

Laws2201 Legal Framework of Business Lecture Notes

Lecture 1

Business Relationships

- **Arm's length transaction** – parties are not looking after each other's interests and transaction is at market rate
- **Caveat emptor** (let the buyer beware – no duties owed to each other i.e. *no duty of full disclosure*)

Outside the norm – normal business relationship that give rise to special duties

- Aim is to protect someone (protect vulnerable/weaker party)
- Imposes duties on parties
 - a) Contracts of utmost good faith
 - Based on *total* honesty i.e. **full disclosure**
 - **Contracts of utmost good faith**
 - Insurance Contract: Indemnity contract (one party agrees to make good losses that might later be suffered by the other party)
 - Must be full disclosure by the person who is being insured (all material information)
 - Material information is based on what a reasonable applicant would consider relevant
 - Distinction between business who take up an insurance contract and individual consumers
 - For businesses they still must supply information if the insurer does not ask certain information
 - General principle: The insured cannot escape duty of utmost good faith and the requirement for full disclosure by pointing to the **defect in questions asked by the insurer**
 - **Insurance Contracts Act 1984** – insurer is only allowed to deduct from payout the actual loss or damage caused by non-disclosure i.e. deduct higher premium from actual premium

Exceptions

- a) **Non-disclosure = fraudulent** and contract may be voidable. Fraud = hard to prove and therefore the insurer must prove the actual state of knowledge and actual intent of insured. However, if the information was purposefully hidden but it doesn't really impact on what actually occurred then the insurance company must still pay full or in part to the insured
- b) Information was not fraudulent it was mere lack of information and insurance company argues that if the information **was** disclosed they would not have insured the party. It is difficult to prove this fact and so must refund premiums but can refuse payout

Cases:

Permanent Trustee Australia Ltd v FAI General Insurance Co Ltd – Exception (b)

Permanent claims \$10.2 million against FAI n professional negligence insurance that had initial one year period from 1st Oct 1990 – 30 Sep 1991

- Claim by Permanent for incident that occurred during 30 day extension period FAI had granted (1st-30 October 1991)
- Permanent did not disclose to FAI that they were contemplating leaving FAI for another insurance company
- Therefore FAI is using this failure amounting to non-disclosure and therefore would not have insured Permanent given that they may not renew
- High Court imposes full liability on FAI because all insurers knows that it is **common business practices for insured to actively seek better prices, so that activity need not be specifically disclosed**

Fiduciary relationships or positions

- Definition 1: (trust) A relationships of **confidence** in which equity imposes duties upon the person in whom **confidence is reposed** in order to prevent the abuse of the confidence
 - The fiduciary must **subordinate** its interest to that of the person that looks to you for guidance (caveat emptor cannot apply here)
- Case: Glavanics v Brunninghausen
 - Co-owners of business had a falling out – still owed each other fiduciary duties
 - The one that remained active in business had a duty to inform the other party of an outsiders offer to purchase the business before concluding negotiations for that active one to buy out the interest of the other
- Definition 2: Undertaking (promise) by one person (the ‘fiduciary’) to act on **behalf** of another person in the exercise of power that will affect the interests of the other person in a legal or practical sense e.g. going to lawyer and lawyer must promise to look after another person’s interest (special vulnerability of one person)
- Definition 3: In a given circumstance, one party is required to put another party **at least** on a level of its own (must see to the interests of the other party first, usually at a higher level)

Examples of Fiduciaries

- a) Lawyer owes duty to client
- b) Agent owes duties to principal
- c) Trustee owes duty to beneficiary
- d) Partner owes duties to other partner
- e) Director owes duties to company

Duties owed

1. No conflict of duty i.e. the fiduciary only owes duty to one party
 - a) Case: Bristol and West Building Society v May May & Merrimans

- b) Case: Blackwell v Barroile (different sections of same law firm are representing opposing clients).
 - Firm had a policy prohibiting exchange of information between partners about clients who may have opposing or conflicting interests = “paper wall, Chinese walls”
 - Court finds situation improper despite the existence of a ‘paper wall’ – a **conflict of duty**
- 2. No conflict of interest (fiduciary must not look after his interests at the expense of the person owed duty)
 - a) Case: Unioil International v Deloitte Touche Tohmatsu and Corrs:
- 3. No Secret Profit – linked to other rules e.g. bribe or secret commissions
 - Receipt of secret fee raises an **irrebuttable** presumption that it was given for corrupt motive and that it influenced the fiduciary to the detriment of the client
 - a) Case: Industries & General Mortgage Co v Lewis
 - Constructive trust, accounting for profits and tracing remedies even if the person cannot prove loss (presumption)
 - If fiduciary has been given fully informed consent by client to receive money etc. then profit is not ‘secret’ and there is no breach of duty
 - b) Case: Boardman v Phipps
- 4. Duties relative to information – 3 duties
 - (i) Information told to person at which duty is owed must be kept secret – related to companies as well (‘paper walls’)
 - There is a **rebuttable** presumption regarding paper walls
 - (ii) Fiduciary must not ‘misuse’ (leaking information) or ‘usurp’ (fiduciary taking opportunity himself) information **even if that person cannot prove they suffered any loss**
 - Case: Tuite v Exelby
 - Regal (Hastings) v Gulliver (even if client is not in position to take advantage of opportunity they are able)
 - (iii) Fiduciary must disclose information to his client (to whom duty is owed)
 - Case: Australian Breeders Co-operative Society v Jones
 - Bristol and West Building Society v May May & Merrimans
- 5. No Undue Influence (do not try to make someone sell something to you at a lower price – abuse trust)
- 6. Duty to account (relates to accountability of actions i.e. expenses have been allocated reasonable)
- 7. No delegation of significant responsibilities (lawyer himself must take on the important responsibilities)
- 8. Duty to act with due care and skill
- If there is a breach of term in a contract the common law requires sue for damages
- If a lawyer has misused information then whatever the lawyer made belongs to claimant (don’t need to show reasonable loss only misuse)
- Remedies for breach of fiduciary duties
 - In order to recover fiduciary remedies the plaintiff must have **clean hands** (innocent) and the court has **discretion** (equitable remedies)

- Case: Pizzale v Gumina Enterprises (no clean hands)
 - Waiting too long to complain of breach of fiduciary duties may also prevent recovery
1. **Regular equitable remedies (rescission, injunction, specific performance)**
 2. **Equitable compensation “but for” causation must still be proved for equitable damages**
 - Case: South Australia v Clark
 - Does not need to be foreseeable only ‘but for’
 - Third parties can be liable for equitable damages if they are **knowingly involved** or encourage fiduciary to breach its duties to the plaintiff
 - Case: Hungary Jacks v Burger King
 3. **Accounting for profits**
 - **Prophylactic** (preventative)
 - Not just compensatory
 - Money that is made in breach of duties belongs to client
 - Case: Warman International v Dwyer – no requirement to prove that there is any loss
 - Fiduciary is sometimes allowed some reasonable compensation for efforts if breach was not done fraudulently
 - Case: O’Sullivan v Management Agency
 - Case: Boardman v Phipps (reasonable compensation for legal services provided – classic lawyer breach of duty case)
 4. **Constructive trust and equitable interest over profits and property obtained by fiduciary in breach of duty**
 - Fiduciary has **legal** title to asset but **equitable** title belongs to client (asset only bought by breach of fiduciary duty)
 - Recovery of asset itself and any increases in value
 - Court uses discretion when imposes a constructive trust
 - Case: Edmonds v Donovan
 5. **Tracing (finding out whether assets belong to client)**
 - Equitable interest is with the client
 - Only an ITP (innocent third party) that pays **good values** (market value) can keep the client’s asset
 - Case: National Australia Bank v Rusu
 - Property can be traced to third party = constructive trustee
 - If this third party is deemed in “knowing receipt” because “wilfully and recklessly” fails to make inquiries which an honest and reasonable person would make
 - If an asset is appreciated in value the client will ask for a constructive trust rather than an account for profit (also gain appreciation of value)
 - If it depreciated = claim damages
 - Case: Attorney General For Hong Kong v Reid
 - Case: Foskett v Mckee
 6. **Criminal penalties for breach of fiduciary duties**
 - WA Criminal Code
 - **Fiduciary relationships**
 - a) Agent-principal Blackham v Haythorpe

- b) Trustee-beneficiary Keech v Sandford
- c) Partners inter Chan v Zacharia
- d) Company director-company Regal v Gulliver
- e) Solicitor-client Boardman v Phipps
- f) Religious leader Allcard v Skinner

- **Extensions of these 6 relationships**

- The **prime** test to show fiduciary duties owed = would a person reasonably expect the alleged fiduciary to **subordinate** its personal interests below the client
- Not an automatic fiduciary relationship
- **Accountant-client** relationship (duty of confidentiality and a duty not to misuse, usurp or make a profit)
 - Case: State of South Australia v Peat Marwick Mitchell (not one of the 6 fiduciary relationships)
 - Australian Breeders Co-operative Society v Jones
 - Pavan v Ratnam (**contrast with above case**)
- **Employee-Employer**
 - Case: Green v Bestobell Industries (look at particular level that employee is on to determine whether or not that employee is owed higher fiduciary duties)
- **Joint-venturers** – if it is kindred to (similar attributes of) partnership or an agency = some fiduciary duties will apply as the ‘prime test’ can be satisfied
 - Case: United Dominions Corporation v Brian
 - Ravinder Rohini v Krizaic
- **Banker-customer**
 - Case: Lloyd’s Bank v Bundy
 - Commonwealth Bank v Smith
- **Doctor-patient**
 - Breen v Williams (not one of the set fiduciary relationships)
 - Is duty of confidentiality
 - Rogers v Whitaker
- **Investment adviser-client**
 - Raises fiduciary duties on conflict of interest and disclosure of information
 - Daly v Sydney Stock Exchange (relationships of confidence between stockbroker and client – raises on stockbroker to make full and accurate disclosure about broker’s own interest in the transaction)
- **Franchisor-Franchisee**
 - Hungary Jack’s Pty Ltd v Burger King Corp (longstanding relationship i.e. franchisor deemed to owe at least a fiduciary duty not to take positive steps to purposely damage the “good will” of its non-exclusive franchisee in Australia)
- **Teacher-student**
 - Duty of confidentiality
 - No undue influence in business dealings
 - Involves ‘special vulnerability’

- O'Sullivan v Management Agency
- **Commercial Transactions unlikely to result in fiduciary duties**
 - U.S. Surgical Corporation v Hospital Products
 - Relationship between USA manufacturer and independent exclusive distributor in Australia – not an agency relationship (otherwise fiduciary duties would be owed) – Australian distributor takes over the market with own locally manufactured products – issue whether fiduciary duties breached so that all Australian profits and assets held in constructive trust for benefit of USA company
- **Summary**
 - a) Derives out of a **representative capacity**
 - b) **Reasonable Reliance** and **confidential information (trust)**
 - c) **Special vulnerability** – immense disparity in terms of knowledge/power
 - d) **Arm's length/commercial transactions** with **equal** bargaining power = do not expect fiduciary relationships, unless you can show prime test
 - e) **Some** fiduciary duties may exist not all

Agency (owes all fiduciary duties)

- Person who trusts agent = **principal**
- Agent can sign contract with third party (TP) and there will be a binding contract if the agent acts within authority
- Agent must look after the principal's interest
- Agent = intermediary
- **Effect of Agency**
 - 1. Principal is liable to third party for improper conduct of agent (**vicarious liability**)
 - 2. The agent acting within authority is not a party to any ensuing contract and the agent's **personal interest is not affected by the dealings**
 - Southwell v Bowditch (a person known to have acted in a representative capacity cannot be sued as if it was a party to the contract)
- **Agency occurs when:**
 - a) Dealings with incorporeal entities (no 'flesh and blood') e.g. board of directors
 - b) Geographical distance (power of attorney)
 - c) Desire for anonymity i.e. undisclosed principal
 - d) Specialised expertise e.g. lawyer, auctioneer, stockbroker
 - e) Agent through process of law e.g. husband and wife (purchase of necessities), agent of necessity
- **True Agent v Pseudo Agent**
 - **Just because the parties may call a person an 'agent' does not mean an agent in the strict legal sense**
 - Sales distributors or agents (even "exclusive" agents), real estate agents, tax agents, typically are not true agents (no requisite power or authority)

- *Hospital Products* case (exclusive sales distributor in Australia not a true agent and so did not owe fiduciary duties)
- **Position of Real Estate Agent (Pseudo Agent)**
 - Often do not have power to sell property
 - Even though they may not be a true agent there are **some fiduciary relationships** owed to owner of property
- **Creation of Agency**
 1. **Express Agency (expressly appointed by principal)**
 - a) E.g. Power of attorney
 2. **Ratification – (Retrospective Conferral of Authority)**
 - a) Agent does not have authority but principal wishes to adopt the contract, principal can do so by way of ratification
 - Known as retrospective agency (a doctrine whereby principal can expressly ratify an ineffective action of agent **after the fact**)
 - When person purports to act on behalf of principal but before appointed, or after leaves, position as an agent, **or**
 - When agent acts on behalf of principal but beyond actual authority granted by principal (e.g. Agent sells at too low a price, or sells on credit when instructed to only sell for cash)
- **Criteria for ratification:**
 - a) At the time of agent's act, agent, from objective viewpoint of third party, must seem to be acting on behalf of another party (no ratification by a "totally undisclosed principal")
- Tiedemann and Ledermann Freres; (agent acted without knowledge or consent of principal, but principal can still ratify and enforce the contract against the third party)
- Keighley, Maxsted and Co v Durant (Agent intends to act on behalf of principal but lacks authority and does not make its intended representative capacity evident to third party – ratification not allowed)
 - b) At the time of principal's ratification the principal must:
 1. Be identified
 2. The ratification must be clear and unambiguous though not necessarily express (based on conduct) Cox v Isles, Love & Co
 3. Be complete – principal cannot choose to ratify only part of agent's actions **relative to the same contract** (no "cherry picking")
 - If agent has purported to create more than one contract, principal may choose to ratify one contract but not the others
 4. Must be made with principal having knowledge of all material facts or principal can later retract ratification (not permitted if results in unfair prejudice to innocent third parties)
- **Effect of Ratification**
 - Effective at date of agent's original action (retrospective authority)
 - Retrospective authority will not be allowed if it will unfairly cause harm to third party

- Once there is ratification then there is a binding contract. Once there is a binding party the third party cannot sue the agent
- If principal is willing to take up contract the principal is acknowledging that the agent has done well Keay v Fenwick
- **Agent of Necessity**
 - Must be a pre-existing **voluntary** relationship (just one person saying “I will think about your assets and try and protect you”)
 - Situation needed **immediate** resolution to **preserve property** of principal (‘crisis’)
 - Situation needs resolution **before** communication with principal is feasible
 - Agent honestly endeavours to act in best interests of principal
 - Case: Great Northern Railway Co v Swaffield (horse case – agent of necessity)
- **Relationships between principal and third party through actions of agent**
 - a) Principal is bound to a contract if agent had:
 1. *Express actual authority* (expressly carry out particular act on principal’s behalf)
 2. *Implied actual authority* (agent is expressly told to carry out an act but it is implied that the agent may carry out some ancillary (minor) acts)
 3. *Ostensible authority*
 4. *No authority at time of authority the principal can ratify* authority (retrospective authority)
- ‘Actual’ refers to only principal and agent know what has been confirmed
- ‘ostensible’ (apparent) refers to third party i.e. how agent appears to third party
- **Situations for Implied Authority**
 - **Business efficacy:** job which cannot be effectively accomplished unless that person has the particular authority in question
 - Case: ANZ Bank v Ateliers de Constructions Electriques de Charleroi (deposit cheque in agent’s account even though it’s in the principal’s name = only way to perform function)
 - **Customary Authority:** Look at the particular customary power attached to a position
 - **Past Dealings:** presupposes that principal and agent = long term relationship i.e. principal does not need to ask again
 - **The overriding and pre-eminent rule: actual authority (express or implied) cannot exist if it is inconsistent with the expressed intent or the implied intent of the principal**
- **Ostensible (apparent authority)**
 - Principal has “held out” agent as having the authority in question
 - Agent cannot make representation = “bootstrapping”
 - Armagas v Mundogas (agent is bootstrapping)
 - When there is bootstrapping = can sue agent for breach of warranty of authority Ocean Fost Case Collen v Wright
 - Regarding reasonable person in the position of the third party in **reliance on conduct of principal** have thought the agent had the authority in question
 - Freeman & Lockyer v Buckhurst Properties; Panorama Developments v Fidelis Furnishing Fabrics
- Need to focus on **reasonable reliance**

- Overbrooke Estates v Glencombe Properties ____ (no ostensible authority = no reasonable reliance)
- Combulk v TNT Management (no ostensible authority = no reasonable reliance)
- **Overlap between implied and ostensible authority**
 - Arise from same set of circumstances (similarities in creation or source of authority)
 - Implied authority can be negated/restricted by an express term Panorama Developments v Fidelis Furnishing Fabrics
 - Ostensible authority can only be negated by actual or constructive notice to third party about the special limitation on authority Panorama Developments v Fidelis Furnishing Fabrics