EQUITABLE DOCTRINES AND FINANCIERS' LIABILITIES [*]

by

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In the late-1990s, I spent several months in court arguing about whether the private company which operated Bond University was entitled, as against the Long Term Credit Bank of Japan, to the land and buildings of the Bond Campus free of the registered mortgage in favour of the Bank which had funded the acquisition of the freehold of the land and buildings by Bond Corporation.

The claim had its origin in assurances given by Alan Bond on behalf of Bond Corporation to representatives of the nascent Bond University that Bond Corporation would provide the infrastructure to the University on a long term lease. The negotiations in relation to the terms of the lease were not concluded before the financial collapse of Bond Corporation. Drafts of the proposed lease were exchanged and discussed: some of these drafts which were put into evidence showed that the parties were talking about a lease of 99 years for a rent of $10 million per annum payable to Bond Corporation. The University never agreed to pay this rent – or any rent.

The University's case invoked a number of equitable doctrines, principally equitable estoppel, in an endeavour to trump the Bank's registered mortgage.

Witness after witness came forward on behalf of the University to give evidence that he or she took part in the establishment of the University only because of Bond's assurances that the campus and buildings would be made available to the University.

What, you might ask, did any of this have to do with the Bank's registered mortgage? The trial judge and the Court of Appeal concluded that the University had no good answer to this question. And no one ever explained how they expected a public company with obligations to shareholders and creditors could have understood to be promising to just give away many tens of millions of dollars. I can't claim to be an unbiased observer, but there seemed to be something undignified about the evidence of the University's witnesses. One can sympathise with the desperation of their position, but legal doctrines which encourage the abandonment of dignity are not attractive.

Just as General Pickett's failed charge at the Battle of Gettysburg has been described as the high tide of the Confederacy, so this case might be described as the high tide of the doctrine of equitable estoppel. Unlike Pickett's charge, however, the Bond University

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case rapidly faded from public memory: it was not even regarded as of sufficient importance to be reported in the Queensland Reports.

I remember the case principally because, as Counsel for the Bank, I spent months of my life, and the parties spent vast sums of money, in an attempt to expand the scope of equitable doctrines, such as equitable estoppel and unconscionability, into the stream of commerce in a way which would have been distinctly adverse to the interests of those who finance commercial transactions.

In the Bond University case, there were a number of what can now be seen to be insuperable difficulties for the plaintiff: the assurances that Bond gave to the University were not clearly categorical – they always seemed to have been given in a context where they could only be seen to be conditional on the University being ready, willing, and able to pay a substantial commercial rent, and at no time was it ready, willing, and able to do so; no agreement as to the quantum of rent or the period of the lease was ever agreed; there was no evidence that the Bank took its mortgage with notice of expectations on the part of the University that it would receive a lease, even if it did not agree to pay rent, and that the lease would subsist even if it could not pay the rent; and there was no evidence that the Bank itself encouraged anyone on the University side to act upon Bond's assurances. No dishonest or dishonourable conduct could be sheeted home to the Bank.

In retrospect, we can see that it was a hopeless case for the University. That observation could not, however, be made at the time. So fluid was the then current understanding of equitable doctrines such as equitable estoppel, unconscionability, fiduciary obligation, and other doctrines such as unjust enrichment, that the University's case was respectably arguable; and it was argued by some of Australia's most respected lawyers.

How much the pendulum has swung back over the last fifteen years.

In August 2009, in an address to the Supreme Court of New South Wales Conference organised by the Judicial Commission of New South Wales, Lord Neuberger of Abbotsbury MR discussed the then very recent decision of the House of Lords in *Cobbe v YRML*.[1] His Lordship was able to say of equitable estoppel:

> "…[I]t is not enough for the plaintiff to show that the defendant has behaved badly, or even to say that, to the defendant's knowledge, the plaintiff acted in the expectation that the defendant would behave in a certain way. In equity, as in common law, a defendant is entitled to say that the plaintiff took the risk that the defendant would not act honourably. It is like a subject to contract agreement: by using the words 'subject to contract', the parties are saying to each other that, however unattractive it might subsequently appear to be, each is entitled to renege. Equity, like the common law, will not permit a cause of action to be founded on such an agreement, save perhaps in thoroughly exceptional circumstances … The message from the House of Lords in *Cobbe v YRML* is that it is

[1] *Cobbe v Yeoman's Row Management Ltd* [2008] 1 WLR 1752.

> simply not for the courts to go galumphing in, wielding some Denningesque sword of justice to rescue a miscalculating, improvident or optimistic property developer from the commercially unattractive, or even ruthless, actions of a property owner, which are lawful in common law".[2]

His Lordship was surely right to emphasise that cases between commercial parties involve a range of policy concerns which are not at play in, for example, a dispute between a mother-in-law and a husband over her rights to a granny flat that she paid for but which is physically attached to his home.

Lord Neuberger went on to say, after reviewing further English and Australian authorities:[3]

> "If the result of this is that proprietary estoppel will not often assist a plaintiff in a commercial context, that is probably all to the good: in the business world, certainty and clarity are particularly important, and judges should be slow to encourage the introduction of uncertainties based on their views of the ethical acceptability of the behaviour of one of the parties."

It is not only in relation to equitable estoppel that the tide of liability for honest financiers has receded. The same can be said of liabilities sourced in equitable doctrines relating to fiduciary relations, unjust enrichment and unconscionability.

I propose to discuss some of these developments, beginning with the observable tightening of the conceptual language in which these doctrines are framed. I will conclude with some speculations as to the dynamics which have driven this tightening after the years in which the expansionary trend predominated.

I emphasise that my concern is not with liabilities to consumers.

FIDUCIARY OBLIGATIONS

In his classic judgment in *Tailby v Official Receiver*,[4] Lord Macnaghten said of a dispute about a fine point of equitable doctrine: "It may be said that this is a question of words. To a great extent it is so; most questions are."[5]

Lord Macnaghten's quip is a pithy reminder of the truism that precision in the language in which we frame our legal concepts is essential if we are not to descend into what Scrutton LJ in another context called "well-meaning sloppiness of thought."[6]

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2 Rt Hon. the Lord Neuberger of Abbotsbury MR, "Thoughts on the law of equitable estoppel" (2010) 84(4) *Australian Law Journal* 225 at 229-230.

3 Rt Hon. the Lord Neuberger of Abbotsbury MR, "Thoughts on the law of equitable estoppel" (2010) 84(4) *Australian Law Journal* 225 at 231.

4 (1888) 13 App Cas 523.

5 *Tailby v Official Receiver* (1888) 13 App Cas 523 at 549 per Lord Macnaghten.

6 *Holt v Markham* [1923] 1 KB 504 at 513.

Over two decades, well-meaning judges, especially in Canada, stretched the language of fiduciary obligations into areas previously the domain of contract or tort in what came to be recognised as an excess of the unifying tendency to which lawyers are disposed.

As Anthony Duggan has said, the line of Canadian Supreme Court decisions after *LAC Minerals Ltd v International Corona Resources Ltd*[7] (harking back to *Guerin v The Queen*,[8] a case concerned with native title) and ending with the string of 1992 cases including *McInerney v MacDonald*,[9] *Norberg v Wynrib*[10] and *M(K) v M(H)*,[11] "substantially reshaped the law of fiduciary obligations and, in doing so … moved Canadian law away from both its historical origins and the law as it is applied in other parts of the Commonwealth."[12]

The Canadian enthusiasm for using the concept of fiduciary obligation as an incantation to solve a range of problems led to the observation attributed to Sir Anthony Mason that in Canada there are three kinds of persons: those who have been held to be fiduciaries, those who are about to be held to be fiduciaries, and judges.

In the 2008 WA Lee Lecture, entitled "Australia's Equity Isolationism",[13] Justice Michael Kirby delivered a trenchant criticism of equity jurisprudence in Australia for its failure to follow the lead of the Canadian Supreme Court in unifying the doctrines of equity and the rules of the common law, particularly in relation to fiduciary obligations as a source of rights and remedies.

In the 2009 WA Lee Lecture,[14] I ventured to respond to Justice Kirby's criticism with the suggestion that there were good reasons, derived from the fundamental values of equity, to resist the unifying tendencies evident in the Canadian jurisprudence.

In that lecture,[15] I sought to make the point that equity was originally, and remains, essentially concerned to restrain, rather than to expand, the exercise of common law rights. That being so, it would be a little surprising if it should have become the driver of an expansionist view of those rights.[16]

The recent decision of the Canadian Supreme Court in *Galambos v Perez*[17] suggests that the expansionary unifying enthusiasm has now run out of steam. Even in Canada it is now recognised that the spillover of fiduciary obligations into other legal categories was

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7 [1989] 2 SCR 574.
8 [1984] 2 SCR 335.
9 [1992] 2 SCR 138.
10 [1992] 2 SCR 226.
11 [1992] 3 SCR 6.
12 Anthony Duggan,"Fiduciary Obligations in the Supreme Court of Canada: A Retrospective".
13 (2008) 8 *Queensland University of Technology Law Journal* 444.
14 P A Keane,"The Conscience of Equity" (2010) 84 *Australian Law Journal* 92.
15 (2010) 84 *Australian Law Journal* 92 at 93-94.
16 (2010) 84 *Australian Law Journal* 92 at 100-101.
17 [2009] 3 SCR 247

not a sound development of equitable principle and threatened the coherence of the law. I will discuss the Canadian developments which culminated in the recent decision of the Canadian Supreme Court.

There have always been reasons for the boundaries between doctrines of equity and the rules of the common law. For a time, it seemed that they receded from view.

Equity operates as an exception to the legal order. Chancery never set out to provide general regulation of dealings in the market place, being, at the outset and for a very long time thereafter, more concerned with real property.

The common law regards the aggressive pursuit by a trader of his or her commercial interests as legitimate so long as it is conducted honestly and with reasonable care for those at risk of harm if reasonable care is not shown. In a market economy "rivalry between participants is an essential and defining feature: rivalry in which each participant seeks to maximise its profit and market share at the expense of all other participants in that market."[18]

Chancery did not set out to correct the clear eyed view of the common law that loss suffered in trade or commerce "is often no more than one of the ordinary consequences of participation in a market economy".[19]

In the market, your loss may be my profit. In our law of contract, the right of self-interested action at the expense of others is a given from which all else proceeds. It is embodied in the traditional common law approach conveyed by the maxim *caveat emptor*.[20]

In trade or commerce a relationship in which one is obliged to disregard one's own material interests for the benefit of another person is obviously exceptional. This is the standard of self-abnegation which equity requires of a fiduciary. And until the Canadian expansion, equity had no occasion to insist on adherence to that standard save where there was voluntarily assumption of the responsibility for the interests of another which brought with it the extraordinary obligation of selflessness.

There are real differences in the interests which inform the standard of absolute loyalty required of a fiduciary and those which inform the standard of reasonable care in negligence and reasonableness in the law of contract.[21] These differences are readily recognisable. They provide a warning to resist the urge to see an underlying unity of concepts. To elide these differences in pursuit of a common standard of fair and reasonable behaviour is to fail to recognise that the rules of equity and the common law

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18 *Perre v Apand Pty Ltd* (1999) 198 CLR 180 at 299.

19 *Perre v Apand Pty Ltd* (1999) 198 CLR 180 at 299.

20 *Gatsios Holdings Pty Ltd v Nick Kritharas Holdings Pty Ltd (In liq)* [2002] ATPR 41-864; 44-800.

21 *Brogden v Metropolitan Railway Co* (1877) 2 App Cas 666; *Mackay v Dick* (1881) 6 App Cas 251 at 263; *Secured Income Real Estate (Australia) Ltd v St Martin's Investments Pty Ltd* (1979) 144 CLR 596 at 607.

reflect radically different views of the legitimacy of human selfishness and of occasions for its control.

In some respects the duty owed by a fiduciary to the beneficiary of that duty is more onerous than the common law duty to take reasonable care, and in some respects it is less rigorous. In one respect, the strictness of the fiduciary obligation surpasses that involved in the concept of reasonable care. The great cases of *Keech v Sandford,*[22] *Regal (Hastings) Ltd v Gulliver,*[23] and *Boardman v Phipps,*[24] establish that a fiduciary must disgorge a profit made from the sale of property acquired by reason of an opportunity which arose in the course of the fiduciary relationship even though the beneficiary could not or would not have taken up the opportunity. In none of these cases could it sensibly be said that the fiduciary had failed to exercise reasonable care to avoid causing harm to the beneficiary.

A person who owes a duty of care in negligence is obliged to do only what is reasonable not to harm the other, and he or she is entitled to give effect to his or her own selfish interests in that regard; indeed, the determination of what is reasonable in the context of tort law can only be made by taking into account the cost to the person of the steps necessary to ameliorate the risk of harm to the other, and deciding whether the risk is such that the incurring of the expense is reasonably warranted.

A classic example of a fiduciary relationship is that between employer and employee. It is the employee who owes the fiduciary obligation to the employer. That is because it is the employee who deals with third parties and with the employer's assets on behalf of the employer. The employee voluntarily agrees to subordinate his or her interests to those of his or her employer in representing the employer to third parties. But it has never been thought that the fiduciary obligation is owed both ways. The duty which the employer owes the employee is one to take reasonable care to avoid causing the employee harm. It is imposed on the employer as part of the social cost of doing business. As Lord Atkin said in *Donoghue v Stevenson:* "liability for negligence … is … based upon a general public sentiment of moral wrongdoing for which the offender must pay."[25]

The employer's obligation extends only so far as the foreseeable risk of harm extends. Altruism has very little to do with the duty to take reasonable care imposed by the law of tort. In sharp contrast, the fiduciary obligation leaves no room for any sort of self-interested calculation so far as the subject matter of the obligation is concerned: the fiduciary is absolutely required to deny his or her own interests in favour of the person for whose benefit he or she must act. And in equity, it is the insistence upon mutuality of conscientious behaviour by claimants, rather than the common law notion of foreseeability, which serves as the principal brake upon what would otherwise be an ever expanding proliferation of liabilities.

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22 (1726) Cas temp King 61; (1726) 25 ER 223.
23 [1967] 2 AC 134.
24 [1967] 2 AC 46.
25 [1932] AC 562 at 580.

Thus the fiduciary obligation is absolute, subject to the knowing consent of the beneficiary, because nothing less is regarded as a sufficient protection for the interests of the beneficiary against the powerful temptations of self-interest.

Another way of putting it is to say that it would be a violation of mutuality in a relationship, and contrary to the conscience of equity, for the soi-disant beneficiary of a fiduciary duty to assert an entitlement to the benefit of an obligation of self-abnegation against a person who has not willingly accepted the corresponding burden.

The conscience of equity is not concerned solely with the state of mind of the defendant against whom rights are asserted, but rather is concerned, as Pomeroy says, to "test the conduct and rights of suitors" as well.[26] One of the principal problems of the unifying tendency is that it seems to work only one way, i.e. to expand liabilities of defendants, not to restrain overweening demands by plaintiffs.

The burdens of the obligation of self-abnegation upon a trustee are heavy. Why would it be thought to accord with conscience to impose those burdens upon a person who had not freely and deliberately accepted them?

In terms of its foundations and historic mission, the Court of Chancery was not concerned to regulate trade or commerce, save insofar as the financial embroilments of owners of real property may have threatened the aristocratic hold on land. The foundations of equity were ecclesiastical within a tradition articulated most authoritatively by Thomas Aquinas. Aquinas himself looked to Aristotle, referring to him with reverence as "the Philosopher". Aristotle was more concerned with virtue than with rights. He regarded an even-handed willingness to restrain one's self from insisting upon the full measure of one's legal rights as a great social virtue. He called this virtue "epieikeia", which became "aequitas" in Latin and "equity" in English. Not surprisingly then, a principal aspect of equity's role was restraining the exercise of rights rather than broadening the occasions for their exercise.

What this meant for our purposes is that the mindset of Chancery has been that when equity intervenes to prevent unconscientious conduct, it is not concerned solely with the conduct of the defendant and with what is necessary to bring that conduct into conformity with conscience; it is concerned to insist that the plaintiff also act in accordance with conscience.

Moreover, the plaintiff has to be able to stake a claim on the conscience of equity. Merely having one's legal rights infringed would not do.

A strong illustration of this point is provided by the cases which made it clear that equity would not allow a borrower of moneys to take advantage of money lending statutes

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[26] John Norton Pomeroy and Spencer W. Symons (eds), *A Treatise on Equity Jurisprudence,* Vol 1 (5th Ed, 1941), p. 94 [57].

which made certain loans illegal for the protection of the borrower, unless the borrower was willing to "submit to the repayment of the moneys borrowed remaining unpaid."[27]

Even where the money lending legislation rendered the loan agreement and securities void, equity would not grant relief to a borrower – not even a declaration of invalidity – unless the borrower was willing to act in good conscience by offering to repay the moneys borrowed. The borrower might have a legal right under the statute to be relieved of the loan but the assistance of a court of equity would only be available if the borrower was prepared to make restitution of the loan moneys.

In *Langman v Handover*,[28] Dixon and Rich JJ identified this insistence on mutuality and fair dealing as expressed in the maxim that a person who seeks equity must do equity. Their Honours said:

> "In the important judgment which *Wigram* VC gave upon the maxim that he who seeks equity must do equity, in *Hanson v Keating* [(1844) 4 Ha 1; 67 ER 537], after instancing the necessity imposed upon a plaintiff in a bill for an account, of submitting himself to account in the same matter, and in a bill for specific performance, of submitting to perform the contract, he proceeds [(1844) 4 Ha, at pp 5, 6; 67 ER 537]:– 'In this, as in the former case, the Court will execute the matter which is the subject of the suit wholly, and not partially. So, if a bill be filed by the obligor in an usurious bond, to be relieved against it, the Court, in a proper case, will cancel the bond, but only upon terms of the obligor refunding to the obligee the money actually advanced. The reasoning is analogous to that in the previous cases. The equity of the obligor is to have the entire transaction rescinded. The Court will do this, so as to remit both parties to their original positions: it will not relieve the obligor from his liability, leaving him in the possession of the fruits of the illegal transaction he complains of.' In such cases the equity is founded, not upon the necessity of protecting the party's legal rights, but upon his willingness to resign them in order that he may be restored to the position he occupied before he embarked upon the transaction which turns out to be unlawful." [29]

That this position in relation to money-lending transactions was ultimately altered by statute does not detract from the force of the point about the even-handed attitude of equitable principle.

As Sir Owen Dixon explained in *Mayfair Trading Co Pty Ltd v Dreyer*,[30] the ability and willingness of a plaintiff to restore the defendant as a pre-condition of equitable relief to

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27 *Mayfair Trading Co Pty Ltd v Dreyer* (1958) 101 CLR 428 at 452. See also *Hanson v Keating* (1844) 4 Hare 1; 67 ER 537; *Jervis v Berridge* (1873) LR 8 Ch App 351 at 358; *Lodge v National Union Investment Co Ltd* [1907] 1 Ch 300; *Langman v Handover* (1929) 43 CLR 334 at 345, 356.

28 (1929) 43 CLR 334 at 353 – 354.

29 (1929) 43 CLR 334 at 353 – 354 (citations footnoted in original).

30 (1958) 101 CLR 428 at 452 – 456.

give effect to a legal right was one of the “basal considerations determining in a court of equity the plaintiff's equitable title to relief.”[31] The plaintiff’s rights, and the public policy reflected in the legislation which conferred those rights, simply were not sufficient to engage the conscience of equity.[32] It was only when the legislation made it abundantly clear that the borrower should be entitled to relief without doing equity that equity’s insistence on conscientious behaviour by the borrower was overcome.

Another illustration of this point is afforded by equity’s long-standing reluctance to grant specific performance of a contract of personal service. At the practical level, this reluctance was explained to be based on perceived difficulties in supervision of the court’s orders. At the deeper level of principle, it was grounded in a concern about the unfairness, in terms of mutuality, of compelling an employer to continue the employment of a person in whom the employer had lost confidence.[33] Justice would best be served in such a case by leaving the parties to their remedies of damages at law.

And in the area of estoppel, in *The Commonwealth v Verwayen*,[34] Deane J recognised that an attempt by a plaintiff to set up an estoppel by conduct might itself be “unconscientious” because that remedy would be disproportionate to any detriment which the plaintiff might suffer if the estoppel were rejected. Such a result could, his Honour said, be defeated by attention to the plaintiff’s position. Deane J supposed:

> “a case in which the party claiming the benefit of an estoppel precluding [the defendant’s] denial of [the plaintiff’s] ownership of a million dollar block of land owned by [the defendant] would sustain no detriment beyond the loss of one hundred dollars spent on the erection of a shed if a departure from the assumed state of affairs were allowed (cf, eg, *Ramsden v Dyson* [(1866) LR 1 HL 129 at 140 – 141]; *Sheridan v Barrett* [(1879) 4 LR Ir 223 at 229 – 230].”[35]

Deane J suggested that in this hypothetical case, “the payment of, or a binding undertaking to pay, adequate compensation would preclude a finding of estoppel by conduct.”[36]

The root of the problem of the unprincipled expansion of the fiduciary obligation, I suggest, can be found in the decision of the Supreme Court of Canada in *LAC Minerals Ltd v International Corona Resources Ltd*.[37] There it was said:

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31 *Mayfair Trading Co Pty Ltd v Dreyer* (1958) 101 CLR 428 at 454.
32 Cf *Bridgewater v Leahy* (1998) 194 CLR 457 at 494 [125].
33 *Visscher v Giudice* (2009) 239 CLR 361 at [54].
34 (1990) 170 CLR 394.
35 *The Commonwealth v Verwayen* (1990) 170 CLR 394 at 441.
36 I am indebted to the discussion of this problem by Mr J D McKenna SC of the Queensland Bar: John McKenna SC, “Remedies in Estoppel” in Aladin Rahemtula (ed), *Justice According to Law: A Festchrift for the Honourable Mr Justice BH McPherson CBE* (2006: Supreme Court of Queensland Library), p. 167 esp at 195 – 201.
37 [1989] 2 SCR 574.

> "There are few legal concepts more frequently invoked but less conceptually certain than that of the fiduciary relationship. In specific circumstances and in specific relationships, courts have no difficulty in imposing fiduciary obligations, but at a more fundamental level, the principle on which that obligation is based is unclear. Indeed, the term 'fiduciary' has been described as 'one of the most ill-defined, if not altogether misleading terms in our law'." [38]

The first step in this process of reasoning was to postulate the conceptual uncertainty of the fiduciary relationship. To take that step was to announce a self-fulfilling prophecy. As the late Professor Birks cautioned, "ambiguity rots the foundations of rationality."[39] If the concept is clearly understood then it ceases to be a house with many mansions. And there is no conceptual uncertainty as to what is meant by a fiduciary relationship in the orthodox proposition that a fiduciary obligation is an incident of a voluntary undertaking to act in given circumstances exclusively on behalf of another and not an obligation called into existence by a court whenever it is thought to be fair or reasonable in the circumstances.[40]

To regard a fiduciary obligation as something to be imposed ad hoc, whenever it is thought fair and reasonable to do so, rather than a consequence of facts found to establish a voluntary self-abnegation in respect of a particular subject matter, was not to develop equitable principle but to break radically with it.

In the two decades after *LAC Minerals*, when Canadian (or American) lawyers discussed issues such as, for example, the obligation of good faith as between parties to a contract, they tended to use the terminology of fiduciary obligation. This loose terminology facilitated the grant of equitable remedies, such as the constructive trust, for breach of contract. Thus a court might prefer one creditor over others in defiance of the intention of statutory regimes of personal and corporate insolvency.

In *Breen v Williams*,[41] the High Court declined to follow the "expansive manner" in which the Canadian Courts had extended the limits of fiduciary law. In that case, Gaudron and McHugh JJ observed:

> "… Australian courts only recognise proscriptive fiduciary duties. This is not the place to explore the differences between the law of Canada and the law of Australia on this topic. With great respect to the Canadian courts, however, many cases in that jurisdiction pay insufficient regard to the effect that the imposition of fiduciary duties on particular relationships has on the law of negligence, contract, agency, trusts and companies in

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38 *LAC Minerals Ltd v International Corona Resources Ltd* [1989] 2 SCR 574 at [24].

39 P. Birks, "A Letter to America: The New Restatement of Restitution" (2003) 3 *Global Jurist Frontiers* at 4, cited in Gummow, "Moses v Macferlan: 250 years on" (2010) 84 *Australian Law Journal* 756 at 758.

40 *Soulos v Korkontzilas* [1997] 25 SCR 217 at [35].

41 (1996) 186 CLR 71.

> their application to those relationships. Further, many of the Canadian cases pay insufficient, if any, regard to the fact that the imposition of fiduciary duties often gives rise to proprietary remedies that affect the distribution of assets in bankruptcies and insolvencies.
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> In this country, fiduciary obligations arise because a person has come under an obligation to act in another's interests. As a result, equity imposes on the fiduciary proscriptive obligations — not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict. If these obligations are breached, the fiduciary must account for any profits and make good any losses arising from the breach. But the law of this country does not otherwise impose positive legal duties on the fiduciary to act in the interests of the person to whom the duty is owed. If there was a general fiduciary duty to act in the best interests of the patient, it would necessarily follow that a doctor has a duty to inform the patient that he or she has breached their contract or has been guilty of negligence in dealings with the patient. That is not the law of this country."[42]
> [Footnotes omitted].

To similar effect, Dawson and McHugh JJ observed:

> "It is, perhaps, reflective of a tendency, not found in this country, but to be seen in the United States and to a lesser extent Canada, to view a fiduciary relationship as imposing obligations which go beyond the exaction of loyalty and as displacing 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. But, with respect, that is achieved by assertion rather than analysis and, whilst it may effectuate a preference for a particular result, it does not involve the development or elucidation of any accepted doctrine."[43]
> [Footnotes omitted].

Specifically, in *Breen v Williams*, the High Court declined to follow the decision of the Supreme Court of Canada in *McInerney v MacDonald*[44] that a patient is entitled to reasonable access to examine and copy the doctor's records.

There was at work in the Canadian jurisprudence a unifying tendency to treat the conscience of equity as equivalent to common law conceptions of what is fair or reasonable in a particular case. This unifying tendency operated by putting to one side considerations of mutuality. These considerations require a fiduciary to sacrifice his or her own interests only insofar as he or she has voluntarily assumed that burden. The demand might be reasonable, but that does not make it equitable for the plaintiff to make it.

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42 (1996) 186 CLR 71 at 113.
43 (1996) 186 CLR 71 at 95.
44 [1992] 2 SCR 138.

Equity is concerned with mutual relations of good conscience, not with a one sided demand that the other side be reasonable.

To say this is not to indulge in the narrow fussiness which animates caricatures of equity lawyers. To illustrate this point, may I give an example from the classics. In Xenophon's *Chyropoedia* (*The Education of Cyrus*), Xenophon relates that Cyrus' teacher left him in charge of the class for a morning. It was a cold day, and while the teacher was away, Cyrus took from a small boy a large cloak and gave it to a bigger boy whose teeth were chattering because his own cloak was too small. In turn, Cyrus gave the big boy's smaller cloak to the little boy. The smaller cloak was perfectly adequate to keep him warm. When the teacher returned to the class room and saw what had happened, he gave Cyrus a sound thrashing. Xenophon, who you will all recall was, along with Plato, a pupil of Socrates, says that the teacher was in the right because while what Cyrus did was perfectly fair and reasonable, it was not justice according to law.

The 2009 case of *Galambos v Perez*[45] demonstrates the unifying tendency to treat the conscience of equity as equivalent to the Court's view of "legitimate expectations" and of what is fair and reasonable in a particular case. Cromwell J, writing on behalf of a unanimous Supreme Court in *Galambos v Perez,* discarded the tests of "reasonable expectations" and "vulnerability", in favour of emphasising the centrality of undertaking to the existence of a fiduciary relationship.

Ms Perez was a bookkeeper at a law firm who had made sizeable voluntary and unsolicited cash advances to the firm to resolve a cash flow problem. The firm was placed in receivership and its founder, Mr Galambos, made bankrupt.

The Court of Appeal found that Mr Galambos and his firm owed Ms Perez fiduciary duties in relation to the cash advances on the basis of Ms Perez' reasonable expectations that the relationship was characterised as one of "power-dependency".

On appeal to the Supreme Court, Cromwell J pointed out that the Court of Appeal's analysis erred when it found a fiduciary duty without finding an undertaking, express or implied, on the part of Mr Galambos, that he would act in relation to the cash advances only in Ms Perez' interests. Ms Perez had not alleged any explicit undertaking to that effect, and in circumstances where the trial judge found that Mr Galambos had not requested the advances and Ms Perez was the party with more knowledge of the firm's finances, no undertaking could be implied: "any reasonable person would have understood that he or she assumed the position of a precarious unsecured creditor, not that of a protected beneficiary."[46]

Cromwell J held that a fiduciary duty could not arise simply on the basis of one party's reasonable expectations in the absence of any mutual understanding that one party has undertaken to act in the interests of the other. His Honour summarised his view:

45 [2009] 3 SCR 247.
46 [2009] 3 SCR 247 at [81].

> "In my view, while a mutual understanding may not always be necessary (a point we need not decide here), it is fundamental to *ad hoc* fiduciary duties that there be an undertaking by the fiduciary, which may be either express or implied, that the fiduciary will act in the best interests of the other party. In other words, while it may not be necessary for the beneficiary in all cases to consent to this undertaking, it is clearly settled that the undertaking itself is fundamental to the existence of an *ad hoc* fiduciary relationship."[47]

His Honour's reasons begin with "some basic principles of fiduciary law": that fiduciary law focuses on relationships and, in particular on "the position of the parties that *results from* the relationship" and on the undertaking of loyalty which is a "critical aspect" of that relationship. Much of his Honour's reasoning is devoted to citations of dicta from the earlier Canadian cases which support his thesis so as to minimise the appearance of a disapproval of the earlier decisions. What this does emphasise, however, is the looseness of the language in the earlier cases. Cromwell J said:

> "An important focus of fiduciary law is the protection of one party against abuse of power by another in certain types of relationships or in particular circumstances. However, to assert that the protection of the vulnerable is the role of fiduciary law puts the matter too broadly. The law seeks to protect the vulnerable in many contexts and through many different doctrines. As La Forest J. noted in *Hodgkinson*, at p. 406: '[W]hereas undue influence focuses on the sufficiency of consent and unconscionability looks at the reasonableness of a given transaction, <u>the fiduciary principle monitors the abuse of a loyalty reposed</u>' (emphasis added). This brief sentence makes two important points which help sharpen the focus on the role of fiduciary law.
>
> The first is that fiduciary law is more concerned with the position of the parties that *results from* the relationship which gives rise to the fiduciary duty than with the respective positions of the parties *before* they enter into the relationship. La Forest J. in *Hodgkinson*, at p. 406, made this clear by approving these words of Professor Ernest J. Weinrib: 'It cannot be the *sine qua non* of a fiduciary obligation that the parties have disparate bargaining strength … In contrast to notions of conscionability, the fiduciary relation looks to the relative position of the parties that results from the agreement rather than the relative position that precedes the agreement' ("The Fiduciary Obligation" (1975), 25 *U.T.L.J.* 1, at p. 6). Thus, while vulnerability in the broad sense resulting from factors external to the relationship is a relevant consideration, a more important one is the extent to which vulnerability arises from the relationship: *Hodgkinson*, at p. 406.

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47 [2009] 3 SCR 247 at [66].

The second is that a critical aspect of a fiduciary relationship is an undertaking of loyalty: the fiduciary undertakes to act in the interests of the other party. This was put succinctly by McLachlin J. in *Norberg*, at p. 273, when she said that 'fiduciary relationships ... are always dependent on the fiduciary's undertaking to act in the beneficiary's interests'. See also *Hodgkinson*, per La Forest J., at pp. 404-7.

Underpinning all of this is the focus of fiduciary law on relationships. As Dickson J. (as he then was) put it in *Guerin v. The Queen*, [1984] 2 S.C.R. 335, at p. 384: 'It is the nature of the relationship … that gives rise to the fiduciary duty …' The underlying purpose of fiduciary law may be seen as protecting and reinforcing 'the integrity of social institutions and enterprises', recognizing that 'not all relationships are characterized by a dynamic of mutual autonomy, and that the marketplace cannot always set the rules': *Hodgkinson*, at p. 422 (*per* La Forest J.). The particular relationships on which fiduciary law focuses are those in which one party is given a discretionary power to affect the legal or vital practical interests of the other: see, e.g., *Frame v. Smith*, [1987] 2 S.C.R. 99, *per* Wilson J., at pp. 136-37; *Norberg*, *per* McLachlin J., at p. 272; Weinrib, at p. 4, quoted with approval in *Guerin*, at p. 384."[48]

Cromwell J concluded that fiduciary duties will only be imposed on those who have expressly or impliedly undertaken them in the following passage:

"The appellants fault the Court of Appeal for holding that fiduciary duties may arise only on the basis of the reasonable expectations of one party. The appellants say that there must be a mutual understanding that the fiduciary will act only in the interests of the other party. While I agree with the appellants that the Court of Appeal erred by basing a fiduciary obligation on Ms. Perez's reasonable expectation, it is not necessary in order to resolve this appeal to go so far as to say that a mutual understanding is necessary in all cases. It is sufficient to say here that what is required in all cases is an undertaking by the fiduciary, express or implied, to act in accordance with the duty of loyalty reposed on him or her.

I note that in *Hodgkinson*, this Court considered competing bases for the imposition of *ad hoc* fiduciary duties, opposing to a certain extent mutual understanding and reasonable expectations of the alleged beneficiary. While the seven judges sitting on the case were not fully unanimous in this respect, they all agreed that *ad hoc* fiduciary obligations may be imposed when there is a mutual understanding to this effect, and, following the example of Dickson J. in *Guerin*, at p. 384, left the door open to such an obligation arising from a unilateral undertaking by the fiduciary (see on this point Professor Lionel Smith's insightful comment

48 [2009] 3 SCR 247 at [67]-[70].

on *Hodgkinson*, 'Fiduciary Relationships — Arising in Commercial Contexts — Investment Advisors: *Hodgkinson* v. *Simms*' (1995), 74 *Can. Bar Rev*. 714). Thus, what is required in all cases of *ad hoc* fiduciary obligations is that there be an undertaking on the part of the fiduciary to exercise a discretionary power in the interests of that other party. To repeat what was said by McLachlin J. in *Norberg*, 'fiduciary relationships … are always dependent on the fiduciary's undertaking to act in the beneficiary's interests' (p. 273). As Dickson J. put it in *Guerin*, fiduciary duties may arise where 'by statute, agreement, or perhaps by unilateral undertaking, one party has an obligation to act for the benefit of another' (p. 384).

The fiduciary's undertaking may be the result of the exercise of statutory powers, the express or implied terms of an agreement or, perhaps, simply an undertaking to act in this way. In cases of *per se* fiduciary relationships, this undertaking will be found in the nature of the category of relationship in issue. The critical point is that in both *per se* and *ad hoc* fiduciary relationships, there will be some undertaking on the part of the fiduciary to act with loyalty.

Commentators support this view. In his seminal work, *Fiduciary Obligations* (1977), Professor P. D. Finn writes at para. 15:

> For a person to be a fiduciary <u>he must first and foremost have bound himself</u> in some way to protect and/or to advance the interests of another. This is perhaps the most obvious of the characteristics of the fiduciary office for Equity will only oblige a person to act in what he believes to be another's interests if he himself has assumed a position which requires him to act for or on behalf of that other in some particular matter. [Emphasis added.]

To the same effect, Professor Smith writes in his comment on *Hodgkinson*, at p. 717 (echoing Dickson J.'s comments in *Guerin*, at p. 384, and Austin W. Scott, "The Fiduciary Principle" (1949), 37 *Cal. L. Rev.* 539, at p. 540):

> The fiduciary must *relinquish* self-interest; that is an act which the fiduciary does, not an act which is done to the fiduciary. This was put slightly differently by Austin Scott, who said that 'a fiduciary is a person who *undertakes* to act in the interest of another person.' [Emphasis in original.]

This does not mean, however, that an express undertaking is required. Rather, the fiduciary's undertaking may be implied in the particular circumstances of the parties' relationship. Relevant to the enquiry of

> whether there is such an implied undertaking are considerations such as professional norms, industry or other common practices and whether the alleged fiduciary induced the other party into relying on the fiduciary's loyalty."[49]

Cromwell J said:

> "As noted, the trial judge held that the evidence did not establish that Ms. Perez relinquished her decision-making power with respect to the loans to Mr. Galambos or that there was any discretion over her interests that he was able to exercise unilaterally or otherwise (para. 46). The Court of Appeal did not disagree with these conclusions and no basis for doing so has been suggested.
>
> In my respectful view, the finding of the trial judge that Mr. Galambos had no discretionary power over Ms. Perez's interests that he was able to exercise unilaterally or otherwise is fatal to her claim that there was an *ad hoc* fiduciary duty on Mr. Galambos's part to act solely in her interests in relation to these cash advances."[50]

The decision in *Galambos v Perez* is to be welcomed. We may, I think, look forward to further important contributions by Cromwell J.

GOOD FAITH AND UNCONSCIONABLE CONDUCT

The label "fiduciary" has no historical or doctrinal relationship to the common law contractual obligation of good faith,[51] but somehow the duty of good faith became involved in the discourse of fiduciary obligation. This was another confusing conceptual slide.

The fiduciary obligation requires self-abnegation. Good faith, whatever it means, is not the same as self-abnegation. People can be honest and selfish at the same time: indeed, most people are.

In Anglo-Australian law it is an implied term of every contract that a party is obliged to do all things reasonably necessary to ensure that the other party obtains the benefit of its bargain. This notion of a duty of good faith is rooted in agreement of parties; it is not a duty of general candour or fairness beyond the structure and terms of the contract; much less is it a duty to sacrifice one's own interests to those of the other party to the bargain.

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49 [2009] 3 SCR 247 at [75]-[79].

50 [2009] 3 SCR 247 at [85]-[86].

51 P Finn, "The Fiduciary Principle" in TG Youdan (ed), *Equity, Fiduciaries and Trusts* (1989: Carswell, Toronto).

In *Market Street Associates Ltd Partnership v Frey,*[52] Posner J described the obligation of good faith in the following terms:

> "This duty is, as it were, halfway between a fiduciary duty … and the duty merely to refrain from active fraud. Despite its moralistic overtones it is no more the injection of moral principles into contract law than the fiduciary concept itself is. It would be quixotic as well as presumptuous for judges to undertake through contract law to raise the ethical standards of the nation's business people. The concept of the duty of good faith like the concept of fiduciary duty is a stab at approximating the terms the parties would have negotiated had they foreseen the circumstances that have given rise to their dispute."[53]

While I would, with great respect, not agree with Judge Posner's implication that the duty of good faith is akin to fiduciary duty, I agree with what he went on to say in his characteristically pungent style:

> "… The office of the doctrine of good faith is to forbid the kinds of opportunistic behaviour that a mutually dependent, cooperative relationship might enable in the absence of rule. 'Good faith' is a compact reference to an implied undertaking not to take opportunistic advantage in a way that could not have been contemplated at the time of drafting, and which therefore was not resolved explicitly by the parties. The contractual duty of good faith is thus not some newfangled bit of welfare-state paternalism or the sediment of an altruistic strain in contract law, and we are therefore not surprised to find the essentials of the modern doctrine well established in nineteenth-century cases …"[54] [citations omitted].

The concept of good faith in contract law is accurately explained by Justice Allsop, the President of the New South Wales Court of Appeal, in his 2010 Sir Frank Kitto Lecture. This concept "has inhered in the fabric of commerce for centuries and which our courts have recognised on a piecemeal basis for a long time".[55] It is not an independent duty, standing apart from the contractual obligations, it is a tool to be used in interpreting and enforcing those obligations.

Unlike fiduciary obligation, the concept of good faith is "intrinsically tied to, and constrained by, the contract entered and to the honest and fair performance of what has been agreed, rather than the superimposition of moral values having their source and legitimacy outside the contract, and operating beyond the agreement of the parties."[56] As

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52 (1991) 941 F.2d 588 (7th Cir. 1991).

53 (1991) 941 F.2d 588 (7th Cir. 1991) at 595.

54 *Market Street Associates Ltd Partnership v Frey* 941 F.2d. 588 (7th Circ. 1991).

55 Allsop, "Good Faith and Australian Contract Law – A Practical Issue and a Question of Theory and Principle", *2010 Sir Frank Kitto Lecture* at [135].

56 Allsop, "Good Faith and Australian Contract Law – A Practical Issue and a Question of Theory and Principle", *2010 Sir Frank Kitto Lecture* at [39].

the Privy Council said in *Re Goldcorp Exchange Ltd*, the essence of the fiduciary relationship is that "it creates obligations of a different character from those deriving from the contract itself."[57]

Contract law allows parties to promote their respective interests, whereas fiduciary law requires the subordination of the principal's interests to the beneficiary. Fiduciary obligations are radically different from the obligation to further mutually beneficial self interest – the essence of the contract.[58] As Justice Allsop observed:

> "The characteristic aspect of the duty of the fiduciary is, within the terms of the relationship, to subordinate its interests in favour of its beneficiary. This subordination will be derived from the degree of power and control and consequent vulnerability of the respective parties in the relationship.
> …
> The usage of the phrase good faith in this equitable context should not give rise to the notion that in a commercial non-fiduciary context it carries with it the obligation upon a contracting party to subordinate its interests to those of the arms' length contractual counterparty. That is not the case. The possibility of confusion with the incidents of faithfulness of the equitable fiduciary have led some (wisely I think) to prefer other terminology: fidelity to the bargain and fair dealing."[59]

What the duty of good faith is not concerned with is the subordination of one's own legitimate interests. In this regard, Justice Allsop observed that:

> "In any given case, it may or may not be reasonable to expect a party to act, or refrain from acting given the expense or risk of the act, to ensure the benefit to the counterparty. This notion of fidelity to the bargain and cooperation to vindicate, or ensure receipt of, benefits can be seen to be restrained or constrained by a sense of reasonableness or fair dealing arising from the parties' mutual rights.
> …
> This is the proper scope and reach of reasonableness in good faith and fair dealing: the element of commercial reasonableness and fairness in behaving with a faithfulness or fidelity to the bargain.
> …
> [T]hese obligations do not require subordination of a party's own interests to those of the other party. The content and scope of the obligation depends upon the other terms of the contract and the context in which the contract was made. Reasonableness takes its place as an objective element in fair dealing together with honesty and fidelity to the bargain in

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57 [1994] 2 All ER 806 at 821.

58 Laura Hoyano, "The Flight to Fiduciary Haven" in Birks (ed), *Privacy and Loyalty* (1997: Oxford University Press, Oxford) at 186.

59 Allsop, "Good Faith and Australian Contract Law – A Practical Issue and a Question of Theory and Principle", *2010 Sir Frank Kitto Lecture* at [35] – [36].

> the furtherance of the contractual objects and purposes of the parties, objectively ascertained."[60]

A further point to be made here is that "good faith" in the contractual sense is not a test of unconscionability standing free of a contract.

In *Commercial Bank of Australia Ltd v Amadio*,[61] migrant parents, who did not speak English and guaranteed a son's debt to a bank, were relieved of their obligations under their guarantee on the basis that they were under a special disadvantage by way of a "disabling condition or circumstance … which seriously affects the ability of the innocent party to make a judgment as to his own best interests, when the other party knows or ought to know of the existence of that condition or circumstance and of its effect on the innocent party."[62] We can now see this decision as a high-water mark rather than a sign-post pointing the way to further expansion of the concept of unconscionability.

A tightening of the language in which the concept of "unconscionability" is framed, is evident in the decision of the High Court in *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd & Ors.*[63] In that case, the High Court accepted by a 4-1 majority that there is a real difference between opportunistic exploitation of an advantage to drive a hard bargain and behaving unconscionably.

In that case, the respondents, CG Berbatis Holdings Pty Ltd owned, in common with others, a shopping centre in Western Australia. Margaret and James Roberts leased one of the premises where they operated a fish and chip business.

In 1996 the Roberts, along with a number of other tenants, were involved in a dispute with Berbatis over alleged overpayments made to the owners during the course of their lease. The overpayments were estimated at $50,000 by the Roberts but if they had gone ahead with the settlement of proceedings, they would have been entitled to only $2,786.43.

While the litigation remained on foot, the Roberts' lease was due to expire; no right of renewal existed. The Roberts sought to sell their business, in part due to their daughter being seriously ill with encephalitis. The Roberts received an offer from a potential purchaser, subject to a lease of the premises being assigned to the purchaser's satisfaction. Berbatis, the owners, were aware of the Roberts' desire to sell, their need to renew the lease and the illness of their daughter. The owners were prepared to agree to the arrangement on the condition that the deed include a clause obliging the Roberts and the purchaser to discharge the owners from all claims arising from any act or omission by the owners before the proposed assignment date, and whereby the Roberts would dismiss

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60 Allsop, "Good Faith and Australian Contract Law – A Practical Issue and a Question of Theory and Principle", *2010 Sir Frank Kitto Lecture* at [61].

61 (1983) 151 CLR 447.

62 *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447 at 462.

63 (2003) 214 CLR 51.

their current legal proceedings against the owners. The Roberts acceded to the inclusion of this clause in the deed of assignment.

The Australian Competition and Consumer Commission (ACCC) brought proceedings on behalf of the Roberts alleging unconscionable conduct on the part of the owners. The ACCC alleged that the owners' imposition of cl 14 contravened Pt IVA of the *Trade Practices Act 1974* (Cth) (TPA), which at the relevant time comprised ss 51AA-51AB. It has since been amended, in particular, by the insertion of s 51AC of the TPA (unconscionable conduct in business transactions) and more recently under the change of the TPA to the *Competition and Consumer Act 2010* (Cth).[64] At the relevant time s 51AA stated:

> 1. A corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time, of the States and Territories.
> 2. This section does not apply to conduct that is prohibited by section 51AB.

The trial Judge, French J, found that s 51AA of the TPA had been contravened because the Roberts suffered from a special disadvantage which the lessor had taken opportunistic advantage.[65] The fact that the Roberts had received competent legal advice was not seen by French J as fatal to their claim. The critical passage in which French J formulated his conclusions was as follows:

> "In my opinion for the owners to insist, as they did through Mr Sullivan in this case, upon the Roberts abandoning their rights to proceed with bona fide litigation in relation to their rights under their existing lease was to engage in unconscionable conduct. The claims that they, in common with other tenants, were raising against the owners were bona fide and serious. They were taken seriously by both the tenants and by the owners."[66]

His Honour added that it was of no consequence that the detriment suffered by the Roberts may have been small in monetary terms as there had been an exploitation of the vulnerability of the Roberts in relation to the sale of their business which was "grossly unfair".

On appeal to the Full Court of the Federal Court, the Full Court unanimously allowed the owners' appeal, taking a qualitatively different view of their conduct from French J. In particular, the Full Court drew a distinction between parties adopting "an opportunistic

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64 Section 51AA of the TPA is now s 20 of *the Competition and Consumer Act 2010* (Cth). I will, however, refer to s 51AA of the TPA for the purposes of this paper.

65 *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* [2000] ATPR 41-778.

66 *Australian Competition and Consumer Commission v CG Berbatis Holdings Pty Ltd* [2000] ATPR 41-778 at 41,197.

approach to strike a hard bargain" and those who act unconscionably within the meaning of the section.[67]

The view of the Full Court was upheld on a further appeal to the High Court. Gleeson CJ referred to the notion of situational disadvantage referred to by French J and warned against such descriptions taking on a life of their own. The critical disadvantage of the lessees was that they had no legal entitlement to a renewal of the lease and that their ability to sell their business depended on the owner's granting such renewal. They were able to make a decision between two financial interests: their legal claim and the sale of their business. In the opinion of Gleeson CJ, the circumstance that a person lacks the commercial ability to pursue both interests at the same time was not a special disadvantage for the purpose of rules against unconscionability. And, with respect, surely it is correct to take a restrictive view of the circumstances in which those who engage in commercial dealings can seek to undo them after they turn out badly by asserting their lack of fitness to be at the bargaining table in the first place.

UNJUST ENRICHMENT AND *FARAH CONSTRUCTIONS PTY LTD v SAY-DEE PTY LTD*

The High Court of Australia in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*[68] addressed, albeit in obiter dicta, the problem which arises when assets have been misdirected by a fiduciary who is unable to make good the loss and the beneficiaries seek to recover from those persons who received the assets. In considering the "fine balance between the interests of people who have entrusted their assets to fiduciaries and the interests of those who deal with fiduciaries in good faith",[69] the High Court adhered to the view expressed in its earlier decision in *Consul Development Pty Ltd v DPC Estates Pty Ltd*[70] that those who deal honestly with fiduciaries will not be liable to the beneficiaries. There has been a deal of criticism of the High Court's position on this issue.[71]

Ironically, in terms of the criticism that Australia is isolated and should follow the Canadian lead to equity's broad sunlit uplands, the Supreme Court of Canada in *Citadel General Assurance Co v Lloyds' Bank Canada*[72] in 1997 took the same line the High Court of Australia took ten years later in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* in insisting upon an element of dishonesty if a recipient of trust property is to be held liable for that receipt.

I propose to confine my discussion of the decision in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* to the criticism of the evident reluctance of the High Court to accede to the restitutionary notion, championed by academic writers such as Peter Birks, that

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67 (2001) 185 ALR 555 at [48] per Hill, Tamberlin and Emmett JJ.
68 (2007) 81 ALJR 1107.
69 Rob Chalmers, "Knowing Receipt: Frozen in Australia" 2007 2 *Journal of Equity* 40.
70 (1975) 132 CLR 373.
71 Rob Chalmers, "Knowing Receipt: Frozen in Australia" 2007 2 *Journal of Equity* 40-41.
72 [1997] 3 SCR 805.

liability for the receipt of trust property should be established without the need for knowledge on the part of the recipient of the breach of trust which has led to the receipt. It is the element of knowledge which makes recipient liability fault-based.

One thing about actually deciding cases within the judicial hierarchy is that it is enough for those of us at intermediate levels within the hierarchy to know what the rules are and to apply them without worrying about whether the rules should be changed. That having been said, I would respectfully suggest that there are good reasons in terms of the fundamental values of equity why the liability should be fault-based rather than absolute.

We are concerned here with what is often referred to as the first limb of the famous statement by Lord Selborne LC in *Barnes v Addy*.[73] It is worth setting out what his Lordship said at some length because the passage shows the importance of the voluntary assumption of responsibility by a defendant who is not a trustee to liability as a de facto trustee. His Lordship said:

> "Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees *de son tort*, or actually participating in any fraudulent conduct of the trustee to the injury of the *cestui que trust*. But, on the other hand, strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees."

There are strong advocates for the view that the mere receipt of the assets of another should be sufficient to give rise to liability. Lord Nicholls of Birkenhead, for example, has said that liability based on "the mere fact of receipt" should be accepted because it recognises "the endurance of property rights."[74] But Lord Parker of Waddington, widely acknowledged as one of the great equity judges of the 20th Century, famously explained that equity, starting from the recognition of personal obligations in respect of property, gave remedies which had proprietary consequences. The property rights of a beneficiary of a fiduciary relationship have never been more enduring than the willingness of courts to require the fiduciary to adhere to obligations voluntarily undertaken.

In this way, equity's refusal to interfere with the rights of a purchaser of property in good faith without notice and for good consideration served to mark out the boundary at which a plaintiff asserting an equitable claim could not, in conscience, be allowed to assert it.

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73 (1874) LR 9 Ch App 244 at 251 – 252.

74 Lord Nicholls of Birkenhead, "Knowing Receipt: The Need for a New Landmark" in William Cornish, Richard Nolan, Janet O'Sullivan, and Graham Virgo (eds), *Restitution, Past, Present and Future: Essays in Honour of Gareth Jones* (1998: Oxford), p. 238.

This rule embodies the fundamental concern of equity, not only with the conscience of the defendant, but with ensuring conscientious dealing by all parties.

Under the first limb in *Barnes v Addy*, strangers to a trust are not to be made constructive trustees unless they have made themselves trustees - *de son tort*, as it is said. In other words, they must have deliberately intermeddled with property in a way which would be regarded as legitimate only if they had lawfully assumed the responsibilities of trustee. That was the view of Stephen J with whom Barwick CJ agreed in *Consul Development Pty Ltd v DPC Estates Pty Ltd*.[75] That is a view which also has the support of other judges whose views on matters of equitable doctrine are entitled to the highest respect.

In *Westdeutsche Landesbank Girozentrale v Islington London Borough Council*,[76] Lord Browne-Wilkinson rejected the possibility that a recipient of a legal interest in property could be fixed with the obligations of a trustee for the true owner while ignorant of the acts which might offend conscience. Similarly, in the Queensland Court of Appeal in *Port of Brisbane Corporation v ANZ Securities Limited (No 2)*, McPherson JA, with whom the other members of the Court agreed, held that it would be "offensive to notions of equity and common sense to hold [a defendant] liable for a supposed breach of trust as trustee for [the plaintiff] at a time when it had never undertaken and was not aware that any such obligation existed."[77]

Lord Goff of Chieveley, the doyen of restitution lawyers, recognised the strength of the view that the ethical concerns embodied in equitable doctrines should not be shoehorned into the common law categories collected and rationalised under the rubric of the law of restitution. In *Westdeutsche Landisbank Girozentrale v Islington London Borough Council*, Lord Goff said: [78]

> "Ever since the law of restitution began, about the middle of this century, to be studied in depth, the role of equitable proprietary claims in the law of restitution has been found to be a matter of great difficulty. The legitimate ambition of restitution lawyers has been to establish a coherent law of restitution, founded upon the principle of unjust enrichment; and since certain equitable institutions, notably the constructive trust and the resulting trust, have been perceived to have the function of reversing unjust enrichment, they have sought to embrace those institutions within

75 (1975) 132 CLR 373 at 408.

76 [1996] AC 669 at 705.

77 [2003] 2 Qd R 661 at 679. This view involved a departure from the approach of the New South Wales Court of Appeal in the earlier case of *State Bank of New South Wales Ltd v Swiss Bank Corporation* (1995) 39 NSWLR 350, where it was held that a recipient of property who could reasonably have undertaken enquiries to establish the true beneficial ownership of the property but did not, was held liable to make good the plaintiff's loss. McPherson JA ([2003] 2 Qd R 661 at 674 – 675) relied upon the view expressed by Sir Frederick Jordan CJ in *Oxley v James* (1938) 38 SR(NSW) 362 at 375, that "in commercial transactions … means of knowledge are not actual knowledge." On this view, so long as a recipient acts in good faith and does not wilfully shut his or her eyes to matters which will reveal actual fraud or impropriety, there can be no liability to the beneficial owner in equity or in restitution.

78 [1996] AC 669 at 685.

> the law of restitution, if necessary moulding them to make them fit for that purpose. Equity lawyers, on the other hand, have displayed anxiety that in this process the equitable principles underlying these institutions may become illegitimately distorted; and though equity lawyers in this country are nowadays much more sympathetic than they have been in the past towards the need to develop a coherent law of restitution, and to identify the proper role of the trust within that rubric of the law, they remain concerned that the trust concept should not be distorted, and also that the practical consequences of its imposition should be fully appreciated. There is therefore some tension between the aims and perceptions of these two groups of lawyers, which has manifested itself in relation to the matters under consideration in the present case."

As Lionel Smith said in his article "Unjust Enrichment, Property, and the Structure of Trusts":[79]

> "The strict liability approach would contemplate that a plaintiff need only allege that a bank received trust property, not that the bank knew or should have known of the trust; with no more than that, the bank would be required to prove its good faith as a defence or to account for what it has done with this money. In other words, there is no procedure which a bank, be it ever so honest, can adopt in order to ensure that it is not prima facie liable for the receipt of trust funds. Prima facie liability implies potentially extended periods of expense and uncertainty when litigation is pending; and of course it throws on the defendant the risk that even though the elements of some defence are present, they cannot be proved to the satisfaction of the trier of fact. Although there may be no difference in the classroom between fault-based liability and strict-liability with defences, there is a great difference in the courtroom."

Third parties who deal with fiduciaries deal with persons clothed with the indicia of title to the asset in question, e.g. possession or control or registration. It is for the very reason that the equitable rights of the beneficiary in respect of the property are not apparent to third parties that equity accords protection to the bona fide purchaser for value against the claims of the beneficiary. A watering down of that protection in relation to recipient liability will not come without cost.[80]

In *Manchester Trust v Furness*, Lindley LJ said: [81]

> "… as regards the extension of the equitable doctrines of constructive notice to commercial transactions, the Courts have always set their faces resolutely against it. The equitable doctrines of constructive notice are common enough in dealing with land and estates, with which the Court is

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79 (2000) 116 *Law Quarterly Review* 412 at 434.
80 *Barclays Bank plc v Boulter* [1999] 1 WLR 1919 at 1925.
81 [1895] 2 QB 539 at 545.

> familiar; but there have been repeated protests against the introduction into commercial transactions of anything like an extension of those doctrines, and the protest is founded on perfect good sense. In dealing with estates in land title is everything, and it can be leisurely investigated; in commercial transactions possession is everything, and there is no time to investigate title; and if we were to extend the doctrine of constructive notice to commercial transactions we should be doing infinite mischief and paralyzing the trade of the country."

Moreover, to accept that an internal misapplication of company funds by the company's directors could result in a co-ordinate liability in the company's bank, where the bank had no notice at all of the misapplication, would be to delete the internal management rule from our company law.[82]

Of course, if a recipient still retains the funds when it receives notice of the breach of fiduciary duty, it is obliged to disgorge them, but that is because it has become a recipient of trust property with actual notice of the claim of the true owner.

Apart from pragmatic considerations, it is contrary to equity's sense of social responsibility to allow a remedy to a plaintiff who has made the choice to deal with a third party through a fiduciary against the third party where the third party has acted honestly and without notice of the agent's breach of trust. If a third party deals honestly with an errant fiduciary, that third party should not find itself fixed with a liability equal to that of the defaulting fiduciary: the third party has never accepted the fiduciary obligation of self-denial in favour of the beneficiary.

Furthermore, within the category of unjust enrichment, the liability to disgorge the amount received is measured not by the defendant's promise – as is the case with breach of contract; nor by the extent of the plaintiff's injury – as is the case with the common law of tort; but by the extent of the defendant's unjust enrichment at the expense of the plaintiff. It is difficult to see that the pursuit and recovery of any unearned windfall derived from the successful investment of the asset can be squared with the requirements of conscience so far as the plaintiff is concerned.

DISHONESTY

Of course, the central concept "dishonesty" is complex. In a criminal case, *R v Salvo*,[83] McInerney J explained why the concept of "dishonesty" is so complex:

> "The word 'dishonesty' implies reference to a standard of morality underlying the law. The law sets standards of legality and illegality but cannot set and never has purported to set standards of morality. Standards of morality underlie the law: they derive not from the law but from the standard of ethics accepted by the community."

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82 Cf *BCCI (Overseas) Ltd v Akindele* [2001] Ch 437 at 455 – 456.

83 [1980] VR 401 at 407.

This standard is thus to be discovered, rather than prescribed by judges. But whether the exercise is one of discovery or prescription by the Court, there is a degree of uncertainty in the concept.

While generally speaking, uncertainty in the law is a bad thing, and a very bad thing indeed in commercial law, there is a view abroad that certainty as to the precise metes and bounds of the concept of dishonesty is not a bad thing. Professor Janet Austin in her recent article, "When does sharp business practice cross the line to become dishonest conduct", has suggested: [84]

> "Paradoxically the very uncertainty inherent in the concept of dishonesty may be beneficial for the community at large in that it may act to foster ethical behaviour. As such, the use of dishonesty as an element of criminal offences in areas of commerce where the community expects the highest standards of ethical conduct, such as dealings between financial advisers and the public, should probably be encouraged."

CONCLUSION

The ethical values of individual restraint, mutuality and social responsibility at play within the framework developed by Chancery differ from the individualism and the universalism of the common law. To regard equitable doctrines as modular, so that they may be mixed and matched with common law rules so as to expand the scope of the judicial branch of government's regulation of self-interested action, is to fail to appreciate these differences.

It was always a troubling feature of the unifying and expansionary jurisprudence that it seemed to work only one way. There is a marked absence of examples of defendants avoiding liabilities. So far as commercial law is concerned, there has always been some scepticism in that the proper development of the law does not mean an inevitable broadening and intensification of judicial intervention in the commercial life of the community. There was always a question-mark over the idea of an evolution which involves an ineluctable expansion in the liabilities imposed by the courts upon those in business who conduct themselves honestly.

There were a number of questions: is it necessarily a good thing that arm's length transactions in the commercial life of the community be subject to regulation in accordance with standards of behaviour devised for the regulation of relationships of trust and confidence which are distinctly not arm's length relationships? Is such a development a sound expression of the values of modern commercial life, bearing in mind that equity never set out to bring to heel what John Maynard Keynes described as "the uncontrollable and disobedient psychology of the business world"?

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[84] (2010) 29(2) *University of Queensland Law Journal* 263 at 278.

As the cases referred to in Lord Neuberger's speech in 2009, and the cases I have referred to here, suggest, that so far as commercial law is concerned, equitable doctrines are no longer on the march to expand the liabilities of financiers.

It is perhaps too early in terms of legal history to give a confident explanation of the underlying reasons for the swing back. I suspect the reasons may be that, at least so far as commercial cases are concerned, the rapidly accelerating processes of globalisation have brought home to businessmen, lawyers and judges alike, that the exacting demands of international trade and commerce cannot accommodate rules which pursue abstract notions of fairness and more perfect justice at the expense of commercial certainty.

In one of my last cases at the Bar, the Swiss Bankers for whom I was acting, were aghast at the suggestion that the express terms of letters of credit which they had issued could be trumped by estoppels based on imperfect understandings arising in the course of oral discussions. The English language is imprecise enough when used by native English speakers: to insist that non-English speakers' written bargains should be altered by the effect of oral statements is hubris of an order which international commerce will not tolerate.

In my last few years at the Bar, I found that frequently when discussing upcoming hearings with managers of corporate clients, they would express their concern as to how we lawyers could get across to the judge the extent to which their companies' reasonable commercial expectations had been disappointed by the other side's performance. I would say to them: "Well, we will read the terms of the contract to the judge."

To which they would usually reply with something like: "But that won't convey the extent to which we were really relying on them. We had many discussions with them in which we explained our problems to them and they always told us that they understood where we were coming from and that they were confident that they could solve our problems. If we had not been given these assurances, we would have signed up with someone who would have."

They were always quite serious. They seemed to have no appreciation of the significance of the written contract as the final and exclusive charter of the parties' rights and obligations. Once again I emphasise that we are not talking about cases involving widows and orphans.

The uncertainty inherent in the equitable doctrines I have been discussing not only affects the parties to the contract, their assigns and their bankers; it also has an adverse impact on the courts and the public interest. The lengthy forensic investigations directed to reconstructing the contractual negotiation in each case come at a cost in terms of time and money for the courts, and the taxpayers who fund them, and for other litigants who are kept in the holding pattern while we all relive the day by day negotiation of the contract.

To those who think I exaggerate the value of certainty, I say that you have not spent months of your professional life in cases in which one side or the other troops witness after witness through the court to say why some arrangement which never actually found its way into a signed contract was utterly crucial to the contract which was actually signed.

And the actual success rate of estoppel claims suggests that it is a dog that rarely barks. It seems that the concern to make commerce safe for those who are not able or willing to conform with considerations of reasonable prudence is a game which is unlikely to be worth the candle so far as the return to the wider community is concerned.

This disproportionate demand of commercial cases on the community's resources is a problem which, a couple of years ago, led Chief Justice Gleeson, formerly the Chief Justice of Australia, to warn against the excessive demands which the commercial sector is making on the legal system in this country.

There are, I suggest, other concerns at stake here which relate to the values which a legal system which operates as part of a globalising world should uphold. There are values of competence and integrity on the part of those who engage in commerce. There are concerns about commercial morality.

The signing of a written contract is a solemn moment in a negotiation. It brings the negotiation to an end. Until then the parties are free to alter their position or even to withdraw from the negotiation altogether. This has been well-understood since the time of Hammurabi.

Commerce proceeds on the assumption that each party to a commercial negotiation is expected to do his or her honest best to ensure that he or she concludes a bargain on the terms most favourable to that party, and that it is that party's responsibility not to execute the contract until it is an accurate charter of the parties' rights and obligations.

Each side gives and takes until the contract is concluded, and each side understands that the document finally executed will reflect the final balance struck between give and take. The notion that the signing of the contract was but a provisional episode in an ongoing and open-ended negotiation is distinctly unattractive in terms of the values of commercial prudence and competence.

Surely no-one would knowingly invest in a company in which the management do not understand or will not accept the solemn importance of the signing of a contract, preferring to pursue the hope that some form of post-contractual royal commission will "make them whole", as the Americans say.

It is impossible to imagine that a manager of a corporation would admit to his shareholders that he has allowed the corporations business to be conducted so gormlessly. And yet before a court that same manager may cheerfully assert his incompetence as he comes forward to claim the rewards of his victimhood.

It seems to me that what was at stake is the integrity of those who engage in business in the market. The law should not offer encouragement to those willing to say that they thought that their tentative and provisional arrangements would either replace the need for a concluded contract or, alternatively, would survive the execution of a contract which did not embody those arrangements.

Another reason may be that the activity of the legislature in proscribing higher standards for financiers and other corporations in their dealings with consumers has taken the pressure off the courts to pursue an agenda of consumer protection. The Courts are no longer impelled to develop doctrine to provide the same level of protection to consumers as is provided to those in business. The Courts are no longer under the pressure of trying to formulate doctrines which can apply at the same time to commercial cases involving consumers or persons at a disadvantage. It is open to legislatures to frame rules which provide such differential protection: it is more difficult for courts to make overt policy choices.

This point was recently illustrated in the decision of the Full Court of the Federal Court in *Leveraged Equities Limited v Goodridge*[85] in relation to s 12CB of the *Australian Securities and Investments Commission Act 2001* (Cth) ("the ASIC Act") which proscribes unconscionable conduct. The Full Court held that the section applies only to financial services of a kind ordinarily acquired for personal, domestic or household use so that a borrower who acknowledges that the borrowed funds would be applied wholly or predominantly for investment was outside the scope of the section, even if the investment was for the purpose of providing for the borrower's retirement. The Full Court also reiterated the view, expressed in *Bacnet Pty Ltd v Lift Capital Partners Pty Ltd (in liq)*,[86] that there is nothing unconscionable in a lender enforcing its legal rights to protect itself against a fall in the value of its security.

The points I would emphasise for present purposes are that to afford a differential level of protection to borrowers based on the purpose of the borrowing is to make and articulate the limits (which may be arbitrary) of a policy choice. That process of arbitrary (because a line has to be drawn somewhere when, eg, defining "consumers") choice is not open to judges and that the Courts are not disposed to strain to protect a commercial borrower.

In summary, so far as commercial cases are concerned, we can, I think, say that the tightening of the conceptual basis of equitable doctrine broadly reflects the judiciary's acceptance that, in a globalizing world in which free market values predominate, commerce cannot be made safe for everyone. Having accepted that market based reality, the Courts recoiled from a looming situation in which they would need to put up a sign outside our commercial courts advising litigants: "Please leave Your Mobile Phones and Your Dignity at the Door."

85 [2011] FCAFC 3.

86 [2010] 183 FCR 384 at [118] – [120].