

**The Remedial Constructive Trust Based on
Unconscionability in the New Zealand
Commercial Environment**

John Dixon *

I: THE CONSTRUCTIVE TRUST

Over the last decade the constructive trust has sparked considerable discussion as it has been applied to an ever-increasing variety of situations. In New Zealand at least, it now appears well settled that constructive trusts are a viable remedy available in de facto cases. In recent years the New Zealand courts have begun to apply constructive trusts more readily in the commercial domain as well.

Prior to any sensible discussion of the topic of constructive trusts in the commercial environment, it is necessary to define what is meant by "constructive trust". It is well settled that an express trust arises by intention of the parties, and a constructive trust is imposed by the courts. However, there are considerable differences throughout the common law world regarding the ambit of the definition and its appropriate application.

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In the United Kingdom the constructive trust is treated as a substantive institution, that is, a type of trust. The express trust and the constructive trust are treated as being closely related, probably because in each case the court is concerned with ensuring that legal title held by one person is retained for the benefit of another. However, the English method has been criticized as being “a cul-de-sac of legal reasoning”.¹ The difficulty with the English position lies in its concentration on the concept of a trust, and its consequent preoccupation with the existence of a fiduciary relationship as a prerequisite to relief. English law has suffered due to the confusion arising from the failure of this approach to explain all the situations where a constructive trust will be awarded. For a time, Lord Denning attempted to expand the scope of equitable remedies,² and some of his reforms have been greeted enthusiastically by commentators.³ However, the House of Lords has not extended quite the same welcome to much of Lord Denning’s work⁴ and the constructive trust in England remains confined to its traditional boundaries.

Notwithstanding some comments by Deane J in *Hospital Products Ltd v US Surgical Corp*,⁵ the Australian law of constructive trusts incorporates many of the characteristics embodied in the English law.

By contrast, the constructive trust in the United States is treated as being wholly separate from the express trust.⁶

An express trust is a substantive institution. Constructive trust, on the other hand, is purely a remedial institution.

For many years now it has been considered that there is only one type of constructive trust in the United States, being the remedial constructive trust.⁷

In Canada there may be several constructive trusts. Commenting on the decision in *Pettkus v Becker*,⁸ Professor McClean declared:⁹

Even though all constructive trusts may be referable to some general principle of preventing unjust enrichment, some may indeed create a conventional trust; others may result simply in the transfer of title. The exact nature ... will depend upon the type of constructive trust that has arisen.

It is a primary submission of this article that the law in New Zealand now recognises two kinds of constructive trust; the institutional constructive trust and the remedial constructive trust.

¹ Waters, *The Constructive Trust* (1964) 3.

² See for example *Lloyds Bank Ltd v Bundy* [1975] QB 326.

³ See infra at notes 11 and 16.

⁴ See for example the speech of Lord Scarman in *National Westminster Bank Plc v Morgan* [1985] AC 686, 707 (HL).

⁵ (1984) 156 CLR 41, 125 (HCA).

⁶ Pound, “The Progress of the Law, 1918-19 – Equity” (1920) 33 Harv L Rev 420, 420-421.

⁷ See Scott, infra at note 43 and accompanying text.

⁸ [1980] 2 SCR 834.

⁹ McClean, “Comment – *Pettkus v Becker*” (1982) 16 UBCLR 155, 168.

The Institutional/Remedial Distinction

The distinction between the two types of constructive trust¹⁰ has now been accepted by writers in several jurisdictions.¹¹ According to Dewar,¹² an institutional constructive trust will be:¹³

... one which arises as a necessary legal consequence, and which necessarily connotes certain legal consequences, whenever certain facts, which are recognised by law as being essential to the creation of the trust, are found to exist.

This type of trust is the constructive trust as it is understood in England. The key points to note are the importance of a fiduciary relationship, or at least the breach of such a relationship, and the mandatory nature of the institutional constructive trust: it is awarded *necessarily* as a result of particular circumstances. It is so closely related to the right that it is almost subsumed within it. Dewar contrasts this with the remedial constructive trust, which is a particular remedy selected from all others available and imposed by the court. The remedial constructive trust is therefore discretionary and is used to give effect to a legal right which exists apart from the remedy.

Commentators have disagreed somewhat as to where the boundary exists between the two types of trust. There is both a broad and a narrow view of the institutional constructive trust. Professor Maudsley advocates the more restricted approach, whereby an institutional constructive trust will be imposed when an express or implied trust is breached. Dewar¹⁴ suggests that Maudsley includes the following situations under this head:¹⁵

- (1) renewal by a trustee of a lease in his own name, (citing *Keech v Sanford* (1726) Sel Cas Ch 61);
- (2) making of an unauthorized profit for himself by a trustee or other fiduciary during the course of administration of the trust, (citing *Phipps v Boardman* [1967] 2 AC 46 (HL));
- (3) fraudulent acquisition of trust property by a purchaser with notice, (citing *Barnes v Addy* (1874) 9 Ch App 255; *Nelson v Larholt* [1948] 1 KB 339);
- (4) secret trusts, (citing *McCormick v Grogan* (1869) LR 4 HL 82); and
- (5) mutual wills, (citing *Re Green* [1951] Ch 148).

The common factor in such situations is that the property of an existing trust has been wrongfully obtained, with the obligations arising under the trust being imposed by law upon the transferee of the property. Professor Maudsley goes on to

¹⁰ Alternatively it could possibly be viewed as two aspects of the constructive trust.

¹¹ The institutional constructive trust is sometimes called “substantive” – see for example *supra* at note 1 and accompanying text. With regard to the remedial constructive trust, Maudsley suggests that it would be preferable to refer to it as the “constructive quasi-trust” in order to avoid the trap of too closely aligning express and constructive trusts: (1959) 75 LQR 234, 237.

¹² Dewar, “The Development of the Remedial Constructive Trust” (1982) 60 Can Bar Rev 265.

¹³ *Ibid*, n 4.

¹⁴ *Ibid*, 270.

¹⁵ *Ibid*, n 29. See also Maudsley, *supra* at note 11.

state that the constructive trust will be remedial when it is imposed by the court to compel the return of property held wrongly by the defendant. However, this categorisation only extends to the case where the plaintiff declares that the property *is* his or hers, and does not extend to the claim that property *ought to be* his or hers.

Professor Sealy, on the other hand, espouses the broad view. He suggests that a remedial constructive trust should arise only where the plaintiff pleads that the property in the possession of the other party *ought to be* his or hers. In such circumstances, the plaintiff's claim will be based "not on ownership in equity but on obligation in equity".¹⁶ By corollary, Professor Sealy considers that the institutional constructive trust should apply not only where a breach of an expressed or implied trust has occurred, but also where one party is claiming a proprietary interest in particular property held by another or is suing a holder with notice of that interest *in personam*.

Obligations Along a Continuum

One possible route to reconciling the different approaches adopted in the cases and academic writings is to consider the framework of equitable obligations and remedies, of which constructive trusts are but one part. It is possible to view equitable obligations as being simply points upon a continuum. This is an idea which has found favour with some writers discussing the fiduciary principle. Finn states:¹⁷

What is being suggested, though, is that the fiduciary principle should not be considered as something separate, complete and whole; that it belongs, most likely, to a family of doctrines; that these may well be found in time to be informed by a common principle; and that to the extent that these make available a range of behavioural standards of varying intensity, there is the need to identify the factors which determine the appropriateness of one rather than another to a given relationship.

Maxton considers that:¹⁸

... it is possible to perceive the factors which make up the fiduciary relationship as at the most rigorous end of a continuum which encompasses other standards for the regulation of human affairs of a like nature, for example, unconscionability and good faith.

Putting it even more broadly, Gautreau wrote:¹⁹

There is no difference in principle between contractual duties, duties of care based on the *Hedley Byrne* principle and fiduciary duties. They all involve the same elements. The difference is only in degree.

¹⁶ Sealy, "Some Principles of Fiduciary Obligations" [1963] CLJ 119, 123. See also Sealy, "Fiduciary Relationships" [1962] CLJ 69.

¹⁷ Finn, "The Fiduciary Principle", in Youdan (ed), *Equity, Fiduciaries and Trusts* (1989) 1, 55-56.

¹⁸ Maxton, "Equity" [1990] NZRLR 89, 91.

¹⁹ Gautreau, "Demystifying the Fiduciary Mystique" (1989) 68 Can Bar Rev 1, 29.

While I respectfully agree with the opinions of Maxton and Finn, I cannot accept the sweeping statement of Gautreau. To suggest that the only difference between the situation of owing a duty of care to one's neighbour, that of the voluntary assumption of a contractual obligation, and that of being obliged to act in the best interests of another, is a matter of degree, would appear to be manifestly wrong. It extends the continuum concept too far. These are separate areas of the law and, despite the overlaps that exist (particularly in respect of remedies), they ought to be treated distinctly.

An interesting point, somewhat ancillary to this argument, arises in relation to the question of whether a similar continuum can be drawn in respect of the remedies that are available. In adopting such a concept, there would need to be a break in the continuum drawn at the point where constructive trusts switch from being the presumptive remedy to being only a discretionary remedy.

II: THE REMEDIAL CONSTRUCTIVE TRUST IN NEW ZEALAND

There can be no dispute that the situations extrapolated by Dewar from the article by Maudsley²⁰ will normally give rise to a constructive trust in New Zealand, whether or not one chooses to describe the trust as an institutional constructive trust. What is not so clear is whether a remedial constructive trust can be awarded. In my opinion, the constructive trust imposed by the New Zealand Court of Appeal in *Elders Pastoral Ltd v Bank of New Zealand*²¹ was a remedial constructive trust.

In June 1987, Elders persuaded the Bank of New Zealand ("the Bank") to advance sums of money to a farmer named Gunn, secured by a registered instrument by way of security over his stock. Clause 15 of the instrument provided that all money payable in respect of stock sold should be paid to the Bank. In January 1988 Gunn, through his stock agent Elders, sold some progeny of the sheep which had been assigned to the Bank under the instrument. Elders retained nearly \$58,000 of the proceeds of sale in satisfaction of Gunn's indebtedness to Elders. The Bank sued for this amount, and were given summary judgment by Master Hansen.

The Court of Appeal was faced with determining whether clause 15 was merely of contractual force between Gunn and the Bank, or whether it gave the Bank an interest in the proceeds of sale or a right to trace the proceeds against a party in the position of Elders. The Court found against the Bank, stating that there had not been an equitable assignment. However, the Court recognised that the Bank was entitled to the remedy of the constructive trust.

²⁰ Supra at note 15.

²¹ [1989] 2 NZLR 180.

On appeal to the Privy Council,²² their Lordships determined that there had been a valid equitable assignment by way of a charge over a future chose in action by Gunn to the Bank. Their Lordships did not find it necessary, therefore, to consider whether the judgment of the Court of Appeal should be affirmed in respect of the awarding of a constructive trust.

Thus, it is submitted that the law stated by the Court of Appeal can be taken as representing the view of the senior judiciary in New Zealand in relation to the constructive trust. It is therefore necessary to examine closely the basis of each judgment.

Cooke P determined from the outset that clause 15 lacked the force contended by the Bank, and went on to note that equitable rights can arise by means other than assignments or contracts to assign. In expanding upon this statement, he cited an excerpt from Goff & Jones, *The Law of Restitution*:²³

Equity's traditional rules suggest that it is necessary to discover a fiduciary relationship before a plaintiff can trace his property. Now that law and equity are fused this requirement makes little sense, and it has been recently accepted that "the receiving of money which consistently with conscience cannot be retained is, in equity, sufficient to raise a trust in favour of the party for whom or in whose account it was received." Indeed ... English courts have never allowed a just claim to fail and have found a fiduciary relationship between the parties because it was necessary to do so. As we have seen, equity's rules and presumptions to identify property have also been moulded to satisfy the equities of the plaintiff's claim.

His Honour then referred to a statement made by Cardozo J in *Beatty v Guggenheim Exploration Co.*:²⁴

A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.

Cooke P then gave an illustration of how this extremely general concept has been viewed in the United Kingdom, citing Bingham J:²⁵

Given the situation of [the defendants] when the last payment was received, any reasonable and honest directors of that company (or the actual directors had they known of it) would, I feel sure, have arranged for the repayment of that sum to the plaintiffs without hesitation or delay. It would have seemed little short of sharp practice for [the defendants] to take any benefit from the payment, and it would have seemed contrary to any ordinary notion of fairness that the general body of creditors should profit from the accident of a payment made at a time when there was bound to be a total failure of consideration. Of course it is true that insolvency always causes loss and perfect fairness is unattainable. The bank, and other creditors, have their legitimate claims. It nonetheless seems to me that at the time of its receipt [the defendants] could not in good conscience retain this payment and that accordingly a constructive trust is to be inferred.

²² [1991] 1 NZLR 385.

²³ (3rd ed 1986) 77-78.

²⁴ 225 NY 380, 386 (1919), as quoted in Snell's *Principles of Equity* (28th ed 1982) 192.

²⁵ *Neste Oy v Lloyd's Bank Plc (The Tiiskeri)* [1983] 2 Lloyd's Rep 658, 666.

In effect, the last sentence of the extract from the judgment of Bingham J provides the basis for the decision of Cooke P. His Honour assessed the close relationship of proximity and knowledge between the three parties and concluded quite simply:²⁶

I do not think that in conscience the stock agents can retain this money.

Significantly, at no point in his judgment did Cooke P use the word “fiduciary”. His Honour imposed a constructive trust because it was “less than conscionable”²⁷ for Elders to retain the money.

In his judgment, Somers J dealt first with the failure of clause 15 to protect the Bank adequately, and then discussed whether there was another basis on which to found an equitable right. He declared that:²⁸

[The Bank] would have such an interest if Mr Gunn or Elders stood in a fiduciary relationship to the Bank or, if, which in the present context comes to much the same thing, the moneys received by Elders could not conscientiously be appropriated by it against the Bank.

His Honour appears to be suggesting that actions against conscience give rise to the same consequences as a breach of a fiduciary relationship.

Somers J goes on to conclude that there was an implied obligation upon Mr Gunn which was “fiduciary in character”.²⁹ This is because the sum in dispute was the proceeds of the sale of stock which, by virtue of the security, were the property of the Bank pending sale. Since Elders were the agent of Mr Gunn, and could not stand in a better position than their principal, Somers J determined that the proceeds of the sale must be held by Elders for the Bank.

This reasoning goes further than that of Cooke P in alleging a fiduciary relationship. However, one must question whether Somers J is committed to the existence of a such a relationship. First, his Honour uses the expression “fiduciary in character” rather than simply “fiduciary”. Second, in granting the remedy of a constructive trust his Honour quotes and refers to the very same passages from Goff and Jones and *Neste Oy* as those reproduced from the judgment of Cooke P above. Those extracts categorically declare that a fiduciary relationship is not a necessary prerequisite to the imposition of a constructive trust. Furthermore, as Somers J himself concludes:³⁰

[A constructive trust] has come to be used as a device for imposing a liability to account on persons who cannot in good conscience retain a benefit in breach of their legal or equitable obligations.

It is therefore unclear exactly what is ratio and what is obiter in this judgment.

Admittedly, it might be possible to class the relationship as fiduciary, although

²⁶ Supra at note 21, at 186.

²⁷ Ibid.

²⁸ Ibid, 191-192.

²⁹ Ibid, 192. What does “fiduciary in character” mean? Is it something *less* than a fiduciary relationship?

³⁰ Ibid, 193.

that would put a great deal of strain on the word.³¹ It appears that relevant, but not conclusive, factors going to the establishment of a fiduciary relationship include; dominance, vulnerability, dependence, honesty, loyalty, reliance, and acceptance by one party of an obligation to act in the best interests of the other.³² At least the first three, and the last, of these criteria would appear to be absent in this case, given that the Bank had the opportunity to protect its own interests in the contract with Gunn. As Mason J pointed out in the *Hospital Products* decision:³³

... the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them.

Furthermore, as stressed by both Gibbs CJ and Dawson J in that case, fiduciary obligations will not be imposed to remedy the inadequacy of the parties' contractual arrangement.³⁴

The essence of the judgment of Somers J appears to be that the relationship which existed was very close to a fiduciary one. On this basis, and owing to the unconscionable behaviour of Elders, the money must be held on constructive trust.

Richardson J authorised Cooke P to say that "broadly for the same reasons given in [the judgment of Cooke P] and the judgment of Somers J he also would dismiss the appeal".³⁵

On the basis of the above analysis, I conclude that a remedial constructive trust was imposed in *Elders*. In order to constitute an institutional constructive trust, a breach of a fiduciary relationship would be required. As Waters wrote in reference to the English institutional constructive trust:³⁶

[T]he fiduciary relationship is clearly wed to the constructive trust over the whole, or little short of the whole, of the trust's operation.

³¹ A not uncommon occurrence; see for example *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105, and *Goodbody v Bank of Montreal*; *Goodbody v Lester* (1974) 47 DLR (3d) 335, 339 (Ont HC), where the Court permitted the plaintiffs to trace in equity and recover the sale proceeds of certain share warrants belonging to them that had been wrongfully acquired and sold by the defendant, Lester. In answer to the defendant's submission that the equitable remedy was not available in the absence of a fiduciary relationship, it was held that, in view of the defendant's guilty involvement in the acquisition and sale of the warrants, "the Court will establish a fiduciary relationship to enable the plaintiffs to follow their property in equity into Lester's bank account", per Lacourciere J.

³² I accept, of course, that this is by no means a definitive list. The authorities contain much guidance as to the duties of one who is in a fiduciary relationship with another, but provide no comprehensive statement of the criteria by reference to which the existence of a fiduciary relationship may be established.

³³ *Supra* at note 5, at 97.

³⁴ *Ibid*, 143.

³⁵ *Supra* at note 21, at 186.

³⁶ *Supra* at note 1, at 33.

In *Elders* the Court of Appeal concentrated less on the abuse of a relationship, and more on the wrongful nature of the act whereby the property was acquired.

Watts has criticised the decision on the following basis:³⁷

[I]f the Court was not able to find that the bank's instrument by way of security extended its proprietary interest to the proceeds it was not for the Court to nurse the bank by imposing a trust based on unconscionability. In other words, any right to trace on these facts ought to have arisen only by intention and not by operation of law.

With respect, this is correct – but only up to a point. It is entirely true that courts are loath, and should be loath, to interfere in the contractual dealings between parties in the absence of any undue influence, duress or unconscionable bargaining. There is unlikely to be a remedy for a hard bargain, or even an unreasonable one.³⁸ On this basis, the Court ought not to “nurse” the Bank. However, that is not what the Court of Appeal was doing. The Court implicitly accepted that the Bank was a commercial party which could look after itself on a contractual basis. Thus, no fiduciary relationship existed. However, the Court then focused on the actions of the defendant. Their Honours were not attempting to nurse the Bank, but rather to prevent the unconscionable retention of the funds by Elders. The emphasis is therefore different and, it is submitted, correct. There must be situations where the courts will grant an equitable remedy, even though the parties have not accepted the opportunity to protect themselves in advance. For instance, should parties be obliged to contract for every eventuality? In particular, should they be obliged to provide for manifest wrongdoing by the promisee, or by a third party?

This concentration on the behaviour of Elders, rather than on any fiduciary relationship between the parties, is further evidence that what was imposed here was a remedial constructive trust, rather than an institutional constructive trust. Furthermore, this case does not fit into any of the five categories listed above.³⁹ Indeed, as Cooke P pointed out:⁴⁰

Despite the wealth of authority and discussion in learned writings drawn to our attention by counsel in their memoranda, no case precisely or even closely in point has been found.

It is unclear from the judgments whether the Bank was pleading that the money was its property, or whether the Bank suggested that the money *ought* to be its property. It is possible that these propositions were pleaded alternatively. In either case, however, there is support for the imposition of a remedial constructive trust.⁴¹

³⁷ Watts, “Restitution” [1989] NZRLR 386, 398.

³⁸ Older equity cases strongly push this point. See *Brusewitz v Brown* [1923] NZLR 1106, 1109: “The mere fact that a transaction is based on an inadequate consideration or is otherwise improvident, unreasonable, or unjust is not in itself any ground on which this Court can set it aside as invalid.”

³⁹ *Supra* at note 15.

⁴⁰ *Supra* at note 21, at 185.

⁴¹ See *supra* at notes 11 and 16.

III: CONSEQUENCES OF FINDING A REMEDIAL CONSTRUCTIVE TRUST

Once it is established that a remedial constructive trust was imposed in *Elders*, there remains the problem of ascertaining the underlying right which was breached. The most obvious suggestion is unjust enrichment. The remedial constructive trust is based on this doctrine in both Canada⁴² and the United States. In fact, in the latter jurisdiction the constructive trust is not considered in the *Restatement of Trusts*,⁴³ but rather is stated in the *Restatement of Restitution*:⁴⁴

Where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises.

Moreover, as stated above, both Cooke P and Somers J cite passages from Goff and Jones' *The Law of Restitution* in their judgments. Cooke P also impliedly approves the broad statement of principle of Cardozo J in *Beatty v Guggenheim Exploration Co*,⁴⁵ which heavily influenced the formulators of the *Restatement*.⁴⁶

It is perhaps possible to view *Elders* as an unjust enrichment situation. It is widely accepted that, in order to found such an action, there must be:⁴⁷

- (i) an enrichment of the defendant;
- (ii) at the expense of the plaintiff; and
- (iii) the absence of any juristic reason for the enrichment.

On the face of the judgments, these requirements would appear to be satisfied. However, Watts suggests that the finding by Somers J that *Elders* was equally affected by the constructive trust because it could not stand in a superior position to its principal. Furthermore, this may be inconsistent with "the leading case on set-off", *Roxburghe v Cox*,⁴⁸ which happened to concern agency:⁴⁹

In the ordinary course, an agent is entitled to set off, in any accounting with its principal, sums owed to it by the principal (see *Bowstead on Agency* (15th ed, 1985) 246-247), and it appears from *Roxburghe* that that right is no different from that of an ordinary debtor. Such persons generally need to have notice of the competing security interest of the third party before losing the right of set off.

⁴² *Pettkus v Becker*, supra at note 8.

⁴³ Except insofar as a constructive trust arises out of a breach of duty by an express trustee; as, for example, where an express trustee in breach of trust transfers trust property to a third person who is not a bona fide purchaser: Scott, "Constructive Trusts" (1955) 71 LQR 39, 41.

⁴⁴ §160.

⁴⁵ Supra at note 24.

⁴⁶ Scott, supra at note 43.

⁴⁷ Kos & Watts, *Unjust Enrichment – The New Cause of Action* (New Zealand Law Society Seminar, February 1990).

⁴⁸ (1881) 17 Ch D 520. For a recent and comprehensive examination of the law in New Zealand on set-off see the judgment of Somers J in *Grant v NZMC Ltd* [1989] 1 NZLR 8.

⁴⁹ Supra at note 37.

This would appear to provide a juristic reason for the enrichment, with the crucial factor being the knowledge of Elders.⁵⁰

In any event, it is unlikely that the Court of Appeal based its decision on unjust enrichment. The status of this doctrine in New Zealand law is uncertain. In 1983 Cooke J was of the opinion that:⁵¹

The scope of [unjust enrichment] in New Zealand is unsettled. Safely if tritely one can say that it may be evolving.

The law does not appear to have changed substantially since then, although in *Gillies v Keogh*⁵² his Honour appeared to take unjust enrichment more seriously, equating it to other more established principles.⁵³

Normally it makes no practical difference in the result whether one talks of constructive trust, unjust enrichment, imputed common intention or estoppel. In deciding whether any of these are established it is necessary to take into account the same factors.

However, it cannot yet be said that unjust enrichment has become accepted in New Zealand as a cause of action. Perhaps it should be, and perhaps it soon will be. However, if and when it is, the Court of Appeal will need to state the position clearly. To assert that unjust enrichment formed the basis for the decision here would be to allow the doctrine in through a side door, and it is unlikely that the Court would have taken such an important step in that manner.⁵⁴

In any respect, I do not believe that unjust enrichment encompasses the real tenor of this decision. It is submitted that a constructive trust was awarded in *Elders* to remedy an action which was unconscionable.

The Meaning of Unconscionability

There is a vocabulary trap which many judges and commentators fall into when using the word “unconscionable”. In strict terms, unconscionability is a narrow and specific form of equitable relief stemming from two distinct areas. The first is the general equity in favour of heirs and expectants to prevent “catching bargains”.⁵⁵ The second is that outlined by Kay J in *Fry v Lane*:⁵⁶

The result of the decisions is that where a purchase is made from a poor and ignorant man at a considerable undervalue, the vendor having no independent advice, a Court of Equity will set aside the transaction.

Recent examples of the application of this principle include *Blomley v Ryan*⁵⁷ and

⁵⁰ For further discussion, see text, *infra* at p161.

⁵¹ *Hayward v Giordani* [1983] NZLR 140, 148.

⁵² [1989] 2 NZLR 327. Decided after *Elders*.

⁵³ *Ibid*, 330.

⁵⁴ Witness the clear and explicit manner in which the House of Lords redefined the law of torts in *Donoghue v Stevenson* [1932] AC 562.

⁵⁵ See the judgment of Lord Hardwicke in *Earl of Chesterfield v Janssen* (1750) 2 Ves Sen 125; 28 ER 82.

⁵⁶ (1888) 40 Ch D 312, 322.

⁵⁷ (1956) 99 CLR 362.

O'Connor v Hart.⁵⁸

What is often referred to as unconscionability in other circumstances is, it is submitted, the application of a wider term encompassing situations in which equity intervenes on the basis that the dealing offends against the principles of good conscience. This principle is known as unconscientiousness, with unconscionable bargains and undue influence comprising mere sub-categories of the principle.⁵⁹

However, it may now be too late to remedy this loose use of language. The term unconscionability is now used predominantly,⁶⁰ and for the sake of clarity, consistency and ease of understanding, I will continue to use it throughout this article.

Acceptance of Unconscionability

It has since been accepted in several recent cases that the decision in *Elders* established unconscionability as a legal right for which the remedy of a constructive trust can be given. In *Mogal Corporation Ltd v Australasia Investment Co Ltd (In Liquidation)*,⁶¹ Smellie J found that there was a fiduciary relationship in favour of Mogal, but then went on to conclude:⁶²

It seems to me, with respect, that the Court of Appeal in the *Elders* case took the view that a fiduciary relationship is no longer a necessary prerequisite for a constructive trust, which may be imposed whenever someone receives money which consistently with conscience cannot be retained In the present case my conclusion is that whether based upon breach of fiduciary duty or unconscionability, AICMF holds the appropriate proportion of the proceeds of the mortgagee sale on a constructive trust for Mogal.

Furthermore in *Re Goldcorp Exchange Ltd (In Receivership)* Thorp J stated:⁶³

[The submissions of Mr Finnigan, counsel for “non-allocated purchasers”] proceeded on the dual basis that constructive trust should be found arising either from fiduciary relationship or from unconscionable conduct. Despite the fact that as recently as *Re Ararimu Holdings Ltd* [1989] 3 NZLR 487, a careful study of the relevant authorities resulted in agreement between the Court and senior counsel that a fiduciary relationship or similar equity is a condition precedent to obtaining an equitable proprietary right by tracing, I agree with Mr Finnigan that *Elders v Bank of New Zealand* has settled the law for this country the other way, and that as a matter of law his alternative bases must be available.

The most radical development since *Elders* is the decision of Thomas J in *Powell v Thompson*.⁶⁴ It is outside the scope of this article to consider the ramifications of that judgment in respect of cases involving knowing receipt and

⁵⁸ [1985] 1 NZLR 159 (PC).

⁵⁹ Supra at note 55.

⁶⁰ Some of this use can perhaps be traced back to *In Re Diplock* [1948] Ch 465, 532: “[E]quity intervenes not to do what might be thought to be absolute justice to a claimant, but to prevent a defendant from acting in an unconscionable [unconscientious] manner.”

⁶¹ (1990) 3 NZBLC 101,783.

⁶² Ibid, 101,807.

⁶³ High Court, Auckland. 17 October 1990 M 1450/88. The Court of Appeal held that there was a fiduciary relationship, and so did not address this issue: (1992) 4 NZBLC 102,574; see also Case Note, infra at p266.

⁶⁴ [1991] 1 NZLR 597.

dealing and knowing assistance.⁶⁵ However, Thomas J clearly accepted that:⁶⁶

[I]n New Zealand the constructive trust has become a broad equitable remedy for reversing that which is inequitable or unconscionable.

Finally, in *Equiticorp Industries Group Ltd v Hawkins*⁶⁷ Wylie J accepted the principle of unconscionability as outlined in *Elders*. His Honour did, however, take a more limited view of the applicability of constructive trusts than that propounded in *Powell v Thompson*.⁶⁸

So what is the result of these cases? It seems that an action in New Zealand can now be founded on unconscionability. The ambit of this principle appears to be disconcertingly broad, even with the reassurance offered by Cooke P in *Gillies v Keogh*.⁶⁹

The experience of the Courts suggests that [de facto cases] are very often marked by a vagueness of intention not expected and less commonly found in commercial dealings. In the commercial sphere I think that constructive trusts should clearly be much more difficult to establish. It is a truism that certainty is particularly valued in commercial law.

If unconscionability is going to be accepted, what are its limits? In order to define these limits it is useful to pose three questions: What was the relationship between the parties in *Elders*? What other remedies might have been available? Finally, what was it that rendered *Elders*' actions less than conscionable?

The Legal Relationship Between the Parties

Elders were not in a contractual relationship with the Bank. If they had been, actions carried out in accordance with the terms of the contract could not have been unconscionable.⁷⁰ If there had been a breach of contract, damages would have surely have been the appropriate remedy.

Elders did not commit a tort by retaining the money. While it could be suggested that *Elders*, acting with knowledge of the contract between Gunn and the Bank, were interfering with contractual rights (those of the Bank to receive the sale proceeds from Gunn), that would appear to be a considerable extension of the usual parameters of that action. If there had been a breach of a tortious duty, damages would once again have been the presumptive remedy.

Elders were not in a fiduciary relationship with the Bank. Cooke P certainly did not find a fiduciary relationship. While Somers J seemed tempted to consider that there might be a fiduciary relationship, I submit that, for the reasons given above, this would have been incorrect. Certainly however, if a fiduciary relationship had

⁶⁵ See Fardell & Fulton, "Constructive Trusts – A New Era" [1991] NZLJ 90.

⁶⁶ *Supra* at note 64, at 615.

⁶⁷ [1991] 3 NZLR 700.

⁶⁸ *Ibid*, 728.

⁶⁹ *Supra* at note 52, at 333.

⁷⁰ With perhaps the exception, as stated above, of the situation where there is manifest wrongdoing on the part of the promisee.

existed, the finding of unconscionability would not have been as relevant. A constructive trust would have been the appropriate remedy.

It would therefore appear that there was no legal relationship between the parties.

Should a Constructive Trust Have Been Imposed in *Elders*?

In *Elders* the Court of Appeal was seeking to compel the transfer of funds from the stock agents to the Bank. In granting the constructive trust, the Court gave the Bank a proprietary right. With respect, this could be viewed as a little extreme, considering the effects of granting such a right (particularly in relation to third parties).⁷¹ Maxton suggests that those consequences might not be of such grave concern since:⁷²

... a proprietary remedy ought only to be effected if damages or an account of profits do not provide adequate recompense.

Damages are, of course, the presumptive common law remedy. Maxton is referring to what is usually termed the "adequacy" doctrine, whereby a specific remedy will not be given where damages are sufficient to compensate the plaintiff. Typical examples of where damages will be inadequate include contracts for the sale of land and negligent destruction of a unique chattel. A more subtle instance occurs where the defendant is insolvent and the plaintiff, if treated as only a creditor, will fail to recover all or even part of the claim.

Paciocco⁷³ criticises the adequacy doctrine, stating that it:⁷⁴

... begs the very question that needs to be answered: when is it just and appropriate to confer on a plaintiff the priority over the general creditors of the defendant? The answer according to the inadequacy doctrine appears to be 'when that priority is required'.

The adequacy doctrine cannot, however, be displaced so easily. The principle refers to more than just the proprietary rights with which Paciocco is concerned. It covers the whole range of specific remedies.⁷⁵ Significantly, it covers the award of injunctions.

I submit that a mandatory injunction⁷⁶ could have been a suitable remedy in the

⁷¹ Usually, and especially, creditors.

⁷² *Supra* at note 18.

⁷³ Paciocco, "The Remedial Constructive Trust: A Principled Basis For Priorities Over Creditors" (1989) 68 Can Bar Rev 315.

⁷⁴ *Ibid*, 339.

⁷⁵ In any respect, as Horack points out in "Insolvency and Specific Performance" (1918) 31 Harv L Rev 702, 720: "Jurisdiction to grant relief and the exercise thereof are entirely different propositions". Thus even if the adequacy doctrine indicates that damages will insufficiently compensate the plaintiff for his or her loss, that does not compel the court to award proprietary relief. This conclusion is supported by Martin, Hanbury & Maudsley, *Modern Equity* (11th ed, 1981) 675: "The remedies, being equitable, are discretionary, and should not be applied where their application would not be conducive to the pursuit of justice."

⁷⁶ That is, one which compels a party to do some act, rather than prohibiting a party from doing some act.

Elders case. While damages, mandatory injunctions, or constructive trusts are three possible remedies, the awarding of damages is doubtful in the absence of a contractual or tortious breach.⁷⁷ A mandatory injunction, however, would have served the same function as the awarding of a constructive trust, without the problems which arise in the granting of a proprietary remedy. It is unclear from the case report whether Mr Gunn was solvent. The mandatory injunction would have compelled Elders to return the monies to Mr Gunn in order to enable the terms of the contract to be carried out. A difficulty could have arisen for the Bank if Mr Gunn was insolvent because the money would then have actually gone to the Official Assignee for appropriate distribution. Given that the Bank had security, this may not have been a problem. However, as the facts appear, it is impossible to reach any sensible conclusion.⁷⁸

Once again it must be stressed that a finding of unconscionability will not necessarily result in the awarding of a remedial constructive trust. It is possible that the duty not to act unconscionably could be a diluted fiduciary obligation. The implication which would then arise is that unconscionability would replace fiduciary obligations and would be a little more expansive, while retaining the same remedy of the institutional constructive trust.

However, it must be remembered that the award of a constructive trust for the breach of a fiduciary relationship concentrates on the abuse of that relationship. Unconscionability pays no heed to the existence of a relationship but, rather, focuses on the wrongful nature of the act or event whereby the property was acquired. Indeed, there may be breaches of a fiduciary relationship which would not be considered unconscionable.⁷⁹

What Was Unconscionable About Elders' Retention?

It is clear that unconscionability must be connected to the knowledge of the parties. Cooke P accepts that a third party whose conscience is not as affected would not be dealt with in the same manner as Elders. His Honour places emphasis not just on the statutory notice arising from registration of the security instrument but also on the fact that Elders entreated the Bank to take the security. On this basis, Elders had actual knowledge of the existence of the document.

Campbell notes that:⁸⁰

... it has never been unconscionable to receive property knowing that such receipt resulted from another's breach of a mere contractual obligation.

Perhaps it is unconscionable to do so now. It is certainly unconscionable to take receipt when one knows of another's breach of a fiduciary relationship. It seems reasonable to assert that the same would be true now, even in the absence of such a

⁷⁷ As is the account of profits, mentioned by Maxton, *supra* at note 18.

⁷⁸ For discussion on priorities over creditors see Paciocco, *supra* at note 73.

⁷⁹ Perhaps *Boardman v Phipps* [1967] 2 AC 46 is an example of this.

⁸⁰ Campbell, Case Note (1990) 6 AULR 463.

relationship. Although Elders may not have initially retained the money with actual knowledge of the terms of the contract between Mr Gunn and the Bank, particularly the stipulations contained in clause 15, they continued to hold the money after the Bank had made demand for it. Cooke P is careful to note that:⁸¹

Elders are taking a stand on what they believe to be their legal rights. Their good faith is not in question.

Nevertheless, it was held that it was unconscionable for Elders to retain the money. It would have been “sharp practice” for them to do so. This is extremely significant. Without too much ado, the Court of Appeal appears to have introduced a new emphasis on commercial morality.

Commercial Morality

The concept of commercial morality has been regaining ground over recent years, especially in Canada and the United States.⁸² The similarity between constructive trust remedies in New Zealand and Canada heightens the potential influence which Canadian decisions could exert on our courts.⁸³ A prominent example of the resurgence of remedies for breach of commercial morals in Canada is the decision of the Supreme Court in *International Corona Resources Ltd v LAC Minerals Ltd*.⁸⁴

In New Zealand a recent example is the decision of Thomas J in *Pacific Industrial Corporation SA v Bank of New Zealand*.⁸⁵ The Bank loaned a considerable sum of money to N Ltd, whose financial position subsequently deteriorated to the point where it was forced to approach C Ltd for assistance. C Ltd agreed to help if loan finance from the Bank would continue and, to that end, C Ltd approached the Bank. In its written response, the Bank indicated to C Ltd its acceptance of a pricing structure and repayment schedule previously discussed by the parties. The Bank later wrote to N Ltd setting out its terms and some deadlines for this extension. However the Bank did not inform C Ltd of these details. The deadlines were not met and the Bank served a notice of default on N Ltd. Once apprised of the situation, C Ltd met the conditions in default and brought an action to restrain the Bank from exercising its powers of possession and sale under its mortgage.

While several issues were disputed before Thomas J, the issue of relevance here is the suggestion that the Bank owed a duty to C Ltd. This was accepted by his Honour:⁸⁶

I consider that the bank would be under an implied obligation to notify [C Ltd] of its intention to demand repayment of the facility. On both the law and the facts this is clearly arguable and, indeed, it is an argument which may eventually prevail.

⁸¹ Supra at note 21, at 186.

⁸² One example is the United States concept of “good faith bargaining” in respect of the formation of contracts. In Australia, Paul Finn also appears to support this concept: supra at note 17.

⁸³ Notwithstanding the debate over unjust enrichment .

⁸⁴ [1989] 2 SCR 574.

⁸⁵ [1991] 1 NZLR 368.

⁸⁶ Ibid, 375.

Thomas J did not cite any authority to support this conclusion. There was no contract between the parties, and the question arises as to whether this implied obligation is tortious or fiduciary. It is probably the latter. His Honour appeared to consider it was arguable that there was a fiduciary relationship, due to the reliance of C Ltd on the Bank. However, with respect, it is submitted that this reasoning is incorrect. Surely this is not a situation where the Bank can be seen to have accepted the obligation to act in the best interests of C Ltd, rather than itself.⁸⁷

It is the undertaking to act for and on behalf of another which imports the fiduciary responsibility.

I would suggest that here, as in *Elders* and *International Corona Resources*, there was no legal relationship between the parties. In my view, it is entirely possible to conclude that Thomas J was declaring the actions of the Bank to be unconscionable.

It would appear that in situations where there is no legal relationship to provide guidance as to the true intentions of the parties involved, and to provide a peg on which to hang liability, the courts are imposing a commercial morality on the parties. At the centre of this is the term “unconscionability”.

Source of the Liability

One explanation alluded to earlier is that the courts are now considering the obligations of parties as points on a continuum. While I do not consider it possible to go so far as to include upon this line all duties that may arise, I submit that the continuum concept goes at least some way towards providing an understanding of the reasoning of the judges.

One obvious goal of fiduciary obligations is to provide for commercial standards. If one accepts the suggestion of Maxton that unconscionability falls near to fiduciary relations at the rigorous end of this continuum, then the courts are simply extending the morality aspect of the fiduciary relationship (and, indeed, some remedies of the fiduciary relationship) along this continuum. This conclusion draws considerable strength from an extrajudicial speech of Sir Robin Cooke, addressing the Australasian Universities Law Schools Association in July 1989.⁸⁸ In his consideration of “fairness”, his Honour stated in respect of the *Elders* decision:⁸⁹

As a matter of fair commercial dealing it was difficult to see that there could be any reasonable doubt [that the agents must hold the proceeds for the bank] ... I venture to submit this case as quite strong evidence that we are ready to do what we reasonably can to allow fairness to have decisive weight in ... New Zealand jurisprudence.

⁸⁷ *Standard Investments Ltd v Canadian Imperial Bank of Commerce* (1983) 5 DLR (4th) 452, 483 (Ont HC).

⁸⁸ Published in (1989) 19 VUWLR 421.

⁸⁹ *Ibid*, 432-433.

IV: SOME CONCLUSIONS

The decision in *Elders* is, at the very least, an important one. The volume of criticism which has been directed at this decision may be taken as some indication of its significance. I submit that the approach of imposing a remedial constructive trust, as adopted in *Elders*, is the correct one. This is primarily because of the flexibility offered by such a trust. It is discretionary and therefore gives a court the opportunity to apply another (personal or specific) remedy. That may not have been the case with an institutional constructive trust. The introduction of “unconscionability” as the basis of this constructive trust removes the strain placed on the meaning of “fiduciary”.

However, with the utmost respect, the Court of Appeal could have given a more expansive explanation of what was meant by the term “unconscionability” and the scope that this principle was intended to embrace. Clearly, New Zealand courts are hesitant in accepting unjust enrichment as an action, and wish to maintain the adaptability that “unconscionability” affords them. This does give cause for concern as to the future application of the term in a commercial context. Cooke P has stated that constructive trusts will not often be granted,⁹⁰ but his Honour does not indicate with any clarity the situations in which they will be so granted. It has been left to subsequent cases to flesh out this new discretionary remedy. It is submitted that to date the courts have succeeded in awarding the remedy of a constructive trust in appropriate circumstances, primarily due to careful and painstaking judicial analysis.

Finally, it is necessary to acknowledge the existence of an expanding notion of commercial morality. Obviously there are many breaches of morals which would shock the conscience of the courts, but for which there are no remedies. I submit that, while the continuum concept advocated by Maxton is useful as a means of analysis, it does not explain the criteria for maintenance of an action for failure to meet the standards of commercial morality. The courts will need to define the parameters of commercial morality, otherwise certainty may be compromised once again.

⁹⁰ Supra at note 52.