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Overview of the constructive trust

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1. Overview of the constructive trust

1.1 Simply put, a constructive trust is the avoidance, by equity, of the consequences of unconscionable conduct, with respect to trust property, and in relation to (at least one) beneficiary.

1.2 Young, Croft and Smith in On Equity, Thomson Reuters, 2009 (**"Young"**) at [6.640] says that it "*… is almost impossible to satisfactorily define a 'constructive trust*'. Lord Westbury in *McCormick v Grogan* (1869) LR 4 HL 82 at 97 opined that a constructive trust is imposed "*… simply on the principle that an individual shall not benefit by his own personal fraud … "*.

1.3 Deane J in *Muschinski v Dodds* (1985) 160 CLR 583 at 614 observed that:

> *Viewed in its modern context, the constructive trust can properly be described as a remedial institution which equity imposes regardless of actual or presumed agreement or intention (and subsequently protects) to preclude the retention or assertion of beneficial ownership of property to the extent that such retention or assertion would be contrary to equitable principle.*

1.4 Ong, D in *Trusts Law in Australia* (4th ed), Federation Press, 2012 (**"Ong"**) at 501 defines a "constructive trust" as one which is:

> *… judicially imposed on the owner of property, with respect to either a part or the whole of that property, to the extent that it would be unconscionable, notwithstanding the absence of any relevant or express or resulting trust of that property, for that owner to enjoy that property beneficially in relation to the person or persons for whose benefit the trust is imposed….*

1.5 Millett LJ in *Paragon Finance PLC v DB Thakerar & Co (a firm)* [1999] 1 All ER 400 at 408-9 observed the following:

> *… The expression 'constructive trust' and 'constructive trustee' have been used by equity lawyers to describe two entirely different situations. The first covers those cases already mentioned, where the defendant, although not expressly appointed as trustee, has assumed the duties of a trustee by a lawful transaction which was independent of and preceded the breach of trust and is not impeached by the plaintiff. The second covers those cases where the trust obligations arises as a direct consequence of the unlawful transaction which is impeached by the plaintiff.*
>
> *A constructive trust arises by operation of law whenever the circumstances are such that it would be unconscionable for the owner of a property (usually but not necessarily the legal estate) to assert his own beneficial interest in the property and*

deny the beneficial interest of another. In the first class of case, however, the constructive trustee really is a trustee. He does not receive the trust property in his own right but by a transaction by which both parties intend to create a trust from the outset and which is not impugned by the plaintiff. His possession of the property is coloured from the first by the trust and confidence by means of which he obtained it and his subsequent appropriation of the property to his own use is a breach of that trust.

1.6 When imposing a constructive trust, the court does not "construct" a trust. Rather, the Court "*… construes the circumstances in the sense that it explains or interprets them; it does not construe them…*" (*Giumelli v Giumelli* (1999) 196 CLR 101 at 111).

1.7 Callinan J in *Australian Broadcasting Commission v Lenah Game Meats Pty Ltd* (2001) 208 CLR 199 at 316 observed that as with other "trust" relationships, a constructive trust requires:

1.7.1 trust property;

1.7.2 trustee;

1.7.3 a beneficiary (or beneficiaries); and

1.7.4 a personal obligation that attaches to the trust property.

1.8 Given the above elements, the beneficiary may have a proprietary interest, and can therefore trace.

1.9 However, there are also constructive trusts wherein a beneficiary does not have a proprietary interest in the trust assets, but there is still an ability to trace. For example, in *Giumelli v Giumelli* (1991) 196 CLR 101 at 112 it was observed that:

The term "constructive trust" is used in various senses when identifying a remedy provided by a court of equity. The trust institution usually involves both the holding of property by the trustee and a personal liability to account in a suit for breach of trust for the breach of the trustee's duties. However, some constructive trusts create or recognise no proprietary interest. Rather, there is the imposition of a personal liability to account in the same manner as that of an express trustee. An example of a constructive trust in this sense is the imposition of personal liability upon one 'who dishonestly procures or assists in a breach of trust or fiduciary obligation' by a trustee or other fiduciary.

1.10 A constructive trust cannot be for a non-charitable "purpose". Further, a charitable trust cannot be imposed for a charitable purpose. This is because a constructive trust is not

imposed as a result of a constructive trustee (or any one else's) intention (see *Bathurst City Council v PWC Properties Pty Limited* (1998) 195 CLR 566 at 584-5).

1.11 A constructive trust can only be imposed with respect to beneficiaries.

2. "*Remedial*" and "*institutional*" constructive trusts

2.1 The positions in Australia and the United Kingdom differ with respect to the scope of constructive trusts. There is much debate as to whether a constructive trust is "institutional", or whether it extends to a "remedial" arrangement (which is the position in Australia). The extended "remedial" scope may be demonstrated in Deane J's observations in *Muschinski v Dodds* at 614, being that:

> *Viewed in its modern context, the constructive trust can properly be described as a remedial institution which equity imposes regardless of actual or presumed agreement or intention (and subsequently protects) to preclude the retention or assertion of beneficial ownership of property to the extent that such retention or assertion would be contrary to equitable principle.*

2.2 Very broadly speaking:

2.2.1 an "institutional" constructive trust arises as an operation of law, as from the date of the circumstances which give rise to a constructive trust; whereas

2.2.2 a "remedial" constructive trust is an enforceable equitable obligation which is a totally retrospective remedy.

2.3 That is a "remedial" constructive trust involves a degree of judicial discretion, and is retrospective in nature.

2.4 Deane J in *Muschinski v Dodds* (with whom Mason J agreed) said that the constructive trust was "predominantly remedial" and "in personam remedy attaching to property" and observed that:

> *In particular, where competing common law or equitable claims are or may be involved a declaration of constructive trust by way of remedy can properly be so framed that the consequence of its imposition are operative only from the date of judgment or formal court order or from other specified date.*

2.5 Such an approach occurred in *Baumgartner v Baumgartner* (1987) 164 CLR 137, where a declaration with respect to ownership, being one from the date of judgment, was made. Heydon and Leeming in *Jacobs' Law of Trusts in Australia* (8th ed), Lexisnexis, 2016 ("**Jacobs'**") at [13-11] observed that in Australia some constructive trusts had the following features:

2.5.1 firstly, they are only to be applied as a last resort;

2.5.2 secondly, from the discretionary character of Australian constructive trusts follow particular outcomes as to timing;

2.5.3 thirdly, an account of profits, rather than a declaration of a constructive trust over parts of a business, may be ordered if the latter would *"thrust the parties into a continuing business relationship where it was clear that there was no confidence or comity between them."* (referring to *Warman International Ltd v Dwyer* (1995) 182 CLR 544 at 554 and 564).

2.5.4 fourthly, the form of any constructive trust or other equitable remedy ordered can vary.

2.6 Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669 at 714 (with whom Lord Glynn at 713 and Lord Lloyd at 738 agreed) distinguished between a "remedial" constructive trust and the "institutional" constructive trust.

2.7 In relation to "institutional" constructive trusts, Lord Browne-Wilkinson observed that:

> *Under an institutional constructive trust, the trust arises by operation of law as from the date of the circumstances which give rise to it: the function of the court is merely to declare that such trust has arisen in the past. The consequences that flow from such trust having arisen (including the possible unfair consequence to third parties who in the interim have received the trust property) are also determined by rules of law, not under a discretion.*

2.8 Lord Browne-Wilkinson observed of a "remedial" constructive trust that:

> *A remedial constructive trust, as I understand it, is different. It is a judicial remedy giving rise to enforceable obligation: the extent to which it operates retrospectively to the prejudice of third parties lies in the discretion of the court.*

2.9 Deane J in *Muschinski v Dodds* (at 614), in discussing the imposition of a constructive trust, considered that such a trust could be imposed "*… regardless of actual or presumed agreement of intention …*".

2.10 The essence of the institutional constructive trust is that there are circumstances which arose, which themselves cause the element of unconciobaility to arise, and pursuant to which a constructive trust should be imposed.

2.11 A remedial constructive trust, however, may be imposed with a degree of judicial discretion.

2.12 Ong at 502 suggests that the observations of Deane J should be qualified. For example, in *Gissling v Gissling* [1971] AC 886 (at 905), a constructive trust was imposed where the relevant parties had a common intent – with both parties agreeing that one had a beneficial interest in the relevant property.

2.13 The basis of a constructive trust is to prevent a person declared to be a constructive trustee from benefiting from their own unconscionable conduct, to the detriment to the person wo has the benefit of the relevant trust property (Ong at 503). The essence is the equitable avoidance of the consequences of unconscionable conduct with respect to a beneficiary.

3. Fairness is not the criteria for the imposition of a constructive trust

3.1 Whilst the remedy of a "constructive trust" is a flexible remedy in equity, and (in Australia at least) may involve a degree of discretion, "fairness" is not the criteria for the imposition of a constructive trust. Rather, the basis of a constructive trust is to prevent a person (i.e. constructive trustee) from benefiting with respect to unconscionable conduct. Brennan J in *Muschinski v Dodds* at 608 observed that:

> *A constructive trust does not arise and cannot be imposed on the grounds of mere fairness… There is no jurisdiction in an Australian court of equity to declare an owner of property to be a trustee of that property for another merely on the ground that, having regard to all the circumstances, it would be fair to so declare … The flexible remedy of the constructive trust is not so formless as to place proprietary rights in the discretionary disposition of a court acting according to vague notions of what is fair.*

4. Remedial Constructive Trust and Presumed Resulting Trust

4.1 An issue to consider is whether or not a remedial constructive trust can arise in circumstances where a presumed resulting trust exists.

4.2 In *Anson v Anson* [2004] NSWSC 766, Campbell J at [37] concluded that:

> *If the factual circumstances are such as to give rise to both the presumption of a resulting trust, and the imposition of a constructive trust on Baumgartner principles, then the application of these two different sets of principles leads to different results, then it is the result arising from the Baumgartner principles which prevails.*

5. Recipients of trust property – constructive trusts

5.1 Those which are in receipt of trust property, and who are not bona fide purchasers for value without notice are, at times, categorised as holding such title as constructive trustees (*Peffer v Rigg* [1978] All ER 745 at 752).

5.2 The 'constructive trustee' in such circumstances holds the property subject to the prior legal and / or equitable interest in the subject property. It is on that basis that equity will provide relief, which strictly speaking is relief with respect to the relevant property. However, if the 'constructive trustee' has disposed of the property, then the principles of constructive trusteeship applies to cause the constructive trustee to be personally liable (and required to personally account) with respect to the disposal.

6. Subsequent awareness of the receipt of trust property

6.1 A person who is in receipt of trust property, not as a bona fide purchaser for value without notice, and who initially does not know of the trusts, but subsequently becomes aware of the trusts, may be a constructive trustee. The New South Wales Court of Appeal in *Fistar v Riverwood Legion and Community Club Ltd* [2016] NSWCA 81 at [47] (**"Fistar"**) observed that:

> *A person who receives trust property, otherwise than as a bona fide purchaser for value without notice, but innocently and thereafter acquires notice of the trust and deals with it in a manner inconsistent with the trust, will also be liable as a constructive trustee.*

6.2 Importantly, the principle only applies if the recipient of the property is not a purchaser for value without notice. Further, the principle does not require dishonesty on the part of the recipient. Rather, what is required is that:

6.2.1 notice is obtained of the trusts to which the property is subject to; and

6.2.2 the property is misapplied when considering the trusts.

6.3 The conceptual difference between the principle in *Barnes v Addy* is highlighted as follows "*Although this is similar to first limb Barnes v Addy liability, it is conceptually distinct, because it is the subsequent dealing, rather than the receipt of property that founds liability*" (Fistar at [47]).

7. Tracing

7.1 Tracing refers to the identification of mixed funds, notwithstanding the mixing (and possible change in character).

7.2 The person holding mixed funds (or who may have mixed the funds) as a person not being a bona fide purchaser for value without notice (for example) may be considered a constructive trustee.

8. Mutual wills and constructive trusts

8.1 A common occurrence of a constructive trust for most practitioners is in the context of mutual wills. The principle of mutual wills can be found in the legal reasoning behind Equity upholding "secret trusts".

8.2 Broadly speaking, where two or more people agree to make Wills in a certain way, and one dies having made a Will in accordance with that agreement, equity will restrain the surviving person or persons from going back on the agreement (Young at [6.810]). Dixon J in *Birmingham v Renfrew* (1937) 57 CLR 666 at 689 considered that mutual Wills give rise to a "floating obligation". The obligation is, as Gleeson CJ observed in *Barnes v Barnes* (2003) 214 CLR 169 at 183 *"… suspended during the lifetime of the survivor… descends upon the assets of the survivor*

8.3 In *Birmingham v Renfrew* (1937) 57 CLR 666, Dixon J at 683 observed that a surviving spouse:

> *… cannot be compelled to make and leave unrevoked a testamentary document and if he dies leaving a last will containing provisions inconsistent with his agreement it is nevertheless valid as a testamentary act. But the doctrines of equity attach the obligation to the property. The effect is… that the survivor becomes a constructive trustee and the terms of the trust are those of the will which he undertook would be his last will."*

8.4 Dixon J in *Birmingham v Renfrew* (1939) 57 CLR 666 at 689 considered as follows:

> *The purpose of an arrangement for corresponding Wills must often be, as in this case, to enable the survivor during his life to deal as absolute owner with the property passing under the Will of the party first dying. That is to say, the object of the transaction is to put the survivor in a position to enjoy for his own benefit the full ownership so that, for instance, he may convert it and expand the proceeds if he chose. But when he dies he is to bequeath what is left in the manner agreed upon. It*

is only by the special doctrines of equity that such a floating obligation, suspended, so to speak, during the lifetime of the survivor can descend upon the assets at his death and crystallise into a trust. No doubt gifts and settlements, inter vivos, if calculated to defeat the intention of the compact, could not be made by the survivor and his right of disposition, inter vivos, is therefore, not unqualified. But, substantially, the purpose of the arrangement will often be to allow full enjoyment for the survivor's own benefit and advantage upon condition that at his death the residue shall pass as arranged.

8.5 Dixon J in *Birmingham v Renfrew* (1937) 57 CLR 666 at 683:

It has long been established that a contract between persons to make corresponding wills give rise to equitable obligations when one acts on faith of such an agreement and dies leaving his will unrevoked so that the other takes property under its dispositions. It operates to impose upon the survivor an obligation regarded as specifically enforceable. It is true that he cannot be compelled to make and leave unrevoked a testamentary document and if he dies leaving a last will containing provisions inconsistent with his agreement it is nevertheless valid as a testamentary act. But the doctrine of equity attach the obligation to the property. The effect is, I think, that the survivor becomes a constructive trustee and the terms of the trust are those of the will which he undertook would be his last will.

8.6 That is, Dixon J considered that the doctrine of mutual wills:

8.6.1 is the equitable jurisdiction for the prevention of fraud; and

8.6.2 fastens equities upon property, as a result of a testamentary disposition made in reliance of an understanding or promise.

8.7 Gummow v Hayne JJ in *Barnes v Barnes* (2003) 214 CLR 169 at 199-200 ([85]):

The propositions are: (i) it is the disposition of the property by the first party under the will in the agreed form and upon the faith of the survivor carrying out the obligation of the contract which attracts the intervention of equity in favour of the survivor; (ii) that the intervention is by the imposition of a trust of a particular character; (iii) the subject matter is "the property passing … [to the survivor] … *under the will of the party first dying"; (iv) that which passes to the survivor is identified after due administration by the legal personal representative whereupon "the dispositions of the will become operative"; (v) there is a "floating obligation" over that property which has passed to the survivor; it is suspended during the lifetime of the survivor and "crystalises" into a trust upon the assets of the survivor upon death.*

9. Trustee de son tort

9.1 A trustee de son tort, being a person who is not properly appointed as trustee and does not have the authority to act in a trustee capacity, is a category of constructive trust.

9.2 Lord Selborne LC in *Barnes v Addy* (1874) LR 9 Ch App 244 at 251:

> *Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended in equity to others who are not properly trustees. The responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees de son tort, or actually participating in any fraudulent conduct of the trustee to the injury of the cesti que trust.*

9.3 In *Mara v Browne* [1861] 1 Ch 199 at 209, Smith LJ observed that:

> *… what constitutes a trustee de son tort? It appears to me if one, not being a trustee and not having authority from a trustee, takes upon himself to intermeddle with trust matters or to do acts characteristic of the office of trustee, he may thereby make himself what is called in law a trustee of his own wrong – i.e. a trustee de son tort, as it is also termed, a constructive trustee.*

9.4 As a result of the assumption of the office of trusteeship (i.e. by intermeddling in trust matters), a trustee *de son tort* is liable for breaches of trust as if a trustee of an express trust.

10. Threshold questions to be considered for there to be constructive trust – breaches of fiduciary duty

10.1 Jacobs' at [13-30] observes that in respect of breaches of fiduciary duty, there is vast scope for the imposition of a constructive trust. In doing so, it is observed that the following threshold questions need to be determined:

10.1. firstly, whether there is any fiduciary duty presented by the circumstances;
10.2. secondly, the scope of that fiduciary duty in the particular circumstances;
10.3. thirdly, whether there has been a breach of that duty;
10.4. fourthly, the appropriate remedy given the above.

10.2 Two common situations wherein breaches of fiduciary duty may cause a constructive trust to subsist include those which relate to directors of companies and employees:

Directors

10.3 Generally speaking, Directors of companies are in a fiduciary relationship to the company (*Furs Ltd v Tomkies* (1936) 54 CLR 583), and may be liable to account to the company for profits made in breach of that duty. However, Directors are generally not in a fiduciary relationship with the individual shareholders of the company (*Percival v Wright* [1902] 2 Ch 421).

10.4 Nor are Directors in a fiduciary relationship in relation to the creditors of the company: *Walker v Wimborne* (1976) 137 CLR 1.

Employees

10.5 In certain situations, employees may be considered constructive trustees (*British Reinforced Concrete Engineering Co v Lind* (1917) 86 LJ Ch 486).

10.6 For example, an employee who is engaged to develop or invent, and who later profits from that invention (without allowing the employer to profit) may be in a fiduciary relationship such that a constructive trust is declared.

11. *Muschinski v Dodds* (1985) 160 CLR 583

11.1 The jurisdiction of Equity to impose a constructive trust was dealt with by the High Court in *Muschinski v Dodds*.

11.2 The relevant facts are as follows:

- 11.2.1 Mrs Muschinski and Mr Dodds were in a *de facto* relationship, having lived together for three (3) years.
- 11.2.2 Mrs Muschinski and Mr Dodds purchased a property as tenants in common.
- 11.2.3 They agreed to purchase land and erect a pre-fabricated house and restore a cottage on the land.
- 11.2.4 Mrs Muschinski was to provide $20,000 from the sale of her house, and Mr Dodds was to pay the cost of construction and improvements from $9,000 he would receive on a finalisation with divorce and from other loans.
- 11.2.5 The property was conveyed to the parties as tenants in common.
- 11.2.6 Whilst some improvements were made by the man, the erection of the house did not proceed and the parties separated.
- 11.2.7 Mrs Muschinski contributed $25,259.45, and Mr Dodds contributed $2,549.77 to the purchase and improvement of the property.

11.3 The High Court declared that the parties held their respective legal interests upon trust to repay his or her respective contribution, and as to the residue for both of them in equal

shares. The High Court unanimously decided that there was no resulting trust, as Mrs Muschinski intended that Mr Dodds would take his half share as beneficial co-owner.

11.4 However, the majority of the High Court (Gibbs CJ, Mason and Deane JJ with Brannan and Dawson JJ dissenting) concluded that the parties held their interest on constructive trust to reimburse each party's respective contributions, and distribute the residue equally between them. Mason and Deane JJ considered that a Court could impose a constructed trust consequent, upon the failure of a joint venture between the parties because it was unconscionable for the Mr Dodds to assert his legal entitlements without recognising the considerable financial input from Mrs Muschinski.

11.5 At 622 Deane J considered that:

> *In circumstances where the parties neither foresaw, nor attempted to provide for the double contingency of the premature collapse of both their personal relationship and their commercial venture, it is simply not to the point to say that the parties had framed that overall agreement without attaching any condition or providing any safeguard specifically to meet the occurrence of that double contingency. As has been seen, the relevant principle operates upon legal entitlement. It is the assertion by Mr Dodds of his legal entitlement in the unforeseen circumstances which arose on the collapse of their relationship and planned venture which lies at the heart of the characterisation of his conduct as unconscionable. Indeed, it is the very absence of any provision for legal defeasance or other specific and effective legal device to meet the particular circumstances which gives rise to the need to call in aid the principle equity applicable to preclude the unconscionable assertion of legal rights in a particular class of case.*

11.6 Deane J evaluated the remedial and institutional nature of a constructive trust, by observing that a constructive trust:

> *… can properly be described as a remedial institution which equity imposes regardless of actual or presumed agreement or intention by the parties involved (and subsequently protects) to preclude the retention or assertion of beneficial ownership of property to the extent that such retention or assertion would be contrary to equitable principle.*

11.7 The approach of Deane J was subsequently affirmed by all the members of the High Court in *Baumgartner v Baumgartner* (1987) 164 CLR 137 (see **[12]** below).

11.8 In their joint judgment, Mason CJ, Wilson and Dean JJ based their decision on the proposition that after the relationship had failed in circumstances where the property had

been financed in part through the pooled funds of the parties, the man's assertion of entitlement to the exclusion of any interest in the woman was unconscionable conduct which attracted the intervention of equity and the imposition of a constructive trust.

11.9 In the context of "joint endeavours", Campbell J in *West v Mead* [2003] NSWSC 161 at [52-64], and in particular at [59] opined as follows:

> *… A plaintiff needs to establish that there is indeed a joint endeavour between the parties, in which expenditure is shared for the common benefit. It is also necessary to identify what the scope of that joint endeavour is. It is a question of fact, for any couple, what the scope of the joint endeavour they are engaging in is. Further, for any couple, the scope of the joint endeavour they are engaged in might change from time to time. If, within the scope of a joint endeavour which lasts for years, an asset is acquired, as a result of contributions both parties have made, and for a purpose of the ongoing joint endeavour of the parties, this gives rise to a presumption that the beneficial interest ought to be shared equally. That presumption can be displaced if one party is able to show that the contributions, both financial and non-financial, to that asset should be regarded as unequal.*

11.10 Campbell J in *West v Mead* [2003] NSWSC 161 considered the necessary elements of the constructive trust in these contexts, concluding that what was needed was:

11.10.1 first, that there be both a joint relationship or endeavour, in which expenditure is shared for the common benefit in the course of and for the purpose of which an asset is acquired;

11.10.2 second, that the substratum of that joint relationship or endeavour must have been removed or the joint endeavour prematurely terminated *"without attributable blame";* and

11.10.3 third, that there must be the requisite element of unconscionability, that is, that it would be unconscionable for the benefit of those monetary and non-monetary contributions to be retained by the other party to the joint endeavour.

12. *Baumgartner v Baumgartner* (1987) 164 CLR 137

12.1 The decision in *Baumgartner v Baumgartner* further develops the concept of a remedial constructive trust provided for in *Muschinski v Dodds*.

12.2 The relevant facts were as follows:

12.2.1 A (male and female) *de facto* couple moved onto a property, which was purchased in the sole name of the male.

12.2.2 The woman provided the man with her pay packet. The pay packet was used (and pooled) for household expenses including mortgage repayments with respect to the property.

12.2.3 Together, the couple contributed a total of $89,000 (being the pooled amount). In particular, the man contributed $51,000, and the woman $38,000.

12.2.4 Upon the breakdown of their relationship, the woman sought a declaration that she had an equitable interest in the property.

12.3 Mason CJ, Wilson and Deane JJ in *Baumgartner v Baumgartner,* adopted the position taken by Deane J in *Muschinski v Dodds.*

12.4 In particular (and generally speaking), Deane J in *Muschinski v Dodds* considered that there was an equitable principle that restores to any party contributions which that party has made in the joint endeavour which fails. That is when the contributions were made in circumstances that it was not intended that the other party should enjoy them.

12.5 Deane J considered that the principle provided that equity would prevent the assertion or exercise of a legal right in circumstances which would constitute unconscientious conduct. In *Muschinski v Dodds* (1985) 160 CLR 583 at 620 Deane J opined that:

> *The 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 specifically 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 so to do…*

12.6 Mason, Wilson and Deane JJ considered that it was correct in acknowledging that constructive trust may be imposed irrespective of the parties' intention to create a trust. Their Honours considered that the appropriate test to impose a constructive trust was not one based on "*fairness*" or "*reasonableness*", but whether it was unconscionable not to impose a trust in the relevant circumstances.

12.7 It was held that there was no basis for a *"common intention*" constructive trust. Rather, Mason, Wilson and Deane JJ considered that a constructive trust should be imposed

because of the unconscionable use of legal title (which was vested in the man). In particular:

12.7.1 The woman did not intend to make a gift to the man. All that was done by both the man and the woman was for their relationship, and for the purposes of supporting them both in the present and the future; and

12.7.2 The assertion by the man that the property was his solely (notwithstanding that it was financed by pooled funds) amounted to unconscionable conduct which attracted the intervention of equity and imposed a constructive trust.

12.8 In *Baumgartner v Baumgartner* at 149, Mason CJ, Wilson and Deane JJ observed as follows:

> *In this situation it is proper to regard the arrangement for the pooling of earnings as one which was designed to ensure that their earnings would be expended for the purposes of their joint relationship and for their mutual security and benefit. To the extent which the pooled funds were the source of payment of mortgage instalments by the appellant, the pooled funds contributed not only to present accommodation expenses but also to the security of the parties' accommodation in the future. In this context it would be unreal and artificial to say that the respondent intended to make a gift to the appellant of so much of her earnings as were applied in payment or mortgage instalments. There is no evidence which would sustain a finding that the respondent intended to make a gift for the appellant in this way.*

12.9 The majority at 149 continued as follows:

> *The case is accordingly one in which the parties have pooled their earnings for the purposes of their joint relationship, one of the purposes of that relationship being to secure accommodation for themselves and their child. Their contributions, financial and otherwise, to the acquisition of the land, the building of the house, the purchase of furniture and the making of their home, were on the basis of, and for the purposes of, that joint relationship. In this situation the appellant's assertion, after the relationship had failed, that the Leumeah property, which was financed in part through the pooled funds, is his sole property, is his property beneficially to the exclusion of any interest at all on the part of the respondent, amounts to unconscionable conduct which attracts the intervention of equity and the imposition of a constructive trust at the suit of the respondent.*

12.10 At 149-150 the majority in *Baumgartner v Baumgartner* outlined the terms of the trust:

> *It therefore becomes necessary to determine the terms of that constructive trust. The facts that the Leumeah property was acquired and developed as a home for the*

parties and that, at least indirectly, it was largely financed out of money drawn from the pool of their earnings, this being one of the purposes which the pool was to serve, combined to support an equality of beneficial ownership at least as a starting point. Equity favours equality and, in circumstances where the parties have lived together for years and have pooled their resources and their efforts to create a joint home, there is much to be said for the view that they should share the beneficial ownership equally as tenants in common, subject to adjustment to avoid any injustice which would result if account were not taken of the disparity between the worth of their individual contributions either financially or in kind. The question which has caused us particular difficulty is whether any such adjustment is necessary in the circumstances of the present case to avoid any injustice which would otherwise result by reason of disparity between individual financial contributions. The conclusion which we have come is that some such adjustment is necessary.

12.11 At 150 the majority made an adjustment based on the proportions, being 55% to the man and 45% to the woman, based on their proportions. By observing that:

In these circumstances, although acknowledging that the case is close to the borderline, we consider that the constructive trust to be imposed should declare the beneficial interest of the parties in the proportions of 55% to the appellant and 45% to the respondent.

12.12 The majority outlined further adjustments at 150-151.

12.13 Toohey J agreed with Mason, Wilson and Deane JJ. However, Toohey J considered that unjust enrichment was an alternative basis to the imposition of a constructive trust.

12.14 Gaudron J also agreed with the majority and added that:

12.14.1 it was unconscionable for the man to retain the woman's contribution; and

12.14.2 it is necessary to consider non-financial domestic contributions by the woman.

13. Accessorial liability and constructive trusts

13.1 A third party who participates with knowledge in a dishonest and fraudulent design on the part of a defaulting fiduciary may become accountable as a constructive trustee. The now well settled position as set out in *Barnes v Addy* (1874) LR 9 Ch App 244 at 251-252 where Lord Selborne LC stated:

Strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions perhaps

of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.

13.2 The relevant facts in *Barnes v* Addy (1874) LR 9 Ch App 244 were as follows:

13.2.1 Addy, who was the sole surviving trustee of an estate, acted in breach of trust by transferring a moiety of that estate to Barnes.

13.2.2 The transfer by Addy to Barnes was to enable Barnes to act as sole trustee of that moiety.

13.2.3 Barnes became a bankrupt after misappropriating the moiety.

13.2.4 The deed which appointed Barnes as sole trustee was prepared by Addy's solicitor, and later approved by Barnes' solicitor.

13.2.5 The beneficiaries in remainder of the moiety, being the children of Barnes, sued Addy and the two solicitors on the basis that:

(a) the appointment of Barnes as sole trustee of the moiety was a breach of trust.

(b) the appointment of Barnes as sole trustee was a fraud committed against the beneficiaries of the moiety by Addy and the two solicitors.

13.3 The plaintiff's claim from the three defendants the restitution of the trust fund. At first instance, Wickens VC held that Addy's deceased estate (as Addy had passed away before the case was heard) was liable to restore the dissipated moiety because the transfer of it to Barnes was in breach of trust. However, the Vice Chancellor dismissed the claims of fraud brought against the two solicitors.

13.4 The plaintiffs appealed to the Court of Appeal in Chancery against dismissal of their claim against the two solicitors.

13.5 Upon appeal, the only issue for determination was whether the conduct of the two solicitors had been fraudulent. In short, the question was whether the two solicitors were fraudulent participants in Barnes' fraud (given that Barnes had been fraudulent in misappropriating the moiety) and did they knowingly assist Barnes in perpetration of Barnes' fraud.

13.6 Further, although Addy was not fraudulent in transferring the moiety to Barnes, Addy did act in breach of trust in making the transfer, so an issue was whether the solicitors for Addy knowingly assisted Addy in his non-fraudulent breach of trust.

13.7 The Court of Appeal in Chancery in *Barnes v Addy* had to determine these two issues:

13.7.1 Did the solicitors knowingly, and therefore fraudulently, assist Addy in his non-fraudulent breach of trust whereby he appointed Barnes as a sole trustee of the moiety?

Ong at 509, observes the following:

> *With respect to the issue of whether or not the solicitors had knowingly assisted Addy in his breach of trust in appointing Barnes to be the sole trustee of the moiety, the Court held that neither one of them had given Addy any assistance in the making of that appointment because Addy's* <u>*power*</u> to *breach the terms of the trust by appointing Barnes the sole trustee of the moiety was neither derived from nor was it increased by either one of the two solicitors. The Court found that the solicitors had not knowingly assisted Addy to breach the trust since, on the Court's view, they had not even assisted him in the breach, let alone knowingly done so.*

13.7.2 Did the solicitors knowingly, and therefore fraudulently, assist Barnes in his embezzlement of the moiety, namely, in his fraudulent breach of trust, by their preparation of the Deed of Appointment which made Barnes a sole trustee of the moiety?

Ong at 510 observes that:

> *… The Court, in the light of the plaintiffs' admission that the solicitors "did not know" of Barnes' intention to embezzle the moiety, had no difficulty in finding that they did not have any knowledge of Barnes' fraudulent design. Absence such knowledge, the solicitors did not participate in Barnes' fraud. Furthermore, Barnes' dishonesty was not the result of his appointment as sole trustee of the moiety, so that the role played by the solicitors in that appointment form no part of Barnes' subsequent decision to misappropriate the moiety.*

13.8 Lord Selborne VC at 251-252 considered as follows:

> *Now in this case we have dealt with certain persons who are trustees, and with certain other persons who are not trustees. That is a distinction to be borne in mind throughout the case. Those create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended to others who are not properly trustees, if they are found either making themselves trustees de son tort or actually participating in any fraudulent conduct of the trustee to the injury of the cestui que trust. But, on the other hand, strangers are not to be made constructive trustees merely because they act as the agent of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity, may disapprove, unless*

those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees. Those are the principles, as it seems to me, which we must bear in mind in dealing with the facts of this case. If those principles were disregarded, I know not how anyone could, in transaction admitting of doubt as to the view which a Court of Equity might take of them, safely discharge the office of solicitor, of banker, or of agent of any sort to trustees. But, on the other hand, if persons dealing honestly as agents are at liberty to rely on the legal power of the trustees, and are not to have the character of trustees constructively imposed upon them, then the transactions of mankind can safely be carried through; and I apprehend those who create trusts to expressly intend, in the absence of fraud and dishonesty, to exonerate such agents of all classes from the responsibilities which are expressly incumbent, by reason of the fiduciary relation, upon the trustees.

13.9 Lord Selborne distinguished between trustees, and persons who merely act as agents for trustees. Agents do not prima facie have the same responsibilities as trustees. Ong at 511 observed that after Lord Selborne made that distinction, to the extent that an agent exceeds its role as agent, it may transform itself into a trustee either:

13.9.1 by purporting, without authority, to deal with the trust property as trustees (*trustees de son tort*);

13.9.2 by receiving trust property from the trustees and agreeing to hold such property in trust for the trustees and, ultimately, for the beneficiaries of the original trust ("*unless those agents receive and become chargeable with some part of the trust property")*; or

13.9.3 by knowingly giving assistance to the appointed trustees in the course of a breach of trust, irrespective of whether or not the giving of such assistance includes the agents' receipt, purportedly for their own benefit, of any trust property (*"unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees*").

13.10 Of the three classes of trusteeship outlined by Lord Selborne, they are all instances where relevant persons have not been appointed as trustee, but may be forced to account as trustees. Only the first and third class are examples of constructive trusts. The second class is a form of express trust, as the relevant person agrees to be a recipient of trust property.

13.11 The different between the first class and the third class, is that a trustee under the first class agrees to take subject to the trusts. A trustee under the third class is not purporting

to take the trust property subject to the trusts. Ong at 512-3 summarises Lord Selborne's principles in *Barnes v Addy* as follows:

> *"(1) A person becomes a trustee of property if that person receives such property (whether or not such property was trust property immediately before the receipt thereof) in their capacity of trustee, either expressly so, or, through estoppel, constructively so.*
>
> *(2) A person becomes a constructive trustee of property if that person, although not appointed as a trustee, purports to acquire for himself beneficially any property (not necessarily originally trust property) through the giving of knowing assistance to a trustee acting in breach of trust, or to any other person acting in breach of fiduciary duty. It may be observed that in a case where the accessory (i.e. the person giving knowing assistance to another in the latter's breach of fiduciary duty) does not make a profit, and has not received any trust property, but who nevertheless causes loss to the person to whom the fiduciary duty is owed, that accessory is placed under an equitable obligation to compensate the person to whom the fiduciary duty is owed for the loss so caused to the latter.*

13.12 Lord Selborne LC in *Barnes v Addy* (1874) LR 9 Ch App 244 at 251:

> *Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended in equity to others who are not properly trustees. The responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees de son tort, or actually participating in any fraudulent conduct of the trustee to the injury of the cesti que trust. But, on the other hand, strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees. … If those principles were disregarded, I know not how anyone could, in transactions admitting of doubt as to the view which a Court of Equity might take of them, safely discharge the office of solicitor, of banker, or of agent of any sort of trustees.*

13.13 As was observed in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at [112], it has become accepted that there are two limbs outlined by Lord Selborne:

13.13.1 the first limb is the "knowing receipt or dealing" – this is concerned with agents who receive and become chargeable with trust property. It is essential that the transfer of the property be in breach of a fiduciary obligation; and

13.13.2 the second limb, being the "knowing assistance" limb, relates to agents that assist, with knowledge, in a dishonest and fraudulent design on the part of a fiduciary (e.g. a trustee).

13.14 A person who retains property, or its traceable proceeds, will be subject to a constructive trust. The constructive trust is of a proprietary kind. The defendant will be liable to restore what has been retained.

13.15 Further, subject to election, a plaintiff may obtain equitable compensation or an account of profits. Compounding interest may also be payable.

13.16 Whether or not the (third party) defendant is jointly and severally liable, or only severally liable will depend on whether the third party defendant and the fiduciary act in concert.

13.17 In *Grimaldi v Chameleon Mining NL* (No 2) (2012) 200 FCR 296 at [556]:

> *… where the advantage of a fiduciary's … wrongdoing accrues to a third party (whether a knowing recipient or assistant) and the third party is the alter ego /"nominee" (usually corporate) of the fiduciary, its liability will be joint and several with the fiduciary's.*

13.18 At [557], it was observed that:

> *… where the party is not the fiduciary's alter ego, the fiduciary and the third party will ordinarily be only severally liable for the profits each makes in consequence of the breach of fiduciary duty … in which it participated / was a recipient.*

13.19 However, at [558] it was observed that:

> *… if the fiduciary and the third party act in concert to secure a mutual benefit, be this to misappropriate trust property or for a particular mutually beneficial purpose or to participate in a breach of fiduciary duty to secure a mutual advantage …, they are jointly and severally liable to the wronged beneficiary / principal to restore the trust or account for the profits made.*

14. Jacobs' five categories of accessory liability

14.1 Jacobs' at [13-35] summarised the overall position for accessorial liability in Australia in relation to breaches of fiduciary duty (including breaches of trust) and thereby identified the following five categories:

14.1.1 the first limb of *Barnes v Addy*: receipt of trust property with particular types of notice;

14.1.2 the second limb of *Barnes v Addy* – assistance in (that is, participating, without inducing or procuring) a dishonest and fraudulent design on the part of a fiduciary with particular types of notice;

14.1.3 procuring or inducing a breach of fiduciary duty (whether that breach be a dishonest or fraudulent design or not) with a particular mental state;

14.1.4 a company which is the "*corporate creature, vehicle, or alter ego*" of the fiduciary who uses it to secure the profits of, or to inflict the loss by, the fiduciary's breach of fiduciary duty is fully liable for the profits made from, and the losses inflicted by, the fiduciary's role;

14.1.5 a person who procures to act as a trustee though not so appointed and then commits a breach of trust or makes a profit from the position may be liable as a trustee *de son tort*.

First limb of Barnes v Addy

14.2 With respect to the first limb of *Barnes v Addy,* it must be established that trust property, or property acquired through a breach of fiduciary duty, has been received by the defendant in the knowledge that such property was received in breach of trust of fiduciary duty (*Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 159).

14.3 For the purposes of the first limb, *"receipt*" includes the situation where a bank knows that a fiduciary has paid the plaintiff's money into the fiduciary's account to reduce its overdraft. There must be a receipt of *"property".* The third party must also have notice of the breach of trust of fiduciary duty.

14.4 There is no requirement under the first limb that the defendant's conduct is dishonest. Acting with notice is sufficient (*Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373).

Second limb of Barnes v Addy

14.5 The second limb of *Barnes v Addy* applies in relation to both breach of trust and breach of fiduciary duty. A third party will be liable if they assist a trustee fiduciary with knowledge of a *"dishonest and fraudulent design on the part of the trustee fiduciary"* (*Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 159).

14.6 By assisting in the wrongdoing, the defendant must be shown to have had the intent of furthering the breach. Merely permitting a fraud to occur is not sufficient.

14.7 The essential elements of the second limb in *Barnes v Addy* may be summarised as:

14.7.1 the existence of a fiduciary duty;

14.7.2 a dishonest and fraudulent design by the fiduciary;

14.7.3 the assistance by the third party in that design;

14.7.4 with knowledge.

Notice – the first and second limb in Barnes v Addy

14.8 Jacobs' at [13-36] observed that in *Baden v Societe Generale pour Favoriser le Developement du Commerce et de l'Industrie en France SA* [1992] 4 All ER 161 at 242 identified five types of *"knowledge notice":*

14.8.1 actual knowledge;

14.8.2 the wilful shutting of eyes to the obvious;

14.8.3 wilful sand recklessly failing to make such inquiries as an honest and reasonable person would make;

14.8.4 knowledge of circumstances which would indicate the facts to an honest and reasonable person; and

14.8.5 knowledge of circumstances which would put a reasonable person on enquiry (that is, constructive notice as traditionally understood).

14.9 In relation to the first limb in Australia, in *Grimaldi v Chameleon Mining ML (No 2)* (212) 200 FCR 296 was held that categories one to four as described in *Baden's Case* was sufficient for liability in Australia, where as Category 5 was not sufficient.

15. *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373

15.1 An agent who is in possession of property which the principal holds on trust for another and who makes, on the instruction of the principal, any disposition of that property which is inconsistent with the trust, is not guilty of a breach of trust, unless he or she was aware, or ought to have been aware, that the disposition made by him or her was in breach of trust. In order to successfully rely on the second limb of *Barnes v Addy* there must be a fiduciary, the fiduciary must have breached his or her fiduciary duty and the defendant must have assisted with knowledge in a dishonest and fraudulent design on the part of the fiduciary. These elements are articulated in *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373.

15.2 In *Consul Development* Grey was manager of a company, DPC, controlled by Walton, a solicitor, which carried on the business of acquiring dilapidated properties which could be renovated and sold for a profit. Walton employed Robert Clowes as his clerk. Grey told Clowes about a number of properties which he had recommended for purchase saying that the company had been interested in them, but could not afford them. Clowes' company,

Consul Development purchased the properties having reached an agreement with Grey that they would share equally any profits or losses. The solicitor's company claimed that those properties were held on trust for it.

15.3 Gibbs J, at page 299, said that Clowes was aware that Grey stood in a fiduciary position; he knew that Walton did not have full knowledge of the transactions and had not assented to them. His Honour then said:

> *If it has been proved that Clowes knew, or that an honest and reasonable man with knowledge of the facts known to Clowes would have thought, that Grey was acting in breach of his fiduciary duty in arranging for Consul to buy the properties to share in the profits, enough will have been established (on the assumption made above) to render Consul accountable to DPC."*

15.4 His Honour later said that as on the facts which Clowes believed to exist Grey was not acting in breach of fiduciary duty, Clowes did not knowingly participate in Grey's breach *"he neither actually knew, nor had reason to believe, that Grey was violating his duty, and in the circumstances an honest and reasonable man would not have thought it necessary to enquire further."*

15.5 Stephen J, with whom Barwick CJ agreed, said at 407-408 that the plaintiff had not only failed to establish actual knowledge against Clowes but the evidence established that Clowes did not wilfully shut his eyes to the truth. He considered that knowledge does not include constructive notice.

16. *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 141

16.1 The High Court in ***Farah Constructions Pty Ltd v Say-Dee Pty Ltd*** (2007) 230 CLR 89 at 141; [2007] HCA 22 in addressing and clarifying the law from ***Barnes v Addy*** has held that:

16.1.1 Liability of a third party under the first limb of Barnes v Addy is limited to situations where the defendant has received property;

16.1.2 Liability under the first limb of Barnes v Addy is limited to situations where the defendant had knowledge of a breach of trust or, possibly, a breach of fiduciary duty. Although this knowledge may be imputed to a defendant, the circumstances in which an agent's knowledge is imputed to a principal are limited;

16.1.3 Liability under the second limb of Barnes v Addy requires knowledge of the fraudulent and dishonest design of a trustee or fiduciary. Knowledge for this

purpose includes actual knowledge, wilfully shutting one's eyes to the obvious, wilfully and recklessly failing to make such inquiries as an honest and reasonable person would make, and knowledge of circumstances that would indicate the facts to an honest and reasonable person. It probably excludes mere knowledge of circumstances that would put an honest and reasonable person on inquiry.

16.2 Mere knowledge is not be enough, the defendant should have knowingly participated in the breaches of fiduciary duties: *Biala Pty Ltd and Anor V Mallina Holdings Ltd and Onor* (1993) 11 ACSR 785; *Ikeuchi v Liu & Ors* [2001] QSC 054 at [143] – [144].

16.3 In *Robb Evans v European Bank Ltd* [2004] NSWCA 82 at[160], Spigelman CJ, with whom Handley and Santow JJA agreed, said:

> *… it is an essential aspect of accessorial liability for 'knowing receipt' that the act of transfer of the property … must be in breach of a fiduciary obligation. The claim arises in equity's exclusive jurisdiction ….*

16.4 Liability may be attached in a wider situations such as in *Biala Pty Ltd v Mollina Holdings Ltd* (1993) 11 ACSR 785, 833 per Ipp J, affirmed by the Western Australian Full Court *Dempster v Mollina Holdings Ltd* (1994) 15 ACSR 1 and *Turner v TR Nominees Pty Ltd* (Santow J, 3.11.1995 unreported) where the directors of a trustee type of company carried on its activities for their own or the company's best interests and not for the benefit of the beneficiary.

16.5 Equity can be flexible and gives relief in cases analogous to Barnes v Addy for example in *Franklin v Giddens* [1978] Qd R 72, 81 a wife who made a profit from a trade in a commodity which she knew her husband had stolen has been held to be accountable.

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