Third Parties and the Australian Remedial Constructive Trust

DAVID WRIGHT*

This article will primarily consider the important role that third parties play in the award of the Australian remedial constructive trust. In his groundbreaking article "Remedies as a Legal Subject"1 Waddams argued that by looking at all remedies together it may be possible to examine individual remedies and to evaluate any differences. This is even more accurate with a developing remedy such as the remedial constructive trust. This article will attempt to do this with this remedy.

INTRODUCTION

The constructive trust is somewhat of an enigma, having been described as "equity's chameleon".[2] Throughout the common-law world, competing jurisprudential theories have resulted in a doctrine full of contradiction and attendant confusion. Recently, Finkelstein J of the Federal Court described the law relating to constructive trusts as a "mess", noting numerous inconsistencies apparent in the leading Anglo-Australian cases which "are not easily synthesised".[3] It has recently been said that it is near impossible to provide a satisfactory definition of a constructive trust.[4]

The constructive trust – as distinct from the express and resulting (or 'implied') trust – first emerged in the seventeenth century as a device for constraining errant trustees and recipients of trust property, but proved so useful that it came to be employed more broadly.[5] Expansive application has lead to a multifarious doctrine which has been labelled a "vague dust-heap for the reception of relationships which are difficult to classify or which are unwanted in other branches of the

* Senior Lecturer University of Adelaide. A much earlier partial version of this paper was presented to Society of Trusts and Estate Practitioners in Sydney on 15th July 2010.

1 Waddams, "Remedies as a Legal Subject" (1983) 3 *Oxford Journal of Legal Studies* 113.

2 Dal Pont, "Equity's Chameleon – Unmasking the Constructive Trust" (1997) 16 *Australian Bar Review* 46.

3 *Imobilari Pty Ltd v Opes Prime Stockbroking Ltd* (2008) 252 ALR 41, [18] (Finkelstein J). Even greater confusion has been served by the fact, as argued by Bant and Byran, in "Constructive trusts and equitable proprietary relief: Rethinking the essentials" (2011) 5 J Eq 171, that several different models of the constructive trust fulfill identical remedial objectives.

4 Young, Croft and Smith, *On Equity* (Thomson Reuters, 2009) 435.

5 Craig Rotherham, *Proprietary Remedies in Context: a study in the judicial redistribution of property rights* (Hart, 2002) 10. See also, Malcolm Cope, *Constructive Trusts* (Law Book Co, 1992) 3, 8.

law".[6] This is an enduring problem[7] largely due to two factors. The first is the disparate contexts in which the term "constructive trust" has been employed and, secondly, the fact that different jurisdictions use the constructive trust in different ways. Many of the difficulties in understanding the constructive trust fall away if these two matters are recognised.

There is a divergence between the United Kingdom and Australia on the constructive trust.[8] This divergence is simply due to different usage of the term "constructive trust".[9] Of course, there is an overlap in meanings but significant differences.[10] This divergence is not simply limited to Australia and the United Kingdom.[11] In the entire common law world there is growing lack of commonality regarding the constructive trust.[12]

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6 Sykes, "The Doctrine of Constructive Trusts" (1941) 15 *Australian Law Journal* 171, 175.

7 The most recent attack in Australia on the constructive trust was Mason, "Deconstructing constructive trusts in Australia" (2010) 4 *Journal of Equity* 98.

8 This divergence is not simply limited to the fact that Australia embraces the constructive trust as primarily remedial, although this is very important. For example, it has become common in Australia for texts on Equity and Trusts to include the constructive trust chapter with all the other chapters on remedies and not with the other varieties of trusts. Perhaps the most important development and divergence (and most difficult to measure) is the rise of the trend in Australian lawyers, following the High Court, who perceive the constructive trust as primarily a remedy.

9 This is not just limited to the constructive trust. For example, as the Canadian and New Zealand professors Berryman and Bigwood, in the Preface to their edited book called *The Law of Remedies: New Directions in the Common Law* (2010) xxiii-xxiv, (publisher? Full reference?) noted as their first overarching theme for the law of remedies, and so relevant to the remedial constructive trust, the decreasing importance of English decisions to the development of the Common Law of remedies, while other jurisdictions are playing an increasingly important role. See also Tilbury and Davis, 'The Law of Remedies in the Second Half of the Twentieth Century: An Australian Perspective' (2004) 41 *San Diego Law Review* 1711, particularly 1718-1722.

10 So Australian courts can, with appropriate caution, use English authorities to resolve cases. But there should be an increased reliance on the decisions from other Common Law jurisdictions to offset this decline in the role of English cases. Australian courts should avoid falling into the trap of becoming isolationist as has been argued has happened with contracts; see Finn "Internationalisation or isolation: the Australian cul de sac? The case of contract law" in Bant and Harding (eds) *Exploring Private Law* (Cambridge University Press, 2010). See also the article by Kirby J "Overcoming equity's Australian isolationism" (2009) 3 *Journal of Equity* 1.

11 Waters in his 2010 article in the *Trust Quarterly Review* has noted this divergence between Canadian and English jurisprudence on the constructive trust. Full reference here?

12 Perhaps there is a form of commonality caused by the fact that many jurisdictions adopt a remedial approach to the constructive trust. But the question then becomes; what does remedial mean? This question, and the quest to find some sort of absolute definition of it, may become some sort of linguistic nightmare. It might be better if some less than absolute, precise definition were acceptable. Much of the law does exactly this. Further, the quest for a perfectly logical legal system not only runs counter to the entire history of the Common Law but is counter to the approach of the Common Law legal system, see *Roxborough v Rothmans of Pall Mall Australia Ltd* (2001) 208 CLR 516, 544 [72] and *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89, 158 [154], cf Mason, "Do top-down and bottom-up reasoning ever meet?" in Bant and Harding (eds) *Exploring Private Law* (Cambridge University Press, 2010).

The Australian constructive trust is primarily, but not exclusively, remedial.[13] This is the consequence of High Court decisions such as *Muschinski v Dodds*,[14] *Bathurst City Council v PWC Properties*,[15] *Giumelli v Giumelli,*[16] *Farah Constructions v Say-Dee*[17] and *Bofinger v Kingsway Group*.[18] Now, in *John Alexander's Clubs* the High Court has attempted to explain the impact of the remedial constructive trust being claimed when the interest of a third party is involved.

The literature on the constructive trust has largely been focused on the issue of the whether the constructive trust is institutional or remedial, particularly the question of employing property as a remedy.[19] It is important to appreciate the fact that the term "constructive trust" is not monolithic.[20] Further, according to *Jacobs' Law of Trusts in Australia*,[21] the established categories of the trust are not uniform in the sense that its incidents vary. It possesses several different meanings.[22] The current debate in the High Court seems to have gone beyond the remedy/institution debate, as having decided that most constructive trusts are predominately remedial.[23] In *Bofinger*[24] the unanimous High Court, after citing Gleeson CJ, McHugh, Gummow and Callinan JJ in *Giumelli,*[25] observed:

> In *Jones v Southall & Bourke Pty Ltd* [(2004) 3 ABC (NS) 1 at 17. See also *Giumelli v Giumelli* (1999) 196 CLR 101 at 119-120 [31]-[32] and the form of the orders made at first instance by McLelland J in *United States Surgical Corporation v Hospital Products International Pty Ltd* [1982] 2 NSWLR 766 at 820-822, after reviewing the authorities, Crennan J said that they:
>
> "make plain [that] the term 'constructive trust' covers both trusts

13 Australia has not reached the point yet where it can be confidently stated that the constructive trust is not a trust and is purely a remedy, as can be said in America.

14 (1985) 160 CLR 583.

15 (1998) 195 CLR 566.

16 (1999) 196 CLR 101.

17 *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89.

18 (2009) 239 CLR 269.

19 See Dal Pont *Equity and Trusts in Australia* (5th ed, Thomson Reuters, 2011) at [P.185]. See also Smith, "Rights and Remedies: A Complex Relationship" in *Taking Remedies Seriously* (Kent full citation required here? Riach and Robert Sharpe, eds, 2010 and Dagan "Remedies, Rights and Properties" (2011) *Journal of Tort Law* Vol 4: Iss 1 Article 3.

20 This is the crux of the Mason's complaint in "Deconstructing constructive trusts in Australia" (2010) 4 *J Eq* 98.

21 JD Heydon and MJ Leeming, *Jacobs' Law of Trusts in Australia*, (LexisNexis, 7th ed, 2006) at [1302].

22 And shades of meanings. See Kull in "Deconstructing Constructive Trusts" (2004) 40 *Canadian Business and Law Journal* 358 at 361.

23 This is not to suggest that all constructive trusts are remedial. There are still some constructive trusts that are purely institutional. Young, Croft and Smith in *On Equity* (Thomson Reuters, 2009) pp441-442 give a list of some constructive trusts which are predominately institutional.

24 (2009) 239 CLR 269, 290 [48].

25 (1999) 196 CLR 101 at 111-112 [2]-[4].

> arising by operation of law and remedial trusts. Furthermore, a constructive trust may give rise to either an equitable proprietary remedy based on tracing or, whether based on or independently of tracing, an equitable personal remedy to redress unconscionable conduct. The equitable personal remedies include equitable lien or charge or a liability to account."

Earlier in her reasons her Honour had noted that the term "constructive trust" had been applied to include the enforcement of the obligation of a defaulting fiduciary to make restitution by a personal rather than a proprietary remedy [(2004) 3 ABC (NS) 1 at 16].

Distilling this, it appears that the main meanings, with sub-meanings, within the term "constructive trust" are:

1. a remedy for the breach of certain legal primary rights,
    a. a personal remedy, and
    b. a proprietary remedy

and

2. a property based institution, very similar to the express and resulting trusts
    a. a proprietary based institution, and
    b. personal liability based institution.

As can be seen, "constructive trust" is an umbrella term; that is, it is a term with several different meanings. But frequently the term "constructive trust" is used interchangeable, causing confusion.[26] The dominant form of the constructive trust is the first. This contention is supported by the observation by Young, Croft and Smith in *On Equity*[27] that "the remedial constructive trust is the most common form of constructive trust."

Ford and Lee in *Principles of The Law of Trusts*[28] define the remedial constructive trust as "a declaration by a court that a constructive trust exists but in respect of which there is uncertainty as to whether the court would declare a constructive trust or give some other equitable remedy".[29]

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26 As has been noted previously, even greater confusion has been caused by the fact, as demonstrated by Bant and Byran, in "Constructive trusts and equitable proprietary relief: Rethinking the essentials" (2011) 5 *Journal of Equity* 171, that several different models of the constructive trust fulfill identical remedial objectives. Swadling in "The Fiction of the Constructive Trust" (2011) *Current Legal Problems* has pointed out the dangers caused by the inappropriate borrowing of decisions from express trusts cases by constructive trusts cases.

27 Young, Croft and Smith, *On Equity* (Thomson Reuters, 2009) 442.

28 Ford and Lee, *Principles of the Law of Trusts* (Loose leaf service) at [22.160].

29 As Kull in "Deconstructing Constructive Trusts" (2004) 40 *Canadian Business and Law Journal* 358, 360 states the term "constructive trust" is a "description of a set of remedial possibility". Also see Smith in "Unravelling Proprietary Restitution" (2004) 40 *Canadian Business and Law Journal* 317 at 331.

The constructive trust is a remedy, albeit a very special remedy because it usually involves property. And, as a remedy, it is quite rare because of this fact.[30] Importantly, it should be noted that Austin[31] has pointed out that "a proprietary remedy should not ever be regarded as mandatory. It should be possible for a court to exercise discretion against decreeing proprietary relief if the circumstances suggest that it would be unwise to do so." Further in *Beatty v Guggenheim Exploration Co* Cardozo J commented:

> A court of equity in decreeing a constructive trust is bound by no unyielding formula. The equity of the transaction must shape the measure of relief.[32]

According to Cardozo J, the dimensions of the constructive trust are not consistent. Importantly, this passage was quoted with approval by Mason J in *Hospital Products Ltd v United States Surgical Corp.*[33]

The current debate in the High Court revolves around the consideration how the constructive trust is to be used in Australia. One of the most important consideration is the impact upon third parties.

In the past Equity has been criticized for not paying sufficient attention to the impact of its remedies on third parties. For example, in a very short judgment in *Hewitt v Court*, Murphy J held "[a]s so often happens in commercial and conveyancing cases, the court was not assisted by any 'commercial impact statement', that is, of what would be the effect in commerce generally, of charges arising in such circumstances."[34] Further Kennedy J has stated extrajudicially that "[o]ne particular criticism which has been leveled at the application of equitable doctrine in commercial transactions is that equity tends to view the case essentially as a problem between the immediate parties to the particular transaction and that, on occasions, insufficient attention is paid to the more remote consequences of a decision, perhaps because the court is ill equipped to do so."[35]

In attempting to remedy this deficiency the High Court might have swung slightly too far in the opposite direction.

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30 It is interesting to speculate whether the non-proprietary form of the remedial constructive trust should also be rare as it does not involve property.

31 Austin "Constructive Trusts" in P D Finn (ed), *Essays in Equity* (Lawbook Co, 1985) 240.

32 (1919) 122 NE 378, 381.

33 (1984) 156 CLR 41, 108.

34 (1982) 149 CLR 639, 651.

35 Kennedy J in "Equity in a Commercial Context" in Finn (ed) *Equity and Commercial Relationships* (Law Book Co, 1987) 10.

The Case of *John Alexander's Clubs*

Facts and Lower Courts' Decisions

It is important to appreciate that there were two different appeals dealt with in this one decision. The first appeal concerned what should be considered when a remedial constructive trust is claimed, whereas the second appeal concerned what should be done when a remedial constructive trust is claimed. The two appeals concerned essentially the same facts. Tennis NSW wanted to sell some land. The respondent and John Alexander's Clubs Clubs (JACS) were going to purchase and develop this land. P, a nominee of JACS, bought this land. In order to do this P obtained a loan from Walker Corporation, which was the appellant in the second appeal. This loan was secured by an unregistered mortgage in favour of Walker Corporation. Relations between the respondent and JACS fell apart. Litigation ensued.

The respondent claimed JACS had breached the fiduciary duty owed to it to hold the land for the two parties and this resulted in a lost opportunity to acquire the land for itself. Alternatively, it claimed equitable fraud, unconscionable or unconscientious conduct. Importantly, the respondent claimed a constructive trust over the land.

At first instance, the Supreme Court of New South Wales dismissed the proceedings, on the grounds no fiduciary duty existed.

However, largely following its own lead of *Carson v Wood,*[36] the New South Wales Court of Appeal found there to be a constructive trust. In *Carson*, a contract provided for the transfer by the respondents of trademarks to another entity, in which the appellants and the respondents were to hold equal shares. The respondents did not transfer the trademarks. It was held by that Court of Appeal that the particular respondent which held the trademarks, held them as constructive trustee for both parties in equal shares. Clarke JA (with whom Kirby P agreed) said that the assertion by the respondents of sole beneficial ownership of the trademarks "involved the subversion of the intention which underlay" the relevant contractual provision and that it was "in these circumstances inequitable and unconscionable" for the respondent "to persist in that claim and the appropriate remedy available to the [appellants] is a declaration of a constructive trust".[37]

Importantly, the court did not suggest that the right of the appellants to a declaration of a constructive trust might be dependent on a finding that a pre-existing fiduciary relationship existed and there was in fact no finding that such a relationship existed. The decision in *Carson* was largely based on the constructive

36 (1994) 34 NSWLR 9.
37 Ibid, 17; see also Sheller JA at 26 to similar effect.

trust established by *Muschinski*[38] by Deane J (with whom Mason J agreed). On similar reasoning, the New South Wales Court of Appeal in the *JAC* case declared a constructive trust existed. The Court of Appeal further described the nature of the relationship between respondent and JACS as a "joint venture".

On appeal, Walker Corporation submitted that the Court of Appeal had failed to consider the impact of declaring a constructive trust on the unregistered mortgage. Further, it claimed that the Court of Appeal erred in failing to join it as a party to proceedings.

The High Court's Decision

The High Court[39] unanimously allowed both appeals. It held that:

(i) The Court of Appeal erred in both determining that JACS' behaviour was unconscionable and finding that there was a fiduciary relationship.
(ii) Further, the Court of Appeal, in determining a constructive trust was the appropriate remedy, failed to consider the impact of the trust on the existing rights of the third party corporation (that is, Walker Corporation).
(iii) Discussing methodology, the High Court observed that it was unsatisfactory to determine first that the respondent had a proprietary right, and then later determine whether other rights had priority. Even if the JACS' appeal had failed, the third party's appeal would have succeeded and orders for a new trial would have been made.

The Remedial Importance of this Judgment

This judgment by the High Court is noteworthy for several reasons.

1. *Cautious Approach to Ordering a Constructive Trust*

The first reason is the Court's cautious approach to using the constructive trust. The constructive trust can be used as a remedy following equitable fraud or unconscionable conduct, as well as breach of fiduciary duty.[40] But the High Court expressed great caution about the widespread use of the constructive trust to remedy these wrongs. For example, the reasoning in *Carson v Wood,*[41] which was based on the reasoning in the *Muschinski*[42] and *Baumgartner v Baumgartner*[43] line of cases, was not applied.[44] Their Honours quoted Judge Learned Hand: "in

38 (1985) 160 CLR 583.
39 The High Court consisted of French CJ, Gummow, Hayne, Heydon and Kiefel JJ.
40 It is interesting to note that the High Court in *John Alexander's Clubs* (2010) 241 CLR 1 [97] left open the possibility that a constructive trust could be awarded following a breach of contract.
41 (1994) 34 NSWLR 9.
42 (1985) 160 CLR 583.
43 (1987) 164 CLR 137.
44 *John Alexander's Clubs* (2010) 241 CLR 1, 25 [57].

commercial transactions it does not in the end promote justice to seek strained interpretations in aid of those who do not protect themselves."[45] Further, their Honours held that where interpretations, strained or otherwise, will not help, assistance to those persons by a strained application of equitable ideas does not promote justice either. So, the constructive trust is available in these cases but should only be exceptionally employed. This caution in the use of Equity has been evident in many cases before this. For example, in *Farah Constructions*[46] the High Court quoted Lord Selborne LC holding in *Barnes v Addy* that "[t]here would be no better mode of undermining the sound doctrines of equity than to make unreasonable and inequitable applications of them."[47]

2. *Disassociation of Primary Right and Remedy*

The second reason to note this decision was the process adopted by the Court. It clearly divided the case into two, interrelated, parts: the right and the remedy. The appropriate remedy will be partially determined by the nature of the right. The task of the court to find the appropriate remedy is facilitated by many recent decisions. These decisions, including *Giumelli,*[48] increase the range of remedies available. Many recent High Court decisions, such as *Bofinger,*[49] recognize the use of the constructive trust to remedy certain legal wrongs.

The purpose of the High Court's discussion was simply to identify some of the possible remedies, particularly as the remedy ordered by the Court of Appeal was a constructive trust. The High Court held that "ordinarily the remedy of constructive trust would have been selected from a range of possible remedies."[50]After discussing the possible remedies available, the High Court began to search for the appropriate remedy for this particular context.

3. *Determining the Appropriate Remedy*

Simply because the constructive trust is available as a remedy does not mean that it will always be appropriate. Determining appropriateness is complex. The High Court noted:

> One point made in the *Giumelli v Giumelli* line of cases is that care must be taken to avoid granting equitable relief which goes beyond the necessities of the case. Another point in those cases is that third party interests must be borne in mind in deciding whether a constructive trust

45 *James Baird Co v Gimbel Bros Inc* 64 F 2d 344 at 346 (2nd Circ Ct of Appeals, 1933, cited at (2010) 241 CLR 1, 25 [101].
46 (2007) 230 CLR 89, [179].
47 (1874) LR 9 Ch App 244, 251.
48 (1999) 196 CLR 101.
49 (2009) 239 CLR 269.
50 *John Alexander's Clubs* (2010) 241 CLR 1, 43 [118].

> should be granted. That line of cases does not permit a constructive trust to be declared in a manner injurious to third parties merely because the plaintiff has no other useful remedy against a defendant.[51]

Another extremely important factor in determining the appropriate remedy is the basis of the right. Another factor which the High Court held was relevant in ordering a constructive trust was the direct impact upon relevant third parties (such as Walker Corporation). In discussing the award of the constructive trust, the High Court held its judgment "was to provide an example of the caution required in imposing a remedial constructive trust to ensure that the legitimate interests of third parties will not be adversely affected." Subsequently the High Court held:

> Walker Corporation submitted that before deciding to declare the constructive trust the Court of Appeal ought to have borne in mind the impact that that course would have on Walker Corporation's unregistered mortgage, of which the Club had notice, and of which the Court of Appeal was or ought to have been aware. The submission was correct, for reasons given in the line of cases associated with *Giumelli v Giumelli* (footnote; [1999] HCA 10; (1999) 196 CLR 101 at 113-114 [10] and 125 [49]-[50]; [1999] HCA 10; *Bathurst City Council v PWC Properties Pty Ltd* [1998] HCA 59; (1998) 195 CLR 566 at 584-585 [40]- [43]; [1998] HCA 59; *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22; (2007) 230 CLR 89 at 172 [200]; [2007] HCA 22. See also *Muschinski v Dodds* [1985] HCA 78; (1985) 160 CLR 583 at 623; [1985] HCA 78, where Deane J would only have imposed a constructive trust from the date when the Court's reasons for judgment were published, "[l]est the legitimate claims of third parties be adversely affected".)[52]

The consideration of directly impacted third parties is generally of paramount importance in insolvency matters.

In *John Alexander's Clubs Clubs*, the High Court adopted the approach of first considering the right, then examining the available remedies. The High Court then selected the appropriate remedy after examining various factors.

4. *The Role of Joinder in Cases Involving Third Parties and Claims for Remedial Constructive Trusts*

A very significant aspect of the High Court's decision in this case is increasing the importance of joinder in cases where there is a claim for the remedial constructive trust. Importing the practice commonly adopted in probate cases,[53] the High

51 Ibid, 45-46 [129].
52 Ibid, 43 [116].
53 Ibid, 49 [142].

Court stated "Walker Corporation submitted that where a court is invited to make, or proposes to make, orders directly affecting the rights or liabilities of a non-party, the non-party is a necessary party and ought to be joined. That submission is correct."[54]

Conclusion

For ease of understanding this decision, it is useful to keep solidly in mind that it actually involved two separate appeals. Essentially, there are two conclusions: the first, which is closely tied to the first appeal, is the strong affirmation of the *Giumelli* decision. As this important case has been adequately examined, further examination would not be productive. The second conclusion, which is closely tied to the second appeal, is the rise of the role of joinder in cases where the remedial constructive trust has been claimed. As the constructive trust is being seen more and more as a remedy in Australia, it is appropriate to consider the role of third parties with respect to other remedies.

Other Equitable Remedies and Third Parties

One of the most important considerations in awarding an equitable remedy is the presence of third parties. For the correct application of this consideration with regard to the remedial constructive trust, it is instructive to consider how equity generally deals with the presence of a third party when awarding a remedy.

Rescission

It is well established that if a third party acquires rights under a voidable contract for valuable consideration and has no notice of the legal problem that makes the contract voidable, the remedy of rescission is barred. But, where the third party is not innocent, Giles J in *Hunter BNZ Finance Ltd v CG Maloney Pty Ltd,*[55] relying upon *Waters Motors Pty Ltd v Cratchley.*[56] held that rescission may still be granted.

Rectification

Likewise, the Federal Court has held that the remedy of rectification may be refused where the rights of an innocent third party would be defeated.[57] Finkelstein J propounded that view by finding:

> [b]y way of analogy there are cases which hold that if a third party has acquired rights bona fide and for value in property transferred under a

54 Ibid, 46 [131], omitting footnotes.
55 (1988) 18 NSWLR 420, 434.
56 (1963) 80 WN (NSW) 1165.
57 *CMG Equity Investments Pty Ltd v Australia and New Zealand Banking Group Ltd* [2008] FCA 455.

> contract, a court will not rescind the contract: *White v Garden* (1851) 10 CB 919 [138 ER 364]; *Clough v London and North Western Railway Co* (1871) LR 7 Exch 26; *In re L G Clarke; Ex parte the Debtor* [1967] Ch 1121. The cases on rectification are to the same effect: see *Latec Investments Ltd v Hotel Terrigal Pty Ltd (in liq)* [1965] HCA 17; (1965) 113 CLR 265; *Coolibah Pastoral Co v Commonwealth* (1967) 11 FLR 173.

Finkelstein J thereby unified the approach taken with innocent third parties and the remedies of rescission and rectification.

Further, Young, Croft and Smith in *On Equity*[58] state that rectification may be refused where the rights of innocent third parties would be defeated but then state that a "different outcome may result if the third party had notice of the mistake".[59]

Injunctions

In relation to injunctions, the High Court held in *Patrick Stevedores v MUA*:

> The interests of the public and of third persons are relevant and have more or less weight according to the other material circumstances. So it has been said that courts of equity 'upon principle, will not ordinarily and without special necessity interfere by injunction, where the injunction will have the effect of very materially injuring the rights of third persons not before the courts'. Regard must be had 'not only to the dry strict rights of the plaintiff and the defendant, but also the surrounding circumstances, to the rights or interests of other persons which may be more or less involved'.[60]

Interestingly, this is a quote from Spry[61] who takes issue with the statement[62] of Isaacs J in *Gall v Mitchell* [63] that "[h]ardships of third persons entirely unconnected with the property are immaterial." Spry stresses the fact that injunctions may be refused if they very materially injure the rights of a third party.

The High Court also held in *Patrick Stevedores that* "the weight to be given to third party interests varies according to the circumstances."[64]

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58 Young, Croft and Smith, *On Equity* (Thomson Reuters, 2009) 757.
59 See *JJ Leonard Properties Pty Ltd v Leonard (WA) Pty Ltd (No 2)* (1987) 13 ACLR 77 for an interesting application.
60 (1998) 195 CLR 1, [65], *emphasis added*.
61 Spry, *Equitable Remedies* (5th ed, Law Book Co) 402-403.
62 Spry, *Equitable Remedies* (7th ed, Thomson Reuters) 202.
63 (1924) 35 CLR 222.
64 (1998) 195 CLR 1, [66].

Specific Performance

It is important to accurately understand the impact an equitable remedy will have upon a third party. As Spry has noted:

> It does not follow that the position of third parties or of the public is commonly of decisive weight: its importance depends on the special circumstances of the case and, in particular, on considerations that affect directly the parties to the agreement. In particular a plaintiff is not ordinarily denied relief merely in view of prejudice or hardship to the public or third persons. Relief is refused by the court only in exceptional cases where considerations of this kind are so disproportionately great, as against prospective prejudice or hardship to the plaintiff, as to render specific performance unjust in all the circumstances.[65]

Conclusion

Considering third parties is always relevant but generally is not decisive. However, the presence of an innocent third party is more likely to be decisive than the presence of a non-innocent third party. This is the application of the bona fide purchaser without notice rule in a remedial context.

Joinder

The court has a discretion to join parties to an action. According to Wilcox J in *Bishop v Bridgelands Securities Ltd*[66] matters relevant to the exercise of the court's discretion to permit joinder of parties include

> (1) the degree to which joinder will minimise costs and delay;
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> (2) whether joinder would occasion unfairness to any party;
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> (3) the degree to which individual parties are relying on matters particular to them; and
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> (4) the number of joined parties.

Essentially, there are both wide and narrow views of the procedure for the addition and substitution of parties. The wide approach was adopted in the English Court of Appeal decision *Gurtner v Circuit,*[67] in which the Court allowed an application from the Motor Insurers' Bureau (MIB) to be joined as a defendant. In that case the plaintiff was injured in a car accident and it was impossible to trace the

65 At 202 of 8th ed (Thomson Reuters, 2011), omitting footnotes, when discussing specific performance.
66 (1990) 25 FCR 311, 314.
67 [1968] 2 QB 587.

offending driver. An order for substituted service was made. Had the defendant not appeared to defend the action, the plaintiff would have been entitled to enter a default judgment. MIB would incur a liability to pay the plaintiff the amount of the assessed damages. As a consequence MIB applied to be made a defendant so that it could apply to have the order for substituted service set aside and to appear at any assessment of damages. Lord Denning MR allowed the joinder on the basis that MIB would become liable on a judgment for the plaintiff. His Lordship was of the opinion that a party could be joined where the determination of proceeding would *directly affect* either the legal rights or the finances of the person applying to be added.

Diplock LJ held that MIB did not qualify to be joined on the ground that it was a person who ought to be joined within the meaning of the rules. While MIB had a commercial interest in the outcome of the dispute, it did not have a legal interest. According to his Lordship the only reason for joining a person as a party is so that the person becomes bound by the judgment. Relevantly for the remedial constructive trust, Diplock LJ examined another basis on which the court may add a person as a party. This is where a right is enforceable by the person against one of the parties, or where a right is enforceable by a party against the person.

The narrow approach to joinder is illustrated by the decision of Devlin J in *Amon v Raphael Tuck & Sons Ltd,*[68] in which the plaintiff sued for damages for breach of an agreement to keep confidential certain information about an invention for which the plaintiff was responsible. He also sought an injunction to restrain the defendant from using the information. There was an application from the defendant to join a co-defendant. It was alleged that the proposed co-defendant was responsible for the invention and that he had authorised the defendant to produce it. Ultimately, the Court allowed the joinder, but only on the ground that the narrow test was satisfied.

While Devlin J acknowledged the existence of both views of the joinder power, his Honour concluded that the narrow view was the correct approach. This view permits a joinder only so that the action will not fail for want of parties; it prevents the operation of an equivalent of the common law plea of abatement. All parties who are necessary for the complete adjudication of the dispute between the existing parties can be joined. The action will not fail because of a non-joinder, as the court might adjudicate between the existing parties. If the court cannot so adjudicate, it may add or substitute other parties. This was the practice in equity before the *Supreme Court of Judicature Act 1875*.

On the narrow approach, a person becomes a necessary party if that person should be bound by the result of the action. Therefore to justify a joinder, the question in the action must be one which cannot be effectively and completely settled unless the joinder is allowed. It may be insufficient for a joinder that the person has a

68 [1956] 1 QB 357

commercial or indirect interest in the resolution of the dispute, as opposed to a direct and legal interest. In *Amon*, the joinder was allowed because the grant of an injunction against the defendant would affect royalty entitlements under an agreement between the defendant and the intended co-defendant. It is interesting to note that in *Lukic v Lukic*[69] a spouse claiming an interest under the *Family Law Act 1975* (Cth) in respect of a former matrimonial home in proceedings in the Family Court was held to be entitled to be joined as a party to proceedings in the Equity Division of the Supreme Court of New South Wales involving that same property. This was because a spouse was a person whose commercial interests might suffer, and it was not necessary for the spouse to establish, as a prerequisite to joinder, that a legal right might be affected.

The New South Wales Court of Appeal in *Qantas Airways Ltd v AF Little Pty Ltd*[70] held that, where a plaintiff applies for leave to add a defendant, the rules should be applied so that a joinder is allowed to include matters which are subjacent to the pleadings. The rules should not be construed as limited to allowing a joinder as to matters arising out of the existing pleadings. In that case, the plaintiff sued an architect and an engineer because of the defective design of a building. The Court allowed the plaintiff to add the builder to allege alternative claims in tort and contract.

A liberal application of the joinder rule is apparent in some Australian authorities. For example, in *Re Great Eastern Cleaning Services Pty Ltd*[71] the Commissioner of Taxation applied for leave to be joined as a respondent to an application for a company to be restored to the register. It was held that tax liability was sufficient to allow the joinder. The Commissioner was joined as a person whose presence was necessary for the complete adjudication of all the issues. However, in *Walker v Commonwealth Trading Bank of Australia*[72] a defendant's application to join a co-defendant was refused. A liquidator commenced proceedings to recover payments which were alleged to be preferences. The joinder of mortgagors and guarantors who secured payment to the creditor was refused by the court because their presence was not necessary for the conduct of the proceeding. A party could not be joined, where relief was not claimed against that party by either the plaintiff or a defendant, merely so that an estoppel could be created. In *Foxe v Brown,*[73] *Bradvica v Radulovic*[74] and *Finlay v Littler*[75] insurance companies were joined because they would be liable on any judgment given for the plaintiff.

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69 (1994) 18 Fam LR 301.
70 [1981] 2 NSWLR 34.
71 [1978] 2 NSWLR 278.
72 (1985) 3 NSWLR 496. See also *National Australia Bank Ltd v Bond Brewing Holdings Ltd* [1991] 1 VR 386.
73 (1984) 58 ALR 542.
74 [1975] VR 434.
75 [1992] 2 VR 181.

Joinder and the Remedial Constructive Trust

One factor which meant the High Court considered the constructive trust was not appropriate in *Giumelli* was the presence of a third party. The decision in *John Alexander's Clubs Clubs*[76] both affirms *Giumelli* and raises the important role of joinder with regard to the remedial constructive trust.

Third Parties Which Should be Joined

As noted previously the High Court held "Walker Corporation submitted that where a court is invited to make, or proposes to make, orders *directly affecting* the rights or liabilities of a non-party, the non-party is a necessary party and ought to be joined. That submission is correct".[77] Joinder is an important issue for two reasons. First, it assists the court to have full and complete arguments put to it when considering whether the constructive trust is the appropriate remedy to order. Secondly, joinder means that any order binds the third party as a party to the proceedings. Joinder seems the High Court's preferred route to determining cases involving third party interests.

The High Court put some limitation on which third parties should be considered. Not all third parties with rights or liabilities that will be affected are relevant third parties. Only those third parties which are *directly affected* should be joined.[78] Obviously, this only relates to joining the third party. To support its conclusion in *John Alexander's Clubs's Clubs*, the High Court cited the earlier High Court judgment in *Victoria v Sutton*[79] which, in turn, relied on the Full Federal Court in *News Ltd v Australian Rugby Football League Ltd,*[80] which required the "directly affect" limitation on which third parties were joined.

Further to the limitation of "directly affect", Walker Corporation argued that if a court makes an order affecting a person who should have been joined as a necessary party, while the order will not be a nullity, that person is entitled to have the order set aside. The High Court did not completely accept this, insteadholding, "[a]s a *general* proposition this submission is correct."[81] The High Court then added, "[i]f there is any exception to the principle relied on (which it is unnecessary to decide in this case), it can have no application in the present circumstances, in which there was evidence that a plaintiff claiming a constructive trust over Torrens system land is cognizant of a mortgage which would be affected by its claim."[82] This would seem to indicate that where the interest is not as "strong" or the plaintiff does not know of it, the effect of not joining the third party may not

76 (2010) 241 CLR 1.
77 Ibid, 46 [131], emphasis added.
78 The High Court repeated "directly affects" requirement in 46 [133].
79 (1998) 195 CLR 291, 316-318.
80 (1996) 64 FCR 410 at 523-525.
81 (2010) 241 CLR 1, 48 [137], emphasis added.
82 Ibid, 48 [138].

have the consequence as Walker Corporation submitted.

Still on the joinder issue, the High Court held that "Chancery procedure, the influence of which is apparent in the modern Judicature systems, was concerned that all persons *materially interested* in the subject matter of a suit *generally* ought to be made parties so as to settle the controversy by binding those interested to the final decree".[83] This statement is of significance for three reasons. First, a limitation (once again) was being imposed. Not all third parties can be joined;nly those third parties "materially interested" could be joined. The second reason is that the High Court in *John Alexander's Clubs* used "*directly affecting"* as the test with the remedial constructive trust, whereas their Honours found the term "*materially interested"* is relevant more generally to Equity. If there is a difference between these two terms then that difference may be exploited. The third reason for the statement being significant is that it cites the earlier High Court authority of *Wong v Silkfield Pty Ltd*[84] for support. After stating this general rule in *Wong*, their Honours unanimously held "[h]owever, as Daniell [*The Practice of the High Court of Chancery*, 5th ed (1871), vol 1 at 283] put it, in answering "the purpose of complete justice, care must be taken not to run into the opposite defect, viz, that of attempting to embrace in [the bill] too many objects", thereby risking a demurrer to the bill on the ground of multifariousness. On such a demurrer, a defendant might object to having been brought in as a party upon a record propounding a case on the basis that he had no connection with a significant portion of it."[85] Therefore it is quite obvious that not all third parties will be joined.

Non-Joined Third Parties (The Spectre of Unsecured Creditors)

1. *Introductory Comments*

The impact of the constructive trust upon third parties in insolvency matters has caused great concern, perhaps too much. It is a fundamental proposition of insolvency law that creditors may only have recourse against property owned by the insolvent person. Numerous attempts have been made to resolve the relationship between the constructive trust and insolvency. Various important approaches to this debate have been suggested by Goode,[86] Cope,[87] Oakley,[88]

83 Ibid, 48 [139], emphasis added.

84 (1999) 199 CLR 255.

85 Ibid, 261.

86 For example, Goode, "The Right to Trace and Its Impact in Commercial Transactions" (1976) 92 *LQR* 360; "Ownership and Obligation in Commercial Transactions" (1987) 103 *LQR* 433 and "Property and Unjust Enrichment" in Burrows (ed), *Essays on the Law of Restitution* (Butterworths, 1991) 215 and "Proprietary Restitutionary Claims" in *Restitution: Past, Present and Future* Cornish et al (eds), (Hart Publishing, 1998) 63.

87 Cope, *Constructive Trusts* (Law Book Co, 1992) and *Proprietary Claims and Remedies* (Federation Press, 1997).

88 For example, Oakley, *Constructive Trusts* (Sweet & Maxwell, 3rd ed, 1997); Oakley, 'The Precise Effect of the Imposition of a Constructive Trust' in Goldstein (ed) *Equity*

Paciocco,[89] Scott,[90] and Worthington.[91] Many of the attempts to solve the issue of when property is or is not owned by the insolvent is related to the idea of the acceptance by unsecured creditors of the risk of the defendant ceasing to be the owner of property.[92] In Australia, the Federal Court has applied the "acceptance of risk" theory.[93]

However, the "acceptance of risk" theory does not completely explain why the successful applicant should deny property to all unsecured creditors. Not all unsecured creditors, such as a judgment creditor, have been in a position to bargain for security and therefore can be said to have accepted this risk.

Further, where there is the creation of equitable property by the order of a remedial constructive trust, it has been assumed that the moral position of unsecured creditors is weaker than that of the plaintiff who is seeking a proprietary remedy. However, this assumption has been challenged.[94]

As a result of these complications, Scott has refined the basic "acceptance of risk" theory.[95] This refined "acceptance of risk" theory should also be understood in the light of the comment by the Queensland Supreme Court that "[c]reditors should be expected in these times to be aware of the possibility of constructive trusts or of equitable interests which may arise when the debtor is married or in a de facto relationship."[96]

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and Contemporary Legal Developments (1992) 427, and "Proprietary Claims and Their Priority in Insolvency" (1995) 54 *CLJ* 377. Importantly, in his *Cambridge Law Journal* article, at pp396-397, Oakley expressed admiration for the High Court's flexible approach in *Warman International v Dwyer* (1995) 182 CLR 544 to the award of remedies for breach of fiduciary duty.

89 Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors" (1989) 68 *Can Bar Rev* 315.

90 Scott, "The Remedial Constructive Trust in Commercial Transactions" [1993] *LMCLQ* 330.

91 Worthington, *Proprietary Interests in Commercial Transactions* (1996).

92 Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors" (1989) 68 *Canadian Bar Rev* 315 is among the leading advocates of the acceptance of risk approach. This approach has the support of Lord Templeman in both *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072 at 1074 and in *Lord Napier and Ettrick v Hunter* [1993] 1 AC 713, 737, but whose reasoning was disapproved of by the Privy Council in *Re Goldcorp Exchange Ltd* [1994] 2 All ER 806 at 827 per Lord Mustill. See also the discussion of this by Glover, *Commercial Equity Fiduciary Relationships* (Butterworths, 1995), 237-240 and Tettenborn "Remedies for the Recovery of Money Paid by Mistake" (1980) 39 *Cambridge Law Journal* 272 at 274-5.

93 *Australian Securities Commission v Melbourne Asset Management Nominees Pty Ltd* (1994) 49 FCR 334.

94 For example, Goode, "Ownership and Obligation in Commercial Transactions" (1987) 103 *LQR* 433, 444-445.

95 Scott, "The Remedial Constructive Trust in Commercial Transactions" [1993] *Lloyds Maritime and Commercial Law Quarterly* 330.

96 *Clout v Markwell* [2001] QSC 91, [21].

2. *Conclusion*

On balance, and it can be stated no higher than that, superior courts should have the power to order remedial proprietary interests, which may impact upon third parties. In addressing this issue, courts should employ the refined "acceptance of risk" theory. There are six main reasons for this conclusion:

1. The majority of creditors can be said to have accepted the risk of the defendant's insolvency. Already with legislation like s79 of the *Family Law Act* 1975 (Cth) creditors are familiar with the discretionary adjustments of property rights. A further extension of this first point is the fact that as the community becomes familiar with the remedial constructive trust, creditors will factor into their calculations the possibility of the debtor ceasing to own property.

2. The policy consideration that it may be necessary to achieve the minimum equity to grant a proprietary remedy. If equity is concerned with the prevention of unconscionability between the plaintiff and defendant, it may be possible to recognise that the impact upon third parties, such as unsecured creditors, is of lesser significance. To put this in another way, why should the plaintiff be denied a proprietary remedy simply upon the basis of the impact of that remedy upon third parties? This may be particularly accurate when there is a policy consideration of protecting the relationship that existed between the plaintiff and the defendant.[97] The obvious example of this relates to the fiduciary relationship. Courts should also consider how to avoid any difficulties for third parties arising from the way the order is framed. This has a direct connection to the operation of the remedial constructive trust. The fact that the third parties may be unjustly enriched if they are permitted to share in the relevant assets is another aspect of this point.[98]

3. The insolvency implications may be overstated. For example, Waters has stated that in Canada he is aware of only three cases, none of which have reached the Supreme Court, that have involved the issue of a claimant gaining priority in insolvency by seeking a proprietary remedy.[99] Certainly the evidence from the jurisdictions that possess various forms of the remedial constructive trust indicates that the insolvency actual problems, rather than the fear, associated with this form of remedy are overstated.

The fourth reason relates to consistency with other equitable remedies. The impact of equitable remedies upon third parties should be considered to some

97 But see Crilley, "A Case of Proprietary Overkill" (1994) 2 *RLR* 57, 72.

98 This is the point that Sherwin makes in "Constructive Trusts in Bankruptcy" [1989] *University of Illinios Law Review* 297.

99 Waters, "Proprietary Relief: Two Privy Council Decisions" (1995) 25 *Canadian Business L aw Journal* 90, 96. Interestingly in the US constructive trust orders are frequently made expressly subject to insolvency rights.

extent.

A further reason for permitting superior courts to possess the powers to grant proprietary interests that give preferential treatment to one party and thereby impact upon third parties is that equity has permitted the creation of proprietary interests that deny property to unsecured creditors in insolvency matters via the doctrine of tracing. To deny courts the ability to utilise a remedial constructive trust goes against equity's history of generating proprietary interests.

Finally, *John Alexander's Clubs* allows directly affected third parties to be joined, allowing those parties to fully argue about the considerations that the court should consider.

It is obvious that the possible impact of ordering a remedial constructive trust makes the consideration of the nature of the interest all the more important. The goal must always is do what is practically just. That is why the flexible approach taken by Burchett J in *Katingal Pty Ltd v Amor*[100] should be adopted. Stressing remedial flexibility, his Honour held the court may take into account the consequences for creditors and the wrongdoer in deciding whether to impose a constructive trust.

Non-Joined Third Parties that the court is actually aware of

The High Court in *John Alexander's Clubs* observed that "before deciding to declare the constructive trust the Court of Appeal ought to have borne in mind the impact that that course would have on Walker Corporation's unregistered mortgage, of which the Club had notice, and of which the Court of Appeal was or *ought* to have been aware."[101] The High Court seemed to suggest that a court should consider a third party's interest even if it did not know of it. Basically, the High Court appears to be saying that courts can have actual or constructive knowledge.

A Brief Consideration of Considerations when awarding the constructive trust

Introduction

It is fundamental to realize that there is no exhaustive list of relevant factors that should be considered in relation to the constructive trust. However, there are common considerations. These have been placed into six non-hierarchical

100 (1999) 162 ALR 287, which was a case of a breach of fiduciary duty producing a business and unsecured creditors who would have been prejudiced by the order of a proprietary constructive trust. Clarify this sentence?

101 *John Alexander's Clubs* (2010) 241 CLR 1,44-45 [126], emphasis added.

categories which are 'obligation-based'; 'conduct-based'; 'result-based'; 'claim-based'; 'administration of justice'; and 'general policy' factors.[102]

The mere presence of third parties, while important, is not determinative of the issue of the use of the remedial constructive trust. In his dissenting judgment in Stephenson Nominees Pty Ltd v Official Receiver,[103] Gummow J, then sitting in the Full Federal Court, acknowledged some of the concerns regarding the priority afforded to beneficiaries of constructive trusts against general creditors:

> Reference was made by Gibbs CJ (in *Daly's case* (supra) at 379) to the effect of the constructive trust in withdrawing assets from the general body of creditors; this generally will be so unless the beneficiary of that trust himself holds his rights for the benefit of a fund he administers, for example, on insolvency (as would be the position of the Official Receiver in the present case). However, in general the result may be seen, as the Chief Justice observed, as unjust to the general creditors of the constructive trustee unless there is given further explanation of the raison d'être of the trust.[104]

Importantly, his Honour did not come to a definitive conclusion as to when third party interests will render it inappropriate to impose a constructive trust. Simply the presence of third parties will not, by itself, mean that the constructive trust cannot be used as a remedy.

In *Disctronics Ltd v Edmonds,*[105] Warren J, after discussing *Muschinski* and *Bathurst*, held that:

> The plaintiffs sought the declaration of a constructive trust as their primary relief. They sought also, and alternatively, equitable compensation and an account of profits. Mindful of the clarification of the relief expressed by the High Court in Bathurst City Council I must consider whether there are other means available to resolve the controversy between the parties. If a constructive trust is imposed it must be capable of being moulded so as to be effective from the date of judgment subject to appropriate orders to protect third parties such as the Buxton interests and any mortgagee including the repayment of moneys owed.
>
> However, I could not be satisfied that in doing so the effect of such declaration and order would be devoid of the risk of giving the plaintiffs unfair priority over others such as any mortgagee. Unfortunately, the consequences of a declaration in the circumstances of this case were not the subject of sufficient evidence as to the risks to other parties such that I

102 Wright, *The Remedial Constructive Trust* (Butterworths, 1998) Ch 5. These categories are frequently overlapping.
103 (1987) 16 FCR 536.
104 (1987) 16 FCR 536, 555.
105 [2002] VSC 454.

> would be prepared to impose a constructive trust in this matter. I consider that in this case there are clear remedies available capable of resolving the matter without resort to the imposition of a constructive trust. I make one further observation. Most of the cases where the imposition of a constructive trust has been contemplated have generally fallen into two broad categories. First, the domestic property cases. Secondly, the insolvency cases where a party seeks priority over creditors. Here the circumstances do not fall easily into either category.[106]

Warren J held in that case that equity could be done by ordering equitable compensation, rather than ordering a remedial constructive trust. Further in *Victoria University of Technology v Wilson,*[107] Nettle J referring to *Distronics* held that:

> I do not think that I can be satisfied that the imposition of a constructive trust over the software would be devoid of the risk of giving the university unfair priority over third party investors. And as will be seen, I do not consider that it is necessary to make such an order in order to do equity to the university.[108]

So merely the presence of third parties, while important, is not determinative of the issue. Some of the more important, and generally relevant factors,[109] will be briefly discussed before embarking on detailed discussions of considerations unique to the remedial constructive trust.

Obviously, the conduct of the parties to an action will be relevant to the appropriate measure of relief granted. One factor the court will always consider is the plaintiff's desire for a particular remedy. But the remedial choice of the plaintiff cannot be exclusive of other proper considerations. Indeed, a court will always have discretion to order any relief — which is open on the pleadings[110] — that it decides appropriate, even if such relief is not specifically claimed.[111] However, a court should give careful consideration not only to the fact that the plaintiff desires a particular remedy, but also to the question of *why* the plaintiff desires a particular outcome.

Perhaps the most common reason for desiring a constructive trust is to obtain possession of the relevant property. For example, in *Soulos v Korkontzilas*, the Supreme Court of Canada imposed a constructive trust in a case where the plaintiff

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106 Ibid, [212-213], emphasis added.

107 [2004] VSC 33. See also *Sui Mei Huen v Official Receiver* (2008) 248 ALR 1, 22 and *Draper v Official Trustee in Bankruptcy* (2006) 236 ALR 499, 522.

108 [2004] VSC 33, [216].

109 But particularly relevant to the remedial constructive trust.

110 *Banque Commerciale SA v Akhil Holdings Ltd* (1990) ALR 53; *SP Hywood Pty Ltd v Standard Chartered Bank* (SC(SA), Perry J, 21 Dec 1992, unreported.)

111 For example see NSW Supreme Court Act 1970 ss 60,63, SCR's NSW Pt 40 r 1 (full reference here?) & *Dare v Pulham* (1983) 57 ALJR 80.

desired that remedy for the purpose of gaining cultural prestige.[112] The plaintiff in *Soulos*, being Greek, asserted that according to Greek culture, the property held special value to him because the tenant of the property was his banker, and to be his banker's landlord was prestigious in the Greek community.

Although not specifically put before the High Court, this "special attachment" can also be seen in the case of *Walker Corporation* (the second case in the *John Alexander's Clubs Clubs* decision). The joint reasons explicitly recognised that "[w]hile ordinarily the remedy of constructive trust would have been selected from a range of possible remedies, by the time the orders were made it was the only remedy sought."[113] The Club's decision not to pursue monetary relief was a result of its desire to regain the White City Land in order to continue operating as a tennis club. For the Club, the White City Land had a particular significance that could not have been compensated for through the grant of alternate relief, such as an equitable lien.[114] The Club was interested in the survival of an 80 year old tennis club, whereas Walker Corporation had a purely pecuniary interest. That is not to say that the plaintiff's interests must be catered for to the exclusion of those of innocent third parties. However, it does highlight the need for courts to grant due consideration to the flexible application of the constructive trust in order to ensure that equity does 'that which ought to be done'.

A further relevant consideration will be the plaintiff's conduct in bringing the action. In *Re Sharpe*, Browne-Wilkinson J considered that if the wife of a bankrupt was to be "deprived of her interest as against the trustee in bankruptcy, it must be because of some conduct of hers which precludes her from enforcing her rights, that is to say, the ordinary principles of acquiescence and laches which apply to all beneficiaries seeking to enforce their rights".[115]

Similarly, regard may be had to the defendant's conduct. The New South Wales Court of Appeal in *United States Surgical Corp v Hospital Products International Pty Ltd* suggested that a court should be more inclined to award relief by way of constructive trust where fraud is involved.[116] Paciocco has queried why a defendant's lack of honesty should have any bearing on the justification for awarding the victim priority over the general creditors of the defendant.[117] However, this view takes remedy selection as completely mechanical and undervalues the role of the remedy as a deterrent. This begins blurring into "obligation based" factors.

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112 [1997] 2 SCR 217.

113 *John Alexander's Clubs*(2010) 241 CLR 1, 43 [117].

114 As in *Giumelli*.

115 *Re Sharpe (a bankrupt); Ex parte the Trustee of the Bankrupt v Sharpe* [1980] 1 WLR 219, 226.

116 [1983] 2 NSWLR 157, 237.

117 Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors" (1989) 68 *Canadian Bar Review* 315, 347.

The primary right or obligation plays an important role in determining the appropriate remedy. For example, this use of a proprietary remedy was considered to be legitimate by Gummow J in *Stephenson's Nominees Pty Ltd v Official Receiver,* speaking in the context of preserving the stringency with which equity regards the fiduciary relationship.[118] This potential has also been recognised in Canada, with McLachlin J noting that "the constructive trust may apply … to condemn a wrongful act and maintain the integrity of the relationships of trust which underlie many of our industries and institutions."[119]

Important considerations when the court is considering imposing a constructive trust as a remedy are discussed below.

Other Remedies Considered First

Repeatedly the High Court has indicated that a remedy falling short of a constructive trust should be ordered if it can do justice. This looks like a very specialised application of the "minimum equity" rule. For example, the High Court in both *Bathurst* [120] and in *Giumelli*[121] has said that before a constructive trust is imposed the court should first decide whether, having regard to the issues in the litigation, there is an appropriate equitable remedy which falls short of the imposition of a trust. In *Bathurst*, their Honours noted that Gibbs CJ in *Muschinski* had seen the imposition of an equitable charge to secure the appellant's entitlement to a contribution from the respondent as an adequate equitable remedy.

One of the reasons for the caution expressed in *Bathurst* and *Giumelli* is further explained by the High Court in *Bathurst*, where their Honours said that:

> ... An equitable remedy which falls short of the imposition of a trust may assist in avoiding a result whereby the plaintiff gains a beneficial proprietary interest which gives an unfair priority over other equally deserving creditors of the defendant.[122]

As a general statement of principle only, a constructive trust will be treated as coming into existence at the time of the conduct which gives rise to the trust. In such a case, the doctrine of priorities would apply and, where the equities are equal, the beneficiary of the constructive trust would be entitled to priority over the holder of a later equitable interest or an unsecured creditor of the constructive trustee. So, for example, in *Australian Building & Technical Solutions Pty Limited v Boumelhem*[123] the NSW Supreme Court declared a constructive did not exit, preferring to order an equitable lien.

118 (1987) 16 FCR 535, 553.
119 *Soulos v Korkontzilas* [1997] 2 SCR 217, 227
120 (1998) 195 CLR 566, 585.
121 (1999) 196 CLR 101, [10].
122 (1998) 195 CLR 566, [42].
123 [2009] NSWSC 460.

Using the Start Date as a Way to Avoid the Adverse Impact Upon Third Parties.

One important service that the debate between the remedial/ institutional models of the constructive trust was that it highlighted the possible use of the start date of it as way to minimize the adverse consequences of the imposition of the constructive trust. The essential distinguishing feature between the institutional and the remedial constructive trust relates to the commencement of the constructive trust. With the institutional constructive trust the commencement date is said to be the date of the wrongdoing. It has been argued that the remedial constructive trust commences from the time of the judgment. In *Bathurst* the High Court accepted a model based upon that proposed by Deane J[124] in *Muschinski*[125] and the majority in *Baumgartner v Baumgartner*.[126] The High Court in *Bathurst*[127] held that "the constructive trust which Mason J and Deane J [in *Muschinski*] favoured was to be imposed only from the date of publication of the reasons for judgment for this court".

There have been conflicting views concerning when the remedial constructive trust arises.[128] Essentially there are two main theoretical positions. The first states that the constructive trust arises independently of any judicial order. According to this view, the court does not create the trust but recognises the pre-existing trust. The trust automatically arises at the date of the wrongdoing. The second position is that the constructive trust only arises when the court orders it.

The first position represents the analysis of Scott who argued that a constructive trust exists separately from the court order and that the order is only recognising the existence of the trust.[129] Importantly, in *Muschinski* Deane J[130] adopted the Scott approach of a pre-existing trust which is recognised by the court.[131] Deane J held that the court could mould the form of relief in order "to give effect to the application and interplay of equitable principles in the circumstances of the

124 With whom Mason J agreed.
125 (1985) 160 CLR 583.
126 (1987) 164 CLR 137.
127 (1998) 195 CLR 566, 584.
128 The two positions discussed here both originate in the United States where the constructive trust is always considered to be a remedy, so these theories are discussing the commencement date of the remedial constructive trust.
129 Fratcher and Scott, *The Law of Trusts*, Vol V, 4th ed, Little, Brown & Co, 1987.
130 With whom Mason J agreed.
131 (1985) 160 CLR 583 at 614–15. O'Connor, "Happy Partners Or Strange Bedfellows: The Blending of the Remedial and Institutional Features In The Evolving Constructive Trust" (1996) 20 *Melbourne University Law Review* 735, 758–61 argues that there are two reasons for why the Scott position has prevailed. They are that the courts desire to be able to deny any redistributive function of the trust and a wish to preserve the claimant's rights in the period between the constructive trust arising and the court order. Can this sentence be better explained? With regard to the first point O'Connor draws heavily upon Rotherham, "The Redistributive Constructive Trust: 'Confounding Ownership With Obligation'?" (1992) 5 *Canterbury Law Review* 84.

particular case".[132] The constructive trust was imposed in that case from the date of judgment in order not to affect the rights of third parties.[133] Deane J in *Muschinski* held if:

> the legitimate claims of third parties be adversely affected, the constructive trust should be imposed only from the date of publication of reasons for judgment of this Court. [134]

In *Re Jonton Pty Ltd*[135] Mackenzie J applied the flexable approach advocated by Deane J to find that although a constructive trust of Torrens title land was not declared to exist until 1991, the beneficiary of the constructive trust possessed an equitable interest that pre-dated the court's declaration. The importance of this finding was that it gave the beneficiary priority over the interests that were created later in time.[136] This approach was utilised by Burchett J in *Zobory v Commissioner of Taxation*.[137] Further, *Re Jonton* was applied in *Re Sabri; Ex parte Brien v Sabri and the ANZ Banking Group.*[138]

The flexibility inherent in the statement by Deane J that the trust exists before the court order is compatible with Cole J's conclusion that:

> In circumstances where a constructive trust is recognised, but no damage flows from it or where to declare the trust would result, for instance, in unjust enrichment to the beneficiary of the trust, the court would grant no relief.[139]

The flexible approach advocated by Deane J was adopted in *Re Osborn*.[140] Pincus J refused to hold that a constructive trust, arising in favour of a de facto spouse on the principles of *Muschinski* and *Baumgartner*, predated the bankruptcy of the man. His Honour held this because it was in the interests of certainty in bankruptcy law that trustees should not have to engage in litigation to establish the uncertain entitlements of a domestic partner in property to which the bankrupt has an apparently absolute legal title.[141] This approach was also followed in *Re Popescu*.[142] In that case the judge held that:

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132 (1985) 160 CLR 583, 615.
133 (1985) 160 CLR 583, 623.
134 Ibid.
135 [1992] 2 Qd R 105.
136 See also the discussion in Oakley, "Proprietary Claims and Their Priority in Insolvency" (1995) 54 *Cambridge Law Journal* 377, 423–4.
137 (1995) 64 FCR 86, 91–2. See also *MacFarlane v Commissioner of Taxation* (1986) 13 FCR 356, 368 per Beaumont J.
138 (1996) 21 Fam LR 213.
139 *Australian National Industries Ltd v Greater Pacific Investments Pty Ltd (in liq) (No 3)* (1992) 7 ACSR 176, 190.
140 (1989) 91 ALR 135.
141 See also Glover, "Bankruptcy and Constructive Trusts" (1991) 19 *Australian Business Law Review* 98.
142 (1995) 55 FCR 583.

> In my opinion a court will be reluctant to declare a constructive trust to commence before settlement in a case such as this where there is no dispute between the applicant and the bankrupt about the ownership of the property needing to be resolved. To decide otherwise would greatly interfere with the administration of bankrupt estates generally, especially in the frequent occurrence of settlements in favour of spouses.[143]

Importantly in *Secretary, Department of Social Security v Agnew*[144] the Full Federal Court held that the commencement date of the constructive trust should be the date of wrong doing only as the prima facie starting point. But this prima facie starting point could be altered. The Court held stated that "the court has a discretion to modify the prima facie date on which the [constructive] trust takes effect".[145] Drummond, Sundberg and Marshall JJ exercised their discretion in holding that the trust was not created at the time of the conduct giving rise to the primary right, nor the date of judgment, but at some unspecified time predating the creditor's interest.

Importantly, in *Parsons v McBain*[146] when discussing the imposition of the common intention constructive trust and not the remedial constructive trust, the Full Federal Court held that the trust was created by the conduct of the parties and arose at the time of wrongdoing, even though this had the effect of defeating unsecured creditors. This approach has been followed in cases like *Parianos v Melluish (Trustee),*[147] outside of the common intention constructive trust.

In Canada, the majority in *Rawluk v Rawluk*[148] also accepted the Scott view. However, the minority rejected the Scott approach.[149] McLachlin J, with whom La Forest and Sopinka JJ concurred, held that to protect third parties means that the court must have discretion to refuse to make a constructive trust order where another, more appropriate remedy is available. The possibility of no operation for the constructive trust recognised by the majority and the retrospective operation sanctioned by the minority gives the court the great flexibility.

By being able to change the operative date of the constructive trust, the approach of Deane J in *Muschinski*, the rigidities in both the Scott and Bogert's positions are avoided. From the judgment of Deane J in *Muschinski* the Scott approach can only be considered the prima facie starting point in evaluating the date from which

143 (1995) 55 FCR 583, 590.
144 (2000) 96 FCR 357, 365.
145 (2000) 96 FCR 357.
146 (2001) 109 FCR 120 and relying upon Browne-Williamson J in *Re Sharpe (a bankrupt); Ex parte Trustee of the Bankrupt's Property v The Bankrupt* [1980] 1 WLR, 225.
147 (2003) 30 Fam LR 524.
148 (1990) 65 DLR (4th) 161 at 176. This is similar to the United States where Sherwin "Constructive Trusts in Bankruptcy" [1989] *University of Illinois Law Review* 297 at 326 has concluded that courts usually adopt Scott's approach.
149 (1990) 65 DLR (4th) 161, 185.

the constructive trust should operate.

To find a hard and fast rule concerning the date of commencement of the constructive date is impossible. Deane J in *Muschinski* recommended a flexible approach to the start date of the constructive trust. This is also consistent with *Bathurst*'s comments regarding remedy selection, which was to adopt a flexible approach.

It is extremely important to realise that this is not to set third parties adrift on a sea of uncertainty because

1. the courts are exercising a discretion and this discretion is tightly controlled,

2. as a general statement of principle only, a constructive trust will be treated as coming into existence at the time of the conduct which gives rise to the trust

3. this flexible approach has not led to huge injustice regarding other remedies,

4. the courts are well aware and incredibly sensitive to the rights of third parties, and

5. by allowing the court to choose between property-based remedies and personal remedies all interests can be taken into account.

The Ability to Award a Constructive Trust on Terms

The ability to award a trust on terms was recognised by the High Court in *Roxborough v Rothmans of Pall Mall Australia Ltd*, although it was not necessary to do so in that case, given the adequacy of legal damages.[150] An example can be found in *International Corona Resources Ltd v LAC Minerals Ltd*.[151] In that case, the Ontario Court of Appeal held it had the power to "relieve the constructive trustee from full liability where to refrain from doing so would, in all the circumstances, be inequitable."[152] Accordingly, although the defendant was considered to hold land acquired in breach of fiduciary duty on constructive trust for the plaintiff, the plaintiff's interest was made subject to an equitable lien representing the costs the defendant had incurred in improving the land.

150 (2001) 208 CLR 516, [57] (Gummow J).
151 (1987) 44 DLR (4th) 592.
152 Ibid 661.

Conclusion

The most important role for the constructive trust in Australia is as a remedy. If it is an available remedy, the next question involves appropriateness. Various considerations came into play in deciding whether to award this remedy. One of the most important considerations in the award of any remedy is the impact upon third parties. The same is true of the constructive trust. It is just another remedy. The constructive trust has special features but like all equitable remedies the core question is whether it is appropriate. As can be seen, this article only provides guidelines, rarely does it provide watertight rules. As Lord Scarman, speaking for the entire House of Lords, noted in the undue influence case of *National Westminster Bank v Morgan*:[153]

> This is the world of doctrine, not of neat and tidy rules … A court in the exercise of this equitable jurisdiction is a court of conscience. Definition is a poor instrument when used to determine whether a transaction is or is not unconscionable: this is a question which depends upon the particular facts of the case.

153 [1985] AC 686, 709.