CASE NOTE: **Farah Constructions Pty Ltd v Say-Dee Pty Ltd**

Lessons for commercial litigators

The aftermath of this development deal provides many lessons, says **Andrew Lyons.**

Farah Constructions Pty Ltd v Say-Dee Pty Ltd[1] **is a landmark judgement of five judges**[2] **of the High Court that addresses a series of equity and related issues relevant to commercial litigators. Due to space limitations, this article mentions only some of those issues.**

The facts

Two companies, Farah and Say-Dee, entered a joint venture to purchase and develop 11 Deane Street. Say-Dee was to advance capital; Farah was to manage the project. After settlement, Farah caused a development application to be made. It was refused. A reason for that was that the site was too small to achieve its full development potential.

The principal of Farah was Mr Elias. Following the refusal, he, his wife and their two daughters each bought one of the four units in each of nos 15 and 20. For reasons that appear below, it is significant that neither of these lots shared a common boundary with no.11.

Farah made a second development application. A council officer told Mr Elias that no.11 was too narrow to maximise its potential without amalgamation with neighbouring sites.

Subsequently Lesmint Pty Ltd entered into a contract to buy no.13. This land was between nos 11 and 15. Lesmint was controlled solely by Mr Elias. As a result of this transaction, parties allied to Mr Elias controlled nos 13, 15 and 20. Thus they had the land required to resolve the council's objection founded on the small size of no.11.

Mr Elias then withdrew Farah's second development application. Farah applied for the appointment of a statutory trustee to sell the joint venture land, that is, no.11.

Say-Dee counterclaimed for a declaration that the Elias family, Farah and Lesmint held their interests in nos 11, 13, 15 and 20 on constructive trust for the partnership of Farah and Say-Dee.

The primary defendant – scope of the fiduciary duty

A key issue was the scope of the fiduciary duty owed by Farah to Say-Dee. The High Court held that if Farah exploited the opportunities to purchase nos 13, 15 and 20 without the informed consent of Say-Dee, then Farah would be placing itself in a position of conflict between its self-interest and its duty to Say-Dee in relation to no.11.

Farah's self-interest included the prospect of enhanced profits by developing no.11 in conjunction with the other lots. Farah's duty was to develop no.11 by itself.

This conclusion set up the next issue.

How probable must the risk of conflict be before there is a breach of the conflict rule?

A fiduciary is required to avoid both actual and potential conflict. How likely must the potential conflict be before the fiduciary's duty is enlivened? It will be recalled that nos 15 and 20 became available for purchase before no.13. Neither lot was adjacent to no.11. Thus, at the time that they became available, it was not possible to develop no.11 in conjunction with either or both of them.

Farah argued that, accordingly, it was not under a duty to make disclosure of their availability – there was then no actual or potential conflict. One can see force in this contention, for example, no.13 may not have come on the market in any relevant time frame.

The High Court rejected that argument. It was sufficient if "there was at least a theoretical possibility" of no.13 coming onto the market.[3] This is a change in the law away from the test of whether there is a real, sensible or significant risk of conflict.[4]

While the High Court's tougher approach gives full weight to the deterrence of temptation, it can operate harshly and be commercially unrealistic. The better approach is that of the earlier authorities.

Informed consent?

Farah won this appeal because the High Court held that it had procured informed consent from Say-Dee. This was sufficient to dispose of the case. Nevertheless, the court considered the position of the parties whose liability depended on Farah being held liable. Those parties included Mr Elias' wife and daughters.

The accessories – Barnes v Addy – introduction

Say-Dee sought to hold the other parties liable by relying on the principles expressed in *Barnes v Addy*. Those principles govern when a third party can be held liable in connection with another's breach of trust. Lord Selborne LC wrote, "strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, **unless those agents receive and become chargeable with some part of the trust property**, or **unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees**".[5] (*bolding added*)

This rule arises frequently in commercial and property litigation and has two limbs. They are highlighted by the bold typeface in the above quotation. The first is the knowing receipt limb. The second is the knowing assistance limb.

The accessories – Barnes v Addy – first limb – knowing receipt

Say-Dee contended that Mrs Elias and her daughters were liable because the units in no.15 were bought in their name and they were fixed with Mr Elias' knowledge of Farah's breach of trust. They were said to be so fixed because Mr Elias acted as their agent in the purchase of the units. >>

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The High Court rejected these contentions. One reason for this was that there was no receipt by the Elias women of property to which a fiduciary obligation attached. The key element in this conclusion was that information (here, about the council's attitude to the development of no. 11) was not property within the meaning of the rule. This was so, even if the information was a trade secret (which it was not).

A consequence of this is that remedies against third parties who receive the benefit of information from a fiduciary acting in breach of fiduciary duty are found under the known assistance, not the knowing receipt, limb of the rule in *Barnes v Addy*.

The accessories – Barnes v Addy – second limb – knowing assistance

Say-Dee sought to hold the Elias women liable under the second limb of *Barnes v Addy*. In rejecting this attempt, the High Court flagged its willingness to consider subsequently the impact in Australia of the Privy Council's decision in *Royal Brunei Airlines Sdn Bhd v Tan*.[6]

The second limb is directed at third parties who assist the trustee in the trustee's dishonest and fraudulent design. It does not cover a third party inducing or procuring a breach of trust by a trustee who does not have an improper purpose.

In *Royal Brunei*, the Privy Council formulated a general principle of accessory liability that seeks to address both classes of cases.

It did this by focussing on the defendant's dishonesty, rather than the *Barnes v Addy* criterion of knowledge: "A liability in equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation. It is not necessary that, in addition, the trustee or fiduciary was acting dishonestly, although this will usually be so where the third party who is assisting him is acting dishonestly. *'Knowingly' is better avoided as a defining ingredient of the principle.*" (*Italics added*)

The joint judgement says that "Until . . . an occasion arises in this Court, Australian courts should continue to . . . apply the formulation in the second limb of *Barnes v Addy*".[7]

A practical implication of this is that practitioners running claims that raise these issues need to consider both *Barnes v Addy* and *Royal Brunei*.

Thus plaintiffs should address both the alleged accessory's knowledge (*Barnes v Addy*) and dishonesty (*Royal Brunei*).

The accessories – unjust enrichment

The NSW Court of Appeal held the Elias women liable because they were enriched unjustly at the expense of Say-Dee.

The High Court made it clear that it will not accept any general doctrine of unjust enrichment: "Unjust enrichment is not a definitive legal principle according to its own terms. . . . The areas in which the concept of unjust enrichment applies are specific and usually long-established. Recipient liability for breach of trust or fiduciary duty has not been one of them."[8]

Conclusion

This is a decision rich in learning.

It is recommended reading for commercial litigators.

Notes

1 (2007) 81 ALJR 1107.
2 Gleeson CJ, Gummow, Callinan, Heydon and Crennan JJ.
3 [104].
4 *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 399 at 401G, *Chan v Zacharia* (1984) 154 CLR178, 198.8 and 199.3, *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 103.8.
5 (1874) 9 Ch App 244, 251-252 (Lord Selborne LC)
6 [1995] UKPC 4; [1995] 2 AC 378.
7 [163]
8 [151] Citations in the original text have been excised from the quotation.