Chapter 5 and 25.6.3.

In *Soulos v Korkontzilas* (1997), the Supreme Court of Canada noted that the general unifying concept underlying the constructive trust was 'good conscience': a general concept which is informed by the situations where constructive trusts have previously been raised and by the desire to do justice between the parties and 'maintain the integrity of institutions dependent on trust-like relationships'. According to McLachlin J, there were two primary categories of 'good conscience': breach of fiduciary obligation, and unjust enrichment by the defendant to the plaintiff's detriment. On the facts of the case, a real estate agent, in breach of fiduciary obligations, had purchased property without making any profit from the transaction. The court held that the trust and confidence of the real estate brokerage would be undermined if real estate agents were permitted to retain properties which they acquired for themselves in breach of their duties to their clients, and courts of equity must make their 'ethical mark'.

38.4 Categories of constructive trust

38.4.1 The Baumgartner *constructive trust*

Where one party to a relationship unconscionably denies the interest of another, a constructive trust may arise. If the circumstances show that the party has an interest in the property, which can be proven through direct financial contributions or non-direct financial contributions, such as labour put into the property, and the other unconscionably denies that interest, the title will be held pursuant to a constructive trust. This form of trust has become known as the *Baumgartner* constructive trust, having emerged from the decision in *Baumgartner v Baumgartner* (1987). In that case, the High Court considered the joint contributions of *de facto* spouses to a common property upon the breakdown of a relationship. The court held that it would be unconscionable for one party to assert his right to the entire legal estate. The fact that each party had jointly pooled their incomes to acquire the property, and that this pooled income was used to purchase the land, build the house, purchase the furniture and generally contribute towards the creation of a home, meant that it would be unconscionable to allow one party to deny the interest of the other. The party who held the legal title would hold a proportion of that title under a constructive trust for the benefit of the other party. As Mason CJ, Wilson and Deane JJ note, the assertion by the legal interest holder, in light of this pooling arrangement, 'amounts to

unconscionable conduct which attracts the intervention of equity and the imposition of a constructive trust at the suit of the respondent'.

The High Court in *Baumgartner* approved, without further elaboration, the pronouncement of the constructive trust by Deane J in *Muschinski v Dodds*. The facts of *Muschinski v Dodds* concerned the purchase of property by parties in a *de facto* relationship. It was agreed that Mrs Muschinski would provide the purchase price whilst Mr Dodds would pay for the improvements at a later stage. The couple purchased the property as tenants in common in equal shares. The relationship ended before the improvements were effected, and, consequently, Mr Dodds only contributed $2,550 while Mrs Muschinski paid $25,259 toward the property. Mrs Muschinski argued that Mr Dodds held his half of the property pursuant to a resulting trust. This argument was rejected and she appealed to the High Court. The High Court rejected the resulting trust argument, because it was found that Mrs Muschinski had originally intended to confer absolute beneficial title upon Mr Dodds. A majority of the court, however, found that the parties held the property according to their respective contributions and, as Mr Dodds held more than his share of the contribution, the excess was held by him pursuant to a constructive trust (according to Deane J and Mason J) and through the application of the equitable doctrine of contribution (according to Gibbs CJ).

The constructive trust introduced by the joint decisions of *Muschinski v Dodds* and *Baumgartner v Baumgartner* has become an institutionalised category. The unconscionability arising from the denial of an interest in circumstances where a clear contribution has been made, or in circumstances where the parties have jointly pooled their resources to acquire property, has become one of the foremost classifications of constructive trust. Importantly, the application of the *Baumgartner* trust has not, in later cases, been restricted to contributions which can be classified as direct financial contributions to the purchase of the property. In *Hibberson v George* (1989), the court held that property which had been purchased in a nine year *de facto* relationship and which was placed in the sole name of one party was held under a constructive trust by that party according to the extent of contributions made by the other party. The court held that, even though the legal title holder had paid the deposit, mortgage and outgoings on the property, the other party had spent money on the contents of the house and the family they had been raising. The court held that, as the contributions had been spent for the purposes of the joint relationship in the expectation that their combined income would be used for the purpose of providing a home, a constructive trust could be raised to circumvent the unconscionable conduct of the legal title holder in asserting full ownership.

It would seem that the *Baumgartner* constructive trust will continue to develop and expand to meet new circumstances and demands. The unconscionability requirement for these trusts does not encompass any 'common intention' requirement at the date of purchasing the property, as was

the case in earlier cases (see *Hohol v Hohol* (1981); *Allen v Snyder* (1977)), and the broad conception of the character of a 'contribution' has ensured its continuing relevance to the continually changing characteristics of *de facto* relationships. The move towards the remedial acceptance of the constructive trust will, inevitably, have a significant effect upon *Baumgartner* constructive trusts, because it will give courts a greater capacity to fashion such trusts to meet the individual needs of the parties. Considerations such as the reasonableness of allowing one party to retain capital increases, the effect of the trust upon third parties, the form of contributions made and their relevance to the acquisition of the property, and the conduct and expectations of the parties involved would acquire greater relevance than is currently accorded (see, also, *Bennett v Tiara* (1992); *Bryson v Bryant* (1992)).

38.4.2 Liability of strangers as constructive trustees where a breach of fiduciary obligation has been committed

Where a breach of fiduciary duty has been committed, a beneficiary may often be unable, for practical reasons, to sue the fiduciary, for example, because the fiduciary is insolvent or outside the jurisdiction of the court. Alternatively, the beneficiary may be unable to obtain full recovery from the trustee. In these cases, the plaintiff may be able to sue a third party, implicated in the breach of duty, for compensation. A third party held liable for the consequences of a breach of fiduciary duty is said to be liable as constructive trustee. The term 'constructive trustee' is, however, somewhat misleading in this context, particularly in its traditional 'institutional' sense. The reality is that the third party is held personally accountable either to make restitution of the value of any benefit received, or to pay compensation for the damage the plaintiff has suffered. The constructive trust is not truly a proprietary remedy for the purposes of third party recovery, although a proprietary remedy may be awarded if the tracing rules (discussed in Chapter 23) have been correctly applied.

The rules governing the imposition of constructive trusteeship on third parties are in an unsatisfactory state. The present pattern of liability was established by the judgment of Lord Selborne LC, in *Barnes v Addy* (1874), which has been treated with more respect than it deserves.

38.4.3 Trustees de son tort

A stranger who purports to act as a fiduciary without having been appointed in that capacity will be held liable for any breach committed as if he or she enjoyed full fiduciary status. Such a person is said to be trustee *de son tort*: a trustee of his or her own wrong.

Executors are commonly held liable as trustees *de son tort*; indeed, it is uncertain if the concept extends beyond executorship. Trusteeship will be

imposed when the intermeddler has trust property vested in him, or else has substantial control over it (*Re Barney* (1892)). The degree of intermeddling must be so substantial that the alleged trustee cannot really be said to be a third party at all, but is the principal wrongdoer. Trustees *de son tort* claim not to act in a personal capacity but on behalf of the beneficiaries. Nevertheless, they are held liable on the same basis as a trustee who has acted in breach of obligation.

38.4.4 Knowing receipt of trust property

A third party who has received property in consequence of a fiduciary's breach of obligation may be held personally accountable as constructive trustee. The existence of this head of constructive trusteeship is not in doubt, but the principles governing the imposition of liability are still undeveloped.

The liability to account is imposed not only on a stranger who, at the time of the action, holds property received as a result of a breach of fiduciary duty; subject to certain conditions set out below, a party who previously held the property can also be made to account a constructive trustee. This head of constructive trusteeship is more likely to be imposed on a party who no longer holds the property. Tracing techniques are generally preferred to recover property from a party who holds it, unless that party is a *bona fide* purchaser for value without notice, or unless the property has depreciated in value in the ultimate recipient's hands, and the beneficiary wants to recover the property and hold the recipient accountable for the fall in the asset's value.

A stranger will be held liable to account for receipt of property from a fiduciary if two conditions are satisfied:

- the stranger holds, or has held, the property beneficially (*Agip (Africa) Ltd v Jackson* (1992)) – the passing of money through a bank account will not constitute receipt, but the bank's use of the money to reduce an overdraft will constitute beneficial receipt (*Stephens Travel Service International Ltd v Quantas Airways* (1988));
- the recipient must have received the property with the requisite degree of knowledge. The authorities are in a state of considerable disarray as to what that degree of knowledge is. The traditional approach has been to hold accountable a stranger who had actual or constructive knowledge of the prior breach of fiduciary duty (*Linter Group Ltd v Goldberg* (1992)). Constructive knowledge can, on this approach, include knowledge of circumstances which would place an honest and reasonable person on inquiry (*Eagle Trust plc v SBC Securities Ltd* (1992)). More recent English authority favours holding a recipient liable on the basis of actual knowledge (*Re Montague* (1987)). Actual knowledge can include wilfully shutting one's eyes to the obvious, and reckless failure to make inquiries. As Megarry VC stated in *Re Montague*, 'the basic question is whether the

conscience of the recipient is sufficiently affected to justify the imposition of such a trust'.

In *Citadel General Assurance Co v Lloyds Bank Canada* (1998) in the Supreme Court of Canada, the court noted that, in 'knowing receipt' cases, relief flows from the breach of a legally recognised duty of inquiry. Relief is granted where a stranger to the trust, having received trust property for his or her own benefit and having knowledge of facts which would put a reasonable person on inquiry, fails to make such inquiry, thereby rendering the recipient's enrichment unjust. Given the emphasis in knowing receipt cases on the overall knowledge of the recipient and the unconscionable failure to act upon receiving this knowledge, it is justifiable to impose liability upon a recipient who only has constructive knowledge of a breach of trust. In *Kooroontang Nominees Pty Ltd v ANZ* (1998), Hansen J also concluded that constructive knowledge would be sufficient to attract liability to a recipient.

Restitution writers have strongly urged that liability of recipients should, in principle, be strict, although recipients should be entitled to set up the defence of a good-faith change of position. This approach is logical, but has so far attracted little judicial support. In the recent Privy Council decision of *Royal Brunei Airlines v Tan* (1995), however, Lord Nicholls noted in *obiter dicta* that 'recipient liability is restitution-based'.

In *Powell v Thompson* (1991), Thomas J adopted an unjust enrichment approach which equated unjust enrichment with the commission of unconscionable conduct by the stranger. The conscience approach is, however, generally thought to be incompatible with a head of constructive trusteeship, which is based on conceptions of equitable title (*Equiticorp Industries Group Ltd v Hawkins* (1991)).

The arguments for strict liability are convincing, especially in view of the fact that the equivalent grounds of common law liability in conversion (where goods are claimed), and for money had and received (where money is claimed), are also strict. As yet, however, there is little support in the authorities for such an approach.

38.4.5 Knowing assistance

A stranger who knowingly assists in a breach of fiduciary duty is accountable as a constructive trustee (*Barnes v Addy* (1874)). Liability can be imposed under this head, even though the stranger may never have received any property from the fiduciary; it is not the receipt of property which attracts equitable intervention but, rather, the knowledge of the stranger about the fraudulent design (*Royal Brunei Airlines v Tan* (1995)). The conditions for imposing an obligation to account for knowing assistance are as follows:

- A breach of trust or other fiduciary duty – in *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975), Gibbs J stated that any breach of fiduciary duty

will suffice. The initial breach of fiduciary duty need not be dishonest (*Royal Brunei Airlines v Tan* (1995)).

- The stranger must have knowingly assisted in the breach of fiduciary duty. Although judicial terminology is not always consistent, there is less disagreement about the meaning of knowledge under this head than under the head of knowing receipt. The leading Australian authority is the High Court decision in *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975). On the facts of that case, the manager of DPC Estates Pty Ltd informed a director of Consul Developments of property investment opportunities which DPC Estates was not following up. The manager suggested that the director and he could invest in the properties jointly and share the profit. This proposal clearly constituted a breach of fiduciary duty on the part of the manager. Nevertheless, the director of Consul Developments was held not to be a constructive trustee of the profits from the investment, as he had no knowledge that it constituted a dishonest or fraudulent design. Stephen J (with whom Barwick CJ agreed) held that the requisite knowledge was actual knowledge or a wilful ignorance, but did not include constructive knowledge.

In *Royal Brunei Airlines Sdn Bhd v Tan* (1995), the Privy Council noted that, in most situations, there is little difficulty in identifying how an 'honest' person would behave: they do not intentionally deceive others to their detriment, and they do not knowingly take others' property. Honest people do not involve themselves in misapplications of trust assets to the detriment of beneficiaries, and do not deliberately ignore circumstances or fail to ask questions in case they might learn something they would rather not know about a transaction they are pursuing. Honesty is an objective standard – an individual is expected to attain the standard observed by an 'honest person' under the same circumstances.

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