(b) Substantive Fusion?

- There was no intention in the legislation to in some way fuse the principles of the common law and equity into one system of law. Nor did the legislation 'change the various reasons for creating equity in the first place nor make its doctrines and remedies any more broadly available than previously'
- "It is stated very plainly that the main object of the Act was to assimilate the transaction of Equity business and Common Law business by different Courts of Judicature. It has been sometimes inaccurately called 'the fusion of Law and Equity'; but it was not any fusion, or anything of the kind; it was the vesting in one tribunal the administration of Law and Equity in every cause, action, or dispute which should come before that tribunal. That was the meaning of the Act. Then, as to that very small number of cases in which there is an actual conflict, it was decided that in all cases where the rules of Equity and Law were in conflict **the rules of Equity should prevail**." – *Salt v Cooper* (1880) 16 ChD 544, 549
- 'The two streams of jurisdiction that run in the same channel, run side by side and do not mingle their water' (Ashburner's metaphor with judicial approval by Windeyer J in *Felton v Mulligan*)
- To *Meagher, Gummow and Lehane*, a fusion fallacy arises when the decision reached in a particular case is one that could not have been reached under the separate system of courts that existed before the judicature system reforms were enacted'
    - "The fusion fallacy involves the administration of a remedy, for example common law damages for breach of fiduciary duty, not previously available at law or in equity, or the modification of principles in one branch of the jurisdiction by concepts which are imported from the other and thus are foreign … The fallacy is committed explicitly, covertly, and on occasion with apparent inadvertence. But the state of mind of the culprit cannot lessen the evil of the offence."

***Walsh v Lonsdale* (1882) 21 Ch D 9**

- **Explanation of equitable lease: a fusion fallacy**

Fact

- Agreement to grant a lease for a term of 7 years
- Agreement recorded in writing but no formal grant of lease, in other words, no deed of lease ever entered into→ equitable lease
- Tenant was paying rent in arears
- Landlord asked tenant to pay rent in advance; tenant refused; landlord wants to distrain the tenant's chattel
- Distrain is a common law remedy

Held

- 'There are not two estates as there were formerly, one estate at common law… and an estate in equity under the agreement. There is only one Court, and the equity rules prevail in it The tenant holds under an agreement for lease. He holds, therefore, under the same terms in equity as if the lease had been granted, it being a case in which both parties admit that relief is capable of being given by specific performance. That being so, he cannot complain of the exercise by the landlord of the same rights the landlord would have if a lease had been granted …' **[this looks like a fusion fallacy but see *Chan v Cresdon Pty Ltd*]**
- N.B. there must be a present right to specific performance for the *Walsh v Lonsdale* rule to apply (*McMahon v Ambrose*)

***Chan v Cresdon Pty Ltd* (1989) 168 CLR 242**

- **Agreement to lease will immediately create an equitable lease if it is specifically performable.**
- **Equitable lease is not the same as legal interest.**
- **This is not an example of fusion fallacy. It is the opposite. This is not a fusion fallacy.**

Facts

- Cresdon agreed in writing to lease land to Sarcourt

- The agreement contained the terms of the lease as an annexure, which was duly executed but never registered
- Sarcourt defaulted under the lease and Cresdon took action against Chan as guarantor of the unregistered lease **under the lease** → Action failed because there was no lease
- Alternative claim based on *Walsh v Lonsdale*

Held

- In equity, the Court can order specific performance retrospectively→ so in *Walsh v Lonsdale,* the equitable lease could have been changed to a legal lease retrospectively → before the plaintiff can order distraining → so no fusion fallacy
- Although the rule in *Walsh v Lonsdale* meant that an agreement to lease gave rise to an equitable lease, it did not create a legal interest
- A consequence of this is that the equitable lesee will be defeated by a bona fide purchaser of the legal estate who acquires the legal estate for valuable consideration and without notice of the equitable lease
- Even if there was specific performance, Cresdon's action was doomed to fail… this was so because under the rule in *Walsh v Lonsdale* all that the agreement to lease amounted to was an equitable lease. The guarantee that Cresdon sought to enforce was of 'obligations under the lease' and the court held that this meant obligations contained in a legal lease. Because no such lease existed there was no enforceable guarantee.
- The power to grant specific performance in a *Walsh v Lonsdale* circumstances was to be exercised sparingly

Day v Mead **[1987] 2 NZLR 443 [Involves fusion fallacy thinking]**

- **Case highlighting where there is fusion and one where, Australia would say, 'No, that is fusion and that is wrong'.**
- **Example of where law and equity are being mingled and it is not appropriate.**
- **Australia does not follow this position put forward in this case. Contributory negligence in compensation for breach of fiduciary duties is rejected in Australia. See *Pilmer v Duke*.**
- **Not right to say that common law and equity were doing the same thing and therefore, the two should converge. This is wrong.**

Facts

- Claim: breach of fiduciary duty

Issue

- The NZ Court used the concept of contributory negligence

Held

- The NZ Court of Appeal held that the Judicature Acts in England allowed the merge of law and equity

Harris v Digital Pulse Pty Ltd **(2003) 56 NSWLR 298**

- Law and equity should not converge. However, that does not mean that they never do. Some argue that the fusion fallacy is taken too far and is used as an excuse to prevent equity from developing when it is completely okay for it to do so.

Issue

- Whether exemplary damages could be awarded for breach of equitable obligations, in this case by a fiduciary

Held

Mason P (in dissent)

- His Honour argued that such an award could be made by analogy to torts law
- However, the following statement by His Honour is correct
    - The "fusion fallacy" condemns law and equity to the eternal separation of two parallel lines, ignoring the history of the two systems both before and after the passing of the Judicature Act
    - Both Equity and Common Law had adequate powers to adopt and adapt concepts from each other's system well before the passing of the *Judicature Act* and nothing in that legislation limits such powers. They are of the very essence of judicial

(ii) Causation in Equitable Claim

Australian Approach

- "a claim for equitable compensation for breach of a fiduciary duty requires a causal link between the breach and the loss" – *O'Halloran v RT Thomas & Family Pty Ltd* (1998) 45 NSWLR 262, 274 (CA)
- "But for" condition satisfied→ causation in equity is satisfied (*Short v Crawley*)

Canadian Approach

***Canson Enterprises v Boughton* [1991] 3 SCR 534**

Facts

- JV to buy the land
- Solicitor did not reveal there is sub-sale involve
- If they had, the JV would not have bought the land
- JV proceeded with the development→ engineer
- Engineer→ negligence→ defect→ but went insolvent
- Turn around to sue lawyer for breach for fiduciary duty

Held

- There is a breach of fiduciary duty
- Majority held that although they are liable for difference between land actual value and its inflated price, the subsequent loss were not within the scope of the fiduciary duty
    - The common law remoteness and novus actus analysis was taken into account in this case
- Minority: even with the equity approach, the lawyer did not contribute to the failure of warehouses development

Note: unclear whether *Canson* could be applied in Australia

(iii) Contributory fault

***Pilmer v Duke Group Ltd* (2001) 207 CLR 165**

Held

- There are severe conceptual difficulties in the path of acceptance of notions of contributory negligence as applicable to diminish awards of equitable compensation for breach of fiduciary duty.
- In other words: fusion fallacy

(iv) Election

- You either seek account for profits or equitable compensation; they are alternatives
- "Sometimes the two remedies are alternative and inconsistent. The classic example, indeed, is (1) an account of profits made by a defendant in breach of his fiduciary obligations and (2) damages for the loss suffered by the plaintiff by reason of the same breach. The former is measured by the wrongdoer's gain, the latter by the injured party's loss. … Faced with alternative and inconsistent remedies a plaintiff must choose, or elect, between them. He cannot have both." – *Tang Man Sit v Capacious Investments Ltd* [1996] 1 AC 514, 521

6.3.4 Proprietary Remedies (Constructive Trust)

- "The general principle is well settled. A solicitor has a fiduciary duty to his clients and any person who has such a duty 'shall not take any secret remuneration or any financial benefit not authorised by the law, or by his contract, or by the trust deed under which he acts, as the case may be' […]. **If the person in a fiduciary position does gain or receive any financial benefit arising out of the use of the property of the beneficiary he cannot keep it unless he can show such authority**" – *Brown v Inland Revenue Commissioners* [1965] AC 244, 256

***Attorney-General for Hong Kong v Reid* [1994] 1 AC 324**

Facts

- Reid was a prosecutor in Hong Kong and he received bribe and invested the bribe in New Zealand
- Hong Kong does not have criminal jurisdiction to confiscate the land in New Zealand
- Hong Kong government argues breach of fiduciary duty in NZ (equity acts in personam)

Held

- A bribe is a gift accepted by a fiduciary as an inducement to him to betray his trust
- A secret benefit, which may or may not constitute a bribe, is a benefit which the fiduciary derives from trust property or obtains from knowledge which he acquires in the course of acting as a fiduciary
- When a bribe is offered and accepted in money or in kind, the money or property constituting the bribe belongs in law to the recipient
- In equity however, which acts in personam, insists that it is unconscionable for a fiduciary to obtain and retain a benefit in breach of duty. The provider of a bribe cannot recover it because he committed a criminal offence when he paid the bribe. The false fiduciary who received the bribe in breach of duty must pay and account for the bribe to the person to whom that duty was owed
- **As soon as** the first respondent received a bribe in breach of the duties he owed to the Government of Hong Kong, he became a debtor in equity to the Crown for the amount of that bribe
- If the bribe consists of property which increases in value or if a cash bribe is invested advantageously, the false fiduciary held the bribe on a **constructive trust** for the person injured
- Equity should provide two remedies: debt and constructive trust (as long as they do not result in double recovery)
- If the property representing the bribe decreases in value the fiduciary must pay the difference between the value and the initial amount of the bribe because he should not have accepted the bribe or incurred the risk of loss (in this case injured party can claim in debt)
- If the property increases in value, the fiduciary is not entitled to any surplus in excess of the initial value of the bribe because he is not allowed by any means to make profit out of breach of duty (in this case injured party can claim a constructive trust)

  QUESTION: What is held on trust here? The bribes or the NZ properties? Are the bribes being held on trust and thus they can trace into the NZ properties?

However, note that in *AG v Reid*, the approach is that the constructive trust immediately arises. In Australia, the constructive trust is a remedial remedy and there is a discretion involved. The court did not have to reward a constructive trust (*Grimaldi v Chameleon*).

Topic 8 Constructive Trusts

8.1 Introductory Observations

- Constructive trust = imposed by court
- Unlike an express (which needs actual intention) trust and a resulting trust (which arises by way of presumed intention), constructive trust can arise in circumstances where there was no actual, implied or presumed **intention to create a trust**
    - However, that is not to say the intention of the parties to a relationship is completely irrelevant to constructive trusts, as there are forms of constructive trust that arise by way of common intention and agreement
- There are two distinct categories of constructive trust (both referred as a constructive trust)
    - Proprietary Constructive Trust
    - Constructive trust in a remedy sense: holding someone personally liable as if they were trustees
- "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 discharge 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." – *Giumelli v Giumelli* [1999] HCA 10 at [4], (1999) 196 CLR 101

8.2 Constructive Trusts and Breach of Fiduciary Duties

***Attorney-General for Hong Kong v Reid* [1994] 1 AC 324**

- See Topic 6

***Hasler v Singtel Optus Pty Ltd* (2014) 87 NSWLR 609**

- Knowing assistance case
- Held liable for knowing assistance

***Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296**

Facts

- Grimaldi was engaged by the directors of Chameleon to raise capital and came to act as a de facto director of Chameleon
- Grimaldi was also a director of Murchison
- Murchison entered into an agreement with Winterfall to purchase an iron ore
- Grimaldi improperly used Chameleon shares and money from Chameleon to fund the Winterfall purchase
- In return he received 'spotter's fee' of several million shares and options in Winterfall
- Chameleon sued that Grimaldi breached his directors' duties and the spotter's fee was a secret commission that could be beneficially claimed by Chameleon

Held

- Court held that the spotter's fee was not a secret commission because the fee arose separately from Grimaldi's actions in improperly using Chameleon shares and money
- However, it affirmed that secret commissions and bribe can be held on constructive trust (affirming the position of *AG (HK) v Reid*)
- Nonetheless, the court stated that:
    - **Constructive trust ought not to be imposed if there are other orders capable of doing full justice**
    - In a case of secret profits, a lien on that property may well be sufficient to achieve practical justice in the circumstances
    - A constructive trust is likely to be awarded where the bribe still exists in its original, or in a traceable, form, and no third party issue arises
- In other words, constructive trust does not automatically arises

- Establishes what is the knowledge for **knowing receipt**. Held that it is as in Baden (i) – (iv) and that is the same for knowing assistance
    - *Baden*:
        (i) Actual knowledge
        (ii) Wilfully shutting one's eyes to the obvious
        (iii) Wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make
        (iv) Knowledge of circumstances which would indicate the facts to an honest and reasonable man
        (v) Knowledge of circumstances which would put an honest and reasonable man on inquiry

8.3 Constructive Trusts that arises against third parties to fiduciary relationship

***Barnes v Addy* (1874) LR 9 Ch App 244**

Facts

- Mr Barnes committed breach of trust
- Two solicitors
    - Mr Duffield prepared an instrument appointing Mr Barnes to be trustee
    - Mr Preston is the solicitor of Mr Barnes who perused and approved the instrument by which Mr Barnes was to be appointed a trustee of the Barnes' share of the trust property
- Are the two solicitors responsible as constructive trustee for the breaches of trust?

Held

Lord Selborne

- 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 trustee, 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.
- Strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions… 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 trustee**
- Mr Preston
    - There is not the slightest trace whatever of knowledge or suspicion on his part of an improper or dishonest design in the transaction
    - There was nothing to lead him to suppose that Mr Barnes was intended to sell out the fund and put the money into his own pocket
    - A solicitor in his position could not be held as a constructive trustee
- Mr Duffield
    - Mr Duffield was not aware the Mr Barnes has any dishonest purpose
    - He had also advised against making a transfer and not having a deed of indemnity
    - Not a scintilla of evidence suggesting that he was aware that something wrong was intended

8.3.1 Category 1: Trustee de son tort

- To qualify as a trustee *de son tort*, the person must have assumed some measure of control of the trust property within the intention to act as trustee for somebody else
- "Now, 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, or, as it is also termed, a constructive trustee." – *Mara v Browne* [1896] 1 Ch 199, 209 (CA)
- If a trustee de son tort has taken trust property→ it is a proprietary trust
- BUT more importantly, it is a personal liability