

Equity and Trusts

Exam Notes

MLP405

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Part 1: Equity

Equitable Fraud (Undue Influence & Unconscionable Conduct)

Equitable fraud matters because it can affect the validity of a trust or transaction. The two heads are undue influence (UI) and unconscionable conduct (UC).

Undue Influence

Approach: identify the category of UI, then work through requirements, defences and any third-party effect.

- Class 1 — Actual UI (harder to argue)
- Class 2 — Presumed UI
 - Class 2A — proven (recognised) relationships
 - Class 2B — relationships of influence proven on the facts

Class 1 — Actual UI

- Requires use of a threat or illegitimate proposal that influences a person into a decision — benefit obtained by actual pressure, violence or threat.
- Must prove the transaction was the outcome of an actual influence over the disponent's mind such that it cannot be considered their free act. The source of power need not arise from an antecedent relationship; it may arise in the particular situation or by the donee's deliberate contrivance: **Johnson v Buttress** (1936) 56 CLR 113, 134.

Class 2A — Presumed Influence (recognised relationships)

- Requires a special relationship of trust and confidence that the law recognises as one where one party can influence the other: **Johnson v Buttress**.
- Where the relationship is of such a nature that it is fair to presume the wrongdoer abused it in procuring the transaction, the court presumes UI: **Barclays Bank v O'Brien** [1994] 1 AC 180. The onus then shifts to the other party to rebut UI.
- Recognised 2A relationships (per Johnson v Buttress):
 - Parent and child — **Lancashire Loans Ltd v Black** [1934] 1 KB 380
 - Guardian and ward — **Powell v Powell** [1900] 1 Ch 234
 - Trustee and beneficiary — **Jenyns v Public Curator** (1953) 90 CLR 113
 - Solicitor and client — **Westmelton (Vic) v Archer and Schulman** [1982] VR 305
 - Physician and patient — **Bar-Mordecai v Hillston** [2004] NSWCA 65
 - Religious adviser/follower — **Hartigan v International Society for Krishna Consciousness Inc** [2002] NSWSC 810 (gift to religious group)
 - Uncle and niece — **Bank of NSW v Rogers**
- Marriage does NOT carry the presumption of UI: **Yerkey v Jones**.

Class 2B — Relationship of influence proven on the facts

- Argue: the relationship between X and Y falls within Class 2B. The circumstances in which a relationship becomes one of influence cannot be concisely defined: **Lloyds Bank v Bundy**.
- Indicators of such a relationship: trust and confidence, loyalty reposed, confidentiality and dependency.

- Character of the parties is relevant: intelligence, understanding of business matters, infirmities of mind or body, and the overall nature of the friendship (cf the weaker, intellectually disabled party in *Johnson v Buttress*).
- **Royal Bank of Scotland v Etridge (No 2)** [2002] 2 AC 773: a relationship of presumed influence may arise where (i) one party had strong trust and confidence in the other so that the other had power to influence their decisions; and (ii) the transaction was not readily explicable by the ordinary motives on which people act.
- **Thorne v Kennedy**: majority referred to six factors the trial judge identified — her lack of financial equality with Mr Kennedy; lack of permanent residency status; reliance on him for all things; emotional connectedness and the prospect of motherhood; emotional preparation for marriage; and the "publicness" of the upcoming marriage. Together these so seriously affected her state of mind as to render her incapable of judging her own best interests.

Defences to UI

- **Independent legal advice** — assess the quality of the advice and its effectiveness in mitigating the UI. The advice must be clear, independent, properly translated (where there is a language barrier) and directed to the particular transaction; it must have an emancipating effect on the recipient: *Ribchenkov v Suncorp Metway Ltd* (2000) 175 ALR 650.
 - Spouses need not always obtain separate advice — a wife may use the same family solicitor to avoid extra cost, but the solicitor must consider any conflict of duty or interest: Lord Nicholls, *Etridge (No 2)*.
 - Criticised by Lord Hobhouse: a creditor assured by the solicitor of the wife's comprehension cannot, without direct contact, be assured of it.
 - Advice is ineffective if it does not emancipate the plaintiff from the UI: *Thorne v Kennedy*.
- **Adequacy of consideration** — not a complete defence but a material factor: *Dixon J, Johnson v Buttress*.
- **Manifest disadvantage** — not accepted as a formal requirement in Australia (cf *National Westminster Bank v Morgan*, UK); best regarded as an important criterion indicating a relationship of influence: *Johnson v Buttress*.

Effect on third parties

A third party (e.g. a bank) who receives and retains a benefit arising from another's UI acts unconscientiously in three situations: (i) it participates with actual or constructive notice; (ii) it procures or holds out the debtor as its agent to obtain the security; or (iii) the special married-women's principle applies (third party denied the wife a full and proper explanation).

- **Agency**: a third party cannot enforce the transaction where the influencing party was its AGENT. There must be an ACTUAL request to act on its behalf — merely sending documents is insufficient. Ostensible authority may suffice where the third party represents that the influencing party is associated with its business: *Bester v Perpetual Trustee Co Ltd*.
- **Notice**: the third party is affected in equity where it participates with actual or constructive notice of the circumstances giving rise to the impropriety: *Yerkey v Jones* (1939) 63 CLR 649; *Bank of NSW v Rogers*; *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447.
- **Barclays Bank v O'Brien** [1994] 1 AC 180: bank increased the husband's business overdraft against a second mortgage over the family home; the manager's instruction to fully inform the O'Briens was not followed; Mrs O'Brien relied on her husband's misrepresentation; transaction set aside. Lord Browne-Wilkinson: the wife's equity is enforceable against the third party where

it has constructive notice; the bank must advise the wife separately and fully; the principle extends to emotional relationships between cohabiters.

- **Midland Bank plc v Massey** [1995] — approved O'Brien; extended to non-cohabiting de facto partners.
- **Banco Exterior International SA v Thomas** [1997] — no notice where a woman assisted a close male friend.
- **CIBC Mortgages plc v Pitt** — O'Brien not applicable where spouses misrepresent the purpose of finance and the loan is advanced jointly (joint-advance vs surety cases).
- **Royal Bank of Scotland v Etridge (No 2)** — a creditor is put on inquiry wherever it is aware of facts suggesting a non-commercial element to a guarantee; it must take reasonable steps to satisfy itself, and the solicitor bears the burden of advising on the nature and consequences of the transaction (summarised in *Ulster Bank Ireland Ltd v Roche and Buttimer* [2012] 1 IR 765).

Third parties — the Yerkey v Jones / Garcia principle

Yerkey v Jones — prima facie a wife may set the transaction aside where: a married woman consents to guarantee her husband's debts; consent is procured by the husband; she executes the guarantee without understanding its effect; and the creditor accepts it without dealing with her directly.

- Two limbs: (1) consent procured by the husband's ACTUAL UI entitles the wife to set aside the transaction, rebuttable by proof she received independent advice; (2) a "volunteer" wife may set aside a transaction she does not understand unless the creditor (reasonably believing she understood) explained it.
- **Garcia v NAB** — four features of the principle: (1) the wife did not understand the nature and effect of the transaction; (2) she was a volunteer (no benefit); (3) the lender knew of the trust and confidence reposed in the husband; (4) the lender did not explain the transaction or ensure she received competent, independent advice.
 - Rationale is NOT female subservience or economic inferiority, nor vulnerability through emotional involvement, but the trust and confidence between marriage partners; the principle remains applicable in the modern context.
 - Kirby J preferred a modified O'Brien principle (surety + creditor knowledge of emotional dependence; valid unless procured by UI/misrepresentation, etc., and the creditor took steps to ensure free and informed entry).
- **Extension beyond marriage:** Garcia left open extension to "long-term and publicly declared relationships short of marriage" (same or opposite sex). *Liu v Adamson* extends it to de facto relationships.
- **Parent/child:** *Mclvor v Westpac* (might apply to an elderly mother/lawyer son in an emotive relationship of dependence) cf *Watt v State Bank of NSW* (insufficient dependence).
Vandenbergh — *Murphy JA* declined to treat aged parent/child as synonymous with husband/wife for Garcia, but applied unconscionable dealing (bank had imputed knowledge; acceptance and retention of the mortgage was unconscientious).
- **UK contrast — Etridge (No 2):** "notice" is the heart of the principle (not restricted to wives). Three elements: (1) transaction not of financial advantage to the surety; (2) proof of substantial risk of influence (bank knew of a close emotional relationship); (3) no separate explanation given to the weaker party. Once on inquiry the bank need not investigate whether UI was exerted, only satisfy itself the implications were brought home meaningfully (a modest burden). *Etridge* guidelines (approved in *Mahon v FBN Bank (UK) Ltd*): the bank should bring the risks to the wife's attention, ideally at a private meeting; in exceptional cases insist on separate advice; the

solicitor should explain the purpose of involvement, advise face-to-face in the husband's absence in non-technical language, and consider any conflict of interest.

Unconscionable Conduct

Statutory/equity framing: under s20(1) ACL a person must not, in trade or commerce, engage in conduct that is unconscionable under the unwritten law. Per **Commercial Bank of Australia v Amadio**, three elements establish UC at general law:

- **Element 1 — special disability/disadvantage** affecting the party's ability to protect themselves (Blomley v Ryan).
 - Kitto J (Blomley): illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affecting the ability to conserve one's interests. Fullagar J: poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy, lack of education, or lack of needed assistance/explanation.
 - Amadio — limited grasp of English; misinformed about the transaction and their son's business. Mason J: "special" connotes more than a mere difference in bargaining power (cf Kirby J's dissent in Berbatis, on which it can be argued s20(1) extends beyond Amadio).
 - Deane J, Louth v Diprose (1992) 175 CLR 621, 638: equity intervenes not merely to relieve foolishness but to prevent victimisation; recognised a special disability the defendant created through manipulation.
 - Kakavas v Crown — no special disability where there has been sufficient rehabilitation.
 - Amadio factors: amount paid by the stronger to the weaker party; existence of independent advice; the weaker party's ability to comprehend the transaction (or the stronger party's knowledge of the weakness).
- **Element 2 — knowledge:** to take advantage of a disability the stronger party must have knowledge of it (ACCC v Radio Rentals Ltd).
- **Element 3 — unconscientious advantage** taken of the special disability (Amadio — not consistent with equity or good conscience). Where the elements are shown, the onus shifts to the stronger party to show the transaction was fair, just and reasonable (Amadio); Louth v Diprose — victimisation.

Key cases:

- ACCC v Berbatis [2003] — no UC (shop lease).
- ACCC v Samton Holdings (2002) 189 ALR 76 — no UC (\$70,000 to renew a lease, despite knowledge of the lessee's vulnerable financial position); but UC can arise from particular features of the relationship.
- ACCC v Zanok Technologies [2009] FCA 1124 — UC found; Zanok posted job offerings/training with no guarantee of a job to job-seekers seeking permanent work.
- Bridgewater v Leahy (1998) 194 CLR 457 — parties met on unequal terms; Neil took advantage of his uncle's emotional dependence to obtain a benefit through a grossly improvident transaction.
- Kakavas v Crown Melbourne (2013) 298 ALR 35 — Kakavas could make rational decisions and at times refrained from gambling; Crown did not knowingly victimise him.
- Louth v Diprose (1992) — defendant manufactured and manipulated the special disability and refused restitution. (Note: even where conduct is not unconscionable under the unwritten law, it may fall under the wider s21(1) ACL.)

Fiduciary Relationships

A fiduciary relationship arises where one party is in a position to legally affect the interests of another. **Answer structure: Relationship → Scope → Breach → Defence → Remedies.**

Limb 1 — Is there a fiduciary relationship?

Categories: well-established (easy), frequent, and circumstantial (proven on the facts).

- **Hospital Products Ltd v United States Surgical Corp** (1984) 156 CLR 41: a fiduciary undertakes or agrees to act for, or in the interests of, another in the exercise of a power or discretion that affects that other's interests in a legal or practical sense. Hallmarks: assumption of responsibility by the stronger party; vulnerability of the weaker party; and an expectation that the stronger party will act in the weaker party's interests.
- Common hallmark features: a relationship of trust and confidence; an undertaking to act in another's interests and assume power over them; entrustment of duty, information or property; the weaker party being vulnerable and at the stronger party's "mercy"; reliance; mutual expectation of reciprocal interest-protection; conferral of confidential information; and a discretionary power that may adversely affect the other's interests or proprietary rights.
- The "**undertaking**" is critical: a person is a fiduciary where they have undertaken to act for, or assumed a responsibility to, another such that the other may reasonably expect them to act in that other's interest to the exclusion of their own: *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296.
- **LAC Minerals v International Corona Resources** (1989) — Sopinka J's three characteristics: (i) scope for the exercise of discretion or power; (ii) the fiduciary can unilaterally exercise it to affect the beneficiary's interests; and (iii) the beneficiary is peculiarly vulnerable to the fiduciary.
- Vulnerability is an important but not determinative indicium: *Hodgkinson v Simms*.
- There is a general disinclination in Australian law to expand fiduciary obligations beyond proprietary interests into personal rights: *Pilmer v Duke* (2001) 207 CLR 165.
- Certain elements of a relationship may be fiduciary while others are not: *Breen v Williams*. Conclusions from *Breen v Williams* (per *Pilmer v Duke*): attempts to make doctor/patient fiduciary have failed (imbalance of power/vulnerability is not enough); fiduciary duties are more onerous, so per se categories are not extended except where clearly warranted; the basis is loyalty to a vulnerable dependant; obligations stay within proprietary interests; and they are PROSCRIPTIVE, not prescriptive. Ms Breen's claim failed because it would impose a positive obligation to grant access to notes.

Established categories

- **Trustee–beneficiary** — implied automatically; always fiduciary (though a fiduciary is not always a trustee); very strong duties because the trustee is vested with trust property; covers express and constructive trustees. Rule in *Keech v Sandford*. Irrebuttable presumption that any gain is obtained by abuse of the relationship: *Chan v Zacharia*.
- **Solicitor–client** — implied automatically; covers the matter the solicitor acts on; strictly enforced. *Farrington v Rowe, McBride & Partners* [1985] 1 NZLR 85 (cannot serve two clients' conflicting interests; fully informed consent required; should advise independent advice; obligations end with the retainer, superseded by confidentiality). In Victoria a lawyer may not act against a former client on fiduciary grounds (*Spincode Pty Ltd v Look Software*) cf *Ismail-Zai v WA* (duty does not survive the retainer).