

# THE DEVELOPMENT OF THE CONSTRUCTIVE TRUST AS A REMEDY IN AUSTRALIA

By

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## 1. Introduction

In the context of a seminar entitled "The Scope for Intervention in Commercial Dealings", discussion of the development of the constructive trust as a remedy in Australia calls for a consideration of the extent to which the imposition of a constructive trust is capable of amounting to an intervention in commercial transactions. At first sight, this question is relatively straightforward since the Australian courts have, generally speaking, resisted the temptation to utilise the constructive trust as a remedy as between the parties to a commercial transaction. This admirable reticence is entirely justified in the light of the potential consequences of the imposition of a constructive trust, which may prejudice not only the person upon whom that trust is imposed but also third parties and, in particular, his general creditors. In fact, however, the imposition of any constructive trust is capable of prejudicing the interests of the general creditors of the constructive trustee and, consequently, of amounting to an interference in the commercial transactions already entered into between the constructive trustee and third parties, something which is not generally taken into account by the Courts when deciding whether or not the imposition of such a trust is an appropriate remedy. It seems appropriate, therefore, to consider first the precise consequences of the imposition of a constructive trust and, subsequently, the extent to which the recent decisions handed down by the Australian courts can be regarded as capable of amounting to an intervention in commercial transactions.

## 2. The consequences of the imposition of a constructive trust

When property is declared to be the subject matter of a constructive trust, the imposition of that trust produces liabilities both of a proprietary and of a personal nature for the constructive trustee. Not only will the beneficiary necessarily be entitled to proprietary rights in the subject matter of the constructive trust, the constructive trustee will also be subject to the liability which is imposed on every trustee to account personally to his beneficiary for his actions as such. What is the relationship between these two distinct liabilities?

Where the property upon which the constructive trust is imposed is still identifiable in the hands of the constructive trustee, both these remedies will be available to the beneficiary who will be able to choose either to exercise his proprietary rights in the subject matter of the constructive trust, or to rely on the personal liability of the constructive trustee to account.<sup>1</sup> Where a beneficiary chooses to rely on his proprietary rights, his position will obviously depend on the precise nature of the constructive trust that has been imposed. If the beneficiary has been held to have an absolute interest in the subject matter of the constructive trust, he will be entitled to call for the transfer of the property to him together with any income or other fruits that the property has produced since the constructive trust

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1. In rare circumstances, the beneficiary may choose to exercise both of these remedies. See footnotes 2 and 3 below.

arose. If, on the other hand, the beneficiary has been held to have less than an absolute interest, such as a joint interest, life interest or future interest, in the subject matter of the trust, he will have the rights appropriate to whatever beneficial interest he has. Where a beneficiary instead chooses to rely on the personal liability of the constructive trustee to account, he will in effect be claiming damage for breach of trust from the constructive trustee. Thus he will be entitled to recover the value of his interest in the property as at the date when the constructive trust arose, following payment of which the constructive trust will be discharged and the constructive trustee will thereafter be beneficially entitled to the property formerly subject thereto.

Where the constructive trustee is solvent, the election between the two remedies will not normally have any particularly significant effects on the measure of the recovery of the beneficiary. When the property has neither produced income or other fruits nor changed in value while it has been in the hands of the constructive trustee, both remedies will lead to exactly the same measure of recovery. When, however, the property upon which the constructive trust has been imposed has produced income or other fruits or has risen in value while it has been in the hands of the constructive trustee, it will obviously be preferable for the beneficiary to choose to rely on his proprietary rights since this will enable him to recover the income, the other fruits or the increase in value in question. And when the property upon which the constructive trust has been imposed has fallen in value while it has been in the hands of the constructive trustee, it will obviously be preferable for the beneficiary to choose to rely on the personal liability of the constructive trustee since this will enable him to recover the amount that the property was worth when it reached the hands of the constructive trustee and so ignore the subsequent fall in its value.<sup>2</sup> Where, on the other hand, the constructive trustee is insolvent, the election between the two remedies will be immensely significant. If the beneficiary chooses to rely on his proprietary rights, he will take priority over the general creditors of the insolvent constructive trustee, whereas if he instead chooses to rely on the personal liability of the constructive trustee to account, he will rank with, rather than ahead of, the general creditors. Consequently, except in extremely unlikely circumstances, the beneficiary will inevitably choose to rely on his proprietary rights so as to obtain this priority.<sup>3</sup> This will in turn diminish the mass of general assets available for distribution among the general creditors of the insolvent trustee so that each general creditor will therefore obtain a smaller proportion of the sum owed to him. Thus the imposition of a constructive trust upon a person who is, or subsequently becomes, bankrupt will almost inevitably prejudice the interests of his general creditors, who will *ex hypothesi* not be before the court to object to the imposition of the constructive trust in question. As has already been mentioned, this potential consequence of the imposition

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2. This will certainly be the best remedy for the beneficiary where the fall in the value of the property cannot be held to have been brought about by the conduct of the constructive trustee. But where it can be shown that the constructive trustee was responsible for the fall in value of the property, there seems no reason why the beneficiary may not alternatively seek to rely on both the remedies available to him. If this is indeed possible, he will be able both to call for the transfer to him of the property and, by relying on the personal liability of the constructive trustee to account, to obtain damages for the fall in value of the property itself.

3. The only situation in which the beneficiary is likely to choose to rely on the personal liability of the constructive trustee to account will be where the property which is the subject matter of the constructive trust has fallen in value to a percentage of its original value smaller than the percentage that is likely to be paid out by the trustee in bankruptcy to the general creditors. Of course, in the event that it can be shown that the constructive trustee was responsible for the fall in value of the property, it will always be in the interest of the beneficiary to take advantage of the possibility mentioned in footnotes 1 and 2 above, to both recover the property and claim damages for the fall in its value. This is because such a double claim will give him both the property and the same percentage of the claim for damages as is paid out to the general creditors.

of a constructive trust is not always taken into account by the Courts when deciding whether or not the imposition of such a trust is an appropriate remedy. It is obviously hardly likely that the matter will be raised by the constructive trustee unless he is already bankrupt and is being represented by his trustee in bankruptcy. In such circumstances, the trustee in bankruptcy can attempt to resist the imposition of a constructive trust on the grounds that its imposition would constitute a fraudulent disposition or voidable preference.<sup>4</sup> Where the constructive trust is instead imposed prior to the bankruptcy of the constructive trustee, the trustee in bankruptcy will similarly be able to seek to set aside the constructive trust on the same grounds provided that he can comply with the time limit contained in the provision in question.

Thus far, the consequences of the imposition of a constructive trust have been considered on the assumption that the constructive trust in question is imposed on property which is still identifiable in the hands of the constructive trustee. Where this is not the case, the property may nevertheless be identifiable in the hands of a third party against whom it is possible to maintain a tracing claim and so recover the property.<sup>5</sup> Where this is possible, the situation will differ very little from that which has already been discussed. The beneficiary will have a choice between, on the one hand, exercising his proprietary rights in the subject matter of the constructive trust by following that property into the hands of the third party and, on the other hand, relying on the personal liability of the constructive trustee to account. The election between the two remedies will be dependent on exactly the same factors as have already been discussed. Where both the third party and the constructive trustee are solvent, the only relevant factors will be the presence or absence of income and other fruits and any changes in the value of the property. Where the constructive trustee is insolvent, the beneficiary will almost inevitably choose to rely on his proprietary rights and follow the property into the hands of the third party. Such a claim will enjoy priority over the general creditors of the third party in the event of his bankruptcy and therefore will inevitably prejudice their interests unless these can be protected by his trustee in bankruptcy in the manner discussed previously.

It may, on the other hand, not be possible to recover the property upon which the constructive trust has been imposed either because it has disappeared as the result of casual expenditure or dissipation by the constructive trustee or a third party or because it has reached the hands of a third party against whom it is not possible to maintain a tracing claim.<sup>6</sup> In this situation, the beneficiary will no longer have any proprietary rights in the subject matter of the constructive trust. Consequently the only remedy available to him will be to rely on the personal liability of the constructive trustee to account. Where the constructive trustee is solvent, this will not normally produce any particularly significant disadvantage, other than the fact that the beneficiary will be unable either to recover any income or other fruits that the property may have produced or to take advantage of any increase in its value.

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4. The relevant legislation is discussed in H.A.J. Ford & W.A. Lee, *Principles of the Law of Trusts*, The Law Book Company Limited, Sydney, 1983 at 238-249. An English case where such an argument succeeded was *Re Densham (A Bankrupt)* [1975] 1 WLR 1519.

5. It will be possible to trace the property into the hands of any third party other than a bona fide purchaser for value of a legal interest therein without notice of the adverse claim of the beneficiary under the constructive trust (or, in the case of land, the statutory equivalent of such a purchaser). This is because the imposition of a constructive trust gives rise to the relationship of a trustee and beneficiary which, on any view, is sufficient to satisfy the prerequisites of such an equitable tracing claim.

6. Because he is a bona fide purchaser for value of a legal interest therein without notice of the adverse claim of the beneficiary under the constructive trust (or, in the case of land, the statutory equivalent of such a purchaser) or because he can rely on one of the other defences to such an equitable tracing claim formulated in *Re Diplock* [1948] Ch 465.

Where, on the other hand, the constructive trustee is insolvent, the absence of any proprietary rights will be extremely significant since it will prevent the beneficiary from being able to claim priority over the general creditors of the constructive trustee since the liability of the latter to account will rank with, rather than ahead of, the claims of the general creditors. Such a situation will thus be likely to be extremely prejudicial to the beneficiary but will limit the possible prejudice to the general creditors to the extent to which the personal liability of the constructive trustee increases the total amount of his unsecured debts.

### **3. The circumstances in which a constructive trust will be imposed**

It is a matter of some controversy precisely what trusts may properly be classified as constructive trusts.<sup>7</sup> However, for present purposes it is necessary to consider only the three well established situations in which it is generally accepted that a constructive trust arises. First, where a fiduciary has obtained an advantage as a result of a breach of his duty of loyalty. Secondly, where there has been a disposition of trust property in breach of trust and, thirdly, where a person has obtained an advantage by acting fraudulently or unconscionably. To what extent is the imposition of a constructive trust in these three situations capable of bringing about a direct or indirect intervention in commercial transactions?

#### **3a. Constructive trusts imposed where a fiduciary has obtained an advantage as a result of a breach of his duty of loyalty**

The authorities which establish that a constructive trust will be imposed upon a fiduciary who has obtained a benefit as a result of a breach of the duty of loyalty which he owes to his principal are both well known and extremely stringent. A fiduciary may, in appropriate circumstances, be deprived of any right to remuneration for his services, of the benefit of transactions into which he has entered in a double capacity, and of benefits which he has obtained as a result of his position to the exclusion of his principal.<sup>8</sup> Many commercial transactions expressly create fiduciary relationships. This will be the case where it is expressly provided that one or more of the parties is subject to fiduciary obligations or where the transaction has expressly created a relationship which is always classified as fiduciary such as the relationships of agent and principal, director and company, or partner and partner. In such circumstances, however, the parties will necessarily be aware of the applicability of these highly onerous duties of loyalty. Consequently, the application by the Courts of the well-established authorities which govern these duties can hardly be said to constitute an interference with the commercial transaction in question. Where, on the other hand, a commercial transaction does not expressly create fiduciary obligations, there is enormous scope for the Courts to intervene in that transaction simply by finding that such obligations have nevertheless arisen since such a finding exposes the party classified as the fiduciary to all the potential liabilities mentioned above. To what extent, therefore, have the Australian Courts been prepared to uphold the existence of fiduciary obligations in commercial transactions where these have not been expressly created by the parties?

It is generally accepted that there is no comprehensive definition of the expression "fiduciary". Consequently, what determines whether or not any particular relationship is fiduciary is a simple question of fact — whether or not one of the parties to the relationship has undertaken to act for or on behalf of the other.<sup>9</sup> In commercial transactions, the answer

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7. A.J. Oakley, *Constructive Trust*, 2nd edn., Sweet & Maxwell, London, 1987 at 14-18.

8. P.D. Finn, *Fiduciary Obligations*, The Law Book Company Limited, Sydney, 1977 at Chapters 19-22, A.J. Oakley *ibid.* n.7 at Chapter 3.

9. P.D. Finn, *supra* n. 8 at 201.

to this question inevitably has to be determined by the provisions of the contract between the parties. Generally speaking, however, where no fiduciary obligations have been expressly created, the Courts have been reluctant to classify commercial relationships entered into at arm's length and on an equal footing as fiduciary relationships and have thus resisted the temptation to intervene in such transactions. The leading Australian authority is the decision of the High Court in *Hospital Products Limited v. United States Surgical Corporation and others*.<sup>10</sup>

In this case, the plaintiff granted to the defendant the exclusive right to distribute in Australia certain surgical products manufactured by the plaintiff. However, the defendant in fact intended to utilise this contract as the means of establishing itself as a manufacturer and distributor of similar products in direct competition with the plaintiff. Consequently, once it had arranged to manufacture in Australia components of the products, it began to defer fulfilment of orders for the plaintiff's products and, subsequently, terminated the relationship with the plaintiff and fulfilled the accumulated orders for the plaintiff's products with products of its own manufacture. The plaintiff claimed that the relationship between the parties was not only contractual but also fiduciary and that, consequently, the defendant was both liable in damages for breach of contract and held its business on constructive trust for the plaintiff. The imposition of such a constructive trust would have enabled the plaintiff to recover the past and future profits made by the defendant from selling its own products, a measure of recovery which would not have been available by way of damages for breach of contract. The New South Wales Court of Appeal had held that the contract between the parties contained an express term that the defendant would devote its best efforts to distributing the plaintiff's products and building up its market in Australia in their mutual interest and an implied term that the defendant would not during the distributorship do anything inimical to the market in Australia for the plaintiff's products.<sup>11</sup> The effect of these terms was that the defendant was bound to act on behalf of and in the best interests of the plaintiff and not only in its own best interest.

Such an obligation was clearly of a fiduciary nature and so the defendant held its business on constructive trust for the plaintiff. However, the High Court unanimously rejected the term so implied into the contract by the New South Wales Court of Appeal. Four of the five members of the High Court then went on to hold that the express terms of the contract did not impose any fiduciary obligations on the defendant for two reasons. First, because the arrangement between the parties was a commercial transaction entered into at arm's length and on an equal footing and, secondly, because it had been clear from the start that the whole purpose of the transaction from the defendant's point of view was to make a profit. Mason J. however held that there was nevertheless a limited fiduciary duty arising out of the exclusive responsibility of the defendant for marketing the plaintiff's products in Australia and the manner in which those products were to be promoted which placed the defendant under a duty not to make a profit by virtue of its fiduciary position and he therefore dissented. Three of the members of the High Court therefore concluded that the defendant was not a constructive trustee of its business for the plaintiff but was merely liable in damages for breach of contract.<sup>12</sup>

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10. (1984) 156 CLR 41.

11. [1983] 2 NSWLR 157.

12. Mason J., having held that the defendant was under a limited fiduciary duty, obviously dissented on this point. Deane J., who had agreed that the defendant was not subject to any fiduciary obligations, expressed the view that the defendant nevertheless could have been held liable as a constructive trustee on an alternative ground which will be considered below and so also dissented on this point.

The majority of the High Court thus declined to intervene in this commercial transaction. However, the fact that both the New South Wales Court of Appeal and, to a more limited extent, Mason J. in the High Court did classify the relationship between the parties in this case as a fiduciary relationship demonstrates how crucial the construction of the contract between the parties will be in determining whether or not one of the parties has undertaken to act for or on behalf of the other. Further, the fact that a commercial transaction has been entered into at arm's length and on an equal footing is important, but not decisive, in indicating that no fiduciary relationship has arisen. This was expressly stated by Gibbs C.J.<sup>13</sup> and has, to some extent at least, been confirmed by the subsequent unanimous decision of the High Court in *United Dominions Corporation v. Brian*.<sup>14</sup> Prior to the signature of a joint venture agreement between three companies, including two parties to the action, relating to a land development largely financed by secured loans from the defendant to the other two companies, the third party mortgaged the joint venture land to the defendant on terms that charged this land with sums advanced to the third party on any account. The plaintiff claimed that this clause, whose significance had not been appreciated by its advisers at the time of the signature of the joint venture agreement, could not be relied on by the defendant on the grounds that its presence in the mortgage constituted a breach of the fiduciary duties which the three participants in the joint venture owed to one another. The High Court classified the joint venture agreement as analogous to a partnership and therefore upheld the plaintiff's claim on the grounds that, at the date of the execution of the mortgage, the arrangements between the future partners had passed the stage of mere negotiation. Consequently, they owed fiduciary obligations to one another and were therefore obliged to refrain from obtaining any collateral advantages in relation to the proposed project without the knowledge and informed assent of the other participants. This was clearly a commercial transaction entered into at arm's length and on equal footing between three independently advised companies. On the other hand, the key to the decision may be the fact that the participants were proceeding towards the signature of an agreement which was held to give rise to fiduciary obligations and that they had, prior to the execution of the mortgage, already embarked on the joint venture in that financial contributions had been made towards its costs. In any event, the decision clearly re-emphasises the enormous possibilities open to the Courts to intervene in commercial dealings by the simple expedient of classifying the relationship between the parties as fiduciary. It is therefore much to be hoped that the restrained attitude displayed by the majority of the High Court in *Hospital Products Limited v. United States Surgical Corporation and others* continues to prevail.

What are the likely consequences for the party classified as the fiduciary where the existence of fiduciary obligations is upheld in a commercial transaction in which these have not been expressly created by the parties? It is not particularly likely that the party classified as the fiduciary will be deprived of any right to remuneration for his services. In the relatively unlikely event that the terms of a commercial transaction made provision for the payment of remuneration, it would be extremely difficult for a party who had agreed to pay such remuneration subsequently to contend that the other party had no right to retain it. It is, on the other hand, possible that a Court might classify as a secret profit a payment such as a commission or bribe received by the fiduciary from a third party and hold the fiduciary liable to account for such secret profits, although it is admittedly unlikely that substantial secret profits will be able to be made in the course of a commercial transaction. It is not

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13. *Supra* n.10 at 70.

14. (1985) 157 CLR 1.

particularly likely that the party classified as the fiduciary will be deprived of the benefit of transactions into which he has entered into a double capacity for the very simple reason that the opportunity of entering into such transactions is unlikely to arise in the context of a commercial relationship. The most probable consequence is rather that the party classified as the fiduciary will be deprived of benefits which he has obtained as a result of his position to the exclusion of the other party. This was of course precisely the relief sought in *Hospital Products Limited v United States Surgical Corporation and others* and in *United Dominions Corporation v Brian*. In the former case, the plaintiff claimed to be entitled to the past and future profits made by the defendant from selling its own products on the basis that its business was subject to a constructive trust while in the latter case the plaintiff claimed that the defendant was not entitled to retain the profits of the joint venture against sums advanced to the third party. Such liabilities are likely to be substantial and, as will be seen later, are capable of causing considerable prejudice to the general creditors of the fiduciary. This is of course a further reason why the Courts should continue to decline to uphold the existence of fiduciary obligations in commercial transactions where these have not been expressly created by the parties.

Finally, to what extent is the imposition of a constructive trust on a fiduciary who has obtained an advantage as a result of a breach of his duty of loyalty capable of prejudicing the interests of his general creditors in the event of bankruptcy? It is not likely that any such prejudice will be possible when a fiduciary is deprived of unauthorised remuneration or secret profits. Such remuneration is unlikely to form a substantial proportion of the assets of a fiduciary while any secret profits of a substantial size are normally concealed and are therefore not likely to be visible to and so mislead a third party creditor. Nor is it likely that the general creditors will be potentially prejudiced when a fiduciary is deprived of the benefit of transactions into which he has entered in a double capacity. The fact that such transactions are normally set aside means that the principal will have to return to the fiduciary the consideration which he originally provided so that there is unlikely to be any substantial reduction of the assets available to the general creditors. However, substantial prejudice to the general creditors is possible when a fiduciary is deprived of benefits which he has obtained as a result of his position to the exclusion of his principal. This will have the effect of depriving the fiduciary of both the past and future profits of the transaction in question, profits to which he will have appeared to be entitled and whose disappearance is capable of reducing very considerably the assets available for his general creditors. Unfortunately, this is not a factor which the Courts tend to consider when deciding whether or not to impose liability of this type, something which is particularly unfortunate in the light of the stringent attitude normally adopted in cases of this kind. In this respect, therefore the imposition of a constructive trust on a fiduciary who has obtained an advantage as a result of a breach of his duty of loyalty is capable of prejudicing his general creditors in the event of his bankruptcy and to this extent at least the imposition of such constructive trusts is capable of amounting to an intervention in commercial transactions.

### **3b. Constructive Trusts imposed as a result of a disposition of trust property in breach of trust**

The situations in which constructive trusts are imposed on recipients of trust property which has been disposed of in breach of trust cannot properly be classified as examples of intervention in commercial dealings. This is simply because the beneficiaries of the trust in question cannot successfully maintain any claim against a bona fide purchaser for value of a legal estate in the property without notice of the breach of trust or the statutory equivalent in the case of land. A party to a commercial transaction under which he has acquired an interest in trust property disposed of in breach of trust will have only himself to blame if he is unable to establish such a defence and in such circumstances the interests

of his general creditors cannot possibly be regarded as having priority to the equitable proprietary interest of the beneficiaries in the trust property.

However, where trust property has been disposed of in breach of trust, constructive trusts can be imposed not only on the recipients of that property but also on any person who has assisted in bringing about the disposition of the property in breach of trust. Such persons are normally agents of a trust such as solicitors or bankers who, as a result of following the instructions of the trustees, have actually made or facilitated the disposition in question. Such a constructive trustee is liable to refund to the beneficiaries the entire value of the trust property in question. Admittedly this does not give the beneficiaries any priority over the general creditors of the constructive trustee since no part of the property disposed of in breach of trust will be able to be identified in his hands and so the beneficiaries will only be able to rely on his personal liability to account, a liability which, as has already been seen, will rank with, rather than ahead of, the claims of the general creditors. However, since such liabilities can be very substantial, this can nevertheless prejudice the general creditors in that it will reduce very considerably the percentage able to be paid out to them. There is important recent Australian authority on the circumstances in which constructive trusts of this type will be imposed. The basic rule is that agents will only be held liable as constructive trustees if they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.<sup>15</sup> There has been considerable controversy as to precisely what types of knowledge should lead to the imposition of such a constructive trust.<sup>16</sup> However, in *Consul Development Pty Ltd v. D.P.C. Estates Pty Ltd*,<sup>17</sup> the High Court unanimously expressed the view that such a constructive trust should only be imposed if the agent either actually knows of the breach of trust, or has consciously refrained from making any enquiries for fear that he may learn of a breach of trust, or knows of facts which themselves would make a reasonable man aware of the breach of trust.<sup>18</sup> However, a majority of the Court took the view that a constructive trust should not be imposed on an agent who has merely been negligent in failing to make any enquiries.<sup>19</sup> These statements were recently applied by the Supreme Court of Western Australia in *Ninety Five Pty Ltd v. Banque Nationale de Paris*,<sup>20</sup> in which Smith J. held that the defendant bank was liable as a constructive trustee for permitting the plaintiff company to be purchased with its own money in breach of s.67 of the Western Australian Companies Act 1961 (WA) in circumstances which would have made any reasonable banker aware of what was happening. The defendant was therefore held liable to refund to this plaintiff the sum of \$1,933,866.62 which had been utilised for this purpose, together with interest thereon of up to \$7,235,072.35. Substantial liabilities of this kind will in many cases inevitably lead to the bankruptcy of the constructive trustee and reduce very considerably the percentage able to be paid out to the general creditors. However, it is difficult to argue that the types of knowledge which will lead to the imposition of this type of constructive trust should be reduced any further. General creditors are of

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15. *Barnes v Addy* (1874) 9 Ch App 244.

16. In England there are at present conflicting lines of authority on this point. See R.P. Austin, *Essays in Equity*, The Law Book Company Limited, Sydney, 1985 at 196, Oakley *supra* n.7 at Chapter 4.

17. (1975) 132 CLR 373.

18. In this case it was claimed that the defendant company had either received property of the plaintiff company or alternatively assisted with knowledge in a dishonest and fraudulent design. Although the defendant was not an agent of the plaintiff, the High Court fully reviewed the authorities on agents in reaching the conclusion that the defendant lacked the necessary knowledge to be liable on either ground.

19. McTiernan J., considered that a constructive trust should also be imposed on an agent who has merely been negligent in failing to make any enquiries.

20. [1988] WAR 132.



course very often prejudiced by the sudden appearance of substantial liabilities in the course of the administration of a bankruptcy. All that can really be said is that at least any prejudice produced will not be due to any alteration of priorities caused by the imposition of a constructive trust, a technicality which is admittedly unlikely to find much favour with the general creditors in question.

### 3c. Constructive trusts imposed where a person has obtained an advantage by acting fraudulently or unconscionably

The traditional situations in which constructive trusts are imposed as a result of fraudulent or unconscionable conduct cannot properly be classified as examples of interventions in commercial dealings. This can be illustrated by reference to what are justifiably described as the most striking examples of equitable relief against fraudulent or unconscionable conduct, the doctrines of undue influence and unconscientious bargains and the principle that no criminal may benefit from his crime. The vast majority of the recent illustrations of the operation of the doctrines of undue influence and unconscientious bargains have admittedly concerned attempts to set aside secured loans or guarantees created in favour of commercial organisations such as banks or finance companies. However, the authorities have clearly established that these doctrines can only be successfully invoked against a party who can be taken to have known, either directly or through his agents, of the fraudulent or unconscionable conduct in question.<sup>21</sup> The grant of relief in such circumstances cannot properly be classified as an intervention in commercial dealings and, in any event, will only rarely require the imposition of a constructive trust.<sup>22</sup> Exactly the same observations can be made in relation to relief given against criminals in respect of the proceeds of crime.<sup>23</sup> It is of course possible to conceive of a situation in which the grant of relief in these circumstances could amount to an interference in commercial transactions already entered into with third parties. If a person who has succeeded in obtaining the transfer of property to himself by undue influence obtains unsecured credit from tradesmen as a result of appearing to be the owner of that property (a secured creditor will of course normally be protected by the equitable doctrine of notice or its statutory equivalent<sup>24</sup>), these general creditors will undoubtedly be prejudiced in the event that the transfer is set aside. However, as between the victim of the undue influence and these general creditors, the fraudulent or unconscionable conduct clearly justifies priority being given to the victim. Similar considerations also apply to the other type of situation which has traditionally been held to fall under this heading, namely constructive trusts which are imposed to enforce oral undertakings or agreements by transferees of land who have subsequently sought to rely on the absence of the written formalities required by the Property Law Act 1974 (Qld). Such cases almost invariably arise out of family or domestic transactions rather than out of

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21. See *National Westminster Bank v Morgan* [1985] AC 686, *Coldunell v Gallon* [1986] 2 WLR 466 (undue influence); *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447 (unconscientious bargains).

22. It is normally sufficient for the court simply to set aside the transaction. If property has actually been transferred, it will have to be returned, while if some mortgage or charge has been obtained by way of security, that security will be unenforceable. A constructive trust will only have to be imposed if any property transferred has reached the hands of a third party. However, no such claim will be able to be maintained against a third party who is a bona fide purchaser for value without notice or the statutory equivalent.

23. All the decided cases concern property which has been acquired as a result of unlawful killing. Such property is normally intercepted before it reaches the hands of the criminal but if this was not the case it would be necessary for a constructive trust to be imposed. This is also necessary where the criminal and his victim hold joint or successive interests (see *Rasmanis v Jurewitsch* [1968] NSWLR 166).

24. A secured creditor will be protected unless he cannot show that he is a bona fide purchaser for value without notice of the adverse claim or the statutory equivalent.

commercial transactions and, although the imposition of a constructive trust in such circumstances is obviously capable of prejudicing the general creditors of the transferee, the fraudulent or unconscionable conduct of the transferee clearly justifies such priority being given.<sup>25</sup>

However, constructive trusts of this type have not been confined to cases of such clearly fraudulent or unconscionable conduct. During the last thirty years, constructive trusts of this type have at times been imposed as a result of conduct classified merely as inequitable with the underlying and indeed often expressed objective of preventing results which would, otherwise, have been inequitable. Decisions of this type have, in general, been confined to cases concerning joint enterprises between members of a family or a de facto relationship and have usually concerned the beneficial interests in the residential property which they occupy.<sup>26</sup> Such joint enterprises cannot of course in any sense be classified as commercial transactions so that the imposition of a constructive trust to do justice and equity as between the members of a family or a de facto relationship does not of itself constitute an interference in a commercial transaction. However, such trusts also necessarily give priority to the member of the family or the de facto relationship in question over the general creditors of the constructive trustee and it is not easy to justify such a priority being given merely because the imposition of such a trust produces an equitable result as between the members of the family or the de facto relationship. The imposition of constructive trusts on this ground, therefore, can certainly be regarded as constituting an interference in commercial transactions.

The traditional rule in governing the acquisition or variation of beneficial interests in property acquired in the course of joint enterprises was laid down by the House of Lords in *Pettitt v. Pettitt*<sup>27</sup> and *Gissing v Gissing*.<sup>28</sup> Beneficial interests in such property have to be determined in the light of the intentions of the parties at the time of the acquisition of the property in question or in accordance with any subsequent agreed variation thereof. The intentions of the parties have to be deduced from their words and deeds at the time taking into account established principles of property law such as the presumptions of resulting trusts and of advancement. Thus, rights of property are to be determined according to the basic rules of property law, not according to what is reasonable and fair or just in all the circumstances. However, in the course of his speech in *Gissing v Gissing*, Lord Diplock stated the following proposition:

A resulting, implied or constructive trust — and it is unnecessary for present purposes to distinguish between these three classes of trust — is created by a transaction between the trustee and the *cestui que trust* in connection with the acquisition by the trustee of a legal estate in land, whenever the trustee has so conducted himself that it would be inequitable to deny to the *cestui que trust* a beneficial interest in the land acquired.<sup>29</sup>

This statement, when thus isolated from its context, appears to suggest that the courts may impose a constructive trust to do justice *inter partes* whenever the result would otherwise be inequitable and it was indeed duly cited as authority for that proposition in several subsequent cases in the English Court of Appeal. A typical illustration is the decision in

25. See *Last v Rosenfeld* [1972] 2 NSWLR 923 and *Ogilvie v Ryan* [1976] 2 NSWLR 504. Where a third party takes the property with notice of the transaction, he will also be liable as a constructive trustee (see *Binions v Evans* [1972] Ch 359).

26. One of the groups of English authorities concerned the effect of contractual licenses on third parties but these authorities have never been adopted in Australia and are in any event now discredited, although not as yet overruled, in England.

27. [1970] AC 777.

28. [1971] AC 886.

29. *Ibid.* at 905.

*Cooke v. Head*.<sup>30</sup> The plaintiff was the mistress of the defendant. They decided to acquire some land on which to buy a bungalow. The defendant paid all the outgoings save for a small amount, but the plaintiff helped him greatly in the actual task of building the bungalow which the parties never in fact occupied because they split up before it was completed. The plaintiff brought an action claiming a share in the proceeds of sale. At first instance, the Judge applied *Pettitt v Pettitt* and *Gissing v Gissing* and, since the plaintiff had contributed one-twelfth of the outgoings, awarded her a one-twelfth interest in the proceeds. However, in the Court of Appeal, Lord Denning M.R. said that, whenever two parties by their joint efforts acquire property to be used for their joint benefit, the Courts may impose or impute a constructive or resulting trust. Applying this principle, he held that the plaintiff was entitled to a one-third interest in the proceeds. In this decision, as in all the other cases of this type, no account was taken of the fact that Lord Diplock had placed an immediate limitation on his statement in the following sentence, in which he said:

And he will be held so to have conducted himself if by his words or conduct he has induced the *cestui que trust* to act to his own detriment in the reasonable belief that by so acting he was acquiring a beneficial interest in the land.<sup>31</sup>

The effect of this limitation and the essential difference between the two approaches is admirably illustrated by the judgments in *Eves v Eves*.<sup>32</sup> The parties, who were living together as man and wife, purchased a dilapidated house as a home for themselves and their children. All the purchase price was found by the man but the woman did a very considerable amount of work on the house. The English Court of Appeal held that she was entitled to a one-quarter share therein under a constructive trust. Lord Denning M.R. based this conclusion on the principle that he had enunciated in *Cooke v Head*. But the other two members of the Court, Browne L.J. and Brightman J., held that it could be inferred from the circumstances that there had been an arrangement between the parties whereby the woman was to acquire a beneficial interest in the house in return for her labour in contributing to its repair and improvement. Hence her work, in pursuance of this inferred arrangement gave her, under *Pettitt v Pettitt* and *Gissing v Gissing*, a beneficial interest in the house. This latter approach is infinitely preferable, not only as a matter of precedent but also as a matter of principle. The operation of the rule enunciated by Lord Denning M.R. is wholly unpredictable and prevents litigants from being safely advised as to their position. Further, the effect of the imposition of a constructive trust to do justice *inter partes* has the effect of giving the person in whose favour it is imposed priority over the interests of the general creditors of the constructive trustee.

These authorities had to be considered by the New South Wales Court of Appeal in *Allen v Snyder*.<sup>33</sup> During the last eight years of a relationship of approximately thirteen years, the parties lived together in a house purchased through the War Service Homes Department. The necessary loan was only forthcoming because the woman made a statutory declaration that she was living with and financially dependent on the man. However, the appropriate legislation did not permit the title to be placed in the name of a *de facto* wife. Consequently, the property was placed in the name of the man, who paid the whole of the purchase price and loan repayments. The woman purchased the furniture. The parties intended that the woman should acquire a half interest in the house as and when they married and the man made a will in her favour. They subsequently separated without having married. The Court

30. [1972] 1 WLR 518.

31. *Supra* n.29.

32. [1975] 1 WLR 1338.

33. [1977] 2 NSWLR 685.

of Appeal applied *Pettitt v Pettitt* and *Gissing v Gissing* and rejected the principle enunciated by Lord Denning M.R. in *Cooke v Head* and *Eves v Eves*. The woman had made no contribution to the purchase price of the house and the only intention of the parties was that the woman should have a one half interest in the house in the event of marriage and an absolute interest therein in the event of the death of the man. Consequently, although the woman was obviously entitled to the furniture which she had purchased, she was not held to be entitled to any beneficial interest in the house. This decision has ensured that in Australia the whole rather than merely the first sentence of the proposition enunciated by Lord Diplock in *Gissing v Gissing* has been applied. Thus in the decision of the Supreme Court of Queensland in *Re Bulankoff*,<sup>34</sup> a stepmother purchased land in the joint names of herself and her stepson on the strength of a promise by him to assist her to work the land. In fact he never made the slightest attempt to comply with this promise. Connolly J. held that the intentions of the parties at the time of the acquisition of the land had been that the stepson should take a one half beneficial interest in the land in consideration of his promise to work it. However, his total failure to comply with his promise meant that he had in effect obtained his beneficial interest unconscionably. Consequently, a constructive trust was imposed under which he held his beneficial interest on trust for his stepmother, who was thus absolutely beneficially entitled to the property.<sup>35</sup>

Subsequent decisions of the High Court have confirmed this rejection in *Allen v Snyder* of the proposition that a constructive trust can be imposed in order to do justice *inter partes* whenever the result would otherwise be inequitable.<sup>36</sup> Indeed, the more recent English decisions have also adopted this view.<sup>37</sup> These same decisions of the High Court have also confirmed that the acquisition or variation of beneficial interests in property acquired in the course of joint enterprises is governed by the principles laid down in *Pettitt v Pettitt* and *Gissing v Gissing*. However, while these traditional rules thus continue to have general application, the High Court has introduced a modification which applies when a joint enterprise between members of a family or a de facto relationship breaks down for a reason for which none of the parties is to blame. In this situation, while the traditional principles continue to apply to the question of who is entitled to any surplus or benefit arising out of the joint enterprise such surplus or benefit is only worked out after the parties have recovered in full all their contributions, both original and subsequent to the joint enterprise and the variation of beneficial interests which this process obviously produces is effected by means of the imposition of a constructive trust.

This modification appears to have had its genesis in some remarks made in *Calverley v Green*.<sup>38</sup> The parties, having lived as man and wife for some five years in a house owned by the man, purchased a property as joint tenants. The man paid about one third of the purchase price with the proceeds of sale of his existing property while the remaining two

34. [1986] 1 Qd R 366.

35. *Allen v Snyder* was also applied in *Morris v Morris* [1982] 1 NSWLR 61, where a widower sold his home unit and used the proceeds of sale to finance an extension to the home jointly owned by his son and daughter-in-law to provide accommodation for himself indefinitely as part of the son's family. Subsequently the son's marriage broke down and the son left the house. Thereafter personal relations between the widower and his daughter-in-law also broke down and he also left. McLelland J. held that there was no basis upon which any trust of the property could be implied, thus applying *Allen v Snyder*. However, he went on to hold that the widower was in the circumstances entitled to an equitable charge on the property for the finance provided and interest thereon. This latter part of the decision would now presumably be decided in accordance with the decisions of the High Court discussed in the next section of the text.

36. *Calverley v Green* (1984) 155 CLR 242, *Muschinski v Dodds* (1986) 160 CLR 583, *Baumgartner v Baumgartner* (1987) 164 CLR 137.

37. In *Burns v Burns* [1984] 1 All ER 244 and *Grant v Edwards* [1986] 2 All ER 426.

38. *Supra* n.36.

thirds was borrowed on a mortgage, which they had obtained by representing themselves to be married and under which they were jointly and severally liable. The repayments of the mortgage were in fact made by the man. The High Court held, by a majority of four to one, that the fact that the balance of the purchase price had been raised by a mortgage under which both parties were liable to the mortgagee constituted a contribution by the woman to the purchase price even though the parties had agreed that the man alone would make the repayments.<sup>39</sup> Thus the parties held the legal estate on trust for themselves as tenants in common in shares proportional to their contributions. When remitting the case to the Supreme Court of New South Wales for this decision to be applied, Gibbs C.J. made reference to the need to take accounts between the parties in which consideration would have to be given to the fact that the man had in fact repaid the mortgage but had, on the other hand, been in sole occupation of the property since the relationship had broken down.<sup>40</sup> The joint judgment of Mason J. and Brennan J. also made brief reference to the possibility of the Supreme Court considering whether the man was entitled to any relief against the woman in respect of his payment of the mortgage instalments.<sup>41</sup>

These remarks were subsequently taken up in *Muschinski v Dodds*.<sup>42</sup> In this case, the parties, having lived as man and wife for three years in a house owned by the woman, bought a cottage as tenants in common in equal shares with the object of restoring the cottage for use by the woman as an arts and crafts centre and of purchasing and erecting a prefabricated house as a home for both of them on another part of the property. All of the purchase price was paid by the woman, the man undertaking to assist in setting up the arts and crafts business and pay for and erect the prefabricated house. The relationship terminated before he had been able to carry out the majority of this work and he was held to have contributed only one eleventh of the total costs. The High Court held unanimously that the woman had intended to give the man an unconditional one half share in the property and that the presumption of resulting trust arising out of her payment of the whole of the purchase price was therefore rebutted. Consequently, the surplus arising on the sale had to be divided in equal shares between the parties. However, the Court went on to hold, by a majority of three to two, that before ascertaining this surplus each party was entitled to be credited with all the expenditure incurred.<sup>43</sup> A constructive trust was imposed to give effect to the variation in the beneficial interests which this process would inevitably produce and it was expressly stated that, in order to avoid any possible prejudice to third parties, this trust would take effect as from the date of the publication of the judgments. The majority reached this conclusion by two different routes. Gibbs C.J. adopted an attitude similar to that which he had taken in *Calverley v Green* and based his conclusion on the fact that the parties had been made jointly and severally responsible to pay the purchase price of the land so that if either discharged more than his or her proper share, he or she could call on the other for contribution.<sup>44</sup> Mason J. and Deane J., on the other hand, adopted

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39. Murphy J. dissented on the grounds that the legal title reflected the interests of the parties and there were no circumstances displacing it.

40. *Supra* n.36 at 253.

41. *Ibid.* at 264.

42. *Supra* n.36.

43. Brennan J. and Dawson J. dissented on the grounds that the woman's claim to be entitled to the full beneficial interest was necessarily based on the hypothesis that she paid the price as sole purchaser and so left no room for a finding that she paid it to discharge a joint and several debt so as to entitle her to contribution. Consequently, her only possible claim was for damages for failure by the man to fulfil his personal obligation to her.

44. *Ibid.* at 596-598. This argument is very limited in ambit since it will function only when the parties are so jointly and severally responsible and even so is restricted to payments of the purchase price.

a much wider view and based their conclusion upon a general principle of equity derived from the authorities on partnerships and contractual joint ventures which operates upon legal entitlement to prevent a person from asserting or exercising a legal right in circumstances where the particular assertion or exercise of it would constitute unconscionable conduct . . . Those circumstances can be more precisely defined by saying that the principle operates in a case where the substratum of a joint relationship or endeavour is removed without attributable blame and where the benefit of money or other property contributed by one party on the basis and for the purposes of the relationship or endeavour would otherwise be enjoyed by the other party in circumstances in which it was not specifically intended or specially provided that the other party should so enjoy it. The content of the principle is that, in such a case, equity will not permit that other party to assert or retain the benefit of the relevant property to the extent that it would be unconscionable for him to do so.<sup>45</sup>

Only this second explanation of the decision in *Muschinski v Dodds* was mentioned in the subsequent decision of the High Court in *Baumgartner v Baumgartner*.<sup>46</sup> In this case, the parties lived together as man and wife for four years, initially in a house owned by the man. This house was subsequently sold and the proceeds were used as the down payment on a further property on which a house was subsequently built. The mortgage repayments and their other living expenses were paid out of their joint earnings which they pooled, of which the man contributed 55% and the woman 45%.<sup>47</sup> The man subsequently asserted that the land and house were his sole property. The High Court, applying *Muschinski v Dodds* for the reasons expressed in that case by Mason J. and Deane J., held unanimously that this assertion amounted to unconscionable conduct which attracted the intervention of equity and the imposition of a constructive trust under which the man held the property on constructive trust for the parties in proportion to their contributions. However, the Court held that the man was entitled to receive out of the proceeds of sale repayment of the contributions effectively made by him before and after the period during which the parties had been living together, namely the proceeds of sale of his former property and the mortgage repayments paid since the separation less an occupation rent, and also the value of furniture purchased from the pooled earnings which the woman had taken with her.

These decisions of the High Court unquestionably establish a brand new legal principle unsupported by any prior authority. In reality, the Judges have taken the decision to apply to joint enterprises between members of a family or a de facto relationship a rule derived from the authorities which govern commercial relationships such as partnerships and contractual joint ventures. That is not to say that this new principle is wrong — in fact, it seems eminently sensible — but that its creation amounts to an act of judicial legislation for which the High Court may not be the most appropriate forum. Viewed as a legal principle, the new rule has the very considerable merit of certainty and predictability, thus permitting litigants to be safely advised as to their position.<sup>48</sup> In this respect, the rule is overwhelmingly

45. *Ibid.* at 620 per Deane J. with whose judgment Mason J. agreed.

46. *Supra* n.36.

47. The figures were adjusted to compensate the woman for the three months when she was bearing and caring for the child of the parties.

48. Thus the predictable result was reached in *Arthur v The Public Trustee* (1988) 90 FLR 203, where a couple were living together and pooling their assets when the man won a substantial prize in Tattsлото. Despite making statements that the winnings were jointly owned, he deposited them in a bank account in his own name and spent them as he wished save that he purchased in his own name a house property intended as their matrimonial home. He was killed before the marriage and the woman claimed a beneficial interest in the property. She failed, the Court of Appeal of the Northern Territory holding that he had not intended to create an express trust, that the common intention of the parties was for her to receive an interest only after marriage, and that he had not behaved unconscionably. As Asche CJ said at 213: "Darwin may be truly blessed by a colourful array of palm trees. But they are not there for the judges of this Court to sit under."

superior to the now discredited rule relating to the availability of the constructive trust as a remedy to do justice *inter partes*. Nevertheless, the fact that a constructive trust has to be imposed to give effect to the variation in beneficial interests which the rule necessarily produces means that the rule is capable of prejudicing the general creditors of the constructive trustee and so of constituting an interference in commercial transactions. However, in the event that the ruling in *Muschinski v Dodds* that the constructive trust imposed in that case took effect only as from the date of the publication of the judgments is of general application, something which is not yet clear, this possible prejudice will be substantially reduced although not, of course, entirely eradicated.

Finally, before leaving this type of constructive trust, it should be observed that in *Hospital Products Limited v United States Surgical Corporation and others*,<sup>49</sup> Deane J. (dissenting on this point) stated that the plaintiff was entitled to a declaration that the defendant was liable to account as a constructive trustee

in accordance with the principles under which a constructive trust may be imposed as the appropriate form of equitable relief in circumstances where a person could not in good conscience retain for himself a benefit or the proceeds of a benefit, which he has appropriated to himself in breach of his contractual or other legal or equitable obligations to another. Since this particular aspect of the matter was not explored in argument and a majority of the Court is of the view that there is no basis for any finding of constructive trust however, it is preferable that I defer until some subsequent occasion a more precise identification of the principles governing the imposition of a constructive trust in such circumstances.<sup>50</sup>

The proposition enunciated in the first part of this passage has even greater potential for the utilisation of the constructive trust as a general equitable remedy than the part of the speech of Lord Diplock in *Gissing v Gissing* which was subsequently utilised out of context by the English Court of Appeal. Although Deane J. has had several subsequent occasions to identify more precisely the principles governing the imposition of a constructive trust in such circumstances, most notably his lengthy judgement in *Muschinski v Dodds*,<sup>51</sup> he has so far emphatically rejected the notion of the constructive trust as a general equitable remedy, saying in that case:

The fact that the constructive trust remains predominantly remedial does not, however, mean that it represents a medium for the indulgence of idiosyncratic notions of fairness and justice. As an equitable remedy, it is available only when warranted by established equitable principles or by the legitimate processes of legal reasoning, by analogy, induction and deduction, from the starting point of a proper understanding of the conceptual foundation of such principles . . .

Thus it is that there is no place in the law of this country for the notion of a “constructive trust of a new model” which, “by whatever name it is described, . . . is . . . imposed by law whenever justice and good conscience” (in the sense of “fairness” or what “was fair”) “require it”: per Lord Denning M.R., *Eves v Eves*.

These admirable sentiments are much to be applauded and it is greatly to be hoped that neither Deane J. nor any of his successors ever adopts a different view since, as has already been seen, any utilisation of the constructive trust as a general equitable remedy must necessarily prejudice the interests of the general creditors of the constructive trustee and so constitute an interference in commercial transactions.

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49. *Supra* n.10.

50. *Ibid.* at 125.

51. *Supra* n.36.

**Conclusion**

The Australian courts have, generally speaking, been reluctant to classify commercial relationships entered into at arm's length and on an equal footing as giving rise to fiduciary obligations where such obligations have not expressly been created by the parties and thus have resisted the temptation to utilise the constructive trust as a remedy in commercial transactions. In light of the effect of the imposition of constructive trusts on the general creditors of the constructive trustee, it is very much to be hoped that this posture is continued. On the other hand, the Australian Courts have not considered particularly fully the effect on the general creditors of the constructive trustee of the imposition of constructive trusts outside the area of commercial transactions. Admittedly the recent decisions handed down by the Australian Courts cannot be regarded as capable of unduly prejudicing the interests of such general creditors. However, it is much to be hoped that the Australian Courts continue to resist the temptation to utilise the constructive trust as a general equitable remedy to do justice *inter partes*, something which would undoubtedly prejudice the interests of the general creditors of the constructive trustee and thus amount to an unjustified intervention in commercial dealings.