# Some Aspects of Recovery under Contract with Trustees

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## 1. Introduction

### *(a) Context*

My concern in this paper is with the legal rules which must be taken into account in the negotiation of contracts between trustees and third parties in connection with the trust. Those contracts vary considerably — they range from humble contracts for the acquisition of office supplies to important (and often complex) investment contracts, service contracts, loan contracts and so on. Of course, the humble contracts do not call for comment: the concern is with contracts the terms of which would normally be formally documented. Generally, my analysis is from the trustee's perspective.

Uppermost in the mind of any trustee who negotiates a contract will be the benefit of the indemnity which the trustee enjoys in relation to its duties and functions as trustee. Although the terms and scope of that indemnity are not matters of concern, in the sense that I do not intend to discuss how the indemnity provisions of the trust instrument should be drafted, it is self-evident that the trustee must always be conscious of the need to ensure, whenever possible, that the liability of the trustee vis a vis the third party is more or less back-to-back with the indemnity.

The importance of this topic cannot be doubted. It is important not only for trustees but also for those who advise trustees. After all, it will be recalled that in *Astley v Austrust Ltd*[1] a firm of solicitors which gave advice to the trustee of a trading trust in connection with its liability as trustee was held to be negligent because it failed to advise the trustee that it would be

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1 (1999) 197 CLR 1; 161 ALR 155.

personally liable in dealings with third parties unless it took steps to control its liability. When the trust failed, the trustee became personally liable for losses that exceeded the value of the trust property. The trustee should have limited its liability to the extent of the trust assets.

*(b) Issues*

There are two principal issues. The first relates to the bases for trustee liability. The second concerns the regulation of that liability by contract.

As we shall see, the bases upon which a trustee may be held liable to contractors in connection with trustee contracts are many and various. Indeed, potentially, the trustee is liable in the same way as any other contracting party. Moreover, its potential liability it is not limited to contractual liability. Thus, even though (almost invariably) the trustee's principal contractual obligation will be to pay money, this does not mean that the sole concern of a trustee is with its potential liability in debt. It must also have in mind liability to pay damages in contract, in tort or under statute.

Nevertheless, the fact that the trustee's principal contractual obligation is to pay money does impact on the contractual regulation of liability. Because the trustee is not a supplier of goods or services to the third party, it will enjoy far greater freedom of contract, particularly in relation to exclusion clauses, than the third party with whom it deals. However, as we will see, a trustee does not enjoy complete freedom of contract.

*(c) Nature and Extent of Liability*

The liability of a trustee is almost invariably a personal liability.[2] Accordingly, unless the contract provides to the contrary, it is not limited by the assets of the trust which the trustee administers.

As a contracting party, the extent of a trustee's liability depends primarily on the contract. Since the meaning and effect of a contract are matters of construction, the extent of a trustee's liability will generally be determined by interpretation. Of course, that underlines the importance of contract drafting to the ultimate liability of the trustee. It is clear beyond doubt that a trustee is entitled to limit its liability to contractors by reference to the trust assets.[3] This will usually be achieved by reference to the trustee's right of indemnity.

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2 The trustee may be authorised by the trust deed to create secured interests, by way of mortgage or charge, over trust assets.

3 For a fairly recent reminder see *Helvetic Investment Corp Pty Ltd v Knight* (1984) 9 ACLR 773 (CA, NSW).

Given that we are focusing on contract liability, the contract rules regulating liability are very important. These are well established. The primary obligation of the trustee under most contracts will be to pay money. An obligation to pay money is a strict obligation. It is no use the trustee claiming that it has not been negligent: if it fails to pay, it is liable in contract. Of course, a trustee may be subject to other obligations. Whether these attract a strict duty or one requiring the exercise of care or diligence will depend on the construction of the contract.

Because a breach of contract is actionable per se, the mere fact of breach will expose the trustee to a liability. However, the extent of liability will ultimately be determined by specific rules and requirements, principally causation and remoteness. The contract rule in relation to the latter is, of course, the rule in *Hadley v Baxendale*:[4]

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, ie, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

Under the first limb of the rule, unless the parties have agreed otherwise, a defendant is responsible for 'natural' losses, of which the parties are presumed to be aware. Under the second limb, unless the parties have agreed otherwise, a defendant is responsible for losses in the contemplation of *both* parties, in the sense that they relate to circumstances of which the parties were actually aware. I deal later[5] with the implications of the rule for contract drafting. For the moment it is sufficient to make one point.

The assessment of damages may be affected by whether the contract has been terminated for breach or repudiation. If the trustee commits a material breach which leads to termination of the contract, the trustee will become liable to pay 'loss of bargain' damages. Such damages are damages assessed by reference to the difference between the market value of the contract or its subject matter at the time of breach and the price (or monetary equivalent) expressed in the contract. Accordingly, the prima facie liability of a trustee is the difference between what it agreed to pay the third party and what the third party can reasonably

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4 (1854) 9 Ex 341 at 354; 156 ER 145 at 151 per Alderson B.

5 See below, text at n 38ff.

obtain for its services under a replacement contract. In *Shevill v Builders Licensing Board*[6] the High Court treated recovery of loss of bargain damages as an instance of recovery of consequential loss. However, it is clear that loss of bargain damages are recovered under the first limb of the rule. This illustrates that, for the purposes of damages rules, the distinction between direct loss and consequential loss is not the same as the contract drawn in the two limbs of the rule in *Hadley v Baxendale*.

Of course, the extent of a trustee's personal liability is not determined solely by the law of contract. Liability in tort or under statute may be important, particularly the latter. The fact that the trustee's liability is not generally a proprietary liability also has an important consequence which is I think easily overlooked. If a trustee becomes subject to a personal liability to make restitution in relation to money or property received is its capacity as trustee, the fact that the trustee's liability is not generally a proprietary liability means that the trustee remains liable even if the money or property is no longer in its possession.[7]

## 2. Bases for Liability

### *(a) Introduction*

The question of liability is not a static one: it depends on the dynamics of contract negotiation and performance. It is nevertheless true to say that since the principal obligation of the trustee vis a vis third parties with whom it contracts will usually be to pay the fees which the trustee has agreed to pay, the contract price itself limits the trustee's debt exposure.

Of course, a claim for contract damages may in particular circumstances exceed the contract price. But it is primarily because the liability world includes tort, restitution and statute that the contract price cannot be treated as a limit on all liability. Assessment of damages in tort does not generally rely on the contract price as a basis for quantification and some claims for restitution may exceed the contract sum. However, the contract may expressly provide that the trustee's liability in contract, tort or restitution is to be limited by the contract sum. But that technique may not be available in relation to liability under statute.

### *(b) Contract*

As I have explained, debt is the most obvious basis for trustee liability to contractors. It is, moreover, a liability which in practice cannot be limited by exclusions. That is not itself a

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6 (1982) 149 CLR 620; 42 ALR 305.

7 See further below, text at n 22ff.

concern, although no doubt many trustees have looked back on contracts and wished they had negotiated a lower price!

If the trustee fails to pay money due to the other party to the contract, it will also be liable in damages. However, in most cases any additional liability will be limited to interest, payable at common law or under statute. Of course, a third party may attempt to establish that the trustee has a greater liability, by relying on breaches of other obligations or by alleging that the trustee's failure to pay has caused additional losses. Although in either case the matter is governed by causation and the rule in *Hadley v Baxendale*, it is important to bear in mind that the common law has had great difficulty with damages claims based on the late payment of money. The original rule — that damages cannot be claimed for the late payment of money — was relaxed somewhat by the High Court in *Hungerfords v Walker*[8] when, not following English authority, the court held that interest may be recoverable under the first limb.[9] But if a contractor claims that the failure of the trustee to pay on time means that the trustee is liable for the loss of a particularly lucrative investment opportunity, the second limb will govern any claim. Therefore, even if there is no contractual exclusion of 'special' damages, the contractor will go away empty handed unless it (at least) communicated the potential loss prior to contract.[10]

It follows that in most cases it is not at all difficult for a trustee to work out its most likely exposure in contract. Unless the contract is terminated, it is limited to payment of interest for the late payment of money. And even if the contract is terminated for serious breach by the trustee, the maximum potential exposure is generally the present value of the sum which the trustee agreed to pay the contractor over the life of the contract. There may perhaps be situations in which damages for consequential loss might be recovered, either under the first limb or the second limb of the rule in *Hadley v Baxendale*. However, that could only ever be determined on a case by case basis.

It is appropriate here to say something about one drafting device commonly found in commercial contracts, including contracts with trustees. Instead of leaving quantum to be determined according to the common law rules regulating damages, parties now regularly

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8 (1989) 171 CLR 125; 84 ALR 119.

9 Conversely, the High Court approved the view, expressed in *President of India v Lips Maritime Corp* [1988] AC 395 at 425, that the common law does not recognise a claim for the late payment of *damages*.

10 Cf *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528.

stipulate for indemnities.[11] This is a disquieting tendency. If party A gives party B an indemnity in relation to a particular event, A is regarded as having breached the contract if the event occurs. A is then liable for all loss or damage suffered by B. Moreover, if it is a true indemnity, A's liability is not limited by the rule in *Hadley v Baxendale*. I can well understand trustees being desirous of receiving the benefit of indemnities, but it is difficult to see why they should ever undertake the burden of such a provision. In effect, it removes the protection (limitation) which the contract price effectively provides in relation to most claims brought in contract.

*(c) Tort*

Generally, although not exclusively, the liability of a contractor to a trustee will depend on proof of negligence.[12] On the other hand, because an obligation to pay money is a strict obligation, and a failure to pay does not amount to the commission of a tort, it is not necessary to say much about the potential liability of a trustee in tort.

Duties of care may also arise in the negotiation of contracts, although this seems to me remote except in situations where the *Hedley Byrne* principle might apply. Thus, it is possible to conceive of the trustee coming under a duty of care in relation to information provided to the third party, for example, in relation to the characteristics of the trust.[13] Even so, the first thought of anyone who seeks a remedy for misinformation provided during the negotiation of a contract is to rely on breach of the statutory prohibition on misleading or deceptive conduct.[14]

In the ordinary course of things, trustee fraud in relation to third party contracts does not enter the liability picture.[15] The tort is committed in relation to a pre-contract representation in three cases:

- actual dishonesty;
- an absence of belief in the truth of the representation; and
- reckless indifference as to whether the representation was true or false.

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11 See further below, text at n 43.

12 See generally J W Carter, 'Contractual Issues for Trustees' (2001) 17 *JCL* 274.

13 Cf *Esso Petroleum Co Ltd v Mardon* [1976] QB 801.

14 See below, text at n 27.

15 Of course, in this context we are referring to the common law tort of deceit rather the concept of equitable fraud which a trustee may commit vis a vis the beneficiaries.

Although fraud is difficult to prove, it did at one time at least have the appeal of a more generous approach to damages. However, given the interpretation of the compensation provisions applicable to misleading or deceptive conduct,[16] that advantage has gone.

*(d) Restitution*

It is natural, when considering the potential liability of a trustee, to think in terms of wrongdoing, and to concentrate on a failure to perform the contract. However, in some situations it will be more important to consider liability which is independent of fault. It is because liability in restitution is independent of fault it tends to be neglected.

An obligation to make restitution arises if the requirements of unjust enrichment are satisfied. There are four elements:

(1) receipt of a benefit by the trustee;

(2) the benefit received by the trustee was obtained at the expense of the plaintiff;

(3) it would be unjust for the trustee not to make restitution; and

(4) the trustee does not have any defence to the claim.

This is not the occasion to consider these elements in detail.[17] For the purpose of considering the potential liability of a trustee it is sufficient to make the following points.

First, in the contract context, there is generally no obligation to make restitution in relation to a benefit unless the contract is an ineffective contract, that is, was inherently invalid or has been terminated or rescinded. Thus, benefits conferred under a valid contract are not usually an appropriate focus for a claim in restitution unless the contract has been rescinded or terminated, for example, for breach on the trustee's part.

Second, although the concept of benefit is a technical one, money is always a benefit. Accordingly, there is an inherent potential for a trustee to become liable in restitution whenever money is received. However, in relation to money paid pursuant to contract, no issue of restitution arises unless:

- there is an overpayment to the trustee; or
- the contract being an ineffective contract, the payment was the subject of an agreed return (counter-performance obligation) which the trustee has not rendered.

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16 See below, text at n 27

17 See Keith Mason and J W Carter, *Restitution Law in Australia*, Butterworths, Sydney, 1995, Chapter 2.

Third, although goods, land or services may count as non-monetary benefits for the purposes of restitution, no issue of restitution arises unless the contract was ineffective and the benefit has been accepted. In practical terms this means that the trustee will not become liable to make restitution for the receipt of a non-monetary benefit unless:[18]

- the contract was void or unenforceable; or
- the contract was discharged for the trustee's breach.

Thus, if the trustee commits a serious breach, for example, by repudiating the contract, the third party will be entitled to terminate the contract and seek restitution in relation to all benefits conferred prior to termination for which no contractual right of payment was earned.[19]

Fourth, the concept of 'injustice' is a principled one. In other words, the requirement of injustice posits the existence of a *recognised* basis for ordering restitution. There are, indeed, a limited number of bases for restitution. Most relevant to a trustee's position are mistake and acceptance of benefit. Indeed, the general principle is simply that if a third party (even one with whom the trustee has a contract) by mistake pays the trustee a sum of money which it was not obliged to pay, the third party is prima facie entitled to restitution equal to the payment plus interest.

Fifth, just as the concept of injustice is a principled one, the idea of a restitutionary defence posits the existence of a *recognised* defence to the claim for restitution. Although general defences such as election between remedies and illegality may operate in the context of restitution, the only genuine restitutionary defence is 'change of position'. This is the idea that if a payment is caused by mistake, but the payee honestly believed that he or she was entitled to receive it, the fact that the payee has incurred expenditure which would not otherwise have been incurred will provide a good defence to a restitutionary claim in relation to the payment. The defence operates pro tanto, that is, to the extent of the expenditure incurred in reliance on the payment.

Sixth an order for restitution requires the payment of a sum of money equal to the value of the benefit, rather than specific restitution. This is obvious in the case of money. However, in relation to non-monetary benefits the impact is that the plaintiff is entitled to a quantum meruit,

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18 The summary relates to the common law. Restitutionary obligations may also arise under statute (see eg *Frustrated Contracts Act* 1978 (NSW)) and the principle of restitutio in integrum governs rescinded contracts.

19 See also below, text at n 48.

that is, 'reasonable remuneration'. Assessment of the quantum meruit depends on the circumstances, including the basis for restitution. One aspect of this is significant. Assume that a trustee materially breaches a contract with a service provider who validly terminates the contract at a time when a substantial amount of work was done for which the service provider had no contractual right of payment. Clearly, as has been explained, the trustee is liable to pay loss of bargain damages, which will be limited by the contract sum. However, the service provider may alternatively seek reasonable remuneration in a claim for restitution. The authorities are clear that in such a situation the contract price is not a ceiling on the liability of the trustee.[20] Therefore, if the service provider made a bad bargain, or market prices increased between the time of the contract and the time when work was done, the liability of the trustee may exceed the contract price.[21]

Of course, a major function of many trustees is to get in money or property for the benefit of the beneficiaries. Although it is important for a trustee to have in place procedures designed to ensure that it only receives for the benefit of the beneficiaries money and property to which they are entitled, mistakes sometimes occur. Thus, an employer may pay more than it is obliged to pay to the trustee of a superannuation fund, a debtor may repay more than it is obliged to repay, or a third party with whom the trustee has contracted may remit more than the value of an investment asset which the third party has realised on the instructions of the trustee.

It might be thought that so long as the trustee has acted honestly when crediting the beneficiaries with money received, it will be protected if the payment is the result of a third party's mistake. However, that is not always true. Because the liability to make restitution in relation to a mistaken payment is a strict personal liability, the trustee remains liable even though it no longer has the money. Therefore, the mere fact that the trustee has credited the beneficiaries is not in itself a defence.[22]

Before the High Court fully recognised the change of position defence in *David Securities Pty Ltd v Commonwealth Bank of Australia*,[23] a special defence — the agency

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20 See, eg *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234.

21 Or perhaps more accurately what would be the proportion of the contract price attributable (on a pro rata basis) to the work done if the contract were severable.

22 In any event, the crediting may amount to no more than an accounting process.

23 (1992) 175 CLR 353; 109 ALR 57.

defence — was often applied to banks and other intermediaries who, although acting for others, are not strictly speaking agents in their dealings with the money received.[24] Thus, in *Restitution Law in Australia*[25] it is explained:

> a bank or other payee which receives a mistaken payment of money on account of a customer will itself avoid liability where it allows a customer to draw on the funds standing to the credit of an account, unless the bank would have allowed funds to be drawn regardless of the receipt.

However, it is also explained[26] that 'this "agency defence" is only available when the money is received as an intermediary'. Although a trustee is in a colloquial sense an 'intermediary' it is not an agent and it does not receive money as a mere intermediary in the sense of being a conduit to the beneficiaries. The conclusion reached is therefore that the agency defence 'is not available to a trustee who accounts to the beneficiary with moneys initially paid under mistake'. This is a most disturbing conclusion for trustees. It is by no means clear that the recognition of the change of position defence makes any difference.

*(e) Statute*

The statutory prohibition on misleading or deceptive conduct affects all contracting parties — trustees are not immune unless they operate outside trade and commerce. Although, generally speaking, only an incorporated trustee can be held liable under the *Trade Practices Act* 1974 (Cth),[27] the fact that there are corresponding provisions in the State and Territory fair trading legislation means that all trustees who engage in conduct in trade or commerce have to take the prohibition into account.[28] Again, although the TPA may not apply to misleading or deceptive conduct in relation to financial services, financial products or securities, parallel provisions in other legislation impose the same prohibition.[29]

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24 See *Australia and New Zealand Banking Group Ltd v Westpac Banking Corp* (1988) 164 CLR 662; 78 ALR 157.

25 Keith Mason and J W Carter, *Restitution Law in Australia*, Butterworths, Sydney, 1995, para 434.

26 Citing *King v Stewart* (1892) 66 LT 339.

27 Hereafter 'TPA'.

28 In some situations other prohibitions may be relevant.

29 See *Australian Securities and Investments Commission Act* 2001, s 12DA(1) (financial services); *Corporations Act* 2001 (Cth), s 995 (securities).

Although it is difficult to summarise accurately and succinctly the effect of the statutory prohibition, the following points may be made.[30]

First, notwithstanding that s 52 is in a sense part of a regime having 'consumer protection' as its object, conduct may be misleading or deceptive even though no consumer is misled or deceived, or likely to be misled or deceived. What matters is whether the trustee misled the contractor.

Second, the effect of the prohibition is to create a norm of conduct in relation to conduct in trade or commerce. This has been interpreted as a strict liability regime. Therefore, the prohibition may be breached by a trustee even if it has no intention to mislead or deceive. Quite simply, any misrepresentation which would at common law be regarded as purely innocent is misleading or deceptive conduct for which damages may be awarded to the contractor if it relied on the conduct to its detriment.

Third, an extremely important feature of the legislation is an extensive remedial regime. There are three principal tiers to that regime:

(1) a statutory jurisdiction to award damages for contravention;

(2) a discretionary jurisdiction to make 'other' orders; and

(2) jurisdiction to grant an injunction.

Fourth, although the main field of operation of the prohibition in the contract context[31] is in relation to pre-contractual representations, it can also apply to conduct in the course of contract performance. For example, a breach of contract may in some cases amount to misleading or deceptive conduct. Thus, it would appear that where a trustee breaches a contractual warranty this may also amount to misleading or deceptive conduct.[32]

Fifth, although the legislation does not in terms prohibit contracting out, the courts (in their wisdom) have seen the prohibition on misleading or deceptive conduct as having a purpose analogous to the common law prohibition on fraud. Therefore, courts generally refuse

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30 For an overview see David Harland, 'Misleading or Deceptive Conduct: the Breadth and Limitations of the Prohibition' (1991) 4 *JCL* 107.

31 See generally on the impact of the prohibition on contract David Harland, 'The Statutory Prohibition on Misleading or Deceptive Conduct in Australia and its Impact on the Law of Contract' (1995) 111 *LQR* 100.

32 See Diane Skapinker and J W Carter, 'Breach of Contract and Misleading or Deceptive Conduct in Australia' (1997) 113 *LQR* 294.

to enforce exclusionary provisions which purport to exclude or limit liability for misleading or deceptive conduct.

Sixth, where damages are sought for breach of the prohibition, the guiding principles tend to reflect the rules in relation to fraud rather than breach of contract or negligence. Therefore, although the basic question is how much worse off the plaintiff is by reason of the conduct, remoteness of damage does not appear to be a limitation on damages assessment.

## 3. Regulation of Liability

*(a) General*

A contract is a planned transaction and in the present context it is reasonable to expect the trustee to have input on the terms of the contract. However, the extent to which the trustee is able to insist on a particular regime regulating liability will depend on the trustee's bargaining position. Assuming, for the purposes of analysis, that the trustee is able to insist on its preferred regime, what factors should be taken into account?[33]

First, the overall objective is to ensure that so far as possible any personal liability of the trustee is matched by an ability to have recourse to its right of indemnity from trust assets. Of course, the right of indemnity is of no value if the trust has no assets, and from that perspective matching liability to the *right* of indemnity may lead to a shortfall. Accordingly, the trust assets should be a cap on total liability.

Second, consideration should be given to the likely sources of liability in order to ensure that all the most likely bases are covered. As mentioned, restitutionary liability may be important.

Third, the form of drafting should reflect the objectives of the clauses. As explained below, most devices fit into particular 'pigeon holes' and should be used appropriately.

Fourth, the relationship between objectives and what can legally be achieved in drafting must be considered in order to ensure that compliance regimes are in place to deal with situations in which the law does not permit the trustee to limit its liability.

A very large number of liability regulation devices are in common use. The discussion below deals with all major types other than entire agreement and force majeure clauses, which have limited utility in the present context.

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33 For potential gaps see below, text at n 44ff.

*(b) Disclaimer*

A disclaimer is a statement or contractual provision the objective of which is to negate responsibility for a particular matter. The (proper) objective is to prevent liability arising, rather than to remove responsibility for an accrued liability.

It is doubtful whether disclaimers are needed in most trustee contracts, but they may be useful in negativing any common law duty in relation to matters discussed during negotiations. The most appropriate use of a disclaimer is therefore to negate a duty of care which might otherwise arise. Although it is common to find disclaimers in contracts, they are effective even if there is no contract. Thus, in *Hedley Byrne & Co Ltd v Heller & Partners Ltd*[34] the House of Lords treated a disclaimer as effective to negative the existence of a duty of care in relation to information provided independently of contract.

*(c) Exclusion*

An exclusion clause may have either of two functions. Thus, it may seek to define a trustee's primary contractual responsibilities or seek to exclude, limit or qualify the impact of a legal rule in relation to liability.

To understand the contrast consider a contractor who does not wish to be responsible unless it is negligent. The clause defines liability if it says that the contractor's only responsibility is to exercise care. It excludes liability if it provides that the contractor is not to be liable unless it is proved to have been negligent. As that illustration shows, the difference may simply be a matter of drafting. Given that we are concentrating on a trustee's position, the question whether there are any substantive differences between the two approaches may be ignored.

The general principle applicable to exclusion clauses was stated as follows by the High Court in *Darlington Futures Ltd v Delco Australia Pty Ltd*:[35]

> [T]he interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in the light of the contract as a whole, thereby giving due weight to the context in which the clause appears including the nature and object of the contract, and, where appropriate, construing the clause contra proferentem in case of ambiguity.

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34 [1964] AC 465.

35 (1986) 161 CLR 500 at 510; 68 ALR 385 per the Full High Court.

As the High Court made clear, the approach is the same no matter whether the clause provides for a total exclusion of liability or places a limitation on liability. Accordingly, limitations are to be treated in the same way as exclusions.

Although the operation of exclusion clauses is generally well understood and appreciated by commercial people, there is one area which remains contentious. This is the exclusion of liability for 'consequential loss'. Although it is common for trustees and contractors to seek to exclude liability for consequential loss, the Australian cases do not provide any real guidance on what this achieves. It is clear that the phrase is intended to relate to categories of loss, and if we were to look solely at the damages cases we would find that the concept of 'consequential loss' does not play a major role.[36] In contract, the key question is whether a particular loss is too remote, not whether it is consequential.[37] Similarly, although we commonly see clauses which purport to exclude liability for 'loss of profit', the contract damages cases generally concentrate on difference in value (as on a breach of warranty) or loss of revenue (loss of bargain damages) rather than loss of profit. And when profit enters the picture it is often notional or assumed — as in sale of goods cases where a seller recovers the difference between the contract price and the market price in an action for non-acceptance.

A rather different approach is to be found in English cases interpreting exclusion clauses.[38] It now seems clearly established[39] that, other things being equal, an exclusion of 'consequential loss' will be treated as applying to a loss which would otherwise be recoverable under the second limb of the rule in *Hadley v Baxendale*. This really is a very narrow category. The first limb sets out the common law default rule whereas the second limb is concerned with losses which are unusual in the sense that they were within the contemplation of the party in breach because they were brought to its attention prior to the contract. A good illustration is

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36 Cf M A Eisenberg, 'The Emergence of Dynamic Contract Law' (2000) 88 *California Law Review* 1743.

37 See *Alfred McAlpine Construction Ltd v Panatown Ltd* [2000] 3 WLR 946 at 959 per Lord Clyde (contrast between 'consequential losses' and losses falling within the second limb). But cf *Joseph & Co Pty Ltd v Harvest Grain Co Pty Ltd* (1996) 39 NSWLR 722 at 728, 735 per Moore DCJ.

38 See generally J W Carter, 'Contractual Issues for Trustees' (2001) 17 *JCL* 274.

39 See *British Sugar Plc v NEI Power Projects Ltd* (1997) 87 BLR 45; *Deepak Fertilisers and Petrochemicals Corp v ICI Chemicals & Polymers Ltd* [1999] 1 Lloyd's Rep 387 at 402-3; *BHP Petroleum Ltd v British Steel Plc* [1999] 2 Lloyd's Rep 583 at 598 (affirmed without reference to the point [2000] 2 Lloyd's Rep 277); *Hotel Services Ltd v Hilton International Hotels Ltd* [2000] BLR 235. See also *Frank Davies Pty Ltd v Container Haulage Group Pty Ltd* (1989) 98 FLR 289 at 313.

*Victoria Laundry (Windsor) Ltd v Newman Industries Ltd.*[40] The plaintiffs, who carried on business as launderers and dyers, purchased a boiler of considerable capacity from the defendants for the purpose of expanding their operations. The plaintiffs sent a lorry to take delivery but found that the boiler had been damaged. They therefore refused to take delivery until repairs had been carried out and this caused a delay of some five months. The issue before the English Court of Appeal was whether, in addition to a sum of £110 awarded by the trial judge, the plaintiffs were entitled to claim in respect of the business profits which they would have made had the boiler been delivered punctually. The plaintiffs said a very large number of new customers could have been served and that a number of highly lucrative dyeing contracts for the Ministry of Supply would have been available to them. The court held that the judge was wrong not to award some 'general (and perhaps conjectural) sum for loss of business in respect of dyeing contracts to be reasonably expected';[41] but it rejected the claim to recover specifically the profit on contracts with the Ministry for the reason that the defendants had no knowledge of that business.

The approach of the exclusion clause cases produces results which may surprise most commercial people. Assume that A supplies a defective machine to B for $5,000. The defect in the machine is such that it is liable to explode when used for more than an hour at a time. Assume then that B uses the machine for more than an hour and that the explosion causes a fire which razes A's $5m factory to the ground. A's claim for damages equal to the value of the factory (or the cost of its rebuilding) would not be affected by an exclusion of 'consequential loss', because the claim will be made under the first limb of the rule in *Hadley v Baxendale.*[42] Of course, a trustee can take comfort from this because it is more likely to be concerned with exclusion clauses which protect contractors from consequential loss than to exclude its own responsibility for consequential loss.

*(d) Indemnity*

Indemnities have variety of objectives. Traditionally, the most common indemnity is against third party claims. Such clauses do not raise any issue of principle. However, a trustee should always try to obtain such an indemnity and at the same time resist giving it!

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40 [1949] 2 KB 528.

41 [1949] 2 KB 528 at 543 per Asquith LJ.

42 Cf *BHP Petroleum Ltd v British Steel Plc* [1999] 2 Lloyd's Rep 583 (affirmed [2000] 2 Lloyd's Rep 277).

The type of indemnity which is becoming increasingly common is the party-party indemnity which requires one party to indemnify the other in relation to various events including the indemnifier's breach of contract.[43] In essence, the effect of such a provision is to replace the common law rules on damages with an indemnity obligation. At least that is the assumption. However, such clauses are also associated with exclusions which are commonly drafted in terms of damages liability, such as an exclusion of consequential loss. This may in particular cases suggest that they are not really indemnities at all, but simply agreements on how contract damages should be assessed.

If the clause is intended to be a genuine indemnity, it is difficult to understand an exclusion of consequential loss. This is because the objective of an indemnity is to ensure that the indemnifier is responsible for all losses, whether consequential or not. Although clauses of this type do not regularly come before the courts, it would appear that remoteness of damage is not relevant to recovery on an indemnity. Rather, the concern is simply with loss or damage caused by a breach of the indemnity.

If a trustee gives an indemnity of this type, it should attempt to ensure that the indemnity reflects its own indemnity under the trust instrument. This may be difficult because there is no a priori reason why the liability of a trustee to a contractor should match exactly its ability to claim on its own indemnity. That leads to the question whether a trustee is likely to face gaps in its risk management.

## 4. Risk Management Gaps

### *(a) Introduction*

In this section I discuss briefly two potential sources of gaps in the trustee's risk management strategy. One is an impact of the discussion above of exclusion clauses. The other relates to the problems inherent in trying to ensure that the liability of a trustee vis a vis a contractor is more or less back-to-back with the indemnity.

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43 Another type of indemnity is simply an exclusion clause in disguise. This is a provision which states that party A will indemnify party B against any loss arising from a breach of contract or negligence by *party B*. Such indemnities do not appear common today.

*(b) Impact of statute*

The only area of statute which needs to be discussed from the contract perspective is the validity of exclusion clauses.[44]

As I noted earlier, the courts in their wisdom have treated liability for breach of s 52 of the TPA as sacrosanct. One way that effect has been given to that wisdom is to treat exclusions as invalid if they seek to qualify liability for breach of s 52. Therefore, an exclusion or limitation of liability which would as a matter of construction be applicable to liability for misleading or deceptive conduct will be treated as ineffective. The same is generally true of disclaimers. However, if a disclaimer is brought to the contractor's attention before contract negotiation commences the clause may be effective if it prevents the other party being misled. On the other hand, there appears to be no form of exclusion clause which can be used to limit liability to a contractor who has been misled.

I am not sure that this approach to exclusions is a major concern for trustees. So long as they are entitled to be indemnified in relation to their liability for misleading or deceptive conduct they should have no residual personal liability. On the other hand, if the extent of a trustee indemnity in favour of a contractor is not limited to the trust assets, there is a potential shortfall.

Given that liability for misleading or deceptive conduct cannot be excluded, there may be good reasons — depending of course on the nature of the trust — to have compliance procedures in place to ensure that no misleading or deceptive conduct occurs.

*(c) Back-to-back arrangements*

It is easy to say that the trustee should ensure that its liability to a contractor is more or less back-to-back with the indemnity. It is (I assume) more difficult in practice to obtain a contractor's agreement to that position.

From a contractor's perspective, insisting on a back-to-back arrangement suffers from a major weakness. This weakness is that if for some reason the trustee loses the benefit of the indemnity, the contractor will cease to have a claim against the trustee. In one situation at least this could not occur. If the trustee is fraudulent in its dealings with the contractor, but the contractor is innocent, the trustee will remain personally liable to the contractor even if the

44 Because the concern is with whether any exclusions which operate for the benefit of the trustee are valid, we may ignore statutory restrictions on the use of exclusions in the context of the supply of goods or services.

contract purports to limit the trustee's liability to losses for which it is entitled to be indemnified out of the trust. This is because the law does not permit the trustee to exclude its liability for common law deceit.[45]

A breach of trust is, however, a different matter entirely. If the trustee's indemnity from the trust ceases to apply if a breach of trust is committed, the contractor will have a major concern with any clause in the contract which makes the liability of the trustee to the contractor contingent on the trustee being entitled to claim on the indemnity. Now, of course, a trustee might well be prepared to agree that the back-to-back limitation does not apply if there is a breach of trust. However, a decision to agree to that must be a considered decision. A breach of trust may occur in a wide variety of circumstances. It is not at all uncommon (I understand) for trustees regularly to commit breaches of trust, for example, because the trust deed has got out of date and is not a totally accurate reflection of what the trustee does for the *benefit* of the beneficiaries. Because such breaches, although intentional, are for the benefit of the beneficiaries, the trustee is not at risk vis a vis the beneficiaries. However, it may well be exposed — personally — to the third party unless the right of indemnity applies to a breach of trust.

Although I appreciate that there may be commercial difficulties for a trustee in doing so, the only way out of these problems is for the trustee to insist on back-to-back arrangements with a limited carve out. One element of that limited carve out might be for actual fraud. Although, as explained above, this would be implied at common law, there may be a good reason for replicating the common law position. Because of the potential liability of a trustee for *equitable* fraud, to have no carve out for fraud might imply that the trustee remains liable to the contractor if it is unable to claim on its indemnity due to equitable fraud. A simple carve out for 'fraud' would on the same basis be ambiguous. A reference to actual fraud (common law deceit) should make the position clear.[46]

This is, I understand, a context in which the concept of 'gross negligence' is sometimes used. Although in the contract world little is heard of the concept, it is a familiar concept in the trustee context[47] and it may give additional comfort for the contractor if the back-to-back limitation is subject to a carve out which includes gross negligence. Of course, it goes without

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45 See *S Pearson & Son Ltd v Dublin Corp* [1907] AC 351.

46 Cf *Armitage v Nurse* [1998] Ch 241.

47 Cf *Armitage v Nurse* [1998] Ch 241.

saying that a contractor who agrees that the trustee's liability is limited by the trustee's indemnity will want to examine the terms of that indemnity.

Finally, I should return briefly to restitution. It may be unclear whether a trustee who is required to make restitution of a benefit — such as a payment made under mistake — is entitled to claim on its indemnity. If that is the case, and the trustee has not succeeded in having back-to-back arrangements, there may be a gap for the trustee to fill from its own assets. Accordingly, any exclusion clause in the contract with the contractor should make it clear that it applies to claims in restitution. The courts have shown a tendency to read general exclusions as inapplicable to claims in restitution.[48]

## 5. Conclusion

I think that the appropriate conclusion for this paper is a restatement of the factors which a trustee should take into account when negotiating a contract with a contractor.

First, the overall objective is to ensure that so far as possible any personal liability of the trustee to a contractor is matched by an ability to have recourse to its right of indemnity from the trust assets.

Second, particular attention must be given to the most likely sources of liability. As mentioned, exclusion of liability for consequential loss may be problematic. Therefore, if the trustee considers that it has a real potential for exposure above and beyond the contract price, a simpler approach is to limit its liability to a cap, namely, the trust assets.

Third, the form of drafting should reflect the objectives of the clauses. Generally, exclusion clauses are more useful than disclaimers.

Fourth, the relationship between objectives and what can legally be achieved in drafting must be considered. Because liability for misleading or deceptive conduct cannot be excluded, in practice a trustee must take steps to prevent such conduct occurring.

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48 See *Iezzi Constructions Pty Ltd v Watkins Pacific (Qld) Pty Ltd* [1995] 2 Qd R 350.

Finally, because of the need to ensure that its liability to a contractor is more or less back-to-back with the indemnity, the trustee must be astute in identifying situations where it will not be covered by the indemnity. Given that restitution is a fairly recent development, it may be important for a trustee to confirm that the indemnity is expressed in terms which make it applicable to a restitutionary liability. **1. Introduction**

*(a) Context*

My concern in this paper is with the legal rules which must be taken into account in the negotiation of contracts between trustees and third parties in connection with the trust. Those contracts vary considerably — they range from humble contracts for the acquisition of office supplies to important (and often complex) investment contracts, service contracts, loan contracts and so on. Of course, the humble contracts do not call for comment: the concern is with contracts the terms of which would normally be formally documented. Generally, my analysis is from the trustee's perspective.

Uppermost in the mind of any trustee who negotiates a contract will be the benefit of the indemnity which the trustee enjoys in relation to its duties and functions as trustee. Although the terms and scope of that indemnity are not matters of concern, in the sense that I do not intend to discuss how the indemnity provisions of the trust instrument should be drafted, it is self-evident that the trustee must always be conscious of the need to ensure, whenever possible, that the liability of the trustee vis a vis the third party is more or less back-to-back with the indemnity.

The importance of this topic cannot be doubted. It is important not only for trustees but also for those who advise trustees. After all, it will be recalled that in *Astley v Austrust Ltd*[49] a firm of solicitors which gave advice to the trustee of a trading trust in connection with its liability as trustee was held to be negligent because it failed to advise the trustee that it would be personally liable in dealings with third parties unless it took steps to control its liability. When the trust failed, the trustee became personally liable for losses that exceeded the value of the trust property. The trustee should have limited its liability to the extent of the trust assets.

*(b) Issues*

There are two principal issues. The first relates to the bases for trustee liability. The second concerns the regulation of that liability by contract.

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49 (1999) 197 CLR 1; 161 ALR 155.

As we shall see, the bases upon which a trustee may be held liable to contractors in connection with trustee contracts are many and various. Indeed, potentially, the trustee is liable in the same way as any other contracting party. Moreover, its potential liability it is not limited to contractual liability. Thus, even though (almost invariably) the trustee's principal contractual obligation will be to pay money, this does not mean that the sole concern of a trustee is with its potential liability in debt. It must also have in mind liability to pay damages in contract, in tort or under statute.

Nevertheless, the fact that the trustee's principal contractual obligation is to pay money does impact on the contractual regulation of liability. Because the trustee is not a supplier of goods or services to the third party, it will enjoy far greater freedom of contract, particularly in relation to exclusion clauses, than the third party with whom it deals. However, as we will see, a trustee does not enjoy complete freedom of contract.

*(c) Nature and Extent of Liability*

The liability of a trustee is almost invariably a personal liability.[50] Accordingly, unless the contract provides to the contrary, it is not limited by the assets of the trust which the trustee administers.

As a contracting party, the extent of a trustee's liability depends primarily on the contract. Since the meaning and effect of a contract are matters of construction, the extent of a trustee's liability will generally be determined by interpretation. Of course, that underlines the importance of contract drafting to the ultimate liability of the trustee. It is clear beyond doubt that a trustee is entitled to limit its liability to contractors by reference to the trust assets.[51] This will usually be achieved by reference to the trustee's right of indemnity.

Given that we are focusing on contract liability, the contract rules regulating liability are very important. These are well established. The primary obligation of the trustee under most contracts will be to pay money. An obligation to pay money is a strict obligation. It is no use the trustee claiming that it has not been negligent: if it fails to pay, it is liable in contract. Of course, a trustee may be subject to other obligations. Whether these attract a strict duty or one requiring the exercise of care or diligence will depend on the construction of the contract.

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50 The trustee may be authorised by the trust deed to create secured interests, by way of mortgage or charge, over trust assets.

51 For a fairly recent reminder see *Helvetic Investment Corp Pty Ltd v Knight* (1984) 9 ACLR 773 (CA, NSW).

Because a breach of contract is actionable per se, the mere fact of breach will expose the trustee to a liability. However, the extent of liability will ultimately be determined by specific rules and requirements, principally causation and remoteness. The contract rule in relation to the latter is, of course, the rule in *Hadley v Baxendale*:[52]

> Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, ie, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

Under the first limb of the rule, unless the parties have agreed otherwise, a defendant is responsible for 'natural' losses, of which the parties are presumed to be aware. Under the second limb, unless the parties have agreed otherwise, a defendant is responsible for losses in the contemplation of *both* parties, in the sense that they relate to circumstances of which the parties were actually aware. I deal later[53] with the implications of the rule for contract drafting. For the moment it is sufficient to make one point.

The assessment of damages may be affected by whether the contract has been terminated for breach or repudiation. If the trustee commits a material breach which leads to termination of the contract, the trustee will become liable to pay 'loss of bargain' damages. Such damages are damages assessed by reference to the difference between the market value of the contract or its subject matter at the time of breach and the price (or monetary equivalent) expressed in the contract. Accordingly, the prima facie liability of a trustee is the difference between what it agreed to pay the third party and what the third party can reasonably obtain for its services under a replacement contract. In *Shevill v Builders Licensing Board*[54] the High Court treated recovery of loss of bargain damages as an instance of recovery of consequential loss. However, it is clear that loss of bargain damages are recovered under the first limb of the rule. This illustrates that, for the purposes of damages rules, the distinction between direct loss and consequential loss is not the same as the contract drawn in the two limbs of the rule in *Hadley v Baxendale*.

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52 (1854) 9 Ex 341 at 354; 156 ER 145 at 151 per Alderson B.

53 See below, text at n 38ff.

54 (1982) 149 CLR 620; 42 ALR 305.

Of course, the extent of a trustee's personal liability is not determined solely by the law of contract. Liability in tort or under statute may be important, particularly the latter. The fact that the trustee's liability is not generally a proprietary liability also has an important consequence which is I think easily overlooked. If a trustee becomes subject to a personal liability to make restitution in relation to money or property received is its capacity as trustee, the fact that the trustee's liability is not generally a proprietary liability means that the trustee remains liable even if the money or property is no longer in its possession.[55]

## 2. Bases for Liability

### *(a) Introduction*

The question of liability is not a static one: it depends on the dynamics of contract negotiation and performance. It is nevertheless true to say that since the principal obligation of the trustee vis a vis third parties with whom it contracts will usually be to pay the fees which the trustee has agreed to pay, the contract price itself limits the trustee's debt exposure.

Of course, a claim for contract damages may in particular circumstances exceed the contract price. But it is primarily because the liability world includes tort, restitution and statute that the contract price cannot be treated as a limit on all liability. Assessment of damages in tort does not generally rely on the contract price as a basis for quantification and some claims for restitution may exceed the contract sum. However, the contract may expressly provide that the trustee's liability in contract, tort or restitution is to be limited by the contract sum. But that technique may not be available in relation to liability under statute.

### *(b) Contract*

As I have explained, debt is the most obvious basis for trustee liability to contractors. It is, moreover, a liability which in practice cannot be limited by exclusions. That is not itself a concern, although no doubt many trustees have looked back on contracts and wished they had negotiated a lower price!

If the trustee fails to pay money due to the other party to the contract, it will also be liable in damages. However, in most cases any additional liability will be limited to interest, payable at common law or under statute. Of course, a third party may attempt to establish that the trustee has a greater liability, by relying on breaches of other obligations or by alleging that the trustee's failure to pay has caused additional losses. Although in either case the matter is

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55 See further below, text at n 22ff.

governed by causation and the rule in *Hadley v Baxendale*, it is important to bear in mind that the common law has had great difficulty with damages claims based on the late payment of money. The original rule — that damages cannot be claimed for the late payment of money — was relaxed somewhat by the High Court in *Hungerfords v Walker*[56] when, not following English authority, the court held that interest may be recoverable under the first limb.[57] But if a contractor claims that the failure of the trustee to pay on time means that the trustee is liable for the loss of a particularly lucrative investment opportunity, the second limb will govern any claim. Therefore, even if there is no contractual exclusion of 'special' damages, the contractor will go away empty handed unless it (at least) communicated the potential loss prior to contract.[58]

It follows that in most cases it is not at all difficult for a trustee to work out its most likely exposure in contract. Unless the contract is terminated, it is limited to payment of interest for the late payment of money. And even if the contract is terminated for serious breach by the trustee, the maximum potential exposure is generally the present value of the sum which the trustee agreed to pay the contractor over the life of the contract. There may perhaps be situations in which damages for consequential loss might be recovered, either under the first limb or the second limb of the rule in *Hadley v Baxendale*. However, that could only ever be determined on a case by case basis.

It is appropriate here to say something about one drafting device commonly found in commercial contracts, including contracts with trustees. Instead of leaving quantum to be determined according to the common law rules regulating damages, parties now regularly stipulate for indemnities.[59] This is a disquieting tendency. If party A gives party B an indemnity in relation to a particular event, A is regarded as having breached the contract if the event occurs. A is then liable for all loss or damage suffered by B. Moreover, if it is a true indemnity, A's liability is not limited by the rule in *Hadley v Baxendale*. I can well understand trustees being desirous of receiving the benefit of indemnities, but it is difficult to see why they should ever undertake the burden of such a provision. In effect, it removes the protection (limitation) which the contract price effectively provides in relation to most claims brought in contract.

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56 (1989) 171 CLR 125; 84 ALR 119.

57 Conversely, the High Court approved the view, expressed in *President of India v Lips Maritime Corp* [1988] AC 395 at 425, that the common law does not recognise a claim for the late payment of *damages*.

58 Cf *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528.

59 See further below, text at n 43.

*(c) Tort*

Generally, although not exclusively, the liability of a contractor to a trustee will depend on proof of negligence.[60] On the other hand, because an obligation to pay money is a strict obligation, and a failure to pay does not amount to the commission of a tort, it is not necessary to say much about the potential liability of a trustee in tort.

Duties of care may also arise in the negotiation of contracts, although this seems to me remote except in situations where the *Hedley Byrne* principle might apply. Thus, it is possible to conceive of the trustee coming under a duty of care in relation to information provided to the third party, for example, in relation to the characteristics of the trust.[61] Even so, the first thought of anyone who seeks a remedy for misinformation provided during the negotiation of a contract is to rely on breach of the statutory prohibition on misleading or deceptive conduct.[62]

In the ordinary course of things, trustee fraud in relation to third party contracts does not enter the liability picture.[63] The tort is committed in relation to a pre-contract representation in three cases:

- actual dishonesty;
- an absence of belief in the truth of the representation; and
- reckless indifference as to whether the representation was true or false.

Although fraud is difficult to prove, it did at one time at least have the appeal of a more generous approach to damages. However, given the interpretation of the compensation provisions applicable to misleading or deceptive conduct,[64] that advantage has gone.

*(d) Restitution*

It is natural, when considering the potential liability of a trustee, to think in terms of wrongdoing, and to concentrate on a failure to perform the contract. However, in some situations it will be more important to consider liability which is independent of fault. It is because liability in restitution is independent of fault it tends to be neglected.

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60 See generally J W Carter, 'Contractual Issues for Trustees' (2001) 17 *JCL* 274.

61 Cf *Esso Petroleum Co Ltd v Mardon* [1976] QB 801.

62 See below, text at n 27.

63 Of course, in this context we are referring to the common law tort of deceit rather the concept of equitable fraud which a trustee may commit vis a vis the beneficiaries.

64 See below, text at n 27

An obligation to make restitution arises if the requirements of unjust enrichment are satisfied. There are four elements:

(1) receipt of a benefit by the trustee;

(2) the benefit received by the trustee was obtained at the expense of the plaintiff;

(3) it would be unjust for the trustee not to make restitution; and

(4) the trustee does not have any defence to the claim.

This is not the occasion to consider these elements in detail.[65] For the purpose of considering the potential liability of a trustee it is sufficient to make the following points.

First, in the contract context, there is generally no obligation to make restitution in relation to a benefit unless the contract is an ineffective contract, that is, was inherently invalid or has been terminated or rescinded. Thus, benefits conferred under a valid contract are not usually an appropriate focus for a claim in restitution unless the contract has been rescinded or terminated, for example, for breach on the trustee's part.

Second, although the concept of benefit is a technical one, money is always a benefit. Accordingly, there is an inherent potential for a trustee to become liable in restitution whenever money is received. However, in relation to money paid pursuant to contract, no issue of restitution arises unless:

- there is an overpayment to the trustee; or
- the contract being an ineffective contract, the payment was the subject of an agreed return (counter-performance obligation) which the trustee has not rendered.

Third, although goods, land or services may count as non-monetary benefits for the purposes of restitution, no issue of restitution arises unless the contract was ineffective and the benefit has been accepted. In practical terms this means that the trustee will not become liable to make restitution for the receipt of a non-monetary benefit unless:[66]

- the contract was void or unenforceable; or
- the contract was discharged for the trustee's breach.

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65 See Keith Mason and J W Carter, *Restitution Law in Australia*, Butterworths, Sydney, 1995, Chapter 2.

66 The summary relates to the common law. Restitutionary obligations may also arise under statute (see eg *Frustrated Contracts Act* 1978 (NSW)) and the principle of restitutio in integrum governs rescinded contracts.

Thus, if the trustee commits a serious breach, for example, by repudiating the contract, the third party will be entitled to terminate the contract and seek restitution in relation to all benefits conferred prior to termination for which no contractual right of payment was earned.[67]

Fourth, the concept of 'injustice' is a principled one. In other words, the requirement of injustice posits the existence of a *recognised* basis for ordering restitution. There are, indeed, a limited number of bases for restitution. Most relevant to a trustee's position are mistake and acceptance of benefit. Indeed, the general principle is simply that if a third party (even one with whom the trustee has a contract) by mistake pays the trustee a sum of money which it was not obliged to pay, the third party is prima facie entitled to restitution equal to the payment plus interest.

Fifth, just as the concept of injustice is a principled one, the idea of a restitutionary defence posits the existence of a *recognised* defence to the claim for restitution. Although general defences such as election between remedies and illegality may operate in the context of restitution, the only genuine restitutionary defence is 'change of position'. This is the idea that if a payment is caused by mistake, but the payee honestly believed that he or she was entitled to receive it, the fact that the payee has incurred expenditure which would not otherwise have been incurred will provide a good defence to a restitutionary claim in relation to the payment. The defence operates pro tanto, that is, to the extent of the expenditure incurred in reliance on the payment.

Sixth an order for restitution requires the payment of a sum of money equal to the value of the benefit, rather than specific restitution. This is obvious in the case of money. However, in relation to non-monetary benefits the impact is that the plaintiff is entitled to a quantum meruit, that is, 'reasonable remuneration'. Assessment of the quantum meruit depends on the circumstances, including the basis for restitution. One aspect of this is significant. Assume that a trustee materially breaches a contract with a service provider who validly terminates the contract at a time when a substantial amount of work was done for which the service provider had no contractual right of payment. Clearly, as has been explained, the trustee is liable to pay loss of bargain damages, which will be limited by the contract sum. However, the service provider may alternatively seek reasonable remuneration in a claim for restitution. The authorities are clear that in such a situation the contract price is not a ceiling on the liability of

67 See also below, text at n 48.

the trustee.[68] Therefore, if the service provider made a bad bargain, or market prices increased between the time of the contract and the time when work was done, the liability of the trustee may exceed the contract price.[69]

Of course, a major function of many trustees is to get in money or property for the benefit of the beneficiaries. Although it is important for a trustee to have in place procedures designed to ensure that it only receives for the benefit of the beneficiaries money and property to which they are entitled, mistakes sometimes occur. Thus, an employer may pay more than it is obliged to pay to the trustee of a superannuation fund, a debtor may repay more than it is obliged to repay, or a third party with whom the trustee has contracted may remit more than the value of an investment asset which the third party has realised on the instructions of the trustee.

It might be thought that so long as the trustee has acted honestly when crediting the beneficiaries with money received, it will be protected if the payment is the result of a third party's mistake. However, that is not always true. Because the liability to make restitution in relation to a mistaken payment is a strict personal liability, the trustee remains liable even though it no longer has the money. Therefore, the mere fact that the trustee has credited the beneficiaries is not in itself a defence.[70]

Before the High Court fully recognised the change of position defence in *David Securities Pty Ltd v Commonwealth Bank of Australia*,[71] a special defence — the agency defence — was often applied to banks and other intermediaries who, although acting for others, are not strictly speaking agents in their dealings with the money received.[72] Thus, in *Restitution Law in Australia*[73] it is explained:

> a bank or other payee which receives a mistaken payment of money on account of a customer will itself avoid liability where it allows a customer to draw on the funds standing to the credit of an account,

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68 See, eg *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234.

69 Or perhaps more accurately what would be the proportion of the contract price attributable (on a pro rata basis) to the work done if the contract were severable.

70 In any event, the crediting may amount to no more than an accounting process.

71 (1992) 175 CLR 353; 109 ALR 57.

72 See *Australia and New Zealand Banking Group Ltd v Westpac Banking Corp* (1988) 164 CLR 662; 78 ALR 157.

73 Keith Mason and J W Carter, *Restitution Law in Australia*, Butterworths, Sydney, 1995, para 434.

unless the bank would have allowed funds to be drawn regardless of the receipt.

However, it is also explained[74] that 'this "agency defence" is only available when the money is received as an intermediary'. Although a trustee is in a colloquial sense an 'intermediary' it is not an agent and it does not receive money as a mere intermediary in the sense of being a conduit to the beneficiaries. The conclusion reached is therefore that the agency defence 'is not available to a trustee who accounts to the beneficiary with moneys initially paid under mistake'. This is a most disturbing conclusion for trustees. It is by no means clear that the recognition of the change of position defence makes any difference.

*(e) Statute*

The statutory prohibition on misleading or deceptive conduct affects all contracting parties — trustees are not immune unless they operate outside trade and commerce. Although, generally speaking, only an incorporated trustee can be held liable under the *Trade Practices Act* 1974 (Cth),[75] the fact that there are corresponding provisions in the State and Territory fair trading legislation means that all trustees who engage in conduct in trade or commerce have to take the prohibition into account.[76] Again, although the TPA may not apply to misleading or deceptive conduct in relation to financial services, financial products or securities, parallel provisions in other legislation impose the same prohibition.[77]

Although it is difficult to summarise accurately and succinctly the effect of the statutory prohibition, the following points may be made.[78]

First, notwithstanding that s 52 is in a sense part of a regime having 'consumer protection' as its object, conduct may be misleading or deceptive even though no consumer is misled or deceived, or likely to be misled or deceived. What matters is whether the trustee misled the contractor.

Second, the effect of the prohibition is to create a norm of conduct in relation to conduct in trade or commerce. This has been interpreted as a strict liability regime. Therefore,

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74 Citing *King v Stewart* (1892) 66 LT 339.

75 Hereafter 'TPA'.

76 In some situations other prohibitions may be relevant.

77 See *Australian Securities and Investments Commission Act* 2001, s 12DA(1) (financial services); *Corporations Act* 2001 (Cth), s 995 (securities).

78 For an overview see David Harland, 'Misleading or Deceptive Conduct: the Breadth and Limitations of the Prohibition' (1991) 4 *JCL* 107.

the prohibition may be breached by a trustee even if it has no intention to mislead or deceive. Quite simply, any misrepresentation which would at common law be regarded as purely innocent is misleading or deceptive conduct for which damages may be awarded to the contractor if it relied on the conduct to its detriment.

Third, an extremely important feature of the legislation is an extensive remedial regime. There are three principal tiers to that regime:

(1) a statutory jurisdiction to award damages for contravention;

(2) a discretionary jurisdiction to make 'other' orders; and

(2) jurisdiction to grant an injunction.

Fourth, although the main field of operation of the prohibition in the contract context[79] is in relation to pre-contractual representations, it can also apply to conduct in the course of contract performance. For example, a breach of contract may in some cases amount to misleading or deceptive conduct. Thus, it would appear that where a trustee breaches a contractual warranty this may also amount to misleading or deceptive conduct.[80]

Fifth, although the legislation does not in terms prohibit contracting out, the courts (in their wisdom) have seen the prohibition on misleading or deceptive conduct as having a purpose analogous to the common law prohibition on fraud. Therefore, courts generally refuse to enforce exclusionary provisions which purport to exclude or limit liability for misleading or deceptive conduct.

Sixth, where damages are sought for breach of the prohibition, the guiding principles tend to reflect the rules in relation to fraud rather than breach of contract or negligence. Therefore, although the basic question is how much worse off the plaintiff is by reason of the conduct, remoteness of damage does not appear to be a limitation on damages assessment.

## 3. Regulation of Liability

*(a) General*

A contract is a planned transaction and in the present context it is reasonable to expect the trustee to have input on the terms of the contract. However, the extent to which the trustee is

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79 See generally on the impact of the prohibition on contract David Harland, 'The Statutory Prohibition on Misleading or Deceptive Conduct in Australia and its Impact on the Law of Contract' (1995) 111 *LQR* 100.

80 See Diane Skapinker and J W Carter, 'Breach of Contract and Misleading or Deceptive Conduct in Australia' (1997) 113 *LQR* 294.

able to insist on a particular regime regulating liability will depend on the trustee's bargaining position. Assuming, for the purposes of analysis, that the trustee is able to insist on its preferred regime, what factors should be taken into account?[81]

First, the overall objective is to ensure that so far as possible any personal liability of the trustee is matched by an ability to have recourse to its right of indemnity from trust assets. Of course, the right of indemnity is of no value if the trust has no assets, and from that perspective matching liability to the *right* of indemnity may lead to a shortfall. Accordingly, the trust assets should be a cap on total liability.

Second, consideration should be given to the likely sources of liability in order to ensure that all the most likely bases are covered. As mentioned, restitutionary liability may be important.

Third, the form of drafting should reflect the objectives of the clauses. As explained below, most devices fit into particular 'pigeon holes' and should be used appropriately.

Fourth, the relationship between objectives and what can legally be achieved in drafting must be considered in order to ensure that compliance regimes are in place to deal with situations in which the law does not permit the trustee to limit its liability.

A very large number of liability regulation devices are in common use. The discussion below deals with all major types other than entire agreement and force majeure clauses, which have limited utility in the present context.

*(b) Disclaimer*

A disclaimer is a statement or contractual provision the objective of which is to negate responsibility for a particular matter. The (proper) objective is to prevent liability arising, rather than to remove responsibility for an accrued liability.

It is doubtful whether disclaimers are needed in most trustee contracts, but they may be useful in negativing any common law duty in relation to matters discussed during negotiations. The most appropriate use of a disclaimer is therefore to negate a duty of care which might otherwise arise. Although it is common to find disclaimers in contracts, they are effective even if there is no contract. Thus, in *Hedley Byrne & Co Ltd v Heller & Partners Ltd*[82]

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81 For potential gaps see below, text at n 44ff.

82 [1964] AC 465.

the House of Lords treated a disclaimer as effective to negative the existence of a duty of care in relation to information provided independently of contract.

*(c) Exclusion*

An exclusion clause may have either of two functions. Thus, it may seek to define a trustee's primary contractual responsibilities or seek to exclude, limit or qualify the impact of a legal rule in relation to liability.

To understand the contrast consider a contractor who does not wish to be responsible unless it is negligent. The clause defines liability if it says that the contractor's only responsibility is to exercise care. It excludes liability if it provides that the contractor is not to be liable unless it is proved to have been negligent. As that illustration shows, the difference may simply be a matter of drafting. Given that we are concentrating on a trustee's position, the question whether there are any substantive differences between the two approaches may be ignored.

The general principle applicable to exclusion clauses was stated as follows by the High Court in *Darlington Futures Ltd v Delco Australia Pty Ltd*:[83]

> [T]he interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in the light of the contract as a whole, thereby giving due weight to the context in which the clause appears including the nature and object of the contract, and, where appropriate, construing the clause contra proferentem in case of ambiguity.

As the High Court made clear, the approach is the same no matter whether the clause provides for a total exclusion of liability or places a limitation on liability. Accordingly, limitations are to be treated in the same way as exclusions.

Although the operation of exclusion clauses is generally well understood and appreciated by commercial people, there is one area which remains contentious. This is the exclusion of liability for 'consequential loss'. Although it is common for trustees and contractors to seek to exclude liability for consequential loss, the Australian cases do not provide any real guidance on what this achieves. It is clear that the phrase is intended to relate to categories of loss, and if we were to look solely at the damages cases we would find that the concept of

83 (1986) 161 CLR 500 at 510; 68 ALR 385 per the Full High Court.

'consequential loss' does not play a major role.[84] In contract, the key question is whether a particular loss is too remote, not whether it is consequential.[85] Similarly, although we commonly see clauses which purport to exclude liability for 'loss of profit', the contract damages cases generally concentrate on difference in value (as on a breach of warranty) or loss of revenue (loss of bargain damages) rather than loss of profit. And when profit enters the picture it is often notional or assumed — as in sale of goods cases where a seller recovers the difference between the contract price and the market price in an action for non-acceptance.

A rather different approach is to be found in English cases interpreting exclusion clauses.[86] It now seems clearly established[87] that, other things being equal, an exclusion of 'consequential loss' will be treated as applying to a loss which would otherwise be recoverable under the second limb of the rule in *Hadley v Baxendale*. This really is a very narrow category. The first limb sets out the common law default rule whereas the second limb is concerned with losses which are unusual in the sense that they were within the contemplation of the party in breach because they were brought to its attention prior to the contract. A good illustration is *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd.*[88] The plaintiffs, who carried on business as launderers and dyers, purchased a boiler of considerable capacity from the defendants for the purpose of expanding their operations. The plaintiffs sent a lorry to take delivery but found that the boiler had been damaged. They therefore refused to take delivery until repairs had been carried out and this caused a delay of some five months. The issue before the English Court of Appeal was whether, in addition to a sum of £110 awarded by the trial judge, the plaintiffs were entitled to claim in respect of the business profits which they would have made had the boiler been delivered punctually. The plaintiffs said a very large number of new customers could have been served and that a number of highly lucrative dyeing

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84 Cf M A Eisenberg, 'The Emergence of Dynamic Contract Law' (2000) 88 *California Law Review* 1743.

85 See *Alfred McAlpine Construction Ltd v Panatown Ltd* [2000] 3 WLR 946 at 959 per Lord Clyde (contrast between 'consequential losses' and losses falling within the second limb). But cf *Joseph & Co Pty Ltd v Harvest Grain Co Pty Ltd* (1996) 39 NSWLR 722 at 728, 735 per Moore DCJ.

86 See generally J W Carter, 'Contractual Issues for Trustees' (2001) 17 *JCL* 274.

87 See *British Sugar Plc v NEI Power Projects Ltd* (1997) 87 BLR 45; *Deepak Fertilisers and Petrochemicals Corp v ICI Chemicals & Polymers Ltd* [1999] 1 Lloyd's Rep 387 at 402-3; *BHP Petroleum Ltd v British Steel Plc* [1999] 2 Lloyd's Rep 583 at 598 (affirmed without reference to the point [2000] 2 Lloyd's Rep 277); *Hotel Services Ltd v Hilton International Hotels Ltd* [2000] BLR 235. See also *Frank Davies Pty Ltd v Container Haulage Group Pty Ltd* (1989) 98 FLR 289 at 313.

88 [1949] 2 KB 528.

contracts for the Ministry of Supply would have been available to them. The court held that the judge was wrong not to award some 'general (and perhaps conjectural) sum for loss of business in respect of dyeing contracts to be reasonably expected';[89] but it rejected the claim to recover specifically the profit on contracts with the Ministry for the reason that the defendants had no knowledge of that business.

The approach of the exclusion clause cases produces results which may surprise most commercial people. Assume that A supplies a defective machine to B for $5,000. The defect in the machine is such that it is liable to explode when used for more than an hour at a time. Assume then that B uses the machine for more than an hour and that the explosion causes a fire which razes A's $5m factory to the ground. A's claim for damages equal to the value of the factory (or the cost of its rebuilding) would not be affected by an exclusion of 'consequential loss', because the claim will be made under the first limb of the rule in *Hadley v Baxendale.*[90] Of course, a trustee can take comfort from this because it is more likely to be concerned with exclusion clauses which protect contractors from consequential loss than to exclude its own responsibility for consequential loss.

*(d) Indemnity*

Indemnities have variety of objectives. Traditionally, the most common indemnity is against third party claims. Such clauses do not raise any issue of principle. However, a trustee should always try to obtain such an indemnity and at the same time resist giving it!

The type of indemnity which is becoming increasingly common is the party-party indemnity which requires one party to indemnify the other in relation to various events including the indemnifier's breach of contract.[91] In essence, the effect of such a provision is to replace the common law rules on damages with an indemnity obligation. At least that is the assumption. However, such clauses are also associated with exclusions which are commonly drafted in terms of damages liability, such as an exclusion of consequential loss. This may in particular cases suggest that they are not really indemnities at all, but simply agreements on how contract damages should be assessed.

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89 [1949] 2 KB 528 at 543 per Asquith LJ.

90 Cf *BHP Petroleum Ltd v British Steel Plc* [1999] 2 Lloyd's Rep 583 (affirmed [2000] 2 Lloyd's Rep 277).

91 Another type of indemnity is simply an exclusion clause in disguise. This is a provision which states that party A will indemnify party B against any loss arising from a breach of contract or negligence by *party B*. Such indemnities do not appear common today.

If the clause is intended to be a genuine indemnity, it is difficult to understand an exclusion of consequential loss. This is because the objective of an indemnity is to ensure that the indemnifier is responsible for all losses, whether consequential or not. Although clauses of this type do not regularly come before the courts, it would appear that remoteness of damage is not relevant to recovery on an indemnity. Rather, the concern is simply with loss or damage caused by a breach of the indemnity.

If a trustee gives an indemnity of this type, it should attempt to ensure that the indemnity reflects its own indemnity under the trust instrument. This may be difficult because there is no a priori reason why the liability of a trustee to a contractor should match exactly its ability to claim on its own indemnity. That leads to the question whether a trustee is likely to face gaps in its risk management.

## 4. Risk Management Gaps

### *(a) Introduction*

In this section I discuss briefly two potential sources of gaps in the trustee's risk management strategy. One is an impact of the discussion above of exclusion clauses. The other relates to the problems inherent in trying to ensure that the liability of a trustee vis a vis a contractor is more or less back-to-back with the indemnity.

### *(b) Impact of statute*

The only area of statute which needs to be discussed from the contract perspective is the validity of exclusion clauses.[92]

As I noted earlier, the courts in their wisdom have treated liability for breach of s 52 of the TPA as sacrosanct. One way that effect has been given to that wisdom is to treat exclusions as invalid if they seek to qualify liability for breach of s 52. Therefore, an exclusion or limitation of liability which would as a matter of construction be applicable to liability for misleading or deceptive conduct will be treated as ineffective. The same is generally true of disclaimers. However, if a disclaimer is brought to the contractor's attention before contract negotiation commences the clause may be effective if it prevents the other party being misled. On the other hand, there appears to be no form of exclusion clause which can be used to limit liability to a contractor who has been misled.

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92 Because the concern is with whether any exclusions which operate for the benefit of the trustee are valid, we may ignore statutory restrictions on the use of exclusions in the context of the supply of goods or services.

I am not sure that this approach to exclusions is a major concern for trustees. So long as they are entitled to be indemnified in relation to their liability for misleading or deceptive conduct they should have no residual personal liability. On the other hand, if the extent of a trustee indemnity in favour of a contractor is not limited to the trust assets, there is a potential shortfall.

Given that liability for misleading or deceptive conduct cannot be excluded, there may be good reasons — depending of course on the nature of the trust — to have compliance procedures in place to ensure that no misleading or deceptive conduct occurs.

*(c) Back-to-back arrangements*

It is easy to say that the trustee should ensure that its liability to a contractor is more or less back-to-back with the indemnity. It is (I assume) more difficult in practice to obtain a contractor's agreement to that position.

From a contractor's perspective, insisting on a back-to-back arrangement suffers from a major weakness. This weakness is that if for some reason the trustee loses the benefit of the indemnity, the contractor will cease to have a claim against the trustee. In one situation at least this could not occur. If the trustee is fraudulent in its dealings with the contractor, but the contractor is innocent, the trustee will remain personally liable to the contractor even if the contract purports to limit the trustee's liability to losses for which it is entitled to be indemnified out of the trust. This is because the law does not permit the trustee to exclude its liability for common law deceit.[93]

A breach of trust is, however, a different matter entirely. If the trustee's indemnity from the trust ceases to apply if a breach of trust is committed, the contractor will have a major concern with any clause in the contract which makes the liability of the trustee to the contractor contingent on the trustee being entitled to claim on the indemnity. Now, of course, a trustee might well be prepared to agree that the back-to-back limitation does not apply if there is a breach of trust. However, a decision to agree to that must be a considered decision. A breach of trust may occur in a wide variety of circumstances. It is not at all uncommon (I understand) for trustees regularly to commit breaches of trust, for example, because the trust deed has got out of date and is not a totally accurate reflection of what the trustee does for the *benefit* of the beneficiaries. Because such breaches, although intentional, are for the benefit of the

93 See *S Pearson & Son Ltd v Dublin Corp* [1907] AC 351.

beneficiaries, the trustee is not at risk vis a vis the beneficiaries. However, it may well be exposed — personally — to the third party unless the right of indemnity applies to a breach of trust.

Although I appreciate that there may be commercial difficulties for a trustee in doing so, the only way out of these problems is for the trustee to insist on back-to-back arrangements with a limited carve out. One element of that limited carve out might be for actual fraud. Although, as explained above, this would be implied at common law, there may be a good reason for replicating the common law position. Because of the potential liability of a trustee for *equitable* fraud, to have no carve out for fraud might imply that the trustee remains liable to the contractor if it is unable to claim on its indemnity due to equitable fraud. A simple carve out for 'fraud' would on the same basis be ambiguous. A reference to actual fraud (common law deceit) should make the position clear.[94]

This is, I understand, a context in which the concept of 'gross negligence' is sometimes used. Although in the contract world little is heard of the concept, it is a familiar concept in the trustee context[95] and it may give additional comfort for the contractor if the back-to-back limitation is subject to a carve out which includes gross negligence. Of course, it goes without saying that a contractor who agrees that the trustee's liability is limited by the trustee's indemnity will want to examine the terms of that indemnity.

Finally, I should return briefly to restitution. It may be unclear whether a trustee who is required to make restitution of a benefit — such as a payment made under mistake — is entitled to claim on its indemnity. If that is the case, and the trustee has not succeeded in having back-to-back arrangements, there may be a gap for the trustee to fill from its own assets. Accordingly, any exclusion clause in the contract with the contractor should make it clear that it applies to claims in restitution. The courts have shown a tendency to read general exclusions as inapplicable to claims in restitution.[96]

## 5. Conclusion

I think that the appropriate conclusion for this paper is a restatement of the factors which a trustee should take into account when negotiating a contract with a contractor.

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94 Cf *Armitage v Nurse* [1998] Ch 241.

95 Cf *Armitage v Nurse* [1998] Ch 241.

96 See *Iezzi Constructions Pty Ltd v Watkins Pacific (Qld) Pty Ltd* [1995] 2 Qd R 350.

First, the overall objective is to ensure that so far as possible any personal liability of the trustee to a contractor is matched by an ability to have recourse to its right of indemnity from the trust assets.

Second, particular attention must be given to the most likely sources of liability. As mentioned, exclusion of liability for consequential loss may be problematic. Therefore, if the trustee considers that it has a real potential for exposure above and beyond the contract price, a simpler approach is to limit its liability to a cap, namely, the trust assets.

Third, the form of drafting should reflect the objectives of the clauses. Generally, exclusion clauses are more useful than disclaimers.

Fourth, the relationship between objectives and what can legally be achieved in drafting must be considered. Because liability for misleading or deceptive conduct cannot be excluded, in practice a trustee must take steps to prevent such conduct occurring.

Finally, because of the need to ensure that its liability to a contractor is more or less back-to-back with the indemnity, the trustee must be astute in identifying situations where it will not be covered by the indemnity. Given that restitution is a fairly recent development, it may be important for a trustee to confirm that the indemnity is expressed in terms which make it applicable to a restitutionary liability.