

# BANKS, FIDUCIARY OBLIGATIONS AND UNCONSCIONABLE TRANSACTIONS

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*The concern of the courts with the fiduciary relationship goes back to the mediæval period, but the remedial applicability of the idea was not fully explored until the nineteenth century. Today it is potentially applicable, depending on the facts, in all cases where one person undertakes to act on behalf of another, and has discretion in how the task is done. The bank is such a person. It will have to show that it did not unduly influence its customer if it has "crossed the line" from debtor to fiduciary, and, if it has not, it still may have its transaction struck down as unconscionable. A bank may be liable in damages, as well as for an accounting and as constructive trustee. If it gives "knowing assistance" to a customer who is a fiduciary, and in breach, it may also be liable for the loss caused to the third party.*

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*Les tribunaux reconnaissent les rapports fiduciaires depuis les temps médiévaux mais ce n'est que depuis le dix-neuvième siècle que l'on explore vraiment l'utilisation de ce concept comme moyen de redressement. De nos jours, il est possible de l'utiliser dans tous les cas où une personne accepte d'agir pour une autre personne tout en restant libre de décider de sa façon d'agir. C'est là le cas des banques. Il leur faut prouver qu'elles n'ont pas induement influencé leurs clients quand elles passent du rôle de débiteur à celui de fiduciaire et, même si elles n'ont pas changé de rôle, elles verront peut-être leurs transactions annulées parce que celles-ci auront été jugées oppressives. Les banques peuvent se trouver redevables de dommages et intérêts tout en étant aussi tenues responsables et de la comptabilité et en tant qu'administrateur d'une fiducie créée par détermination de la loi. Et si, au courant de l'intention d'un client fiduciaire, elles l'assistent en violation de ses devoirs, elles peuvent être tenues responsables de la perte encourue par le tiers.*

## I. *Standard Investments—A New Turn in the Banker's Liability?*

Even as *Standard Investments Ltd. v. Canadian Imperial Bank of Commerce*<sup>1</sup> came to trial in the Ontario Supreme Court, it was news. That was in October, 1983, and on the thirteenth of November, at the close of the trial, the Toronto Globe and Mail ran a blow-by-blow account of the revealed facts and the arguments of counsel for the contending parties. There were

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<sup>1</sup> (1984), 5 D.L.R. (4th) 452, 45 O.R. (2d) 16 (Ont. H.C.), and on appeal (1986), 22 D.L.R. (4th) 410, 52 O.R. (2d) 473 (Ont. C.A.). Application for leave to appeal to the Supreme Court of Canada dismissed February 3, 1986 ((1986), 53 O.R. (2d) 663).

celebrated names involved—on the one side J.A. (Bud) McDougald, the legendary Toronto financier who had voting control of the Crown Trust Company, and his successor, so to speak, Conrad Black; on the other side, Reuben Cohen and Leonard Ellen, owners of the Halifax-based Central Trust Company, multi-millionaires also. But it was not just the personalities involved, it was the plaintiff's argument that caused the flurry.

Cohen and Ellen, together with their companies, were customers of the defendant bank, the Bank of Commerce, their business was of some significance to the Bank, and the Bank actively sought their business. The two investors were planning a take-over of the Crown Trust Company by way of a share purchase, and they borrowed from the Bank on the security of their sound commercial assets in the Maritimes in order to finance their market acquisitions of Crown's shares. Indeed, in April, 1972, sometime after the loans and purchases had commenced, Cohen and Ellen told the Bank's president in confidence at an arranged interview in Toronto everything of their plans, and he in return assured them of the advice and assistance that the Bank could and would afford them. However, McDougald was another customer of the Bank. He was, too, a director of the Bank, and to the Bank's chairman known to be opposed to this take-over. McDougald wanted the Toronto-based Crown Trust, itself a customer of the Bank, to remain a small, closely-held and controlled company, as it was, with continuity of control. The outcome was that in January, 1972, three months before Cohen and Ellen sat down with the Bank's president, the Bank decided to enter the market, and, by acquiring the maximum ten per cent position in Crown's shares permitted to the Bank under the Bank Act,<sup>2</sup> to help prevent any take-over. Then, after McDougald's death in 1978, when Conrad Black, his successor, another substantial customer and director of the Bank, had assembled a nineteen per cent shareholding in Crown, and had arranged to purchase a further twenty-five per cent holding of Crown owned by the estate of a deceased Torontonian within the close circle (a holding which the Bank knew Cohen and Ellen wanted), the Bank financed the acquisition. Finally, when Black sold his forty-four per cent holding, the Bank supported Black by selling to Black's Winnipeg purchaser its own "pivotal" ten per cent. Cohen and Ellen were thus left with a minority thirty-two per cent holding, the final defeat of their take-over efforts, and an inevitable subsequent drop in the market value of their shares.

It was argued for Cohen and Ellen that, while the Bank may not have breached any common law duty of care, throughout it had been in a fiduciary relationship with the plaintiffs, and that it consequently owed them fiduciary obligations. One of these obligations is that a fiduciary shall not permit its own interest to conflict with the interest of the benefi-

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<sup>2</sup> Bank Act (enacted by the Banks and Banking Law Revision Act, S.C. 1980-81-82-83, c. 40), s. 193(2).

ciary of the relationship, and if it does it must account for any advantage or profit it has made.

Judgment was handed down by Griffiths J. on the nineteenth of December, 1983, and he found there had indeed been a fiduciary relationship between the bank and its Halifax customers. He also found on the facts that there had been no breach of that relationship, but he described the bank's "policy" of purchasing shares "to thwart the efforts of one of its customers in favour of another, although not illegal, . . . [to be] morally offensive",<sup>3</sup> and he made no award of costs. This was perhaps the first time in Canadian experience that in a high profile trial a bank had been held by the courts in categorical terms to be a fiduciary *vis-à-vis* its customer, rather than being merely in a debtor-creditor relation, and, though the Bank had emerged without consequent liability on this occasion, the stir this judgment caused in banking circles was predictable. As one banker said to the present writer at the time: "Where has this fiduciary business come from, and what does it mean for us? We are simply business people, hoping to make a profit. That's all. We are not trustees." The Financial Post on the last day of the year in 1983 ran an article on the implications of the judgment, and probably summed up the concern when it said: "The judgment . . . may extend the charted section of the law in what lawyers describe as the expanding area of equity in fiduciary or trust relationships."<sup>4</sup>

However, the story was not over. The disappointed Cohen and Ellen appealed, and on the third of October, 1985, the Ontario Court of Appeal handed down a judgment, holding that the trial judge had "carefully and . . . accurately"<sup>5</sup> described the law relating to fiduciary relationships, in particular that of banker and customer, but roundly reversing him on his findings of fact. The Bank was indeed a fiduciary *vis-à-vis* the plaintiffs, said the court, and it remained so throughout—from the time it met with them in Toronto in 1972 until it sold its ten per cent holding to Black's Winnipeg purchaser in 1979. During these years it was in an increasingly blatant conflict of interest and duty position, which it never revealed to Cohen and Ellen. It was never frank with them about the ten per cent shareholding in Crown, and it consistently and secretly worked against their interests behind their backs, while lending them as customers substantial funds which it knew they needed in order to purchase Crown shares. Damages were awarded against the Bank, necessarily running into the millions of dollars, in order to compensate Cohen and Ellen for all that they had lost through investing in Crown Trust shares.

Of course, this was now a case of fiduciary responsibility plus a so-found breach of that obligation, and the concern the present writer had

<sup>3</sup> *Supra*, footnote 1, at pp. 488 (D.L.R.), 52 (O.R.) (Ont. H.C.).

<sup>4</sup> The Financial Post, Dec: 31st, 1983, p. 40, "Corporate Affairs".

<sup>5</sup> *Supra*, footnote 1, at pp. 431 (D.L.R.), 495 (O.R.) (Ont. C.A.).

earlier heard expressed became very real. Was this a case simply of extraordinary facts? Was it with the ten percent share purchase that the Bank "overdid it"? Or did the case emphasize something of broader significance, a principle that could also be applied in less unusual circumstances?

This particular litigation concerned customers with competing interests, and the bank caught—or which has allowed itself to be—in the middle. For the bank it is really a problem of conflict of duties, rather than interest and duty as the trial judge and the Court of Appeal described it in *Standard Investments*.<sup>6</sup> And, though there is very little law in Canada on the subject, the problem is by no means new. For some years the American courts have been concerned with the obligations a bank ought to be held to have when it is approached, usually by a corporate customer, for a loan, and the customer reveals to the bank that it intends to make a take-over offer for the shares of another corporation which is also a customer of the bank. There is agreement in the United States that a bank may not reveal to third parties confidential information acquired from and concerning the target corporation, but there is no agreement in the authorities as to whether the bank may internally employ that information in determining whether, and if so on what terms, it will lend funds to the would-be offeror. Some courts have expressly approved of banks acting in this manner—the decision of the Third Circuit Court of Appeals to this effect in *Washington Steel Corporation v. TW Corporation*<sup>7</sup> in 1979 created its own flurry of both critical and supporting comment in the journals of the time.<sup>8</sup> Other courts have made it clear they would not regard a bank as free to use this information.<sup>9</sup> And this debate has its root in a difference of opinion in the courts as to the basis of a bank's liability to its customer, beyond the debtor-creditor obligation. Is liability founded on a fiduciary obligation, an agency relationship, or an implied term of the contract between the bank and the customer?<sup>10</sup>

There is no disagreement that a bank may have obligations beyond those of a debtor in certain circumstances, and there is widespread support for the conclusion that these added obligations stem from an equity-

<sup>6</sup> It is true that the Bank profited personally by the sale of its 10% holding to the Winnipeg purchaser at Black's sale price of \$44 per share, but that was by no means the Bank's prime object.

<sup>7</sup> 602 F. 2d 594 (3rd Cir., 1979).

<sup>8</sup> See, e.g., R.B. Hagedorn, *The Impact of Fiduciary Principles in the Bank-Customer Relationship in Washington (1979-80)*, 16 *Willamette L. Rev.* 803; Roger Patterson, *The Responsibilities of Banks in Financing Tender Offer Takeovers of Customers* (1981), 48 *Univ. of Chi. L. Rev.* 439; P.R. Lovejoy, *Bank Financing of Hostile Acquisitions of Corporate Loan Customers (1980-81)*, 31 *Case Western L. Rev.* 132.

<sup>9</sup> *American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago*, 475 F. Supp. 5 (U.S.D.C., N.D. Ill., 1977).

<sup>10</sup> See further, E.L. Symons, Jr., *The Bank-Customer Relation* (1983), 100 *Banking L.J.* 220 and 325.

recognized relationship. However, the courts have variously described this relationship. Most have used the term "fiduciary", but others have spoken of a "confidential" relationship, and the "confidential" has been distinguished from the "fiduciary"—something less, but requiring of the bank similar good faith conduct. There are also authorities speaking of a "special" relationship, and of a quasi-fiduciary<sup>11</sup> relationship between the bank and its customer. And, as might fairly be expected, there are those commentators who describe all these terms, including agency and implied term, as mere labels.<sup>12</sup> The terms express a general judicial concern to describe the balance that must be found between the customer who in the particular circumstances has reasonable expectations of bank conduct, and the bank which must operate in a competitive business environment in a cost effective manner.<sup>13</sup> Such a balance is therefore essentially concerned with the nature of the added obligations that in certain circumstances ought to be imposed upon the bank, and, secondly, what those circumstances are.

Some courts will find the balance by narrowing or widening the description of these circumstances, others by concentrating upon the scope or applicability of the added obligations themselves. For instance, Griffiths J. at first instance in the *Standard Investments* case appeared to attach no legal significance to the fact that the Bank of Commerce gave letters of credit to the tune of five million dollars to Conrad Black when he had decided to purchase from the deceased owner's estate the twenty-five per cent of Crown Trust shares held by that estate, though at that time the Bank well knew the desire of Cohen and Ellen to make a bid for that crucial holding.<sup>14</sup> This seems to constitute a limitation of the circumstances in which bank obligations will arise. The Court of Appeal for its part recites the fact of the five million dollar loan to Black,<sup>15</sup> but does not refer to it again. An American court on the contrary might well have seen this as within the circumstances that will give rise to obligations, but have

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<sup>11</sup> *Hutson v. Wenatchee Federal Savings & Loan Association*, 22 Wash. App. 91, 588 P. 2d 1192 (Wash. Ct. Apps., 1978). See also *Commercial Cotton Co. v. United California Bank*, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (Cal. App. 4 Dist., 1985), discussed in T.T. Kitada, *Emerging Theories of Bank Liability—The Breach of Covenant of Good Faith and Fair Dealing* (1986), 103 *Banking L.J.* 80.

<sup>12</sup> *Supra*, footnote 10.

<sup>13</sup> Not to mention the interests of the public that this movement of support capital be as unrestricted as possible.

<sup>14</sup> He appears to have thought it enough that Cohen and Ellen had earlier offered \$33.00 a share to the executors, and received no reply. Black was successful in getting them for \$34.00 a share. The evidence also suggests the estate beneficiaries would not have been "comfortable" with a sale to Cohen and Ellen. Maybe this was also a factor in the trial judge's mind.

<sup>15</sup> *Supra*, footnote 1, at pp. 424 (D.L.R.), 488 (O.R.) (Ont. C.A.). In the Court of Appeal this loan to Black was overshadowed in significance by the Bank's purchase for itself of the 10% interest in Crown.

asked itself the question whether a bank is subject to the duty not to lend at all when it is aware (or should reasonably have been aware) that it is acting adversely to the interests of another of its customers by inserting itself into an antagonistic dealing. Its duty may be to refuse to make the loan. And maybe overall the Court of Appeal was intending to be understood as supporting this position.

Commonwealth jurisdictions other than Canada have been more concerned with the nature of the remedies that are available against the bank. English courts, like Australian courts, have no doubt that in certain circumstances a bank may be a fiduciary *vis-à-vis* its customer, but the English authorities have been particularly concerned with when a presumption of undue influence is imposed upon the bank in relation to its customer. Such a presumption arises when the circumstances cause a fiduciary relationship between bank and customer to come into existence; and whether it had done so, and the presumption had been met, were the major issues in *Lloyds Bank v. Bundy*,<sup>16</sup> a leading authority which was cited at length by Griffiths J. and the Court of Appeal<sup>17</sup> in the *Standard Investments* case. On a number of occasions English courts have also had to consider when a third party—it might be a bank—becomes liable for participating with a fiduciary in the breach of his obligations, and this has been a concern for Australian courts as well. Neither English nor Australian courts have accepted the Canadian and American thesis that the constructive trust is a remedy for unjust enrichment, but English and Australian courts have both struggled in recent years with determining the circumstances in which a party, whether the individual in immediate relationship with the injured person or a third party involved with the breach of another, is liable as a constructive trustee. Where Australian courts have made a singular contribution directly concerning banks is with the applicability to the bank of the equitable concept of unconscionable bargain. A fiduciary relationship is not necessary in this instance, and, given that this Australian authority is directly in line with the unconscionability concept, derived from nineteenth century and earlier English authorities, and actively adopted in Canadian courts, it has singular significance for Canadian bankers. What is the relationship between a bank's liability when on the one hand it has entered into an "unconscionable bargain" with its customer, and its liability to its customer on the other hand as a fiduciary, or the "knowing assistant" of a fiduciary, in breach of fiduciary obligations.

Beyond the creditor-debtor relationship, banks can become liable to their customers in a number of ways. *Standard Investments* arose in the corporate banking field, but liabilities of a similar kind are probably more

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<sup>16</sup> [1975] Q.B. 326, [1974] 3 All E.R. 757 (C.A.).

<sup>17</sup> *Supra*, footnote 1, at pp. 482-483 (D.L.R.), 45-47 (O.R.) (Ont. H.C.); and at pp. 432-433 (D.L.R.), 496-497 (O.R.) (Ont. C.A.).

familiar in Canada in the consumer banking area. The bank (or its employee) may have personally benefitted by the misuse of information confidentially supplied by the customer to the bank, or it may have communicated that information without the customer's consent to a third party. It may have failed to communicate information to the customer which had a material importance for that customer about to enter into the proposed transaction with the bank, or it may have failed to ensure that the customer had the opportunity of gaining the assistance of professionals who would have known of the significance of matters upon which no information was supplied. Typically the bank is putting before the customer documents whereby the customer is providing a guarantee of the debts of another customer, or is providing security or added security to the bank in respect of another customer's loan or overdraft. Essentially the bank is shifting the risk of the other customer's default from the bank to the customer providing the guarantee or the security.

Of course, the bank may object, and does object, that provided the customer understands the nature of the documents he is signing it is no business of the bank to explain to the customer the wisdom entering into the transaction. If the customer is adult and has mental capacity, the bank might argue that, like the storekeeper, it is entitled to assume the customer has weighed the pros and cons of his entering into the transaction. A bank is not a curator of the customer's best interests. It must be honest and discharge the duty of care which contract imposes on it. What more can reasonably be expected of it? It borrows, it lends, and it takes security; it is a trader dealing in funds. Hence the question put by the banker to the present writer—"Where has all this fiduciary business come from, and what does it mean for us"?

So let us turn to this banker's questions, for had he turned to Paget or Baxter on the fiduciary status of the banker he would have been even more puzzled. He would have found these standard works all but silent on the subject.<sup>18</sup>

## II. *The Background to, and the Origins of, the Fiduciary Relationship*

The concept of the fiduciary relationship arose in the Court of Chancery in England, and it did so as long ago as the second half of the seventeenth century. This was the court that "did equity", when a suitor was able to persuade the judge hearing the application that the remedies of the common law courts were inadequate to do justice for him. The court had both

<sup>18</sup> M. Megrah and F.R. Ryder, *Paget's Law of Banking* (9th ed., 1982), and I.F.G. Baxter, *Law of Banking* (3rd ed., 1981) appear silent on the subject of the banker as fiduciary, though aspects of the subject appear from time to time in other settings. M.H. Ogilvie, *Banking: The Law in Canada* (1985), paras. 391-398 (pp. 263-266), and paras. 475-476 (p. 295), has some useful synoptic notes. See, however, by the same author, *Banks, Advice-Giving and Fiduciary Obligation* (1985), 17 *Ottawa L. Rev.* 263.

an exclusive jurisdiction and a supplementary jurisdiction. For instance, the trust was recognized solely by the Court of Chancery, and therefore all matters concerning trusts were heard in that court alone. The trust was a product of the exclusive jurisdiction. In fact the relationship between the trustee and the trust beneficiary was the first "fiduciary relationship" and the dominant one until the turn of the nineteenth century, when courts of equity—as Chancery was widely known—began to employ the term more extensively, and to hold that others, besides trustees and personal representatives,<sup>19</sup> were subject to the kinds of obligations that were imposed upon the trustee. The supplementary jurisdiction was invoked when Chancery "supplemented" the work of the common law courts by giving remedies that were not available at law. For example, courts of law would determine whether the defendant was in breach of contract, but those courts could only award damages for the breach. If the plaintiff wanted specific performance, or injunctive relief, he had to seek that remedy in Chancery—in equity, as it came to be known.

Prior to the nineteenth century the courts of equity were working out what was the scope of the "trust" concept, deciding the circumstances in which it might apply other than when a settlor or testator had expressly created a trust. It was the term, trust, with which they were then concerned. During and after Lord Eldon's Chancellorship (1801-1827) the term "fiduciary relationship" becomes increasingly more familiar, and the question regularly asked whether a particular relationship known to the common law might not also have a fiduciary nature. Sometimes, as in the case of solicitors, courts of equity conclude that fiduciary obligations essentially attach to the office that they perform. In other cases of agency, only those fiduciary obligations arise which are relevant to the scope of the particular agency in question, and as for employees they are merely subject to one fiduciary obligation—that they shall not make secret profits for themselves while engaged in duties on behalf of their employers. It was the exclusive jurisdiction of equity to rule on matters of the fiduciary relationship, but its supplementary jurisdiction which allowed courts of equity to characterize established common law and corporate relationships as fiduciary, and so make equity's remedies available to the party to the relationship who is bringing the complaint.

After the abolition of the Court of Chancery in England in 1873, law and equity became administered in the one High Court of England, and a similar combined jurisdiction was introduced into almost all Commonwealth common law jurisdictions within a short space of time thereafter. Indeed, in the western Canadian provinces law and equity were never distinct jurisdictions. However, the remedies of equity, essentially discretionary in nature, continued to supplement remedies at common law, and

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<sup>19</sup> Deceaseds' estates also were solely administered in Chancery.

it therefore becomes important to determine what these remedies at law are which equity supplements.

If the complainant and another have entered into a contract, that contract will be held void at law where the complainant can show that his mental consent to the contract was absent. Duress, which at law means physical coercion, prevents the requisite mental element from being present, and fundamental mistake may reveal that the parties were agreeing to totally different propositions. They were *non ad idem*. Fraud will be remedied at law where a party can show that the other misrepresented to him a fact which the other knew to be false, or cared not at all whether it was true or false. However, absent any of these elements the parties are held to their contract if on an objective test there was both an offer and an acceptance. Breach of an express or implied term, if established, allows the injured party to obtain damages, but if there is no breach that is the end of the matter. A bargain struck is binding on both parties.<sup>20</sup> Fraud in the common law sense will also ground an action in deceit, and negligence leading to the giving of incorrect advice may not only constitute a breach of a contractual term, but also a tort. In either case damages are the award given. The complainant may also recover in a so-called quasi-contractual situation in an action for money had and received.

Equitable principles are based upon the precepts of fairness and custom-made justice. They will also rectify innocent misrepresentation with rescission where *restitutio in integrum* is possible, specific performance or injunction may be granted in appropriate cases, and the proprietary remedies of constructive trust and equitable lien, together with tracing, will permit the injured party to gain restitution. In all these instances equity offers remedies which go beyond common law remedies to bring about the most meritorious outcome to the dispute. Except in a very few instances, equity does not set aside the common law; it aids and supports it. It fulfills the object of the law. Similarly equity does not deny the common law relationships any effect they would have at law, it merely finds in some of those relationships circumstances which justify the imposition on a party who is to act, or is acting, on behalf of the other, one or more of the obligations which equity imposes on the express trustee. The justification is the parallel between the trust and confidence placed in the trustee, and that placed in the party who in the circumstances of the common law relationship is to act, or is acting, for the benefit of another. Again equity is fulfilling the law.

### III. *Fiduciary Relationship and the Principles of Constructive Fraud*

Fraud in common law means actual fraud—knowing a statement is false, or being unconcerned whether it is true or false. In the pursuit of fairness and a more morally inclined concept of justice, courts of equity between

<sup>20</sup> Unless statute confers any relief.

the seventeenth century and the turn of the twentieth carried the notion of fraud much beyond thinking of this kind. Fraud came to embrace all activity that was unconscionable, where property had been obtained through abuse of power or opportunity. In fact fraud in equity became something of an umbrella for a range of activities which, if they resulted in gain, equity would not allow to go without remedy.

Unconscionable acquisition by the fiduciary is a part of the terrain which equity remedies under the heading of constructive (or equitable) fraud. Indeed, the fiduciary is first and foremost the person who must account for unconscionable conduct. Between 1660 and Lord Eldon's time the courts speak in terms of the "constructive" —sometimes the "implied"—trust which equity will impose on the person who has gained by conduct that it cannot condone. But by 1800 the courts are beginning to emphasize that it is the breach of a fiduciary relationship which gives rise to the constructive trust. The emphasis now turns from the meaning of the word, trust, something which by this time is fairly settled, to the relationship between persons. A trustee is subject to a number of obligations stemming from the trust and confidence which is reposed in him. The nineteenth century courts of equity begin to suggest that other relationships of a not dissimilar kind, that is to say, also involving a degree of trust and confidence, should equally give rise to the kind of obligations equity imposes on the trustee. He who is a fiduciary will be called upon in equity's action of accounting to explain why he should be permitted to keep a proprietary gain acquired during the performance of his task on behalf of the "beneficiary", and therefore surely at the expense of his "beneficiary". He will also be called upon to make restitution, that is, to compensate the "beneficiary" for loss occasioned by his wrongful acts. By the second half of the nineteenth century the term, fiduciary relationship, has become familiar. The list of relationships known to the common law, but categorized by equity courts as fiduciary, is growing, and so far as constructive fraud is concerned this fiduciary element will normally, though not always, put the burden of proof upon the fiduciary that he acquired gain, from whatever source it came, without violating his fiduciary obligation of selfless service.

### A. *Undue Influence*

The most significant area of constructive fraud where this burden of proof becomes apparent is that of undue influence.<sup>21</sup> In this instance equity accords relief by way of setting aside a gift, or rescinding a contract, where the donor or the dominant party in a setting of contract overbears the mind of the donor or weaker party to the contract, so that

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<sup>21</sup> For a contemporary and stimulating discussion of the subject, see R.P. Meagher, W.M.C. Gummow and J.F.R. Lehane, *Equity: Doctrines and Remedies* (2nd ed., 1984), ch. 15.

there can be said to be no real consent by the transferor to the transfer taking place. The capacity of the donor or contracting weaker party is not in question; the true intent of the weaker party in either instance, whatever it may have been, is prevented from being translated into conduct by the pressure of the dominant party whose own intention prevails. The stronger will have victimized the weaker; additionally, the weaker will have suffered an injury thereby. Either the victimization has resulted in a gift, which is by nature a loss to the transferor, or the transaction has resulted in the weaker receiving a consideration considerably less than the true value of the property transferred.

If the enriched person and his victim are in a fiduciary relationship, equity in very many such cases makes undue influence a presumption. That is to say, it is presumed that the enriched person has gained the benefit by abusing his fiduciary office, and in this way the burden of proof that there was no undue influence is thrown upon the enriched person.<sup>22</sup> Of course it is always open to a person to bring express evidence to show that undue influence took place, and he will have to assume the burden of proof when he is not in a fiduciary relationship with the person who allegedly practised the undue influence. But if the alleged victim can establish that the other was a fiduciary, the victim clearly has a stronger evidentiary position. The fiduciary must now prove a negative—that the proprietary advantage he acquired was *not* obtained by overbearing the mind of the other. A person may be a fiduciary, and so subject to the presumption, for one of two reasons. Either equity has already ruled that the relationship in question is inherently fiduciary, such as that of solicitor and client, company director and the company on whose board he sits, and partner *vis-à-vis* another partner, or, if such a ruling has not taken place, the alleged victim is able to show on the facts and in the circumstances of his case that the other owed him a fiduciary standard of behaviour.<sup>23</sup> Whichever way the fiduciary relationship is established, the presumption is thereupon imposed upon the person who allegedly carried out the victimization, and thereby secured for himself or another the enrichment at the victim's expense.

### B. *Unconscionable Bargain*

However, there is another area of constructive fraud which does not require the establishment of a fiduciary relationship, and yet the burden of proof is upon the person who was enriched or caused the enrichment of a

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<sup>22</sup> Where gifts are concerned, the presumption is only made with regard to *inter vivos* gifts. Probate courts did not entertain any such presumption where testamentary gifts were attacked with the allegation of undue influence.

<sup>23</sup> These two relationships might be described as the pre-existing fiduciary relationship, and the *ad hoc* fiduciary relationship. See D.W.M. Waters, *The Constructive Trust* (1964), p. 67 *et seq.*

third party. This is the area of the unconscionable transaction (or bargain). Though in England it appears to have been invoked only once since the nineteenth century, it is a "well-established jurisdiction" of equity,<sup>24</sup> and in both Canada and Australia case authorities within recent years have demonstrated that this remains a most important area of equitable relief. The relief is available when one party has taken advantage of the weakness or necessity of another to the extent that oppression has occurred. Unlike the doctrine of undue influence, equity is not concerned in these situations with whether the mind of one party was overborne by another so that the victim's true consent was lacking; it asks the question as to whether, looked at objectively, the transaction in all the circumstances was sufficiently unconscionable that it cannot be allowed to stand. If the transaction does not pass that test, rescission will be awarded. The typical transaction under such attack is a sale or provision of security by way of mortgage, and it is generally accepted that four elements must exist; (1) an ignorance of business normally associated with low educational level or the condition of blindness or deafness, (2) unfamiliarity with the English language, or a lack of a similar kind on the part of the oppressed person rendering him incapable of protecting himself, (3) knowledge or the ready means of knowledge by the other party of that weakness or necessity, and (4) the use of the inequality of the parties by that other party in order to drive a hard bargain. An undervalue received by the oppressed party seems invariably to be the factor which triggers the oppressed party to complain, and it is widely accepted that such an undervalue is another necessary element.<sup>25</sup> If the person alleging oppression can establish these elements, then, as we have said, regardless of whether a fiduciary relationship exists, the person who allegedly took advantage must show that in all the circumstances the transaction was nevertheless fair, and should be allowed to stand. In other words, the burden of proof to establish a negative, as with undue influence, passes to the apparent oppressor.

### *C. The Relation Between Undue Influence and Unconscionable Bargain*

The relation between the doctrine of unconscionable transaction, just discussed, and that of presumed undue influence, is obviously close. In

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<sup>24</sup> See Meagher, Gummow and Lehane, *op. cit.*, footnote 21, ch. 16. The sole English authority in the present century is *Cresswell v. Potter*, [1978] 1 W.L.R. 255 (Ch. D.). The jurisdiction goes back to the eighteenth century when the courts began to remedy the situation of the youthful, guileless heir-apparent to family fortune who is persuaded by the older, shrewd business person to bargain away the future inheritance for present trinkets.

<sup>25</sup> Some suggestion has been made in Australian courts in recent years that undervalue (or inadequate reciprocal benefit) is not necessarily a vital element. Everything depends on the circumstances. The essential concern is oppression. See *The Commercial Bank of Australia v. Amadio* (1983), 151 C.L.R. 447, 57 A.L.J.R. 358 (Aust. H.C.), which is discussed later in this article.

*Lloyds Bank v. Bundy*,<sup>26</sup> a case argued solely in undue influence, Lord Denning M.R. set out five different doctrines, that is, duress of goods, unconscionable transaction, undue influence, undue pressure, and salvage agreements, and reached the conclusion that, taking these doctrines together, today the courts are guided by a single thread which runs through them all, namely, an inequality of bargaining power. Though there was some early acceptance of this opinion in Canada, and Lord Denning's synthesis has been often cited in Canadian courts, it has not been well received by the commentators, and was recently categorically rejected by an unanimous House of Lords.<sup>27</sup> The House considered that an undervalue—"an advantage taken"—is a fundamental element of the undue influence doctrine, and that the essential ground for equity's intervention is the victimization of the weaker party through the taking of this advantage.

There is no doubt that undue influence, like duress, is concerned with the mental element of consent. If as a result of the undue influence there was no genuine consent, then rescission will be awarded. The concern is with the conduct of the dominant party—was he in a position which offered him the opportunity of influencing the other? Did he use that influence "unduly", that is, did he overbear the mind and prevent the true consent of the other so as to obtain an unfair advantage for himself at the expense of the other?<sup>28</sup> On the other hand, when a party pleads that a bargain was unconscionable, the transaction itself and the circumstances leading up to and surrounding it are the essential concern. As Professor Sheridan put it, writing in 1957, the question is whether, given the weakness of one party's bargaining position and the undervalue which he received, "a greater advantage" was obtained by the stronger party "than the current morality of the ordinary run of business allows".<sup>29</sup>

The immediate legacy of Lord Denning's judgment in the *Bundy* case may have been that some Canadian cases, shortly after *Bundy* was reported, were decided purely on the principle of the inequality of bargaining power,<sup>30</sup> but, though this particular notion undoubtedly caught the

<sup>26</sup> *Supra*, footnote 16.

<sup>27</sup> *National Westminster Bank plc. v. Morgan*, [1985] 1 A.C. 686, [1985] 1 All E.R. 821 (H.L.). Followed in *Hayward v. Bank of Nova Scotia* (1985), 19 D.L.R. (4th) 758, 51 O.R. (2d) 193 (Ont. C.A.). (The plaintiff sued for damages for breach of a fiduciary duty). Its significance is discussed in C.J. Barton and P.M. Rank, *Undue Influence—A Retreat?* (1985), 49 Conv. 387, and it is critically examined in Malcolm Cope, *Undue Influence and Alleged Manifestly Disadvantageous Transactions: National Westminster Bank plc v. Morgan* (1986), 60 A.L.J. 87.

<sup>28</sup> Having influence does not necessarily involve wrong-doing. The most well-meaning, attentive person may in fact have overborne the mind of the weaker person.

<sup>29</sup> L.A. Sheridan, *Fraud in Equity* (1957), p. 73. The distinction is clearly made in Malcolm Cope, *The Review of Unconscionable Bargains in Equity* (1983), 57 A.L.J. 279.

<sup>30</sup> *E.g., McKenzie v. Bank of Montreal* (1976), 70 D.L.R. (3d) 113, 12 O.R. (2d) 719 (Ont. C.A.).

judicial imagination in Canada, it was not long before it tended to give way to closer analysis. In *Buchanan v. Canadian Imperial Bank of Commerce*<sup>31</sup> Taggart J.A. in the British Columbia Court of Appeal drew attention to the statement of Davey J.A. in *Morrison v. Coast Finance Ltd.*,<sup>32</sup> a pre-*Bundy* decision that, though the two doctrines are closely related, they are separate and distinct. However, the fact situations involved in an undue influence case or an unconscionable bargain case will very often resemble each other. There will be superior business skill or office on one side, and ignorance of business, poor education, low income group, need, old age, language difficulties, or factors of that kind, on the other.<sup>33</sup> Inevitably, it seems, in all these cases there is also the fact that the weaker party to the challenged transaction has obtained significantly lower value than he or she might normally have been expected to obtain. Nevertheless, facts are often significant in undue influence cases which are absent in unconscionable bargain cases. For instance, the weaker party may be a bedridden elderly person who is under medication, or a person who at the time was under the influence of drugs or alcohol. This difference arises precisely because a charge of undue influence is a charge that the weaker party gave no consent of his own; he merely gave way to pressure. In the case of the unconscionable bargain the weaker party retains the power to give a real consent, but does not appreciate the legal or financial implications of what he is doing. The other is aware of this, and presses home his advantage.

All the same, it is clear that the weaker party will very often be able to argue both undue influence and unconscionable bargain in the alternative. It may be that the former doctrine is concerned subjectively with consent, and the latter objectively with the taking of advantage, but as the facts are revealed during trial both doctrines may seem to raise the general question of whether the weaker party was not pressured into a bad bargain.<sup>34</sup> This could be the explanation of the Canadian judgments where *Lloyds Bank v. Bundy* was cited though the weaker party had pleaded not undue influence, but unconscionable bargain. And in *Harry v. Kreutziger*,<sup>35</sup> though explicitly directing his mind to the unconscionable bargain doctrine, Lambert J.A. said that from "statements of principle" in *Morrison*

<sup>31</sup> (1980), 125 D.L.R. (3d) 394, 23 B.C.L.R. 324 (B.C.C.A.). For further authorities, see D.W.M. Waters, *Law of Trusts in Canada* (2nd ed., 1984), p. 424, n. 5.

<sup>32</sup> (1965), 55 D.L.R. (2d) 710, 54 W.W.R. 257 (B.C.C.A.).

<sup>33</sup> *Lloyds Bank v. Bundy*, *supra*, footnote 16 (undue influence), and *Commercial Bank of Australia v. Amadio*, *supra*, footnote 25 (unconscionable transaction), are very good evidence of this.

<sup>34</sup> "... in my view of the evidence . . . he was overborne by the respondent because of the inequality in their positions . . .": McIntyre J.A. in *Harry v. Kreutziger* (1979), 95 D.L.R. (3d) 231, at p. 239, 9 B.C.L.R. 166, at p. 175 (B.C.C.A.), a case pleaded before the Court of Appeal solely in unconscionable bargain.

<sup>35</sup> *Ibid.*

v. *Coast Finance Ltd.*, a classic exposition of the unconscionable bargain doctrine, and in Lord Denning's judgment in the *Bundy* case, he saw the various factors as "really aspects of one single question. That single question is whether the transaction, seen as a whole, is sufficiently divergent from community standards of commercial morality that it should be rescinded".<sup>36</sup> Now, since then, the House of Lords in *National Westminster Bank plc. v. Morgan*,<sup>37</sup> an undue influence case, has said that the "inequality of bargaining power" principle is incorrect.<sup>38</sup> Not only does it ignore that equity has never interfered with bargains as such, requiring that an abuse be established before remedy will be given, but in Lord Scarman's view (for the whole House) it is preferable in any event to leave issues of that kind to Parliament rather than that the courts erect a general principle of relief against such inequality. The House, it should be noted, said nothing of the unconscionable bargain doctrine; it was not, of course, before the House, and in any event the doctrine is remarkably absent from the English law reports of this century. On the other hand, for the purposes of the bargain doctrine, Lambert J.A. in the *Harry* case was of the view that it is indeed appropriate to look at legislation for guidance as to what are the "community standards of commercial morality",<sup>39</sup> an opinion followed with enthusiasm by Lander J. in the later case of *Vencer Mortgage Investments Ltd. v. Batley*.<sup>40</sup> We clearly have a difference of opinion here as to the scope the court should give these related remedies, and it may be part of the broader phenomenon that, in general, Canadian courts do seem to see the elements of these two remedies as the same. Of this instances abound.<sup>41</sup>

It may be a matter for regret that Lord Denning chose to extrapolate so far as to reach a single theme of "inequality of bargaining power". It also seems likely that he did not intend to be read so literally that inequality of positions becomes the sole test for the presumption of undue influence to arise, or for the successful assertion of an unconscionable

<sup>36</sup> *Ibid.*, at pp. 241 (D.L.R.), 177 (B.C.L.R.).

<sup>37</sup> *Supra*, footnote 27. See Barton, *loc. cit.*, footnote 27.

<sup>38</sup> Lord Scarman pointed out (*ibid.*, at pp. 708 (A.C.), 830 (All E.R.)) that it is totally irrelevant to the cases of gifts induced by undue influence, though this does not appear in the *Lloyds Bank* judgment.

<sup>39</sup> *Supra*, footnote 34, at pp. 241 (D.L.R.), 178 (B.C.L.R.).

<sup>40</sup> (1983), 54 B.C.L.R. 374 (B.C.S.C.), reversed on a different interpretation of the facts, (1985), 64 B.C.L.R. 254 (B.C.C.A.).

<sup>41</sup> Typical is *Bank of Montreal v. Hancock* (1982), 137 D.L.R. (3d) 648, 39 O.R. (2d) 82 (Ont. H.C.). As to the relationship between the roles of the legislatures and of the courts, seeing them as complementary in this matter, see D.C. Ford, *Unconscionable Conduct—A Matter for the Courts or the Legislatures?* (1985), 13 Aust. Bus. L. Rev. 307.

transaction.<sup>42</sup> It might have been preferable for him to limit the number of doctrines under consideration to presumed undue influence and unconscionable transactions, and to reach the more limited conclusion of an Australian writer: "Abuse of a perceived position of special advantage is the thread that links these two equitable doctrines".<sup>43</sup> In Canada at least, where the opinion of the House of Lords will be persuasive on a topic like this, and where our courts have emphasized that "inequality in the position of the parties" and "proof of substantial unfairness in the bargain"<sup>44</sup> are both required before an unconscionable bargain can arise, it seems clear that both special advantage and *prima facie* abuse (that is, unfairness) must be established before any presumption can arise of an abused fiduciary relationship, or unconscionability be realistically asserted.

#### D. *Fiduciary Relationship: Its Function and Meaning*

A presumption of undue influence will arise when the person who acquired the gain is a fiduciary. But who is a fiduciary, and what does that involve? It is relationships which are in some degree comparable to the relationship of the express trustee and his beneficiary that are fiduciary. That is the key to understanding the concept of fiduciary. Since the seventeenth century, courts of equity have consistently analogized with the trust relationship, a relationship so familiar to them in settlements and wills.

The trustee of a settlement or a will, in discharging the duties set out by the instrument or by law, is subject to several very clear obligations; these stem from the "trust and confidence" placed in him that, with the powers he has and the discretionary decisions he may have to make, he will be faithful and loyal to the task he has undertaken, and so to the beneficiaries on behalf of whom he is acting. The obligations are: (1) that he will act scrupulously only for the benefit of the trust while engaged in his duties, never for himself; (2) that he will be active in carrying out his duties, and perform them with complete integrity; (3) that because of the trust and confidence reposed in him personally he will personally carry out his duties; and (4) that as between the beneficiaries he will act impartially, showing a favour unauthorized by the instrument to none. To compel his adherence to these obligations, as well as the duties that he has, Equity requires the settlement or will trustee to render an account of his trusteeship. If breach is discovered, the trustee is required by Equity

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<sup>42</sup> He spoke only of a single thread running through the five instances. See also Lambert J.A. in *Harry v. Kreutziger*, *supra*, footnote 34, at pp. 241 (D.L.R.), 177 (B.C.L.R.).

<sup>43</sup> Ian J. Hardingham, *Unconscionable Dealing*, in P.D. Finn (ed.), *Essays in Equity* (1985), p. 18. However, this was written before the House of Lords gave judgment in the *Morgan* case, *supra*, footnote 27, reversing the Court of Appeal.

<sup>44</sup> McIntyre J.A. in *Harry v. Kreutziger*, *supra*, footnote 34, at pp. 237 (D.L.R.), 173 (B.C.L.R.).

out of his own assets to make good to the trust the loss which it has suffered, and to hand over to the trust any profit which he has improperly acquired for himself.

When allegations were made against solicitors, agents, and guardians, for instance, the law of express trusts suggested to courts of equity that other relationships, like that of solicitor and client, agent and principal, guardian and ward, might properly be said to be subject to the same obligations. Not all of these trust obligations might be relevant to the non-trust relationship in question; indeed, it might be only one of them. But, if the improper conduct alleged breached an obligation with which the particular non-trust relationship could be associated, these courts of equity were prepared to require the alleged perpetrator of the improper conduct to account, as would an express trustee. The party to a relationship who was so required to meet one or more of the trustee obligations was described by Equity as a fiduciary *vis-à-vis* the person on behalf of whom he was acting. This was, and remains, the function of the fiduciary relationship; it describes a situation where accounting as a trustee will be required.<sup>45</sup>

However, many relationships known to the law are non-fiduciary (the creditor and the debtor, for instance, because the debtor returns kind, not the notes and coins borrowed), and relationships which are fiduciary may be so treated for totally different reasons. For instance, an employee must account to his employer for an improper profit, but it is unlikely that a court would impose any other trustee obligation upon him, because, unlike a trustee, he normally acts under specific instructions. A solicitor on the other hand must account almost as if he were a trustee; all of the trustee obligations could reasonably be said to apply to his position *vis-à-vis* his client. A medical doctor who acquires a gift or a marked contractual advantage from his patient will be presumed to have employed undue influence. In this respect the doctor is in a position of respected authority *vis-à-vis* his patient. He is therefore a fiduciary. He must prove that in fact

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<sup>45</sup> The obligations to hand over not approved personal profit and to compensate by way of restitution for loss sustained through his breach of obligation are both enforceable against the fiduciary through the equitable accounting remedy. See *Nocton v. Lord Ashburton*, [1914] A.C. 932, at p. 946 (H.L.). But where the relationship, like principal and agent, or the wrongdoing, like conversion, deceit or negligence, is also known to the law, common law remedies in contract or tort may also be available against him, both to make compensation by way of damages and to compel the handing over of profit (an action for money had and received). Accounting is a remedy enforcing a personal obligation owed by the fiduciary to the beneficiary. However, the injured beneficiary may also be able to invoke equity's proprietary remedies (constructive trust and equitable lien), and so pursue specific property, the subject matter of an action, through the fiduciary into the hands of third parties acquiring with notice. And there will be occasions when the equitable remedies of rescission and injunction will protect the injured beneficiary's position, as previously explained. See further on the liability of the trustee (and other fiduciaries) for breach, *Waters, op. cit.*, footnote 31, pp. 993-1005.

all was fair and free of any abuse. However, it is most unlikely that any of the trustee obligations other than this—abusing the intimacy of his position for his personal gain—could be shown to be applicable to the doctor-patient relationship. But, as in all these instances, it depends on the circumstances in the individual case. They can vary enormously. Two agents may each be fiduciaries *vis-à-vis* their respective principals, but for different reasons and to a different extent. Agent A is to take goods each afternoon to a warehouse, and leave them with the warehouse clerk; agent B is a stockbroker and investment consultant. The functionary nature of A's task, and the intimate advisory nature of B's task, makes B comparable to a settlement or will trustee much more extensively than is the case with A.

What then are the criteria by which courts will determine whether or not a relationship is in any respect comparable to an express trust relationship? Two features of an express trust have dominated the courts' thinking; the fact that the trustee is vested with title to specific, earmarked property, for which property he must account to the beneficiary, and, secondly, that the trustee is discharging a task for the exclusive benefit of another. The first characteristic means that Equity could not describe the debtor-creditor relationship as fiduciary, and could only describe the bailor-bailee relationship as fiduciary by understanding "title" as really meaning control to the exclusion of others. The second characteristic allowed Equity to bring within the analogy of trusts all those who put their skills at the service of others, and exercise a degree of discretion as to how best to carry out the task at hand. The two characteristics together readily suggested that in an express trust specific property and skills are put at the service of another. From this conclusion came the prominence of the trustee obligation to avoid the conflict of interest and duty; this obligation with its many branches (undue influence, breach of confidence, secret profits, and conflict of duties) was capable of being seen as the obligation also of very many who made their services available to others.

Nevertheless, the essence of a trust is the nature of the relationship between two persons, the trustee and the beneficiary. In the case of a trust that relationship owes much of its origin to the fact that the trustee is vested with and controls property on behalf of the beneficiary. But it is not essential for a fiduciary relationship, as such, to come into existence that both characteristics—control of property *and* an obligation to act for another—are present. A partner is a fiduciary *vis-à-vis* his co-partner,<sup>46</sup> because he has undertaken with another to work to their mutual advantage. A joint venturer may be in the same position with respect to his

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<sup>46</sup> *Gordon v. Holland* (1913), 10 D.L.R. 734, 4 W.W.R. 419 (P.C.). See L. Beane, *The Fiduciary Relationship of a Partner* (1980), 5 J. of Corp. Law 483.

co-joint venturer.<sup>47</sup> The one has placed trust and confidence in his partner or co-joint venturer, and that confidence is abused if the partner or joint venturer so trusted acts other than as a fiduciary within the scope of the agreement. An agent undertakes to act for his principal; he, too, may be a fiduciary within the scope of his undertaking. Nor is it necessary that there be a contract enforceable at law between the one and the other. The parties may commonly intend a partnership or joint venture, but no contract has yet been drawn up or signed;<sup>48</sup> one person may purport to act as the agent of another, but he was not appointed by the other so to act, or perhaps even known by the "principal" to be so acting. The "agent" merely assumed the office. The understanding between the parties, or the assumption of agency,<sup>49</sup> is enough to raise the relationship of trust and confidence. A property element enters when the person who has entered the association or undertaken the task subsequently acquires a proprietary advantage at the expense of the other; the breach of the relationship may have resulted in a loss of property to the beneficiary, which loss the fiduciary must make good.

Effectively, what we are saying of course is that the contract, or alternatively the fact, of association or agency, depending upon the nature of the association or agency, can itself give rise to the necessary obligation to act with loyalty and conscientiousness.<sup>50</sup>

For their part, however, courts of equity never felt the need to spell out the criteria for the fiduciary relationship in any detail, and things have not been different since law and equity became administered in the same courts. The courts have appeared willing to say simply that one person is a fiduciary *vis-à-vis* the other, thus merely assuming the answer to the primary issue of whether the particular person should be subject to a particular express trustee obligation. They have also described the fiduciary, if they have described him at all, as one in whom trust and confidence is placed by the person who looks to the fiduciary for the performance of some act. No doubt, as Lord Scarman recently observed,<sup>51</sup> the

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<sup>47</sup> *United Dominions Corp. Ltd. v. Brian Pty Ltd.* (1985), 60 A.L.R. 741 (Aust. H.C.), cited with approval and followed by R.E. Holland J. in *International Corona Resources Ltd. v. Lac Minerals Ltd.*, (1986), 53 O.R. (2d) 737, 9 C.P.R. (3d) 8 (Ont. H.C.).

<sup>48</sup> *Ibid.*

<sup>49</sup> The assumption would normally be manifested by the "self-appointed agent" representing himself as an agent when dealing with third parties (see, e.g., *Boardman v. Phipps*, [1967] 2 A.C. 46, [1966] 3 All E.R. 721 (H.L.)).

<sup>50</sup> For a valuable discussion of the fiduciary relationship in its various facets, see Meagher, Gummow and Lehane, *op. cit.*, footnote 21, pp. 123-151. For an enumeration of persons who as fiduciaries have been subject in Canadian courts to the conflict of interest and duty rule, see Waters, *op. cit.*, footnote 31, pp. 712-715.

<sup>51</sup> *National Provincial Bank plc. v. Morgan*, *supra*, footnote 27, at pp. 709 (A.C.), 831 (All E.R.).

doctrines of equity are essentially statements of principle; they cannot be spelt out beyond what they inherently are. He might perhaps have added that the application of principles to any given set of facts is also a question of judgment in each instance. There is an intimacy, a reliance upon another's good faith, in a fiduciary relationship. That perhaps, the courts seem to be declaring, is all that can usefully be said.

Into the perceived gap have stepped the writers and commentators, each of whom has grasped at the elusive with varying degrees of persuasiveness. Some perceive a classification of types of fiduciary, others have ventured a thesis as to the nature of fiduciary relationship, and yet others have analyzed the attributes that they see as the constituents of the relationship.<sup>52</sup> The subject has something of the fascination for equity lawyers, and the present writer includes himself, that the search for the Holy Grail had for the knights of antiquity. In recent years, however, American writing in particular has turned to the practical question of what is precisely expected by the courts within certain professional and commercial relationships. The relation of the bank and its customer has been the subject of illuminating study both by the courts<sup>53</sup> and by the writers.<sup>54</sup>

### E. *The Bank and its Customer: Their Relationship*

It is axiomatic that a bank and its customer are in a debtor-creditor relationship so far as money to the credit of the customer's account is concerned. The banker is obliged to pay the customer an amount equivalent to the customer's previous deposit, plus any agreed interest,<sup>55</sup> and the customer has no right to question any profit the bank makes investing the customer's money with third parties. As Lord Scarman said in *National Westminster Bank plc. v. Morgan*,<sup>56</sup> it is "business for profit so far as the bank . . . [is] concerned". However, it is also well established that the relationship is that of agent and principal so far as the bank is obliged to make payments on cheques drawn by the customer against his account, or to collect from other banks cheques drawn by other persons in favour of the customer. Both the agency and also the debtor-creditor relationship will arise out of a contract between the bank and its customer, and there-

<sup>52</sup> One of the finest studies to date is P.D. Finn, *Fiduciary Obligations* (1977). The judgments of Gibbs C.J. and Mason J. of the High Court of Australia in *Hospital Products Ltd. v. United States Surgical Corporation* (1984), 58 A.L.J.R. 587, 55 A.L.R. 417 (Aust. H.C.), contain particularly clear and thought-provoking analyses of the fiduciary relationship and obligation. See, e.g., Mason J.'s analysis of the conflict of interest and duty rule, and of the profit rule, at pp. 611 (A.L.J.R.), 459 (A.L.R.), picking up the thought of J.C. Shepherd, *The Law of Fiduciaries* (1981), pp. 147-151.

<sup>53</sup> See, in particular, *infra*, footnote 98.

<sup>54</sup> See, e.g., R. B. Hagedorn, *Fiduciary Aspects of the Bank-Customer Relationship* (1978), 34 Mo. Bar J. 406; R.B. Hagedorn, *loc. cit.*, footnote 8.

<sup>55</sup> Subject to the banker's set-off rights.

<sup>56</sup> *Supra*, footnote 27, at pp. 701 (A.C.), 825 (All E.R.).

fore not only express terms, but in all probability implied terms, will be in existence. Another contractual relationship occurs when the customer makes term loans to the bank, that is, loans repayable other than on demand. This is the position at common law.

Equitable principles also apply to the banker-customer relationship. As we have seen, agents are subject to the trustee obligation that they shall neither be in a position of, nor derive a "secret" profit from, a conflict of interest and duty. So already we are in the area of fiduciary obligation, however unlikely it is that a bank could secure a commission, unknown to and not agreed by the customer, in the process of collecting from other banks. That a bank *can* become subject to the obligations that are associated with trustees has been established for many years.

Would Equity today be more inclined to hold banks subject to trustee obligations? The answer to that question could well lie in the character of modern banking. Traditionally banks have made loans and taken security; they have held for their customers depository accounts, but they have also extended lines of credit. This is the pattern of consumer banking. However, corporate banking has become much more complex. Business today is looking for a total financial service from the banks, and, so far as the Bank Act permits, the banks are more than anxious, in the highly and increasingly more competitive financial services industry, to extend to their customers reliable credit alternatives together with informational and advisory facilities. The move towards "one stop financial shopping" elsewhere in the industry also impels the banks, within the permitted limits prescribed by the Act, to follow the trend towards all round financial servicing in their consumer banking facilities.<sup>57</sup>

At the same time the courts have been markedly more willing within the last two decades to apply to all kinds of non-express trust situations the obligations associated with the express trustee. There has also been a noticeable tendency for the courts to apply the conflict of interest and duty rule to non-express trust relationships with more rigour than they have done in the past. The attitude towards the corporate director and senior corporate executives is a case in point, an attitude carried forward by contemporary company legislation.<sup>58</sup>

It is against this background that the question is asked—when will the courts impose express trustee obligations upon the bank, describing it as a fiduciary *vis-à-vis* its customer? Relatively speaking, there has been considerable American authority on this subject, but surprisingly little in Canada. This was why *Standard Investments* attracted so much interest. What authority there is has followed the lead of English authority, and

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<sup>57</sup> See the Manufacturers Hanover advertisement (1983), 100 Banking L.J. 325, at p. 327, and the Toronto Globe & Mail newspaper, September 30, 1985.

<sup>58</sup> E.g., Canada Business Corporations Act, S.C. 1974-75-76, c. 33, s. 115.

that authority has made one thing abundantly clear. Where the bank in its dealings with a customer (for instance, in the grant of a loan or the taking of security) adheres simply to explaining the nature and effect of the documentation, it will be regarded as carrying out "the normal business" of a bank. But where the bank "goes further and advises on more general matters germane to the wisdom of the transaction",<sup>59</sup> then the court may form the view that it has passed from the common law relationship to a fiduciary relationship with its customer. That is to say, it *may* have "crossed the line"<sup>60</sup> so that an appropriate trustee obligation—such as the rule against the conflict of interest and duty—becomes relevant. The question then, in all the circumstances, is whether that obligation has become applicable. In *Lloyds Bank v. Bundy*,<sup>61</sup> for example, cited at length by both trial and appeal courts in *Standard Investments*,<sup>62</sup> in all the circumstances the presumption of undue influence was held to have arisen. Undue influence, though now a distinct body of law, is essentially a violation of the conflict of interest and duty rule. On the other hand, in the *Morgan*<sup>63</sup> case the House of Lords held on the facts that the line had not been crossed, and reversed the judgment of the Court of Appeal below.

"All the circumstances" is an important factor in determining whether the line has been crossed. The bank assumes some degree of risk in giving more general advice (for example, whether it is a good thing for the customer to be entering the particular transaction), but the customer may be a business person who is well able to weigh advice, and who will take an independent opinion if an element of doubt argues in favour of such a course of action. However, the customer may lack that kind of awareness and experience; he or she is hanging on the words of the banker, as if waiting to be told what to do. The bank is now distinctly at risk that the line is being crossed. Another "circumstance" of importance is the interest of the bank in the transaction. So often, as American cases demonstrate,<sup>64</sup> this is the element which will carry the situation across the line. If, for instance, the loan is to be used in whole or in part to pay down the overdraft of another customer of the bank, or the mortgage security is to

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<sup>59</sup> *Lloyds Bank v. Bundy*, *supra*, footnote 16, at pp. 347 (Q.B.), 772 (All E.R.), per Sir Eric Sachs, approved by Lord Scarman in *National Westminster Bank plc. v. Morgan*, *supra*, footnote 27, at pp. 708-709 (A.C.), 830-831 (All E.R.).

<sup>60</sup> *Ibid.*

<sup>61</sup> *Supra*, footnote 16.

<sup>62</sup> *Supra*, footnote 1, at pp. 482-483 (D.L.R.), 45-47 (O.R.) (Ont. H.C.); and at pp. 432-433 (D.L.R.), 496-497 (O.R.) (Ont. C.A.).

<sup>63</sup> *Supra*, footnote 27.

<sup>64</sup> See E.L. Symons, Jr., *The Bank-Customer Relation: Part II—The Judicial Decisions* (1983), 100 *Banking L.J.* 325, at pp. 334-337. It is critical that the bank knew or ought to have known that the customer was relying on the bank to counsel and inform him. Previous dealings with the bank by the customer may also prove an essential factor.

provide security for the unsecured debt of another customer, or the debt of another whose existing security has become inadequate, the conflict of interest and duty rule is now hovering at the banker's door. Was the customer, in taking the loan or providing the security, aware of what was to be done with his money or assets? Did the customer realise that the bank was shifting the risk from its own on to the customer's shoulders?

Independent legal advice is not an indispensable requirement if the bank is to avoid assuming a fiduciary role, though some dicta would suggest this. But, if the customer has not the requisite skill, or the acumen to see that he or she is at a disadvantage, faced with a knowledgeable banker and being none too clear of the ramifications of an apparently attractive course of action, did the banker suggest a delay of a day or two while the customer obtained independent advice?<sup>65</sup> Elderly parents assisting their adult child in some kind of ill-understood financial need at the bank are classic examples of the situation where the bank is so easily capable of attracting an express trustee obligation, of becoming a fiduciary. A properly perceptive banker will give little weight to the "advice" that such a son or daughter may have given, or said that he or she has given, to the parents.<sup>66</sup>

The crucial circumstance is the customer who is putting trust and confidence in the bank, who is relying upon that advice in deciding what to do. Such an attitude may come from a long period of doing business at a particular branch of the bank; each successive manager is given by the customer the trust and confidence that was given to his predecessor. On the other hand, it may be that the customer, a businessman, has sought advice of the bank, bared his soul with regard to his plans, and the bank has undertaken to assist him. Or the fiduciary obligation may come solely from a factor such as age, infirmity, poor education, or difficulty with the English language, as we have seen. Did the bank, unwittingly or otherwise, take advantage of this situation? American authorities<sup>67</sup> often pose

Professor Symons argues forcibly that the "reasonable expectations" of such a customer should also lead to his obtaining a remedy in contract.

<sup>65</sup> *National Westminster Bank plc. v. Morgan*, *supra*, footnote 27, at pp. 709D (A.C.), 831c (All E.R.). See Cope, *loc. cit.*, footnote 29, for comment on independent legal advice; *Royal Bank of Canada v. Poisson* (1980), 103 D.L.R. (3d) 735, 26 O.R. (2d) 717 (Ont. H.C.) (wife of the customer).

<sup>66</sup> In *Coldunell Ltd. v. Gallon*, [1986] 2 W.L.R. 466, [1986] 1 All E.R. 429 (C.A.), the court held that, if the loaning institution has indeed recommended the elderly parental would-be borrowers to obtain independent legal advice, has required the documents to be executed in the presence of a solicitor (see, *ibid.*, at pp. 480 (W.L.R.), 440 (All E.R.)), and has not authorized the adult child, for whose benefit the loan is being obtained, to act as its agent in any way, the institution is not required to do more, even if it knows the loan is for the adult child.

<sup>67</sup> *E.g.*, *Klein v. First Edina National Bank*, 293 Minn. 418, 196 N.W. 2d 619, at p. 623 (S.C. Minn., 1972). Followed on this point in *Pigg v. Robertson*, 549 S.W. 2d 597, at p. 600 (Mo. Ct. Apps., 1977). See also, *supra*, footnote 54. American authorities empha-

the following question: did the bank know or ought it to have known (constructive knowledge) that the customer was relying upon it for advice?

Knowing, actually or constructively, of this reliance, the bank may have been negligent in the advice it gave, or in the preparation of documentation it put before the client. It does not need the duty of care in tort law to make the bank liable. The confidence reposed in the bank, the reliance, and the bank's knowledge of that situation may justify the imposition of an express trustee standard of behaviour upon the bank. In one American authority<sup>68</sup> the bank had omitted to explain to its customers, husband and wife, for whom it was providing a loan on mortgage, the procedures for obtaining mortgage insurance protection. The husband and wife had also misconstrued the meaning of the documentation they had signed; they thought it was the bank which was going to obtain the insurance cover. The express trustee must act in good faith on behalf of the beneficiary, and that means with honesty, competence and sustained attention. The bank official ought to have realized that the husband and wife, a couple unfamiliar with matters of this sort, were following his advice implicitly. His explanations of the procedures were inadequate, given the situation.

"[A] fiduciary relationship may be created between the bank and its customer where the customer reposes a special confidence or reliance in the bank and in consequence of that confidence and reliance, the bank undertakes to act for or on behalf of the customer." In *Standard Investments* that was the way Griffiths J. described the creation of the relationship.<sup>69</sup> And he defined the express trustee obligation to which the bank becomes subject in those circumstances as twofold: (1) "where he has undertaken to act for or on behalf of another, he must refrain from letting any personal interest sway him from the proper performance of his undertaking"; and (2) "he must not misuse the position of trust his undertaking gives him to further his own interest. He must not profit from his position of trust".<sup>70</sup> This is the conflict of interest and duty rule. Its scope is wide; it embraces all kinds of behaviour from the trustee's purchase for himself of trust property to the seizure of an opportunity to benefit himself which his office makes available to him.

An express trustee may indeed be prohibited in principle from utilizing his office or the trust property for his own benefit, but Equity has always permitted such benefit if the trustee has previously acquired the informed consent of the trust beneficiaries. He must hide nothing, he

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size the placing of trust and confidence by the customer, and the invitation or acceptance of such trust by the bank.

<sup>68</sup> *Hutson v. Wenatchee Federal Savings & Loan Association*, *supra*, footnote 11.

<sup>69</sup> *Supra*, footnote 1, at pp. 481-482 (D.L.R.), 45 (O.R.), approved by the Court of Appeal, *ibid.*, at pp. 431 (D.L.R.), 495 (O.R.).

<sup>70</sup> *Ibid.*, at pp. 481-482 (D.L.R.), 45 (O.R.) (Ont. H.C.).

must not unwittingly forget to disclose anything. If he does hide or overlook anything material, any consent of the beneficiaries he obtains is not informed. In other words, if a trustee is to derive any personal benefit, whether in dealing with the beneficiary, or dealing with others on behalf of the trust (and, therefore, the beneficiaries), he must have disclosed all relevant information about the circumstances before he can be said to have the beneficiaries' agreement.

The bank is in business for profit; it is always putting a "deal" to the customer. And in the ordinary course of commerce when one party has superior information and a better appraisal it has a legitimate competitive advantage.<sup>71</sup> When the bank becomes subject to the express trustee obligation not to allow personal benefit to conflict with duty, however, its obligation is to disclose to the customer all the information which the bank has and which is relevant to the proposed "deal" or transaction.<sup>72</sup> In judging what information needs to be disclosed, the bank has to ask itself whether the bank itself, if it were on the other side, would have wished to know the fact in question. In other words, the bank has to place itself in a position of parity with the customer. Similarly, the advice which it gives on the basis of that information must be equally as frank and adequate to the occasion.

In the same manner, once it has "crossed the line" and become subject to the conflict rule, the bank must treat confidential information as if it were trust property. Whether the information is acquired from the customer, or from third parties while the bank is engaged in a task on behalf of the customer, the bank has a duty not to disclose it to others. Of course, there is an implied term in the contract between the banker as debtor and its customer as creditor that no confidential information will be disclosed, and so there is a common law remedy. Moreover, Equity will grant injunctive relief, if such relief is necessary. As an agent the bank also breaks its contract with the customer, and contravenes the rule against conflict of interest and duty, by any disclosure, even without having otherwise placed itself in a trusted position towards the customer. With regard to disclosure, however, Equity sees agency itself as carrying the agent "across the line". It was given the information for the purposes of the agency, and solely for that purpose. Breach of confidence is a breach of the fiduciary relationship consequent upon the agency, and this fiduciary element, though not clearly expressed in the judgment, is apparent in the leading case of *Tournier v. National Provincial & Union Bank of England*,<sup>73</sup> where the judgment is couched in the language of implied

<sup>71</sup> See Patterson, *loc. cit.*, footnote 8 (a comment).

<sup>72</sup> This will also extend to the potential customer when, *vis-à-vis* that person, the bank has "crossed the line".

<sup>73</sup> [1924] 1 K.B. 461 (C.A.). In the *Standard Investments* case (*supra*, footnote 1, at pp. 439 (D.L.R.), 503 (O.R.) (Ont. C.A.)) Goodman J.A. for the court pointed out that,

term. An obvious breach occurred in *Guertin v. Royal Bank of Canada*,<sup>74</sup> where the bank manager was found to have purchased for himself real estate of which he learned from a customer who revealed his own plans to purchase while seeking information about a bank loan.

Breach of confidence, like undue influence, has now become a distinct branch of law.<sup>75</sup> It can no longer be seen purely as an instance of the conflict of interest and duty rule in operation, and the impact of breach of that duty upon the fiduciary. Moreover, at law contract and agency remedies are also available, as we have seen. Nevertheless, American authorities have canvassed at some depth the problem of the bank with customers who have conflicting interests. For instance, in the course of considering whether to grant a loan to corporate customer A, the bank may have acquired confidential information about the financial health and forward plans of A. Later, customer B applies to the bank for a loan with which it intends to make an offer for all the issued shares, or a majority of the voting stock, of A. B reveals the entirety of its take-over plans to the bank, and the bank grants the loan. The bank may or may not be aware of the hostility of A's board to any such take-over bid, but, since well-financed take-over plans are rarely popular with the boards of target companies, the bank is not unaware of what may well be A's expectation of the bank. In short, this may be a problem of the conflict of duties. No fiduciary can properly serve two persons with opposing interests, and the bank may be a fiduciary, either as an agent, who owes loyalty to his principal within the scope of the agency, or as the possessor of confidential information concerning a customer which placed trust and reliance in the bank.

The first question, therefore, is whether the bank has brought itself within range of express trustee obligations by receiving confidential information from customer A, and then loaning to customer B who intends with that loan to take over A. Clearly the bank may not disclose confidential information to another, including another customer, but is it subject to the rule against conflict of duties? This depends upon whether it was acting as an agent for customer A when it acquired the confidential information from A, or for B when B revealed its plans to the bank in seeking a take-over loan. If it was not, in either case, then it depends upon whether in relation to A or B (or both) it placed itself in a position of trust and confidence, and reliance of the customer existed, of which it knew or ought in the circumstances to have known. In the *Standard Investments* case it was not the target company that was complaining, but Cohen and

as a consequence of the liability at law, the absence of a fiduciary relationship does not prevent a bank from remaining subject to a duty of non-disclosure of confidential information received from a customer.

<sup>74</sup> (1983), 1 D.L.R. (4th) 68, 43 O.R. (2d) 363 (Ont. H.C.).

<sup>75</sup> See Francis Gurry, *Breach of Confidence* (1984).

Ellen who wished to take over the target. They complained that, though as customers of the Bank they had revealed their plans to the Bank in 1972 and acquired the promise of its assistance, the Bank was in fact assisting and continued to assist others down to the final date in 1979 when Black and the Bank itself sold out to the Winnipeg purchaser.

Both Griffiths J. and the Court of Appeal were of the view that the interview in 1972 between Cohen and Ellen on the one side and the Bank's president on the other gave rise to a fiduciary relationship, because the investors "bared their souls"<sup>76</sup> and the president promised advice and assistance. But the two levels of courts saw the facts thereafter in a very different light.

To the trial judge the president had merely promised to introduce Cohen and Ellen to McDougald, and otherwise to advise on the soundness of their plan. This limited assistance he had given. It was not illegal to help a customer avoid a take-over, even if it was "morally offensive,"<sup>77</sup> when the take-over bid was being made by another customer, and the Bank could not tell Cohen and Ellen about its ten per cent share purchase without breaching its duty of confidence to McDougald and Black, who were also its customers. Nor would knowledge of the Bank's purchase policy have discouraged them. As for any duty of the Bank to tell the plaintiffs of McDougald's opposition, they must have found this out for themselves when they met him. Nor was there any conflict of interest and duty on the Bank's part; soon after the 1972 interview Cohen and Ellen's plans were widely known, simply from their market activities. And with the plaintiff's knowledge of McDougald's opposition, there ended the fiduciary relationship. The Bank received no other confidential information from the plaintiffs than it received in April, 1972, and thereafter it merely lent money as a bank to its customer. It had not undertaken to protect their interests, or to avoid conflict of interest situations.

In the Court of Appeal this urbane interpretation of Cohen and Ellen's reasonable expectations of the Bank was totally rejected. To the appeal court, whose attitude is contrastingly pristine in its adherence to principle, there were two crucial factors. First, McDougald and the Bank's chairman had a shrewd suspicion in 1971 that a take-over intention by Cohen and Ellen explained market purchases of Crown shares, and, following discussion with McDougald, the Bank in 1971 had decided to enter the market for itself and bring its holding of Crown up to the permitted ten per cent with the object of thwarting any take-over. It began to make those purchases at once, and continued steadily until it had reached its full complement in 1973. Secondly, the president—whose

<sup>76</sup> *Supra*, footnote 1, at pp. 462 (D.L.R.), 26 (O.R.) (Ont. H.C.); pp. 419 (D.L.R.) 483 (O.R.) (Ont. C.A.).

<sup>77</sup> *Ibid.*, at pp. 488 (D.L.R.), 52 (O.R.) (Ont. H.C.).

actions, like those of the chairman, bound the Bank—knew in April, 1972, that Cohen and Ellen, valued customers, were relying upon the Bank for advice and assistance in their plans to acquire Crown and so make Central Trust national in its operations. Confidentiality between the Bank and its two customers arose at the same interview. The consequence of these two factors meant, said the court, that the Bank was in a “clear and serious”<sup>78</sup> conflict of interest and duty situation thereafter, with which it never came to terms. It continued actively to support McDougald and Black, and it did nothing to inform Cohen and Ellen, whose custom it retained, of its true purposes and activities.<sup>79</sup>

The relaxed approach of the trial judge towards the Bank's conduct left some awkward questions. While he was prepared to agree that a bank must take an entirely neutral position when it is approached for a loan by two separate corporate customers, each of which is interested in the same acquisition, he did not think that duty relevant when one customer is seeking a loan in order to obtain control of another corporate customer. Though fiduciary duties may have arisen between the bank and each of its customers, the bank may apparently both retain each of its customers, and also secretly assist one at the expense of the other. Presumably, therefore, the trial judge would have approved internal use by the bank of confidential information about the target customer when considering the size of the loan it will make to the take-over customer, and the terms it will impose. For the Court of Appeal on the other hand the duty of loyalty owed by the fiduciary to his beneficiary made it irrelevant whether it was legal of a bank to assist one customer in a take-over struggle with another. “The point is that by . . . [assisting the target customer] the bank had a conflict of interest with other customers who were relying on it for advice as to the feasibility of those other customers acquiring control.”<sup>80</sup> But would this prohibition extend, one asks, to any circumstances where the bank finds itself asked for assistance, or is given confidential information, by either of two customers who have opposed interests? If the Bank of Commerce had not engaged in the extraordinary act of entering the market for itself, would it still have been required to forego the business of McDougald, Black and the Crown Trust Company, unless with their informed consent, while it financed the plaintiffs' purchase of Crown shares? Could it have internally used its confidential information about its

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<sup>78</sup> *Ibid.*, at pp. 439 (D.L.R.), 502 (O.R.) (Ont. C.A.).

<sup>79</sup> The key to the difference between these two judgments is (1) the very different interpretation put upon the purpose and scope of the April 1972 interview, and (2) the difference of opinion between the courts as to how a fiduciary relationship arising out of a *Lloyds Bank v. Bundy* situation (reliance by A—knowledge by B of the reliance—benefit obtained by B—non-arm's length type relationship between A and B) comes to an end. Advisers to banks would surely do well to analyse these differences, and prescribe accordingly.

<sup>80</sup> *Supra*, footnote 1, at pp. 437 (D.L.R.), 500 (O.R.) (Ont. C.A.).

customer, Crown Trust, to inspire its loan policy towards Cohen and Ellen? The better view, one would think, is that this judgment prohibits any partisan or self-interested action by a fiduciary where its beneficiaries have competing interests.

A controversial decision in 1978 by the Third Circuit Court of Appeals, *Washington Steel Corporation v. TW Corporation*,<sup>81</sup> makes an interesting comparison. It was held in this instance, reversing the lower court, that (1) there is no duty *per se* of the bank not to act adversely to the interest of its customer, the target company, and (2) within the commercial loan department of the bank use may be made of all information available to the bank. The principal reasons given by the court for the first ratio is that the free flow of capital is the more important consideration, and in any event it should not be possible for a target company to develop a "shark repellent" in the form of loans taken from all the major banks. The second ratio is justified on the basis that it is poor policy to require banks to make "blind" loans.

Critics have asserted that the first reason nevertheless flies in the face of the rule against conflict of interest and duty, a fiduciary duty, and that as to the second reason a lending bank should be concerned with the credit-worthiness of the borrower, not with the use that borrower intends to make of a secured loan.<sup>82</sup> There is also pressure in the United States for legislative intervention to deal with this problem. Neither the courts nor the commentators are agreed, however, and we may be witnessing here the beginnings of a debate on what is really a significant, economic policy issue. In Canada we have made to this point the one step which *Standard Investments* represents.

#### F. The Bank and The Unconscionable Transaction

For this remedy, it will be recalled, no fiduciary relationship need exist. In *Morrison v. Coast Finance Ltd.*,<sup>83</sup> the leading Canadian authority on the subject of the unconscionable bargain, where the finance company had acquired considerable benefit by the plaintiff's mortgage of her sole asset to the company, and she had obtained none, Davey J.A. described the doctrine as concerned with "an unfair advantage gained by an unconscientious use of power by a stronger party against a weaker". Basing

<sup>81</sup> *Supra*, footnote 7.

<sup>82</sup> In *American Medicorp, Inc. v. Continental Illinois National Bank and Trust Company of Chicago*, *supra*, footnote 9, internal use of confidential information was denied. See also *Lovejoy, loc. cit.*, footnote 8. There appears to be much support in the literature and banking circles for the maintenance within each bank of a "Chinese Wall", that is, an exclusion of those officials considering new loan applicants from files concerning other previous borrowers.

<sup>83</sup> *Supra*, footnote 32, at pp. 713 (D.L.R.), 259 (W.W.R.).

himself on two classic English decisions of the nineteenth century, he went on.<sup>84</sup>

On such a claim the material ingredients are proof of inequality in the position of the parties arising out of the ignorance, need or distress of the weaker, which left him in the power of the stronger, and proof of substantial unfairness of the bargain obtained by the stronger.

The presumption of equitable fraud which then arose, he continued, could be met by the stronger showing that the bargain was fair, just and reasonable, or "perhaps" by showing that no advantage was taken.

In *Commercial Bank of Australia Ltd. v. Amadio*,<sup>85</sup> the only reported Commonwealth case at the highest appellate level against a bank on the basis of this doctrine, the High Court of Australia in extensive judgments set aside the transaction in question. It was found as a fact that the bank had not exercised any undue influence, nor were the terms of the transaction in themselves found to be improper. It was the totality of the circumstances which showed the unfair advantage that was taken by the bank of two customers, husband and wife, whose significantly disadvantageous position it ought to have realized. The facts would have raised a very real question in the mind of any reasonable person, said Mason J., whether these two people had the ability to make a judgment as to what was in their own best interests.

The son of the two plaintiffs was thought by his parents to be doing well, and his company prospering. In fact the company was heavily overdrawn at the bank, and senior bank officials were requiring the branch manager to have the size of the overdraft lowered. However, because the son brought business, and was therefore a valued customer, the bank entered into an arrangement with the son that the bank would only selectively dishonour his cheques, so that his trade creditors were paid. At this point the son asked his parents to mortgage real property belonging to them, in order that his business might be assisted. The parents were elderly working people of Italian background with only a limited understanding of English. They thought the loan was to be for no more than \$(Aust.)50,000 and was to be limited to six months. Very shortly thereafter the bank manager called on them at their home with the mortgage documents, which also contained a guarantee, so that *in toto* the company's entire existing and likely indebtedness to the bank was met. The parents did not read the documents, and the bank manager did not explain the documents to them. He later said he thought their son had done this.

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<sup>84</sup> *Ibid.*

<sup>85</sup> *Supra*, footnote 25. For commentary see Antony Siopis, *Unconscionable Bargains and General Principle* (1984), 100 *Law'Q. Rev.* 523; Ian J. Hardingham, *The High Court of Australia and Unconscionable Dealing* (1984), 4 *Oxford J. of Legal Studies* 275; Ian J. Hardingham, *op. cit.*, footnote 43. *Cf. Bomek v. Bomek* (1983), 21 *B.L.R.* 205 (Man. C.A.).

The father did say to the bank manager that the loan was to be for six months only, and the manager made it clear to him this was not so. But no more was said about the documents. The manager did not tell them that the bank through the cheque arrangement had been supporting a company which in truth was insolvent, and indeed nothing was said about the state of the company's accounts. Nor did the manager tell the parents that, despite the mortgage and guarantee,<sup>86</sup> the son was still required to clear his indebtedness to the bank within a very short period of time. The company's decline continued, and ultimately the bank wrote to the parents seeking payment of the company's entire indebtedness to the bank.

While it has been doubted whether the House of Lords would be prepared to give such an effect to the doctrine of unconscionable bargain, and there is some evidence the courts in England might in any event take a more restricted view of the scope of the doctrine,<sup>87</sup> Canadian judicial opinion, particularly in British Columbia, seems more in line with the High Court of Australia's position. At this point, therefore, banks in Canada need to be mindful of the *Amadio* decision. Of course, everything turns on the facts of the case, but it is clear that a wider range of factors is relevant here than would be so with a plea of undue influence.

#### G. *The Bank as a Third Party: Involvement with a Fiduciary's Breach of Trust*<sup>88</sup>

It has long been established that, if a person interferes in a trust, purporting to act as if he were a properly appointed trustee, and subsequently loss occurs to the trust, the interfering person will be held responsible for the loss. He is said to become a trustee by his wrongdoing—a trustee *de son tort*—and traditionally equity has dubbed him a constructive trustee. Thereby he will be held to an accounting, and trust property may be traced through his hands into the hands of wrongdoers who retain that property. The characteristics of trusteeship *de son tort* are that the stranger has received title to or control over trust property, he intermeddles purporting to act as a trustee for the beneficiaries, and breach of trust occurs. It is not necessary to establish any fraud on his part, though of course it may exist; he may be just an officious minder of other people's

<sup>86</sup> It is well-established, however, that in the normal course of business the bank's only responsibility to the guarantor is that it puts before the guarantor for signature a document which represents the nature and terms of the guarantee, and does not misrepresent in responding to questions. See Baxter, *op. cit.*, footnote 18, pp. 227-228.

<sup>87</sup> See further Siopis, *loc. cit.*, footnote 85. "Unconscionable transaction" does not appear to have been canvassed in *Coldunell Ltd. v. Gallon*, *supra*, footnote 66.

<sup>88</sup> On the subject to be discussed in this section, see Waters, *op. cit.*, footnote 31, pp. 399-403. For a full and searching analysis of the English and Australian case law on the subject, see R.P. Austin, *Constructive Trusts*, in Finn, *op. cit.*, footnote 43, to which the present writer is indebted.

business. Nor must it be shown he was aware of a trust when he intermeddled, though in most cases of trusteeship *de son tort* so found it will usually be the case that he knew of the trust, and if there was unawareness it was of the trust terms.

Agents, especially banks, will very rarely be found in this category. It will almost always be the case that the bank is providing services to a customer who has instructed the bank to act—to receive the customer's moneys on deposit, to honour the customer's cheques drawn in favour of another, and to collect on cheques drawn by another in favour of the customer—and such an agent is authorized to receive or control the customer's moneys as part of his agency duties. When the moneys are trust moneys, the customer a trustee, and loss occurs to the beneficiaries through the wrongdoing of the now insolvent trustee, the most likely allegation against the bank is that, though not an intermeddler purporting to act for the beneficiaries, it knew or, if it had been on its toes, would have known that the moneys it was handling were trust moneys. A second frequent allegation is that the bank drew on these moneys for its own benefit, that it was looking after itself by making sure loans and overdraft concessions extended by the bank to the customer were paid off. This again is not the character of a trustee *de son tort*.

The bank's concern, therefore, has to be with the ramifications of Lord Selborne's well-known words of 1874 in *Barnes v. Addy*.<sup>89</sup>

. . . responsibility [for breach] may no doubt be extended in equity [beyond express trustees] to others who are not properly trustees, if they are found either making themselves trustees *de son tort* [this we have discussed], or actually participating in any fraudulent conduct of the trustee to the injury of the *cestui que trust*.

The second part of that sentence gives room for thought as to what is "actual participation", but he then went on to say something distinct about agents. He was very well aware, he said, that the solicitor, the banker, or any agent to trustees could not discharge his instructions if the applicability of principles of equity left him in doubt as to his position. Such agents, he concluded, are not made constructive trustees merely for acting within their legal authority,

unless [they] 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.<sup>90</sup>

The ideas contained there had been forming awhile, but this was probably the first time they had been so brought together and succinctly expressed. Since that time many members of the judiciary have rephrased this language of Lord Selborne, or differently expressed the categories of those liable. Lord Esher M.R. in *Soar v. Ashwell*<sup>91</sup> spoke of a "fraudulent

<sup>89</sup> (1874), L.R. 9 Ch. App. 244, at p. 251.

<sup>90</sup> *Ibid.*, at pp. 251-252.

<sup>91</sup> [1893] 2 Q.B. 390, at pp. 394-395 (C.A.).

and dishonest disposition of the trust property" instead of "design". Ungood-Thomas J. in *Selangor United Rubber Estates, Ltd. v. Cradock (a bankrupt) (No. 3)*<sup>92</sup> distinguished between those, such as trustees *de son tort*, who assume office prior to the breach which renders them liable, and those who are made subject to the trusteeship because they have acted to the injury of the beneficiaries. Brightman J. in *Karak Rubber Co. Ltd. v. Burden (No. 2)*<sup>93</sup> adopted *Snell's* labels of Lord Selborne's two classes—"knowing receipt or dealing" and "knowing assistance".<sup>94</sup> He spoke of "assisting in a breach of trust at the direction of trustees", and he appears to ignore trusteeship *de son tort* as a previously dealt with and distinct class.<sup>95</sup> Lawson J. in *International Sales and Agencies Ltd. v. Marcus*<sup>96</sup> considered "knowing receipt or dealing" to incorporate receiving for one's own benefit, while "knowing assistance" refers to the third party who channels the property to others. Australian courts at both appellate and first instance levels have also analyzed the components of this particular kind of constructive trust liability.<sup>97</sup>

However, while all this suggests the law in this area is still at a formative stage, the elements of the liability are arguably quite clear. If you receive, control or deal with the trust property, when you know or in the circumstances you could reasonably have known that what you are doing is a breach of trust, or you assist or participate in the trustee's morally culpable breach with the same actual or constructive knowledge, whether or not you receive, control or deal with the trust property, you will be personally liable to make good the loss to the trust. And, if the trustee has absconded or is insolvent or bankrupt, this means you may have to make good the whole loss yourself.

It will be apparent that "knowing receipt or dealing" largely, if not completely, falls within the scope of "knowing assistance". Moreover, since agents because of their authorized receipt or control as agents are seldom likely to be liable for "knowing receipt or dealing", the attention of the banker at once turns to the elements and scope of "knowing assistance". And the leading case on this head of liability, certainly so far

<sup>92</sup> [1968] 1 W.L.R. 1555, [1968] 2 All E.R. 1073 (Ch. D.).

<sup>93</sup> [1972] 1 W.L.R. 602, [1972] 1 All E.R. 1210 (Ch. D.).

<sup>94</sup> P. St.J. Langan and P.V. Baker (eds.), *Snell's Principles of Equity* (28th ed., 1982), pp. 194-195, in its formulation of these principles of liability has had a very persuasive effect on the courts. *Snell* describes "knowing receipt" as applying where trust property has been received by the third party (the bank), and "knowing assistance" where it has not. However, as Peter Gibson J. has pointed out (*Baden, Delvaux and Lecuit v. Société Général pour Favoriser le Développement du Commerce et de l'Industrie en France SA*, [1983] Butterworths Company Law Cases 325, at para. 240), there is no apparent reason for this exclusivity. "Receipt" and "assistance" can go together.

<sup>95</sup> *Supra*, footnote 93, at pp. 633 (W.L.R.), 1235 (All E.R.).

<sup>96</sup> [1982] 3 All E.R. 551 (Q.B.D.).

<sup>97</sup> See R.P. Austin, *op. cit.*, footnote 88, for a full discussion.

as bankers are concerned, must now be regarded as Peter Gibson J.'s decision in 1983 in *Baden, Delvaux and Lecuit v. Société Général*,<sup>98</sup> with its exhaustive analysis of the present state of the law.

However, it should first be noted that in Canada most litigation to date has concerned the liability of the banker who operates an account or accounts for a customer engaged in construction whose receipts include payments subject to the statutory mechanics' lien trust.<sup>99</sup> The banker is usually the customer's bank, and the funds in question have either been drawn upon by the bank to meet loans or overdraft indebtedness advanced to the customer, or they have been paid over on instructions to an unentitled third party stranger to the trust. Following the *Fonthill Lumber*<sup>100</sup> decision of 1959, and the *John M.M. Troup*<sup>101</sup> decision in the Supreme Court of Canada in 1962, the courts have followed a traditional line of constructive trust reasoning not dissimilar from the nature of *The Barnes v. Addy* and *Selangor* principle, but independent of it. Only in the *Groves-Raffin*<sup>102</sup> decision of the British Columbia Court of Appeal was the *Selangor* principle cited and followed, until in January 1986, Judge Gow, sitting as a local judge of the British Columbia Supreme Court, based his decision in *Grinnel Fire Protection Systems Co. Ltd. v. Bank of Montreal*,<sup>103</sup> against the bank, exclusively on that principle. This latest decision may mark in these frequent cases a new direction, one which proves to focus much more attention in Canada on the "knowing assistance" concept of liability. To date most of the "frontier" thinking concerning this concept has occurred in the judgments of English and Australian courts.

The "knowing receipt or dealing" aspect of the *Selangor* principle, as Canadian courts seem to prefer to name the principle, involves a control of the trust property, or of the proceeds of a breach by the trustee, a resultant benefit to the controller (here the bank), and actual or constructive notice of the true origin of that property or those proceeds. The more embracive "knowing assistance" aspect<sup>104</sup> has three elements; assis-

<sup>98</sup> *Supra*, footnote 94. It should be noted that Butterworths Company Law Cases is the only series reporting this case.

<sup>99</sup> Of the latest authorities, see *Ellis-Don Ltd. v. Norton* (1982), 5 C.L.R. 281 (Ont. H.C.); *Professional Welding Consultants Ltd. v. Bank of Nova Scotia*, [1983] 1 W.W.R. 614 (B.C.S.C.); *Inlaid Floor & Supply Co. v. Bastion Construction Ltd.* (1984), 10 C.L.R. 141 (B.C. Co. Ct.).

<sup>100</sup> *Fonthill Lumber Ltd. v. Bank of Montreal* (1959), 19 D.L.R. (2d) 618, [1959] O.R. 451 (Ont. C.A.).

<sup>101</sup> *John M.M. Troup Ltd. and National Painting & Decorating Ltd. v. Royal Bank of Canada*, [1962] S.C.R. 487, 34 D.L.R. (2d) 556.

<sup>102</sup> *Groves-Raffin Construction Ltd. v. Bank of Nova Scotia* (1975), 64 D.L.R. (3d) 78, [1976] 2 W.W.R. 673 (B.C.C.A.).

<sup>103</sup> Unreported, Vancouver Registry, January 28, 1986.

<sup>104</sup> *MacDonald v. Hauer* (1976), 72 D.L.R. (3d) 110, [1977] 1 W.W.R. 51 (Sask. C.A.), the leading Canadian authority on the application of the principle, followed *Selangor* in finding only two categories, trusteeship *de son tort* and "knowing assistance".

tance, a dishonest and fraudulent design by the trustee, and knowledge by the assistant (here the bank). Assistance means any dealing by a stranger to the trust relationship with the intention of furthering the trustee's dishonest purpose, and a dishonest and fraudulent purpose does not include the technical breach, that is, mere unsatisfactory behaviour or misfeasance. It involves some sort of moral reprehensibility. In *Baden, Delvaux and Lecuit* Gibson J. adopted the agreed position of counsel in that case, and described it as the taking of a risk to the prejudice of another's rights, a risk which is known to be one that there is no right to take.<sup>105</sup> Nor need the act of assistance inevitably lead in itself to the loss. An act within a chain of acts would be enough. A wildly speculative investment, or an unsecured loan without authority, springs at once to mind, or an act facilitating an opportunity for such an investment or loan. It is the concept of "knowledge" that has proved to be the uncertain frontier of "knowing assistance". It clearly covers constructive as well as actual knowledge by the stranger (the bank). But knowledge of what? And how remote can the constructive knowledge be for the stranger to be caught by "knowing assistance"?

As to the first question the stranger must know that there is an existing or intended dishonest design, even if he is unaware of the whole design, and he must know that his act will assist in furthering the design.<sup>106</sup> It is also clear that there must be a knowledge of facts, not of mere claims or allegations, whoever makes them.<sup>107</sup> It is a nice point, however, whether the stranger to the trust (here the banker) need know of the legal consequences of the facts. The better view, it would seem, certainly the safer view, given the authorities, is that the competent stranger as professional agent would be aware of the legal consequences of what he is doing. After all, it is his act, whether surely of commission or omission, which is being judged.

The second question has never been answered more fully than in *Baden, Delvaux and Lecuit*. Accepting counsel for the plaintiff's argument, Gibson J. said that there are "five different mental states".<sup>108</sup>

... (i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which would put an honest and reasonable man on inquiry.

In an extensive consideration of the authorities, the learned judge observed that, while knowledge of types (i) to (iii) is generally undisputed, the objective test involved with types (iv) and (v) has produced differences of

<sup>105</sup> *Supra*, footnote 94, para. 245.

<sup>106</sup> *Ibid.*, para. 248.

<sup>107</sup> *Ibid.*, para. 249.

<sup>108</sup> *Ibid.*, para. 250.

judicial opinion. Though Ungood-Thomas J. in *Selangor* and Brightman J. in *Karak Rubber* accepted both, other courts have been more hesitant. The High Court of Australia to this point has expressly rejected type (v).<sup>109</sup> The concern, of course, is for the admittedly honest banker; a banker has a primary duty to honour his customer's instructions, and may not plead the title of a third party to the funds. The courts do not wish to make the performance by the banker of his task impracticably difficult, and any imputation of knowledge raises the issue of whether that imputation does not create impracticable difficulties. Nevertheless, there are the competing interests of the beneficiary of the trust. If the conduct of the reasonable banker would have resulted in the safeguarding of those interests, surely the beneficiary has a legitimate expectation that such conduct will be carried out. Type (iv) knowledge bears a comparison with the duty of care in tort. A banker may be sued for negligence, and it is difficult to see why Equity for its own part should take a more restricted position.<sup>110</sup> As for inquiries, Gibson J. concluded that, despite its legal obligations to the customer, the bank, faced with suspicious facts, is under a duty to refuse compliance until it has made inquiries. "It ceases to be under a duty when it receives information, whether in answer to its inquiries or from another source, that the honest and reasonable banker would accept without further inquiry."<sup>111</sup> But suppose the banker did not make type (v) inquiries, or, having made them, did not await the answers. What knowledge is now to be imputed? Can one make the presumption that, had inquiries been made, the answers would have been truthful? For his part Gibson J. held back from the presumption. It is all a question, he felt, of whether the complaining trust beneficiary can discharge the onus of proof upon him, and all that can be expected of the banker is that he will make those inquiries which *would* have given to the honest and reasonable banker knowledge of the facts.

However, there is a last point; Gibson J. described it as being the first element in making the stranger (here the banker) liable as a constructive trustee for "knowing assistance" to a breach of trust.<sup>112</sup> There must be a trust, but—and here the banker needs to be alert:<sup>113</sup>

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<sup>109</sup> *Consul Development Pty. Ltd. v. D.P.C. Estates Pty. Ltd.* (1975), 132 C.L.R. 373 (Aust. H.C.). For a valuable later authority on this subject from New Zealand, see *Westpac Banking Corporation v. Savin*, [1985] 2 N.Z.L.R. 41 (C.A.), noted [1986] N.Z.L.J. 183.

<sup>110</sup> A. Tettenborn, *The Fiduciary Duties of Banks*, [1980] J. of Bus. Law 10.

<sup>111</sup> *Supra*, footnote 94, para. 248. That sentence sets out the limit of inquiries. "The banker cannot be expected to play the detective"; (*ibid.*, para. 276), a point which Robertson J.A. made in *Groves-Raffin*, *supra*, footnote 102, at pp. 139 (D.L.R.), 738 (W.W.R.), concerning the collecting bank, when in favour of another a cheque has been drawn by the dishonest trustee on the account in his own bank.

<sup>112</sup> It is also a first element for "knowing receipt or dealing".

<sup>113</sup> *Supra*, footnote 94, para. 242.

... the trust need not be a formal trust. It is sufficient that there should be a fiduciary relationship between the 'trustee' and the property of another person. If A is placed in possession of or continues to exercise command or control over the property of B while it remains B's property and A can deal with B's property only for the benefit of B or for purposes authorised by B, A is a trustee of that property for the purposes of constructive trusteeship.

A, of course, is the 'trustee' for whom the bank is providing banking services. And there at this point is the significance of the *Selangor* principle in the context of this paper—the bank must watch not only for express trust situations, as in *MacDonald v. Hauer*,<sup>114</sup> or statutory trust breaches, as in *Grinnell Fire Protection Co. Ltd. v. Bank of Montreal*.<sup>115</sup> It is concerned for every situation where the customer is a fiduciary of the funds that are committed to the bank. Moreover, this extended applicability of the *Selangor* principle is firmly accepted not only in England (*Baden, Delvaux and Lecuit* is an instance) and Australia, but in Canada. In *Selangor* and *Karak Rubber* themselves, authorities regarded in Canada as the leading cases, it was fiduciary relationships that had been breached. Nor does it stop there. *Ontario Wheat Producers' Marketing Board v. Royal Bank of Canada*<sup>116</sup> surely puts the matter beyond question; there the *Selangor* principle was forthrightly applied to the Bank whose customer was a fiduciary.

As for the presumption of undue influence, if it is not rebutted by the customer, and the bank had lent its "knowing assistance" to that customer, is the bank liable because of the fiduciary relationship between the customer and its victim? Then there is the unconscionable bargain. If the equitable considerations that give rise to the fiduciary relationship are similar to those which cause the courts to remedy unconscionable bargains, would the bank necessarily be successful in arguing that it is not liable as an assisting third party, whatever and however it knew of the customer's mode of acquisition of the victim's property, because the customer/wrongdoer and the victim were not in a fiduciary relationship? There is no precedent on these issues, and perhaps until judgment has been given a plaintiff asserting undue influence or an unconscionable bargain is merely making a claim which, as Gibson J. pointed out,<sup>117</sup> is beyond the scope of the *Selangor* principle. But this "frontier" has yet to be explored.

<sup>114</sup> *Supra*, footnote 104.

<sup>115</sup> *Supra*, footnote 103.

<sup>116</sup> (1983), 145 D.L.R. (3d) 663, 41 O.R. (2d) 294 (Ont. H.C.). The appeal ((1984), 9 D.L.R. (4th) 729, 46 O.R. (2d) 362) was dismissed; but the court held that the trial judge had had no need to consider whether the Bank had "knowingly participated in a fraudulent scheme": (at pp. 734 (D.L.R.), 366 (O.R.)).

<sup>117</sup> *Supra*, footnote 107.

### Conclusion

In the absence of greater Bank Act protection, the best response the banking community can make to the possibilities of liability discussed here is surely in-house manuals. These should be compiled following an analysis of the case authorities by lawyers, and set out procedures to be followed by each level of staff once any of the danger signals appear. The courts have shown no desire to depart from the principle that a bank is beyond attack if it adheres to practices consonant with the ordinary course of banking business.<sup>118</sup> What they have been doing is alerting the banker to what they discern as the extraordinary. It is at these times that employees need to be able to recognize the extraordinary, and to know what procedures they should automatically follow once the extraordinary is suspected or discovered. And in the long run a policy of staff training and staff procedures to meet these needs, especially at the branch office level, may prove more productive than attempting to persuade a consumer-minded public and consumer-conscious Parliament that protection should be conferred upon the banks at those very points where the courts have thought protection was needed by members of the public.

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<sup>118</sup> See, as examples of cases in which the "line" was not "crossed": *New Westminster Bank plc. v. Morgan*, *supra*, footnote 27 (undue influence); *Bank of Nova Scotia v. MacLellan* (1980), 30 N.B.R. (2d) 596, 70 A.P.R. 596, esp. at p. 602 (N.B.C.A.) (undue influence); *Hayward v. Bank of Nova Scotia* (1985), 19 D.L.R. (4th) 758, 51 O.R. (2d) 193 (Ont. C.A.) (alleged breach of fiduciary duty); *Konefal v. Canadian Imperial Bank of Commerce* (1985), 62 B.C.L.R. 305 (B.C.C.A.) (alleged breach of fiduciary duty); *Toronto-Dominion Bank v. Wong and Lim* (1985), 65 B.C.L.R. 243 (B.C.C.A.) (unconscionable transaction).