Pacific West Health Medical Center Inc. Employees Retirement Trust et al ...ld Greenwich Group et al Doc. 98 Att. 9

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PASHA S. ANWAR, *et al.*, Plaintiffs, v. FAIRFIELD GREENWICH LIMITED, *et al.*, Defendant. This Document Relates To: All Actions	Master File No. 09-cv-118 (VM)

Affidavit of Mark A C Diel

Tab 8

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Daly ⇨ v ⇦ Sydney ⇨ Stock Exchange Ltd [1986] HCA 25; (1986) 160 CLR 371 (22 May 1986)

HIGH COURT OF AUSTRALIA

⇦ **DALY** ⇨ v. ⇦ **SYDNEY** ⇨ STOCK EXCHANGE LTD. [1986] HCA 25; (1986) 160 CLR 371
No. F.C. 86/025

Trust - Companies

High Court of Australia
Gibbs C.J.(1), Wilson(2), Brennan(3) and Dawson(4) JJ.

CATCHWORDS

Trust - Constructive - Stockbroker - Moneys received from client - Fiduciary relationship - Stock exchange fidelity fund - Compensation for pecuniary loss - Loan at interest to stockbroker - Whether trustee of money - Securities Industry Act 1970 (N.S.W.), s. 58 - Securities Industry Act 1975 (N.S.W.), s. 97(1)(b).

Companies - Stockbroker - Stock exchange fidelity fund - Compensation for pecuniary loss - Defalcation - Securities Industry Act 1970 (N.S.W.), s. 58 - Securities Industry Act 1975 (N.S.W.), s. 97(1)(b).

HEARING

1985, November 6, 7; 1986, May 22. 22:5:1986
APPEAL from the Supreme Court of New South Wales.

DECISION

GIBBS C.J.: This appeal is said to be a test case concerning the right of persons, who have suffered pecuniary loss as a result of the insolvency of stockbrokers to whom they have advanced money, to recover compensation from the fidelity fund of the ⇦ **Sydney** ⇨ Stock Exchange. The facts of the case are as follows. In April 1975, the appellant's husband, Dr ⇦ **Daly** ⇨, had some money that he wished to invest, and sought advice from a firm of stockbrokers, Patrick Partners, as to the shares in which the money might be invested. At the time Patrick Partners, although apparently a large and prosperous firm, was in a precarious financial situation. An employee of the firm, Mr Toltz, told Dr Daly that it was not a good time to buy shares and suggested that the money be placed on deposit with the firm until the time was right to buy; Mr Toltz added that the firm was as safe as a bank. The learned trial judge found that although the partners in the firm must have been aware of its worsening financial position, there was no evidence that Mr Toltz was aware that the firm was other than large and successful. Dr ⇦ **Daly** ⇨ thereupon lent money to the firm at what was then quite a high rate of interest. He

intended the loan to be at call but the receipt for the money required ninety days notice of call. In June 1975 Dr ⇦ **Daly** ⇨ deposited a further sum on the same terms. In the same month he assigned the deposits to the appellant. In July 1975 the firm ceased trading; it was insolvent and unable to repay to the appellant the amounts advanced on deposit. The appellant's claim for compensation from the fidelity fund was rejected by the learned trial judge whose decision was affirmed by the Court of Appeal.

2. It is common ground that the appellant will succeed if her claim comes within either s.97 of the Securities Industry Act 1975 (N.S.W.), as amended, or s.58 of the Securities Industry Act 1970 (N.S.W.), as amended. The latter Act has been repealed by the Securities Industry Act 1975 but it is agreed that s.58 applies to unresolved claims in respect of defalcations before 1 March 1976 (the date of commencement of the Securities Industry Act 1975) if s.97 does not apply. In fact, although there are some verbal differences between the two sections, there is only one difference of substance. The relevant provisions of s.97 of the Securities Industry Act 1975 are in the following terms:

"(1) Subject to this Part, a fidelity fund of a stock exchange shall be held and applied for the purpose of compensating persons who suffer pecuniary loss -

(b) by reason of a defalcation, or fraudulent misuse of securities or documents of title to securities or of other property, by a person who, when the loss is suffered is a partner in a member firm, or by an employee or servant of such a firm, in respect of money, securities, documents of title to securities or other property that, in the course of or in connection with the firm's business of dealing in securities, was entrusted to or received by a partner in the firm or an employee or servant of the firm (whether before or after the commencement of this Act) -

(i) for or on behalf of another person; or

(ii) by reason that the firm, or a partner in the firm, was a trustee of the money, securities, documents of title or other property."

3. The words of s.97(1)(b) make it clear that the appellant can succeed in obtaining compensation for her pecuniary loss only if three conditions are satisfied. First, the loss must

have been by reason of a defalcation by a partner or employee of Patrick Partners. Secondly, the money must have been received by the firm in the course of or in connexion with the firm's business of dealing in securities. Thirdly, the money must have been entrusted to or received by the firm for or on behalf of the appellant or by reason that the firm was trustee of the money. It is in relation to the second condition that s.58 differs from s.97; the former section requires only that the money shall have been entrusted or received "in the course of or in connection with the business of that firm".

4. In the present case the second of these conditions was satisfied. The money was received in connexion with the firm's business of dealing in securities. The connexion lay in the fact that Dr ⇦ **Daly** ⇨ went to the firm for the purpose of investing in securities and was instead persuaded to advance the money to the firm. However, if the transaction was what it purported to be - one of loan - the first and third conditions were not satisfied. A borrower does not commit a defalcation either by receiving the money lent to him or by failing to repay his debt. Nor, in the absence of special stipulation, does a borrower receive the money that is lent to him for or on behalf of the lender or as a trustee.

5. The argument for the appellant was that Patrick Partners owed a fiduciary duty to Dr Daly and were in breach of that duty in borrowing money from him without disclosing the firm's unsatisfactory financial situation. The failure to account for money received in a fiduciary capacity was, so it was submitted, a defalcation. Further, it was said, a constructive trust arose immediately the money was received, so that the money was received for or on behalf of Dr Daly, or as trustee, within the meaning of the sections.

6. It was right to say that Patrick Partners owed a fiduciary duty to Dr Daly and acted in breach of that duty. The firm, which held itself out as an adviser on matters of investment, undertook to advise Dr Daly, and Dr Daly relied on the advice which the firm gave him. In those circumstances the firm had a duty to disclose to Dr Daly the information in its possession which would have revealed that the transaction was likely to be a most disadvantageous one from his point of view. Normally, the relation between a stockbroker and his client will be one of a fiduciary nature and such as to place on the broker an obligation to make to the client a full and accurate disclosure of the broker's own interest in the transaction: In re Franklyn; Franklyn v. Franklyn (1913) 30 TLR 187; Armstrong v. Jackson (1917) 2 KB 822; Thornley v. Tilley [1925] HCA 13; (1925) 36 CLR 1, at p 12; Glennie v. McDougall & Cowans Holdings Ltd. (1935) 2 DLR 561; Burke v. Cory (1959) 19 DLR (2d) 252; Culling v. Sansai Securities Ltd. (1974) 45 DLR (3d) 456. The duty arises when, and because, a relationship of confidence exists between the parties: see Tate v. Williamson (1866) LR 2 ChApp 55, at pp 61, 66 and see also McKenzie v. McDonald (1927) VLR 134, at pp 144-145; Hospital Products Ltd. v. U.S. Surgical Corporation [1984] HCA 64; (1984) 58 ALJR 587, at pp 596-598, 628; [1984] HCA 64; 55 ALR 417, at pp 431-436, 488-489.

7. It is however not enough for the appellant to establish that the relationship between Dr ⇦ **Daly** ⇨ and the firm of stockbrokers to which the money was paid was a fiduciary one. To bring the case within either s.97 or s.58 it is necessary to show that the moneys were received by the firm for or on behalf of Dr ⇦ **Daly** ⇨, or as trustee. The appellant seeks to do that by establishing that the moneys when received by the firm were the subject of a constructive trust in

favour of Dr ⇦ **Daly** ⇨. The argument assumes that as a general rule when a person who stands in a fiduciary relation to another, and who has failed in his duty to make full disclosure, receives money from the person who has placed confidence in him, the money is impressed with a constructive trust. That seems to me to be too sweeping an assumption. According to Halsbury's Laws of England, 4th ed., vol.48, par.585, there are two clear categories of constructive trusts, those involving profits made by fiduciaries and those created by the intermeddling of strangers. The present case does not fall within either of those categories; but, as the learned authors of the article in Halsbury go on to say, the categories are not closed. Since, in the present matter, it is sought to find a constructive trust in circumstances which do not fall within either of the established categories, and which are not governed by any precedent, it is necessary to resort to general considerations of principle. In Carl Zeiss Stiftung v. Herbert Smith (No. 2) (1969) 2 Ch 276, Edmund Davies L.J. said, at pp 300-301:

"The American Restatement of the Law of Restitution (1937) sets out to define a constructive trust by declaring in paragraph 160, p.640, that:

'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.'

English law provides no clear and all-embracing definition of a constructive trust. Its boundaries have been left perhaps deliberately vague, so as not to restrict the court by technicalities in deciding what the justice of a particular case may demand. But it appears that in this country unjust enrichment or other personal advantage is not a sine qua non. ... Nevertheless, the concept of unjust enrichment has its value as providing one example among many of what, for lack of a better phrase, I would call 'want of probity,' a feature which recurs through and seems to connect all those cases drawn to the court's attention where a constructive trust has been held to exist."

He said that the same idea is expressed in Snell's Principles of Equity where it is said that (see now 28th ed. (1982), at p.192):

"A possible definition is that a constructive trust is a trust which is imposed by equity in order to satisfy the demands of justice and good conscience, without reference to any express or presumed intention of the parties."

8. Carl Zeiss Stiftung v. Herbert Smith (No. 2) was a case of intermeddling with trust property,

and therefore a case unlike the present, and it is unnecessary to consider whether the dicta of Edmund Davies L.J. regarding a want of probity in cases of that kind were correct. In the present case there was a want of probity in the case of Patrick Partners. The statement in Snell is of course vague and general and in Orakpo v. Manson Investments (1978) AC 95, at p 105, Lord Diplock said that the American view, that a constructive trust arises whenever it is necessary to prevent unjust enrichment, has not yet been accepted in English law. It has nevertheless been suggested that the law ought to recognize a general right to restitution "whenever a person has been incontrovertibly benefitted at another's expense": Goff and Jones, The Law of Restitution, 2nd ed. (1978), at p.24; Ford and Lee, Law of Trusts (1983), at p.992. If one accepts this suggestion, in the present case it was not necessary to find that a constructive trust existed in order to ensure that the firm was not unjustly enriched. The benefit which the firm obtained in consequence of its breach of fiduciary duty was a loan of money, and the firm, as a debtor, was bound to repay the debt to the creditor, the appellant. It is no doubt true that the intervention of equity may have been required if the appellant had sought repayment within the period of ninety days mentioned in the receipt, but even if repayment had been sought at a date earlier than that specified, the demands of justice and good conscience could have been satisfied without the creation of a constructive trust. In deciding whether or not the money should be held to have been subject to a constructive trust it is not unimportant that the ordinary legal remedy of a creditor would have been adequate to prevent the firm from being benefitted at the expense of the appellant: cf. Foley v. Hill (1848) 11 HLC 28, at pp 38-40 [1848] EngR 837; (9 ER 1002, at p 1006-1007). Further, the consequences of holding the money to be subject to a constructive trust and thereby transforming the creditor into a beneficiary suggest that it would be contrary to principle to recognize the existence of a constructive trust in a case such as the present. One consequence would be that the money, and any property acquired with it, would, on the firm's bankruptcy, be withdrawn from the general body of creditors; another would be that the appellant could require the firm to account for any profits made with the use of the money. Considerations of this kind led Lindley L.J. in Lister & Co. v. Stubbs (1890) 45 ChD 1, at p 15, to say that to hold that the relationship between the parties (who were there a company and its agent who had corruptly received a commission) was that of trustee and cestui que trust would be to confound ownership with obligation. The decision in that case has been criticized as unjust, but the reasons of Lindley L.J. appear to me to be impeccable when applied to the case in which the person claiming the money has simply made an outright loan to the defendant. It is true that in some cases where money is lent, legal and equitable rights and remedies may co-exist; in particular, where a loan is made for a designated purpose the lender acquires a right to see that the money is applied for that purpose and, if the purpose cannot be carried out, the borrower may hold the money on trust for the lender if there is an agreement, express or implied, to that effect: Quistclose Investments Ltd. v. Rolls Razor Ltd. [1968] UKHL 4; (1970) AC 567, at pp 581-582. However, the loan in the present case was not made for any specified purpose and there was no agreement, express or implied, that the moneys lent should not form part of the borrower's general assets. For the reasons I have given, and particularly because the existence of a constructive trust was on the one hand unnecessary to protect the legitimate rights of the lender and on the other hand could lead to consequences unjust both to the creditors of the borrower and the borrower itself, I hold that no constructive trust came into existence when the moneys were paid by Dr ⇦ **Daly** ⇨ to Patrick Partners.

9. It follows that the money was not received by Patrick Partners for or on behalf of another person or as a trustee of the moneys and that the conditions of s.97 of the Securities Industry Act 1975 and s.58 of the Securities Industry Act 1970 have not been satisfied. It further follows that there was no defalcation. It was held in the Court of Appeal that the word "defalcation" within the meaning of ss.97 and 58 imports a dishonest dealing. With all respect I think that although the typical case of defalcation will be likely to involve dishonesty, it is too narrow a view to hold that there can be no defalcation within the meaning of the sections without dishonesty. According to the Oxford English Dictionary, the relevant meaning of "defalcation" is "a monetary deficiency through breach of trust by one who has the management or charge of funds; a fraudulent deficiency in money matters". The Macquarie Dictionary defines the word as "misappropriation of money, etc., held by a trustee or other fiduciary". The etymology of the word supports the view that a wrongful diminution or reduction of the amount of the moneys held in trust or in a fiduciary capacity can properly be called a defalcation even if the deficiency was not due to dishonesty. In the United States the word has been held capable of including any failure by a person acting in a fiduciary capacity to account for trust funds: see In re Herbst (1937) 22 F Supp 353, at p 354; First Citizens' Bank & Trust Co. v. Parker (1945) 163 ALR 1003, at p 1007, and see the other cases cited in 26A C.J.S., at p 125. Those cases of course depended on the statutory context in which the word "defalcation" appeared. The provisions of the Securities Industry Acts which deal with fidelity funds appear to have been intended to afford a relief which the law did not provide and should be given a liberal construction. It would seem consonant with the object of those provisions that a person who had suffered loss as a result of a failure to account for funds entrusted to a firm as trustee should be able to recover from the fund even if the failure was due, for example, to negligence rather than dishonesty. The context provided by those Acts does not lead to any different conclusion. The insertion in s.97 of the Securities Industry Act 1975 of the reference to "fraudulent misuse of securities or documents of title to securities or other property" does not suggest that "defalcation" also must necessarily be fraudulent; in any case those words do not appear in s.58 of the Securities Industry Act 1970. The facts that s.99 of the Securities Industry Act 1975 (and s.60 of the Securities Industry Act 1970) give certain rights to an innocent partner who "acted honestly and reasonably in the matter", and that s.101(7) of the Securities Industry Act 1975 (s.62(7) of the Securities Industry Act 1970) refer to the fact that the person against whom the defalcation is alleged has not been convicted or prosecuted do not provide any indication that a defalcation within s.97 (or s.58) must be criminal, for cases of defalcation will very often be criminal and the statute necessarily provides for such cases. The relevant provisions of the Securities Industry Act 1970 were modelled on those of the Legal Profession Practice Act 1958 (Vict.), under which a defalcation has been held to mean a criminal act or a criminal failure to account (Eumeralla Finance Co. Pty. Ltd. v. Law Institute of Victoria (1973) VR 98, at pp 99, 105), but that result depended on the words of a definition of "defalcation" which appears in the Victorian statute but was not repeated in the Securities Industry Acts.

10. However, even though a defalcation within ss.97 and 58 need not be dishonest, it was right to hold that there was no defalcation in the present case. Notwithstanding the fact that Patrick Partners owed a fiduciary duty to Dr ⇦ **Daly** ⇨, the only relevant relationship between the firm and the appellant was that of debtor and creditor. Since there was no constructive trust, the money advanced to the firm became the firm's money, to use as it wished, and a failure to repay the amount advanced was not a defalcation.

11. One cannot fail to sympathize with the appellant, but she has not satisfied the conditions upon which the statutory right which she seeks to enforce is made to depend and her appeal must be dismissed.

WILSON J.: I would dismiss the appeal for the reasons given by the Chief Justice and Brennan J.

BRENNAN J.: Dr ⇦ **Daly** ⇨ was a beneficiary in his father's estate. He received a cheque from the trustees of the estate which he decided to invest in shares. He was a medical practitioner with little experience in investments. He was recommended to Patrick Partners, then one of the largest firms of stockbrokers in ⇦ **Sydney** ⇨. On 11 April 1975 he went to their offices and spoke to one of their employees, a Mr Toltz. Mr Toltz was employed to advise clients of the firm on investments. Mr Toltz advised Dr ⇦ **Daly** ⇨ that it was not a good time to buy shares in the market, that he should wait until the market had "bottomed out" before buying shares and that Dr ⇦ **Daly** ⇨ should put his money on deposit with Patrick Partners until the time was right to buy. Mr Toltz assured Dr ⇦ **Daly** ⇨ that Patrick Partners were "as safe as a bank". Thereupon Dr ⇦ **Daly** ⇨ deposited $27,000 with Patrick Partners at 14% per annum interest. He understood that the money was to be available on call without notice. However, a confirmatory letter from Patrick Partners stated that the deposit was on "90-days notice of call" and Dr ⇦ **Daly** ⇨ did not demur to that term. Subsequently he invested a further $2,000. In June 1975 Dr ⇦ **Daly** ⇨ assigned his interest in the interest-bearing deposits to his wife, the present appellant. Patrick Partners acknowledged that assignment. Later in that month Dr ⇦ **Daly** ⇨ again spoke to Mr Toltz and was advised that it was still not a good time to buy.

2. For some time prior to the making of these deposits Patrick Partners were in some financial difficulty. An amount of $2,760,000 which the firm had lent to Patrick Intermarine Acceptance Ltd. (a subsidiary of Mittina Pty. Ltd. in which the firm held all the issued shares) and which the firm was treating as a current asset was not a current asset. The firm had entered into a deed binding them not to call up that amount until certain debts owing by Mittina Pty.Ltd. to another corporation had been paid. At all material times, Mittina Pty.Ltd. was unable to pay those debts. As at 31 December 1974 there was a deficiency of current assets to cover current liabilities of $2,493,959. The firm had sustained operating losses for the six months to 31 December 1974 and for the three months to 31 March 1975. On 27 July 1975 the firm closed its doors. A statement of the firm's assets and accrued liabilities at that time showed an estimated deficiency of assets of $2,620,596. Contingent liabilities exceeded $1,000,000. There is no evidence to suggest that anything was paid to Mrs ⇦ **Daly** ⇨ in respect of moneys deposited or interest thereon after that date except, possibly, some small dividend paid to her as a participating creditor under a Deed of Arrangement under the provisions of Part X of the Bankruptcy Act 1966 (Cth) into which the partners in the firm appear to have entered after 27 July 1975. Mrs ⇦ **Daly** ⇨, being advised by the General Manager of the ⇦ **Sydney** ⇨ Stock Exchange Limited of the provisions of Part IX of the Securities Industry Act 1975 (N.S.W.), made a claim in respect of her loss against the respondent, pursuant to ss.97 and 98 of that Act. When her claim was refused, she commenced proceedings in the Supreme Court of New South Wales to enforce her claim. At the trial before Powell J. an alternative claim under ss.58 and 59 of the Securities Industry Act 1970 (N.S.W.) was made. Sections 97 and 98 of the 1975 Act and ss.58 and 59 of the 1970 Act provide for payment out of a fidelity fund of compensation to persons who suffer pecuniary loss caused in the manner therein specified. Mrs ⇦ **Daly** ⇨ claimed $29,300 which apparently represents an

allowance for interest in addition to the principal sums deposited. It was and is common ground that, by reason of the Securities Industry (Fidelity Funds) Amendment Act 1979 (N.S.W.), Mrs ⇦ **Daly** ⇨'s claim should succeed against the fidelity fund if the claim is within either s.97 of the 1975 Act or s.58 of the 1970 Act. Powell J. dismissed her claim and the Court of Appeal dismissed an appeal against his Honour's judgment.

3. Section 58(1)(b) of the 1970 Act provides:

" (1) Subject to this Part a fidelity fund shall be held and applied for the purpose of compensating persons who suffer pecuniary loss -

...

(b) from any defalcation committed by the partners or by any of the partners in a member firm who are liable to contribute to that fund, whether or not they have been freed and discharged from payment under section fifty-four of this Act, or by any of the clerks or servants of such a member firm in relation to any money or other property which, whether before or after the commencement of this Act, in the course of or in connection with the business of that firm -

(i) was entrusted to or received by the partners or any of the partners or any of the firm's clerks or servants for or on behalf of any other person; or

(ii) (the partners or any of the partners being in respect of the money or other property either the sole trustee or trustees or trustee or trustees with any other person or persons) was entrusted to or received by the partners or any of the partners or any of the firm's clerks or servants as trustee or trustees or for or on behalf of the trustees of the money or property."

4. Section 97(1)(b) of the 1975 Act is in similar but not identical terms. Under either section it was necessary for Mrs ⇦ **Daly** ⇨ to show that there had been a "defalcation" in relation to (or in

respect of) money which "was entrusted to or received by (the firm) for or on behalf of any other person" or as a trustee.

5. Dr ⇦ **Daly** ⇨ lent the money to Patrick Partners. As borrowers, Patrick Partners received the money on their own account, not on behalf of Dr ⇦ **Daly** ⇨ nor as trustees. They were Dr ⇦ **Daly** ⇨'s debtors. When the debt was assigned, Patrick Partners became Mrs ⇦ **Daly** ⇨'s debtors. A contract for the lending of money repayable on demand does not itself create a relationship of trustee and cestui que trust: see Stephens v. The Queen [1978] HCA 35; (1978) 139 CLR 315, at pp 322-323, 333; Foley v. Hill [1848] EngR 837; (1848) 2 HLC 28 (9 ER 1002); Reg. v. Davenport (1954) 1 WLR 569; (1954) 1 All ER 602. The appellant argues, however, that Patrick Partners obtained the loan in breach of a fiduciary obligation resting on them, that the moneys lent are and have been held on a constructive trust, at first for Dr ⇦ **Daly** ⇨ and now for Mrs ⇦ **Daly** ⇨. That is sufficient, so the argument runs, to establish that the moneys deposited with the firm were "entrusted to or received by" the firm "as trustee".

6. A stockbroker who is engaged to buy or sell shares on behalf of his client has been held to be an agent subject to a fiduciary's obligations in buying and selling: see Armstrong v. Jackson (1917) 2 KB 822; Christoforides v. Terry (1924) AC 566, at p 574; Thornley v. Tilley [1925] HCA 13; (1925) 36 CLR 1; In re Arthur Wheeler & Co. (1933) 102 Law J Ch 341; and cf. Brown v. Inland Revenue Commissioners (1965) AC 244, at p 265. But Patrick Partners did not buy or sell shares on behalf of Dr ⇦ **Daly** ⇨. Dr ⇦ **Daly** ⇨ sought advice from Patrick Partners on the investment of his money and they advised him. The question is whether, in advising Dr ⇦ **Daly** ⇨, Patrick Partners were in the position of a fiduciary. In Tate v. Williamson (1866) 2 LRChApp 55, at p 61, Lord Chelmsford L.C. said:

> " Wherever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation had existed."

7. A fiduciary relationship in respect of a transaction may arise though there has been no anterior relationship between the parties to that transaction (Tufton v. Sperni (1952) 2 TLR 516, at p 522). In Lloyds Bank v. Bundy (1975) 1 QB 326, Sir Eric Sachs, referring to the cases in which a relationship giving rise to a fiduciary duty had been held to exist, said (at p.341):

> " Such cases tend to arise where someone relies on the guidance or advice of another, where the

other is aware of that reliance and where the person upon whom reliance is placed obtains, or may well obtain, a benefit from the transaction or has some other interest in it being concluded. In addition, there must, of course, be shown to exist a vital element which in this judgment will for convenience be referred to as confidentiality. It is this element which is so impossible to define and which is a matter for the judgment of the court on the facts of any particular case."

Whenever a stockbroker or other person who holds himself out as having expertise in advising on investments is approached for advice on investments and undertakes to give it, in giving that advice the adviser stands in a fiduciary relationship to the person whom he advises. The adviser cannot assume a position where his self-interest might conflict with the honest and impartial giving of advice: see In re a Solicitor; Ex parte Incorporated Law Society (1894) 1 QB 254, at p 256; Armstrong v. Jackson, at pp 824-825.

8. The duty of an investment adviser who is approached by a client for advice and undertakes to give it, and who proposes to offer the client an investment in which the adviser has a financial interest, is a heavy one. His duty is to furnish the client with all the relevant knowledge which the adviser possesses, concealing nothing that might reasonably be regarded as relevant to the making of the investment decision including the identity of the buyer or seller of the investment when that identity is relevant, to give the best advice which the adviser could give if he did not have but a third party did have a financial interest in the investment to be offered, to reveal fully the adviser's financial interest, and to obtain for the client the best terms which the client would obtain from a third party if the adviser were to exercise due diligence on behalf of his client in such a transaction. Such a duty has been established by authority: see Haywood v. Roadknight (1927) VLR 512 and the cases therein referred to at p 521, especially Gibson v. Jeyes (1801) 6 VesJun.266, at pp 271, 278 [1801] EngR 379; (31 ER 1044, at pp 1046-1047, 1050) and McPherson v. Watt (1877) 3 App.Cas.254, at p 266.

9. Patrick Partners were therefore under a duty, before borrowing from Dr ⇦ **Daly** ⇨ without security the money on the investment of which their advice had been sought, to tell him fully and truthfully what they knew about their financial position and to warn him, as they could and should have warned him if a third party in their financial position had sought a loan from Dr ⇦ **Daly** ⇨, that it was unwise to lend the money. No information was given to Dr ⇦ **Daly** ⇨ as to the firm's financial position. Far from giving him a warning as to the risks of lending money to the firm, Mr Toltz advised that the firm was "as safe as a bank". At that time, the partners knew of the firm's financial difficulty and, as the learned trial judge found, they must then have known that a loan to them would prove to be "a singularly hazardous investment". Nevertheless, in order to improve the firm's liquidity, they had instructed their employees to suggest to clients that they should invest funds on interest-bearing deposits with the firm. It is immaterial that Mr Toltz, to whom it fell to perform the firm's fiduciary duty to Dr ⇦ **Daly** ⇨, may not have known of his employer's financial position. Patrick Partners obtained the loans from Dr ⇦ **Daly** ⇨ without performing the fiduciary duty which equity imposes on borrowers in their position. Their

conduct amounted to equitable fraud as Viscount Haldane L.C. explained that term in Nocton v. Lord Ashburton (1914) AC 932, at p 954. It was not submitted that Dr ⇦ **Daly** ⇨ was induced to deposit the money by any actual fraud on the part of Patrick Partners. In the absence of any allegation of actual fraud, it is immaterial for present purposes to enquire whether he or Mrs ⇦ **Daly** ⇨ was entitled to any relief at law. The consequences of Patrick Partners' equitable fraud depend entirely on equitable principles.

10. When a gift of property is made to a donee who has failed to discharge his fiduciary duty to the donor, the gift may be set aside so that the donee holds the gift on a constructive trust for the donor. The principle is well expressed in an American case:

" if a party obtain the legal title to property by virtue of a confidential relation, under such circumstances that he ought not, according to the rules of equity and good conscience as administered in chancery, to hold and enjoy the benefits, out of such circumstances or relations a court of equity will raise a trust by construction, and fasten it upon the conscience of the offending party, and convert him into a trustee of the legal title."

(Pollard v. McKenney (1903) 96 NW 679, at p 681, followed in Maddox v. Maddox (1949) 38 NW 2d 547, at p 550). When property is not given but sold, the sale may be set aside. In Tufton v. Sperni Jenkins L.J., referring to the passage earlier cited from Tate v. Williamson said, at p 526:

" The transaction set aside in that case was a purchase by the defendant from a person to whom he stood in a fiduciary relationship, and although the principles enunciated in the passage I have quoted have been more commonly applied to cases of gift, there is, I think, no distinction for this purpose between a gift, a purchase at an undervalue, and a sale at an excessive price, where the donee or the person making the purchase or effecting the sale, as the case may be, stands in a fiduciary relationship to the person making the gift to him, selling to him or buying from him."

11. The usual case in which a court of equity is asked to intervene to set aside a conveyance or transfer on sale between a fiduciary and the person to whom he stands in a fiduciary relationship is a purchase at an undervalue or a sale at an excessive price, but unfairness in the terms of an impugned contract is not a condition of its avoidance. The fiduciary may have failed in his duty in some respect other than the obtaining of fair consideration. A conveyance or transfer on sale

may be set aside though the terms of the contract are fair if it appears that the fiduciary has failed to give the advice which he was bound to give in respect of that contract. In McPherson v. Watt Lord Blackburn, speaking of a breach of the fiduciary obligation owed by an attorney to his client said, at p 272, that the client -

" ... is entitled to say, 'This may be a very fair and proper bargain, but I do not choose to let it stand.' I think the law, both in England and in Scotland, is that in such cases we do not inquire whether it was a good bargain or a bad bargain, before we set it aside. The mere fact that you, being in circumstances which made it your duty to give your client advice, have put yourself in such a position that, being the purchaser yourself, you cannot give disinterested advice, your own interests coming in conflict with his, that mere fact authorizes him to set aside the contract if he chooses so to do."

(And see Commercial Bank of Australia Ltd. v. Amadio [1983] HCA 14; (1983) 151 CLR 447, per Deane J. at p 475).

12. Irrespective of the fairness of its terms, equity regards a contract made between a fiduciary and the person to whom he stands in a fiduciary relationship as voidable if the fiduciary has breached his fiduciary duty in respect of the contract. If property is transferred to the fiduciary pursuant to the contract, the transfer may be set aside in consequence of the avoidance of the contract (Armstrong v. Jackson, at pp 825-826). The contract and the transfer are voidable, but not void. If the transfer is set aside, the fiduciary transferee (and, no doubt, a volunteer or a purchaser with notice of the circumstances) holds the property transferred on a constructive trust for the transferor which a court of equity will enforce subject to any accounts or enquiries that may be necessary to do equity to the transferee. The transferor may elect to avoid the contract and to assert his title to the land or other property transferred assuming it still exists in specie or, being money, can be traced. He may invoke the assistance of equity to recover the land or other property in specie or to trace the money.

13. The principles governing the setting aside of contracts of purchase or sale are applicable to contracts of loan. Since equity intervenes to prevent a fiduciary from retaining property acquired under a contract entered into in breach of his fiduciary obligation, equity will intervene to prevent him from retaining money acquired in like circumstances. Of course, the occasions for invoking the assistance of equity to recover money lent may be infrequent, and the remedy of tracing the money lent into hands other than the borrower's - a remedy which the common law does not afford - may frequently be frustrated by dissipation of the money or its payment to another creditor (cf. In re Diplock, Diplock v. Wintle (and Associated Actions) (1948) 1 Ch 465, at p 521). Nevertheless, a person lending money to a fiduciary who obtains the loan without discharging his fiduciary duty is entitled in equity to avoid the contract of loan and to recover, by tracing if need be, the money lent.

14. It may be said that a party who elects to avoid a contract and set aside a transfer of property made pursuant to the contract had an equitable interest in the property from the beginning, that the equitable remedies available to him are incidental to that interest and that his equitable interest arose before, and does not depend upon the court's decree (see Scott on Trusts, 3rd ed. (1967), Vol.5, 462.4, p 3421). Thus, in Stump v. Gaby (1852) 2 De GM & G 623 (42 ER 1015), where the plaintiff had conveyed an estate in land to his attorney pursuant to a contract of sale for an undervalue, Lord St Leonards L.C., held the contract to be voidable, saying at p.630 (p.1018):

" In the view of this Court he remains the owner, subject to the repayment of the money which has been advanced by the attorney, and the consequence is that he may devise the estate, not as a legal estate, but as an equitable estate, wholly irrespective of all question as to any rights of entry or action, leaving the conveyance to have its full operation at law, but looking at the equitable right to have it set aside in this Court."

If a decree setting aside the conveyance is made, the plaintiff's equitable title is treated "as having been, from the first, a trustee for the grantor, who, therefore, has an equitable estate, not a mere right of suit". That was the effect, according to Menzies J. in Latec Investments Ltd. v. Hotel Terrigal Pty.Ltd. (In Liquidation) [1965] HCA 17; (1965) 113 CLR 265, at p 290, of the decision of Knight Bruce L.J. in Gresley v. Mousley [1859] EngR 516; (1859) 4 De G & J 78 (45 ER 31). Menzies J. in Latec Investments referred to the view that a plaintiff who was entitled to avoid a contract of sale and to have the conveyance set aside had a mere equity and the competing view that he had an equitable interest in the property from the beginning. He said, at pp.290-291:

" If there is a difference between the two lines of authority, that difference seems to me to arise from concentration upon different aspects of what follows from a voidable conveyance. Thus, Phillips v. Phillips ((1861) [1861] EngR 1044; 4 De GF & J 208 (45 ER 1164)), in so far as it says that a person with the right to have a voidable conveyance set aside has but a mere equity, directs attention to the right to have the conveyance set aside as a right to sue which must be successfully exercised as a necessary condition of there being any relation back of the equitable interest established by the suit. Stump v. Gaby directs attention to the result of the eventual avoidance of the conveyance upon the position ab initio and throughout of the persons by whom and to whom the conveyance of property

was made and says that, in the event of a successful suit (which may be maintained by a devisee), the conveyor had an equitable estate capable of devise and that the conveyee holds, and has always held, as trustee."

15. But where property has been sold and conveyed, the purchaser's beneficial title must be ascertained by reference to the sale so long as it stands; the vendor cannot insist on an equitable interest in the property if he does not choose to enforce his equity to avoid the sale (see per Kitto J. in Latec Investments, at pp 277-278; and In re Sherman decd. (1954) 1 Ch 653, at p 658). Similarly, until the lender elects to avoid the contract of loan, he cannot assert an equitable title to the money lent. He cannot at once leave the contract on foot and deny the borrowers the title to the money which the contract confers. When, as in the present case, a borrower acquires title to money paid to him under and pursuant to a contract of loan, the borrower cannot be made a trustee of the money without his consent so long as the contract stands. There is no analogy between the present case and one in which a constructive trust is imposed on money or other property which is acquired by a fiduciary in breach of his duty but not pursuant to a voidable contract. In such a case there is no question of avoiding the contract before the constructive trust is imposed. A fortiori, there is no analogy between the present case and one where a constructive trust is imposed on money or other property which is acquired by a non- fiduciary otherwise than by contract (as, for example, in Chase Manhattan Bank N.A. v. Israel-British Bank (London) Ltd. (1981) 1 Ch 105, at pp 118-120).

16. Although Dr ⇦ **Daly** ⇨ or Mrs ⇦ **Daly** ⇨ was entitled to avoid the contracts of loan for breach of the fiduciary obligation resting on Patrick Partners, there is no evidence that the contracts of loan were avoided. In equity, Patrick Partners' title to the money lent was imperfect from the beginning by reason of their failure to discharge their duty as a fiduciary (cf. Allcard v. Skinner (1887) 36 ChD 145, per Lindley L.J. at p 184) and, had the contract of loan been avoided, Mrs ⇦ **Daly** ⇨'s rights as against Patrick Partners might have been determined as though the firm had from the beginning held the money lent on a constructive trust for Dr ⇦ **Daly** ⇨ and then for Mrs ⇦ **Daly** ⇨. But even if that be the true basis on which to measure Mrs ⇦ **Daly** ⇨'s rights as against Patrick Partners and any person into whose hands the borrowed moneys can be traced (a question which ought not be determined in the absence of the parties directly interested in the answer), it does not satisfy the statutory criterion of a liability enforceable against the fidelity fund.

17. As I construe that criterion, it is incumbent on a claimant to show that, at the time when the stockbroker received the moneys in question, he received them on behalf of another or as a trustee. The criterion is not satisfied if he received the moneys under a contract which gave him a beneficial title recognized by equity, albeit a beneficial title that is imperfect and liable to be divested by relation back in the event of avoidance of the contract of loan. In the absence of evidence of avoidance of the contracts of loan, there is nothing to show that Dr ⇦ **Daly** ⇨ or Mrs ⇦ **Daly** ⇨ has the equitable interest in the moneys lent by Dr ⇦ **Daly** ⇨ to Patrick Partners which might have arisen by relation back. The relationship between Dr ⇦ **Daly** ⇨ and

Mrs ⇦ **Daly** ⇨ on the one hand and Patrick Partners on the other was in the beginning and has remained that of creditor and debtor.

18. A failure to honour the debts of the firm is not a "defalcation" which attracts the operation of s.58(1)(b) of the 1970 Act or s.97 of the 1975 Act. A defalcation cannot be committed in relation to money if the money is diminished or abstracted by the person who owns it. There must be at least an interference with another person's beneficial interests in the money. Patrick Partners did not commit a defalcation by using their own funds, including moneys borrowed by them, for whatever purpose they chose, though the expenditure of the moneys diminished the funds available to repay their borrowings. Something more than the mere failure of a debtor to pay his creditors is needed to constitute a defalcation. As no more appears in the evidence than a failure by Patrick Partners to repay the money lent to them by Dr ⇦ **Daly** ⇨, the appeal should be dismissed.

DAWSON J.: I agree with the reasons for judgment of the Chief Justice and do not wish to add anything.

ORDER

Appeal dismissed with costs.